ANNUAL REPORT
2013

PUBLIC SECTOR
PENSION INVESTMENT
BOARD

PSP
INVESTMENTS

WHO WE ARE AND WHAT WE DO

CORPORATE PROFILE

The Public Sector Pension Investment Board ("PSP Investments" or the "Corporation") is a Canadian Crown corporation established to invest the amounts transferred by the Government of Canada equal to the proceeds of the net contributions since April 1, 2000, for the pension plans of the Public Service, the Canadian Forces and the Royal Canadian Mounted Police, and since March 1, 2007, for the Reserve Force Pension Plan (collectively the "Plans"). The amounts so transferred to the Corporation are to fund the liabilities under the Plans for service after the foregoing dates (the "Post-2000 Liabilities").

Its statutory objects are to manage the funds transferred to it in the best interests of the contributors and beneficiaries under the Plans and to maximize investment returns without undue risk of loss, having regard to the funding, policies and requirements of the Plans and their ability to meet their financial obligations.

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HIGHLIGHTS / FISCAL YEAR 2013

Total portolio
return of
10.7%

Consolidated net assets increased by $11.6 billion or 18% to $76.1 billion.

•

Investment income of $7.0 billion after expenses.
Value-added of $1.4 billion above benchmark return of 8.6%.

•

Four-year annualized return of 12.2%, investment income of $23.7 billion and value-added above benchmark of $3.7 billion.

•

Public Markets, Real Estate, Private Equity, Infrastructure and Renewable Resources all outperformed their respective benchmarks.

•

Assets managed internally increased by $7.9 billion to reach $55.8 billion.
Assets actively managed internally totalled $29.1 billion, an increase of 25% over fiscal year 2012.

•

Public Markets portfolios' returns ranged from 3.4% for Fixed Income to 19.2% for Small Cap Equity.

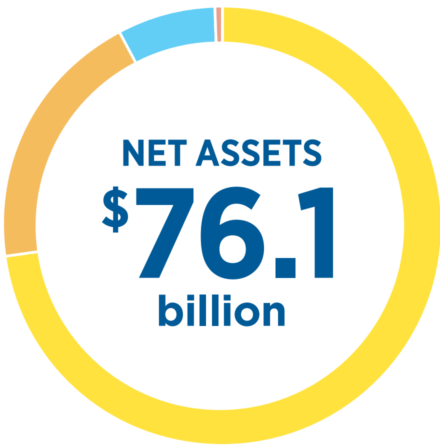
•

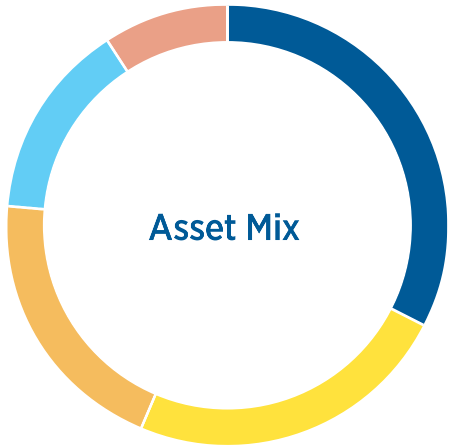
Infrastructure, Real Estate, Private Equity and Renewable Resources portfolios achieved returns ranging from 10.1% to 16.7%.

•

Launched a US$3 billion commercial paper program in the United States.
Received AAA credit ratings from Moody's, DBRS and Standard & Poor's.

FINANCIAL HIGHLIGHTS





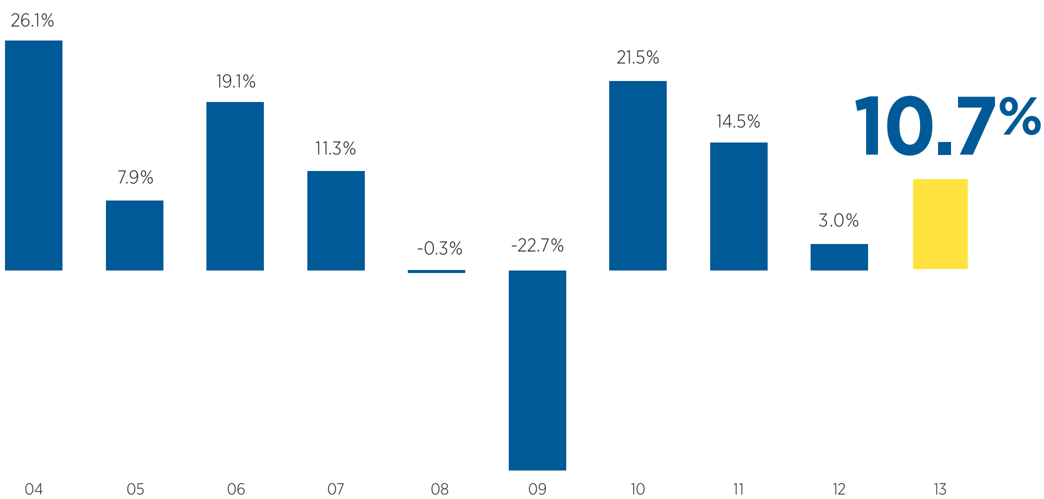
Net Assets per Pension Plan Account
As at March 31, 2013 (millions)

Public Service	72.9%	**$55,483**
Canadian Forces	19.5%	**$14,872**
RCMP	7.1%	**$5,374**
Reserve Force	0.5%	**$402**

Asset Mix
As at March 31, 2013

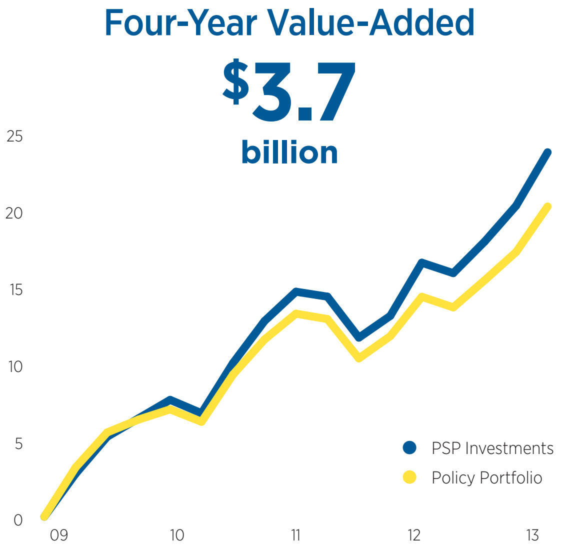
Foreign Equity	32.6%
Real Return Assets	23.8%
Canadian Equity	20.2%
Nominal Fixed Income	14.3%
Private Equity	9.1%

Annual Performance
As at March 31

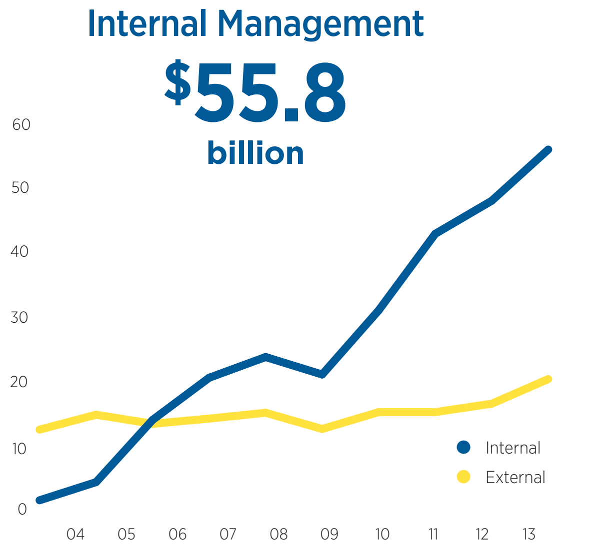


FISCAL YEAR 2013

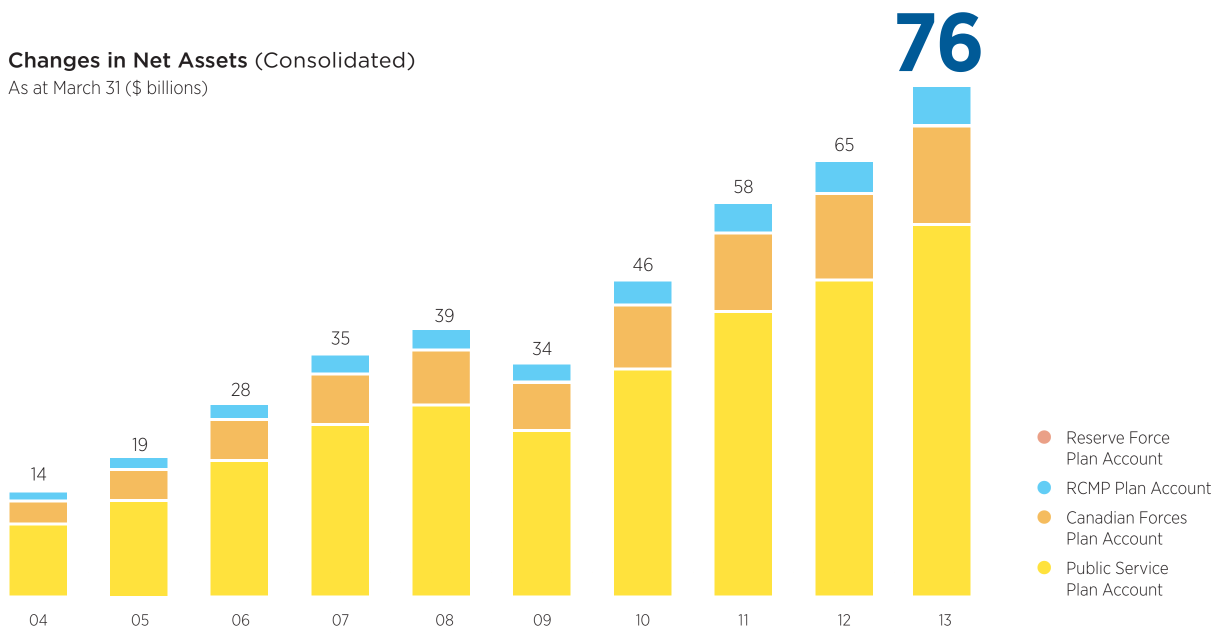
Four-Year Cumulative Income
As at March 31 ($ billions)



Growth in Internal Management
As at March 31 ($ billions)



Changes in Net Assets (Consolidated)
As at March 31 ($ billions)



CORPORATE OBJECTIVES
FISCAL YEAR 2013

INVESTMENTS

Continue to execute the Private Markets business plans towards the 42% target allocation and greater internal and active management in Public Markets. Increase network of international investment partners. Maintain a competitive total investment cost structure.

ACHIEVEMENTS

- The value of Private Markets investments increased by $3.2 billion to $20.6 billion.
- The proportion of active strategies in Public Markets managed internally increased from 60% to 65%.
- Completed 28 transactions in international markets with 22 new investment partners.
- PSP Investments' cost ratio as a percentage of average net assets has decreased for a fifth consecutive year.

ENTERPRISE RISK MANAGEMENT

Continue to refine risk management activities and reporting measures required for increased internal and active management. Ensure policies and procedures framework is aligned with changing economic and regulatory environment. Continue implementation of Responsible Investment Policy.

ACHIEVEMENTS

- Established a special Risk Committee of the Board to develop a comprehensive Risk Appetite Statement.
- Implementation of credit ratings for Private Markets.
- Enhanced reporting of key risk indicators and risk dashboards.
- A Risk and Control Self-Assessment update was conducted to review the most significant risks across the Corporation.
- Appointed a Vice President, Responsible Investment, to lead further implementation of environmental, social and governance factors into the investment decision-making process.

STRATEGIC PLAN

Implement first year of Vision 2015 three-year Strategic Plan. Ensure individual objectives are aligned with Strategic Plan. Communicate Vision 2015 to the Corporation.

ACHIEVEMENTS

- Internally managed assets increased by $7.9 billion to $55.8 billion.
- Assets actively managed internally increased by 25% to reach $29.1 billion.
- Vision 2015 objectives cascaded through documented individual objectives.
- Communicated Vision 2015 Strategic Plan and investment beliefs to the Corporation and other PSP Investments' stakeholders.

TALENT

Ensure proper teams are in place through internal appointments and recruitment of high-performing employees to support the deployment of the investment strategies. Evolve leadership and development plans to extend succession planning at deeper levels in the Corporation. Develop and implement engagement initiatives to build upon the results of the fiscal 2012 employee survey.

ACHIEVEMENTS

- Reduced turnover ratio for a second consecutive year.
- Implemented culture of development and learning, where 94% of employees have a documented development plan.
- Received Award of Excellence from the Canadian Society for Training and Development for leadership development program.
- Implemented corporate and departmental engagement initiatives to maintain a high level of employee engagement.

KEY CORPORATE OBJECTIVES
FISCAL YEAR 2014

2014

INVESTMENTS

Consider adding or expanding asset classes within the Policy Portfolio. Continue increasing internal and active management within Public Markets. Pursue Private Markets investments towards target allocation and increase investments in international markets.

TALENT MANAGEMENT

Continue supporting the deployment of investment strategies through the recruitment and development of top talent. Strengthen succession planning in leadership roles and increase manager capability at all levels of the Corporation. Complete employee engagement initiatives and measure progress with a new employee engagement survey.

STRATEGIC PLAN

Successfully implement second year of Vision 2015 Strategic Plan and perform mid three-year review to ensure progress is tracking according to plan.

ENTERPRISE RISK MANAGEMENT

Finalize and approve comprehensive Risk Appetite Statement to define PSP Investments' appetite, attitude and tolerance to risks, and enhance the risk-aware culture across the Corporation. Continue implementation of the Responsible Investment Policy. Complete interim update of Risk and Control Self-Assessment monitoring PSP Investments' top risks and continue refining the Fraud Risk Management Program. Maintain a competitive cost structure.

AN EXCELLENT FISCAL YEAR 2013

INTERIM CHAIR'S REPORT

PSP Investments achieved an excellent performance for fiscal year 2013, outperforming its benchmark for the fourth year running and generating significant value-added over benchmark that helped drive consolidated net assets to another new high.

The fact that PSP Investments has been able to consistently achieve this level of performance attests to a strong, clearly defined vision and strategy, as approved by the Board of Directors, and effective execution by management.

The Board's action plan for fiscal year 2013 focused on providing oversight and direction in areas of critical importance to the Corporation's current and future success — vision; investment strategy; enterprise risk management; and talent management, particularly succession planning.

VISION AND STRATEGY

One of PSP Investments' key objectives involved successfully implementing the first year of the new Vision 2015 Strategic Plan, which received formal Board approval in June 2012. The main goals of this latest three-year plan include refining the Corporation's investment strategy and policies in order to further align them with the Plans' liabilities, and leveraging PSP Investments' competitive advantages — most notably the large annual cash inflows that are expected to continue until approximately 2030.

The underlying blueprint for any changes to our investment strategy is the Policy Portfolio, which essentially dictates how every dollar we receive will be deployed in the markets and thus represents a dominant determinant of risks and returns over time. The Policy Portfolio falls under the responsibility of the Board and, in light of its importance, is reviewed at least once a year, or more often should circumstances warrant. Our latest review was carried out in November 2012. Taking into account

PSP Investments' long-term market expectations, the Board and management determined that following the significant changes to the Policy Portfolio which took effect in fiscal year 2012, no further modifications were required at this time.

Those projections for continuing large inflows of capital mentioned previously have facilitated PSP Investments' ongoing diversification from public equities to Private Market and Real Return asset classes, where our size and liquidity enable us to commit for the longer term and, critically, to control the timing of our exit from an investment. Simply put, with no pressing near-term obligations, we do not face the spectre of having to sell assets at distressed valuations should markets take a downturn. The value of Private Markets investments increased by $3.2 billion to $20.6 billion during fiscal year 2013.

Most importantly from an investment performance perspective, as PSP Investments has continued to grow and evolve we have managed to exceed the targeted long-term "actuarial rate" of return, currently 4.1% after inflation, without undue risk. The actuarial rate is the rate of return required to maintain funding requirements and pension benefits for the Plans at their present levels. One hundred dollars invested in PSP Investments 10 years ago would have been worth $214 at the end of fiscal year 2013, whereas that same $100 earning the actuarial rate of return would have been worth $180.

RISK MANAGEMENT

PSP Investments places a high priority on maintaining a risk-aware culture in which undue risks are avoided while calculated risks are taken in pursuit of investment objectives. This is in line with our statutory mandate to "maximize returns without undue risk". It is a responsibility of the Board to ensure that guiding principles for effective risk management are in place.

A special committee of the Board was formed during fiscal year 2013 to oversee the development of a comprehensive Risk Appetite Statement that will define the Board's appetite, attitude and tolerance to risk. This will enable us to look at risk from a multi-dimensional perspective and — crucially — provide a cohesive set of guidelines that we can communicate to employees and stakeholders to enhance the risk-aware culture across the Corporation. The statement as envisioned will formalize and pull together a number of essential elements, including PSP Investments' overall risk profile; the role of the Board versus that of management; our risk management framework; the risk governance structure; diversification considerations; liquidity risk; valuation risk and operational risks. Finalization and approval of the Risk Appetite Statement is anticipated in the first half of fiscal year 2014.

TALENT MANAGEMENT AND SUCCESSION PLANNING

From an organizational perspective, realization of the Vision 2015 Strategic Plan requires continued development of PSP Investments' capabilities and resources in order to successfully manage a fast-growing entity with assets that exceeded $76 billion at year's end. Our investment teams need the means to meet the demands stemming from the internal active management of increasingly large and complex portfolios, along with the requisite support in vital areas ranging from Finance and Operations to Human Resources (HR), Legal Affairs and Information Technology.

Effective talent management clearly is a prerequisite in terms of supporting PSP Investments in its next development stage. The Board's Human Resources and Compensation Committee continues to provide direction in this key area through recent undertakings designed to strengthen the senior leadership succession plan and refine our compensation plans.

As well, the Committee has been working with senior management and HR to drive forward the Corporation's comprehensive Talent Management Strategy, which encompasses innovative outreach and diversity initiatives. I am pleased to note that PSP Investments' outstanding leadership development program has been recognized with an Award of Excellence from the Canadian Society for Training and Development.

ACKNOWLEDGEMENTS

I am grateful to my fellow Directors for their unstinting support and commitment over the course of another busy and successful year for PSP Investments.

On behalf of the Board, I would also like to take this opportunity to thank Gordon J. Fyfe and his leadership team as well as employees throughout the Corporation, whose collective efforts have helped us sustain a high level of performance and fulfill our mandate.

Cheryl Barker.

Cheryl Barker
Interim Chair

STRONG 4-YEAR PERFORMANCE

INVESTMENT INCOME

$23.7 billion

VALUE-ADDED ABOVE BENCHMARK

of **$3.7 billion**

PRESIDENT'S REPORT

A solid company-wide effort drove strong results with all asset classes performing well. PSP Investments recorded a total portfolio return of 10.7% for fiscal year 2013, compared with 8.6% for the Policy Portfolio Benchmark.

Taking into account investment income of $7.0 billion after expenses, as well as net cash inflows of $4.6 billion, PSP Investments' consolidated net assets increased by 18% to a new high of $76.1 billion as at March 31, 2013. Value-added, over and above benchmark returns, amounted to $1.4 billion for fiscal year 2013.

This marks the fourth consecutive year, and the eighth time in the past ten years, that we have generated value-added returns. Over the four years since the global financial crisis of 2008-2009, PSP Investments has achieved an annualized return of 12.2%, generating $23.7 billion in investment income and $3.7 billion of value-added.

This sustained performance over a period punctuated by lingering economic uncertainty and market volatility indicates clearly that our strategic focus on increased diversification in Private Markets and internal active management is paying off — for now and for the longer term.

The results for fiscal year 2013 represent the coming together of everything we have been working so hard for in recent years. Our investments in Public Markets, Real Estate, Private Equity, Infrastructure and our newest asset class, Renewable Resources, all contributed to value-added.

Also noteworthy, in February 2013, PSP Investments launched a US$3 billion commercial paper program in the United States. The new program is part of PSP Investments' corporate debt activities and will help finance investment strategies, particularly in Private Market asset classes. Three ratings agencies, namely Moody's, DBRS and Standard & Poor's, assigned a AAA rating, their highest rating, to PSP Investments, recognizing its extremely strong credit profile.

LOOKING BACK ON A DECADE OF GROWTH

Preparing to sign off on this, my 10th annual report as PSP Investments' President and CEO, caused me to pause and reflect on how things have changed over the years. We have gone from some $8 billion in consolidated net assets — all of it invested in public markets — to $76.1 billion, of which $20.6 billion is invested in the private market asset classes mentioned above. Since diversification efforts began in earnest during fiscal year 2004, the Canadian, Foreign Equity and Fixed Income instruments that comprised the entire portfolio "back in the day" have been complemented by an array of other attractive assets ranging from timber to office towers, pipelines to port facilities, as well as ownership positions in profitable private enterprises engaged in everything from the provision of satellite systems to health care and insurance.

As noted above, while Public Markets still account for a substantial portion (71%) of the overall portfolio, we have been steadily increasing our investments in Private Markets, including Real Return assets that are a good match for the inflation-sensitive nature of the Plans' long-term liabilities. These changes also enable us to take advantage of PSP Investments' exceptional liquidity.

The other big change is our steadily increased focus on internal active management, designed to help us generate those value-added returns while providing for better control in terms of investment risks and costs. As at March 31, 2013, some $43 billion of PSP Investments' assets were under active management, compared with $6.6 billion 10 years ago. Over that same period, the volume of assets managed internally has increased from $1.7 billion to $55.8 billion, representing some 73% of current net assets compared with 12% a decade ago.

Over the past 10 years, which included the worst market meltdown since the Great Depression, PSP Investments recorded a strong investment performance with an annualized return of 8.2%. In retrospect, it really has been a challenging but rewarding 10 years.

FURTHER DIVERSIFICATION UNDER WAY

Our Vision 2015 strategic plan is designed to help us maintain our momentum by pursuing further diversification and introducing more internal active management. To that end — and in keeping with our 2013 corporate objectives — we have continued to implement changes to the Policy Portfolio that came into effect at the beginning of the previous fiscal year, working towards a targeted allocation of 42% to Private Markets.

Among noteworthy transactions during fiscal year 2013 was the Renewable Resources team's agreement to purchase a 30% equity interest in New Zealand's Kaingaroa Forest — the largest contiguous softwood timber plantation in the southern hemisphere. With an area of 178,000 hectares, the Kaingaroa Forest is managed in an environmentally sustainable manner in accordance with its stringent Forest Stewardship Council certification. This transaction closed subsequent to the 2013 fiscal year end.

Our Infrastructure team made a significant investment in Isolux Infrastructure, which manages electricity transmission lines, toll-road concessions and more than 280 megawatts of solar photovoltaic power generation in seven countries (Brazil, India, Mexico, the U.S., Spain, Italy and Peru). The partnership fits well with PSP Investments' objectives of investing in solid assets alongside leading industry players, in sectors and regions offering attractive long-term growth potential.

Notable Real Estate transactions during fiscal year 2013 included the purchase of a 50% interest in the 51-storey TD Canada Trust Tower, one of the most iconic office buildings in Toronto's financial district, as well as additional investments in office properties in New York and London. In total, the Real Estate team completed $3.1 billion of new investments in fiscal year 2013.

PSP Investments' Private Equity team, meanwhile, acquired joint control of one of the largest global wholesale insurance and reinsurance brokerage companies, London-based Cooper Gay Swett & Crawford (CGSC). With more than 1,400 employees across 60 offices, CGSC specializes in hard-to-place insurance policies, generating over $3.5 billion in premiums from clients in the U.K., the U.S. and international insurance markets.

As well, we are continuing to identify and pursue attractive investment opportunities in the dynamic emerging economies of Asia and Latin America. The demographics of these regions, where rapidly expanding middle-class populations have been driving robust demand — for real estate development, in particular — fit well with the "young" nature of our Plans' Post-2000 Liabilities, with strong positive inflows of capital projected to continue for at least the next 15 years.

With respect to Public Markets, PSP Investments was among the first major pension investment organizations to construct a scalable investment platform focused solely on identifying and capitalizing on "value investment" opportunities — publicly traded companies that we believe can deliver above-average equity returns over the long term. Since the start of this strategy during calendar 2010, our Value Opportunity Portfolio (VOP) has grown to include 7 investments totaling $1.6 billion and is expected to expand to $5 billion in assets over the next two years.

OUTSTANDING TALENT IS KEY

Of course, even the most well-thought-out investment strategy is only as good as the men and women entrusted with its implementation and the organization behind them. Our strong performance in recent years reflects not only quality assets but also the high calibre of the team — now more than 430 strong — that we have been able to build here at PSP Investments.

OVER THE PAST 10 YEARS, WHICH INCLUDED THE WORST MARKET MELTDOWN SINCE THE GREAT DEPRESSION, PSP INVESTMENTS RECORDED A STRONG INVESTMENT PERFORMANCE WITH AN ANNUALIZED RETURN OF 8.2%.

In accordance with another of the key objectives we set for ourselves in fiscal year 2013, we have been busy expanding and strengthening our investment operational systems in lock step with the growth of assets, to support the Corporation in its next development stage.

I am particularly pleased with our success in attracting and retaining some of the best talent to be found anywhere in the global investment community. PSP Investments adheres to the very highest standards with respect to recruiting — and it shows in our performance.

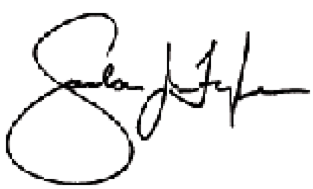
Close cooperation between our Human Resources Department and team leaders throughout the Corporation has enabled us to instill a performance culture rooted in respect, where people are truly engaged, with a shared vision and goals and clarity of purpose. Documented development programs are in place for 94% of employees at every level of PSP Investments, as are programs designed to ensure that talent is duly recognized and rewarded.

I should note, too, that the exceptional capabilities and enthusiasm of PSP Investments team members does not go unnoticed in broader financial and investment circles. In fact, our reputation in that regard represents a distinct competitive advantage in terms of being able to attract the best external partners and access the most attractive investment opportunities.

ACKNOWLEDGEMENTS

In conclusion, I wish to reiterate that much of what we have accomplished can be directly attributed to our people and thank all employees for a job well done during fiscal year 2013.

I would also like to thank the Board of Directors for its continued support, with particular thanks to Interim Chair Cheryl Barker for her wise counsel.



Gordon J. Fyfe
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION OF FUND PERFORMANCE AND RESULTS

INVESTMENT APPROACH, OBJECTIVES, POLICY PORTFOLIO AND ACTIVE MANAGEMENT

Investment Approach and Objectives

PSP Investments' mandate is described in Section 4 of the *Public Sector Pension Investment Board Act* (the "Act"):

– To manage the amounts transferred to it 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 Plans and the ability of those Plans to meet their financial obligations.

Based on these statutory objects, PSP Investments' Board of Directors implemented an investment approach around two key pillars:

1. A Policy Portfolio (defining the asset mix — how assets will be allocated among various asset classes), which is expected to achieve a return at least equal to the long-term actuarial rate of return used by the Chief Actuary of Canada in his latest actuarial valuations of the Plans (a real return of 4.1%[1], i.e. after inflation). In the absence of other factors affecting the funding of the Plans as it relates to the Post-2000 Liabilities, it is the rate of return required to maintain funding requirements and pension benefits at current levels.
2. Active management activities, which are designed to generate returns over and above the Policy Portfolio and assist in attaining the actuarial rate of return within an active risk budget.

The following investment objectives were established to assess the performance of this investment approach:

– Absolute Return: achieve a long-term return (net of expenses) at least equal to the actuarial rate of return;
– Relative Performance: achieve a target return exceeding the Policy Portfolio return.

Policy Portfolio

A key pillar of PSP Investments' approach is the Policy Portfolio. The Policy Portfolio is reviewed at least annually within an asset-liability framework, affording a thorough understanding of the linkage between the Policy Portfolio and the Plans' Post-2000 Liabilities and their funding. Understanding this linkage helps ensure that PSP Investments' approach and results not only meet the actuarial rate of return, but also achieve this rate of return with an acceptable level of risk related to the funding of the Plans. This framework also ensures proper alignment of interests between PSP Investments and the Plans' stakeholders.

– PSP Investments' Policy Portfolio is expected to achieve a return at least equal to the actuarial rate of return over the long term (i.e. a real return of 4.1%), with a level of funding risk that is deemed acceptable.

[1] Real rate of return used in the actuarial reports on the Plans for the Public Service and Royal Canadian Mounted Police as at March 31, 2011.

A risk-free real rate of return could be achieved with Canada Real Return Bonds (RRBs). However, the current yield on RRBs is approximately 0%. This is well short of the 4.1% required to maintain funding requirements at their current level. Taking on market risk is therefore required to achieve this 4.1% real rate of return. Consequently, it is not possible for PSP Investments to deliver the actuarial rate of return consistently year after year. PSP Investments, by undertaking market risk, attempts to achieve the actuarial rate of return over the long term with a reasonable probability of success.

While aiming for this actuarial rate of return, PSP Investments takes into consideration the risk that additional funding for the Plans would be required as a result of market risk (i.e. funding risk). The level of risk deemed acceptable is the funding risk associated with a portfolio composed of public, liquid asset classes (debt and equity securities) which, based on PSP Investments' expectations of long-term market conditions, has a long-term expected real return equal to (but no higher than) the actuarial rate of return.

– PSP Investments' Policy Portfolio recognizes the unique characteristics of the Plans' Post-2000 Liabilities and the net inflows expected to fund these liabilities.

A portfolio composed of public, liquid asset classes would miss out on opportunities afforded by the unique characteristics of the Plans' Post-2000 Liabilities and their funding. PSP Investments is expected to receive positive net inflows until at least 2030, an exceptional situation that constitutes a significant competitive advantage. The high level of liquidity allows for further diversification into less-liquid asset classes such as Private Markets, including Private Equity, Infrastructure, Real Estate and Renewable Resources. The latter three provide for additional exposure to Real Return assets, recognizing the inflation-sensitive nature of the Post-2000 Liabilities.

Asset-liability studies conducted on behalf of the Board of Directors indicate that the increased diversification and the liability-matching characteristics of the Policy Portfolio should provide for a higher likelihood of meeting the actuarial target rate of return, with an equivalent or even lower level of funding risk over time, compared to a portfolio composed solely of public, liquid asset classes.

