Investissements PSP Investments

2006 ANNUAL REPORT
THE PUBLIC SECTOR PENSION INVESTMENT BOARD

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

HIGHLIGHTS – FISCAL YEAR 2006

- Consolidated net assets increase 43% to $27.6 billion
- Total portfolio return is 19.1%, compared to Policy Benchmark of 18.0%
- Diversification into private assets and global investment opportunities continues
- Policy Portfolio asset mix revised to include an allocation for infrastructure
- Administrative and support systems strengthened to keep pace with growth
- Communications and Government Relations unit added to the management team
- Team building continues – number of employees increases from 75 to 138

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The legislation governing PSP Investments requires the annual report to include its objectives for the fiscal year under review, indicating to what extent they were met, and to state its objectives for the new fiscal year. This information is summarized below.

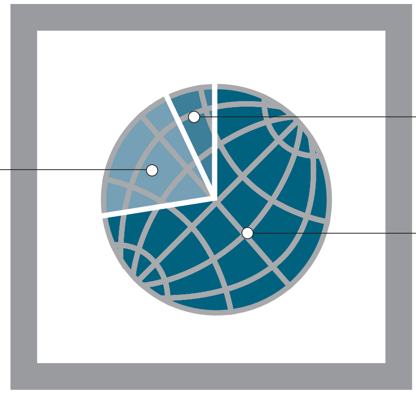
FISCAL YEAR 2006 OBJECTIVES	COMPLETED
• Continue implementing investments in real estate, private equity and other new asset classes	✓
• Further increase the level of active risk, within the authorized ceiling, in order to increase the level of returns	✓
• Develop enhanced capabilities to manage private transactions	✓
• Strengthen support staff and systems to keep pace with rapid growth of investment activities	✓

KEY OBJECTIVES FOR FISCAL YEAR 2007

- Further enhance support systems and services, with a particular focus on information technology, to reflect the increased size and complexity of the organization
- Assemble Infrastructure team and roll out infrastructure investments, while expanding investments in other private assets such as private equities and real estate
- Continue looking — with a longer-term view — for new sources of returns that will complement PSP Investments' liquidity and extended investment time horizon

PLAN ACCOUNTS' NET ASSETS

(As of March 31, 2006)
($,000)
% of total net assets



Fiscal year 2006 saw the continued rapid growth of PSP Investments and further diversification into new asset classes and new global markets. The sheer volume of net inflows to be invested — some $350 million a month — along with removal of the 30% limit on foreign content are among the factors that have necessitated moving beyond public markets to invest in assets such as private equity, real estate and infrastructure, while increasing our exposure to non-Canadian opportunities.

Paul Cantor
Chairperson

In the President's Report that follows, and throughout this annual report, we highlight the growth of PSP Investments and our achievements during the past year. On behalf of the Board of Directors, I wish to congratulate and thank our President and Chief Executive Officer (CEO), Gordon J. Fyfe, his management team and each and every member of the PSP Investments staff for their dedication and their contributions to the success of the organization.

From a governance perspective, "going global" has entailed taking steps to ensure that PSP Investments' Board — as well as management — is appropriately equipped to oversee an organization with a rapidly expanding, and increasingly complex, worldwide portfolio.

INVESTMENT SUB-COMMITTEE

One such initiative in 2006 involved the formation of a new investment sub-committee. This was done with a view to facilitating review of the steadily increasing numbers of investment transactions, while leaving more time on the Board agenda for discussions of broader investment-management policy. The sub-committee, comprised of directors with particular investment expertise, reviews real estate, private equity and infrastructure proposals presented for approval by management, summarizes them and conveys the information to the full Board, along with its recommendations with regard to the various proposals.

EDUCATION POLICY

The legislation governing PSP Investments calls for the Board to have directors with proven financial ability or other relevant experience to effectively achieve its objectives. In addition to directors with extensive investment-management experience, we need directors knowledgeable in key competencies like finance, risk management, human resources, regulatory affairs and communications. That said, investment management is PSP Investments' core business, and all Board members — regardless of their other expertise — need to continually enhance their knowledge in this critical area. Even within investment management, increased understanding of particular markets and asset classes such as real estate, private equity and infrastructure is required, given that PSP Investments now is making direct investments in these areas around the world.

Accordingly, we introduced a new Education Policy, which encourages Board members to augment their understanding of investment management. Under the policy, new directors with less extensive previous exposure to investment management are expected to take one of several available courses tailored to the particular needs of pension fund trustees. Beyond that, education will be a shared responsibility with management, which will provide training in areas of particular importance to PSP Investments, coupled with self-study initiatives to be undertaken by individual directors as appropriate.

PEER REVIEW

From the outset, PSP Investments has been committed to high standards in corporate governance. With regard to the assessment of Board performance, we previously followed a procedure whereby members evaluated the work of the Board as a whole and, more recently, the Chair's performance. During fiscal 2006, we took things a step further, instituting a comprehensive process of peer review whereby each director evaluates the individual performance of all other Board members. This robust procedure places PSP Investments in the front ranks of both private and public sector organizations with regard to performance assessment. A planned next step is to incorporate a process for evaluating the performance of the chairs of our various Board committees.

AMENDED CODE OF CONDUCT

Integrity, honesty and trust are essential elements of PSP Investment's business success, and they also form the underlying principles of the Code of Conduct that all officers and employees are bound to adhere to. In February 2006, as part of a regular review process, the Board approved amendments to the Code that stemmed from the growth of the organization, as well as changing expectations in governance. The amendments included new procedures with respect to the handling, maintenance and communication of confidential information; updated restrictions governing the personal trading of securities by employees; and new procedures for employees to report apparent instances of non-compliance.

INTERNAL POLICIES AND PROCEDURES

A Special Examination of PSP Investments' financial and management controls, systems and practices — which, according to our legislation, must be carried out at least once every six years — was completed during fiscal 2006. The Examination concluded that our framework was well developed. While a number of recommendations for enhancements were proposed, we were pleased that no significant deficiencies were identified.

LIAISON WITH PLAN REPRESENTATIVES

Gordon J. Fyfe and I met with representatives of the three pension plans in October 2005 to review events of the previous year and outline our plans and objectives for fiscal year 2007. As well, Ms. Monique Collette, current Chair of the plan representative group, attended an off-site conference with Board members and the senior management team, where she had the opportunity to participate in in-depth discussions of underlying issues of investment management.

We also formalized the process by which the Board's Governance Committee provides the plan members' Nominating Committee with information on desirable competencies for new directors needed to round out the Board. As a result, our nominating process meets the requirements of the federal government's new accountability legislation, while providing an extra layer of independence by virtue of a Nominating Committee that operates at arm's length from the Board of Directors.

ACKNOWLEDGEMENTS

In summary, fiscal 2006 was another busy and challenging year for PSP Investments and its Board of Directors. I would like to take this opportunity to express my appreciation to my fellow Board members for their hard work and wise counsel.

As the theme of this year's report indicates, PSP Investments is operating these days with much more of a world view, reflecting the reality of today's rapidly changing global investment climate. From a governance perspective, we already have been addressing this new reality, as evidenced by recent initiatives with regard to investment policy and directors' education, and by our continual review of key practices and procedures. Indeed, the Board's approval of diversification into new asset classes and new global markets is very much in keeping with PSP Investments' vision and mandate, which entail looking everywhere for opportunities to maximize returns and achieve superior investment performance, without undue risk of loss.

A crucial consideration going forward will be the need to identify and attract directors who possess the broadly-based understanding of global markets that the Board will require to address ever more complex investment management issues, provide sound advice and give informed consent.

In conclusion, I wish to reiterate the Board's commitment to building on the strong foundations already in place and delivering the very highest standards of corporate governance, appropriate to changing times and circumstances.

Paul Cantor
Chairperson

This is my third President's Report since joining PSP Investments as President and CEO in late 2003. Over the intervening 30 months, my colleagues and I, working in collaboration with the Board, have made numerous changes to the investment portfolio — always with a view to improving the fund's projected long-term returns. Although it will be some time yet before the full impact of these changes is evident, we have begun to see beneficial results in the form of strong returns from investments in new asset classes.

Gordon J. Fyfe
President and Chief Executive Officer

The return on the Consolidated Pension Plan Account for fiscal year 2006 was 19.1%, while investment income created during the year was $4.14 billion. This compares to a consolidated account return of 7.9% and investment income of $1.35 billion in fiscal year 2005. Noteworthy contributions to our results for fiscal 2006 came from emerging-market equities, which delivered returns of 39.6%, and from real estate, at 21.6%. Canadian equities, U.S. small-capitalization equities and non-North American equities also performed well. All the teams involved are to be commended for their contributions to a successful year.

The rate of return for the Consolidated Pension Plan Account for fiscal 2006 was 1.1% above the return of the Policy Benchmark of 18.0%. Over the past three fiscal years, the fund's total return has averaged 0.9% above the Policy Benchmark return of 16.6%.

While I am pleased with the results for the latest fiscal year, I wish to reiterate that the changes we have been making are aimed primarily at generating enhanced long-term performance. The goal is to achieve a 4.3% rate of return, after inflation. Over the past three fiscal years, PSP Investments has returned an annualized 17.5%, or 15.5% after inflation.

PRESIDENT'S REPORT

CONTINUED DIVERSIFICATION AND GLOBALIZATION

By the end of fiscal year 2006, approximately $2.7 billion had been committed to private equity. Although less liquid than public-market investments (the cycle from investment to return of capital can extend up to 12 years in some cases), private equity offers the prospect of superior long-term returns, enabling us to take advantage of PSP Investments' unique liquidity and its long investment time horizon. While we have high expectations for the returns from this portfolio, it will be a number of years before we begin to see the full benefit of the efforts PSP Investments' Private Equity team is currently making.

Approximately $1.9 billion had been invested in real estate as of March 31, 2006, up from $429 million a year earlier. The attraction of real estate to a pension fund like ours is that it's an inflation-sensitive investment. Our expanding global real estate portfolio includes quality residential and commercial assets in Canada, the United States, Europe and Asia. Holdings range from light-industrial complexes to retirement residences, hotels, office towers and high-end residential buildings in cities such as Calgary, New York and Tokyo. PSP Investments' Real Estate team is still actively investing to achieve the 10% target weight set by the Board, but our efforts of fiscal 2006 brought us a long way towards meeting that objective.

Our diversification away from public markets continued this year with the introduction of an 8% Policy Benchmark target in infrastructure. Examples of typical investments in the infrastructure asset class range from airports, highways and ports to pipelines and power plants. Like real estate, infrastructure investments are inflation-sensitive — revenues earned tend to increase with inflation — are generally long-term in nature and require large outlays of capital.

In the wake of a federal government decision to drop the 30% limit on the foreign content of pension funds, assets may now flow around the world to where they can generate the best returns. Here again, PSP Investments' Policy Benchmark has changed to reflect this development. We have become decidedly more global in terms of seeking out the best investment opportunities by increasing our non-Canadian target allocations to small-capitalization equities, fixed income and world inflation-linked bonds.

Our target allocation to less liquid assets — real estate, private equity, infrastructure, small caps and emerging market equities — now represents a combined 40%. These new allocations are quite a departure from the 97% of assets that were invested in liquid large-cap, public equity markets and Canadian government bonds just over two years ago. Our target allocation to inflation-sensitive assets – real estate, infrastructure and inflation-linked bonds — has increased from zero to 23% of assets over the same period.

ENSURING THAT ADMINISTRATIVE AND SUPPORT SYSTEMS KEEP PACE

To help sustain this ongoing diversification and globalization, we have been strengthening the requisite support and administrative systems in key areas like finance, legal, taxation, information technology, human resources, communications and government relations.

Net assets under management totaled $27.6 billion at the end of fiscal 2006. Given the expected level of inflows and conservative estimates of future returns, the net asset figure is projected to exceed $40 billion in another three years and will likely hit the $100-billion mark within 10 years. Consequently, we are managing the organization not only to generate returns on the net assets under management today, but also in preparation for what PSP Investments will become in the future. This means focusing not only on the scope of resources but — even more importantly — the quality of those resources. In short, we are building for the future.

That said, however, our essential corporate infrastructure is now in place and the job of assembling a senior management team largely completed. As of March 31, 2006, PSP Investments had 138 employees, compared with 75 a year earlier. In addition to the administrative areas I alluded to earlier, we have added leadership for the infrastructure asset class over the past year, as well as expanding internal management of public markets. The challenge now is to build on that foundation, so that we are able to provide the strategic direction, support and oversight appropriate to an organization with considerably increased scope, scale and sophistication of operations.

In that regard, we were encouraged by the findings of a legislated mandatory Special Examination of PSP Investments' controls, systems and practices that was carried out over the past fiscal year. In a final report issued in November 2005, the examiners not only concluded there were no significant deficiencies, but also noted that we have "continued to build a team that has the depth and specialized expertise required to manage an expanding, increasingly diversified pool of assets within a growing organization."

