

# Public Sector Pension Investment Board



# Public Sector Pension Investment Board

## Auditors' Report

To the Board of Directors of  
Public Sector Pension Investment Board

We have audited the Balance Sheet and the Statement of Investment Portfolio of the Public Sector Pension Investment Board ("PSP Investments") as at March 31, 2004 and the Statements of Net Income (Loss) 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 financial statements present fairly, in all material respects, the financial position of PSP Investments and the investments held as at March 31, 2004 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.

Further, in our opinion, the transactions of PSP Investments that have come to our attention during our audit of the financial statements have, in all significant respects, been in accordance with the *Public Sector Pension Investment Board Act* (the "Act") and the by-laws.

Further, in our opinion, the record of investments kept by PSP Investments' management pursuant to paragraph 35 (1) (c) of the *Act* fairly presents, in all material respects, the information required by the *Act*.

*Deloitte & Touche LLP*

Chartered Accountants  
Toronto, Ontario  
April 30, 2004

# Public Sector Pension Investment Board

## Balance Sheet

As at March 31

	2004 (\$,000)	2003 (\$,000)
<b>ASSETS</b>		
Investments—at fair value (Note 2)	<b>14,233,209</b>	8,101,641
Cash	<b>1,571</b>	—
Other assets (Note 3)	<b>3,039</b>	2,031
	<b>14,237,819</b>	8,103,672
<b>LIABILITIES</b>		
Bank overdraft (Note 4)	—	2,973
Accounts payable and accrued liabilities	<b>5,890</b>	4,987
	<b>5,890</b>	7,960
<b>NET ASSETS</b>	<b>14,231,929</b>	8,095,712
<b>NET ASSETS REPRESENTED BY</b>		
Public Service Pension Plan Account	<b>10,205,922</b>	5,756,832
Canadian Forces Pension Plan Account	<b>2,969,369</b>	1,723,935
Royal Canadian Mounted Police Pension Plan Account	<b>1,056,638</b>	614,945
	<b>14,231,929</b>	8,095,712

On behalf of the Board of Directors:



Keith Martell

Director and Chair of the Audit and Conflicts Committee

## Statement of Changes in Net Assets

For the year ended March 31

	2004 (\$,000)	2003 (\$,000)
NET ASSETS, BEGINNING OF YEAR	<b>8,095,712</b>	5,646,639
<b>CHANGES IN NET ASSETS</b>		
Fund transfers (Note 5)	<b>3,695,567</b>	3,382,074
Net income (loss) from operations	<b>2,440,650</b>	(933,001)
<b>NET ASSETS, END OF YEAR</b>	<b>14,231,929</b>	8,095,712

# Public Sector Pension Investment Board

## Statement of Net Income (Loss) from Operations

For the year ended March 31

	2004 (\$,000)	2003 (\$,000)
INVESTMENT INCOME AND GAINS (LOSSES) (Note 6)		
Interest and dividends	312,240	247,218
Net realized gains (losses)	192,369	(163,819)
Change in unrealized appreciation (depreciation) in value of investments	1,957,158	(1,003,410)
	<b>2,461,767</b>	(920,011)
EXPENSES		
Operating expenses (Note 8a)	12,110	8,997
External investment management fees	9,007	3,993
	<b>21,117</b>	12,990
<b>NET INCOME (LOSS) FROM OPERATIONS (Note 9)</b>	<b>2,440,650</b>	(933,001)

## Statement of Investment Portfolio

As at March 31

	2004		2003	
	Cost (\$,000)	Fair Value (\$,000)	Cost (\$,000)	Fair Value (\$,000)
Investments (Note 2)				
<b>PSP Canadian Equities Fund</b>				
Active management	2,092,955	2,467,869	1,599,043	1,478,865
Indexed management	2,456,707	2,863,973	1,885,369	1,683,141
	<b>4,549,662</b>	<b>5,331,842</b>	3,484,412	3,162,006
<b>PSP Foreign Equities Fund</b>				
Active management	1,419,440	1,612,849	1,361,247	1,164,159
Indexed management	2,234,584	2,314,825	1,174,264	916,272
	<b>3,654,024</b>	<b>3,927,674</b>	2,535,511	2,080,431
<b>PSP Currency Overlay Fund</b>				
Net cash, options on currency and currency contract investment (Note 2g)	88,960	87,590	—	—
<b>PSP Real Estate Fund</b>				
Net Real Estate investment (Note 2h)	72,042	74,342	—	—
<b>PSP Fixed Income Fund</b>				
Active management	2,192,974	2,252,362	1,273,561	1,285,882
Indexed management	2,496,071	2,537,529	1,363,255	1,328,868
	<b>4,689,045</b>	<b>4,789,891</b>	2,636,816	2,614,750
<b>PSP Cash Equivalents Fund</b>				
Cash Equivalents	21,870	21,870	244,454	244,454
	<b>13,075,603*</b>	<b>14,233,209*</b>	8,901,193*	8,101,641*