Policy Portfolio
As at March 31, 2013

LONG-TERM TARGET WEIGHTS

WORLD EQUITY 54%	Public Market Equity	40%
	Private Equity	14%
REAL RETURN ASSETS 33%	Real Estate	13%
	Infrastructure	13%
	World Inflation-Linked Bonds	5%
	Renewable Resources	2%
NOMINAL FIXED INCOME 13%	Fixed Income	11%
	Cash & Cash Equivalents	2%

There were no changes to the Policy Portfolio in fiscal year 2013.

Active Management

Active management activities form the second pillar of PSP Investments' approach. They are designed to generate returns over and above the Policy Portfolio and assist in attaining the actuarial rate of return within an active risk budget. These activities typically involve the creation of investment strategies that are different from the Policy Portfolio benchmarks. In equities, this is usually accomplished by overweighting or underweighting specific sectors or securities relative to the Policy Portfolio equity benchmarks.

PSP Investments believes that its size makes the deployment of active management strategies particularly advantageous. Notably, this approach offers economies of scale and allows for an increased scope of activities in selected asset classes. Accordingly, PSP Investments has been increasing the proportion of its assets under internal active management and expanding relationships with selected partners. Bringing more investment management in house provides for better control in terms of risk, investment cost savings and increased influence over major decisions.

CHANGE IN NET ASSETS AND FUND PERFORMANCE

Performance Measurement and Evaluation

Based on its Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments evaluates its investment strategies, as well as individual investment mandates, through performance measurement. The performance for each investment strategy and mandate is compared to an appropriate benchmark.

Benchmarks

A combined Policy Portfolio benchmark ("Policy Benchmark") is constructed using the asset class benchmarks weighted by the actual portfolio asset class weightings. The return for each asset class is compared to the relevant benchmark return, while PSP Investments' overall return is compared to the Policy Benchmark return.

The following benchmarks were used to measure relative performance for each asset class and for the Policy Benchmark return for fiscal year 2013.

Asset Class	Benchmark
World Equity	
Canadian Equity	S&P/TSX Composite Index
Foreign Equity US Large Cap Equity EAFE Large Cap Equity Small Cap Equity Emerging Markets Equity	 S&P 500 Index MSCI EAFE Index S&P 600 Index MSCI EMF Index
Private Equity	Private Equity Fund Universe and Private Equity Cost of Capital[1]
Nominal Fixed Income	
Cash & Cash Equivalents	DEX 91 Day T-Bill Index
Fixed Income	JP Morgan Government Bond Index Global and DEX Universe Bond Index
Real Return Assets	
World Inflation-Linked Bonds	Four Country ILB Index[1]
Real Estate	Real Estate Cost of Capital[1]
Infrastructure	Inflation Adjusted Infrastructure Risk Premium and Infrastructure Cost of Capital[1]
Renewable Resources	Renewable Resources Cost of Capital[1]

[1] Customized benchmark.

PSP Investments

As at March 31, 2013

ONE YEAR RATE OF RETURN
10.7%

Net income from operations
$7.0 billion

Net contributions
$4.6 billion

Net assets
$76.1 billion

Change In Net Assets

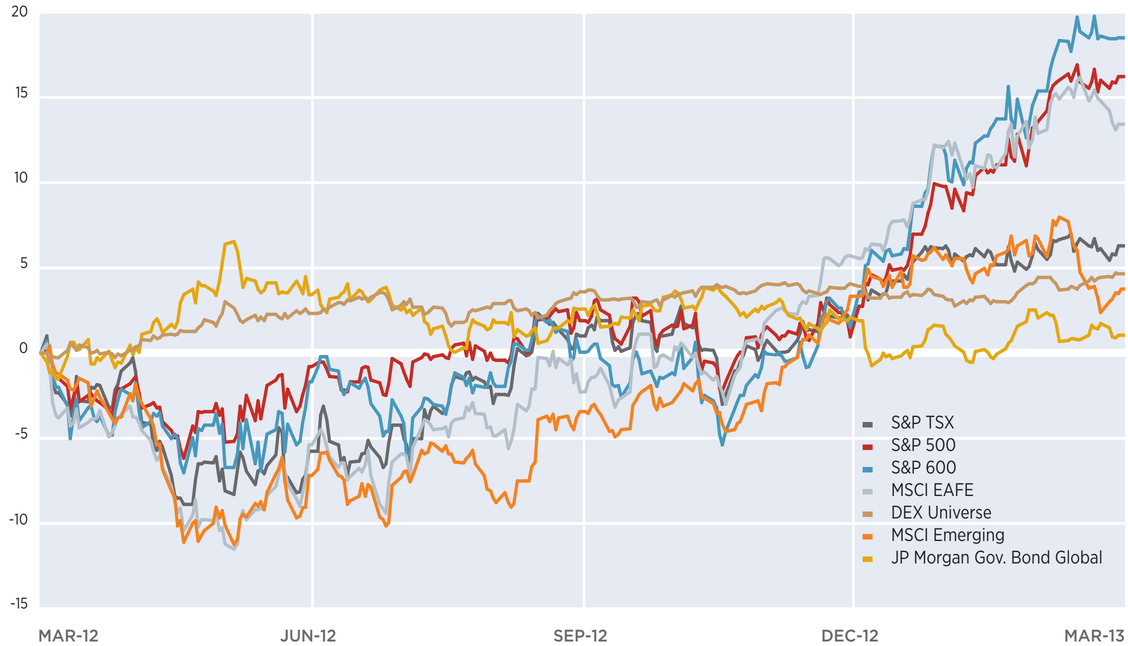
The net assets of PSP Investments increased by $11.6 billion during fiscal year 2013, a gain of 18% that was attributable to strong investment performance and net contributions. Net assets at the end of fiscal year 2013 were $76.1 billion, up from $64.5 billion at the end of the previous fiscal year.

PSP Investments generated net income from operations of $7.0 billion during the latest fiscal year, compared to $1.7 billion of income generated in fiscal year 2012. The results for fiscal year 2013 represent a consolidated rate of return of 10.7%, compared to 3.0% in fiscal year 2012. PSP Investments received $4.6 billion in net contributions during fiscal year 2013.

Market Overview

Performance of Major World Indices

Fiscal year 2013 ($ CAD, percent)



Equity market performance varied greatly across regions, most notably between developed and emerging markets. The MSCI World index delivered a 14.3% return in local currency terms, with the US indices hitting new peaks after the resolution of the “fiscal cliff” issue. The combination of weak economic growth in Canada and softer commodity prices weighed heavily on the S&P/TSX Composite Index, which significantly underperformed its US counterpart, with a gain of 6.1%. After the prior year’s weak performance, European indices also bounced back strongly. Meanwhile, the MSCI Emerging Markets index managed only a 5.2% gain as concerns about the extent of the slowdown in emerging economies, particularly in China, continued to linger.

On the fixed-income front, markets managed to gain ground despite the already-low level of bond yields. The US Federal Reserve helped drive yields lower by introducing another asset-purchase program (QE3) and linking its policy rate to labour market conditions, pointing to no increase until mid-2015. At the same time, peripheral Europe’s borrowing costs receded sharply after the European Central Bank (ECB) introduced its conditional asset-purchase program (Outright Monetary Transactions). As a result, the JP Morgan Global Index posted a 4.5% gain.

Consolidated Returns

PSP Investments achieved a 10.7% rate of return in fiscal year 2013, driven in part by the strong performance of global markets described on the previous page. The fiscal year 2013 return exceeded the Policy Benchmark rate of return by 2.1% and added $1.4 billion in value over and above the Policy Benchmark return. Over the past four fiscal years, PSP Investments has recorded a compound annualized rate of return of 12.2%, compared to the Policy Benchmark rate of return of 10.5% for that same period.

All investment portfolios recorded positive investment returns in the current fiscal year. The strong overall performance of 10.7% for fiscal year 2013 was driven primarily by the Public Markets Equities, Private Equity, Real Estate and Infrastructure portfolios. Investment returns for all Public Markets Equities portfolios were positive, ranging from 4.9% for Emerging Markets Equity to 19.2% for the Small Cap Equity portfolio. The returns generated by the equity portfolios reflected the strong performance of the US and EAFE Large Cap Equity and Small Cap Equity stock markets.

The excess return of 2.1% (relative to the Policy Benchmark) achieved during fiscal year 2013 was generated primarily by Real Estate, Public Markets absolute-return mandates, Public Markets Equities and Infrastructure. Private Equity and Renewable Resources portfolios were also contributors to the fiscal 2013 excess return. The main drivers of the excess returns for each of the respective portfolios are presented in further detail on pages 18 to 27 of this annual report.

Portfolio and Benchmark Returns

As at March 31, 2013

Asset Class	Fiscal Year 2013				4-year	
	Fair Value ($ millions)[1]	Fair Value %	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
World Equity						
Canadian Equity	15,425	20.2	6.7	6.1	12.7	12.6
Foreign Equity						
US Large Cap Equity	7,163	9.4	18.1	15.8	15.1	14.7
EAFE Large Cap Equity	6,745	8.9	12.8	13.1	9.8	9.6
Small Cap Equity	4,738	6.2	19.2	18.1	18.7	19.3
Emerging Markets Equity	6,163	8.1	4.9	3.6	13.7	12.6
Private Equity	6,924	9.1	16.0	14.2	18.5	13.4
Nominal Fixed Income						
Cash & Cash Equivalents[2]	1,456	1.9	1.6	1.0	1.2	0.8
Fixed Income	9,481	12.4	3.4	3.3	4.0	3.7
Real Return Assets						
World Inflation-Linked Bonds	4,427	5.8	7.0	7.0	3.8	3.9
Real Estate	9,427	12.4	11.5	5.4	9.8	6.4
Infrastructure	3,854	5.1	10.1	7.0	5.1	6.8
Renewable Resources[3]	382	0.5	16.7	4.9	11.8	4.9
Total	**76,185**	**100.0**	**10.7**	**8.6**	**12.2**	**10.5**

Except as otherwise indicated, returns are time-weighted rates of return.

The internal rate of return methodology is used to calculate returns for the Real Estate, Private Equity, Infrastructure and Renewable Resources asset classes.

The total portfolio return includes the performance impact of asset allocation and absolute-return strategies and is calculated gross of direct expenses. Private Markets asset class returns are presented net of currency hedging.

[1] The 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.

[2] Fair value includes amounts related to absolute-return strategies.

[3] The Renewable Resources asset class was created in fiscal year 2012. The four-year portfolio and benchmark returns presented are since inception (1.75 years).

Public Markets

As at March 31, 2013

ONE YEAR RATE OF RETURN
9.8%

Investment income*
$4.7 billion

*Excluding external investment management fees

Net assets
$54.1 billion
71.0%
of total net assets

PUBLIC MARKETS IS COMPOSED OF CANADIAN EQUITY, FOREIGN EQUITY, FIXED INCOME AND WORLD INFLATION-LINKED BONDS. NET ASSETS IN PUBLIC MARKETS TOTALLED $54.1 BILLION AT THE END OF FISCAL YEAR 2013, AN INCREASE OF $8.6 BILLION FROM $45.5 BILLION AT THE END OF FISCAL YEAR 2012.

Overall, Public Markets recorded investment income of $4.7 billion, excluding external investment management fees, for a return of 9.8% compared to a benchmark return of 8.5%. Six of the seven Public Markets portfolios equalled or outperformed their respective benchmarks.

Public Markets investments are overseen by both internal and external managers using a combination of active and index-replication strategies. Net assets managed in active strategies totalled $20.8 billion at the end of fiscal year 2013, an increase of $2.9 billion from $17.9 billion at the end of fiscal year 2012. The proportion of active strategies managed internally increased to 65%, from 60% at the end of the previous fiscal year.

TOTAL VALUE-ADDED

External equity managers added $127 million of relative value during fiscal year 2013, mainly as a result of the outperformance by emerging markets managers. External global macro and fixed income absolute return strategies added $126 million of relative value, mainly as a result of credit spreads tightening and good idiosyncratic credit selection. Internal active management added $114 million of relative value, generated from equity, mainly from US Large Cap portfolios, and fixed income strategies. Asset-backed term notes contributed $168 million of relative value as PSP Investments fully benefited from a reduction of risk on the underlying assets as they approach maturity, and were also positively impacted by the contraction of credit spreads.

EQUITIES

Net assets in Public Markets equities totalled $40.2 billion at the end of fiscal year 2013, an increase of $7.3 billion from the $32.9 billion total at the end of fiscal year 2012.

Public Markets equities recorded an investment gain of $3.8 billion for a return of 10.6% in fiscal year 2013, versus the benchmark return of 9.9%. The outperformance of the Public Markets equities portfolio vis-à-vis the benchmark was mainly due to a strong relative performance from US Large Cap portfolios.

As noted in the Market Overview, equity market performance varied greatly across regions, most notably between developed and emerging markets. As a result, the Canadian Equity portfolio gained 6.7% during fiscal year 2013, the US Large Cap Equity portfolio gained 18.1%, the EAFE Large Cap Equity portfolio gained 12.8% and, finally, the Small Cap Equity and Emerging Markets Equity asset classes posted investment returns of 19.2% and 4.9%, respectively.

FIXED INCOME

Net assets in Fixed Income and World Inflation-Linked Bonds totalled $13.9 billion at the end of fiscal year 2013, up from $12.6 billion at the end of fiscal year 2012. Overall, these fixed income portfolios earned $583 million in investment income for a return of 4.6% in fiscal year 2013, versus a benchmark return of 4.5%.

Real Estate

As at March 31, 2013

ONE YEAR RATE OF RETURN

11.5%

Investment income*

$909 million

*Excluding transaction costs

Net assets

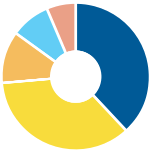
$9.4 billion

12.4% of total net assets

REAL ESTATE

Diversification by Geography

As at March 31, 2013



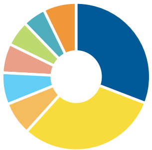
Canada	38.3%
United States	35.5%
Europe	11.4%
Developed Asia & Australia	8.5%
Emerging Countries	6.3%

The majority of the Real Estate portfolio exposure is in North America.

REAL ESTATE

Diversification by Sector

As at March 31, 2013



Retirement/Residential	30.9%
Office	30.8%
Retail	7.4%
Real Estate Debt	7.0%
Industrial	6.3%
Health Care	5.5%
Hotel	4.9%
Other	7.2%

NET ASSETS OF THE REAL ESTATE PORTFOLIO TOTALLED $9.4 BILLION AT THE END OF FISCAL YEAR 2013, AN INCREASE OF $2.3 BILLION FROM $7.1 BILLION AT THE END OF FISCAL YEAR 2012.

Real Estate investments generated $909 million in investment income, excluding transaction costs, for a total return of 11.5% in fiscal year 2013, compared to a benchmark of 5.4%.

The strong returns are attributable to consistent cash flows generated by a portfolio diversified across multiple property types and geographies, combined with various value-added initiatives undertaken with respect to specific assets within the portfolio. The portfolio includes multi-residential, seniors, office, industrial, hotel and retail properties located across Canada, the U.S., Europe, Australia and Latin America. Also contributing to the return in 2013 are strategic investments in real estate debt instruments. Valuation increases recognized during the year were broad-based gains across the entire portfolio, with no individual asset, property type, geography or strategy contributing a disproportionate amount.

Over a four-year period Real Estate investments generated a 9.8% annualized return, compared to a benchmark return of 6.4% for the same period.

The year-over-year increase in net assets reflects both new investments and increased valuation gains from existing assets. The most significant new direct investments made during fiscal year 2013 were a 40% participation in the privatization of the Charter Hall Office Trust, a publicly listed Real Estate Investment Trust in Australia, and the acquisition of a 50% interest in the TD Canada Trust Tower, an iconic office tower located in the heart of the Toronto Central Business District. Other significant new investments included retail and industrial properties in Australia; a portfolio of multi-family buildings located in key Canadian cities; US office and residential properties located in gateway and 24 hour cities such as New York, the Silicon Valley, Los Angeles, Miami, and Washington; residential properties in London, England; and retail properties in France and Sweden. Commitments were also made, but not yet fully funded, to various development opportunities, including an office development in London, a retail centre in Mexico and office and industrial buildings in Brazil.

As at March 31, 2013, direct ownership and co-investments accounted for 84% of the assets in Real Estate, up from 79% at the end of the previous fiscal year.

Private Equity

As at March 31, 2013

ONE YEAR RATE OF RETURN
16.0%

Investment income*
$1.0 billion

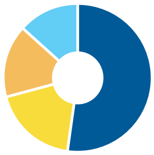
*Excluding transaction costs

Net assets
$6.9 billion
9.1%
of total net assets

PRIVATE EQUITY

Diversification by Geography

As at March 31, 2013



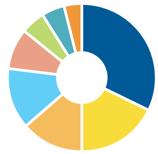
United States	52.4%
Canada	18.5%
Asia	15.9%
Europe	13.2%

The majority of the Private Equity portfolio exposure is in North America.

PRIVATE EQUITY

Diversification by Sector

As at March 31, 2013



Communications	32.3%
Consumer Non-Cyclical	17.9%
Technology	13.6%
Consumer Cyclical	13.2%
Financial	9.1%
Energy	5.2%
Industrial	4.9%
Other	3.8%

NET ASSETS OF THE PRIVATE EQUITY PORTFOLIO TOTALLED $6.9 BILLION AT THE END OF FISCAL YEAR 2013, AN INCREASE OF $0.5 BILLION FROM $6.4 BILLION AT THE END OF FISCAL YEAR 2012.

Private Equity generated $1.0 billion in investment income, excluding transaction costs, for a rate of return of 16.0% for fiscal year 2013, exceeding the benchmark return by 1.9%. The income is split between income from funds of $534 million, for a 12.6% internal rate of return (IRR) and income from co-investments of $466 million for a 23.5% IRR.

Portfolio gains were driven by exposures to the US and Canadian markets, while European funds lagged behind confronted by a difficult credit and macroeconomic environment. The largest fund returns were earned by Bedford Capital, Apollo Funds and Green Equity Partners which collectively generated $321 million of investment income.

The strong performance of the co-investment portfolio is mainly attributable to Telesat and Kinetic Concepts Inc., which recorded continued growth in revenue and EBITDA[1] and also benefitted from the implementation of operational efficiencies, creating added value in the portfolio. These two investments contributed $431 million of investment income.

From a total-portfolio perspective, exposures to both the US and Canadian markets performed particularly well, while Asian and European exposures lagged. On a four-year basis, Private Equity investments generated an 18.5% annualized return, compared to the benchmark return of 13.4 % for the same period.

The Private Equity strategy is focused on long-term investments, targeting individual investments of $200 million to $500 million, usually held between five to ten years. The portfolio is invested globally in cooperation with select strategic partners with whom PSP Investments has established close relationships. PSP Investments continues to concentrate its Private Equity portfolio in fewer funds, focusing instead on an increased number of co-investments.

During the past fiscal year, Private Equity committed strategically to two funds selected on the basis of unique and specialized investment strategies, underpinned by a strong alignment of interests, preferred terms and strong potential deal flow for co-investments.

Among the year's noteworthy transactions were the acquisitions of Ferrara Candy Company (US – Consumer Non-Cyclical), which was partnered alongside Catterton Partners, and Noranco Limited, a Canadian aircraft parts supplier, partnered with Midocean Partners. Notable as well is the significant value that continues to be generated by Telesat, reflected this past year with a $232 million dividend and the repayment of preferred shares of $145 million.

As at March 31, 2013, co-investments accounted for 35% of the assets of the Private Equity portfolio.

[1] Earnings before interest, taxes, depreciation and amortization.

Infrastructure

As at March 31, 2013

ONE YEAR RATE OF RETURN
10.1%

Investment income*
$369 million
*Excluding transaction costs

Net assets
$3.9 billion
5.1%
of total net assets

INFRASTRUCTURE

Diversification by Geography

As at March 31, 2013

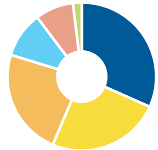
United Kingdom	23.6%
Europe	17.8%
United States	17.2%
Latin America	14.2%
Canada	13.6%
Australia and Asia	13.6%

The Infrastructure portfolio is diversified mostly across the Americas and Europe.

INFRASTRUCTURE

Diversification by Sector

As at March 31, 2013



Transportation	31.7%
Electric Generation & Transmission	24.7%
Oil & Gas Storage and Transport	23.4%
Oil & Gas Exploration and Production	10.1%
Water Utilities	8.4%
Other	1.7%

THE NET ASSETS OF THE INFRASTRUCTURE PORTFOLIO TOTALLED $3.9 BILLION AT THE END OF FISCAL YEAR 2013, AN INCREASE OF $0.3 BILLION FROM THE $3.6 BILLION AT THE END OF FISCAL YEAR 2012.

The Infrastructure portfolio generated $369 million in investment income, excluding transaction costs, for a return of 10.1% in fiscal year 2013, compared to the benchmark return of 7.0%. This income includes $296 million of distributions. The portfolio return was driven mainly by direct investments in the utilities and transportation sectors in Canada and Europe. In the energy sector, the changing patterns in supply and demand for natural gas in North America impacted by new shale gas discoveries continued to negatively affect the portfolio as gas prices and volatility remained low.

Over a four-year period, Infrastructure investments generated a 5.1% annualized return compared to a benchmark return of 6.8% for the same period. The investment horizon of Infrastructure investments is approximately 10 years. Since the inception of this asset class in June 2006, Infrastructure investments have generated a 5.2% annualized return, compared to a Policy Benchmark return of 5.3%.

The year-over-year increase in net assets in Infrastructure included amongst others new direct investments totalling $474 million, and the divestment of its ownership in Sutton and East Surrey Water, a company based in the United Kingdom. Over the course of the fiscal year, the Infrastructure group created a new strategic partnership called Isolux Infrastructure, a company which owns toll roads, transmission-line concessions and solar power generation plants diversified throughout seven countries, as well as a portion of the mezzanine debt of an airport in the United Kingdom. In addition, the Infrastructure group committed $1.0 billion with existing and new partners in North and South America. The diverse nature of these investments as well as the variety of sectors and regions involved contributed to enhanced portfolio diversification.

The Infrastructure strategy remains focused on building partnerships with other financial investors and strategic operators to acquire companies offering a good mix of predictable cash flows and growth opportunities, and on owning these investments for many years.

As at March 31, 2013, direct and co-investments accounted for 85% of the assets of the Infrastructure Portfolio, up from 83% at the end of the previous fiscal year.

Renewable Resources

As at March 31, 2013

ONE YEAR RATE OF RETURN

16.7%

Investment income*

$54 million

*Excluding transaction costs

Net assets

$382 million

0.5%

of total net assets

NET ASSETS OF THE RENEWABLE RESOURCES PORTFOLIO TOTALLED $382 MILLION AT THE END OF FISCAL YEAR 2013, AN INCREASE OF $57 MILLION FROM $325 MILLION AT THE END OF FISCAL YEAR 2012.

Renewable Resources generated $54 million in investment income, excluding transaction costs, for a rate of return of 16.7% in fiscal year 2013, compared to a benchmark return of 4.9%. Portfolio returns were driven by distributions and valuation gains attributable to the investment in TimberWest.

The Renewable Resources asset class was initiated in fiscal year 2012, with the objective of investing in assets that involve the production and harvest of renewable resources such as timber and agricultural products. The new asset class is a good strategic fit for the Plans given the following unique characteristics:

- Inflation-hedging ability, which is well matched with the long-term nature of the Plans' Post-2000 Liabilities;
- Ability to capture liquidity premiums, which takes advantage of PSP Investments' strong liquidity profile; and
- Diversification benefits, given that return fundamentals are different from PSP Investments' other asset classes.

In fiscal year 2012, the Renewable Resources team completed its first investment by acquiring a 50% interest in TimberWest Forest Corp., Western Canada's largest private timber and land-management company. TimberWest owns approximately 325,000 hectares (810,000 acres) of private land on Vancouver Island and Crown harvest rights to 0.7 million cubic meters of logs per year.

During fiscal year 2013, the Renewable Resources team entered into an agreement to purchase a significant participation in New Zealand's Kaingaroa Forest. The estate totals approximately 178,000 hectares (440,000 acres) of planted forest and is the largest contiguous softwood plantation in the southern hemisphere. The transaction closed shortly after the end of the fiscal year.

As at March 31, 2013, direct investments accounted for 100% of the assets in the Renewable Resources portfolio.

OPERATING AND ASSET MANAGEMENT EXPENSES

In fiscal year 2013, PSP Investments' cost ratio (i.e. operating expenses plus asset management expenses as a percentage of average net investment assets) decreased to 56.9 basis points, or 56.9 cents per $100 of average net investment assets, from 60.6 basis points, or 60.6 cents per $100 of average net investment assets in fiscal 2012. This improvement is the result of increased efficiencies and economies of scale driven by an increase in the internal active management of assets and a significant growth in net investment assets. Asset management expenses include management fees paid to external asset managers and transaction costs. Transaction costs can vary significantly year over year, depending on the complexity and size of the Private Markets investment activities.

From a cost perspective, PSP Investments has been carefully managing growth in investment activities by ensuring rigorous oversight as asset levels increased over the past several years. PSP Investments' cost ratio has declined in each of the past five fiscal years, going from 86.9 basis points (86.9 cents per $100 of average net investment assets) in fiscal year 2009 to 56.9 basis points in the current fiscal year, a decrease of 35%. This decline is attributable to PSP Investments' internal active management investment strategy adopted in fiscal 2004. Assets managed internally increased to approximately $56 billion at the end of fiscal 2013 compared to $48 billion at the end of the previous fiscal year. Over the past five fiscal years, internally managed assets have increased by approximately $35 billion, while operating expenses grew by only $98 million. We estimate that for fiscal year 2013 alone, based on market data on investment implementation style, the increase in internally managed assets of $35 billion has resulted in savings ranging from $160 million to $250 million, compared with what costs would have been had PSP Investments deployed these assets with external investment managers.

PSP Investments' cost ratio includes operating expenses of $184 million for fiscal year 2013, compared to $148 million for fiscal year 2012. As a percentage of net investment assets, operating expenses amounted to 26.8 basis points, or 26.8 cents per $100 of average net investment assets, compared to 24.8 basis points, or 24.8 cents per $100 of average net investment assets in fiscal year 2012. The increase in operating expenses for the current fiscal year can be attributed to the increase in headcount and related expenses required to support the execution of the internal active investment strategy mentioned previously and incentive payments related to the strong investment performance in fiscal 2013. The increase in operating expenses expressed in basis points has been more than offset by the decrease in basis points with respect to external asset management expenses.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

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

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

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of implementing its IFRS adoption plan and analyzing the impact of the adoption on PSP Investments' consolidated financial statements.

RISK MANAGEMENT

ENTERPRISE RISK MANAGEMENT

As the manager of federal public sector pension plan assets, PSP Investments is responsible for acting in the best interest of the contributors and beneficiaries under the Plans and maximizing returns without undue risk of loss. PSP Investments acknowledges that it must take risks to achieve its statutory mandate and that the management of the full spectrum of risks must be integrated on an enterprise-wide basis.

Accordingly, the Corporation emphasizes continuous improvement of its risk management capabilities. During fiscal year 2013, management and a newly constituted special Risk Committee of the Board of Directors initiated the development of a comprehensive Risk Appetite Statement, which will clearly define PSP Investments' appetite, attitude and tolerance to risks that can be taken in pursuit of objectives.

The Risk Appetite Statement will complement existing elements of risk management at PSP Investments, including the Enterprise Risk Management (ERM) Policy, which sets out the guiding principles governing the Corporation's overall approach, philosophy, culture and values with respect to risk management.

The ERM Policy provides a framework for identifying, evaluating, managing, monitoring and reporting the various investment and non-investment risks faced by the Corporation. The framework is guided by the following principles:

- Promote a risk-aware culture involving all employees;
- Integrate enterprise risk management into strategic and financial objectives;
- Optimize the risk/return ratio, based on consistent investment performance combined with prudent Policy Portfolio diversification and disciplined risk budgeting;
- Operationalize sound risk management processes supporting investment and non-investment activities; and
- Ensure effective and transparent communication of emerging risk trends.

AS THE MANAGER OF FEDERAL PUBLIC SECTOR PENSION PLAN ASSETS, PSP INVESTMENTS IS RESPONSIBLE FOR ACTING IN THE BEST INTEREST OF THE CONTRIBUTORS AND BENEFICIARIES UNDER THE PLANS AND MAXIMIZING RETURNS WITHOUT UNDUE RISK OF LOSS.

PSP INVESTMENTS' ENTERPRISE RISK CATEGORIES

The Enterprise Risk Management Policy defines and categorizes enterprise risks to facilitate a universal understanding of all the risks faced by PSP Investments. The Corporation's enterprise risk categories are defined as:

- Investment risk: the risk of loss inherent in achieving investment objectives, including market, liquidity, credit and counterparty, leverage and concentration risks.
- Strategic risk: the risk of not achieving strategic goals or business objectives.
- Governance risk: the risk of a lack of consistent corporate management, cohesive policies and organizational structure alignment.
- Stakeholder risk: the risk of not maintaining efficient relations with PSP Investments' Plan sponsors and key business partners.
- Legal and regulatory risk: the risk of non-compliance with applicable regulations, or a change in legislation, regulations or other mandatory industry practices.
- Operational risk: the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events.
- Reputational risk: the risk that an activity undertaken by PSP Investments or its representatives or partners impairs its image in the community or lowers public opinion and stakeholder confidence in it.

Each risk category encompasses different types of underlying risks that must be taken into account in order to accurately identify and efficiently manage all investment and investment risks inherent in PSP Investments' activities.

INVESTMENT RISK				
Market Risk	Liquidity and Financing Risk	Credit and Counterparty Risk	Leverage Risk	Concentration Risk

NON INVESTMENT RISK		
Strategic Risk	**Governance Risk**	**Stakeholder Risk**
– Strategic Planning – Strategy Implementation	– Corporate Oversight and Management – Organizational Structure – Policies and Tolerance Levels	– Plan Sponsor Relations – Business Partner Relations
Legal and Regulatory Risk	**Operational Risk**	**Reputational Risk**
– Misinterpretation of Regulations – Change in Regulations	– Talent Management – Process and Information Management – Systems and Data Management – Theft and Fraud – Business Disruption – Model and Valuation	– Corporate Visibility – Responsible Investing

RISK MANAGEMENT DEPARTMENT

The Risk Management department's mandate is derived from PSP Investments' Risk Management Policy established by the Board of Directors.