One of my stated priorities when I became CEO was to build a strong management team. I believe we now have the pool of talent we require to succeed and a culture that will enable us to do so. Indeed, I am pleased that many of the strategies being put in place today have sprung from the minds of key personnel attracted over the past couple of years. We are committed to maintaining the entrepreneurial culture that has enabled us to quickly evolve into a dynamic, results-oriented organization. At the end of the day, the bottom line here at PSP Investments — our raison d'être — is returns.

PRIORITIES FOR FISCAL YEAR 2007

Much of our recent focus has been on growing the investment side of the organization. For the balance of fiscal 2007— and probably for the following year as well — we will be increasingly focused on the support side of things, particularly information technology, to ensure that we have the robust, state-of-the-art systems and procedures required to support continued growth. At the same time, however, we will be rolling out and ramping up new investment categories. Going forward, the prospects for returns from traditional asset classes are diminishing, so we must continue to look for new sources of returns that complement PSP Investments' liquidity and long-term investment time horizon.

ACKNOWLEDGEMENTS

In closing, I wish to thank the entire PSP Investments team for their hard work and commitment throughout another busy and successful year. I also would like to formally welcome Bruno Guilmette, Vice President, Infrastructure Investments, and Anne-Marie Laurendeau, Director, Communications and Government Relations, both of whom joined our team during fiscal 2006. I am also grateful to the Board of Directors for its continued support and to our Chairman, Paul Cantor, for his dedication and guidance throughout the year. And finally, I would like to remember Josée Dufresne, a wonderful member of our Real Estate team, who recently passed away. Josée reminded us all of the difference a single person can make.

Gordon J. Fyfe
President and Chief Executive Officer

PSP Investments completed its sixth year of operation on March 31, 2006. During that period, it received $4.2 billion in net contributions from the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. The market value of invested net assets as of March 31, 2006 totaled $27.6 billion, compared with $19.4 billion a year earlier.

MARKET PERFORMANCE

Fiscal year 2006 saw a continuation of essentially the same major underlying economic and investment themes that had prevailed during the previous year.

Even though world gross domestic product (GDP) has been expanding at a satisfactory level, the significant imbalances that exist between some of the world's major economic regions continue to surprise observers. For instance, the United States is running twin trade and current-account deficits equivalent to approximately 9.5% of GDP, while Asia is running a huge surplus.

The U.S. now attracts about 70% of world savings. Asian central banks hold massive reserves of U.S.-dollar-denominated debt, and the Bank of China has just displaced the Bank of Japan as the biggest holder of U.S. dollars.

Meanwhile, the world is awash in liquidity. This situation tends to compress the liquidity premium in all markets, as more money chases the same finite opportunities worldwide. This environment could well persist for the next year, maintaining pressure on risk premiums.

Most central banks in the developed world either initiated or maintained a tightening trend with regard to monetary policy during fiscal year 2006. The U.S. Federal Reserve raised rates eight times during the period, by a total of 2 percentage points. The Fed Fund rate now stands at 4.75% — it was at 1% in June 2004.

Both the European Central Bank (ECB) and the Bank of Canada started their own tightening campaigns. Beginning in December 2005, the ECB raised rates twice. Meanwhile, the Bank of Canada raised its overnight rate five times between September 2005 and the end of fiscal year 2006, during which the rate climbed from 2.5% to 3.75%. As well, the Bank of Japan announced that it intended to cease its quantitative easing policy as soon as possible, which could well bring an end to the low interest rates that have prevailed in that region of the world.

Surprisingly, the rate increases in the short end of the spectrum did not translate into higher long-term bond yields. The result was a significant flattening of yield curves in Canada and the United States. The demand for long-dated, fixed-income instruments is probably responsible for this special situation.

The increased pace of rate hikes helped support demand for the U.S. dollar, which gained 1% on a trade-weighted basis. The Canadian dollar — well supported by merger-and-acquisition activities, higher oil prices and generally higher commodity prices — gained 3.5% against the U.S. dollar, 9.8% against the Euro and almost 14% against the Japanese yen.

Commodities showed high levels of volatility. For instance, in futures markets, the natural gas price went from $7.20 to a high of $15.78 and then back to $7.20, all in the same fiscal year. The oil price increased by 15% over that same period. Copper and gold were up 81% and 36%, respectively.

The Canadian stock market, as reflected by the S&P/TSX total return Index, gained 28.6% during fiscal year 2006, mostly driven by the energy (+55%), materials (+34%) and financial (+27%) sectors. On U.S. markets, meanwhile, the S&P 500 total return Index gained 11.7% in local currency, and the Dow Jones Industrial Index was up 8.3%.

FISCAL YEAR 2006 RESULTS

INVESTMENT RESULTS

In fiscal year 2006, the Consolidated Pension Plan Account produced investment income of $4.1 billion, before expenses. This compares with investment income of $1.3 billion generated in fiscal 2005. The net increase of $2.8 billion reflects a consolidated rate of return of 19.1% for the Consolidated Pension Plan Account in fiscal 2006, surpassing the return of 7.9% recorded in fiscal 2005.

PERFORMANCE MEASUREMENT AND EVALUATION

PSP Investments uses rigorous performance measurement as an essential tool for management to evaluate its investment strategies, as well as its internal and external managers.

BENCHMARKS

- PSP Investments' Statement of Investment Policies, Standards and Procedures (SIP&P) defines the relevant benchmark for each of the asset classes.
- The return for each asset class is compared against the relevant benchmark return.
- A combined Policy Benchmark is calculated by taking into account the asset class benchmarks and the asset class weights as established in the SIP&P.
- The Consolidated Pension Plan Account return is compared to the Policy Benchmark return.

RATES OF RETURN ON CONSOLIDATED PENSION PLAN ACCOUNT (AS OF MARCH 31, 2006)

	One year		Four-Year (annualized)	
	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
Equities (Developed world, small cap, emerging markets, private equity)	24.6	24.3	8.8	8.6
Fixed Income (Cash & cash equivalents, world government bonds, Canadian fixed income)	4.4	4.5	7.0	6.8
Real Return Assets (World inflation-linked bonds, real estate, infrastructure)	17.5	9.7	n/a*	n/a*
Total Return	**19.1**	**18.0**	**8.8**	**8.4**

These are time-weighted rates of return, before fees and expenses, for the consolidation of the three pension plan accounts. They are calculated in accordance with the performance calculation methodology recommended by the CFA Institute, and are audited as such. The total portfolio return includes the performance impact of absolute return strategies.

* PSP Investments began investing in real-return assets in October 2003. Accordingly, annualized 4-year returns will not be available before 2007 for this asset class.

RATE OF RETURN

In fiscal year 2006, the rate of return for the Consolidated Pension Plan Account was 19.1%. The account outperformed its Policy Benchmark — which returned 18.0% — by 1.1%. Since inception, the account generated a rate of return of 5.5% compared to the benchmark's return of 5.3%.

The improved performance achieved during fiscal 2006, in both absolute and relative terms, reflects the benefits of a more diversified portfolio with regard to asset classes and strategies. Over the course of the year, initiatives were implemented to increase the allocation of capital to private investments and to develop absolute-return strategies. In fiscal year 2007, PSP Investments will continue to ramp up investments in asset classes such as private equities and infrastructure in order to achieve the long-term target weights established in the Policy Portfolio.

CHANGES IN NET ASSETS

The Consolidated Pension Plan Account began fiscal year 2006 with net assets of $19.4 billion at market value. Consolidated net contributions during the year added $4.2 billion. After factoring in the net income from operations, consolidated net assets as of the fiscal 2006 year-end were $27.6 billion at market value.

EXPENSES

The cost of operating PSP Investments during fiscal year 2006 totaled $79.1 million, compared to $35.1 million in fiscal year 2005. That total includes operating expenses ($39.3 million in fiscal year 2006 versus $20.8 million in 2005) and external investment management fees ($39.9 million in fiscal year 2006 versus $14.3 million in fiscal year 2005). The higher costs can be attributed primarily to the growth in assets under management and to a continuing shift to actively managed assets, which entail considerably higher expense than passive mandates. Actively managed assets, such as absolute return mandates, international equities and private investments, experienced the highest growth in fiscal 2006. Although these actively managed asset classes are generally more expensive to manage, they offer the potential of higher returns.

In fiscal year 2006, expenses amounted to 0.342% of average assets — or 0.170% of average assets, when external investment management fees are excluded (compared with 0.211% and 0.125%, respectively, in fiscal year 2005).

Expenses will continue to increase in fiscal year 2007 due to the following factors:

1. An increase in externally managed active mandates for public markets, primarily in the foreign equity and absolute-return asset classes;
2. An increased allocation to private assets, which necessitated the building of a new Infrastructure investment team, the formation of a Real Estate debt team and staff additions for the Private Equity team to support co-investments and monitor existing investments;
3. A general increase in the volume of investments in the absolute-return, international equities and private investment asset classes; and
4. An increase in technology-related expenditures to effectively support new and existing asset classes, to ensure a secure, robust and efficient technology platform, and to enable the organization to properly manage enterprise-wide data through a period of sustained growth.

PSP Investments remains vigilant with regard to expenses and is committed to maintaining tight financial controls. However, the organization remains in a ramp-up mode. Investment activities undertaken by PSP Investments are as complex and diversified as those of larger funds/plans but, as yet, without the critical asset base over which to spread the requisite costs. With assets forecast to continue increasing at a significant rate over the next few years and the continued deployment of funds in newly created asset classes, we expect PSP Investments' expense ratios (as a percentage of assets) to gradually decrease.

This section summarizes the statutory investment objectives of PSP Investments as well as the policy and strategy being used to achieve these objectives. A complete review of investment strategy carried out during fiscal 2005 led to the development of a revised asset-mix policy, which includes allocating more money to asset classes that are less liquid and provide greater protection against inflation. In fiscal 2006, the Policy Portfolio was further revised to encompass infrastructure investments and to authorize increased exposure to non-Canadian investment opportunities. As well, management continued to implement and expand its active-management strategy, which focuses on the efficient utilization of active risk in order to generate returns in excess of those of the Policy Portfolio.

INVESTMENT OBJECTIVES

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

- To manage funds in the best interests of contributors and beneficiaries under the plans; and
- To maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the pension plans and the ability of those plans to meet their financial obligations.

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

1. ***Absolute Performance***: Achieving a return (net of expenses) at least equal to the actuarial rate of return as determined by the Chief Actuary of Canada; and
2. ***Relative Performance***: Achieving a return exceeding the Policy Benchmark return by 0.50% (with a minimum value-added component equal to expenses).

These two objectives were met in fiscal 2006.

ASSET MIX POLICY

In fiscal year 2006, the Canadian government removed the 30% limit imposed on the foreign content of registered pension plans. This enabled PSP Investments to review its asset allocation.

The ultimate objective of any defined-benefit (DB) plan is to achieve and maintain a positive funded status — i.e. the difference between the market value of assets and the present value of liabilities — at the lowest possible cost to the plan sponsor. PSP Investments utilized the opportunity afforded by the removal of the foreign content limit to work closely with the Office of the Chief Actuary in order to better understand the liability structure of the three pension funds whose contributions it is responsible for investing.

Among the key conclusions in that regard, it was established that:

- The three funds are the youngest in Canada — and among the youngest in the world. They therefore exhibit specific features not attributable to more mature plans. The duration of their liabilities is around 20 years, compared with the average 12-15 year duration of typical DB plans in Canada, the United States and Europe.
- Forecasted net contributions remain positive for the next 28 years.

Such lengthy duration drives the need for inclusion in the portfolio of long-term assets with bond-like cash-flow structure, which will respond symmetrically to movements in real interest rates. Accordingly, amendments to the Policy Portfolio approved by the Board of Directors during fiscal 2006 introduced infrastructure as a new asset class, in recognition of its diversification benefits and better liability-matching characteristics. The latest amendments also reflected the new opportunities created by the removal of the foreign-content limits to geographically diversify investments in fixed-income instruments, small-capitalization equities and real-return bonds.

INVESTMENT POLICY AND STRATEGY

At the same time, targets for Canadian fixed-income investments and EAFE large-cap equities have been reduced. The changes are designed to enable PSP Investments to fully participate in and benefit from the ongoing trend to globalization. Other new asset classes could be added in the future.

The Board of Directors approved the amended asset-mix policy in February 2006. PSP Investments' Statement of Investment Policies, Standards and Procedures (SIP&P) may be viewed on PSP Investments' website: **www.investpsp.ca** under Investments – Investment Policy.

REVISED POLICY PORTFOLIO

The changes are reflected in the revised Policy Portfolio depicted below, which shows the market exposure of the various asset classes in the approved weightings. This market exposure will be achieved using both internal and external managers, by investing in both physical and synthetic assets and by employing both active and passive strategies.