\* Includes investment receivables of \$19.1 million (2003 - \$57.5 million) and investment payables of \$58.0 million (2003 - \$83.4 million) pertaining to pending trades and forward currency contracts for a net payable of \$38.9 million (2003 - \$25.9 million). Also includes accrued income of \$36.0 million (2003 - \$25.0 million).

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 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 in financial markets the contributions to the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans. Prior to the implementation of the provisions of the Act, the balances of the plans were credited with a rate of interest based on long-term Government of Canada bonds.

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 to achieving a maximum rate of return, without undue risk of loss, having regard 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 financial statements present the financial position and operations of PSP Investments 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 statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Act.

### Plan Accounts

PSP Investments maintains records of each Pension Funds' 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 published.

### Valuation of investments

Investments are recorded as of the trade date and are stated at fair value. Fair value is 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 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 investments. Unit values reflect the quoted market prices of the underlying securities.
- (c) Fixed Income securities are valued at year-end quoted market prices where available. Where quoted market prices are not available, estimated values are calculated using an appropriate interest rate curve with a spread associated with the credit quality of the issuer.
- (d) Currency forward contracts are derivative financial instruments between two parties to exchange currencies at a designated price and future delivery date. Forward contracts are valued at the gain or loss that would arise as a result of closing the position at the reporting date.
- (e) Currency options are derivative financial instruments which give the owner the opportunity to buy or sell the underlying currency, from or to respectively, the writer of the option at a fixed price on the option's expiry date. Currency options are traded over-the-counter and are valued at the premium adjusted by the gain or loss that would arise as a result of closing the position at the reporting date.
- (f) The fair value of investments in Real Estate is determined at least annually using acceptable industry valuation methods, such as discounted cash flows.

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### **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. These income items include the related distributions from pooled funds.

#### **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 each Pension Fund are recorded on a cash basis in their respective Plan Account.

#### **Income Taxes**

PSP Investments is exempt from Part I tax under paragraph 149(1) (d) of the *Income Tax Act* (Canada).

#### **Use of estimates**

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

### 2. INVESTMENTS

The Statement of Investment Portfolio provides details of investments held as at March 31, 2004.

#### **(a) Investment Policy**

PSP Investments has established a Statement of Investment Policies, Standards and Procedures, (the "Investment Policy") which sets out the manner in which the assets shall be invested for the three Plan Accounts. Asset mix policy and benchmarks as at March 31, 2004 were as follows:

Asset Class	Policy Mix	Benchmark
Canadian Equities	35.0%	S&P/TSX
Foreign Equities	30.0%	S&P 500, MSCI EAFE
Real Estate *	up to 5.0%	CPI + 4%
Fixed Income	32.0%	SC Bond Universe
Cash Equivalents	3.0%	SC 91-day T-bill

\* Any investments in the Real Estate asset class will automatically reduce the designated target weight for the Fixed Income asset class.

#### **(b) Investment asset mix**

The investment asset mix, after allocating the impact of PSP Currency Overlay Fund, as at March 31, was as follows:

Asset Class	2004			2003		
	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)
Canadian Equities	4,549,662	5,331,842	37.5	3,484,412	3,162,006	39.0
Foreign Equities	3,669,399	3,941,679	27.7	2,535,511	2,080,431	25.7
Real Estate	72,042	74,342	0.5	—	—	—
Fixed Income	4,689,045	4,789,891	33.6	2,636,816	2,614,750	32.3
Cash Equivalents	95,455	95,455	0.7	244,454	244,454	3.0
	<b>13,075,603</b>	<b>14,233,209</b>	<b>100.0%</b>	8,901,193	8,101,641	100.0%

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 2. INVESTMENTS (continued)

#### (c) Foreign currency exposure

PSP Investments is exposed to currency risk through holdings of securities and units in pooled funds of non-Canadian assets where investment values will fluctuate due to changes in foreign exchange rates. PSP Investments also takes, through derivative contracts, trading positions in foreign currencies with the objective of adding value.