The Risk Management department supports PSP Investments' activities and is responsible for ensuring the management of investment and non-investment risks.

Public Markets Risk

The Public Markets Risk team monitors and reports on all aspects of investment risk for publicly traded securities. Essentially the team is responsible for:

- Market risk: measuring value-at-risk related to the Policy Portfolio and active management, and performing portfolio stress tests and sensitivity analysis.
- Liquidity risk: monitoring cash on hand versus liquidity floors to meet financial obligations as they come due, without having an adverse economic consequence.
- Credit and counterparty risk: reviewing the credit ratings of all counterparties, and the evolution of credit ratings of all credit-sensitive financial securities.

Private Markets Risk

Private Markets Risk is overseen by a dedicated team within the Risk Management department responsible for risk analysis of private market assets.

In addition to quantitative analyses such as value-at-risk, the Private Markets Risk team also performs qualitative analysis for all Private Markets investments to complement quantitative parameters, and to ascribe and monitor risk ratings.

Leverage and Concentration Risks

In addition to the activities detailed above, the Risk Management department also tracks total leverage and its sub-components against pre-determined thresholds to ensure the best use of PSP Investments' balance sheet.

Concentration risk is monitored and managed by reviewing concentration evolution over time and by class, sector, market, country or other parameters versus predetermined thresholds.

Liquidity Risk

Risk management is responsible for the monitoring of liquidity, corporate leverage and currency exposure. The team ensures that investments held meet high standards in terms of their liquidity and credit profiles and that leverage and currency hedging activities are within limits and guidelines established by PSP Investments.

Corporate Risk

While all enterprise risks fall within the scope of the Corporate Risk team, its primary focus is on operational risks and other non-investment risks.

The Corporate Risk team ensures that PSP Investments' risk management framework is aligned to industry standards, and that the management of identified risks is aligned to both business objectives and the strategic plan.

The team is also responsible, in conjunction with the Information Technology department, for managing the business continuity management program to mitigate risks associated with a business disruption.

MANAGEMENT OF INVESTMENT RISKS

As part of the Enterprise Risk Management Policy, PSP Investments has developed an Investment Risk Management Policy to support the management of risks incurred through the Corporation's investment processes. The policy establishes an investment risk management framework, with a goal of ensuring that investment activities respect the risk philosophy of PSP Investments.

The Investment Risk Management Policy also supplements the SIP&P. It is designed to effectively manage all investment risks related to the implementation of the Policy Portfolio and to active management activities:

- The Policy Portfolio, as defined in the SIP&P and described on page 12, includes a strategy to mitigate risk through a diversified investment portfolio.
- Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

In order to thoroughly assess investment risks within its portfolios, PSP Investments complements its quantitative analyses with a qualitative approach.

During fiscal year 2013, PSP Investments undertook the following initiatives designed to further improve the management of various types of investment risk:

- Market risk: Further refined active risk measurement and attribution through detailed reports.
- Liquidity risk: Enhanced the liquidity framework through improved cash flow projections.
- Credit and counterparty risk: Increased counterparty risk mitigation through a review of related documentation.
- Leverage risk: Carried out an in-depth review of all potential sources of leverage, which led to the establishment of a detailed limit structure.
- Concentration risk: Developed a comprehensive view of PSP Investments' aggregated portfolio across all asset classes.
- Private Market risk: Enhanced reporting for internally assigned credit ratings for all Private Markets investments and developed the ongoing monitoring of these internal credit ratings.

MANAGEMENT OF NON-INVESTMENT RISKS

Given that the management of different categories of risk entails utilizing different approaches, all of the various risk management policies and procedures in force are regularly reviewed to ensure that they are in accordance with the guiding principles stated in the Enterprise Risk Management Policy.

Operational risk is one of the key enterprise risks that PSP Investments is exposed to in its daily activities. An Operational Risk Management Policy has been developed to comply with, and to supplement, the Enterprise Risk Management Policy. PSP Investments' employees are active participants in mitigating all sources of potential operational failure, whether internal or external.

During fiscal year 2013, PSP Investments took the following actions to enhance the management of non-investment risks:

- Risk Assessment: A risk and control self-assessment (RCSA) update was conducted to review PSP Investments' most significant risks, their key impacts, mitigation factors and the adequacy of the mitigation environment.
- Operational Risk Reporting: Developed risk reporting and enhanced key indicators to provide a more dynamic vision of risk at all levels of PSP Investments, for Public and Private Markets investments.
- Market Rule Monitoring: Certain processes were automated to ensure efficient monitoring of Public Markets activities in compliance with various market rules.
- Responsible Investing: A Vice President, Responsible Investment, was appointed to lead further implementation of environmental, social and governance factors into the investment decision-making process.
- Fraud Prevention: Based on a fraud risk management program review, a number of improvements were made to procedures and business practices to enhance fraud protection.

RISK MANAGEMENT GOVERNANCE

Given that it faces risks in all aspects of its activities, PSP Investments promotes a corporate-wide risk-aware culture. Senior management and employees are not only active participants in risk identification, but also in risk evaluation, management, monitoring and reporting.

The Board of Directors contributes to risk oversight by:

- Establishing the investment objectives, SIP&P and Policy Portfolio;
- Participating in the definition of PSP Investments' risk philosophy;
- Ensuring that PSP Investments' management has established effective enterprise risk management within the Corporation;
- Reviewing the corporate risk profile provided by management; and
- Being apprised of material risks and how PSP Investments' management is responding to them.

As previously noted, during fiscal year 2013 the Board established a special Risk Committee that has been mandated to oversee the development of PSP Investments' Risk Appetite Statement in concert with management.

In order to oversee and manage risks related to its investments and operations, senior management relies on various committees, including the Management Investment Committee, Management Operations Committee, Risk Steering Committee, Valuation Committee, New Business Activity Committee and Information Technology Governance Committee.

INTERNAL AUDIT AND COMPLIANCE

INTERNAL AUDIT

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve PSP Investments' operations. It helps to achieve PSP Investments' objectives by using a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

INTERNAL CONTROL

The definition of internal control adhered to by PSP Investments is derived from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Integrated Framework. COSO defines internal control as a process, effected by an entity's Board of Directors, management and personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Operational – Effectiveness and efficiency of operations;
- Reporting – Reliability of financial reporting;
- Compliance – Compliance with applicable laws and regulations.

PSP Investments conducts an annual review of its control environment as well as its key controls, including those related to fraud risk, as required under Section 28 of the Act.

The control functions are carried out at various levels and in different departments. Each control is designed to ensure that PSP Investments' policies and procedures are respected and applied consistently, and that the risk of fraud is mitigated. All policies are approved by the Board of Directors and are supported by procedures that provide a framework for their implementation.

COMPLIANCE

PSP Investments, and each of its employees, must act with integrity and maintain high ethical standards at all times. The objective of the Compliance Department, in conjunction with the Legal Affairs Department, is to ensure rigorous compliance by PSP Investments and its employees with relevant laws and statutory requirements and with its policies and procedures, which include the Code of Conduct for Officers, Employees and Others (the "Employee Code").

Compliance with internal investment policies and procedures is achieved primarily through daily monitoring of transactions, monthly oversight and quarterly reporting to the Audit Committee, which is responsible for monitoring the compliance function. Processes are also in place to monitor compliance with regards to the Employee Code. The Employee Code provides a practical framework designed to help employees better understand PSP Investments' principles and values, with the aim of assisting employees and those subject to its provisions in determining appropriate business practices and behavior.

Among other things, the Employee Code includes sections on: personal and professional conduct, which requires unwavering commitment to honesty and integrity; conflicts of interest; gifts; hospitality and other benefits; fraud and corruption; and protecting PSP Investments' assets and personal trading, which requires the pre-authorization and reporting of personal investment transactions.

PSP Investments takes the Employee Code seriously. Violators are subject to appropriate disciplinary measures, including termination of employment or engagement. The Employee Code also contains a whistleblowing and non-retaliation provision designed to encourage and protect employees, and those subject to its provisions, who step forward and report fraudulent or inappropriate activities.

The Compliance Officer is responsible for the Employee Code's procedures and reports quarterly to the Governance Committee of the Board which is responsible for monitoring application of the Employee Code. The Employee Code may be consulted on PSP Investments' website at **www.investpsp.ca**.

GOVERNANCE

Effective governance is essential to safeguard the capital transferred to PSP Investments and to ensure that appropriate objectives are pursued and achieved, consistent with the fulfillment of the Corporation's statutory mandate. This section describes PSP Investments' governance framework, including its mandate, the roles of the Board of Directors and Board committees and key governance policies and practices that guide the Corporation's activities and behaviour.

MANDATE

PSP Investments is a Crown corporation created in 1999 by Act of Parliament (the *Public Sector Pension Investment Board Act*, or the "Act"). PSP Investments' mandate is twofold: managing the funds transferred to it by the Government of Canada for the Canadian Forces, the Reserve Force, the Public Service and the Royal Canadian Mounted Police ("RCMP") pension plans (the "Plans") in the best interests of the contributors and beneficiaries; and investing its assets 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 their ability to meet their financial obligations.

Effective April 1, 2000, the Government of Canada created three new pension fund accounts (the "Pension Funds"), one for each of the Public Service, the Canadian Forces and the RCMP Plans. On March 1, 2007, the Government established the Reserve Force Pension Plan and created a Pension Fund for it as well. Employer and employee contributions in respect of service after the date of creation of a particular Pension Fund ("post-funding service") are credited to the relevant Pension Fund. Amounts equal to the net balances credited to these Pension Funds (that is contributions minus benefits payments for post-funding service, and plan administration expenses) are transferred to separate accounts maintained at PSP Investments (the "Pension Plan Accounts") for each of the Pension Funds, to be invested in accordance with the approved investment policy and strategy.

The Government of Canada manages and administers the Plans. The President of the Treasury Board is responsible for the Public Service Pension Plan, the Minister of National Defence for the Canadian Forces Pension Plan and the Reserve Force Pension Plan, and the Minister of Public Safety for the RCMP Pension Plan. Pursuant to the Act, PSP Investments is the sole investment manager of the amounts transferred to the Pension Plan Accounts.

BOARD OF DIRECTORS

In accordance with the Act, PSP Investments' operations and activities are overseen by a Board of Directors composed of 11 members, including the Chair of the Board. Directors are appointed by the Governor in Council on the recommendation of the President of the Treasury Board to hold office during good behaviour for a term not exceeding four years. Candidates for directorships are selected from a list of qualified Canadian residents proposed by an external nominating committee established by the President of the Treasury Board (the "Nominating Committee") pursuant to the Act. The Nominating Committee operates separately from the Board of Directors, the President of the Treasury Board and the Treasury Board Secretariat. Members of the Senate, the House of Commons and provincial legislatures, as well as employees of PSP Investments or the Government of Canada and those entitled to benefits from the Plans, are disqualified from serving as Directors. The Chair of the Board is designated from among the Directors by the Governor in Council on the recommendation of the President of the Treasury Board, after consultation with the Board of Directors, the Minister of National Defence and the Minister of Public Safety. On the expiry of the term of an incumbent Director, the incumbent may be reappointed and, in any event, continues in office until a successor is appointed.

There were no changes to the Board composition in fiscal year 2013. On March 31, 2013, the Board was composed of the following nine Directors, with two vacant positions in the process of being filled:

- Cheryl Barker, Interim Chair
- Micheline Bouchard
- Anthony R. Gage
- Lynn Haight
- Michael P. Mueller
- Diane Bean
- Léon Courville
- Garnet Garven
- William A. MacKinnon

Canadian securities regulators have defined the concept of "independent director" applicable to publicly-listed issuers as an individual who has no direct or indirect material relationship with the issuer. A "material relationship" has been defined as a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of an individual's independent judgment. Those regulations do not apply to PSP Investments, given that it is not a publicly-listed issuer. However, based on the same definitions, all Directors of PSP Investments would be considered independent directors.

ACCOUNTABILITY

PSP Investments is a Crown corporation with a unique governance and accountability regime which is set out in the Act. The Act provides that PSP Investments operates at arm's length from the Government of Canada and imposes on it reporting obligations to the Government of Canada and the contributors to the Plans.

The Board of Directors is responsible for the selection, appointment, performance evaluation and compensation of the President and CEO, who reports to the Board of Directors. PSP Investments reports to the ministers responsible for the Plans through its quarterly financial statements and annual report. The annual report must also be made available to contributors to the Plans and is tabled in each House of Parliament by the President of the Treasury Board, who is responsible for the Act.

The President and CEO and the Chair of the Board are required to meet once a year with advisory committees appointed to oversee the Plans. PSP Investments is also required to hold an annual public meeting. In addition, PSP Investments communicates on an ongoing basis with the Chief Actuary of the Office of the Superintendent of Financial Institutions Canada, Treasury Board officials and other Government of Canada officials in the execution of its statutory mandate.

Pursuant to the *Financial Administration Act* ("FAA"), the Auditor General of Canada and Deloitte LLP were appointed to serve as joint external auditors of PSP Investments for fiscal year 2013. The external auditors are also responsible for conducting Special Examinations as stipulated in the FAA at least once every ten years. PSP Investments' joint auditors conducted a Special Examination in fiscal year 2011 to determine if PSP Investments' financial and management controls, information systems and management practices were maintained in a manner that provides reasonable assurance that they met the requirements of the FAA. The report on such Special Examination formed part of the annual report for fiscal year 2011 as required by the Act.

DIRECTOR COMMITMENT, SKILLS AND COMPETENCIES

The Board of Directors plays an active role in guiding PSP Investments. Therefore, a substantial time commitment is expected of Directors, particularly the Chair of the Board and the Chairs of Board committees, for meetings, preparation for meetings and travel.

All Directors of PSP Investments must have an excellent understanding of the role of a director and possess a general knowledge of pensions and a broad knowledge of investment management and its related risks.

In addition to investment management knowledge, the Directors of PSP Investments possess a wide range of professional experience in a variety of fields, including accounting, finance, economics and human resources. Biographies of each Director, as of March 31, 2013, can be found beginning on page 63.

In fiscal year 2013, the Governance Committee updated its Board skills and competencies matrix in order to identify and manage any skill gaps at the Board level. This review is expected to be useful for the Interim Chair when communicating desired candidate profiles to the Nominating Committee.

CONDUCT OF BOARD AND COMMITTEE MEETINGS

Board members' deep knowledge of the Corporation allows them to exercise management oversight and provide insight, where appropriate, in terms of strategy. This leads to active discussion at the Board and committee levels between Directors and management.

All regular Board and Board committee meetings include in-camera sessions, where no member of management is in attendance. As discussed below, the Audit Committee also has in-camera meetings with each of the internal and external auditors. In addition, the Board has in-camera meetings with the President and CEO, in which no other members of the management team are present.

In order to fulfill their duties set out in the Act and in their respective Terms of Reference, the Board and its committees may use external advisors. This was the case for the Board as a whole as well as for the Risk and Human Resources and Compensation Committees during fiscal year 2013. While the Board and its committees take into account the independent recommendations of such advisors, final decisions are solely those of the Board or the committee in question, as the case may be.

ASSESSMENT OF BOARD PERFORMANCE

A formal process to evaluate the performance of the Chair of the Board, the Chairs of Board committees, individual Directors and the Board as a whole is overseen by the Governance Committee. Every Director, as well as the President and CEO and certain members of senior management, participate in the evaluation process. The Chair of the Governance Committee presents the results of the evaluation to the Board of Directors. Ensuing Board discussions focus on concerns and opportunities for improvement, what is working properly and what has improved since previous assessments, following which any measures deemed necessary are implemented.

ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS AND BOARD COMMITTEES

Board of Directors

In order to ensure that PSP Investments' statutory mandate is met, the Board of Directors, in addition to the requirements of the Act, has defined its role to include, among other responsibilities, the following:

- Appointment and termination of the President and CEO;
- Annual review and approval of proposed amendments to the written Statement of Investment Policies, Standards and Procedures ("SIP&P") for each Pension Plan Account;
- Approval of strategies for achieving investment performance objectives and benchmarks against which to measure performance;
- Adoption of appropriate policies for the proper conduct and management of PSP Investments, including a Code of Conduct for Officers, Employees and Others ("Employee Code"), and a Code of Conduct for Directors ("Director Code");
- Ensuring that effective enterprise, investment and operations risk policies are in place;
- 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 the remuneration of all officers, including the President and CEO; and
- Approval of quarterly and annual financial statements for each Pension Plan Account and for PSP Investments as a whole.

The Terms of Reference describing the roles and responsibilities of the Board of Directors and its committees and the Chair of the Board may be viewed in their entirety on PSP Investments' website **www.investpsp.ca**.

Board Committees

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

- Investment Committee
- Governance Committee
- Special Risk Committee
- Audit Committee
- Human Resources and Compensation Committee

Investment Committee

The Investment Committee is responsible for overseeing the investment management function of PSP Investments. The Investment Committee's duties assigned to it by the Board or provided for in the Act include the following:

- Approving all investment proposals and related borrowings above thresholds delegated by the Board to management for approval;
- Making annual and other recommendations to the Board of Directors on the SIP&P for each Pension Plan Account;
- Overseeing PSP Investments' investment risks and ensuring that an appropriate control environment is in place to govern the management of investment risks; and
- Approving the engagement of external investment managers having discretionary authority to invest PSP Investments' assets under management.

The Investment Committee is composed of all members of the Board of Directors and is chaired by Mr. Anthony R. Gage.

Audit Committee

The Audit Committee's role is generally to review financial statements and the adequacy and effectiveness of PSP Investments' systems of internal controls. This includes internal controls over the accounting and financial-reporting systems within PSP Investments, as well as internal information system controls and security. Many of the duties of the Audit Committee are set out in the Act. These duties include:

- Reviewing quarterly and annual financial statements for each Pension Plan Account and for PSP Investments as a whole, recommending them to the Board for approval and discussing any letters to management regarding any significant concerns on the part of the joint external auditors;
- Meeting separately with PSP Investments' joint external auditors and internal auditors, without management present, to discuss and review specific issues related to the Audit Committee;
- Overseeing PSP Investments' operational risks and ensuring that an appropriate control environment is in place to govern the management of operational risks inherent to PSP Investments' activities;
- Ensuring that internal audits are conducted in respect of PSP Investments and its subsidiaries; and
- Adopting and maintaining an appropriate whistle-blowing mechanism for reporting fraudulent, illegal or inappropriate activities.

On March 31, 2013, the Audit Committee was composed of the following Directors:

- William A. MacKinnon, Chair
- Anthony R. Gage
- Lynn Haight
- Cheryl Barker
- Garnet Garven

All Audit Committee members are financially literate with accounting or finance expertise, and possess the requisite experience and knowledge to read and understand PSP Investments' and the Pension Plan Accounts' financial statements and properly fulfill their role. For more information on the experience of each committee member, as well as their occupations and education, please see their biographies on page 63.

Governance Committee

The Governance Committee's role is generally to assist the Board of Directors in monitoring governance matters at PSP Investments and developing related policies. The Governance Committee has responsibility for the application of the Director Code and the Employee Code. The Governance Committee's duties also include the following:

- Monitoring and assessing the relationship between the Board of Directors and management, defining the limits to management's responsibilities and ensuring that the Board of Directors functions independently of management;
- Reviewing at least every two years, with the assistance and input of the President and CEO and the Chair of the Board of PSP Investments, the Terms of Reference for the Board of Directors and the committees of the Board, and recommending to the Board such amendments as may be necessary or advisable;
- Developing and recommending to the Board of Directors for approval new or amended by-laws and governance-related policies, including the Director Code and the Employee Code;
- Developing target recruitment skill sets and other recruiting capabilities to facilitate the identification by the independent Nominating Committee of suitable candidates for appointment as Directors of PSP Investments;
- Overseeing the implementation of procedures for assessing the effectiveness of the Board of Directors as a whole, as well as the performance of individual Directors; and
- Overseeing PSP Investments' governance risks and ensuring that an appropriate governance framework is in place.

On March 31, 2013, the Governance Committee was composed of the following Directors:

- Cheryl Barker, Chair
- Garnet Garven
- Léon Courville
- Michael P. Mueller

Human Resources and Compensation Committee

The Board of Directors strongly believes in the importance of human resources to the success of PSP Investments. Accordingly, the Human Resources and Compensation Committee assists the Board of Directors in ensuring that the necessary policies and procedures are in place to efficiently and effectively manage PSP Investments' human resources and to offer all employees fair and competitive compensation aligned with performance. The Human Resources and Compensation Committee is therefore responsible for:

- Making recommendations to the Board of Directors regarding PSP Investments' human resources, training and compensation policies, and periodically reviewing such policies and recommending changes as necessary;
- Reviewing annually, on an aggregate basis, the total compensation of all employees of PSP Investments;
- Reviewing annually, the performance evaluations of the President and CEO and other Officers of PSP Investments and making recommendations to the Board on the remuneration of these individuals;
- Overseeing PSP Investments' human resources risks and ensuring that an appropriate governance environment is in place to manage human resources risks inherent to PSP Investments' activities; and
- Reviewing and reporting to the Board on PSP Investments' succession planning.

On March 31, 2013, the Human Resources and Compensation Committee was composed of the following Directors:

- Michael P. Mueller, Chair
- Micheline Bouchard
- Diane Bean
- Léon Courville

All Human Resources and Compensation Committee members are knowledgeable about issues related to human resources, talent management, executive compensation and risk management. Understanding of such issues was gained by professional experience as former chief executives or senior officers with oversight of human resources functions. For more information on the experience of each committee member, as well as their occupations and education, please see their biographies on page 63.

Risk Committee

The Board of Directors established a special Risk Committee effective October 3, 2012. The mandate of this special committee has been extended into fiscal year 2014 and may be further extended at the Board's discretion.

The Risk Committee is responsible for, among other matters:

- Reviewing any aspect of risk or risk management at PSP Investments that is deemed appropriate; and
- Developing for approval by the Board a Risk Appetite Statement for PSP Investments.

On March 31, 2013, the Risk Committee was composed of the following Directors:

- Diane Bean, Chair
- Lynn Haight
- Anthony R. Gage
- Michael P. Mueller

CODE OF CONDUCT FOR DIRECTORS

The Director Code together with the Employee Code were developed to establish and maintain a culture that guides decision-making throughout the Corporation. The purpose of the Director Code goes beyond complying with minimum statutory requirements; it reflects the expectation that Directors will have the highest level of integrity and ethical standards. The Director Code is designed to provide a workable process for identifying, minimizing and resolving potential conflicts of interest. Derived from the Act and the *Conflict of Interest Act*, the Director Code sets out in detail Directors' statutory and fiduciary duties relating to conflicts of interest and helps ensure that Directors have a full understanding and appreciation of PSP Investments' principles and values. Ultimately, the Director Code aims to assist Directors in determining appropriate business practices and behaviour.

Among other stipulations, the Director Code:

- Requires Directors to give written notice to the Board of Directors of the nature and extent of their interest in a transaction or proposed transaction;
- Prohibits Directors from voting on a resolution or participating in a discussion in any circumstances where they have a conflict of interest;
- Requires the disclosure of any other business activity in which they participate that directly or indirectly affects PSP Investments' activities or is in competition with PSP Investments' activities; and
- Requires the Directors to pre-clear all securities trades, except exempt trades, and to report quarterly to a PSP Investments' auditor on their personal trading activities.

The Governance Committee is responsible for monitoring the application of the Director Code. The Director Code may be viewed in its entirety on PSP Investments' website **www.investpsp.ca**.

DIRECTOR EDUCATION AND ORIENTATION

The Act requires the Nominating Committee to have regard to the desirability of having on the Board of Directors a sufficient number of Directors with proven financial ability or relevant work experience such that PSP Investments will be able to effectively achieve its mandate. The Act also requires Directors with relevant expertise to use their knowledge or skills in exercising their duties.

To enhance Directors' financial knowledge and skills, PSP Investments created a Director Education Program. Each Director is allocated an individual education and training budget to be used primarily to strengthen their understanding of investment management. Directors are required to report annually on the nature of their individual development plans and the status with respect to implementation. As well as providing individual courses, conferences and reading material, the Director Education Program usually stages group educational forums the day before each regular Board of Directors meeting. During these sessions, industry speakers are invited to make presentations on a variety of topics that contribute to the individual and collective expertise of Board members. Topics covered during fiscal year 2013 included credit markets and investment opportunities in Asia.

Furthermore, newly appointed Directors are expected to complete an in-house Orientation Program. The purpose of the Orientation Program is to provide newcomers with the information necessary to acquaint them with the operations and culture of the Corporation and enable them to contribute effectively to the Board of Directors as soon as possible after their appointment.

Both the Director Education Program and the Orientation Program are monitored by the Governance Committee.

DIRECTORS' COMPENSATION

The approach to Director compensation adopted by the Board of Directors reflects the requirements of the Act. The first requirement is that the Board should include a sufficient number of Directors with proven financial ability or relevant work experience such that PSP Investments will be able to effectively achieve its mandate. The second requirement is 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 any changes that may be warranted based on a report and recommendations provided by the Governance Committee. The following compensation for Directors was approved by the Board of Directors for fiscal year 2012, and the Board subsequently agreed that there would be no increase in these amounts for fiscal years 2013 and 2014:

- Annual retainer for the Interim Board Chair: $150,000
- Annual retainer for each Director other than the Board Chair: $30,000
- Annual retainer for each Chair of a committee of the Board: $10,000
- Attendance fee for each Board meeting: $1,500[1,2]
- Attendance fee for each committee meeting: $1,500[1,2]
- Travel fees for each Director who attends a meeting in person if the Director's primary residence is outside Québec or Ontario, or in any case where a Board of Directors or committee meeting is held in a location outside Québec and requires a Director to travel more than three hours away from his or her primary residence: $1,500.

The Interim Chair of the Board is not entitled to any meeting fees or annual retainer as Chair of a committee of the Board. Directors of PSP Investments are not entitled to additional compensation in the form of retirement benefits or short-term or long-term incentives.

The Board met eight times during fiscal year 2013 and its Committees held 35 meetings. This translated into total remuneration for Directors of $705,445. The tables on the following two pages illustrate and break down the above-mentioned information.

[1] $500 for a meeting of less than one hour.

[2] A single meeting fee will be paid to a Director who attends meetings of the Board of Directors and the Investment Committee held concurrently.

ATTENDANCE OF DIRECTORS BOARD AND COMMITTEE MEETINGS FISCAL YEAR 2013[1]

	Board of Directors		Investment Committee		Audit Committee		Governance Committee		Human Resources and Compensation Committee		Risk Committee[2]	
	Regular	Special	Regular	Special	Regular	Special	Regular	Special	Regular	Special	Regular	Special
Number of meetings Fiscal Year 2013	8	N/A	6	1	6	1	5	N/A	6	N/A	3	N/A
Cheryl Barker	8/8		6/6	1/1	5/6	1/1	5/5					
Diane Bean	8/8		6/6	1/1					6/6		3/3	
Micheline Bouchard	6/8		4/6	0/1					5/6			
Léon Courville	8/8		6/6	1/1			5/5		6/6			
Anthony R. Gage	7/8		5/6	1/1	5/6	1/1					2/3	
Garnet Garven	8/8		6/6	1/1	6/6	1/1	5/5					
Lynn Haight	8/8		6/6	1/1	6/6	1/1					3/3	
William A. MacKinnon	7/8		5/6	1/1	6/6	1/1						
Michael P. Mueller	8/8		6/6	1/1			5/5		6/6		3/3	

1 During fiscal year 2013, Directors were not able to attend certain meetings, in part or in whole, due mainly to family or prior work commitments.

2 The Risk Committee was created on October 3, 2012.

REMUNERATION OF DIRECTORS FISCAL YEAR 2013

Name	Remuneration[1]				
	Annual Retainer	Chair of a Committee/ Annual Retainer	Boards/ Committees Meeting Fees	Travel Fees	Total
Cheryl Barker	$150,000	–	–	$10,500	$160,500
Diane Bean	$30,000	$4,946	$33,500	–	$68,446
Micheline Bouchard	$30,000	–	$21,000	–	$51,000
Léon Courville	$30,000	–	$35,500	–	$65,500
Anthony R. Gage	$30,000	$10,000	$27,000	$9,000	$76,000
Garnet Garven	$30,000	–	$35,000	$10,500	$75,500
Lynn Haight	$30,000	–	$33,000	–	$63,000
William A. MacKinnon	$30,000	$10,000	$25,500	–	$65,500
Michael P. Mueller	$30,000	$10,000	$40,000	–	$80,000

1 The Directors are also entitled to reimbursement of their reasonable travel related expenses when applicable.

INVESTMENT GOVERNANCE OVERSIGHT

As a long-term investor, PSP Investments believes in the importance of establishing strong governance oversight of its investments. PSP Investments uses its ownership positions to promote good corporate governance practices by exercising its proxy voting rights and actively engaging with companies through service providers, individually and through collaborative initiatives with other like-minded institutional investors.

Proxy Voting

PSP Investments has adopted Proxy Voting Guidelines (the "Guidelines") addressing the areas of corporate governance with respect to which it may be requested to vote on from time to time, as well as the principles on which PSP Investments will rely in determining a response to such requests. 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.

As part of the active management of its proxy voting, PSP Investments reviews proxy circulars and research from service providers when voting the equities held in accounts managed internally as well as those in segregated accounts managed by external managers.

The Guidelines may be viewed on PSP Investments' website **www.investpsp.ca**.

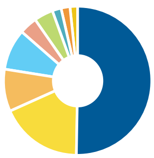
PROXY VOTING ACTIVITIES

Most proposals at shareholder meetings are submitted by the company's management and relate to the election of directors, the appointment of auditors and other matters that arise in the normal course of business.

In fiscal year 2013, PSP Investments exercised its voting rights at 2,950 meetings, voting against or abstaining from management's recommendations on 10.8% of the 30,824 proposed resolutions.

The issues on which PSP Investments voted against management's recommendation or abstained on such resolutions are shown below followed by a description of each category:

Issues
Fiscal year 2013



Board Independence and Effectiveness	51%
Compensation	18%
Capital Structure	9%
Shareholder Proposals	9%
Anti-takeover Protection	4%
Other	4%
Amendments to Articles	2%
Mergers, Acquisitions and Disposals	2%
Auditors Irregularities	1%

BOARD INDEPENDENCE AND EFFECTIVENESS

PSP Investments believes that a strong independent board of directors is best positioned to successfully direct and control a company in a way that ensures the creation of long-term shareholder value. This category includes resolutions where PSP Investments withheld its votes from nominees seeking election as directors. In the latest fiscal year, PSP Investments withheld its votes from selected nominees because of non-independence issues, non-separation of the role of Chair and CEO, poor attendance records and director time-commitment issues.