Name	Asset Class	Long-term target weight	Long-term range
Developed World Equity (Total)		**40%**	
	Canadian Equity	30%	24–36
	US Large Cap Equity	5%	4–6
	EAFE Large Cap Equity	5%	4–6
Small Cap Developed World Equity		**7%**	5–9
Emerging Markets Equity		**7%**	6–8
Private Equity		**8%**	6–10
Nominal Fixed Income (Total)		**15%**	
	Cash & Cash Equivalents	2%	0–4
	World Government Bonds	5%	3–7
	Canadian Fixed Income	8%	4–12
Real Return Assets (Total)		**23%**	
	World Inflation-linked Bonds	5%	3–7
	Real Estate	10%	5–15
	Infrastructure	8%	5–11

Until the phase-in is complete, there will be discrepancies between long-term policy and actual asset allocations for these asset classes. Existing Policy Portfolio weightings will be drawn down to bring these asset classes to their respective long-term policy weightings during the transition period.

In December 2005, the composition of the S&P/TSX Composite Index was altered to include 72 income trusts. Initially, 50% of the trusts' market capitalization was included in the index and the remaining 50% was added in March 2006. PSP Investments has decided to authorize its portfolio managers to determine which income trusts are suited to their respective portfolios, rather than requiring them to hold a broader range of income trusts by including them in the benchmark.

ACTIVE MANAGEMENT STRATEGY

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

Active-management activities involve both internal and external managers and are not limited to the asset classes of the Policy Portfolio. They include mandates in other spheres such as currency management and tactical asset-allocation across countries and asset classes.

Indeed, PSP Investments believes that the best way to achieve its active management target is through the diversification of its revenue sources. That process continued in fiscal year 2006, with active mandates awarded to eight new external managers and the addition of four new internal processes. The value at risk increased by about 50% in dollar terms but only by 10% when expressed in basis points, due to the increase in assets under management.

INVESTMENT RISK MANAGEMENT

A critical aspect of the revised asset-mix policy and active-management strategy is PSP Investments' focus on measuring and managing investment risk. A fundamental law in investing is that the search for returns necessarily involves taking on some level of risk. In this context, risk is not something to be avoided. Rather, it is something to be managed, intelligently and efficiently, in the quest for superior investment performance.

The risk-management philosophy at PSP Investments has evolved constantly since the organization's inception. A rigorous process is in place, overseen by a dedicated team of professionals and supported by the appropriate systems. Risk is measured at all levels, from individual stocks up to total PSP Investments assets. The diversification benefits of investment in different asset classes and investment styles also can be quantified.

During fiscal year 2006, we further enhanced the rigour and scope of the risk-management process to reflect PSP Investments' continuing diversification into new asset classes such as real estate and infrastructure. In addition to monitoring and measuring market risks, we now have in place a team that focuses on credit risks incurred in both public and private market investments.

The main benefit of the process is that new opportunities – in terms of asset classes, investment styles and individual managers – can be evaluated with regard to the additional risk they entail and the potential rewards and/or diversification benefits they offer.

By following the risk-management process, PSP Investments is able to optimize its investment structure, with a view to maximizing returns for a given level of risk.

Effective governance is essential in order to safeguard the capital entrusted to PSP Investments and to ensure that appropriate objectives are pursued and achieved in line with the fulfillment of its legislated mandate. This section of the annual report presents pertinent information on PSP Investments' mandate, the roles of the Board of Directors and Board Committees and key policies designed to guide the organization's activities and behaviour.

LEGISLATED MANDATE

The legislated mandate of PSP Investments is:

- To manage funds received "in the best interests of the contributors and beneficiaries" of the three Plans; and
- To invest "with a view to achieving a maximum rate of return without undue risk of loss, having regard to the funding, policies and requirements of the Plans… and the ability of those Plans to meet their financial obligations."

RELATIONSHIP TO PENSION PLANS

Effective April 1, 2000, the federal government created three new pension funds – one each for the existing Public Service, Canadian Forces and Royal Canadian Mounted Police (RCMP) pension plans. These pension funds receive the employer and employee contributions in respect of each plan to provide for liabilities for service after April1, 2000. The balances (that is, contributions after payment of benefits accrued since April 1, 2000 and after plan administration expenses) are transferred to separate accounts at PSP Investments, to be invested in accordance with the approved investment policy and strategy.

The government is the sponsor and administrator of the Plans. The President of the Treasury Board is responsible for the Public Service Plan, the Minister of National Defence for the Canadian Forces Plan, and the Minister of Public Safety for the RCMP Plan.

The President and CEO and the Chairperson meet once a year with the Advisory Committees of the Plans. Ongoing communication also is in place with the Chief Actuary of Canada and with Treasury Board officers.

ACCOUNTABILITY AND REPORTING

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

SELECTION OF DIRECTORS

A Board of Directors comprised of 12 members, including the Chairperson, governs PSP Investments. At March 31, 2006, 11 board positions were occupied and the nominating process to fill current and anticipated vacancies was ongoing. The Governor in Council appoints all members on the recommendation of the President of the Treasury Board. Qualified candidates for directorship are selected and recommended to the President of the Treasury Board by an eight-member Nominating Committee that operates at arm's length from the Board of Directors. PSP Investments' legislation disqualifies as directors members of the Senate, the House of

Commons and provincial legislatures, federal government employees and those entitled to benefits from the three Plans. (The list of current Directors may be found on page 62.)

Biographical information about each of the Directors may also be viewed on PSP Investments' website: **www.investpsp.ca** under About Us – Board of Directors.

DUTIES OF DIRECTORS

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

- Appointment of the CEO;
- Approval of a written Statement of Investment Policies, Standards and Procedures;
- Approval of strategies and benchmarks for achieving investment performance objectives;
- Adoption of appropriate policies for the proper conduct and management of PSP Investments, including a Code of Conduct, Conflict of Interest Procedures and risk-management policy;
- 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;
- Preparation and approval of quarterly and annual financial statements for each underlying pension plan account and for PSP Investments as a whole.

BOARD COMMITTEES

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

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

Recommendations of Board committees are subject to the approval of the full Board. The Investment Committee includes all the members of the Board. The composition of the other committees is set out on page 62 of this report.

The Investment Sub-Committee was formed during fiscal year 2006, with a view to facilitating and expediting review of the steadily increasing numbers of investment transactions, while leaving more time on the Board agenda for discussions of broader investment-management policy. The sub-committee, comprised of directors with particular investment expertise, reviews all individual transactions presented for approval by management, summarizes them and conveys the information to the Board, along with its recommendations with regard to the various proposals.

All of PSP Investments' directors would be considered to be "independent" for the purposes of Canadian securities legislation. One of the directors, Carol Hansell, although an independent member of the board of directors, would not be considered to be an independent member of the Audit and Conflicts Committee as she is a partner of a firm which provides legal advisory services to subsidiaries of PSP Investments from time to time. The contribution that Ms. Hansell could make to the Audit and Conflicts Committee was regarded as important and, as the remaining four members of the Audit and Conflicts Committee would be considered independent, in our view, any conflict of interest that might arise could be handled by our well-developed conflict of interest procedures. The fees paid by the PSP subsidiaries to Ms. Hansell's firm are not material to either party. However, in order to achieve the highest governance standard, Ms. Hansell is no longer a member of that Committee. The Human Resources and Compensation Committee is composed entirely of independent directors.

Further information relative to PSP Investments' committees, including their specific terms of reference, may be viewed on PSP Investments' website: **www.investpsp.ca** under Governance – Duties & Responsibilities.

DIRECTORS' COMPENSATION

The approach to director remuneration adopted by the Board, on the recommendation of the Governance Committee, reflects key requirements of the *Act*, which state that: (a) the Board should include: a "sufficient number of directors with proven financial ability or relevant work experience such that the Board will be able to effectively achieve its objectives"; and (b) that directors' compensation should be set "having regard to the remuneration received by persons having similar responsibilities and engaged in similar activities".

The Board reviews directors' compensation once every two years and considers whatever changes may be warranted based on a report and recommendations provided by the Governance Committee. The most recent review was conducted in fiscal year 2004 and in 2005 there were no significant changes. Each director receives an annual retainer of $20,000 and meeting fees of $1,500 for each Board of Directors' meeting and $1,000 for each committee meeting. However, only a single fee is paid when Board and Investment Committee meetings are held concurrently. Should a Board meeting or any standing or ad hoc committees of the Board last less than one hour, the meeting fee is reduced to $500. In recognition of the significant additional time and responsibility demanded of the chairs of Board committees, committee chairs receive an additional retainer of $7,500 per year.

The Board Chairperson – who is responsible for the effective overall operation of the Board and its activities, as well as for the relationship between the Board and management, and for PSP Investments' reporting relationship to its stakeholders – is paid a total of $98,000 per annum in recognition of those services, while foregoing all other retainers and meeting fees.

The Board met 11 times during fiscal year 2006 and its Committees held 20 meetings. In recognition of the added impact on Board members who are not from central Canada, an additional fee of $1,000 is paid to directors who attend a meeting in person if their primary residence is not in Quebec or Ontario.

The compensation paid to directors during fiscal year 2006 is summarized in Note 7(a) to the financial statements of PSP Investments. The Terms of Reference for the Board Chairperson and for the Board of Directors may be viewed in their entirety on PSP Investments' website: **www.investpsp.ca** under Governance – Duties & Responsibilities.

CONFLICT OF INTEREST PROCEDURES FOR DIRECTORS

The Conflict of Interest Procedures for Directors are derived from the *Act* and are intended to provide a workable process for identifying, minimizing and resolving potential conflicts of interest. They help ensure that directors have a full understanding and appreciation of PSP Investments' principles and values to assist them in determining appropriate business practices and behaviour.

The Conflict of Interest Procedures for Directors sets out in detail the statutory and fiduciary duties of the directors relating to conflicts of interest. The Conflict of Interest Procedures include a requirement for the provision of written notice by directors to the Board of Directors of the nature and extent of the directors' interest in a transaction or proposed transaction; prohibit directors from voting on a resolution or participating in a discussion relating to any transaction involving their interests; require the disclosure of any other business activity which, directly or indirectly, affects the activities of, or is in competition with, PSP Investments; require the abstention from voting and the physical absence from discussions relating to any resolution if the director has a conflict of interest. The Governance Committee of the Board of Directors is responsible for monitoring the application of these procedures.

The Conflict of Interest Procedures may be viewed in their entirety on PSP Investments' website: **www.investpsp.ca** under Governance – Conflict of Interest Policy.

ASSESSMENT OF BOARD PERFORMANCE

The regulations adopted under PSP Investments' governing legislation require that the Board of Directors set out in the annual report the procedures in place for the assessment of its own performance. A formal performance evaluation policy, adopted in accordance with those requirements, focuses on procedures designed to encourage frank and confidential discussions between the Chairperson and individual directors, as well as between the Chairperson and the President and CEO of PSP Investments.

To facilitate the assessment process, guidelines for evaluating the performance of the Chairperson and of the Board as a whole are distributed once a year to every director as well as to the President and CEO. The guidelines take the form of a questionnaire. Directors submit their completed questionnaires to the Chair of the Governance Committee, who summarizes the information and presents it to the Board of Directors. The discussion focuses on concerns and opportunities for improvement, what is working properly or has improved since previous assessments. During fiscal 2006, the board-review process was expanded, with each director also required to evaluate the individual performance of all other Board members. A planned next step is to incorporate a process for evaluating the performance of the chairs of Board committees.

CODE OF CONDUCT

In accordance with its governing legislation, PSP Investments has a Code of Conduct for officers and employees. As well as ensuring stringent compliance with the relevant statutory requirements, the Code serves as a framework that provides officers and employees with a full understanding of the organization's corporate principles and values to assist them in determining appropriate business practices and behaviour. It includes a whistle-blowing provision, designed to encourage officers and employees to step forward and report any questionable practices or apparent instances of non-compliance. The Code also provides that an employee may report non-compliance with the Code or questionable financial practices to the Chair of the Audit Committee in all confidentiality in accordance with PSP Investments' whistle-blowing Procedures.

In fiscal year 2006, the Board of Directors reviewed the Code and a number of amendments were made to take into account the continued growth in the number of employees and volume of assets entrusted to PSP Investments' management, as well as the changing nature of the investment business.

Among other things, the Code deals with overall honesty and integrity; compliance with the Code and the law; conflict-of-interest procedures for officers and employees; the integrity of accounting records and financial information; the handling and use of confidential information; prohibitions on insider trading; the reporting of personal investment transactions; receiving or giving entertainment or gifts; membership in nonprofit associations; political activities; and dealings with public officials. As well, PSP Investments maintains a restricted list of securities in respect of which the organization has confidential knowledge. Officers and employees are prohibited from trading in securities on the restricted list.