The underlying net foreign currency exposures in Canadian Dollars, before allocating the economic impact of PSP Currency Overlay Fund, as at March 31 were as follows:

Currency	2004		2003	
	Fair Value (\$,000)	% of Total	Fair Value (\$,000)	% of Total
US Dollars	2,196,766	55.8	1,223,964	58.9
Euro	655,043	16.6	315,711	15.2
Yen	431,609	11.0	176,794	8.5
British Pound	325,194	8.3	197,733	9.5
Others	328,131	8.3	164,628	7.9
	<b>3,936,743</b>	<b>100.0%</b>	2,078,830	100.0%

The fair values of PSP Foreign Equities Fund and PSP Currency Overlay Fund include \$4,936 thousand of Canadian dollars (2003 - \$1,601 thousand) which are not included in the foreign currency exposure.

#### (d) Credit risk

Credit risk arises in the Cash Equivalents and the Fixed Income asset classes. Credit risk is managed through minimum DBRS (or equivalent) rating requirements.

PSP Investments' highest concentration of credit risk is with the Government of Canada through its holding of \$1.8 billion of Government of Canada issued securities.

PSP Investments, to minimize derivative contract credit risk, deals only with counterparties, which are major financial institutions with a minimum credit standard rating of "A", as supported by a recognized credit rating agency.

#### (e) 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 manage this risk.

*PSP Canadian Equities Fund - 10 largest holdings*

Company Name	Fair Value (\$,000)	% of PSP Canadian Equities Fund
1 Bank of Nova Scotia	269,892	5.1
2 Royal Bank of Canada	254,876	4.8
3 Nortel Networks Corporation	213,712	4.0
4 Manulife Financial Corporation	203,180	3.8
5 The Toronto Dominion Bank	189,523	3.6
6 Encana Corporation	183,087	3.4
7 Bank of Montreal	161,311	3.0
8 Canadian Imperial Bank of Commerce	158,028	3.0
9 Alcan Inc.	129,296	2.4
10 Sun Life Financial Services of Canada Inc.	122,267	2.3
<b>Total 10 largest Holdings</b>	<b>1,885,172</b>	<b>35.4 %</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 2. INVESTMENTS (continued)

#### (e) Market risk (continued)

*PSP Foreign Equities Fund – 10 largest holdings*

Company Name	Fair Value (\$,000)	% of PSP Foreign Equities Fund
1 Citigroup Inc.	59,653	1.5
2 Vodafone Group Plc	51,150	1.3
3 General Electric Company	45,320	1.2
4 Tyco International Ltd	44,303	1.1
5 Nextel Communications Inc.	43,761	1.1
6 Exxon Mobil Corporation	40,390	1.0
7 Royal Dutch Petroleum Company	40,311	1.0
8 Microsoft Corporation	39,568	1.0
9 Pfizer Inc.	39,304	1.0
10 Wal-Mart Stores Inc.	38,046	1.0
<b>Total 10 largest Holdings</b>	<b>441,806</b>	<b>11.2%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

The PSP Fixed Income Fund holds securities invested in Canada as follows:

	Fair Value (\$,000)	% of PSP Fixed Income Fund
Government of Canada	1,807,738	37.7
Provincial	1,083,539	22.6
Municipal	13,996	0.3
Corporate	1,574,920	32.9
Cash and Cash Equivalents	309,698	6.5
<b>Total of PSP Fixed Income Fund</b>	<b>4,789,891</b>	<b>100.0%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

As at March 31, 2004, 47% of the PSP Fixed Income Fund was managed actively with duration of 6.3 years (a 1% increase in interest rates would result in a decline in the value of the actively managed fixed income securities of 6.3%). The balance of portfolio is managed passively against the SC Bond Universe index. The index has a duration of 6.0 years.

#### (f) Securities lending

PSP Investments participates in securities lending programs whereby it lends securities it owns to other parties. Any such securities lending requires collateral in cash or high quality debt instruments or shares securities with a fair value equal to no less than 105% of the value of the securities lent. As at March 31, 2004, securities with an estimated fair value of \$763,886 thousand (2003- nil) were loaned out, while securities contractually receivable as collateral had an estimated fair value of \$805,868 thousand (2003- nil).

#### (g) PSP Currency Overlay Fund

The PSP Currency Overlay Fund comprises cash equivalents and derivative instruments (currency forward and currency options contracts) used to reduce the foreign currency risk exposure or, as an alternative to holding the underlying currency.

In accordance with the Investment Policy, the market exposures created by the derivative contracts are fully covered by cash or other assets.



# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 2. INVESTMENTS (continued)

#### (g) PSP Currency Overlay Fund (continued)

The following table summarizes the portfolio of the PSP Currency Overlay Fund as at March 31:

Investment	2004		2003	
	Notional Value*	Fair Value	Notional Value *	Fair Value
	(\$,000)	(\$,000)	(\$,000)	(\$,000)
Cash Equivalents		81,296		—
Currency Options	785,775	13,294	—	—
Currency Forwards	374,561	(7,000)	—	—
		87,590		—

\* 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. All amounts are in Canadian dollars.