COMPENSATION

PSP Investments believes that compensation incentives to executives should be suitably structured to enhance shareholder value while rewarding performance that meets or exceeds stated objectives. During the latest fiscal year, PSP Investments voted against several compensation plans that were misaligned with performance or that failed to adequately disclose performance conditions.

CAPITAL STRUCTURE

PSP Investments is generally supportive of changes to a company's capital structure, provided there are sound business reasons for the proposed changes. In the latest fiscal year, PSP Investments voted against certain changes to capital structures because of dilution issues not justified by business considerations.

SHAREHOLDER PROPOSALS

Shareholder-initiated proxy proposals can be a useful and relevant means of addressing concerns and effecting change at companies that underperform or have poor environmental, social and governance practices. PSP Investments reviews all shareholder proposals on a case-by-case basis. PSP Investments generally supports shareholder proposals that increase the board of directors' level of accountability to shareholders and serve the company's financial interest, without putting excessive constraints on the company, its board of directors or its management. In the latest fiscal year, PSP Investments supported shareholder proposals relating to compensation, majority voting for the election of directors, and additional disclosure with respect to risks.

ANTI-TAKEOVER PROTECTION

PSP Investments always evaluates takeover-protection policies and proposals as well as shareholder rights plans on a case-by-case basis. During the past fiscal year, PSP Investments voted against takeover proposals, policies and shareholder rights plans where it felt they did not provide for an equal treatment of shareholders in the event of a takeover offer or included anti-takeover measures such as the right to issue shares should the company be subject to a bid.

AMENDMENT TO ARTICLES

From time to time, PSP Investments is asked to consider resolutions regarding amendments to the articles of a company. In the past fiscal year, PSP Investments was asked to vote on amendments to articles that would limit the right to call a special meeting, that called for the adoption or elimination of cumulative voting that amended or eliminated "supermajority" requirements, or that would change the jurisdiction of incorporation of a company. All resolutions amending articles are reviewed on a case-by-case basis in light of the proposed changes to the company's governance structure. PSP Investments generally votes against amendments to articles that reduce shareholders' rights.

MERGERS, ACQUISITIONS AND DISPOSALS

Proposed mergers, acquisitions and disposals have important impacts on shareholder value. Such transactions should be structured to maximize shareholder value without compromising the rights of shareholders. Given the nature of these transactions, they are voted on a case by case basis.

AUDITORS IRREGULARITIES

PSP Investments supports the election of auditors where they meet generally accepted independence standards and the integrity of an audit has not been compromised. On a limited number of occasions during the past fiscal year, PSP Investments voted against auditors who, in the opinion of PSP Investments, did not meet these standards.

EXAMPLES OF SHAREHOLDER PROPOSALS SUPPORTED

In fiscal year 2013, PSP Investments voted on 522 shareholder proposals, and supported 56% of these proposals.

Shareholder proposals	For votes	Rationale
Independent Board Chair and separation of Chair and CEO	71 proposals	We believe that the Chair of the Board should be an independent director.
Declassification of the Board	61 proposals	We believe that shareholders should have the opportunity to vote for the election of each director rather than as a slate. The annual election process makes it possible to periodically assess all directors.
Proxy access and right to call a special meeting	34 proposals	We support proposals that remove restrictions on the right of shareholders to nominate candidates for directors, subject to sufficient requirement regarding share ownership.
Majority vote for the election of directors	32 proposals	Electing directors is the most fundamental right for shareholders and thus we should have the opportunity to vote for or withhold from a director candidate.
Political contributions and expenditures report	31 proposals	We encourage the full and transparent disclosure of company practices regarding political contributions. When this disclosure is not found, we will support shareholders proposals requesting greater disclosure.
Report on sustainability and other environmental matters	28 proposals	We support proposals that seek to increase Board of Directors' level of accountability to shareholders on sustainability and environmental matters.

Responsible Investing

PSP Investments recognizes that a broad range of financial and non-financial considerations can be relevant in terms of making investment decisions. PSP Investments has adopted a Responsible Investment Policy which embodies its belief that responsible corporate behaviour with respect to environmental, social and governance ("ESG") factors can generally have a positive influence on long-term financial performance. In analyzing the risks inherent in any investment, PSP Investments looks to identify, monitor and mitigate ESG issues that are, or could become, material to long-term financial performance. Consideration of ESG risks is part of the due diligence process with respect to potential investments and the assessment of the practices of external managers. The monitoring of these risks is part of an ongoing dialogue with external managers, boards of directors and senior management of the private and public companies in which PSP Investments invests.

PSP Investments' Responsible Investment Policy may be viewed on PSP Investments' website **www.investpsp.ca**.

DIRECT ENGAGEMENT ACTIVITIES

With the assistance of a service provider, PSP Investments actively engages in dialogue with public companies with a view to improving their ESG practices. Public companies are selected for engagement based on a process that takes into account elements such as a company's ability to create shareholder value, the prospects for successful engagement and the ESG issues at hand. The intensity of PSP Investments' involvement with public companies evolves over time: some engagements entail one or two meetings over a period of months, while others are more complex and entail multiple meetings with board members and senior management over several years. PSP Investments tracks its engagement objectives primarily in the context of issues where it feels changes in behavior are warranted. Often there are multiple ESG issues to be addressed within the same company, each of which may require different levels of effort and engagement approaches as well as different contact points.

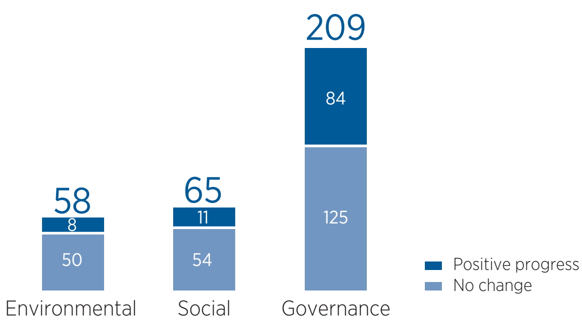
When undertaking extensive engagements, a five-step milestone approach is used to guide the engagement process and assess the success of the engagements:

Milestone 0	Milestone 1	Milestone 2	Milestone 3	Milestone 4
New Objective	Raised Concerns	Acknowledgement of Issue	Develop Credible Strategy/Set Stretching Targets	Strategy Implemented

In fiscal year 2013, PSP Investments made progress in delivering engagement objectives across regions and themes. The following graphic depicts the progress that has been made through the achievement of new milestones for the respective objectives:

Engagement Objectives

Fiscal year 2013 (number)

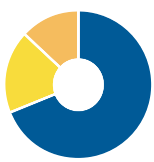


In fiscal year 2013, PSP Investments directly engaged with 163 public companies held in PSP Investments' portfolios on a range of ESG issues.

Below is a breakdown of PSP Investments' engagement activities by issue followed by a description of each category:

Engagements

Fiscal year 2013



Governance	69%
Social	18%
Environmental	13%

GOVERNANCE

Governance can be defined as the framework of rules and practices by which a board of directors ensures accountability and transparency in the company's relationship with its shareholders. PSP Investments engaged with public companies on a number of governance issues during the past fiscal year. Examples of issues raised were director independence, majority voting, separation of Chair and CEO roles, succession planning, committee structures, risk management and disclosure quality.

Example of an Engagement with a Canadian Oil and Gas Exploration and Production Company

Engagement objective

– Reduce the company's reliance on large stock option grants for directors and develop a more meaningful compensation regime.

What we achieved

As part of our engagement with an independent Canadian oil and gas producer, we encouraged the company to seek external advice on remuneration practices for directors and bring their remuneration in line with peers. The company subsequently announced significant changes, moving away from the use of stock options for directors and replacing them with deferred share grants, a form of remuneration that is better linked to long-term company performance.

SOCIAL

PSP Investments engaged public companies on a variety of social issues, including labour activities in troubled regions and health-and-safety concerns.

Example of an Engagement with a Multinational Oil and Gas Company

Engagement objective

– Establish an ombudsman or independent oversight of the progress to deliver structural changes to the management of safety issues following a health and safety incident.

What we achieved

PSP Investments had several engagements with a large multinational oil and gas company to discuss health and safety in its drilling operations. The company recently announced the appointment of an independent expert to provide assurance to the Board on the implementation of recommendations to improve safety in its drilling operations. This person will have authority to look throughout the business and will be answerable solely to the safety, environment and ethics committee of the Board.

ENVIRONMENTAL

PSP Investments met with a significant number of public companies on environmental-related issues in fiscal year 2013. These engagements focused mainly on climate change, water stress, oil extraction, forestry and biodiversity.

Example of an Engagement with a Global Power Company

Engagement objective

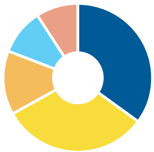
– Enhance transparency and disclosure on the company's environmental policies.

What we achieved

Following PSP Investments' intensive engagement with a global power company headquartered in the U.S., the company published its final release of a new sustainability report which we worked with the company to develop. In addition to improved reporting, we are encouraged by the positive steps taken by the company to adopt sustainability as one of its three strategic priorities.

Below is a breakdown of PSP Investments' engagement activities by country or region:

Engagement Activities by Country or Region
Fiscal year 2013



USA	35%
Europe	32%
Emerging Markets	14%
Asia Pacific, Australia and New Zealand	10%
Canada	9%

Collaborative Initiatives

In addition to its direct-engagement efforts with public companies, PSP Investments participates in collaborative governance initiatives and engagements with other like-minded institutional investors to strengthen its voice with regard to corporate governance issues. For instance, PSP Investments is an active member of the Canadian Coalition for Good Governance, which represents 46 institutional investors managing assets of nearly $2 trillion.

PSP Investments is also a signatory of the CDP, formerly known as the Carbon Disclosure Project. The CDP acts on behalf of 722 institutional investors representing over US$87 trillion in assets under management, to encourage public companies to disclose how they are managing climate-change risks and opportunities that may be affecting their businesses.

Since fiscal year 2010, PSP Investments has been a signatory of the CDP Water program, which enables institutional investors to better understand the business risks and opportunities associated with water scarcity and other water-related risks by increasing the availability of high-quality information on this issue.

PSP Investments is also a member of the Pension Investment Association of Canada ("PIAC"). PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

As well, PSP Investments has long been an active participant in collaborative initiatives by groups of limited partners to facilitate improvement with respect to the consistency of reporting, the uniformity of information made available and governance best practices. Most recently, PSP Investments was part of a group of more than 40 limited partners that developed an ESG disclosure framework for Private Equity investments. Launched in late March 2013, the framework is designed to help limited partners and general partners work together to define reasonable expectations and set appropriate standards for ESG disclosure.

Additionally, PSP Investments is an active member of a group of Canadian pension funds that decided in early 2012 to cooperate on initiatives aimed at bringing greater transparency and improved efficiency to the proxy voting system in Canada. To that end, the group has been corresponding with and meeting representatives of various securities commissions and market participants to find solutions to improve the efficiency of the proxy voting system in Canada.

Public Consultations

During fiscal year 2013, PSP Investments responded to over 80 public requests in Canada and abroad for consultations on governance-related topics. Examples of public consultations in Canada to which PSP Investments responded are found below.

– Submission to Canadian Securities Administrators on Consultation Paper 25-401: potential regulation of proxy advisory firms

  In August 2012, PSP Investments made a submission to the Canadian Securities Administrators on their consultation paper regarding the regulation of Proxy Advisory Firms. PSP Investments made comments on all the areas of interest addressed in the consultation paper, but noted that it is not concerned about the role or current structure of proxy advisory firms, nor does it see the need for regulation of these firms as they provide a number of valuable services and generally promote good corporate governance practices.

– Amendments to Part IV of the Toronto Stock Exchange Company Manual

  In October 2012, PSP Investments made a submission to the Toronto Stock Exchange (TSX) and the Ontario Securities Commission in reply to the TSX's request for comment on amendments to Part IV of the TSX Company Manual. The proposed amendments would require issuers listed on the TSX to have majority voting for director elections at uncontested meetings. PSP Investments reiterated its strong support for mandatory majority voting and responded directly to the three specific questions set out in the request for comments:

  • Support for mandating that listed issuers have majority voting;
  • Support for the TSX providing in the TSX Company Manual specific guidance outlining the expectations of the board of directors when considering the resignation of a director that receives a majority of "withhold" votes; and
  • Support for the jurisdiction of the TSX to adopt and enforce the proposed amendments.

  The proposed amendments to the TSX Company Manual subsequently received the approval of the Ontario Securities Commission and became effective December 31, 2012.

– 2012-2013 OSC Statement of Priorities

  In response to the Ontario Securities Commission (OSC) statement of priorities for the fiscal year ended March 31, 2013, PSP Investments encouraged the OSC to move forward as quickly as possible with shareholder empowerment in director elections. PSP Investments also invited the OSC and the Canadian Securities Administrators to conduct an empirical review of the Canadian proxy voting system.

HUMAN RESOURCES AND COMPENSATION COMMITTEE CHAIR'S REPORT

The activities of the Human Resources and Compensation Committee (HRCC) during fiscal year 2013 included reviewing and, where deemed necessary, recommending changes to key human resources, compensation and talent-management policies.

EXECUTIVE COMPENSATION

One such initiative involved an in-depth review of executive compensation programs, carried out with the support of an independent compensation consultant. Our aim was to ensure that PSP Investments is maintaining a balanced, performance-based structure that will enable us to continue attracting, retaining and motivating outstanding senior personnel by offering competitive remuneration packages.

Incentive compensation forms the largest component of total target remuneration for PSP Investments executives — an approach designed to reward outstanding performance while discouraging undue risk-taking. Both our Short-Term and Long-Term Incentive Plans are based on rolling four-year periods. Given our very strong relative investment performance over the past four years — during which PSP Investments realized some $3.7 billion of value added over and above benchmark returns — these plans generated maximum or close to maximum payouts for many senior executives for fiscal year 2013.

These awards fairly reflect our current pay-for-performance approach. Nevertheless, in the wake of our review, the Committee recommended changes to compensation for senior executives — subsequently approved by the Board of Directors — that effectively reduce potential maximum payouts.

Changes include the introduction of a new Corporate Objective component that has been added to existing incentive compensation criteria for the executive management team, along with a reduction in weighting of the formulaic-based component tied solely to investment performance. Another change, which applies to all investment professionals working at PSP Investments, will reduce potential maximum payouts under the Total Fund component of both the Short-Term and Long-Term Incentive Plans. The changes took effect as of April 1, 2013 and will help ensure that compensation remains in line with those of peer organizations, even in periods of sustained superior performance.

PENSIONS

At the Committee's recommendation, the Board also approved several changes to the pension plan for employees. Amendments to cost-sharing arrangements for PSP Investments' defined benefit pension plan will see contributions move to a 50/50 ratio by January 1, 2017, aligning the PSP Investments' pension plan with those covering federal government employees. As of January 1, 2014, new employees will be enrolled in a separate defined contribution plan, which will provide the Corporation with more control over the risks associated with employee benefits while maintaining PSP Investments' appeal to potential new hires.

TALENT MANAGEMENT AND SUCCESSION PLANNING

Another crucial responsibility of the HRCC is to ensure that comprehensive succession plans are in place for the President and CEO as well as other Officers and key employees within the Corporation. Committee members met during the year with the President and CEO Gordon J. Fyfe and the Senior Vice President, Human Resources, Guy Archambault to discuss measures aimed at further strengthening the senior leadership succession plan as well as management-development programs.

The strong focus on talent and leadership development extends throughout the Corporation. More than 94% of employees and managers now have documented development plans. I would like to take this opportunity to commend Guy Archambault and his team, whose outstanding efforts with respect to the leadership development training program resulted in PSP Investments capturing a Silver Award from the Canadian Society for Training and Development at the 2012 Canadian Awards for Training Excellence.

An on-going priority for the HRCC involves overseeing the continued rollout of a diversity action plan, designed to help PSP Investments build an increasingly diverse workforce that will encompass greater numbers of women as well as members of visible and ethnic minorities at all levels of the Corporation.

In conclusion, the HRCC is satisfied that the incentive compensation plans for PSP Investments' senior management and investment professionals, including the changes that came into effect for fiscal year 2014, will enable us to maintain total compensation at a fair and competitive level. The Committee remains committed to providing transparent and effective governance with respect to human resources and compensation matters.

Michael P. Mueller
Chair, Human Resources and Compensation Committee

COMPENSATION

The Board of Directors approves PSP Investments' compensation framework as well as total compensation for the President and Chief Executive Officer and other officers upon recommendation by the Human Resources and Compensation Committee (HRCC). Other compensation matters, including the total aggregate compensation for all of the Corporation's employees, are the responsibility of the HRCC.

In a highly competitive market for qualified personnel, PSP Investments' Compensation Policy is designed to attract and retain talented employees, reward performance and reinforce business strategies and priorities. The Board of Directors recognizes the fundamental value of a motivated and committed team and strongly believes that the recruitment and retention of high-performing employees is critical to achieving PSP Investments' objectives.

To that end, the Board of Directors has established a Compensation Policy that aims to maintain total compensation at a fair and competitive level. Compensation plans are aligned with PSP Investments' strategic plan and integrated with business performance measurement. PSP Investments' Compensation Policy provides balanced performance-based compensation and is effectively designed to reward responsible risk taking. Total compensation is comprised of base salary, short-term and long-term incentives, benefits, pension and other remuneration.

The Corporation's Performance Management and Professional Development process also contributes to improving business performance and employee engagement.

As part of the latest Special Examination performed by the Office of the Auditor General of Canada and Deloitte LLP conducted in fiscal year 2011, the Examiners reviewed PSP Investments' compensation framework and practices. They concluded that the short-term and long-term incentive programs are comparable to industry practices, are designed to reduce the potential for excessive risk-taking and are aligned with the Corporation's strategic objectives and investment policies. PSP Investments' compensation programs and policies are consistent with the G20 Working Group recommendations that are based on the Financial Stability Forum Principles for Sound Compensation.

In order to ensure that PSP Investments offers competitive compensation to its employees, managers and officers, their compensation levels are benchmarked with those of a select group of peers — Canadian organizations in the pension fund and investment management industry, the financial-services industry and other similar industries appropriate for the positions being benchmarked. The main comparator group in fiscal year 2013 was comprised of the following pension funds: Alberta Investment Management Corporation, British Columbia Investment Management Corporation, *Caisse de dépôt et placement du Québec*, Canada Pension Plan Investment Board, Ontario Municipal Employees Retirement System and Ontario Teachers' Pension Plan. These organizations were selected based on three main criteria: the size of the assets under management, their business sector (pension fund investment) and the commonality of the talent pool.

THE EXAMINERS CONCLUDED THAT THE INCENTIVE PROGRAMS ARE COMPARABLE TO INDUSTRY PRACTICES, ARE DESIGNED TO REDUCE THE POTENTIAL FOR EXCESSIVE RISK-TAKING AND ARE ALIGNED WITH THE CORPORATION'S STRATEGIC OBJECTIVES AND INVESTMENT POLICIES.

In addition, data from these peer organizations are gathered periodically and on an ad-hoc basis using compensation surveys published by well-established, specialized compensation consulting firms, such as McLagan's Investment Management and Private Equity Surveys, Towers Watson's Investment Management Compensation Survey, Mercer's Canadian Investment Management Compensation Survey and Canadian Benchmark Database.

To remain competitive, PSP Investments strives to offer:

1. base salaries at the median of the comparator group;
2. incentive compensation with potential payouts superior to the median of the comparator group for superior performance; and
3. benefits that are competitive.

The Board of Directors continually ensures that PSP Investments' executive compensation is consistent with PSP Investments' Compensation Policy. For this purpose, the services of independent compensation consulting firms were retained in fiscal year 2013 to assist the HRCC in its review of executive compensation. These compensation consulting firms report solely to the HRCC when executing their mandates.

Principles of PSP Investments' Compensation Framework

PSP Investments believes that its compensation framework should be driven by a pay-for-performance approach that:

- Rewards long-term performance (see *Figure A* below);
- Discourages short-term decision-making and undue risk-taking;
- Establishes incentive compensation as the largest component of target total compensation for executives (see *Figure B* below);
- Ensures that total fund investment performance is a component of incentive compensation at all levels of PSP Investments, in order to encourage and reinforce the benefits of teamwork.

Figure A: Seven Years of Investment Performance Are Measured by the STIP and the LTIP

Both the Short-Term Incentive Plan ("STIP") and the Long-Term Incentive Plan ("LTIP") are built around rolling four-year periods spanning a total of seven years of investment performance.

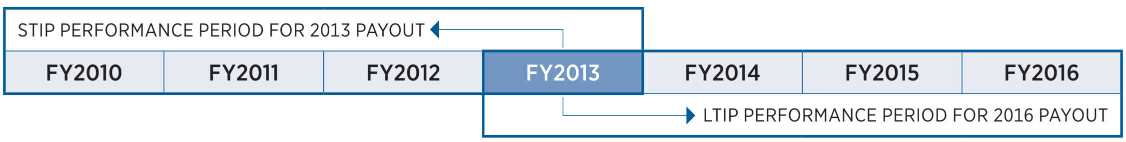
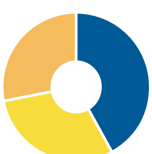


Figure B: Compensation Mix of Total Compensation for Fiscal Year 2013 (Target Awards)

Consistent with PSP Investments' pay-for-performance approach, total compensation for the President and Chief Executive Officer and for Senior Vice President positions is composed primarily of incentive compensation tied to the performance of PSP Investments and, where applicable, to the investment performance of a particular asset class.

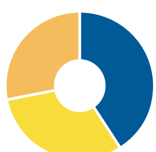
The following tables present the compensation mix for the President and CEO and for the Senior Vice-President positions (Investment):

President and Chief Executive Officer



Long-term Incentive Compensation	42%
Short-term Incentive Compensation	30%
Base Salary	28%

Senior Vice President Positions – Investment



Long-term Incentive Compensation	41%
Base Salary	31%
Short-term Incentive Compensation	28%

Base Salary

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

The annual budget for base salary increases in fiscal year 2013 was consistent with PSP Investments' comparator group and in accordance with the Compensation Policy.

Incentive Plans

Annually, PSP Investments reviews its incentive plans to ensure that total compensation remains competitive with the main comparator group and reflects PSP Investments' principles and objectives of attracting, retaining and motivating employees to achieve sustained high performance. The fiscal year 2013 review was conducted with the support and advice of an independent compensation consulting firm. There were no changes to the incentive plans for fiscal year 2013.

As indicated in the HRCC Chair Report, changes were introduced to PSP Investments' STIP and LTIP effective for fiscal year 2014. The addition of a new Corporate Objective component and the reduction in weighting of the formulaic-based component in the STIP for executives, along with the reduction in the maximum payout opportunity for the Total Fund performance under the STIP and LTIP for investment professionals, will help ensure that compensation remains in line with those of peer organizations, even in periods of sustained superior performance.

The following plans comprise incentive compensation at PSP Investments:

1) A STIP, to recognize performance results for the current year and the previous three years;
2) A LTIP, based on four-year, forward-looking cycles with possible payouts after the fourth year to recognize long-term results; and
3) A Restricted Fund Unit Plan ("RFU"), designed to help retain key employees.

Short-Term Incentive Plan

PSP Investments' STIP is designed to: (i) reward participants for the achievement of superior and sustained individual contributions and for PSP Investments' overall performance; (ii) help attract and retain high-calibre employees; and (iii) align the interests of participants with PSP Investments' stakeholders. PSP Investments' permanent salaried employees and any other employees designated by the President and CEO are eligible to participate in the STIP.

The STIP is a cash-based plan with a target incentive award based on a percentage of base salary. At the beginning of each fiscal year, each participant in the STIP is advised of his or her short-term incentive target amount. The target incentive amount, the performance measures and the weighting given to each measure will vary according to the participant's position level. The target incentive amount is measured on the achievement of individual objectives as well as 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. Investment performance is measured against relative or absolute benchmarks (total fund, asset classes, portfolios) and thresholds below which no payments are made.

For the first four years of participation in the STIP, participants will go through a transition period building up to a rolling sequence of four consecutive years of performance. The investment performance measure is calculated on the current year as well as up to the three preceding years of investment performance, depending on the number of years an employee has participated in the STIP.

The STIP provides that the investment performance of each year is independently weighted. A greater weight is given to performance of the current year in order to more closely link shorter-term contribution and rewards, while still taking into account the investment performance of the previous three years. Investment performance floors and maximum levels are applied to the STIP calculation methodology, in order to ensure that the results of a single year's investment performance do not unduly impact the overall calculation. The HRCC reviews the annual incentive compensation payment process to ensure that payments are calculated in accordance with the terms of the STIP. In addition, the Board of Directors approves the annual incentive compensation payable to officers of PSP Investments.

FISCAL YEAR 2013 PERFORMANCE

For fiscal year 2013, investment performance by asset classes for STIP purposes have been summarized in the table below:

Asset Class	1-year	4-year
Public Markets	Exceeded target	Exceeded target
Private Equity	Exceeded target	Exceeded target
Real Estate	Exceeded target	Exceeded target
Infrastructure	Exceeded target	Exceeded target
Renewable Resources	Exceeded target	Not applicable
Total Fund	Exceeded target	Exceeded target

The results of the individual objective component of the STIP were achieved and, therefore, generated, on an aggregate basis, the right for eligible employees to receive an incentive award.

The total incentive amount paid under the STIP was $29.9 million in fiscal year 2013 (404 employees), $23.1 million in fiscal year 2012 (362 employees), and $18.8 million in fiscal year 2011 (317 employees).

Long-Term Incentive Plan

PSP Investments' LTIP is designed to: (i) reward participants for the achievement of superior and sustained investment performance by PSP Investments; (ii) attract and retain high-calibre employees; and (iii) align the interests of participants with those of PSP Investments' stakeholders.

The LTIP is a cash-based plan that pays a percentage of base salary to participants holding senior positions, solely taking into account the achievement of investment performance on the assets managed by PSP Investments. It requires above-threshold performance over a four-year period before a payout is earned.

At the beginning of each fiscal year, each participant in the LTIP is advised of his or her target incentive amount. This target incentive amount is measured on a forward-looking, four-year investment performance, which may include any combination of: (i) the total fund investment performance of PSP Investments and (ii) for investment professionals, the investment performance of a particular asset class. The target incentive level, performance measures and the weighting given to each measure depend on the participant's position level.

The LTIP was amended in fiscal year 2012 to introduce investment performance floors and maximum levels to the LTIP calculation methodology in order to ensure that the results of a single year's investment performance do not unduly impact the overall calculation. These floors and maximums are applied to all performance years where each year has equal weight.

The incentive amount payable is determined at the end of the four-year performance period based on the amount by which the total fund actual value added and (if applicable) the asset class actual value added exceeded the incentive thresholds. In addition, the incentive amount calculated for the participant is either increased or decreased based on the total fund rate of return over the four-year performance period.

The HRCC reviews the long-term incentive compensation process to ensure that the grants are calculated in accordance with the terms of the LTIP. In addition, the Board of Directors approves long-term incentive grants to officers of PSP Investments.

Long-Term Incentive Plan Payments

In fiscal year 2013, the four-year total fund investment performance of PSP Investments as well as that of the various asset classes was above the incentive threshold and therefore, payouts were earned for those components of the LTIP for eligible participants.

Asset Class	4-year
Public Markets	Exceeded target
Private Equity	Exceeded target
Real Estate	Exceeded target
Infrastructure	Below target but above benchmark
Renewable Resources	Not applicable
Total Fund	Exceeded target

The total incentive amount paid under the LTIP was $15.2 million in fiscal year 2013 (55 employees) and $6.7 million in fiscal year 2012 (42 employees).

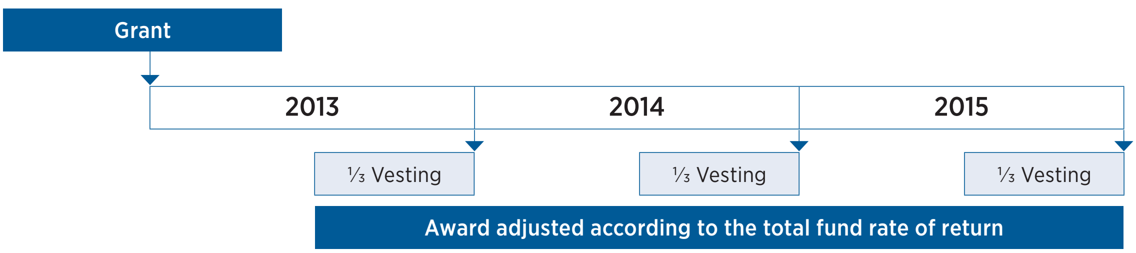
Restricted Fund Unit Plan

PSP Investments' RFU Plan is an incentive component of total compensation to retain key individuals in the organization.

Under the RFU Plan, grants of restricted fund units can be made to the President and Chief Executive Officer and, upon recommendation of the President and Chief Executive Officer, to other members of the senior management team. Grants may also be made to other key senior employees based on performance or market-related considerations. The HRCC reviews and approves the grants of restricted fund units. In addition, the Board of Directors approves grants to officers of PSP Investments.

Restricted fund units are a nominal investment whose value fluctuates in accordance with the total fund performance over a three-year period. One third of the award vests and is paid each year over this period, unless the participants elected to defer payment. Participants may elect to defer payment of RFUs until the end of the third year following the grant, as long as their election is made prior to the end of the fiscal year of the year of grant (see *Figure C* below).

Figure C: Restricted Fund Unit Framework



The total incentive amount paid under the RFU in fiscal year 2013 was $4.5 million to recognize the contribution of key individuals to the performance of PSP Investments' results. The amount paid in fiscal year 2012 was $4.0 million and $2.5 million in fiscal year 2011.

GROUP INSURANCE BENEFITS

The Group Insurance Plan 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 Group Insurance Plan is intended to ensure a proper balance between employee needs and competitiveness with the peer group.

OTHER REMUNERATION

PSP Investments' executives are provided with a perquisites allowance. In addition, PSP Investments offers its executives a health-and-lifestyle assessment.

RETIREMENT PLANS

All PSP Investments' eligible employees participate in the Public Sector Pension Investment Board Pension Plan (the "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 partially indexed post-retirement pension benefits for each year of participation, calculated using 2% of the participant's average of the best consecutive three years of salary. The benefits payable under the Employee Pension Plan are limited by 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 Employee Pension Plan, where such benefits are so limited. Employees participating in the Employee Pension Plan and the SERP contribute 3.5% of their base salary, up to the maximum contribution allowable under the *Income Tax Act* (Canada). This contribution was increased to 4.25% on April 1, 2013 and will represent a 50/50 ratio in cost-sharing by January 1, 2017.