The Audit and Conflicts Committee is responsible for monitoring the application of the Code.

The Code of Conduct may be viewed on PSP Investments' website: **www.investpsp.ca** under Governance – Code of Conduct.

PROXY VOTING GUIDELINES

The Proxy Voting Guidelines are designed to ensure that shares beneficially owned by PSP Investments will be voted in accordance with its investment policy and objectives.

The Guidelines stipulate that PSP Investments will give due consideration to corporate governance principles when considering the merits of an issue and will exercise its voting rights with a view to maximizing the value of its shareholdings. The Guidelines focus on four areas considered crucial in terms of their potential impact on performance:

- The independence, size and effectiveness of a company's board of directors;
- Management and directors' compensation, including stock options and incentive compensation plans;
- Takeover protection; and
- Shareholder rights.

The Guidelines apply equally to securities managed internally and those held in portfolios managed for PSP Investments by external managers.

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

POLICY ON SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

The primary responsibility of PSP Investments is to provide for the financial benefit of contributors and beneficiaries of the Plans from which it receives funds, and to support the fulfillment of the pension promise explicit in those plans. That responsibility notwithstanding, the Policy on Social and Environmental Responsibility states that "…we believe that the adoption of socially responsible policies and practices in the corporations and entities in which we invest will enhance long-term shareholder value."

The Policy on Social and Environmental Responsibility may be viewed on PSP Investments' website: **www.investpsp.ca** under Investments – Policy on Social & Environmental Responsibility.

SPECIAL EXAMINATION

As provided in subsection 44(1) of the *Act**, the President of the Treasury Board is required to cause a Special Examination to be carried out at least once every six years in respect of PSP Investments and its subsidiaries.

This is not an audit in the conventional sense. Rather, the purpose of the Special Examination is to determine if the financial and management control and information systems and management practices, referred to in paragraph 35(1)(b) of the *Act*, "were... being maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 35(2)(a) and (c)" of the *Act*.

There are three phases to the Special Examination process: Phase I, completed in fiscal 2005, entailed the definition of focus areas; Phase II, the actual examination, was carried out during the first half of fiscal 2006; Phase III entailed reporting the findings. The Special Examination Report, dated November 15, 2005, found that there were no significant deficiencies in PSP Investments' systems and practices.

*In June 2005, as legislated by the *Budget Implementation Act, 2005* – Bill C-43 (assented to June 29, 2005), sections 36 to 46 of the *Act* were repealed and Section 3(6) was amended to state that Sections 132 to 147 of the *Financial Administration Act* (*FAA*) applied to PSP Investments. Pursuant to the *FAA*, a special examination must now be carried out at least once every five years (s.138 (2))

A

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

Active Investment Management
The application of manager skill in selecting investments, with the goal of earning higher returns than the general market.

Active Risk
The probability of investment losses relative to a benchmark from active investment management.

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

Annualized Rate of Return
A rate of return expressed over one year, although the actual rates of return being annualized are for periods longer or shorter than one year.

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

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

B

Basis Point
One-hundredth of a percentage point. The difference between 5.25 per cent and 5.50 per cent is 25 basis points.

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

C

CFA Institute
The CFA Institute (CFAI) is an international, nonprofit organization of more than 70,000 investment practitioners and educators in over 100 countries. The investment performance standards of CFA details methodology and guidelines that promote uniformity in reporting investment performance.

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

Cost Value (or Book Value)
The purchase price, or original cost, of an investment.

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

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

D

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

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

E

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

F

Fair Value (or Market Value)
The most recent price at which a security transaction took place.

Fiscal Year
A company's accounting or financial reporting year. Our fiscal year commences April 1 and ends March 31.

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

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

I

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

Index Fund
An investment fund that closely replicates the return of a market index.

Inflation-Linked
That has a behavior highly correlated with inflation.

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

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

M

Market Risk
Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, or factor affecting all securities traded in the market.

GLOSSARY

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

O

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

P

Passive Investment Management
A strategy designed to replicate a market index return by gaining exposure to individual securities in proportions that closely resemble their composition in an underlying index.

Pension Plan Account (or Plan Account)
Separate account established by PSP Investments for each of the pension plan funds to receive the pension fund's net contributions as well as the allocation of its investments and the results of its operations. There are three (3) pension plan accounts, one for each pension plan fund.

Pension Plan Fund
Created effective April 1, 2000 by the federal government to receive the employer and employee contributions in respect of the pension plans to provide for liabilities for service after April 1, 2000. There are three (3) pension plan funds, one for each of the Public Service Pension Plan; the Canadian Forces Pension Plan and the Royal Canadian Mounted Police (RCMP) Pension Plan.

Pension Plans (or Plans)
The pension plans of the federal Public Service, the Canadian Forces and the Royal Canadian Mounted Police.

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

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

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

Private Equity
Ownership interest in assets that do not trade on public exchanges or over the counter.

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

R

Return (or Rate of Return)
The percentage change in assets in a particular period, consisting of income (such as interest, dividends or rent), plus realized and unrealized capital gains or capital losses.

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

Risk-Adjusted Return
A measure of investment return adjusted to reflect the risk that was assumed to produce that return.

S

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

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

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

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

T

Time-Weighted Rate of Return
A return calculation methodology that eliminates the impact of cash flows into (or out of) a portfolio. This methodology recognizes the fact that managers have no control over the size and timing of cash flows.

V

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

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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 and the Royal Canadian Mounted Police 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, 2006, were in accordance with the *Act* and the SIP&P.

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

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

Gordon J. Fyfe
President and Chief Executive Officer
April 28, 2006

John Valentini
First Vice President and Chief Financial Officer
April 28, 2006

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, 2006, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures*".

Paul Cantor
Chairperson
May 10, 2006

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Public Service Pension Plan Account (the "Public Service Pension Plan Account") as at March 31, 2006 and the Statements of Net Income and Accumulated Net Income from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's ("PSP Investments") management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2006 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the 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, as appropriate, the *Public Sector Pension Investment Board Act* (the "*Act*") and regulations and the by-laws of PSP Investments.

Deloitte & Touche LLP

Chartered Accountants
Toronto, Ontario
April 28, 2006

BALANCE SHEET

As at March 31, 2006

($000's)	2006	2005
ASSETS		
Investments (Note 2)	$20,268,133	$13,977,850
Other assets (Note 3)	2,600	1,659
Due from the Canadian Forces Pension Plan Account (Note 6a)	3,124	2,071
Due from the Royal Canadian Mounted Police Pension Plan Account (Note 6a)	1,111	737
TOTAL ASSETS	$20,274,968	$13,982,317
LIABILITIES		
Investment-related liabilities (Note 2)	253,502	–
Accounts payable and accrued liabilities	24,977	7,047
	278,479	7,047
NET ASSETS	$19,996,489	$13,975,270
Accumulated net income from operations	$ 4,892,175	$ 1,958,743
Accumulated fund transfers	15,104,314	12,016,527
NET ASSETS	$19,996,489	$13,975,270

On behalf of the Board of Directors:

Lynn Loewen
Director and Chair of the Audit and Conflics Committee

STATEMENT OF NET INCOME AND ACCUMULATED NET INCOME FROM OPERATIONS

For the year ended March 31, 2006

($000's)	2006	2005
INVESTMENT INCOME		
Interest and dividends	$ 432,264	$ 318,723
Net realized gains	1,734,154	302,983
Change in unrealized appreciation in value of investments	824,174	347,772
	2,990,592	969,478
EXPENSES		
Operating expenses (Note 6b)	28,346	14,905
External investment management fees	28,814	10,311
	57,160	25,216
NET INCOME FROM OPERATIONS	2,933,432	944,262
Accumulated net income from operations, beginning of year	1,958,743	1,014,481
Accumulated net income from operations, end of year	$ 4,892,175	$ 1,958,743

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2006

($000's)	2006	2005
NET ASSETS, BEGINNING OF YEAR	$13,975,270	$10,205,922
Fund transfers (Note 4)	3,087,787	2,825,086
Net income from operations	2,933,432	944,262
Increase in net assets for the year	6,021,219	3,769,348
NET ASSETS, END OF YEAR	$19,996,489	$13,975,270

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

ORGANIZATION

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* (the "*Act*") with a mandate to invest the contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets.

The Public Service pension fund was established by amendments to the *Public Service Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The excess of contributions over benefits is transferred, by the Public Service pension fund, to PSP Investments – Public Service Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in each of 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 *Public Service Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plan established under the *Public Service Superannuation Act*.

1 Summary of Significant Accounting Policies

Basis of Presentation

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the excess funds transferred to it from the Public Service fund. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of the Public Service pension fund. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the *Act*.

The financial statement presentation has been changed from the prior year's presentation. References to the "PSP Funds" have been eliminated in the current year's presentation. Whereas prior years' financial statements presented a statement of investment portfolio holding unit interests in the "PSP Funds", this has been replaced by Note 2(a), an investment portfolio depicting the effective asset class holdings and maintaining the respective fair value and cost of the underlying investments held by PSP Investments.

Comparative figures have been re-classified to conform to the current year's presentation.

Valuation of Investments

Investments for each asset class are recorded as of the trade date and are stated at fair value. Fair value is an estimate of the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value of investments in pooled funds is based on unit values, which reflect the quoted market prices or other generally accepted pricing methodologies for the underlying securities.

Income Recognition

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

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends, and net operating income from private market real estate investments. These income items include the related distributions from pooled funds and limited partnerships.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

1 Summary of Significant Accounting Policies (continued)

Translation of Foreign Currencies

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

Fund Transfers

Amounts received from the Public Service pension fund are recorded on a cash basis.

Use of Estimates

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

2 Investments

(a) Investment Portfolio

The investment portfolio, as at March 31, is as follows:

($000's)	2006		2005	
ASSET CLASS	**FAIR VALUE**	**COST**	FAIR VALUE	COST
Developed World Equity				
Canadian Equity	$6,767,034	$5,832,659	$5,598,409	$4,637,602
US Large Cap Equity	1,895,296	1,754,068	1,670,120	1,654,927
EAFE Large Cap Equity	2,329,008	1,883,006	1,808,483	1,661,467
Small Cap Developed World Equity	1,452,710	1,315,588	75,906	67,918
Emerging Markets Equity	1,406,870	1,104,398	255,498	259,480
Private Equity	218,169	221,872	2,151	2,599
Nominal Fixed Income				
Cash Equivalents	284,402	284,402	316,115	316,115
Canadian Fixed Income	3,794,447	3,844,078	3,711,173	3,668,364
Real Return Assets				
World Inflation-linked Bonds	305,005	278,690	158,399	150,390
Real Estate	1,399,758	1,345,554	309,616	307,744
Absolute Return	415,434	401,894	71,980	73,494
INVESTMENTS	$20,268,133	$18,266,209	$13,977,850	$12,800,100
Investment-related liabilities (Note 7)	(253,502)	(253,502)	–	–
NET INVESTMENTS	$20,014,631	$18,012,707	$13,977,850	$12,800,100

World Government Bonds and Infrastructure were introduced as asset classes during the current fiscal year and no investments have been made as at March 31, 2006.

Direct investments, derivative contracts, and investment-related receivables and liabilities are classified by asset-mix category based on the intent of the investment strategies of PSP Investments. In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

2 Investments (continued)

(b) Investment Asset Mix

PSP Investments has established a Statement of Investment Policies, Standards and Procedures (the "SIP&P"). The SIP&P sets out the manner in which the assets shall be invested for the three plan accounts. During the course of the year, PSP Investments modified its asset mix policy.

The investment asset mix, as set out in the SIP&P as at March 31, is as follows:

	2006		2005	
	ACTUAL ASSET MIX	POLICY PORTFOLIO	ACTUAL ASSET MIX	POLICY PORTFOLIO
Equities	70.2%	62.0%	67.3%	63.0%
Fixed Income	22.4	15.0	29.4	22.0
Real Return Assets	7.4	23.0	3.3	15.0
	100.0%	100.0%	100.0%	100.0%

Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, real return assets include real estate and infrastructure assets with policy portfolio target weights of 10% and 8%, respectively, and actual asset weights of only 7% and nil, respectively.

(c) 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 where investment values will fluctuate due to changes in foreign exchange rates. To mitigate this risk, PSP Investments may take, through derivative contracts, trading positions in foreign currencies.