#### (h) PSP Real Estate Fund

The PSP Real Estate Fund comprises investment in two funds managed by external advisors. These funds hold a diversified portfolio of primarily Canadian income producing properties. Certain of the funds require investors to finance any cash deficiencies. The Funds are permitted to use financing on the underlying properties to a maximum leverage of 65% for one of the funds and a maximum leverage of 75% for the second fund.

Management fees are based upon a percentage of assets under management and are charged to the funds. The reported fair value for the funds is net of these fees.

As at March 31, 2004, PSP Investments has committed to invest an additional \$15.9 million in those real estate funds.

The underlying real estate exposures by type of property and location as at March 31, were as follows:

Type of Property	2004	2003	Location	2004	2003
	%	%		%	%
Office	48	—	Ontario	51	—
Industrial	33	—	Alberta	29	—
Retail	17	—	British Columbia	20	—
Land	2	—			
	100%	—%		100%	—%

### 3. OTHER ASSETS

Other assets as at March 31 consist of the following:

	2004	2003
	(\$,000)	(\$,000)
Fixed assets	2,152	1,287
Other assets	887	744
	3,039	2,031

### 4. BANK OVERDRAFT

The bank overdraft is an infrequent occurrence and arises from temporary requirements to settle security purchases prior to receiving the contribution from one of the Pension Funds. The amount is repaid within two business days.

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 5. FUND TRANSFERS

During the year, PSP Investments received \$3,695.6 million (2003 - \$3,382.1 million) of transfers from the three Pension Funds. The transfers result from net current employer and employee contributions to their respective Pension Plan.

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

	2004 (\$,000)	2003 (\$,000)
Public Service Pension Fund	2,708,522	2,442,872
Canadian Forces Pension Fund	728,979	687,973
Royal Canadian Mounted Police Pension Fund	258,066	251,229
<b>Total Fund Transfers</b>	<b>3,695,567</b>	<b>3,382,074</b>

### 6. INVESTMENT INCOME AND GAINS(LOSSES)

#### (a) Investment income and gains (losses) before allocating the effect of derivative contracts

Investment income and gains (losses), before giving effect to derivative contracts and before allocating the realized gains (losses) and change in unrealized appreciation (depreciation) in value of investments for the year ended March 31, is presented below. Income from assets backing derivative financial instruments is reported in the particular backing asset category.

	2004 (\$,000)	2003 (\$,000)
<b>Interest-Bearing Investments</b>		
Short-term	4,881	6,380
Canadian bonds and debentures	178,741	143,221
	<b>183,622</b>	149,601
<b>Equity Investments</b>		
Canadian equities dividends	71,819	48,842
Foreign equities dividends	55,602	48,775
	<b>127,421</b>	97,617
<b>Real Estate Investments</b>	<b>1,197</b>	—
	<b>312,240</b>	247,218
Net gain (loss) on investments and derivatives financial instruments	<b>2,149,527</b>	(1,167,229)
	<b>2,461,767</b>	(920,011)

#### (b) Investment income and gains(losses) by Asset Class

Investment income and gains (losses) by asset class, after allocating the effect of derivative contracts and net realized gains (losses) and change in unrealized appreciation (depreciation) in value of investments, for the year ended March 31, is as follows:

Asset Class	2004 (\$,000)	2003 (\$,000)
Canadian Equities	1,275,930	(449,105)
Foreign Equities <sup>1</sup>	808,064	(657,459)
Real Estate	3,496	—
Fixed Income	369,396	180,173
Cash Equivalents	4,881	6,380
	<b>2,461,767</b>	(920,011)

<sup>1</sup> Including foreign currency realized gains of \$1,987 thousand (2003 - \$1,425 thousand) and foreign currency unrealized gains of \$152,261 thousand (2003 - unrealized loss of \$27,209 thousand)

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 7. INVESTMENT PERFORMANCE

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

	2004		2003		
	Portfolio Returns	Benchmark Returns	Portfolio Returns	Benchmark Returns	
Canadian Equities	<b>36.1%</b>	<b>37.7%</b>	(18.6)%	(17.6)%	S&P/TSX
Foreign Equities	<b>30.7%</b>	<b>28.8%</b>	(30.5)%	(29.9)%	S&P 500, MSCI EAFE
Real Estate	<b>3.6%</b>	<b>2.5%</b>	—	—	CPI + 4%
Fixed Income	<b>10.9%</b>	<b>10.8%</b>	9.4%	9.2%	SC Bond Universe
Cash Equivalents	<b>3.2%</b>	<b>3.0%</b>	3.2%	2.7%	SC 91-day T-bill
Total Return	<b>26.1%</b>	<b>25.4%</b>	(13.5)%	(12.9)%	