Furthermore, as of January 1, 2014, new employees will be enrolled in a newly created defined contribution pension plan which will provide the Corporation with more control over its long-term costs while being competitive and flexible.

RETIREMENT BENEFITS

Name	Number of Years of Credited Service [1]	Annual Benefit		Accrued Obligation at Start of Year (Final Regulations) [2,4]	Compensatory Increase [5]	Non-Compensatory Increase [6]	Accrued Obligation at Year End [2,7]
		At Year End [2]	At Age 65 [2,3]				
Gordon J. Fyfe	9.5	$93,800	$193,400	$1,239,400	$72,200	$249,100	$1,560,700
Daniel Garant	4.6	$28,100	$139,500	$275,500	$83,500	$92,900	$451,900
Neil Cunningham	5.4	$32,900	$98,200	$387,600	$81,800	$94,700	$564,100
Derek Murphy	9.1	$57,700	$117,000	$754,500	$47,600	$152,900	$955,000
Bruno Guilmette	7.4	$44,600	$151,800	$493,300	$41,500	$144,400	$679,200

1 Number of credited years of service used for both the Employee Pension Plan and the Supplemental Employee Retirement Plan.

2 Sum of benefits accrued under the Employee Pension Plan and the Supplemental Employee Retirement Plan.

3 For the purpose of calculating the annual benefits payable at age 65, the final average earnings are calculated as at March 31, 2013.

4 Accrued obligation using a discount rate of 4.7%. The obligations are calculated as at March 31, 2012 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2011.

5 Includes employer service cost at the beginning of the year, the impact arising from the difference between actual pensionable earnings and those anticipated at the prior year end and the impact of amendments to the pension plans if any.

6 Includes employee contributions and benefit payments made in the year, change in assumptions, non-pay-related experience and the interest cost for the year.

7 Accrued obligation using a discount rate of 4.1%. The obligations are calculated as at March 31, 2013 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2012.

SUMMARY COMPENSATION TABLE

Total compensation paid to and earned by PSP Investments' five highest-paid officers in fiscal year 2013 totaled $16,272,284 compared to the approximately $10.9 million reported in the 2012 annual report. The increase is mainly due to the superior performance of the total fund and of all asset classes that all exceeded their respective benchmarks. It was the fourth consecutive year that the total fund outperformed its benchmark. For the four-year period ended March 31, 2013, PSP investments generated $3.7 billion of value added over and above benchmarks returns. The strong relative performance of each of the past four years has had a positive impact on both the short– and long-term incentive compensation which are calculated over four-year periods.

Name	Fiscal Year	Base Salary	Short-term Incentive Plan	Long-Term Incentive Plan [1]	Restricted Fund Units	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe President and Chief Executive Officer	2013	$500,000	$1,755,000	$2,425,000	$519,582	$35,759	$72,200	$5,307,541
	2012	$500,000	$1,285,656	$1,010,092	$471,020	$35,678	$102,300	$3,404,746
	2011	$485,000	$1,276,763	$484,927	$292,238	$35,681	$60,800	$2,635,409
Daniel Garant Senior Vice President, Public Markets Investments[2,3]	2013	$330,000	$1,035,237	$1,192,500	$431,682	$23,636	$83,500	$3,096,555
	2012	$306,000	$822,578	$349,674	$320,533	$23,604	$47,200	$1,869,589
	2011	$300,000	$813,909	n/a	$220,489	$23,609	$49,400	$1,407,407
Neil Cunningham Senior Vice President, Real Estate Investments[2]	2013	$320,000	$1,074,608	$1,170,000	$343,344	$25,736	$81,800	$3,015,488
	2012	$306,000	$789,693	$363,594	$274,321	$25,654	$58,500	$1,817,762
	2011	$300,000	$605,996	$345,839	$175,465	$34,663	$72,800	$1,534,763
Derek Murphy Senior Vice President, Private Equity Investments[2]	2013	$320,000	$675,993	$1,284,925	$388,497	$25,736	$47,600	$2,742,751
	2012	$320,000	$487,213	$662,516	$348,235	$25,656	$59,200	$1,902,820
	2011	$314,000	$716,772	$194,339	$243,278	$43,256	$41,400	$1,553,045
Bruno Guilmette Senior Vice President, Infrastructure Investments[2]	2013	$306,000	$663,096	$824,305	$249,314	$25,734	$41,500	$2,109,949
	2012	$306,000	$370,908	$246,484	$242,804	$25,654	$44,100	$1,235,950
	2011	$300,000	$381,109	$549,448	$167,709	$41,323	$66,000	$1,505,589

[1] PSP Investments' Long-Term Incentive Plan ("LTIP") was introduced in fiscal year 2009, replacing the former Long-Term Incentive Plan known as the Deferred Incentive Plan ("DIP"). The fiscal year 2011 Long-Term Incentive payment was made under the DIP. The DIP has since been discontinued. The first LTIP amounts were payable as of fiscal year 2012.

[2] Further to a market study, the Senior Vice President title was introduced in fiscal year 2013 for positions formerly known as First Vice President.

[3] The Long-Term Incentive payment for the Senior Vice President, Public Markets should have read $349,674 instead of $348,915 in the fiscal year 2012 annual report.

LONG-TERM INCENTIVE PLAN AWARDS GRANTED FOR FISCAL YEAR 2013

The following table shows the range of future potential payouts. Payments will be based on PSP Investments' total fund investment and asset class performance.

Name	Award Type	Fiscal Year 2013 Grant	Vesting Period	Estimated Future Payouts [1]		
				Threshold [2]	Target	Maximum
Gordon J. Fyfe	LTIP	$500,000	4 years	$0	$500,000	$2,000,000
	RFU	$0	3 years	n/a	$0	$0
Daniel Garant	LTIP	$297,000	4 years	$0	$297,000	$1,336,500
	RFU	$297,000	3 years	n/a	$297,000	$297,000
Neil Cunningham	LTIP	$288,000	4 years	$0	$288,000	$1,296,000
	RFU	$144,000	3 years	n/a	$144,000	$144,000
Derek Murphy	LTIP	$288,000	4 years	$0	$288,000	$1,296,000
	RFU	$72,000	3 years	n/a	$72,000	$72,000
Bruno Guilmette	LTIP	$275,400	4 years	$0	$275,400	$1,237,500
	RFU	$0	3 years	n/a	$0	$0

[1] Actual payouts will be adjusted upwards or downwards by PSP Investments' compounded rate of return over the performance vesting periods.

[2] Threshold refers to the minimum amount payable for a certain level of performance, below which level no award is payable.

LONG-TERM INCENTIVE PLAN AWARDS CUMULATIVE VALUE

The total cumulative value[1] as at March 31, 2013 of all long-term incentive awards granted but not yet vested or paid to PSP Investments' five highest-paid officers is shown in the following table.

Name	Plan	Awards paying out at the end of fiscal year			Total
		2014	2015	2016	
Gordon J. Fyfe	LTIP RFU	$1,566,550 $188,704	$1,225,000 $0	$995,000 $0	$3,786,550 $188,704
Daniel Garant	LTIP RFU	$885,600 $213,145	$682,992 $109,207	$546,480 $0	$2,115,072 $322,352
Neil Cunningham	LTIP RFU	$967,950 $156,887	$750,465 $52,949	$574,560 $0	$2,292,975 $209,836
Derek Murphy	LTIP RFU	$584,982 $135,168	$463,680 $26,474	$434,880 $0	$1,483,542 $161,642
Bruno Guilmette	LTIP RFU	$436,050 $77,953	$426,870 $0	$501,228 $0	$1,364,148 $77,953

1 LTIPs' accumulated values are estimated using actual total fund and asset class performance for those years where performance is known, and a multiplier of one (1.0x) is applied for future years. RFUs' accumulated values reflect PSP Investments' total fund rate of return for fiscal years 2012 and 2013, where applicable, but no returns for future years.

POST-EMPLOYMENT POLICIES

The President and CEO's severance pay is equivalent to two times his annual base salary, plus two times the average annual amount earned under the short-term and long-term incentive plans for the three-year period prior to the termination.

For Senior Vice Presidents, the severance pay is set at 12 months of base salary and target STIP award, plus one month of salary and target STIP award (one-twelfth of the full-year target STIP award) for every year of service, up to a maximum of 18 months. Insured benefits such as health, dental and life insurance are continued during the severance period.

The next table shows the potential payments that would be made upon termination (without cause) for the five highest-paid officers at PSP Investments, excluding any amounts that would become payable as per applicable incentive plan provisions.

Name	Years of service[1]	Severance	Resignation
Gordon J. Fyfe	9.6 years	$4,098,412	$0
Daniel Garant	4.6 years	$836,000	$0
Neil Cunningham	8.8 years	$912,000	$0
Derek Murphy	9.1 years	$912,000	$0
Bruno Guilmette	7.3 years	$872,100	$0

1 Assumes a notional termination as at March 31, 2013.

DIRECTORS' BIOGRAPHIES

CHERYL BARKER
Interim Chair, PSP Investments

Member:
Investment Committee / Audit Committee / Governance Committee – Chair

Board member since December 18, 2006

Ms. Barker is a member of the Board of Directors and Chair of the Audit Committee of Canada Media Fund. She also serves as a trustee and Chair of the Audit Committee of Lanesborough REIT. She was President of Manitoba Telecom Services Inc. (MTS) from 2004 until her retirement in February 2006. Ms. Barker's career at MTS spanned 19 years, during which she served in a variety of key positions, including President and COO of MTS Communications Inc.; Chair, President and CEO of Bell Intrigna Inc.; and CFO and Treasurer of MTS. A Chartered Accountant (CA), Ms. Barker holds a Bachelor of Science as well as a Certificate in Education from the University of Manitoba.

DIANE BEAN
Corporate Director

Member:
Investment Committee / Human Resources and Compensation Committee / Risk Committee – Chair

Board member since June 18, 2010

Ms. Bean is a member of the Boards of Directors of Manulife International Ltd (Asia), The Insurance Company of the West Indies and Roy Thomson Hall/Massey Hall, and was founding Co-Chair of the Toronto Region Immigrant Employment Council. Until her retirement in 2011, she was Executive Vice-President of Manulife Financial where, over 30 years, she also served as its Regional Executive in Canada, the United States, Asia and Europe, and held senior positions in IT, Business Development, Corporate Communications and, most recently, as head of Global HR. Ms. Bean holds a Bachelor of Commerce from the University of Toronto.

MICHELINE BOUCHARD
Corporate Director

Member:
Investment Committee / Human Resources and Compensation Committee

Board member since September 29, 2011

Ms. Bouchard is a member of the Boards of Directors of Telus and Dominion Diamond Corp. She has extensive experience as a director with public and private companies and volunteer boards. Past board memberships include Banque Nationale de Paris, Ford Motor Canada, London Insurance Group and Home Capital/Home Trust. Ms. Bouchard was Global Corporate Vice-President of Motorola Inc. in the U.S., after having served as President and CEO of Motorola Canada Inc. She holds a Bachelor's Degree in Applied Sciences (Engineering Physics) and a Master's Degree in Applied Sciences (Electrical Engineering) from École Polytechnique. Ms. Bouchard is a Member of the Order of Canada, a Member of the National Order of Quebec and a certified member of the Institute of Corporate Directors.

LÉON COURVILLE
Corporate Director

Member:
Investment Committee / Governance Committee / Human Resources and Compensation Committee

Board member since March 5, 2007

Mr. Courville has devoted his entire career to the sciences of management and finance, serving as a professor and researcher at universities in Canada and the United States before being appointed President of the National Bank of Canada. He is enjoying an active "retirement" as a corporate director, an Associate Professor at l'École des Hautes Études Commerciales and proprietor of the Domaine Les Brome vineyard, which he founded in 1999. Mr. Courville is a member of the Boards of Directors of the Institut de tourisme et d'hôtellerie du Québec and the Institut économique de Montréal, and Chairman of the Institute of Structured Finance and Derivative Instruments. His research and publications have garnered awards and bursaries in Canada and abroad, including the Coopers & Lybrand Award for his work entitled "The Storm – Navigating the New Economy". Mr. Courville holds a Ph.D. in Economics from Carnegie-Mellon University.

DIRECTORS' BIOGRAPHIES

ANTHONY R. GAGE
Corporate Director

Member:
Investment Committee – Chair /
Audit Committee /
Risk Committee

Board member since June 27, 2006

Mr. Gage is a member of the Board of Governors of the University of Victoria, Chairman of Sky Investment Counsel, Head of the Management Committee of JEA Pension System Solutions and Chairman of the University of Victoria Properties Investments Inc. He is a former Chair of the Board of Phillips, Hager & North Investment Management. His career at Phillips, Hager & North, where he served as President and CEO from 1994 to 1999, spanned more than 20 years. Previously, Mr. Gage was Assistant Vice-President and Director of Confed Investment Counseling, the pension fund management arm of Confederation Life. Mr. Gage holds a Bachelor of Arts (Economics) from the University of Victoria, an MBA (Finance) from the University of British Columbia and a Chartered Director designation from McMaster University. He is also a Chartered Financial Analyst (CFA).

GARNET GARVEN
Corporate Director

Member:
Investment Committee /
Audit Committee /
Governance Committee

Board member since September 29, 2011

Mr. Garven is Senior Fellow at Canada's Public Policy Forum, a think tank focusing on governance and public-service issues. He previously served as Deputy Minister to the Premier and Saskatchewan Cabinet Secretary. Educated in Business Administration at the Universities of Regina, Saskatchewan and Western Ontario, he holds an Honourary CMA from the Society of Management Accountants. A long-time Dean of Business at the University of Regina, Mr. Garven also was a Research Fellow in corporate governance at the Richard Ivey School of Business. A founding director of the Investment Corporation of Saskatchewan (now Greystone Managed Investments Inc.) and former Chairman and CEO of the Saskatchewan Workers' Compensation Board, he has served on a variety of other public, private and not-for-profit boards.

LYNN HAIGHT
Corporate Director

Member:
Investment Committee /
Audit Committee /
Risk Committee

Board member since January 14, 2010

Ms. Haight is a member of the Board of Directors and Chair of the Audit Committee of World Bank's Consultative Group on International Agricultural Research (CGIAR) and Green Shield Canada. She also sits on the Boards of the Bank of India (Canada) and Somerville College, Oxford University. Ms. Haight retired in 2009 as Chief Operating Officer and Chief Financial Officer of the Foresters insurance organization. She previously served as Vice President, US Fixed Annuities, and Chief Accountant of Manulife Financial. She has also served as a Trustee and Chair of the Audit Committee of the Ontario Arts Council, Chair of Foresters Holdings Europe, Chair of the World Agroforestry Centre in Nairobi, Kenya, and Chair of the Sectoral Advisory Group for business services to the federal Minister of Trade. Ms. Haight holds an MA Honours from Oxford. She is a Fellow of the Canadian Institute of Chartered Accountants, a Fellow of the Canadian Association of Management Consultants and a Certified Corporate Director.

WILLIAM A. MACKINNON
Corporate Director

Member:
Investment Committee / Audit Committee – Chair

Board member since January 14, 2010

Mr. MacKinnon is a member of the Boards of Directors of Telus, Pioneer Petroleum, Osisko Mining Corporation and Novadaq Technologies. Very active in professional and community circles, he serves as Chair of the Toronto Region Board of Trade and of The Toronto East General Hospital Board. He is also a member of the Boards of the Toronto Community Foundation, Roy Thomson Hall and St. Stephen's Community House. Mr. MacKinnon joined KPMG Canada in 1968, became a Partner in 1977 and was the firm's Chief Executive Officer from 1999 until his retirement at the end of 2008. As well, he served on the KPMG International Board of Directors. Mr. MacKinnon holds a Bachelor of Commerce from the University of Manitoba. He obtained his Chartered Accountant (CA) designation in 1971 and became a FCA in 1994.

MICHAEL P. MUELLER
Corporate Director

Member:
Investment Committee / Governance Committee / Human Resources and Compensation Committee – Chair / Risk Committee

Board member since December 18, 2006

Mr. Mueller is Chairman of Annidis Corporation and a member of the Boards of Directors of the Scarborough Hospital (past Chair), Canadian Tire Bank, Magor Communications Corp. and AIM Therapeutics Inc. From 2003 to 2005, he was President and CEO of MDS Capital Corporation. Mr. Mueller previously held a series of senior executive positions at TD Bank, including Vice Chairman and Global Head of Investment and Corporate Banking. He is a former member of the Boards of Directors of the Scarborough Hospital Foundation, Biovest Corp. 1, Budco, TM BioScience, MDS Capital and Canadian Medical Discoveries Funds I and II. Mr. Mueller holds a Bachelor of Science from the University of Western Ontario and an MBA from York University.

MANAGEMENT TEAM AND OFFICERS

GORDON J. FYFE
President and Chief Executive Officer

JOHN VALENTINI
Executive Vice President, Chief Operating Officer and Chief Financial Officer

GUY ARCHAMBAULT
Senior Vice President, Human Resources

NEIL CUNNINGHAM
Senior Vice President, Real Estate Investments

DANIEL GARANT
Senior Vice President, Public Market Investments

BRUNO GUILMETTE
Senior Vice President, Infrastructure Investments

DEREK MURPHY
Senior Vice President, Private Equity

MARC LACOURCIÈRE
Senior Vice President and Chief Legal Officer

STÉPHANIE LACHANCE
Vice President, Responsible Investment and Corporate Secretary

CONSOLIDATED TEN-YEAR FINANCIAL REVIEW

($ millions)	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
CHANGE IN NET ASSETS										
Investment income (loss)	**$ 7,194**	$ 1,888	$ 7,043	$ 7,605	$ (9,493)	$ (197)	$ 3,414	$ 4,097	$ 1,334	$ 2,453
Operating expenses	**184**	148	114	92	86	77	52	39	21	12
Net income (loss) from operations and comprehensive income	**$ 7,010**	$ 1,740	$ 6,929	$ 7,513	$ (9,579)	$ (274)	$ 3,362	$ 4,058	$ 1,313	$ 2,441
Fund transfers	**$ 4,635**	$ 4,733	$ 4,814	$ 4,980	$ 4,431	$ 4,237	$ 3,990	$ 4,197	$ 3,816	$ 3,696
Increase/(decrease) in net assets	**$11,645**	$ 6,473	$11,743	$12,493	$ (5,148)	$ 3,963	$ 7,352	$ 8,255	$ 5,129	$ 6,137
NET INVESTMENT ASSETS										
Investments										
World Equity										
Canadian Equity	**$15,425**	$14,464	$18,665	$13,547	$ 8,815	$11,538	$10,328	$ 9,346	$ 7,758	$ 5,332
Foreign Equity:										
US Large Cap Equity	**7,163**	5,294	3,829	2,111	926	1,763	2,498	2,618	2,314	2,125
EAFE Large Cap Equity	**6,745**	4,760	3,052	2,043	1,043	1,831	1,720	3,217	2,506	1,738
Small Cap Equity	**4,738**	3,641	3,221	1,977	781	1,930	2,936	2,006	105	65
Emerging Markets Equity	**6,163**	4,787	4,062	2,987	2,122	2,726	2,501	1,943	354	–
Private Equity	**6,924**	6,444	5,582	5,426	4,191	3,972	1,669	301	3	–
Nominal Fixed Income										
Cash & Cash Equivalents [1,2]	**1,456**	1,597	1,254	1,892	73	533	468	967	537	109
Fixed Income	**9,481**	8,569	7,685	6,958	6,358	7,097	7,089	5,243	5,143	4,790
Real Return Assets										
World Inflation-Linked Bonds	**4,427**	3,982	3,022	2,145	2,389	2,211	1,714	421	219	–
Real Estate [2]	**9,427**	7,055	5,312	5,118	4,653	4,029	3,596	1,584	429	74
Infrastructure	**3,854**	3,607	2,356	2,073	2,446	1,343	479	–	–	–
Renewable Resources	**382**	325	–	–	–	–	–	–	–	–
Net investments	**$76,185**	**$64,525**	**$58,040**	**$46,277**	**$33,797**	**$38,973**	**$34,998**	**$27,646**	**$19,368**	**$14,233**
PERFORMANCE (%)										
Annual rate of return	**10.7**	3.0	14.5	21.5	(22.7)	(0.3)	11.3	19.1	7.9	26.1
Benchmark	**8.6**	1.6	12.7	19.8	(17.6)	1.2	10.1	18.0	7.2	25.4

PSP Investments' total rate of return since inception (April 2000) is 5.0%.

[1] Includes amounts related to absolute return strategies.

[2] Since 2013, amounts related to real estate debt strategies are reported under Real Estate.

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

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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, 2013 were in accordance with the Act and the SIP&P.

The Audit Committee ("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 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 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 14, 2013

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 14, 2013

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, 2013, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Cheryl Barker.

Cheryl Barker
Interim Chair of the Board
May 14, 2013

PUBLIC SECTOR PENSION INVESTMENT BOARD
CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the President of the Treasury Board

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of the Public Sector Pension Investment Board (PSP Investments), which comprise the consolidated balance sheet as at March 31, 2013, and the consolidated statement of net income from operations and comprehensive income and consolidated statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments as at March 31, 2013, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

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

Further, in our opinion, the transactions of PSP Investments and 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 LLP[1]

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

May 14, 2013
Montréal, Canada

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

May 14, 2013
Ottawa, Canada

CONSOLIDATED BALANCE SHEET

As at March 31

($ millions)	2013	2012
ASSETS		
Investments (Note 3 (A))	**$ 81,808**	$ 70,275
Investment-related assets (Note 3 (A))	**2,122**	1,258
Cash	**2**	8
Other assets	**81**	65
	$ 84,013	$ 71,606
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 7,745**	$ 7,008
Accounts payable and other liabilities	**137**	112
	$ 7,882	$ 7,120
NET ASSETS	**$ 76,131**	$ 64,486
Share capital (Note 5)	**$ –**	$ –
Public Service Pension Plan Account	**55,483**	47,128
Canadian Forces Pension Plan Account	**14,872**	12,438
Royal Canadian Mounted Police Pension Plan Account	**5,374**	4,556
Reserve Force Pension Plan Account	**402**	364
NET ASSETS	**$ 76,131**	$ 64,486

Commitments (Note 13)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

CONSOLIDATED STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2013	2012
INVESTMENT INCOME (NOTE 7)	**$ 7,194**	$ 1,888
OPERATING EXPENSES (NOTE 8)	**$ 184**	$ 148
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME (NOTE 9)	**$ 7,010**	$ 1,740

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

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2013	2012
NET ASSETS, BEGINNING OF YEAR	**$ 64,486**	$ 58,013
Fund transfers (Note 6)	**4,635**	4,733
Net income from operations and comprehensive income	**7,010**	1,740
Increase in net assets for the year	**11,645**	6,473
NET ASSETS, END OF YEAR	**$ 76,131**	$ 64,486

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2013

Organization

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

The funds for which amounts are currently transferred to PSP Investments by the Government of Canada (individually the "Fund" and collectively the "Funds") relate to pension obligations under the Plans for service on or after April 1, 2000 except, in the case of the Reserve Force Plan, they relate to service on or after March 1, 2007. The accounts managed by PSP Investments for the Funds are herein referred to individually as the "Plan Account" and collectively as 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 *Superannuation Acts*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of the Plans to meet their financial obligations.

Pursuant to the *Superannuation Acts*, the Government of Canada, which administers the Funds, may call upon PSP Investments for amounts required for the purpose of paying benefits under the Plans in respect of service on or after April 1, 2000 or for the purpose of reducing any non-permitted surplus in the Funds. Amounts remitted by PSP Investments for such purposes cannot exceed, at any time, the net assets of PSP Investments.

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 for the Funds. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plans. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

PLAN ACCOUNTS

PSP Investments maintains records of net contributions for each Fund, 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 are prepared.

VALUATION OF INVESTMENTS

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

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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

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

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

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

INCOME RECOGNITION

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

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for the Funds are recorded in their respective Plan Account.

INCOME TAXES

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

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

The AcSB's decision was in response to an announcement by the International Accounting Standards Board (IASB) in 2010, regarding an Exposure Draft (ED) being developed for investment entities. The objective of the ED was to create an exception from consolidation and provide a fair value reporting framework for qualifying investment entities.

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRSs into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Finally, the AcSB discontinued its project to expand the scope of Section 4600, "Pension Plans" to entities like PSP Investments, which are separate from a pension plan and without a pension obligation, and whose sole purpose is to hold and invest assets received from one or more pension plans. This project was intended to allow qualifying entities to use a fair value reporting framework in the event that IFRS would not provide similar treatment.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of finalizing its IFRS adoption plan. Under such plan, Management will analyze the impact of the adoption of IFRS on PSP Investments' consolidated financial statements.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2013		2012	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
Public markets				
Canadian equity	**$ 9,224**	**$ 8,822**	$ 9,141	$ 8,867
Foreign equity	**20,951**	**18,453**	16,225	14,996
Private markets				
Real estate	**10,896**	**9,379**	7,452	6,451
Private equity	**7,018**	**5,413**	6,180	5,269
Infrastructure	**4,458**	**4,622**	4,268	4,475
Renewable resources	**420**	**376**	376	376
Fixed income				
Cash and money market securities	**3,604**	**3,604**	2,390	2,390
Government and corporate bonds	**11,211**	**10,993**	12,748	12,480
Inflation-linked bonds	**4,377**	**3,818**	3,950	3,609
Other fixed income securities	**7,857**	**7,033**	6,370	5,739
Alternative investments	**1,792**	**1,503**	1,175	927
INVESTMENTS	**$ 81,808**	**$ 74,016**	$ 70,275	$ 65,579
Investment-related assets				
Amounts receivable from pending trades	**$ 1,121**	**$ 1,121**	$ 629	$ 629
Interest receivable	**152**	**152**	160	160
Dividends receivable	**67**	**67**	59	59
Derivative-related receivables	**782**	**284**	410	81
	$ 2,122	**$ 1,624**	$ 1,258	$ 929
Investment-related liabilities				
Amounts payable from pending trades	**$ (1,104)**	**$ (1,104)**	$ (989)	$ (989)
Interest payable	**(24)**	**(24)**	(24)	(24)
Securities sold short	**(468)**	**(465)**	(429)	(415)
Securities sold under repurchase agreements	**(609)**	**(609)**	(1,272)	(1,268)
Derivative-related payables	**(645)**	**(246)**	(370)	(82)
Capital market debt financing:				
Short-term	**(2,900)**	**(2,900)**	(901)	(901)
Long-term	**(1,995)**	**(1,934)**	(3,023)	(2,959)
	$ (7,745)	**$ (7,282)**	$ (7,008)	$ (6,638)
NET INVESTMENTS	**$ 76,185**	**$ 68,358**	$ 64,525	$ 59,870

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

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

Valuation Techniques

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

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

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments was $3,599 million (2012 – $2,662 million).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments was $277 million (2012 – $285 million).

Renewable resources investments are comprised of properties involving the production and harvesting of replenishable resources. As at March 31, 2013, renewable resources included one investment in timberlands.

Valuation Techniques

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

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

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

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

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 12.

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

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

Valuation Techniques

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

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

ABTNs are measured at fair value whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 12.