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

	2006		2005	
CURRENCY	**FAIR VALUE**	**% OF TOTAL**	FAIR VALUE	% OF TOTAL
(in Canadian $)	($000'S)		($000's)	
US Dollar	$4,201,445	57.0%	$1,984,909	49.8%
Euro	1,140,725	15.4	691,634	17.3
Yen	669,089	9.1	358,723	9.0
British Pound	487,024	6.6	376,349	9.4
Other	878,768	11.9	576,948	14.5
	$7,377,051	100.0%	$3,988,563	100.0%

3 Other Assets

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

($000's)	2006	2005
Fixed assets	$2,522	$1,623
Other assets	78	36
	$2,600	$1,659

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

4 Fund Transfers

During the year, PSP Investments received fund transfers of $3,088 million (2005 – $2,825 million) from the Public Service pension fund. The transfers received are comprised of net current employer and employee contributions to the Public Service pension plan.

5 Investment Performance

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

	2006		2005	
	PORTFOLIO RETURNS	BENCHMARK RETURNS	PORTFOLIO RETURNS	BENCHMARK RETURNS
Developed World Equity				
Canadian Equity	28.8%	28.7%	15.6%	13.9%
US Large Cap Equity	9.5%	7.7%	(0.6)%	(1.8)%
EAFE Large Cap Equity	20.8%	20.0%	4.3%	5.9%
Small Cap Developed World	18.6%	19.3%	n.a.	n.a.
Emerging Markets Equity	39.6%	42.6%	n.a.	n.a.
Private Equity	0.6%	n.a.	(33.8)%	n.a.
Nominal Fixed Income				
Cash Equivalents	2.7%	2.8%	2.9%	2.2%
Canadian Fixed Income	4.7%	4.9%	5.0%	5.0%
Real Return Assets				
World Inflation-linked Bonds	10.9%	11.8%	8.8%	9.2%
Real Estate	21.6%	8.3%	7.9%	6.7%
Total Return	19.1%	18.0%	7.9%	7.2%

Returns have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute. Returns are presented gross of expenses.

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

The total benchmark return aggregates the asset class benchmark returns according to the weights under the actual asset mix. The return of the private equity asset class is not being measured against any benchmark during the ramp-up period as disclosed in PSP Investments' SIP&P. However, for purposes of calculating the total 2006 and 2005 benchmark returns, the actual private equity portfolio returns of 0.6% and (33.8)%, respectively, are used.

The total portfolio returns includes the performance impact of absolute return strategies. Hedging investment returns have been netted against respective hedged assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

6 Expenses

(a) Allocation of Expenses

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

Operating expenses, excluding custodial fees, have been allocated as follows:

	2006	2005
Public Service Pension Plan Account	72.2%	71.7%
Canadian Forces Pension Plan Account	20.5	20.9
Royal Canadian Mounted Police Pension Plan Account	7.3	7.4
	100.0%	100.0%

Expenses are financed by the Public Service Pension Plan Account, which is reimbursed by the other plan accounts on a quarterly basis.

(b) Operating Expenses

Operating expenses allocated to this plan account consist of the following:

($000's)	2006	2005
Salaries and benefits	$16,328	$7,579
General operating expenses	8,042	5,142
Professional and consulting fees	3,976	2,184
	$28,346	$14,905

Further details of operating expenses are shown in the PSP Investments' financial statements.

7 PSP Capital Inc.

As of March 31, 2006, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $350 million of short-term promissory notes outstanding with maturity dates within 60 to 90 days of issuance of which $253 million has been allocated to the Public Service Pension Plan Account. The capital raised was used primarily to finance real estate investments.

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 6 (a).

AUDITORS' REPORT

CANADIAN FORCES PENSION PLAN ACCOUNT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account (the "Canadian Forces Pension Plan Account") as at March 31, 2006 and the Statements of Net Income and Accumulated Net Income from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's ("PSP Investments") management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2006 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the 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, as appropriate, the *Public Sector Pension Investment Board Act* (the "*Act*") and regulations and the by-laws of PSP Investments.

Deloitte & Touche LLP

Chartered Accountants
Toronto, Ontario
April 28, 2006

BALANCE SHEET

As at March 31, 2006

CANADIAN FORCES PENSION PLAN ACCOUNT

($000's)	2006	2005
ASSETS		
Investments (Note 2)	$5,699,169	$3,964,971
Cash	22	–
Other assets	733	486
TOTAL ASSETS	$5,699,924	$3,965,457
LIABILITIES		
Investment-related liabilities (Note 2)	71,282	–
Accounts payable and accrued liabilities	6,768	2,030
Due to the Public Service Pension Plan Account (Note 5a)	3,124	2,071
	81,174	4,101
NET ASSETS	$5,618,750	$3,961,356
Accumulated net income from operations	$1,398,309	$ 568,650
Accumulated fund transfers	4,220,441	3,392,706
NET ASSETS	$5,618,750	$3,961,356

On behalf of the Board of Directors:

Lynn Loewen

Lynn Loewen
Director and Chair of the Audit and Conflics Committee

STATEMENT OF NET INCOME AND ACCUMULATED NET INCOME FROM OPERATIONS

For the year ended March 31, 2006

($000's)	2006	2005
INVESTMENT INCOME		
Interest and dividends	$ 121,548	$ 90,410
Net realized gains	495,456	95,773
Change in unrealized appreciation in value of investments	228,867	92,442
	845,871	278,625
EXPENSES		
Operating expenses (Note 5b)	8,056	4,348
External investment management fees	8,156	2,955
	16,212	7,303
NET INCOME FROM OPERATIONS	829,659	271,322
Accumulated net income from operations, beginning of year	568,650	297,328
Accumulated net income from operations, end of year	$1,398,309	$ 568,650

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2006

($000's)	2006	2005
NET ASSETS, BEGINNING OF YEAR	$3,961,356	$2,969,369
Fund transfers (Note 3)	827,735	720,665
Net income from operations	829,659	271,322
Increase in net assets for the year	1,657,394	991,987
NET ASSETS, END OF YEAR	$5,618,750	$3,961,356

ORGANIZATION

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* (the "*Act*") with a mandate to invest the contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets.

The Canadian Forces pension fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The excess of contributions over benefits is transferred, by the Canadian Forces pension fund, to PSP Investments – Canadian Forces Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in each of 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 *Canadian Forces Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the *Canadian Forces Superannuation Act*.

1 Summary of Significant Accounting Policies

Basis of Presentation

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the excess funds transferred to it from the Canadian Forces fund. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of the Canadian Forces pension fund. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the *Act*.

The financial statement presentation has been changed from the prior year's presentation. References to the "PSP Funds" have been eliminated in the current year's presentation. Whereas prior years' financial statements presented a statement of investment portfolio holding unit interests in the "PSP Funds", this has been replaced by Note 2(a), an investment portfolio depicting the effective asset class holdings and maintaining the respective fair value and cost of the underlying investments held by PSP Investments.

Comparative figures have been re-classified to conform to the current year's presentation.

Valuation of Investments

Investments for each asset class are recorded as of the trade date and are stated at fair value. Fair value is an estimate of the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value of investments in pooled funds is based on unit values, which reflect the quoted market prices or other generally accepted pricing methodologies for the underlying securities.

Income Recognition

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

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends, and net operating income from private market real estate investments. These income items include the related distributions from pooled funds and limited partnerships.

1 Summary of Significant Accounting Policies (continued)

Translation of Foreign Currencies

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

Fund Transfers

Amounts received from the Canadian Forces pension fund are recorded on a cash basis.

Use of Estimates

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

2 Investments

(a) Investment Portfolio

The investment portfolio, as at March 31, is as follows:

($000's)	2006		2005	
ASSET CLASS	**FAIR VALUE**	**COST**	FAIR VALUE	COST
Developed World Equity				
Canadian Equity	$1,902,816	$1,640,080	$1,588,060	$1,315,515
US Large Cap Equity	532,942	493,229	473,730	469,420
EAFE Large Cap Equity	654,897	529,486	512,976	471,275
Small Cap Developed World Equity	408,490	369,933	21,531	19,265
Emerging Markets Equity	395,601	310,547	72,472	73,602
Private Equity	61,356	62,398	623	752
Nominal Fixed Income				
Cash Equivalents	79,890	79,890	89,610	89,610
Canadian Fixed Income	1,067,019	1,080,976	1,052,782	1,040,638
Real Return Assets				
World Inflation-linked Bonds	85,769	78,369	44,934	42,662
Real Estate	393,630	378,357	87,922	87,390
Absolute Return	116,759	112,954	20,331	20,759
INVESTMENTS	$5,699,169	$5,136,219	$3,964,971	$3,630,888
Investment-related liabilities (Note 6)	(71,282)	(71,282)	–	–
NET INVESTMENTS	$5,627,887	$5,064,937	$3,964,971	$3,630,888

World Government Bonds and Infrastructure were introduced as asset classes during the current fiscal year and no investments have been made as at March 31, 2006.

Direct investments, derivative contracts, and investment-related receivables and liabilities are classified by asset-mix category based on the intent of the investment strategies of the underlying portfolios of PSP Investments. In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies.

2 Investments (continued)

(b) Investment Asset Mix

PSP Investments has established a Statement of Investment Policies, Standards and Procedures (the "SIP&P"). The SIP&P sets out the manner in which the assets shall be invested for the three plan accounts. During the course of the year, PSP Investments modified its asset mix policy.

The investment asset mix, as set out in the SIP&P as at March 31, is as follows:

	2006		2005	
	ACTUAL ASSET MIX	POLICY PORTFOLIO	ACTUAL ASSET MIX	POLICY PORTFOLIO
Equities	70.2%	62.0%	67.3%	63.0%
Fixed Income	22.4	15.0	29.4	22.0
Real Return Assets	7.4	23.0	3.3	15.0
	100.0%	100.0%	100.0%	100.0%

Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, real return assets include real estate and infrastructure assets with policy portfolio target weights of 10% and 8%, respectively, and actual asset weights of only 7% and nil, respectively.

(c) 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 where investment values will fluctuate due to changes in foreign exchange rates. To mitigate this risk, PSP Investments may take, through derivative contracts, trading positions in foreign currencies.

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

	2006		2005	
CURRENCY	FAIR VALUE	% OF TOTAL	FAIR VALUE	% OF TOTAL
(in Canadian $)	($000'S)		($000's)	
US Dollar	$1,183,460	57.0%	$563,120	49.8%
Euro	321,113	15.4	196,178	17.3
Yen	188,158	9.1	101,813	9.0
British Pound	137,118	6.6	106,751	9.4
Other	247,141	11.9	163,574	14.5
	$2,076,990	100.0%	$1,131,436	100.0%

3 Fund Transfers

During the year, PSP Investments received fund transfers of $828 million (2005 – $721 million) from the Canadian Forces pension fund. The transfers received are comprised of net current employer and employee contributions to the Canadian Forces pension plan.

4 Investment Performance

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

	2006		2005	
	PORTFOLIO RETURNS	BENCHMARK RETURNS	PORTFOLIO RETURNS	BENCHMARK RETURNS
Developed World Equity				
Canadian Equity	28.8%	28.7%	15.6%	13.9%
US Large Cap Equity	9.5%	7.7%	(0.6)%	(1.8)%
EAFE Large Cap Equity	20.8%	20.0%	4.3%	5.9%
Small Cap Developed World	18.6%	19.3%	n.a.	n.a.
Emerging Markets Equity	39.6%	42.6%	n.a.	n.a.
Private Equity	0.6%	n.a.	(33.8)%	n.a.
Nominal Fixed Income				
Cash Equivalents	2.7%	2.8%	2.9%	2.2%
Canadian Fixed Income	4.7%	4.9%	5.0%	5.0%
Real Return Assets				
World Inflation-linked Bonds	10.9%	11.8%	8.8%	9.2%
Real Estate	21.6%	8.3%	7.9%	6.7%
Total Return	19.1%	18.0%	7.9%	7.2%

Returns have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute. Returns are presented gross of expenses.

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

The total benchmark return aggregates the asset class benchmark returns according to the weights under the actual asset mix. The return of the private equity asset class is not being measured against any benchmark during the ramp-up period as disclosed in PSP Investments' SIP&P. However, for purposes of calculating the total 2006 and 2005 benchmark returns, the actual private equity portfolio returns of 0.6% and (33.8)%, respectively, are used.

The total portfolio returns includes the performance impact of absolute return strategies. Hedging investment returns have been netted against respective hedged assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

5 Expenses

(a) Allocation of Expenses

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

Operating expenses, excluding custodial fees, have been allocated as follows:

	2006	2005
Public Service Pension Plan Account	72.2%	71.7%
Canadian Forces Pension Plan Account	20.5	20.9
Royal Canadian Mounted Police Pension Plan Account	7.3	7.4
	100.0%	100.0%

Expenses are financed by the Public Service Pension Plan Account, which is reimbursed by the other plan accounts on a quarterly basis.

(b) Operating Expenses

Operating expenses allocated to this plan account consist of the following:

($000's)	2006	2005
Salaries and benefits	$4,636	$2,209
General operating expenses	2,291	1,502
Professional and consulting fees	1,129	637
	$8,056	$4,348

Further details of operating expenses are shown in the PSP Investments' financial statements.