The total benchmark return aggregates the asset class benchmark returns according to the weights specified in the Investment Policy, as disclosed in Note 2 (a). The total return includes the impact of the PSP Currency Overlay Fund. Returns have been calculated in accordance with the mandatory requirements set forth by the Association for Investment Management and Research (AIMR). Returns are presented gross of expenses.

### 8. EXPENSES

#### (a) Operating expenses

Operating expenses consist of the following:

	2004	2003
	(\$,000)	(\$,000)
Salaries and benefits	<b>5,582</b>	4,544
Professional and consulting fees*	<b>1,867</b>	1,273
Office supplies and equipment	<b>1,476</b>	1,091
Occupancy costs	<b>729</b>	570
Depreciation of fixed assets	<b>621</b>	105
Custody and fund administration	<b>460</b>	351
Remuneration earned by Directors	<b>434</b>	425
Travel and related expenses for Directors	<b>177</b>	150
Communication expenses	<b>224</b>	151
Other operating expenses	<b>540</b>	337
	<b>12,110</b>	8,997

\* Included in Professional and consulting fees are audit and audit-related fees of \$428 thousand (2003 - \$187 thousand) that were paid to the external auditors of PSP Investments. No amounts were paid for non-audit fees to the external auditors in fiscal years 2004 and 2003.

Total remuneration earned by Directors in fiscal year 2004 includes 1) an annual retainer of \$71,500 for the Board Chairperson and of \$16,000 for each Director; 2) an annual retainer of \$5,000 for each committee chair; 3) Board and committee meeting fees of \$1,000 per meeting and; 4) a travel time meeting fee of \$1,000 if distance to and from the meeting is greater than 1,000 km from the director's primary residence. 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.

# Public Sector Pension Investment Board

## Notes to the Financial Statements

For the year ended March 31, 2004

### 8. EXPENSES (continued)

#### (b) Salaries and benefits

Included in salaries and benefits is compensation earned by executive officers. The total compensation earned during the fiscal year by the executive officers was as follows:

Employee / Position	Year	Base Salary (\$)	Annual Bonus <sup>5</sup> (\$)	Long Term Incentive Plan <sup>5</sup> (\$)	Benefits <sup>6</sup> (\$)
Gordon J. Fyfe <sup>1</sup> President and Chief Executive Officer	2004	188,000	244,000	—	17,000
Danielle G. Morin <sup>2</sup> First Vice President and Chief Financial Officer (CFO)	2004 2003	208,000 195,000	144,000 88,800	— —	29,000 29,000
Pierre Malo <sup>3</sup> Vice President	2004	65,000	78,500	—	8,000
Derek Murphy <sup>4</sup> First Vice President, Private Equity	2004	—	—	—	—

1 The President and Chief Executive Officer commenced employment on October 9, 2003, and in addition to above, was awarded a signing bonus of \$450,000.

2 The bonus for fiscal year 2004 includes a special bonus of \$50,000, for being acting CEO.

3 The Vice President commenced employment on December 8, 2003, and in addition to above, was awarded a signing bonus of \$325,000.

4 The First Vice President, Private Equity commenced employment on March 31, 2004, and was awarded a signing bonus of \$51,000.

5 Bonus awards include short-term and long-term components and are based on the achievement of agreed objectives. PSP Investments has established a new program for the long-term bonus which was implemented in fiscal year 2003.

6 Benefits include other miscellaneous non-cash remuneration. In addition to the above, the executive officers are covered by a contributory defined benefit pension plan which provides them with a pension benefit of 2% of the best 3 years average earnings for each year of service. Furthermore, the President and CEO and the CFO are members of a supplementary executive retirement plan.

### 9. ALLOCATION OF NET INCOME (LOSS) FROM OPERATIONS

The allocation of the net income (loss) from operations of PSP Investments to each Plan Account is as follows:

#### (a) Investment Income and Gains (Losses)

The investment income has been allocated according to the number of units of PSP funds 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 Defence and the Solicitor General of Canada. 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:

	2004	2003
Public Service Pension Plan Account	71.1%	70.4%
Canadian Forces Pension Plan Account	21.3%	21.9%
Royal Canadian Mounted Police Pension Plan Account	7.6%	7.7%

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.