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

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

(iv) Alternative Investments

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

Valuation Techniques

The fair value of these investments is obtained from the audited financial statements of the funds and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 10. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2013				2012			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 846	$ –	$ –	$ –	$ 1,012	$ –	$ –	$ –
Total return swaps	9,935	166	(50)	116	8,157	131	(43)	88
Warrants and rights	2	–	–	–	1	–	–	–
Options:								
Listed-purchased	2,570	27	–	27	1,128	15	–	15
Listed-written	1,002	–	(15)	(15)	965	–	(11)	(11)
OTC-purchased	877	97	–	97	538	6	–	6
OTC-written	856	–	(78)	(78)	495	–	(9)	(9)
Currency derivatives								
Forwards	34,291	342	(334)	8	23,088	156	(185)	(29)
Futures	42	–	–	–	152	–	–	–
Swaps	1,063	24	(29)	(5)	940	3	(18)	(15)
Options:								
OTC-purchased	3,631	56	–	56	491	5	–	5
OTC-written	3,281	–	(45)	(45)	819	–	(6)	(6)
Interest rate derivatives								
Bond forwards	846	5	(6)	(1)	1,800	4	(3)	1
Futures	1,330	–	–	–	1,564	–	–	–
Interest rate swaps	11,562	23	(39)	(16)	7,578	27	(30)	(3)
Total return swaps	2	–	–	–	–	–	–	–
Swaptions	2,811	7	(5)	2	808	15	(6)	9
Options:								
Listed-purchased	5,055	4	–	4	8,254	3	–	3
Listed-written	4,967	–	(3)	(3)	8,331	–	(5)	(5)
OTC-purchased	1,761	10	–	10	799	15	–	15
OTC-written	2,784	–	(10)	(10)	3,853	–	(24)	(24)
Credit derivatives[1]								
Purchased	1,914	17	(17)	–	1,206	28	(9)	19
Sold	934	4	(14)	(10)	584	2	(21)	(19)
Total	**$ 92,362**	**$ 782**	**$ (645)**	**$ 137**	$ 72,563	$ 410	$ (370)	$ 40

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2013:

($ millions)

Less than 3 months	**$ 53,074**
3 to 12 months	**25,224**
Over 1 year	**14,064**
Total	**$ 92,362**

(C) FAIR VALUE MEASUREMENT

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

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 9,224	$ –	$ –	$ –	$ 9,224
Foreign equity	17,217	3,732	2	–	20,951
Private markets					
Real estate	–	–	10,896	–	10,896
Private equity	–	–	7,018	–	7,018
Infrastructure	–	–	4,458	–	4,458
Renewable resources	–	–	420	–	420
Fixed income					
Cash and money market securities	629	2,975	–	–	3,604
Government and corporate bonds	–	11,211	–	–	11,211
Inflation-linked bonds	–	4,377	–	–	4,377
Other fixed income securities	–	3,398	4,459	–	7,857
Alternative investments	–	885	907	–	1,792
INVESTMENTS	$ 27,070	$ 26,578	$ 28,160	$ –	$ 81,808
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 1,121	$ 1,121
Interest receivable[1]	–	–	–	152	152
Dividends receivable[1]	–	–	–	67	67
Derivative-related receivables	31	750	1	–	782
	$ 31	$ 750	$ 1	$ 1,340	$ 2,122
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (1,104)	$ (1,104)
Interest payable[1]	–	–	–	(24)	(24)
Securities sold short	(468)	–	–	–	(468)
Securities sold under repurchase agreements	–	(609)	–	–	(609)
Derivative-related payables	(18)	(623)	(4)	–	(645)
Capital market debt financing:					
Short-term	–	(2,900)	–	–	(2,900)
Long-term	–	(1,995)	–	–	(1,995)
	$ (486)	$ (6,127)	$ (4)	$ (1,128)	$ (7,745)
NET INVESTMENTS	$ 26,615	$ 21,201	$ 28,157	$ 212	$ 76,185

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2012:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 9,141	$ –	$ –	$ –	$ 9,141
Foreign equity	15,243	812	170	–	16,225
Private markets					
Real estate	–	–	7,452	–	7,452
Private equity	–	–	6,180	–	6,180
Infrastructure	–	–	4,268	–	4,268
Renewable resources	–	–	376	–	376
Fixed income					
Cash and money market securities	763	1,627	–	–	2,390
Government and corporate bonds	–	12,748	–	–	12,748
Inflation-linked bonds	–	3,950	–	–	3,950
Other fixed income securities	–	2,384	3,986	–	6,370
Alternative investments	–	871	304	–	1,175
INVESTMENTS	$ 25,147	$ 22,392	$ 22,736	$ –	$ 70,275
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 629	$ 629
Interest receivable[1]	–	–	–	160	160
Dividends receivable[1]	–	–	–	59	59
Derivative-related receivables	18	392	–	–	410
	$ 18	$ 392	$ –	$ 848	$ 1,258
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (989)	$ (989)
Interest payable[1]	–	–	–	(24)	(24)
Securities sold short	(429)	–	–	–	(429)
Securities sold under repurchase agreements	–	(1,272)	–	–	(1,272)
Derivative-related payables	(15)	(345)	(10)	–	(370)
Capital market debt financing:					
Short-term	–	(901)	–	–	(901)
Long-term	–	(3,023)	–	–	(3,023)
	$ (444)	$ (5,541)	$ (10)	$ (1,013)	$ (7,008)
NET INVESTMENTS	$ 24,721	$ 17,243	$ 22,726	$ (165)	$ 64,525

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

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

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2013 (no significant transfers during the year ended March 31, 2012).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

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

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)	Transfer out of Level 3	Closing Balance
Public markets	$ 170	$ 1	$ (6)	$ –	$ 1	$ (14)	$ (150)	$ 2
Private markets	18,276	4,835	(1,844)	–	212	1,313	–	22,792
Fixed income	3,986	1,355	(1,174)	(65)	200	157	–	4,459
Alternative investments	304	576	–	–	–	27	–	907
Derivative-related receivables/payables (net)	(10)	8	(10)	–	2	7	–	(3)
Total	**$ 22,726**	**$ 6,775**	**$ (3,034)**	**$ (65)**	**$ 415**	**$ 1,490**	**$ (150)**	**$ 28,157**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2012:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)	Transfer out of Level 3	Closing Balance
Public markets	$ –	$ 152	$ (16)	$ –	$ 2	$ 32	$ –	$ 170
Private markets	13,346	6,255	(2,257)	–	204	749	(21)	18,276
Fixed income	3,678	1,054	(978)	(221)	42	411	–	3,986
Alternative investments	–	296	–	–	–	8	–	304
Derivative-related receivables/payables (net)	(8)	–	–	(3)	3	(2)	–	(10)
Total	$ 17,016	$ 7,757	$ (3,251)	$ (224)	$ 251	$ 1,198	$ (21)	$ 22,726

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 4% increase/decrease (2012 – 2% increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $10,178 million (2012 – $8,565 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2013, PSP Investments has re-invested $2,217 million of collateral held (2012 – $1,735 million).

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

($ millions)	2013	2012
Securities lending		
Securities lent	$ 7,395	$ 6,991
Collateral held [1]	7,789	7,369
Securities borrowing		
Securities borrowed	468	429
Collateral pledged [2]	470	478

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

PSP Investments pledged collateral under the repurchase agreements with a fair value of $609 million as at March 31, 2013 (2012 – $1,272 million).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

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

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

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

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

	2013	2012
Policy Portfolio VaR	**20.2 %**	21.7 %
Active VaR	**2.6**	2.6
Total VaR (undiversified)	**22.8**	24.3
Diversification effect	**(1.3)**	(1.6)
Total VaR	**21.5 %**	22.7 %

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

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

(i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2013:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 718	$ 3,553	$ 1,841	$ 2,220	$ –	$ 8,332
Corporate bonds	295	1,382	890	312	–	2,879
Inflation-linked bonds	2	1,084	1,162	2,129	–	4,377
Asset-backed securities	85	1,841	26	1	–	1,953
Private debt portfolios:						
Directly held	51	670	161	–	–	882
Held through funds [1]	–	–	–	–	1,811	1,811
Total investments with significant exposure to interest rate risk	**$ 1,151**	**$ 8,530**	**$ 4,080**	**$ 4,662**	**$ 1,811**	**$ 20,234**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 6,815**	**$ 6,815**
Total fixed income	**$ 1,151**	**$ 8,530**	**$ 4,080**	**$ 4,662**	**$ 8,626**	**$ 27,049**

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

[2] Consists of $3,604 million in cash and money market securities and $3,211 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

The terms to maturity of PSP Investments' capital market debt financing are disclosed in Note 10.

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in millions of Canadian $)	**2013**		2012	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 15,290**	**53.3 %**	$ 12,978	57.9 %
Euro	**2,573**	**9.0**	2,660	11.9
British Pound	**2,128**	**7.4**	1,756	7.8
Brazilian Real	**1,205**	**4.2**	908	4.0
Japanese Yen	**1,143**	**4.0**	1,012	4.5
Hong Kong Dollar	**1,034**	**3.6**	675	3.0
Australian Dollar	**943**	**3.3**	404	1.8
Korean Won	**775**	**2.7**	490	2.2
Taiwanese New Dollar	**468**	**1.6**	–	–
Norwegian Krone	**427**	**1.5**	344	1.5
Swiss Franc	**382**	**1.3**	78	0.3
Indian Rupee	**353**	**1.2**	192	0.9
South African Rand	**304**	**1.1**	164	0.7
Mexican Peso	**242**	**0.9**	151	0.7
Others	**1,397**	**4.9**	619	2.8
Total	**$ 28,664**	**100.0 %**	$ 22,431	100.0 %

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $9,388 million (US$8,747 million, €231 million, £59 million, R79 million South African Rands and R$199 million Brazilian Reals) which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

As at March 31, 2013, PSP Investments' maximum exposure to credit risk amounted to approximately $24 billion (2012 – approximately $22 billion). This amount excludes investments in distressed debt in the amount of approximately $1.4 billion as at March 31, 2013 (2012 – approximately $1.4 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 12.

As at March 31, 2013, PSP Investments had a net notional exposure of $120 million (2012 – $168 million) to various tranches of collateralized debt obligations, of which approximately 67% (2012 – approximately 61%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 12, to support potential margin calls on the ABTNs.

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

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

	2013	2012
Investment grade (AAA to BBB–)	**97.9 %**	98.2 %
Below investment grade (BB+ and below)	**1.0**	0.7
Not rated:		
Rated by a single credit rating agency	**0.1**	0.1
Not rated by credit rating agencies	**1.0**	1.0
Total	**100.0 %**	100.0 %

Counterparty Risk

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

PSP Investments' policy also requires the use of the International Swaps and Derivatives Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. PSP Investments pledged securities with a fair value of $72 million as collateral with respect to derivative contracts at March 31, 2013 (2012 – $3 million). Securities with a fair value of $145 million were received from counterparties as collateral at March 31, 2013 (2012 – $104 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital market debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 10 provides additional information on the usage of the capital market debt program.

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2013:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (1,104)	$ –	$ –	$ (1,104)
Interest payable	(22)	(2)	–	(24)
Securities sold short	(468)	–	–	(468)
Securities sold under repurchase agreements	(609)	–	–	(609)
Capital market debt financing	(1,730)	(1,170)	(1,995)	(4,895)
Accounts payable and other liabilities	(96)	–	(41)	(137)
Total	**$ (4,029)**	**$ (1,172)**	**$ (2,036)**	**$ (7,237)**

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 442	$ 287	$ 53	$ 782
Derivative-related payables [1]	(350)	(197)	(98)	(645)
Total	**$ 92**	**$ 90**	**$ (45)**	**$ 137**

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

5 SHARE CAPITAL

Pursuant to the Act, PSP Investments' share capital consists of 10 shares having a par value of $10 each that were issued to the President of the Treasury Board, to be held on behalf of Her Majesty in Right of Canada. The Act does not attribute any voting, dividend, residual or other rights to these shares.

6 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $4,635 million for the year ended March 31, 2013 (2012 – $4,733 million) for the Funds, recorded in their respective Plan Accounts.

The breakdown of the fund transfers, for the years ended March 31, was as follows:

($ millions)	**2013**	2012
Public Service Pension Fund	**$ 3,258**	$ 3,556
Canadian Forces Pension Fund	**1,055**	815
Royal Canadian Mounted Police Pension Fund	**322**	331
Reserve Force Pension Fund	**–**	31
Total	**$ 4,635**	$ 4,733

7 INVESTMENT INCOME

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

($ millions)	2013	2012
Interest income	$ 804	$ 709
Dividend income	1,179	908
Interest expense (Note 10)	(102)	(82)
Transaction costs	(50)	(64)
External investment management fees[1]	(37)	(33)
Other (net)	(18)	(6)
	1,776	1,432
Net realized gains[2]	2,246	1,013
Net unrealized gains (losses)	3,172	(557)
Investment income	**$ 7,194**	$ 1,888

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $21 million for the year ended March 31, 2013 (2012 – $56 million). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments.

Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $127 million for the year ended March 31, 2013 (2012 – $119 million).

[2] Includes foreign currency losses of $203 million for the year ended March 31, 2013 (2012 – losses of $45 million).

8 OPERATING EXPENSES

Operating expenses consisted of the following for the years ended March 31:

($ thousands)	2013	2012
Salaries and benefits	$122,178	$ 96,683
Professional and consulting fees	11,848	10,816
Office supplies and equipment	18,704	15,050
Other operating expenses	7,895	6,461
Depreciation of fixed assets	13,018	9,257
Occupancy costs	6,284	5,531
Custodial fees	2,803	3,060
Remuneration earned by Directors	765	802
Travel and related expenses for Directors	210	246
Communication expenses	146	218
Total	**$183,851**	$148,124

Professional and consulting fees paid or accrued to the external auditors include audit fees of $498 thousand (2012 – $406 thousand), audit-related fees of $579 thousand (2012 – $196 thousand) and non-audit fees of $352 thousand (2012 – $147 thousand).

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

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

	2013	2012
Public Service Pension Plan Account	73.0 %	72.9 %
Canadian Forces Pension Plan Account	19.3	19.4
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.6	0.6
Total	**100.0 %**	100.0 %

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

10 CAPITAL MARKET DEBT FINANCING

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

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

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

	2013		2012	
($ millions)	**Capital amounts to be paid at maturity**	**Fair Value**	Capital amounts to be paid at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 1.03% and 1.17% and maturing within 31 and 191 days of issuance (March 31, 2012 – 31 and 364 days)	**$ 863**	**$ 861**	$ 902	$ 901
Short-term US Dollar promissory notes, bearing interest between 0.16% and 0.24% and maturing within 29 and 189 days of issuance	**$ 1,016**	**$ 1,016**	$ –	$ –
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 1,000**	**$ 1,023**	$ 1,000	$ 1,052
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 700**	**$ 726**	$ 700	$ 722
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**$ 350**	**$ 352**	$ 350	$ 350
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**$ 900**	**$ 917**	$ 900	$ 899
Total	**$ 4,829**	**$ 4,895**	$ 3,852	$ 3,924

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

($ thousands)	**2013**	2012
Short-term promissory notes	**$ 10,660**	$ 12,675
Medium-term notes	**90,859**	69,618
Total	**$101,519**	$ 82,293

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan Account as described in Note 9 (B).

11 CAPITAL MANAGEMENT

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

- To invest fund transfers, outlined in Note 6, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the Plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc. and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 10 provides information on the capital market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

12 GUARANTEES AND INDEMNITIES

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

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

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 10.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs. As at March 31, 2013, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2013, as part of investment transactions, PSP Investments agreed to guarantee and, in some cases, provide indemnification in connection with certain borrowing arrangements of its investees. In the event a default occurs under such borrowing arrangements, which is of limited recourse in certain cases, PSP Investments could assume obligations of up to $999 million (2012 – $668 million) plus interest and other related costs. Such borrowing arrangements mature between July 2013 and July 2021.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $41 million as at March 31, 2013 (2012 – $9 million) in relation to investment transactions.

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. The commitments were as follows as at March 31, 2013:

($ millions)	
Real estate	$ 1,279
Private equity	4,629
Infrastructure	2,005
Renewable resources	610
Other fixed income securities	751
Alternative investments	746
Total	**$ 10,020**

PUBLIC SERVICE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the President of the Treasury Board

Report on the Financial Statements

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Public Service Pension Plan Account (the Public Service Pension Plan Account), which comprise the balance sheet as at March 31, 2013, and the statement of net income from operations and comprehensive income and statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2013, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

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

Further, in our opinion, the transactions of the 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

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

May 14, 2013
Montréal, Canada

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

May 14, 2013
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2013	2012
ASSETS		
Investments (Note 3 (A))	$ 59,610	$ 51,345
Investment-related assets (Note 3 (A))	1,547	919
Other assets	60	55
Due from the Canadian Forces Pension Plan Account	7	8
Due from the Royal Canadian Mounted Police Pension Plan Account	3	3
	$ 61,227	$ 52,330
LIABILITIES		
Investment-related liabilities (Note 3 (A))	$ 5,644	$ 5,120
Accounts payable and other liabilities	100	82
	$ 5,744	$ 5,202
NET ASSETS	$ 55,483	$ 47,128
Accumulated net income from operations and comprehensive income	$ 17,059	$ 11,962
Accumulated fund transfers	38,424	35,166
NET ASSETS	$ 55,483	$ 47,128

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2013	2012
INVESTMENT INCOME (NOTE 6)	$ 5,231	$ 1,381
OPERATING EXPENSES (NOTE 7)	$ 134	$ 108
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 5,097	$ 1,273

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2013	2012
NET ASSETS, BEGINNING OF YEAR	$ 47,128	$ 42,299
Fund transfers (Note 5)	3,258	3,556
Net income from operations and comprehensive income	5,097	1,273
Increase in net assets for the year	8,355	4,829
NET ASSETS, END OF YEAR	$ 55,483	$ 47,128

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2013

Organization

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

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for the Fund in the best interests of the beneficiaries and contributors under the *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, having regard to the funding, policies and requirements of the Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Public Service Superannuation Act*, the Government of Canada, which administers the Fund, may call upon PSP Investments for amounts required for the purpose of paying benefits under the Plan in respect of service on or after April 1, 2000 or for the purpose of reducing any non-permitted surplus in the Fund. Amounts remitted by PSP Investments for such purposes cannot exceed, at any time, the net assets of PSP Investments allocated to the Plan Account.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it for the Fund in respect of 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 under the Plan. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

VALUATION OF INVESTMENTS

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

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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

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

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

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

INCOME RECOGNITION

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

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

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

The AcSB's decision was in response to an announcement by the International Accounting Standards Board (IASB) in 2010, regarding an Exposure Draft (ED) being developed for investment entities. The objective of the ED was to create an exception from consolidation and provide a fair value reporting framework for qualifying investment entities.

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRSs into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Finally, the AcSB discontinued its project to expand the scope of Section 4600, "Pension Plans" to entities like PSP Investments, which are separate from a pension plan and without a pension obligation, and whose sole purpose is to hold and invest assets received from one or more pension plans. This project was intended to allow qualifying entities to use a fair value reporting framework in the event that IFRS would not provide similar treatment.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of finalizing its IFRS adoption plan. Under such plan, Management will analyze the impact of the adoption of IFRS on PSP Investments' consolidated financial statements.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2013		2012	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
Public markets				
Canadian equity	**$ 6,721**	**$ 6,439**	$ 6,679	$ 6,488
Foreign equity	**15,266**	**13,453**	11,854	10,961
Private markets				
Real estate	**7,939**	**6,833**	5,445	4,714
Private equity	**5,114**	**3,942**	4,515	3,848
Infrastructure	**3,248**	**3,368**	3,119	3,270
Renewable resources	**306**	**274**	275	275
Fixed income				
Cash and money market securities	**2,626**	**2,626**	1,746	1,746
Government and corporate bonds	**8,169**	**8,009**	9,314	9,118
Inflation-linked bonds	**3,190**	**2,782**	2,886	2,637
Other fixed income securities	**5,725**	**5,125**	4,654	4,193
Alternative investments	**1,306**	**1,094**	858	678
INVESTMENTS	**$ 59,610**	**$ 53,945**	$ 51,345	$ 47,928
Investment-related assets				
Amounts receivable from pending trades	**$ 817**	**$ 817**	$ 460	$ 460
Interest receivable	**111**	**111**	117	117
Dividends receivable	**49**	**49**	43	43
Derivative-related receivables	**570**	**207**	299	59
	$ 1,547	**$ 1,184**	$ 919	$ 679
Investment-related liabilities				
Amounts payable from pending trades	**$ (805)**	**$ (805)**	$ (722)	$ (722)
Interest payable	**(18)**	**(18)**	(18)	(18)
Securities sold short	**(341)**	**(339)**	(314)	(304)
Securities sold under repurchase agreements	**(444)**	**(444)**	(929)	(926)
Derivative-related payables	**(470)**	**(179)**	(270)	(60)
Capital market debt financing:				
Short-term	**(2,113)**	**(2,113)**	(658)	(658)
Long-term	**(1,453)**	**(1,409)**	(2,209)	(2,162)
	$ (5,644)	**$ (5,307)**	$ (5,120)	$ (4,850)
NET INVESTMENTS	**$ 55,513**	**$ 49,822**	$ 47,144	$ 43,757

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

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

Valuation Techniques

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

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

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $2,623 million (2012 – $1,945 million).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $202 million (2012 – $208 million).

Renewable resources investments are comprised of properties involving the production and harvesting of replenishable resources. As at March 31, 2013, renewable resources included one investment in timberlands.

Valuation Techniques

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

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

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

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

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

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

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

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

Valuation Techniques

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

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

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

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

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

(iv) Alternative Investments

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

Valuation Techniques

The fair value of these investments is obtained from the audited financial statements of the funds and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2013				2012			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 616	$ –	$ –	$ –	$ 739	$ –	$ –	$ –
Total return swaps	7,240	121	(36)	85	5,960	96	(32)	64
Warrants and rights	2	–	–	–	1	–	–	–
Options:								
Listed-purchased	1,872	20	–	20	824	11	–	11
Listed-written	730	–	(11)	(11)	706	–	(8)	(8)
OTC-purchased	639	70	–	70	393	4	–	4
OTC-written	624	–	(57)	(57)	362	–	(6)	(6)
Currency derivatives								
Forwards	24,986	249	(243)	6	16,869	114	(135)	(21)
Futures	31	–	–	–	111	–	–	–
Swaps	774	17	(21)	(4)	687	2	(13)	(11)
Options:								
OTC-purchased	2,645	41	–	41	358	4	–	4
OTC-written	2,391	–	(33)	(33)	598	–	(5)	(5)
Interest rate derivatives								
Bond forwards	617	4	(5)	(1)	1,315	3	(2)	1
Futures	969	–	–	–	1,143	–	–	–
Interest rate swaps	8,425	17	(29)	(12)	5,536	19	(22)	(3)
Total return swaps	2	–	–	–	–	–	–	–
Swaptions	2,048	6	(4)	2	590	11	(4)	7
Options:								
Listed-purchased	3,683	3	–	3	6,030	2	–	2
Listed-written	3,619	–	(2)	(2)	6,087	–	(4)	(4)
OTC-purchased	1,283	7	–	7	584	11	–	11
OTC-written	2,028	–	(7)	(7)	2,815	–	(17)	(17)
Credit derivatives[1]								
Purchased	1,395	12	(12)	–	881	20	(6)	14
Sold	681	3	(10)	(7)	427	2	(16)	(14)
Total	$ 67,300	$ 570	$ (470)	$ 100	$ 53,016	$ 299	$ (270)	$ 29

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2013:

($ millions)

Less than 3 months	$ 38,673
3 to 12 months	18,379
Over 1 year	10,248
Total	**$ 67,300**

(C) FAIR VALUE MEASUREMENT

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

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 6,721	$ –	$ –	$ –	$ 6,721
Foreign equity	12,546	2,719	1	–	15,266
Private markets					
Real estate	–	–	7,939	–	7,939
Private equity	–	–	5,114	–	5,114
Infrastructure	–	–	3,248	–	3,248
Renewable resources	–	–	306	–	306
Fixed income					
Cash and money market securities	458	2,168	–	–	2,626
Government and corporate bonds	–	8,169	–	–	8,169
Inflation-linked bonds	–	3,190	–	–	3,190
Other fixed income securities	–	2,476	3,249	–	5,725
Alternative investments	–	644	662	–	1,306
INVESTMENTS	$ 19,725	$ 19,366	$ 20,519	$ –	$ 59,610
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 817	$ 817
Interest receivable[1]	–	–	–	111	111
Dividends receivable[1]	–	–	–	49	49
Derivative-related receivables	23	546	1	–	570
	$ 23	$ 546	$ 1	$ 977	$ 1,547
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (805)	$ (805)
Interest payable[1]	–	–	–	(18)	(18)
Securities sold short	(341)	–	–	–	(341)
Securities sold under repurchase agreements	–	(444)	–	–	(444)
Derivative-related payables	(13)	(454)	(3)	–	(470)
Capital market debt financing:					
Short-term	–	(2,113)	–	–	(2,113)
Long-term	–	(1,453)	–	–	(1,453)
	$ (354)	$ (4,464)	$ (3)	$ (823)	$ (5,644)
NET INVESTMENTS	$ 19,394	$ 15,448	$ 20,517	$ 154	$ 55,513

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2012:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 6,679	$ –	$ –	$ –	$ 6,679
Foreign equity	11,137	593	124	–	11,854
Private markets					
Real estate	–	–	5,445	–	5,445
Private equity	–	–	4,515	–	4,515
Infrastructure	–	–	3,119	–	3,119
Renewable resources	–	–	275	–	275
Fixed income					
Cash and money market securities	557	1,189	–	–	1,746
Government and corporate bonds	–	9,314	–	–	9,314
Inflation-linked bonds	–	2,886	–	–	2,886
Other fixed income securities	–	1,742	2,912	–	4,654
Alternative investments	–	636	222	–	858
INVESTMENTS	$ 18,373	$ 16,360	$ 16,612	$ –	$ 51,345
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 460	$ 460
Interest receivable[1]	–	–	–	117	117
Dividends receivable[1]	–	–	–	43	43
Derivative-related receivables	13	286	–	–	299
	$ 13	$ 286	$ –	$ 620	$ 919
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (722)	$ (722)
Interest payable[1]	–	–	–	(18)	(18)
Securities sold short	(314)	–	–	–	(314)
Securities sold under repurchase agreements	–	(929)	–	–	(929)
Derivative-related payables	(11)	(252)	(7)	–	(270)
Capital market debt financing:					
Short-term	–	(658)	–	–	(658)
Long-term	–	(2,209)	–	–	(2,209)
	$ (325)	$ (4,048)	$ (7)	$ (740)	$ (5,120)
NET INVESTMENTS	$ 18,061	$ 12,598	$ 16,605	$ (120)	$ 47,144

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

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

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2013 (no significant transfers during the year ended March 31, 2012).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

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

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 124	$ 1	$ (5)	$ –	$ 1	$ (11)	$ (109)	$ 1
Private markets	13,354	3,520	(1,343)	–	154	922	–	16,607
Fixed income	2,912	987	(855)	(47)	146	106	–	3,249
Alternative investments	222	420	–	–	–	20	–	662
Derivative-related receivables/payables (net)	(7)	5	(7)	–	2	5	–	(2)
Total	**$ 16,605**	**$ 4,933**	**$ (2,210)**	**$ (47)**	**$ 303**	**$ 1,042**	**$ (109)**	**$ 20,517**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2012:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ –	$ 110	$ (12)	$ –	$ 2	$ 24	$ –	$ 124
Private markets	9,730	4,571	(1,648)	–	149	568	(16)	13,354
Fixed income	2,680	770	(713)	(161)	30	306	–	2,912
Alternative investments	–	216	–	–	–	6	–	222
Derivative-related receivables/payables (net)	(5)	–	–	(2)	2	(2)	–	(7)
Total	$ 12,405	$ 5,667	$ (2,373)	$ (163)	$ 183	$ 902	$ (16)	$ 16,605

[1] Includes Plan Account allocation adjustments.

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 4% increase/decrease (2012 – 2% increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $7,416 million allocated to the Plan Account (2012 – $6,258 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2013, PSP Investments, on behalf of the Plan Account, has re-invested $1,615 million of collateral held (2012 – $1,268 million).

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

($ millions)	2013	2012
Securities lending		
Securities lent	$ 5,389	$ 5,108
Collateral held[1]	5,676	5,384
Securities borrowing		
Securities borrowed	341	314
Collateral pledged[2]	343	349

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $444 million as at March 31, 2013 (2012 – $929 million).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

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

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

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

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

	2013	2012
Policy Portfolio VaR	**20.2 %**	21.7 %
Active VaR	**2.6**	2.6
Total VaR (undiversified)	**22.8**	24.3
Diversification effect	**(1.3)**	(1.6)
Total VaR	**21.5 %**	22.7 %

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

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

(i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2013:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 523	$ 2,589	$ 1,341	$ 1,618	$ –	$ 6,071
Corporate bonds	215	1,008	648	227	–	2,098
Inflation-linked bonds	2	790	847	1,551	–	3,190
Asset-backed securities	62	1,341	19	1	–	1,423
Private debt portfolios:						
Directly held	37	488	118	–	–	643
Held through funds [1]	–	–	–	–	1,319	1,319
Total investments with significant exposure to interest rate risk	**$ 839**	**$ 6,216**	**$ 2,973**	**$ 3,397**	**$ 1,319**	**$ 14,744**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 4,966**	**$ 4,966**
Total fixed income	**$ 839**	**$ 6,216**	**$ 2,973**	**$ 3,397**	**$ 6,285**	**$ 19,710**

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

[2] Consists of $2,626 million in cash and money market securities and $2,340 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in millions of Canadian $)	2013		2012	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 11,141**	**53.3 %**	$ 9,482	57.9 %
Euro	**1,875**	**9.0**	1,943	11.9
British Pound	**1,550**	**7.4**	1,283	7.8
Brazilian Real	**878**	**4.2**	664	4.0
Japanese Yen	**833**	**4.0**	740	4.5
Hong Kong Dollar	**754**	**3.6**	493	3.0
Australian Dollar	**687**	**3.3**	295	1.8
Korean Won	**565**	**2.7**	358	2.2
Taiwanese New Dollar	**341**	**1.6**	–	–
Norwegian Krone	**311**	**1.5**	252	1.5
Swiss Franc	**278**	**1.3**	57	0.3
Indian Rupee	**257**	**1.2**	140	0.9
South African Rand	**221**	**1.1**	119	0.7
Mexican Peso	**177**	**0.9**	111	0.7
Others	**1,018**	**4.9**	452	2.8
Total	**$ 20,886**	**100.0 %**	$ 16,389	100.0 %

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $6,840 million (US$6,373 million, €169 million, £43 million, R58 million South African Rands and R$145 million Brazilian Reals) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

As at March 31, 2013, the Plan Account's maximum exposure to credit risk amounted to approximately $17 billion (2012 – approximately $16 billion). This amount excludes investments in distressed debt in the amount of approximately $1 billion as at March 31, 2013 (2012 – approximately $1 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2013, the Plan Account had a net notional exposure of $87 million (2012 – $123 million) to various tranches of collateralized debt obligations, of which approximately 67% (2012 – approximately 61%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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

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

	2013	2012
Investment grade (AAA to BBB–)	**97.9 %**	98.2 %
Below investment grade (BB+ and below)	**1.0**	0.7
Not rated:		
Rated by a single credit rating agency	**0.1**	0.1
Not rated by credit rating agencies	**1.0**	1.0
Total	**100.0 %**	100.0 %

Counterparty Risk

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

PSP Investments' policy also requires the use of the International Swaps and Derivatives Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $53 million as collateral with respect to derivative contracts at March 31, 2013 (2012 – $2 million). Securities with a fair value of $106 million were received from counterparties as collateral at March 31, 2013 (2012 – $76 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2013:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (805)	$ –	$ –	$ (805)
Interest payable	(16)	(2)	–	(18)
Securities sold short	(341)	–	–	(341)
Securities sold under repurchase agreements	(444)	–	–	(444)
Capital market debt financing	(1,261)	(852)	(1,453)	(3,566)
Accounts payable and other liabilities	(69)	–	(31)	(100)
Total	$ (2,936)	$ (854)	$ (1,484)	$ (5,274)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 322	$ 209	$ 39	$ 570
Derivative-related payables [1]	(255)	(143)	(72)	(470)
Total	$ 67	$ 66	$ (33)	$ 100

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $3,258 million for the year ended March 31, 2013 (2012 – $3,556 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2013	2012
Interest income	$ 585	$ 518
Dividend income	858	664
Interest expense (Note 8)	(74)	(60)
Transaction costs	(36)	(47)
External investment management fees[1]	(27)	(24)
Other (net)	(13)	(5)
	1,293	1,046
Net realized gains[2]	1,634	740
Net unrealized gains (losses)	2,304	(405)
Investment income	**$ 5,231**	$ 1,381

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $16 million for the year ended March 31, 2013 (2012 – $41 million). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments.

Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $92 million for the year ended March 31, 2013 (2012 – $87 million).