6 PSP Capital Inc.

As of March 31, 2006, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $350 million of short-term promissory notes outstanding with maturity dates within 60 to 90 days of issuance of which $72 million has been allocated to the Canadian Forces Pension Plan Account. The capital raised was used primarily to finance real estate investments.

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 5 (a).

AUDITORS' REPORT

To the Minister of Public Safety

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Royal Canadian Mounted Police Pension Plan Account (the "Royal Canadian Mounted Police Pension Plan Account") as at March 31, 2006 and the Statements of Net Income and Accumulated Net Income from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's ("PSP Investments") management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2006 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the 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, as appropriate, the *Public Sector Pension Investment Board Act* (the "*Act*") and regulations and the by-laws of PSP Investments.

Deloitte & Touche LLP

Chartered Accountants
Toronto, Ontario
April 28, 2006

BALANCE SHEET

As at March 31, 2006

($000's)	2006	2005
ASSETS		
Investments (Note 2)	$2,028,987	$1,425,627
Cash	8	–
Other assets	260	173
TOTAL ASSETS	$2,029,255	$1,425,800
LIABILITIES		
Investment-related liabilities (Note 2)	25,347	–
Accounts payable and accrued liabilities	2,408	725
Due to the Public Service Pension Plan Account (Note 5a)	1,111	737
	28,866	1,462
NET ASSETS	$2,000,389	$1,424,338
Accumulated net income from operations	$ 496,731	$ 202,253
Accumulated fund transfers	1,503,658	1,222,085
NET ASSETS	$2,000,389	$1,424,338

On behalf of the Board of Directors:

Lynn Loewen

Director and Chair of the Audit and Conflics Committee

STATEMENT OF NET INCOME AND ACCUMULATED NET INCOME FROM OPERATIONS

For the year ended March 31, 2006

($000's)	2006	2005
INVESTMENT INCOME		
Interest and dividends	$ 43,273	$ 32,507
Net realized gains	176,948	33,382
Change in unrealized appreciation in value of investments	80,024	34,148
	300,245	100,037
EXPENSES		
Operating expenses (Note 5b)	2,868	1,540
External investment management fees	2,899	1,059
	5,767	2,599
NET INCOME FROM OPERATIONS	294,478	97,438
Accumulated net income from operations, beginning of year	202,253	104,815
Accumulated net income from operations, end of year	$ 496,731	$ 202,253

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2006

($000's)	2006	2005
NET ASSETS, BEGINNING OF YEAR	$1,424,338	$1,056,638
Fund transfers (Note 3)	281,573	270,262
Net income from operations	294,478	97,438
Increase in net assets for the year	576,051	367,700
NET ASSETS, END OF YEAR	$2,000,389	$1,424,338

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2006

ORGANIZATION

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* (the "*Act*") with a mandate to invest the contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets.

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

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

1 Summary of Significant Accounting Policies

Basis of Presentation

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the excess funds transferred to it from the Royal Canadian Mounted Police fund. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of the Royal Canadian Mounted Police pension fund. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the *Act*.

The financial statement presentation has been changed from the prior year's presentation. References to the "PSP Funds" have been eliminated in the current year's presentation. Whereas prior years' financial statements presented a statement of investment portfolio holding unit interests in the "PSP Funds", this has been replaced by Note 2(a), an investment portfolio depicting the effective asset class holdings and maintaining the respective fair value and cost of the underlying investments held by PSP Investments.

Comparative figures have been re-classified to conform to the current year's presentation.

Valuation of Investments

Investments for each asset class are recorded as of the trade date and are stated at fair value. Fair value is an estimate of the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value of investments in pooled funds is based on unit values, which reflect the quoted market prices or other generally accepted pricing methodologies for the underlying securities.

Income Recognition

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

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends, and net operating income from private market real estate investments. These income items include the related distributions from pooled funds and limited partnerships.

1 Summary of Significant Accounting Policies (continued)

Translation of Foreign Currencies

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

Fund Transfers

Amounts received from the Royal Canadian Mounted Police pension fund are recorded on a cash basis.

Use of Estimates

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

2 Investments

(a) Investment Portfolio

The investment portfolio, at March 31, is as follows:

($000's)	2006		2005	
ASSET CLASS	FAIR VALUE	COST	FAIR VALUE	COST
Developed World Equity				
Canadian Equity	$676,632	$583,204	$571,073	$473,065
US Large Cap Equity	189,509	175,388	170,341	168,791
EAFE Large Cap Equity	232,876	188,280	184,454	169,458
Small Cap Developed World Equity	145,256	131,545	7,741	6,927
Emerging Markets Equity	140,672	110,428	26,059	26,465
Private Equity	21,830	22,200	221	267
Nominal Fixed Income				
Cash Equivalents	28,518	28,518	32,201	32,201
Canadian Fixed Income	381,496	386,486	378,552	374,186
Real Return Assets				
World Inflation-linked Bonds	30,665	28,020	16,157	15,340
Real Estate	139,958	134,539	31,533	31,343
Absolute Return	41,575	40,220	7,295	7,449
INVESTMENTS	$2,028,987	$1,828,828	$1,425,627	$1,305,492
Investment-related liabilities (Note 6)	(25,347)	(25,347)	–	–
NET INVESTMENTS	$2,003,640	$1,803,481	$1,425,627	$1,305,492

World Government Bonds and Infrastructure were introduced as asset classes during the current fiscal year and no investments have been made as at March 31, 2006.

Direct investments, derivative contracts, and investment-related receivables and liabilities are classified by asset-mix category based on the intent of the investment strategies of PSP Investments. In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies.

2 Investments (continued)

(b) Investment Asset Mix

PSP Investments has established a Statement of Investment Policies, Standards and Procedures (the "SIP&P"). The SIP&P sets out the manner in which the assets shall be invested for the three plan accounts. During the course of the year, PSP Investments modified its asset mix policy.

The investment asset mix, as set out in the SIP&P as at March 31, is as follows:

	2006		2005	
	ACTUAL ASSET MIX	POLICY PORTFOLIO	ACTUAL ASSET MIX	POLICY PORTFOLIO
Equities	70.2%	62.0%	67.3%	63.0%
Fixed Income	22.4	15.0	29.4	22.0
Real Return Assets	7.4	23.0	3.3	15.0
	100.0%	100.0%	100.0%	100.0%

Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, real return assets include real estate and infrastructure assets with policy portfolio target weights of 10% and 8%, respectively, and actual asset weights of only 7% and nil, respectively.

(c) 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 where investment values will fluctuate due to changes in foreign exchange rates. To mitigate this risk, PSP Investments may take, through derivative contracts, trading positions in foreign currencies.

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

	2006		2005	
CURRENCY	FAIR VALUE	% OF TOTAL	FAIR VALUE	% OF TOTAL
(in Canadian $)	($000'S)		($000's)	
US Dollar	$420,101	57.0%	$202,428	49.8%
Euro	114,073	15.4	70,540	17.3
Yen	66,896	9.1	36,620	9.0
British Pound	48,696	6.6	38,380	9.4
Other	87,850	11.9	58,803	14.5
	$737,616	100.0%	$406,771	100.0%

3 Fund Transfers

During the year, PSP Investments received fund transfers of $281 million (2005 – $270 million) from the Royal Canadian Mounted Police pension fund. The transfers received are comprised of net current employer and employee contributions to the Royal Canadian Mounted Police pension plan.

4 Investment Performance

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

	2006		2005	
	PORTFOLIO RETURNS	BENCHMARK RETURNS	PORTFOLIO RETURNS	BENCHMARK RETURNS
Developed World Equity				
Canadian Equity	28.8%	28.7%	15.6%	13.9%
US Large Cap Equity	9.5%	7.7%	(0.6)%	(1.8)%
EAFE Large Cap Equity	20.8%	20.0%	4.3%	5.9%
Small Cap Developed World	18.6%	19.3%	n.a.	n.a.
Emerging Markets Equity	39.6%	42.6%	n.a.	n.a.
Private Equity	0.6%	n.a.	(33.8)%	n.a.
Nominal Fixed Income				
Cash Equivalents	2.7%	2.8%	2.9%	2.2%
Canadian Fixed Income	4.7%	4.9%	5.0%	5.0%
Real Return Assets				
World Inflation-linked Bonds	10.9%	11.8%	8.8%	9.2%
Real Estate	21.6%	8.3%	7.9%	6.7%
Total Return	19.1%	18.0%	7.9%	7.2%

Returns have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute. Returns are presented gross of expenses.

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

The total benchmark return aggregates the asset class benchmark returns according to the weights under the actual asset mix. The return of the private equity asset class is not being measured against any benchmark during the ramp-up period as disclosed in PSP Investments' SIP&P. However, for purposes of calculating the total 2006 and 2005 benchmark returns, the actual private equity portfolio returns of 0.6% and (33.8)%, respectively, are used.

The total portfolio returns includes the performance impact of absolute return strategies. Hedging investment returns have been netted against respective hedged assets.

5 Expenses

(a) Allocation of Expenses

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

Operating expenses, excluding custodial fees, have been allocated as follows:

	2006	2005
Public Service Pension Plan Account	72.2%	71.7%
Canadian Forces Pension Plan Account	20.5	20.9
Royal Canadian Mounted Police Pension Plan Account	7.3	7.4
	100.0%	100.0%

Expenses are financed by the Public Service Pension Plan Account, which is reimbursed by the other plan accounts on a quarterly basis.

(b) Operating Expenses

Operating expenses allocated to this plan account consist of the following:

($000's)	2006	2005
Salaries and benefits	$1,651	$782
General operating expenses	815	533
Professional and consulting fees	402	225
	$2,868	$1,540

Further details of operating expenses are shown in the PSP Investments' financial statements.

6 PSP Capital Inc.

As of March 31, 2006, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $350 million of short-term promissory notes outstanding with maturity dates within 60 to 90 days of issuance of which $25 million has been allocated to the Royal Canadian Mounted Police Pension Plan Account. The capital raised was used primarily to finance real estate investments.

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 5 (a).

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Consolidated Balance Sheet of the Public Sector Pension Investment Board ("PSP Investments") as at March 31, 2006 and the Consolidated Statements of Net Income from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of PSP Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments as at March 31, 2006 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of PSP Investments and those of its 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, as appropriate, the *Public Sector Pension Investment Board Act* (the "*Act*") and regulations and the by-laws of PSP Investments and its subsidiaries.

Deloitte & Touche LLP

Chartered Accountants
Toronto, Ontario
April 28, 2006

CONSOLIDATED BALANCE SHEET

As at March 31, 2006

($000's)	2006	2005
ASSETS		
Investments (Note 2)	$27,996,289	$19,368,448
Cash	1,950	3,341
Other assets (Note 3)	5,518	4,508
TOTAL ASSETS	28,003,757	19,376,297
LIABILITIES		
Investment-related liabilities (Note 2)	350,131	–
Accounts payable and accrued liabilities	37,998	15,333
	388,129	15,333
NET ASSETS	$27,615,628	$19,360,964
Public Service Pension Plan Account	$19,996,489	$13,975,270
Canadian Forces Pension Plan Account	5,618,750	3,961,356
Royal Canadian Mounted Police Pension Plan Account	2,000,389	1,424,338
NET ASSETS	$27,615,628	$19,360,964
Commitments (Note 11)		

On behalf of the Board of Directors:

Lynn Loewen

Lynn Loewen
Director and Chair of the Audit and Conflics Committee

CONSOLIDATED STATEMENT OF NET INCOME FROM OPERATIONS

For the year ended March 31, 2006

($000's)	2006	2005
INVESTMENT INCOME (Note 5)		
Interest and dividends	$ 597,085	$ 441,640
Net realized gains	2,406,558	432,138
Change in unrealized appreciation in value of investments	1,133,065	474,362
	4,136,708	1,348,140
EXPENSES		
Operating expenses (Note 7)	39,270	20,793
External investment management fees	39,869	14,325
	79,139	35,118
NET INCOME FROM OPERATIONS (Note 8)	$ 4,057,569	$ 1,313,022

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2006

($000's)	2006	2005
NET ASSETS, BEGINNING OF YEAR	$19,360,964	$14,231,929
Fund transfers (Note 4)	4,197,095	3,816,013
Net income from operations	4,057,569	1,313,022
Increase in net assets for the year	8,254,664	5,129,035
NET ASSETS, END OF YEAR	$27,615,628	$19,360,964

PUBLIC SECTOR PENSION INVESTMENT BOARD

ORGANIZATION

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* (the "*Act*") with a mandate to invest the contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets.

The Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds were established by amendments to the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* and the *Royal Canadian Mounted Police Superannuation Act* (the "*Superannuation Acts*"), to receive contributions and make benefit payments in respect of member service after April 1, 2000. The excess of contributions over benefits is transferred, by each Pension Fund, to their respective PSP Investments – Plan Account for investment.