[2] Includes foreign currency losses of $148 million for the year ended March 31, 2013 (2012 – losses of $34 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

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

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

	2013	2012
Public Service Pension Plan Account	73.0 %	72.9 %
Canadian Forces Pension Plan Account	19.3	19.4
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.6	0.6
Total	**100.0 %**	100.0 %

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

(B) OPERATING EXPENSES

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

($ thousands)	2013	2012
Salaries and benefits	$ 89,276	$ 70,482
Professional and consulting fees	8,657	7,885
Office supplies and equipment	13,667	10,971
Other operating expenses	5,769	4,710
Depreciation of fixed assets	9,512	6,749
Occupancy costs	4,592	4,032
Custodial fees	2,040	2,231
Remuneration earned by Directors	559	585
Travel and related expenses for Directors	154	179
Communication expenses	107	160
Total	**$134,333**	$107,984

8 CAPITAL MARKET DEBT FINANCING

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

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

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

	2013		2012	
($ millions)	**Capital amounts to be paid at maturity**	**Fair Value**	Capital amounts to be paid at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 1.03% and 1.17% and maturing within 31 and 191 days of issuance (March 31, 2012 – 31 and 364 days)	**$ 629**	**$ 627**	$ 659	$ 658
Short-term US Dollar promissory notes, bearing interest between 0.16% and 0.24% and maturing within 29 and 189 days of issuance	**$ 740**	**$ 740**	$ –	$ –
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 729**	**$ 746**	$ 730	$ 769
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 510**	**$ 529**	$ 512	$ 528
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**$ 255**	**$ 256**	$ 256	$ 255
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**$ 656**	**$ 668**	$ 658	$ 657
Total	**$ 3,519**	**$ 3,566**	$ 2,815	$ 2,867

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

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

($ thousands)	**2013**	2012
Short-term promissory notes	**$ 7,761**	$ 9,252
Medium-term notes	**66,139**	50,816
Total	**$ 73,900**	$ 60,068

9 CAPITAL MANAGEMENT

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

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

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

10 GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $705 million has been allocated to the Plan Account. As at March 31, 2013, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2013, as part of investment transactions, PSP Investments agreed to guarantee and, in some cases, provide indemnification in connection with certain borrowing arrangements of its investees. In the event a default occurs under such borrowing arrangements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $728 million (2012 – $488 million) plus interest and other related costs. Such borrowing arrangements mature between July 2013 and July 2021.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $41 million as at March 31, 2013 (2012 – $9 million), of which $30 million has been allocated to the Plan Account (2012 – $6 million) in relation to investment transactions.

11 COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2013:

($ millions)

Real estate	$ 932
Private equity	3,373
Infrastructure	1,461
Renewable resources	444
Other fixed income securities	547
Alternative investments	544
Total	**$ 7,301**

CANADIAN FORCES PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Minister of National Defence

Report on the Financial Statements

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account (the Canadian Forces Pension Plan Account), which comprise the balance sheet as at March 31, 2013, and the statement of net income from operations and comprehensive income and statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2013, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

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

Further, in our opinion, the transactions of the 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

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

May 14, 2013
Montréal, Canada

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

May 14, 2013
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2013	2012
ASSETS		
Investments (Note 3 (A))	**$ 15,989**	$ 13,565
Investment-related assets (Note 3 (A))	**415**	243
Other assets	**16**	13
	$ 16,420	$ 13,821
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 1,514**	$ 1,353
Accounts payable and other liabilities	**27**	22
Due to the Public Service Pension Plan Account	**7**	8
	$ 1,548	$ 1,383
NET ASSETS	**$ 14,872**	$ 12,438
Accumulated net income from operations and comprehensive income	**$ 4,654**	$ 3,275
Accumulated fund transfers	**10,218**	9,163
NET ASSETS	**$ 14,872**	$ 12,438

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2013	2012
INVESTMENT INCOME (NOTE 6)	$ 1,414	$ 363
OPERATING EXPENSES (NOTE 7)	$ 35	$ 29
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 1,379	$ 334

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2013	2012
NET ASSETS, BEGINNING OF YEAR	$ 12,438	$ 11,289
Fund transfers (Note 5)	1,055	815
Net income from operations and comprehensive income	1,379	334
Increase in net assets for the year	2,434	1,149
NET ASSETS, END OF YEAR	$ 14,872	$ 12,438

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2013

Organization

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

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for the Fund in the best interests of the beneficiaries and contributors under the *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, having regard to the funding, policies and requirements of the Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Canadian Forces Superannuation Act*, the Government of Canada, which administers the Fund, may call upon PSP Investments for amounts required for the purpose of paying benefits under the Plan in respect of service on or after April 1, 2000 or for the purpose of reducing any non-permitted surplus in the Fund. Amounts remitted by PSP Investments for such purposes cannot exceed, at any time, the net assets of PSP Investments allocated to the Plan Account.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it for the Fund in respect of 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 under the Plan. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

VALUATION OF INVESTMENTS

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

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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

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

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

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

INCOME RECOGNITION

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

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

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

The AcSB's decision was in response to an announcement by the International Accounting Standards Board (IASB) in 2010, regarding an Exposure Draft (ED) being developed for investment entities. The objective of the ED was to create an exception from consolidation and provide a fair value reporting framework for qualifying investment entities.

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRSs into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Finally, the AcSB discontinued its project to expand the scope of Section 4600, "Pension Plans" to entities like PSP Investments, which are separate from a pension plan and without a pension obligation, and whose sole purpose is to hold and invest assets received from one or more pension plans. This project was intended to allow qualifying entities to use a fair value reporting framework in the event that IFRS would not provide similar treatment.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of finalizing its IFRS adoption plan. Under such plan, Management will analyze the impact of the adoption of IFRS on PSP Investments' consolidated financial statements.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2013		2012	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
Public markets				
Canadian equity	**$ 1,803**	**$ 1,718**	$ 1,764	$ 1,706
Foreign equity	**4,095**	**3,605**	3,132	2,894
Private markets				
Real estate	**2,130**	**1,831**	1,438	1,241
Private equity	**1,372**	**1,059**	1,193	1,017
Infrastructure	**871**	**903**	823	864
Renewable resources	**82**	**73**	72	72
Fixed income				
Cash and money market securities	**704**	**704**	462	462
Government and corporate bonds	**2,191**	**2,148**	2,461	2,408
Inflation-linked bonds	**855**	**747**	763	696
Other fixed income securities	**1,536**	**1,375**	1,230	1,108
Alternative investments	**350**	**300**	227	182
INVESTMENTS	**$ 15,989**	**$ 14,463**	$ 13,565	$ 12,650
Investment-related assets				
Amounts receivable from pending trades	**$ 219**	**$ 219**	$ 121	$ 121
Interest receivable	**30**	**30**	31	31
Dividends receivable	**13**	**13**	12	12
Derivative-related receivables	**153**	**55**	79	16
	$ 415	**$ 317**	$ 243	$ 180
Investment-related liabilities				
Amounts payable from pending trades	**$ (216)**	**$ (216)**	$ (191)	$ (191)
Interest payable	**(4)**	**(4)**	(5)	(5)
Securities sold short	**(92)**	**(91)**	(83)	(80)
Securities sold under repurchase agreements	**(119)**	**(119)**	(246)	(245)
Derivative-related payables	**(126)**	**(48)**	(71)	(15)
Capital market debt financing:				
Short-term	**(567)**	**(567)**	(174)	(174)
Long-term	**(390)**	**(378)**	(583)	(571)
	$ (1,514)	**$ (1,423)**	$ (1,353)	$ (1,281)
NET INVESTMENTS	**$ 14,890**	**$ 13,357**	$ 12,455	$ 11,549

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

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

Valuation Techniques

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

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

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $703 million (2012 – $514 million).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $54 million (2012 – $55 million).

Renewable resources investments are comprised of properties involving the production and harvesting of replenishable resources. As at March 31, 2013, renewable resources included one investment in timberlands.

Valuation Techniques

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

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

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

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

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

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

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

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

Valuation Techniques

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

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

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

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

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

(iv) Alternative Investments

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

Valuation Techniques

The fair value of these investments is obtained from the audited financial statements of the funds and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2013				2012			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 166	$ –	$ –	$ –	$ 195	$ –	$ –	$ –
Total return swaps	1,942	32	(10)	22	1,574	25	(8)	17
Options:								
Listed-purchased	502	6	–	6	218	3	–	3
Listed-written	196	–	(3)	(3)	186	–	(2)	(2)
OTC-purchased	171	19	–	19	104	1	–	1
OTC-written	167	–	(15)	(15)	95	–	(2)	(2)
Currency derivatives								
Forwards	6,702	67	(65)	2	4,457	30	(36)	(6)
Futures	8	–	–	–	29	–	–	–
Swaps	208	5	(6)	(1)	182	1	(3)	(2)
Options:								
OTC-purchased	710	11	–	11	95	1	–	1
OTC-written	641	–	(9)	(9)	158	–	(1)	(1)
Interest rate derivatives								
Bond forwards	165	1	(1)	–	348	1	(1)	–
Futures	260	–	–	–	301	–	–	–
Interest rate swaps	2,260	4	(7)	(3)	1,463	5	(6)	(1)
Swaptions	550	1	(1)	–	156	3	(1)	2
Options:								
Listed-purchased	988	1	–	1	1,593	1	–	1
Listed-written	971	–	(1)	(1)	1,608	–	(1)	(1)
OTC-purchased	344	2	–	2	154	3	–	3
OTC-written	544	–	(2)	(2)	744	–	(5)	(5)
Credit derivatives [1]								
Purchased	374	3	(3)	–	233	5	(1)	4
Sold	182	1	(3)	(2)	113	–	(4)	(4)
Total	$ 18,051	$ 153	$ (126)	$ 27	$ 14,006	$ 79	$ (71)	$ 8

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2013:

($ millions)

Less than 3 months	**$ 10,372**
3 to 12 months	**4,930**
Over 1 year	**2,749**
Total	**$ 18,051**

(C) FAIR VALUE MEASUREMENT

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

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 1,803	$ –	$ –	$ –	$ 1,803
Foreign equity	3,364	730	1	–	4,095
Private markets					
Real estate	–	–	2,130	–	2,130
Private equity	–	–	1,372	–	1,372
Infrastructure	–	–	871	–	871
Renewable resources	–	–	82	–	82
Fixed income					
Cash and money market securities	123	581	–	–	704
Government and corporate bonds	–	2,191	–	–	2,191
Inflation-linked bonds	–	855	–	–	855
Other fixed income securities	–	665	871	–	1,536
Alternative investments	–	173	177	–	350
INVESTMENTS	$ 5,290	$ 5,195	$ 5,504	$ –	$ 15,989
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 219	$ 219
Interest receivable[1]	–	–	–	30	30
Dividends receivable[1]	–	–	–	13	13
Derivative-related receivables	6	147	–	–	153
	$ 6	$ 147	$ –	$ 262	$ 415
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (216)	$ (216)
Interest payable[1]	–	–	–	(4)	(4)
Securities sold short	(92)	–	–	–	(92)
Securities sold under repurchase agreements	–	(119)	–	–	(119)
Derivative-related payables	(3)	(122)	(1)	–	(126)
Capital market debt financing:					
Short-term	–	(567)	–	–	(567)
Long-term	–	(390)	–	–	(390)
	$ (95)	$ (1,198)	$ (1)	$ (220)	$ (1,514)
NET INVESTMENTS	$ 5,201	$ 4,144	$ 5,503	$ 42	$ 14,890

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2012:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 1,764	$ –	$ –	$ –	$ 1,764
Foreign equity	2,942	157	33	–	3,132
Private markets					
Real estate	–	–	1,438	–	1,438
Private equity	–	–	1,193	–	1,193
Infrastructure	–	–	823	–	823
Renewable resources	–	–	72	–	72
Fixed income					
Cash and money market securities	148	314	–	–	462
Government and corporate bonds	–	2,461	–	–	2,461
Inflation-linked bonds	–	763	–	–	763
Other fixed income securities	–	460	770	–	1,230
Alternative investments	–	168	59	–	227
INVESTMENTS	$ 4,854	$ 4,323	$ 4,388	$ –	$ 13,565
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 121	$ 121
Interest receivable[1]	–	–	–	31	31
Dividends receivable[1]	–	–	–	12	12
Derivative-related receivables	4	75	–	–	79
	$ 4	$ 75	$ –	$ 164	$ 243
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (191)	$ (191)
Interest payable[1]	–	–	–	(5)	(5)
Securities sold short	(83)	–	–	–	(83)
Securities sold under repurchase agreements	–	(246)	–	–	(246)
Derivative-related payables	(3)	(66)	(2)	–	(71)
Capital market debt financing:					
Short-term	–	(174)	–	–	(174)
Long-term	–	(583)	–	–	(583)
	$ (86)	$ (1,069)	$ (2)	$ (196)	$ (1,353)
NET INVESTMENTS	$ 4,772	$ 3,329	$ 4,386	$ (32)	$ 12,455

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

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

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2013 (no significant transfers during the year ended March 31, 2012).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

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

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 33	$ –	$ (1)	$ –	$ –	$ (2)	$ (29)	$ 1
Private markets	3,526	947	(361)	–	42	301	–	4,455
Fixed income	770	265	(230)	(13)	39	40	–	871
Alternative investments	59	112	–	–	–	6	–	177
Derivative-related receivables/payables (net)	(2)	2	(2)	–	–	1	–	(1)
Total	**$ 4,386**	**$ 1,326**	**$ (594)**	**$ (13)**	**$ 81**	**$ 346**	**$ (29)**	**$ 5,503**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2012:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains[1]	Transfer out of Level 3	Closing Balance
Public markets	$ –	$ 30	$ (3)	$ –	$ –	$ 6	$ –	$ 33
Private markets	2,598	1,208	(437)	–	40	121	(4)	3,526
Fixed income	717	204	(190)	(43)	8	74	–	770
Alternative investments	–	57	–	–	–	2	–	59
Derivative-related receivables/payables (net)	(2)	–	–	(1)	1	–	–	(2)
Total	$ 3,313	$ 1,499	$ (630)	$ (44)	$ 49	$ 203	$ (4)	$ 4,386

[1] Includes Plan Account allocation adjustments.

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 4% increase/decrease (2012 – 2% increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $1,989 million allocated to the Plan Account (2012 – $1,653 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2013, PSP Investments, on behalf of the Plan Account, has re-invested $433 million of collateral held (2012 – $335 million).

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

($ millions)	2013	2012
Securities lending		
Securities lent	**$ 1,445**	$ 1,350
Collateral held[1]	**1,522**	1,422
Securities borrowing		
Securities borrowed	**92**	83
Collateral pledged[2]	**92**	92

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $119 million as at March 31, 2013 (2012 – $246 million).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

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

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

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

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

	2013	2012
Policy Portfolio VaR	**20.2 %**	21.7 %
Active VaR	**2.6**	2.6
Total VaR (undiversified)	**22.8**	24.3
Diversification effect	**(1.3)**	(1.6)
Total VaR	**21.5 %**	22.7 %

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

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

(i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2013:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 140	$ 694	$ 360	$ 434	$ –	$ 1,628
Corporate bonds	58	270	174	61	–	563
Inflation-linked bonds	–	212	227	416	–	855
Asset-backed securities	17	360	5	–	–	382
Private debt portfolios:						
Directly held	10	131	31	–	–	172
Held through funds [1]	–	–	–	–	354	354
Total investments with significant exposure to interest rate risk	**$ 225**	**$ 1,667**	**$ 797**	**$ 911**	**$ 354**	**$ 3,954**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 1,332**	**$ 1,332**
Total fixed income	**$ 225**	**$ 1,667**	**$ 797**	**$ 911**	**$ 1,686**	**$ 5,286**

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

[2] Consists of $704 million in cash and money market securities and $628 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in millions of Canadian $)	2013		2012	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 2,988**	**53.3 %**	$ 2,505	57.9 %
Euro	**503**	**9.0**	514	11.9
British Pound	**416**	**7.4**	339	7.8
Brazilian Real	**236**	**4.2**	175	4.0
Japanese Yen	**223**	**4.0**	195	4.5
Hong Kong Dollar	**202**	**3.6**	130	3.0
Australian Dollar	**184**	**3.3**	78	1.8
Korean Won	**151**	**2.7**	95	2.2
Taiwanese New Dollar	**92**	**1.6**	–	–
Norwegian Krone	**84**	**1.5**	66	1.5
Swiss Franc	**75**	**1.3**	15	0.3
Indian Rupee	**69**	**1.2**	37	0.9
South African Rand	**59**	**1.1**	32	0.7
Mexican Peso	**47**	**0.9**	29	0.7
Others	**273**	**4.9**	119	2.8
Total	**$ 5,602**	**100.0 %**	$ 4,329	100.0 %

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $1,835 million (US$1,710 million, €45 million, £12 million, R15 million South African Rands and R$39 million Brazilian Reals) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

As at March 31, 2013, the Plan Account's maximum exposure to credit risk amounted to approximately $5 billion (2012 – approximately $4 billion). This amount excludes investments in distressed debt in the amount of approximately $0.3 billion as at March 31, 2013 (2012 – approximately $0.3 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2013, the Plan Account had a net notional exposure of $24 million (2012 – $32 million) to various tranches of collateralized debt obligations, of which approximately 67% (2012 – approximately 61%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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

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

	2013	2012
Investment grade (AAA to BBB–)	**97.9 %**	98.2 %
Below investment grade (BB+ and below)	**1.0**	0.7
Not rated:		
Rated by a single credit rating agency	**0.1**	0.1
Not rated by credit rating agencies	**1.0**	1.0
Total	**100.0 %**	100.0 %

Counterparty Risk

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

PSP Investments' policy also requires the use of the International Swaps and Derivatives Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $14 million as collateral with respect to derivative contracts at March 31, 2013 (2012 – $528 thousand). Securities with a fair value of $28 million were received from counterparties as collateral at March 31, 2013 (2012 – $20 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2013:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (216)	$ –	$ –	$ (216)
Interest payable	(4)	–	–	(4)
Securities sold short	(92)	–	–	(92)
Securities sold under repurchase agreements	(119)	–	–	(119)
Capital market debt financing	(338)	(229)	(390)	(957)
Accounts payable and other liabilities	(19)	–	(8)	(27)
Total	$ (788)	$ (229)	$ (398)	$ (1,415)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 87	$ 56	$ 10	$ 153
Derivative-related payables [1]	(69)	(38)	(19)	(126)
Total	$ 18	$ 18	$ (9)	$ 27

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $1,055 million for the year ended March 31, 2013 (2012 – $815 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2013	2012
Interest income	$ 157	$ 137
Dividend income	231	175
Interest expense (Note 8)	(20)	(16)
Transaction costs	(10)	(12)
External investment management fees[1]	(7)	(7)
Other (net)	(4)	(1)
	347	276
Net realized gains[2]	440	197
Net unrealized gains (losses)	627	(110)
Investment income	**$ 1,414**	$ 363

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $4 million for the year ended March 31, 2013 (2012 – $11 million). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments.

Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $25 million for the year ended March 31, 2013 (2012 – $23 million).

[2] Includes foreign currency losses of $40 million for the year ended March 31, 2013 (2012 – losses of $8 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

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

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

	2013	2012
Public Service Pension Plan Account	73.0 %	72.9 %
Canadian Forces Pension Plan Account	19.3	19.4
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.6	0.6
Total	**100.0 %**	100.0 %

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

(B) OPERATING EXPENSES

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

($ thousands)	2013	2012
Salaries and benefits	$ 23,580	$ 18,824
Professional and consulting fees	2,287	2,106
Office supplies and equipment	3,610	2,930
Other operating expenses	1,524	1,258
Depreciation of fixed assets	2,512	1,801
Occupancy costs	1,213	1,077
Custodial fees	549	596
Remuneration earned by Directors	148	156
Travel and related expenses for Directors	40	48
Communication expenses	28	42
Total	**$ 35,491**	$ 28,838

8 CAPITAL MARKET DEBT FINANCING

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

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

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

	2013		2012	
($ millions)	**Capital amounts to be paid at maturity**	**Fair Value**	Capital amounts to be paid at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 1.03% and 1.17% and maturing within 31 and 191 days of issuance (March 31, 2012 – 31 and 364 days)	**$ 169**	**$ 168**	$ 174	$ 174
Short-term US Dollar promissory notes, bearing interest between 0.16% and 0.24% and maturing within 29 and 189 days of issuance	**$ 199**	**$ 199**	$ –	$ –
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 195**	**$ 200**	$ 193	$ 203
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 137**	**$ 142**	$ 135	$ 139
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**$ 68**	**$ 69**	$ 67	$ 68
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**$ 176**	**$ 179**	$ 174	$ 173
Total	**$ 944**	**$ 957**	$ 743	$ 757

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

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

($ thousands)	**2013**	2012
Short-term promissory notes	**$ 2,089**	$ 2,454
Medium-term notes	**17,809**	13,483
Total	**$ 19,898**	$ 15,937

9 CAPITAL MANAGEMENT

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

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

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

10 GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $190 million has been allocated to the Plan Account. As at March 31, 2013, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2013, as part of investment transactions, PSP Investments agreed to guarantee and, in some cases, provide indemnification in connection with certain borrowing arrangements of its investees. In the event a default occurs under such borrowing arrangements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $195 million (2012 – $129 million) plus interest and other related costs. Such borrowing arrangements mature between July 2013 and July 2021.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $41 million as at March 31, 2013 (2012 – $9 million), of which $8 million has been allocated to the Plan Account (2012 – $2 million) in relation to investment transactions.

11 COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2013:

($ millions)	
Real estate	$ 250
Private equity	905
Infrastructure	391
Renewable resources	119
Other fixed income securities	147
Alternative investments	146
Total	**$ 1,958**

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Minister of Public Safety

Report on the Financial Statements

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Royal Canadian Mounted Police Pension Plan Account (the Royal Canadian Mounted Police Pension Plan Account), which comprise the balance sheet as at March 31, 2013, and the statement of net income from operations and comprehensive income and statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2013, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

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

Further, in our opinion, the transactions of the 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

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

May 14, 2013
Montréal, Canada

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

May 14, 2013
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2013	2012
ASSETS		
Investments (Note 3 (A))	$ 5,777	$ 4,968
Investment-related assets (Note 3 (A))	149	89
Other assets	6	5
	$ 5,932	$ 5,062
LIABILITIES		
Investment-related liabilities (Note 3 (A))	$ 546	$ 495
Accounts payable and other liabilities	9	8
Due to the Public Service Pension Plan Account	3	3
	$ 558	$ 506
NET ASSETS	$ 5,374	$ 4,556
Accumulated net income from operations and comprehensive income	$ 1,677	$ 1,181
Accumulated fund transfers	3,697	3,375
NET ASSETS	$ 5,374	$ 4,556

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2013	2012
INVESTMENT INCOME (NOTE 6)	**$ 509**	$ 133
OPERATING EXPENSES (NOTE 7)	**$ 13**	$ 10
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 496**	$ 123

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2013	2012
NET ASSETS, BEGINNING OF YEAR	**$ 4,556**	$ 4,102
Fund transfers (Note 5)	**322**	331
Net income from operations and comprehensive income	**496**	123
Increase in net assets for the year	**818**	454
NET ASSETS, END OF YEAR	**$ 5,374**	$ 4,556

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2013

Organization

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

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for the Fund in the best interests of the beneficiaries and contributors under the *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, having regard to the funding, policies and requirements of the Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Royal Canadian Mounted Police Superannuation Act*, the Government of Canada, which administers the Fund, may call upon PSP Investments for amounts required for the purpose of paying benefits under the Plan in respect of service on or after April 1, 2000 or for the purpose of reducing any non-permitted surplus in the Fund. Amounts remitted by PSP Investments for such purposes cannot exceed, at any time, the net assets of PSP Investments allocated to the Plan Account.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it for the Fund in respect of 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 under the Plan. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

VALUATION OF INVESTMENTS

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

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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

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

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

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

INCOME RECOGNITION

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

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

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

The AcSB's decision was in response to an announcement by the International Accounting Standards Board (IASB) in 2010, regarding an Exposure Draft (ED) being developed for investment entities. The objective of the ED was to create an exception from consolidation and provide a fair value reporting framework for qualifying investment entities.

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRSs into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Finally, the AcSB discontinued its project to expand the scope of Section 4600, "Pension Plans" to entities like PSP Investments, which are separate from a pension plan and without a pension obligation, and whose sole purpose is to hold and invest assets received from one or more pension plans. This project was intended to allow qualifying entities to use a fair value reporting framework in the event that IFRS would not provide similar treatment.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of finalizing its IFRS adoption plan. Under such plan, Management will analyze the impact of the adoption of IFRS on PSP Investments' consolidated financial statements.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2013		2012	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
Public markets				
Canadian equity	**$ 651**	**$ 616**	$ 646	$ 620
Foreign equity	**1,479**	**1,300**	1,147	1,058
Private markets				
Real estate	**769**	**662**	527	456
Private equity	**495**	**385**	437	375
Infrastructure	**315**	**326**	302	316
Renewable resources	**30**	**27**	27	27
Fixed income				
Cash and money market securities	**255**	**255**	169	169
Government and corporate bonds	**792**	**778**	901	884
Inflation-linked bonds	**309**	**270**	279	256
Other fixed income securities	**555**	**496**	450	406
Alternative investments	**127**	**106**	83	65
INVESTMENTS	**$ 5,777**	**$ 5,221**	$ 4,968	$ 4,632
Investment-related assets				
Amounts receivable from pending trades	**$ 79**	**$ 79**	$ 44	$ 44
Interest receivable	**10**	**10**	11	11
Dividends receivable	**5**	**5**	4	4
Derivative-related receivables	**55**	**20**	30	6
	$ 149	**$ 114**	$ 89	$ 65
Investment-related liabilities				
Amounts payable from pending trades	**$ (77)**	**$ (77)**	$ (70)	$ (70)
Interest payable	**(2)**	**(2)**	(1)	(1)
Securities sold short	**(33)**	**(33)**	(30)	(29)
Securities sold under repurchase agreements	**(43)**	**(43)**	(90)	(90)
Derivative-related payables	**(45)**	**(18)**	(26)	(6)
Capital market debt financing:				
Short-term	**(205)**	**(205)**	(64)	(64)
Long-term	**(141)**	**(136)**	(214)	(209)
	$ (546)	**$ (514)**	$ (495)	$ (469)
NET INVESTMENTS	**$ 5,380**	**$ 4,821**	$ 4,562	$ 4,228

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

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

Valuation Techniques

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

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

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $254 million (2012 – $188 million).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $20 million (2012 – $20 million).

Renewable resources investments are comprised of properties involving the production and harvesting of replenishable resources. As at March 31, 2013, renewable resources included one investment in timberlands.

Valuation Techniques

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

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

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

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

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

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

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

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

Valuation Techniques

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

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

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

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

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

(iv) Alternative Investments

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

Valuation Techniques

The fair value of these investments is obtained from the audited financial statements of the funds and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2013				2012			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 60	$ –	$ –	$ –	$ 72	$ –	$ –	$ –
Total return swaps	701	12	(4)	8	577	10	(3)	7
Options:								
Listed-purchased	182	2	–	2	80	1	–	1
Listed-written	71	–	(1)	(1)	68	–	(1)	(1)
OTC-purchased	62	7	–	7	38	1	–	1
OTC-written	60	–	(5)	(5)	35	–	(1)	(1)
Currency derivatives								
Forwards	2,422	24	(24)	–	1,632	11	(13)	(2)
Futures	3	–	–	–	11	–	–	–
Swaps	75	2	(2)	–	67	–	(2)	(2)
Options:								
OTC-purchased	256	4	–	4	35	–	–	–
OTC-written	232	–	(3)	(3)	58	–	–	–
Interest rate derivatives								
Bond forwards	60	–	–	–	127	–	–	–
Futures	94	–	–	–	111	–	–	–
Interest rate swaps	816	2	(3)	(1)	536	3	(2)	1
Swaptions	198	–	–	–	57	1	–	1
Options:								
Listed-purchased	357	–	–	–	584	–	–	–
Listed-written	351	–	–	–	589	–	–	–
OTC-purchased	125	1	–	1	56	1	–	1
OTC-written	197	–	(1)	(1)	272	–	(2)	(2)
Credit derivatives[1]								
Purchased	135	1	(1)	–	85	2	(1)	1
Sold	66	–	(1)	(1)	41	–	(1)	(1)
Total	$ 6,523	$ 55	$ (45)	$ 10	$ 5,131	$ 30	$ (26)	$ 4

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2013:

($ millions)

Less than 3 months	$ 3,749
3 to 12 months	1,781
Over 1 year	993
Total	**$ 6,523**

(C) FAIR VALUE MEASUREMENT

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

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 651	$ –	$ –	$ –	$ 651
Foreign equity	1,216	263	–	–	1,479
Private markets					
Real estate	–	–	769	–	769
Private equity	–	–	495	–	495
Infrastructure	–	–	315	–	315
Renewable resources	–	–	30	–	30
Fixed income					
Cash and money market securities	45	210	–	–	255
Government and corporate bonds	–	792	–	–	792
Inflation-linked bonds	–	309	–	–	309
Other fixed income securities	–	240	315	–	555
Alternative investments	–	63	64	–	127
INVESTMENTS	$ 1,912	$ 1,877	$ 1,988	$ –	$ 5,777
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 79	$ 79
Interest receivable[1]	–	–	–	10	10
Dividends receivable[1]	–	–	–	5	5
Derivative-related receivables	2	53	–	–	55
	$ 2	$ 53	$ –	$ 94	$ 149
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (77)	$ (77)
Interest payable[1]	–	–	–	(2)	(2)
Securities sold short	(33)	–	–	–	(33)
Securities sold under repurchase agreements	–	(43)	–	–	(43)
Derivative-related payables	(1)	(44)	–	–	(45)
Capital market debt financing:					
Short-term	–	(205)	–	–	(205)
Long-term	–	(141)	–	–	(141)
	$ (34)	$ (433)	$ –	$ (79)	$ (546)
NET INVESTMENTS	$ 1,880	$ 1,497	$ 1,988	$ 15	$ 5,380

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2012:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 646	$ –	$ –	$ –	$ 646
Foreign equity	1,078	57	12	–	1,147
Private markets					
Real estate	–	–	527	–	527
Private equity	–	–	437	–	437
Infrastructure	–	–	302	–	302
Renewable resources	–	–	27	–	27
Fixed income					
Cash and money market securities	54	115	–	–	169
Government and corporate bonds	–	901	–	–	901
Inflation-linked bonds	–	279	–	–	279
Other fixed income securities	–	168	282	–	450
Alternative investments	–	62	21	–	83
INVESTMENTS	$ 1,778	$ 1,582	$ 1,608	$ –	$ 4,968
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 44	$ 44
Interest receivable[1]	–	–	–	11	11
Dividends receivable[1]	–	–	–	4	4
Derivative-related receivables	1	29	–	–	30
	$ 1	$ 29	$ –	$ 59	$ 89
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (70)	$ (70)
Interest payable[1]	–	–	–	(1)	(1)
Securities sold short	(30)	–	–	–	(30)
Securities sold under repurchase agreements	–	(90)	–	–	(90)
Derivative-related payables	(1)	(24)	(1)	–	(26)
Capital market debt financing:					
Short-term	–	(64)	–	–	(64)
Long-term	–	(214)	–	–	(214)
	$ (31)	$ (392)	$ (1)	$ (71)	$ (495)
NET INVESTMENTS	$ 1,748	$ 1,219	$ 1,607	$ (12)	$ 4,562

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

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

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2013 (no significant transfers during the year ended March 31, 2012).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

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

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 12	$ –	$ –	$ –	$ –	$ (1)	$ (11)	$ –
Private markets	1,293	341	(130)	–	15	90	–	1,609
Fixed income	282	96	(83)	(5)	14	11	–	315
Alternative investments	21	41	–	–	–	2	–	64
Derivative-related receivables/payables (net)	(1)	1	(1)	–	–	1	–	–
Total	**$ 1,607**	**$ 479**	**$ (214)**	**$ (5)**	**$ 29**	**$ 103**	**$ (11)**	**$ 1,988**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2012:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains[1]	Transfer out of Level 3	Closing Balance
Public markets	$ –	$ 11	$ (1)	$ –	$ –	$ 2	$ –	$ 12
Private markets	944	440	(159)	–	14	55	(1)	1,293
Fixed income	260	74	(69)	(16)	4	29	–	282
Alternative investments	–	21	–	–	–	–	–	21
Derivative-related receivables/payables (net)	(1)	–	–	–	–	–	–	(1)
Total	$ 1,203	$ 546	$ (229)	$ (16)	$ 18	$ 86	$ (1)	$ 1,607

[1] Includes Plan Account allocation adjustments.

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 4% increase/decrease (2012 – 2% increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $719 million allocated to the Plan Account (2012 – $606 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2013, PSP Investments, on behalf of the Plan Account, has re-invested $157 million of collateral held (2012 – $122 million).

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

($ millions)	2013	2012
Securities lending		
Securities lent	**$ 522**	$ 494
Collateral held[1]	**550**	521
Securities borrowing		
Securities borrowed	**33**	30
Collateral pledged[2]	**33**	34

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $43 million as at March 31, 2013 (2012 – $90 million).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

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

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

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

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

	2013	2012
Policy Portfolio VaR	**20.2 %**	21.7 %
Active VaR	**2.6**	2.6
Total VaR (undiversified)	**22.8**	24.3
Diversification effect	**(1.3)**	(1.6)
Total VaR	**21.5 %**	22.7 %

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

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

(i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2013:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 51	$ 251	$ 130	$ 157	$ –	$ 589
Corporate bonds	20	98	63	22	–	203
Inflation-linked bonds	–	76	82	151	–	309
Asset-backed securities	6	130	2	–	–	138
Private debt portfolios:						
Directly held	4	47	11	–	–	62
Held through funds [1]	–	–	–	–	129	129
Total investments with significant exposure to interest rate risk	$ 81	$ 602	$ 288	$ 330	$ 129	$ 1,430
Other investments [2]	$ –	$ –	$ –	$ –	$ 481	$ 481
Total fixed income	$ 81	$ 602	$ 288	$ 330	$ 610	$ 1,911

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

[2] Consists of $255 million in cash and money market securities and $226 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in millions of Canadian $)	2013		2012	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 1,080**	**53.3 %**	$ 918	57.9 %
Euro	**181**	**9.0**	188	11.9
British Pound	**150**	**7.4**	124	7.8
Brazilian Real	**85**	**4.2**	64	4.0
Japanese Yen	**81**	**4.0**	71	4.5
Hong Kong Dollar	**73**	**3.6**	48	3.0
Australian Dollar	**67**	**3.3**	29	1.8
Korean Won	**55**	**2.7**	34	2.2
Taiwanese New Dollar	**33**	**1.6**	–	–
Norwegian Krone	**30**	**1.5**	24	1.5
Swiss Franc	**27**	**1.3**	6	0.3
Indian Rupee	**25**	**1.2**	14	0.9
South African Rand	**22**	**1.1**	12	0.7
Mexican Peso	**17**	**0.9**	10	0.7
Others	**99**	**4.9**	44	2.8
Total	**$ 2,025**	**100.0 %**	$ 1,586	100.0 %

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $663 million (US$618 million, €16 million, £4 million, R6 million South African Rands and R$14 million Brazilian Reals) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

As at March 31, 2013, the Plan Account's maximum exposure to credit risk amounted to approximately $2 billion (2012 – approximately $2 billion). This amount excludes investments in distressed debt in the amount of approximately $0.1 billion as at March 31, 2013 (2012 – approximately $0.1 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2013, the Plan Account had a net notional exposure of $8 million (2012 – $12 million) to various tranches of collateralized debt obligations, of which approximately 67% (2012 – approximately 61%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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

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

	2013	2012
Investment grade (AAA to BBB–)	**97.9 %**	98.2 %
Below investment grade (BB+ and below)	**1.0**	0.7
Not rated:		
Rated by a single credit rating agency	**0.1**	0.1
Not rated by credit rating agencies	**1.0**	1.0
Total	**100.0 %**	100.0 %

Counterparty Risk

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

PSP Investments' policy also requires the use of the International Swaps and Derivatives Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $5 million as collateral with respect to derivative contracts at March 31, 2013 (2012 – $193 thousand). Securities with a fair value of $10 million were received from counterparties as collateral at March 31, 2013 (2012 – $7 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2013:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities[1]				
Amounts payable from pending trades	$ (77)	$ –	$ –	$ (77)
Interest payable	(2)	–	–	(2)
Securities sold short	(33)	–	–	(33)
Securities sold under repurchase agreements	(43)	–	–	(43)
Capital market debt financing	(122)	(83)	(141)	(346)
Accounts payable and other liabilities	(7)	–	(2)	(9)
Total	$ (284)	$ (83)	$ (143)	$ (510)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 31	$ 20	$ 4	$ 55
Derivative-related payables[1]	(24)	(14)	(7)	(45)
Total	$ 7	$ 6	$ (3)	$ 10

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $322 million for the year ended March 31, 2013 (2012 – $331 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2013	2012
Interest income	$ 57	$ 50
Dividend income	83	64
Interest expense (Note 8)	(7)	(6)
Transaction costs	(4)	(5)
External investment management fees[1]	(3)	(2)
Other (net)	(1)	–
	125	101
Net realized gains[2]	159	71
Net unrealized gains (losses)	225	(39)
Investment income	**$ 509**	$ 133

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $1 million for the year ended March 31, 2013 (2012 – $4 million). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments.

Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $9 million for the year ended March 31, 2013 (2012 – $8 million).

[2] Includes foreign currency losses of $14 million for the year ended March 31, 2013 (2012 – losses of $3 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

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

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

	2013	2012
Public Service Pension Plan Account	73.0 %	72.9 %
Canadian Forces Pension Plan Account	19.3	19.4
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.6	0.6
Total	**100.0 %**	100.0 %

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

(B) OPERATING EXPENSES

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

($ thousands)	2013	2012
Salaries and benefits	$ 8,638	$ 6,836
Professional and consulting fees	838	764
Office supplies and equipment	1,322	1,064
Other operating expenses	558	457
Depreciation of fixed assets	921	655
Occupancy costs	444	391
Custodial fees	198	216
Remuneration earned by Directors	54	57
Travel and related expenses for Directors	15	17
Communication expenses	10	15
Total	**$ 12,998**	$ 10,472

8 CAPITAL MARKET DEBT FINANCING

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

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

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

($ millions)	2013 Capital amounts to be paid at maturity	2013 Fair Value	2012 Capital amounts to be paid at maturity	2012 Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 1.03% and 1.17% and maturing within 31 and 191 days of issuance (March 31, 2012 – 31 and 364 days)	$ 61	$ 61	$ 64	$ 64
Short-term US Dollar promissory notes, bearing interest between 0.16% and 0.24% and maturing within 29 and 189 days of issuance	$ 72	$ 72	$ –	$ –
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	$ 71	$ 72	$ 71	$ 74
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	$ 49	$ 51	$ 49	$ 51
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	$ 25	$ 25	$ 25	$ 25
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	$ 63	$ 65	$ 63	$ 64
Total	**$ 341**	**$ 346**	$ 272	$ 278

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

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

($ thousands)	2013	2012
Short-term promissory notes	$ 753	$ 896
Medium-term notes	6,419	4,920
Total	**$ 7,172**	$ 5,816

9 CAPITAL MANAGEMENT

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

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

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

10 GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $69 million has been allocated to the Plan Account. As at March 31, 2013, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2013, as part of investment transactions, PSP Investments agreed to guarantee and, in some cases, provide indemnification in connection with certain borrowing arrangements of its investees. In the event a default occurs under such borrowing arrangements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $71 million (2012 – $47 million) plus interest and other related costs. Such borrowing arrangements mature between July 2013 and July 2021.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $41 million as at March 31, 2013 (2012 – $9 million), of which $3 million has been allocated to the Plan Account (2012 – $1 million) in relation to investment transactions.

11 COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2013:

($ millions)

Real estate	$	90
Private equity		327
Infrastructure		142
Renewable resources		43
Other fixed income securities		53
Alternative investments		53
Total	**$**	**708**

RESERVE FORCE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Minister of National Defence

Report on the Financial Statements

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account (the Reserve Force Pension Plan Account), which comprise the balance sheet as at March 31, 2013, and the statement of net income from operations and comprehensive income and statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 2013, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

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

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

Deloitte LLP[1]

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

May 14, 2013
Montréal, Canada

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

May 14, 2013
Ottawa, Canada

BALANCE SHEET

As at March 31

($ thousands)	2013	2012
ASSETS		
Investments (Note 3 (A))	**$431,940**	$397,229
Investment-related assets (Note 3 (A))	**11,206**	7,107
Other assets	**270**	180
	$443,416	$404,516
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 40,897**	$ 39,585
Accounts payable and other liabilities	**572**	437
Due to the Public Service Pension Plan Account	**197**	221
	$ 41,666	$ 40,243
NET ASSETS	**$401,750**	$364,273
Accumulated net income from operations and comprehensive income	**$ 91,178**	$ 53,701
Accumulated fund transfers	**310,572**	310,572
NET ASSETS	**$401,750**	$364,273

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ thousands)	2013	2012
INVESTMENT INCOME (NOTE 6)	$ 38,506	$ 10,801
OPERATING EXPENSES (NOTE 7)	$ 1,029	$ 830
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 37,477	$ 9,971

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ thousands)	2013	2012
NET ASSETS, BEGINNING OF YEAR	$364,273	$323,247
Fund transfers (Note 5)	–	31,055
Net income from operations and comprehensive income	37,477	9,971
Increase in net assets for the year	37,477	41,026
NET ASSETS, END OF YEAR	$401,750	$364,273

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2013

Organization

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

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

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

Pursuant to the CFSA and the CFSA Regulations, the Government of Canada, which administers the Fund, may call upon PSP Investments for amounts required for the purpose of paying benefits under the Plan in respect of service on or after March 1, 2007 or for the purpose of reducing any non-permitted surplus in the Fund. Amounts remitted by PSP Investments for such purposes cannot exceed, at any time, the net assets of PSP Investments allocated to the Plan Account.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it for the Fund in respect of 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 under the Plan. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

VALUATION OF INVESTMENTS

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

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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

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

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

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

INCOME RECOGNITION

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

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

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

The AcSB's decision was in response to an announcement by the International Accounting Standards Board (IASB) in 2010, regarding an Exposure Draft (ED) being developed for investment entities. The objective of the ED was to create an exception from consolidation and provide a fair value reporting framework for qualifying investment entities.

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

In December 2012, the AcSB approved the incorporation of the above amendments to IFRSs into Part I of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for investment companies applying AcG-18. Consequently, the first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015.

Finally, the AcSB discontinued its project to expand the scope of Section 4600, "Pension Plans" to entities like PSP Investments, which are separate from a pension plan and without a pension obligation, and whose sole purpose is to hold and invest assets received from one or more pension plans. This project was intended to allow qualifying entities to use a fair value reporting framework in the event that IFRS would not provide similar treatment.

Management has determined that PSP Investments qualifies as an investment entity under the amendments to IFRS 10 "Consolidated financial statements" and is in the process of finalizing its IFRS adoption plan. Under such plan, Management will analyze the impact of the adoption of IFRS on PSP Investments' consolidated financial statements.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2013		2012	
($ thousands)	**Fair Value**	**Cost**	Fair Value	Cost
Public markets				
Canadian equity	**$ 48,701**	**$ 49,225**	$ 51,632	$ 52,862
Foreign equity	**110,622**	**95,168**	91,648	82,727
Private markets				
Real estate	**57,532**	**52,807**	42,091	40,083
Private equity	**37,054**	**26,943**	34,909	28,534
Infrastructure	**23,538**	**24,626**	24,109	25,436
Renewable resources	**2,218**	**1,984**	2,122	2,122
Fixed income				
Cash and money market securities	**19,031**	**19,031**	13,787	13,787
Government and corporate bonds	**59,191**	**57,501**	72,005	70,080
Inflation-linked bonds	**23,108**	**19,718**	22,309	20,094
Other fixed income securities	**41,483**	**37,129**	35,982	32,419
Alternative investments	**9,462**	**3,123**	6,635	759
INVESTMENTS	**$431,940**	**$387,255**	$397,229	$368,903
Investment-related assets				
Amounts receivable from pending trades	**$ 5,921**	**$ 5,921**	$ 3,554	$ 3,554
Interest receivable	**805**	**805**	902	902
Dividends receivable	**352**	**352**	336	336
Derivative-related receivables	**4,128**	**1,501**	2,315	458
	$ 11,206	**$ 8,579**	$ 7,107	$ 5,250
Investment-related liabilities				
Amounts payable from pending trades	**$ (5,831)**	**$ (5,831)**	$ (5,584)	$ (5,584)
Interest payable	**(126)**	**(126)**	(137)	(137)
Securities sold short	**(2,475)**	**(2,454)**	(2,425)	(2,345)
Securities sold under repurchase agreements	**(3,215)**	**(3,217)**	(7,186)	(7,160)
Derivative-related payables	**(3,405)**	**(1,303)**	(2,090)	(464)
Capital market debt financing:				
Short-term	**(15,312)**	**(15,312)**	(5,088)	(5,088)
Long-term	**(10,533)**	**(10,220)**	(17,075)	(16,728)
	$ (40,897)	**$ (38,463)**	$ (39,585)	$ (37,506)
NET INVESTMENTS	**$402,249**	**$357,371**	$364,751	$336,647

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

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

Valuation Techniques

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

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

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $19,000 thousand (2012 – $15,037 thousand).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2013, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $1,461 thousand (2012 – $1,612 thousand).

Renewable resources investments are comprised of properties involving the production and harvesting of replenishable resources. As at March 31, 2013, renewable resources included one investment in timberlands.

Valuation Techniques

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

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

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

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

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

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

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

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

Valuation Techniques

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

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

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

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

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

(iv) Alternative Investments

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

Valuation Techniques

The fair value of these investments is obtained from the audited financial statements of the funds and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2013				2012			
		Fair Value				Fair Value		
($ thousands)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 4,468	$ –	$ –	$ –	$ 5,718	$ –	$ –	$ –
Total return swaps	52,455	878	(261)	617	46,073	737	(244)	493
Warrants and rights	11	1	–	1	6	3	–	3
Options:								
Listed-purchased	13,570	146	–	146	6,371	84	–	84
Listed-written	5,293	–	(81)	(81)	5,453	–	(59)	(59)
OTC-purchased	4,628	511	–	511	3,040	33	–	33
OTC-written	4,521	–	(412)	(412)	2,797	–	(52)	(52)
Currency derivatives								
Forwards	181,054	1,807	(1,761)	46	130,411	880	(1,047)	(167)
Futures	222	–	–	–	856	–	–	–
Swaps	5,612	125	(151)	(26)	5,310	19	(100)	(81)
Options:								
OTC-purchased	19,169	293	–	293	2,770	29	–	29
OTC-written	17,323	–	(237)	(237)	4,627	–	(36)	(36)
Interest rate derivatives								
Bond forwards	4,468	30	(34)	(4)	10,167	21	(19)	2
Futures	7,021	–	–	–	8,836	–	–	–
Interest rate swaps	61,049	119	(209)	(90)	42,802	150	(169)	(19)
Total return swaps	13	–	–	–	–	–	–	–
Swaptions	14,840	40	(29)	11	4,561	85	(33)	52
Options:								
Listed-purchased	26,688	20	–	20	46,619	19	–	19
Listed-written	26,226	–	(18)	(18)	47,059	–	(26)	(26)
OTC-purchased	9,299	50	–	50	4,511	87	–	87
OTC-written	14,697	–	(52)	(52)	21,764	–	(134)	(134)
Credit derivatives[1]								
Purchased	10,107	89	(91)	(2)	6,815	157	(51)	106
Sold	4,931	19	(69)	(50)	3,297	11	(120)	(109)
Total	$ 487,665	$ 4,128	$ (3,405)	$ 723	$ 409,863	$ 2,315	$ (2,090)	$ 225

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2013:

($ thousands)

Less than 3 months	$280,227
3 to 12 months	133,180
Over 1 year	74,258
Total	**$487,665**

(C) FAIR VALUE MEASUREMENT

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

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 48,701	$ –	$ –	$ –	$ 48,701
Foreign equity	90,907	19,704	11	–	110,622
Private markets					
Real estate	–	–	57,532	–	57,532
Private equity	–	–	37,054	–	37,054
Infrastructure	–	–	23,538	–	23,538
Renewable resources	–	–	2,218	–	2,218
Fixed income					
Cash and money market securities	3,321	15,710	–	–	19,031
Government and corporate bonds	–	59,191	–	–	59,191
Inflation-linked bonds	–	23,108	–	–	23,108
Other fixed income securities	–	17,943	23,540	–	41,483
Alternative investments	–	4,672	4,790	–	9,462
INVESTMENTS	$142,929	$140,328	$148,683	$ –	$431,940
Investment-related assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 5,921	$ 5,921
Interest receivable [1]	–	–	–	805	805
Dividends receivable [1]	–	–	–	352	352
Derivative-related receivables	166	3,959	3	–	4,128
	$ 166	$ 3,959	$ 3	$ 7,078	$ 11,206
Investment-related liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (5,831)	$ (5,831)
Interest payable [1]	–	–	–	(126)	(126)
Securities sold short	(2,475)	–	–	–	(2,475)
Securities sold under repurchase agreements	–	(3,215)	–	–	(3,215)
Derivative-related payables	(99)	(3,285)	(21)	–	(3,405)
Capital market debt financing:					
Short-term	–	(15,312)	–	–	(15,312)
Long-term	–	(10,533)	–	–	(10,533)
	$ (2,574)	$ (32,345)	$ (21)	$ (5,957)	$ (40,897)
NET INVESTMENTS	$140,521	$111,942	$148,665	$ 1,121	$402,249

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2012:

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
Public markets					
Canadian equity	$ 51,632	$ –	$ –	$ –	$ 51,632
Foreign equity	86,098	4,590	960	–	91,648
Private markets					
Real estate	–	–	42,091	–	42,091
Private equity	–	–	34,909	–	34,909
Infrastructure	–	–	24,109	–	24,109
Renewable resources	–	–	2,122	–	2,122
Fixed income					
Cash and money market securities	4,599	9,188	–	–	13,787
Government and corporate bonds	–	72,005	–	–	72,005
Inflation-linked bonds	–	22,309	–	–	22,309
Other fixed income securities	–	13,465	22,517	–	35,982
Alternative investments	–	4,921	1,714	–	6,635
INVESTMENTS	$142,329	$126,478	$128,422	$ –	$397,229
Investment-related assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 3,554	$ 3,554
Interest receivable[1]	–	–	–	902	902
Dividends receivable[1]	–	–	–	336	336
Derivative-related receivables	103	2,212	–	–	2,315
	$ 103	$ 2,212	$ –	$ 4,792	$ 7,107
Investment-related liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (5,584)	$ (5,584)
Interest payable[1]	–	–	–	(137)	(137)
Securities sold short	(2,425)	–	–	–	(2,425)
Securities sold under repurchase agreements	–	(7,186)	–	–	(7,186)
Derivative-related payables	(85)	(1,945)	(60)	–	(2,090)
Capital market debt financing:					
Short-term	–	(5,088)	–	–	(5,088)
Long-term	–	(17,075)	–	–	(17,075)
	$ (2,510)	$ (31,294)	$ (60)	$ (5,721)	$ (39,585)
NET INVESTMENTS	$139,922	$ 97,396	$128,362	$ (929)	$364,751

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

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

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2013 (no significant transfers during the year ended March 31, 2012).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

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

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 960	$ 6	$ (31)	$ –	$ 5	$ (115)	$ (814)	$ 11
Private markets	103,231	26,478	(10,043)	–	1,146	(470)	–	120,342
Fixed income	22,517	7,420	(6,397)	(352)	1,079	(727)	–	23,540
Alternative investments	1,714	3,155	–	–	–	(79)	–	4,790
Derivative-related receivables/payables (net)	(60)	46	(54)	–	10	40	–	(18)
Total	**$ 128,362**	**$ 37,105**	**$ (16,525)**	**$ (352)**	**$ 2,240**	**$ (1,351)**	**$ (814)**	**$ 148,665**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2012:

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ –	$ 880	$ (92)	$ –	$ 12	$ 160	$ –	$ 960
Private markets	74,401	36,134	(12,948)	–	1,176	4,596	(128)	103,231
Fixed income	20,497	6,066	(5,630)	(1,271)	255	2,600	–	22,517
Alternative investments	–	1,672	–	–	–	42	–	1,714
Derivative-related receivables/payables (net)	(43)	–	–	(18)	17	(16)	–	(60)
Total	$ 94,855	$ 44,752	$ (18,670)	$ (1,289)	$ 1,460	$ 7,382	$ (128)	$ 128,362

[1] Includes Plan Account allocation adjustments.

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 4% increase/decrease (2012 – 2% increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $53,738 thousand allocated to the Plan Account (2012 – $48,376 thousand), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2013, PSP Investments, on behalf of the Plan Account, has re-invested $11,701 thousand of collateral held (2012 – $9,803 thousand).

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

($ thousands)	**2013**	2012
Securities lending		
Securities lent	**$ 39,048**	$ 39,490
Collateral held [1]	**41,126**	41,621
Securities borrowing		
Securities borrowed	**2,475**	2,425
Collateral pledged [2]	**2,485**	2,700

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $3,215 thousand as at March 31, 2013 (2012 – $7,186 thousand).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

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

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

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

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

	2013	2012
Policy Portfolio VaR	**20.2 %**	21.7 %
Active VaR	**2.6**	2.6
Total VaR (undiversified)	**22.8**	24.3
Diversification effect	**(1.3)**	(1.6)
Total VaR	**21.5 %**	22.7 %

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

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

(i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2013:

($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 3,792	$ 18,759	$ 9,718	$ 11,720	$ –	$ 43,989
Corporate bonds	1,554	7,300	4,698	1,650	–	15,202
Inflation-linked bonds	8	5,726	6,133	11,241	–	23,108
Asset-backed securities	450	9,718	139	5	–	10,312
Private debt portfolios:						
Directly held	270	3,538	851	–	–	4,659
Held through funds [1]	–	–	–	–	9,561	9,561
Total investments with significant exposure to interest rate risk	**$ 6,074**	**$ 45,041**	**$ 21,539**	**$ 24,616**	**$ 9,561**	**$106,831**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 35,982**	**$ 35,982**
Total fixed income	**$ 6,074**	**$ 45,041**	**$ 21,539**	**$ 24,616**	**$ 45,543**	**$142,813**

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

[2] Consists of $19,031 thousand in cash and money market securities and $16,951 thousand in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in thousands of Canadian $)	2013		2012	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 80,727**	**53.3 %**	$ 73,305	57.9 %
Euro	**13,584**	**9.0**	15,025	11.9
British Pound	**11,233**	**7.4**	9,919	7.8
Brazilian Real	**6,363**	**4.2**	5,133	4.0
Japanese Yen	**6,036**	**4.0**	5,720	4.5
Hong Kong Dollar	**5,461**	**3.6**	3,812	3.0
Australian Dollar	**4,982**	**3.3**	2,282	1.8
Korean Won	**4,093**	**2.7**	2,768	2.2
Taiwanese New Dollar	**2,469**	**1.6**	–	–
Norwegian Krone	**2,255**	**1.5**	1,941	1.5
Swiss Franc	**2,016**	**1.3**	441	0.3
Indian Rupee	**1,863**	**1.2**	1,083	0.9
South African Rand	**1,604**	**1.1**	925	0.7
Mexican Peso	**1,280**	**0.9**	853	0.7
Others	**7,376**	**4.9**	3,495	2.8
Total	**$151,342**	**100.0 %**	$126,702	100.0 %

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $49,567 thousand (US$46,182 thousand, €1,220 thousand, £311 thousand, R416 thousand South African Rands and R$1,053 thousand Brazilian Reals) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

As at March 31, 2013, the Plan Account's maximum exposure to credit risk amounted to approximately $137 million (2012 – approximately $125 million). This amount excludes investments in distressed debt in the amount of approximately $7.2 million as at March 31, 2013 (2012 – approximately $7.9 million). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2013, the Plan Account had a net notional exposure of $633 thousand (2012 – $948 thousand) to various tranches of collateralized debt obligations, of which approximately 67% (2012 – approximately 61%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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

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

	2013	2012
Investment grade (AAA to BBB–)	**97.9 %**	98.2 %
Below investment grade (BB+ and below)	**1.0**	0.7
Not rated:		
Rated by a single credit rating agency	**0.1**	0.1
Not rated by credit rating agencies	**1.0**	1.0
Total	**100.0 %**	100.0 %

Counterparty Risk

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

PSP Investments' policy also requires the use of the International Swaps and Derivatives Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $379 thousand as collateral with respect to derivative contracts at March 31, 2013 (2012 – $15 thousand). Securities with a fair value of $764 thousand were received from counterparties as collateral at March 31, 2013 (2012 – $589 thousand). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2013:

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (5,831)	$ –	$ –	$ (5,831)
Interest payable	(113)	(13)	–	(126)
Securities sold short	(2,475)	–	–	(2,475)
Securities sold under repurchase agreements	(3,215)	–	–	(3,215)
Capital market debt financing	(9,133)	(6,179)	(10,533)	(25,845)
Accounts payable and other liabilities	(391)	–	(181)	(572)
Total	$ (21,158)	$ (6,192)	$ (10,714)	$ (38,064)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 2,330	$ 1,517	$ 281	$ 4,128
Derivative-related payables [1]	(1,846)	(1,039)	(520)	(3,405)
Total	$ 484	$ 478	$ (239)	$ 723

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

5 FUND TRANSFERS

PSP Investments did not receive any fund transfers from the Government of Canada for the year ended March 31, 2013 (2012 – $31,055 thousand recorded in the Plan Account) for the Fund.

6 INVESTMENT INCOME

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

($ thousands)	2013	2012
Interest income	$ 4,366	$ 4,093
Dividend income	6,412	5,243
Interest expense (Note 8)	(549)	(472)
Transaction costs	(271)	(363)
External investment management fees[1]	(201)	(186)
Other (net)	(96)	(35)
	9,661	8,280
Net realized gains[2]	12,071	5,743
Net unrealized gains (losses)	16,774	(3,222)
Investment income	**$ 38,506**	$ 10,801

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $113 thousand for the year ended March 31, 2013 (2012 – $314 thousand). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments.

Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $669 thousand for the year ended March 31, 2013 (2012 – $672 thousand).

[2] Includes foreign currency losses of $1,088 thousand for the year ended March 31, 2013 (2012 – losses of $281 thousand).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

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

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

	2013	2012
Public Service Pension Plan Account	73.0 %	72.9 %
Canadian Forces Pension Plan Account	19.3	19.4
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.6	0.6
Total	**100.0 %**	100.0 %

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

(B) OPERATING EXPENSES

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

($ thousands)	2013	2012
Salaries and benefits	$ 684	$ 541
Professional and consulting fees	66	61
Office supplies and equipment	105	85
Other operating expenses	44	36
Depreciation of fixed assets	73	52
Occupancy costs	35	31
Custodial fees	16	17
Remuneration earned by Directors	4	4
Travel and related expenses for Directors	1	2
Communication expenses	1	1
Total	**$ 1,029**	$ 830

8 CAPITAL MARKET DEBT FINANCING

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

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

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

	2013		2012	
($ thousands)	**Capital amounts to be paid at maturity**	**Fair Value**	Capital amounts to be paid at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 1.03% and 1.17% and maturing within 31 and 191 days of issuance (March 31, 2012 – 31 and 364 days)	**$ 4,555**	**$ 4,548**	$ 5,097	$ 5,088
Short-term US Dollar promissory notes, bearing interest between 0.16% and 0.24% and maturing within 29 and 189 days of issuance	**$ 5,364**	**$ 5,362**	$ –	$ –
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 5,280**	**$ 5,402**	$ 5,648	$ 5,941
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 3,696**	**$ 3,834**	$ 3,954	$ 4,080
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**$ 1,848**	**$ 1,856**	$ 1,977	$ 1,977
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**$ 4,752**	**$ 4,843**	$ 5,084	$ 5,077
Total	**$ 25,495**	**$ 25,845**	$ 21,760	$ 22,163

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

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

($ thousands)	**2013**	2012
Short-term promissory notes	**$ 57**	$ 73
Medium-term notes	**492**	399
Total	**$ 549**	$ 472

9 CAPITAL MANAGEMENT

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

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

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

10 GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $4,840 thousand has been allocated to the Plan Account. As at March 31, 2013, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2013, as part of investment transactions, PSP Investments agreed to guarantee and, in some cases, provide indemnification in connection with certain borrowing arrangements of its investees. In the event a default occurs under such borrowing arrangements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $5,275 thousand (2012 – $3,772 thousand) plus interest and other related costs. Such borrowing arrangements mature between July 2013 and July 2021.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $41 million as at March 31, 2013 (2012 – $9 million), of which $218 thousand has been allocated to the Plan Account (2012 – $55 thousand) in relation to investment transactions.

11 COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2013:

($ thousands)

Real estate	$ 6,752
Private equity	24,442
Infrastructure	10,585
Renewable resources	3,218
Other fixed income securities	3,968
Alternative investments	3,941
Total	**$ 52,906**

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