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

1 Summary of Significant Accounting Policies

Basis of Presentation

These consolidated financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the excess funds transferred to it from the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of all three Pension Funds. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the *Act*.

The consolidated financial statement presentation has been changed from the prior year's presentation. References to the "PSP Funds" have been eliminated in the current year's presentation. Whereas prior years' consolidated financial statements presented a statement of investment portfolio comprised of the "PSP Funds", this has been replaced by Note 2 (a), an investment portfolio depicting actual asset class holdings.

Comparative figures have been re-classified to conform with the current year's presentation.

Plan Accounts

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

Valuation of Investments

Investments for each asset class are recorded as of the trade date and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value for investments in pooled funds is based on unit values, which reflect the quoted market prices or other generally accepted pricing methodologies for the underlying securities.

1 Summary of Significant Accounting Policies (continued)

Valuation of Investments (continued)

Fair values of investments are determined as follows:

(a) Short-term deposits are recorded at cost which, together with accrued interest income, approximates fair value.

(b) Market prices for equities and unit values for pooled funds are used to represent the fair value of these investments. Unit values reflect the quoted market prices of the underlying securities.

(c) Private equity investments, where quoted market prices are not available, are fair-valued annually by external managers of limited partnerships and funds in which the investments are made. The fair value is determined by the external managers using acceptable industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flow and third party transactions.
In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private equity investments unless there is an indication of permanent impairment of value.

(d) The fair value of investments in real estate is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions.
In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for real estate, unless there is an indication of permanent impairment of value.
Management may use the services of a third party appraiser to determine the fair value of real estate investments.

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

(f) All derivative financial instruments are recorded at fair value using market prices. Where quoted market prices are not available, appropriate valuation techniques are used to determine fair value.

Income Recognition

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends, and net operating income from private market real estate investments. These income items include the related distributions from pooled funds and limited partnerships.

Translation of Foreign Currencies

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

Fund Transfers

Amounts received from each pension fund are recorded on a cash basis in their respective plan account.

Use of Estimates

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

2 Investments

(a) Investment Portfolio

The investment portfolio, as at March 31, is as follows:

($000's)	2006		2005	
ASSET CLASS	FAIR VALUE	COST	FAIR VALUE	COST
Developed World Equity				
Canadian Equity	$9,346,482	$8,055,943	$7,757,542	$6,426,182
US Large Cap Equity	2,617,747	2,422,685	2,314,191	2,293,138
EAFE Large Cap Equity	3,216,781	2,600,772	2,505,913	2,302,200
Small Cap Developed World Equity	2,006,456	1,817,066	105,178	94,110
Emerging Markets Equity	1,943,143	1,525,373	354,029	359,547
Private Equity	301,355	306,470	2,995	3,618
Nominal Fixed Income				
Cash Equivalents	392,810	392,810	437,926	437,926
Canadian Fixed Income	5,242,962	5,311,540	5,142,507	5,083,188
Real Return Assets				
World Inflation-linked Bonds	421,439	385,079	219,490	208,392
Real Estate	1,933,346	1,858,450	429,071	426,477
Absolute Return	573,768	555,068	99,606	101,702
INVESTMENTS	$27,996,289	$25,231,256	$19,368,448	$17,736,480
Investment-related liabilities (Note 9)	(350,131)	(350,131)	–	–
NET INVESTMENTS	$27,646,158	$24,881,125	$19,368,448	$17,736,480

World Government Bonds and Infrastructure were introduced as asset classes during the current fiscal year and no investments have been made as at March 31, 2006.

Direct investments, derivative contracts, and investment-related receivables and liabilities are classified by asset-mix category based on the intent of the investment strategies of PSP Investments. In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies.

The investment portfolio includes investment receivables of $1,614 million (2005 – $56 million) and investment payables of $2,125 million (2005 – $82 million) pertaining to pending trades and forward currency contracts for a net payable of $511 million (2005 – $26 million) as well as accrued income of $118 million (2005 – $37 million). The investment receivables of $1,614 million are primarily made up of forward bond contracts in the amount of $1,582 million having maturity dates within 30 days of year-end. The investment payables of $2,125 million are also made up primarily of forward bond contracts in the amount of $1,893 million having maturity dates within 30 days of year-end.

2 Investments (continued)

(b) Derivative Financial Instruments

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

Notional value represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows and it does not represent the potential gain, loss or net exposure associated with the market or credit risk of such transactions. Rather, it serves as the basis upon which the returns from, and the fair value of the contracts, are determined.

On November 10, 2005, PSP Investments commenced writing credit default derivatives and, hence, indirectly guaranteed the underlying reference obligations. The maximum potential exposure is the notional amount of written credit default derivatives as shown in the table below. No payments related to written credit default derivatives have been made to date.

The following table summarizes PSP Investments' derivatives portfolio as at March 31:

($000's)	2006		2005	
INVESTMENTS	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
Equity derivatives				
Options	$1,676,816	$240,148	$4,597	$484
Swaps	2,227,418	46,060	365,581	1,314
Futures	968,250	12,013	94,987	(436)
Currency derivatives				
Forwards	4,628,854	(31,460)	261,695	(2,091)
Options	478,659	923	181,475	3,552
Interest Rate derivatives				
Bond forwards	3,438,819	56	–	–
Options	12,033,513	4,734	–	–
Swaps	7,121,432	2,990	–	–
Swaptions	3,134,448	(3,573)	–	–
Futures	1,707,593	1,306	–	–
Credit Default derivatives				
Swaps	3,092,432	(4,339)	–	–
Other derivatives				
Variance swaps	681,136	(525)	–	–
	$41,189,370	$268,333	$908,335	$2,823

The term to maturity based on notional value for the derivatives listed in the above table is as follows:

($000's)	2006	2005
Under 1 year	$26,372,689	$542,754
1 to 5 years	11,136,741	365,581
Over 5 years	3,679,940	–
	$41,189,370	$908,335

PUBLIC SECTOR PENSION INVESTMENT BOARD

2 Investments (continued)

(c) Investment Asset Mix

PSP Investments has established a Statement of Investment Policies, Standards and Procedures (the "SIP&P"). The SIP&P sets out the manner in which the assets shall be invested for the three plan accounts. During the course of the year, PSP Investments modified its asset mix policy.

The investment asset mix, as set out in the SIP&P as at March 31, is as follows:

	2006		2005	
	ACTUAL ASSET MIX	POLICY PORTFOLIO	ACTUAL ASSET MIX	POLICY PORTFOLIO
Equities	70.2%	62.0%	67.3%	63.0%
Fixed Income	22.4	15.0	29.4	22.0
Real Return Assets	7.4	23.0	3.3	15.0
	100.0%	100.0%	100.0%	100.0%

Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, real return assets include real estate and infrastructure assets with policy portfolio target weights of 10% and 8%, respectively, and actual asset weights of only 7% and nil, respectively.

(d) 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 where investment values will fluctuate due to changes in foreign exchange rates. To mitigate this risk, PSP Investments may take, through derivative contracts, trading positions in foreign currencies.

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

	2006		2005	
CURRENCY	FAIR VALUE	% OF TOTAL	FAIR VALUE	% OF TOTAL
(in Canadian $)	($000'S)		($000's)	
US Dollar	$5,805,006	57.0%	$2,750,457	49.8%
Euro	1,575,911	15.4	958,352	17.3
Yen	924,143	9.1	497,156	9.0
British Pound	672,838	6.6	521,480	9.4
Other	1,213,759	11.9	799,325	14.5
	$10,191,657	100.0%	$5,526,770	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies, in real estate and private equity investments for an amount of $3,316 million ($1,927 million US, €645 million Euros and £78 million GBP) which are not included in the foreign currency exposure table above.

2 Investments (continued)

(e) Credit Risk

PSP Investments is exposed to the risk that a counterparty will default or become insolvent.

As at March 31, 2006, PSP Investments' highest concentration of credit risk is with the Government of Canada through holdings of $1.8 billion of Government of Canada issued securities. In order to minimize derivative contract credit risk, PSP Investments deals only with counterparties which are major financial institutions with a minimum credit rating of "A", as supported by a recognized credit rating agency.

(f) Market Risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, or factors affecting all securities traded in the market. PSP Investments has a diversification strategy to mitigate this risk.

(g) Interest Rate Risk

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

As at March 31, 2006, the fixed income asset class was managed with an average duration of 6.3 years. An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.3%, or $351 million.

(h) Securities Lending

PSP Investments participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2006, securities with an estimated fair value of $2,964 million (2005 – $1,981 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $3,125 (2005 – $2,118 million). Securities lending income amounted to $3 million in fiscal 2006 (2005 – $2 million).

(i) Private Equity Investments

PSP Investments' Private Equity asset class is comprised of interests in limited partnerships and in funds which are managed by general partners. The underlying investments represent equity ownerships or investments with the risk and return characteristics of equity.

Investment management fees for these private equity investments are generally incurred by the partnerships and funds. Accordingly, PSP Investments' gains (losses) on investments are net of such fees.

(j) Real Estate Investments

PSP Investments' Real Estate asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of income-producing properties, third party loans and public and private funds.

Investment management fees for these real estate investments are generally incurred by the partnerships or the funds. Accordingly, PSP Investments' gains (losses) on investments are net of such fees.

3 Other Assets

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

($000's)	2006	2005
Fixed assets	$3,515	$2,281
Other assets	2,003	2,227
	$5,518	$4,508

4 Fund Transfers

During the year, PSP Investments received fund transfers of $4,197 million (2005 – $3,816 million) from the three pension funds. The transfers received are comprised of net current employer and employee contributions to their respective pension plan.

The breakdown of the fund transfers is as follows:

($000's)	2006	2005
Public Service Pension Fund	$3,087,787	$2,825,086
Canadian Forces Pension Fund	827,735	720,665
Royal Canadian Mounted Police Pension Fund	281,573	270,262
	$4,197,095	$3,816,013

5 Investment Income

(a) Investment Income

Investment income, before allocating the net realized and unrealized gains on investments, is as follows:

($000's)	2006	2005
Interest-bearing investments		
Short-term	$36,709	$14,572
Canadian bonds and debentures	224,164	216,627
Foreign bonds and debentures	4,982	–
Real Return Bonds	10,891	5,986
	276,746	237,185
Equity investments		
Canadian equities dividends	88,719	113,306
Foreign equities dividends	124,383	84,002
	213,102	197,308
Real estate investments	106,536	7,147
Private equity investments	701	–
Total interest and dividends	$597,085	$441,640
Net gain on investments	3,539,623	906,500
Investment income	$4,136,708	$1,348,140

5 Investment Income (continued)

(b) Investment Income by Asset Mix

Investment income by asset mix, after allocating net realized and unrealized gains and losses on investments, is as follows:

($000's)	2006	2005
Equities	$3,565,243	$1,096,230
Fixed Income	263,096	239,161
Real Return Assets	225,143	17,105
Absolute Return	83,226	(4,356)
	$4,136,708	$1,348,140

Investment income includes foreign currency realized loss of $3 million (2005 – $16 million) and foreign currency unrealized gain of $50 million (2005 – unrealized loss of $159 million).

6 Investment Performance

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

	2006		2005	
	PORTFOLIO RETURNS	BENCHMARK RETURNS	PORTFOLIO RETURNS	BENCHMARK RETURNS
Developed World Equity				
Canadian Equity	28.8%	28.7%	15.6%	13.9%
US Large Cap Equity	9.5%	7.7%	(0.6)%	(1.8)%
EAFE Large Cap Equity	20.8%	20.0%	4.3%	5.9%
Small Cap Developed World	18.6%	19.3%	n.a.	n.a.
Emerging Markets Equity	39.6%	42.6%	n.a.	n.a.
Private Equity	0.6%	n.a.	(33.8)%	n.a.
Nominal Fixed Income				
Cash Equivalents	2.7%	2.8%	2.9%	2.2%
Canadian Fixed Income	4.7%	4.9%	5.0%	5.0%
Real Return Assets				
World Inflation-linked Bonds	10.9%	11.8%	8.8%	9.2%
Real Estate	21.6%	8.3%	7.9%	6.7%
Total Return	19.1%	18.0%	7.9%	7.2%

Returns have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute. Returns are presented gross of expenses.

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

The total benchmark return aggregates the asset class benchmark returns according to the weights under the actual asset mix. The return of the private equity asset class is not being measured against any benchmark during the ramp-up period as disclosed in PSP Investments' SIP&P. However, for purposes of calculating the total 2006 and 2005 benchmark returns, the actual private equity portfolio returns of 0.6% and (33.8)%, respectively, are used.

The total portfolio returns includes the performance impact of absolute return strategies. Hedging investment returns have been netted against respective hedged assets.

7 Expenses

(a) Operating Expenses

Operating expenses consist of the following:

($000's)	2006	2005
Salaries and benefits	$22,615	$10,570
Professional and consulting fees	5,499	3,046
Office supplies and equipment	3,696	2,461
Other operating expenses	2,184	937
Custodial fees	1,441	994
Occupancy costs	1,254	770
Depreciation of fixed assets	1,046	749
Travel and meeting expenses	686	459
Remuneration earned by Directors	585	536
Communication expenses	137	148
Travel and related expenses for Directors	127	123
	$39,270	$20,793

Professional and consulting fees paid and accrued to the external auditors include audit fees paid and accrued of $450,000 (2005 – $395,000), audit-related fees of $41,000 (2005 – $70,000), special exam fees of $348,000 (2005 – $188,000), and non-audit fees of $112,000 (2005 – $21,000). Audit fees of $177,000 (2005 – $237,000) and non audit fees of $209,000 (2005 – $5,000) were paid and accrued to the internal auditors of PSP Investments.

During the year, advisory fees of $55,000 (2005 – $110,000) were paid to Towers Perrin for compensation-related matters.

Total remuneration earned by Directors in fiscal year 2006 includes 1) an annual retainer of $98,000 for the Board Chairperson and of $20,000 for each Director; 2) an annual retainer of $7,500 for each committee chair; 3) Board meeting fees of $1,500 per meeting ($500 for meetings less than one hour); 4) Committee meeting fees of $1,000 per meeting ($500 for meetings less than one hour) and 5) a travel time meeting fee of $1,000 if the director's primary residence is outside Quebec and Ontario at the time of the meeting. Separate fees are not paid for investment committee meetings when they are held as a committee of the whole during Board meetings. The Board Chairperson is not eligible for Board and committee meeting fees.

Directors of PSP Investments come from various regions of the country and accordingly they incur travel and accommodation expenses in attending meetings of the Board and committees.

7 Expenses (continued)

(b) Executive Compensation

Included in salaries and benefits is compensation earned by executive officers. The total compensation earned by the five most highly compensated executive officers was as follows:

Employee / Position	Year	Base Salary ($)	Annual Incentive Plan[1] ($)	Deferred Incentive Plan[2] ($)	Other[3] ($)	Total Compensation ($)
Gordon J. Fyfe	**2006**	**425,000**	**555,900**	**–**	**35,000**	**1,015,900**
President and Chief Executive Officer	2005	385,000	454,300	184,800	36,000	1,060,100
André Collin	**2006**	**283,500**	**453,500**	**–**	**23,000**	**760,000**
First Vice President, Real Estate Investments	2005	221,000	324,000	–	23,000	568,000
Derek Murphy	**2006**	**221,000**	**244,100**	**–**	**25,000**	**490,100**
First Vice President, Private Equity	2005	200,000	224,000	–	41,000	465,000
John Valentini	**2006**	**240,000**	**119,100**	**–**	**73,000**	**432,100**
First Vice President and Chief Financial Officer	2005	–	–	–	–	–
Pierre Malo	**2006**	**200,000**	**130,100**	**–**	**24,000**	**354,100**
First Vice President, Public Market Investments	2005	200,000	119,600	–	24,000	343,600

[1] The annual incentive plan, effective April 1, 2004, is based on a combination of achieving corporate and individual performance targets, including investment performance targets and strategic objectives. Investment performance targets are based on a combination of total fund and asset class performance. Investment performance is measured in dollars or basis points of value-added above established benchmarks. Incentives are paid annually, based on investment performance measured over a retroactive period of four consecutive fiscal years ("performance period") and/or strategic objectives measured over the current fiscal year. The performance period is subject to transitional provisions during the first four years of the plan.

[2] The deferred incentive plan, effective April 1 2004, awards incentives based on a combination of total fund and asset class investment performance targets over the performance period, as defined in point (1) above, and are paid two fiscal years thereafter. The performance period is subject to transitional provisions during the first four years of the plan, as described in point (1) above.

[3] Includes allowances, other taxable benefits and a signing bonus of $55,000 for John Valentini, who joined PSP Investments on April 4, 2005.

(c) Retirement Benefits

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

The benefits payable under the Employee Pension Plan are limited from provisions under the *Income Tax Act* (Canada). The SERP has been established for all employees, as an unfunded arrangement, to provide benefits in excess of the Employee Pension Plan, where such benefits are limited by reason of the requirements in respect of registered pension plans under the *Income Tax Act* (Canada).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2006

8 Allocation of Net Income from Operations

The allocation of the net income from operations of PSP Investments to each plan account is 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 three 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 Defense and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, and allocates, on a quarterly basis, operating expenses excluding custodial fees, based upon the asset value of each plan account.

Operating expenses, excluding custodial fees, for the year ended March 31, have been allocated as follows:

	2006	2005
Public Service Pension Plan Account	72.2%	71.7%
Canadian Forces Pension Plan Account	20.5	20.9
Royal Canadian Mounted Police Pension Plan Account	7.3	7.4
	100.0%	100.0%

Expenses are paid by PSP Investments by way of an advance from the Public Service pension plan account, which is reimbursed by the other plan accounts on a quarterly basis.

9 PSP Capital Inc.

As of March 31, 2006, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $350 million of short-term promissory notes outstanding with maturity dates within 60 to 90 days of issuance. The capital raised was used primarily to finance real estate investments.

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 8 (b).

10 Guarantees and Indemnity

PSP Investments provides guarantees to its directors. Under these agreements, PSP Investments may be required to compensate, without limitation but subject to the *Act*, these parties for costs incurred, such as claims, actions or litigations. This indemnity is explicitly declared to be in excess and in addition to any indemnity of any policy of insurance purchased and maintained by PSP Investments under subsection 18 (1) of the *Act*. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

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

11 Commitments

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2006, the outstanding commitments, in funds and real estate-related investments amounted to $3,584 million ($2,692 million for private equity investments and $892 million for real estate investments).

CANADIAN EQUITIES- 10 LARGEST HOLDINGS

	Company Name	Fair Value ($000's)	% of Canadian Equities
1	Royal Bank of Canada	$ 341,976	3.7%
2	Manulife Financial Corporation	303,644	3.2
3	Bank of Nova Scotia	268,124	2.9
4	EnCana Corporation	227,890	2.4
5	Toronto Dominion Bank	212,770	2.3
6	Canadian Natural Resources Ltd.	177,091	1.9
7	Talisman Energy Inc.	169,902	1.8
8	Canadian National Railway Company	168,938	1.8
9	Suncor Energy Inc.	155,083	1.7
10	Nexen Inc.	133,593	1.4
	Total 10 largest Holdings	**$ 2,159,011**	**23.1%**
	Total Canadian Equities	**$ 9,346,482**	

FOREIGN EQUITIES – 10 LARGEST HOLDINGS

	Company Name	Fair Value ($000's)	% of Foreign Equities
1	Citigroup Inc.	$ 69,947	0.7%
2	Royal Dutch Petroleum Company	62,671	0.6
3	JP Morgan Chase & Company	60,936	0.6
4	Royal Bank of Scotland Group	57,111	0.6
5	Sprint Nextel Corp.	56,471	0.5
6	Vodafone Group	56,277	0.5
7	Exxon Mobil Corporation	51,590	0.5
8	General Electric Company	50,566	0.5
9	Microsoft Corp.	46,971	0.5
10	Nestle SA	46,303	0.5
	Total 10 largest Holdings	**$ 558,843**	**5.5%**
	Total Foreign Equities	**$10,085,482**	

FIXED INCOME

	Fair Value ($000's)	% of Fixed Income
Government of Canada	$ 1,788,836	29.5%
Provincial	1,318,561	21.8
Municipal	94,960	1.6
Corporate	2,461,806	40.6
Cash and Cash Equivalents	393,048	6.5
Total Fixed Income	**$ 6,057,211**	**100.0%**

BOARD OF DIRECTORS AND INVESTMENT COMMITTEE

BOB BALDWIN
Consultant and Senior Associate
Informetrica Ltd.
Ottawa, Ontario

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Former Chairman
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AMEC Earth & Environmental
St.John's, Newfoundland and Labrador

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AUDIT AND CONFLICTS COMMITTEE

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Lynn Loewen, Chair
Keith G. Martell
Anil K. Rastogi

GOVERNANCE COMMITTEE

Bob Baldwin, Chair
Carol Hansell
Lynn Loewen
Carl H. Otto

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Vice President,
Infrastructure Investments

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Senior Director,
External Manager Search & Monitoring

ANNE-MARIE LAURENDEAU
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Communications and Government Relations

PIERRE MALO
First Vice President,
Public Market Investments

DEREK MURPHY
First Vice President,
Private Equity

JOHN VALENTINI
First Vice President and
Chief Financial Officer

CATALIN ZIMBRESTEANU
Senior Director,
Investment Risk

PUBLIC SECTOR PENSION INVESTMENT BOARD ATTENDANCE

Board and Investment Committee – FY 2006

Name	04.07.05	05.11.05	05.26.05	06.08.05	06.09.05	08.04.05	09.15.05	11.10.05	01.17.06	02.09.06	03.24.06	Total Attendance
Bob Baldwin	X	X	X	X	X	X	X	X	X	X	X	**11/11**
Richard Bradshaw	X	X	X	X	X	X	X		X	X		**9/11**
Paul Cantor	X	X	X	X	X	X	X	X	X	X	X	**11/11**
Jean E. Douville	X	X	X	X	X	X	X	X	X		X	**10/11**
Carol Hansell	X	X	X	X	X	X	X	X	X	X (part-time only)	X	**10/11**
Jean Lefebvre	X	X		X	X	X	X	X	X	X	X	**10/11**
Lynn Loewen	X	X	X		X	X	X	X		X	X	**9/11**
Keith G. Martell	X	X	X			X	X	X	X	X	X	**9/11**
Carl H. Otto	X	X		X	X	X	X	X	X	X	X	**10/11**
Anil K. Rastogi	X	X	X	X	X	X	X	X		X		**9/11**
Susan Sherk		X	X	X	X		X	X		X	X	**8/11**

Audit and Conflicts Committee (ACC) – FY 2006

Name	04.06.05	05.11.05	08.03.05	11.09.05	02.08.06	03.29.06	Total Attendance
Paul Cantor (1)	X	X	X	X	X	X	**6/6**
Jean E. Douville	X	X	X	X		X	**5/6**
Carol Hansell (2)	X	X		X		X	**4/6**
Lynn Loewen (3)	X	X	X	X	X	X	**6/6**
Keith G. Martell (3)	X	X	X	X	X	X	**6/6**
Anil K. Rastogi		X	X	X	X		**4/6**

(1) Mr. Cantor is not a member of the ACC, but he is invited to all of the Meetings.
(2) Ms. Hansell has resigned as member effective May 12th, 2006.
(3) Effective April 6, 2006, Mr. Martell resigned as Chair of the ACC and Ms. Loewen was appointed as his replacement.

Governance Committee – FY 2006

Name	04.21.05	07.18.05	10.27.05	12.09.05	01.16.06	03.23.06	Total Attendance
Bob Baldwin (1)	X	X	X	X	X	X	**6/6**
Paul Cantor (2)	X	X		X	X	X	**5/6**
Carol Hansell	X	X	X	X	X	X	**6/6**
Lynn Loewen (1)	X	X	X	X	X	X	**6/6**
Carl H. Otto	X	X	X	X	X	X	**6/6**

(1) Effective April 6, 2006, Ms. Loewen resigned as Chair of the Governance Committee and Mr. Baldwin was appointed as her replacement.
(2) Mr. Cantor is not a member of the Governance Committee, but he is invited to all of the Meetings.

Human Resources and Compensation Committee (HRCC) – FY 2006

Name	04.06.05	06.08.05	06.09.05	08.03.05	09.14.05	11.09.05	02.08.06	Total Attendance
Bob Baldwin (1)	X	X	X	X (part-time only)	X	X	X	**6/7**
Richard Bradshaw	X	X	X	X	X		X	**6/7**
Paul Cantor (2)	X	X	X	X	X	X	X	**7/7**
Jean Lefebvre	X	X	X	X	X	X	X	**7/7**
Susan Sherk		X	X	X	X	X	X	**6/7**

(1) Effective April 6, 2006, Mr. Baldwin resigned as Chair of the HRCC and Mr. Keith G. Martell was appointed as his replacement.
(2) Mr. Cantor is not a member of the HRCC, but he is invited to all of the Meetings.

Investment Sub-Committee – FY 2006

Name	02.08.06	Attendance
Richard Bradshaw	X	**1/1**
Paul Cantor (1)	X	**1/1**
Jean Lefebvre	X	**1/1**
Carl H. Otto	X	**1/1**

(1) Mr. Cantor is Chair of the Investment Sub-Committee and therefore, a member of this Committee.

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