



National  
Defence

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nationale

CANADIAN FORCES PENSION PLANS



2011 - 2012 ANNUAL REPORT

# YOUR PLANS... YOUR FUTURE



Canada



## Foreword

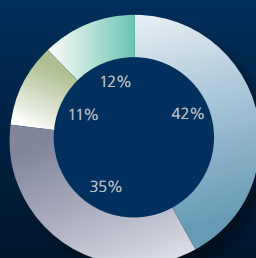
# Financial Highlights

## Your Plans at a Glance

Benefits:	Benefits paid under the pension plans during the year totalled \$2.592 billion, including \$2.550 billion paid to retired reservists under the RFPF. At 31 March 2012, there were 86,760 pensioners, 23,199 surviving spouses and 747 surviving children in receipt of monthly annuity payments.
Investment performance:	The investments of contributions from members of the pension plans managed by PSPIB earned income of \$374 million (\$1.415 billion in 2011), or 3.0 % with an investment policy benchmark of 1.6 % (14.5 % return and an investment benchmark of 12.7 % in 2011). The CF Superannuation Account was credited with \$2.680 billion (\$2.887 billion in 2011) in interest, representing a 5.8 % (6.3 % in 2011) rate of return.
Contributions:	Member and Government of Canada contribution receipts during the year totalled \$352 million and \$831 million respectively. At 31 March 2012, there were 67,702 Regular Force contributors, 4,171 Reserve participants in the CFPP and 21,511 Reserve participants in the RFPF.
Contributions receivable:	Members elected to purchase prior service with an estimated actuarial value of \$77.3 million. The Government of Canada share of these elections has an estimated actuarial value of \$134.5 million.

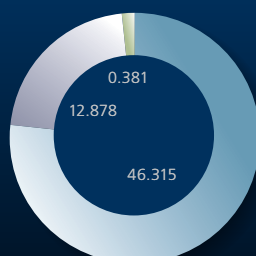
### MEMBERSHIP STATISTICS AS OF 31 MARCH 2012

- Retired Members
- Serving Members — CFPP
- Serving Members — RFPF
- Survivors



### PLAN ASSETS (IN \$ BILLIONS)

- CFSA
- CFPP
- RFPF



### RATE OF RETURN ON ASSETS AND INVESTMENTS

- CFPP/RFPF
- CFSA





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# Messages



## From the Chief of Military Personnel

As a member of the Canadian Forces (CF), both you and the Federal Government contribute to a pension plan that provides a strong foundation on which to build a secure financial future. Your pension is a key part of your overall compensation package. Your CF pension, along with your own savings, investments, and benefits from the Canada Pension Plan (CPP)/Québec Pension Plan (QPP) and Old Age Security, provide the basis for stable retirement years.

My responsibilities for the administration, policy development and improvement of the CF pension plans, in addition to my other personnel obligations, shape my priorities as Chief of Military Personnel. We will continue to recruit Canada's best, and work hard to enable their lasting service in the Canadian Forces. We will continue to care for those who are ill or injured, whether physically or mentally. We will care for our military families, who have such a central role to play in keeping us strong. Your CF pension is part of the way that we continue that care into your retirement years. Your service to your country is highly valued, and the government's investment in your CF pension plans reflects the importance of that service.





## From the Assistant Deputy Minister — Finance and Corporate Services

As the Chief Financial Officer of the Department, my interests include the financial aspects of the Canadian Forces pension plan and the Reserve Force pension plan, collectively referred to as the pension plans. This includes the investment returns generated by the Public Sector Pension Investment Board (PSPIB) and the funding status of the pension plans as determined by the Office of the Chief Actuary.

PSPIB has a large investment base, investing for the four major federal public sector pension plans. As a result, they have economies of scale in investments that would not be achievable for each plan individually. Leveraging this competitive advantage is critical to the successful funding of the pension funds.

The financial results for the year ended 31 March 2012 provided by PSPIB indicated a rate of return of 3.0 %, compared to 14.5 % in the previous year. The relatively weaker performance in the public equity asset class was caused by an unstable global economy, while relatively strong returns were realized in the real estate, fixed income, and private equity asset classes. The return reported by PSPIB exceeded its overall policy portfolio target of 1.6 %.

The Chief Actuary of Canada reports on the fund status of the pension plans every three years, while also providing accounting updates on an annual basis. These evaluations confirm that the financial aspects of the plan are considered on a frequent basis to ensure that funding issues are addressed in a timely manner.

The Office of the Auditor General has given a clean audit opinion on the Canadian Forces pension plan financial statements for fiscal year 2011–2012. This marks the 12<sup>th</sup> consecutive unmodified audit opinion obtained by this pension plan. The Reserve Force pension plan was not audited for fiscal year 2011–2012. The Department is working on reducing the backlog of Reserve Force past service elections, to allow the Office of the Chief Actuary to formulate an auditable estimate of the pension obligation against that plan. The Department expects that the Reserve Force pension plan financial statements will not be auditable until at least fiscal year 2013–2014.

The buyback of Reserve Force past service elections has required an increase in administrative expenses, particularly for the Reserve Force pension plan. As a result, the cost per member for the Reserve Force pension plan is higher than other public sector pension plans. These additional costs are temporary and should begin to abate by 2018. At that time, the cost per member for the Reserve Force pension plan should approach the cost per member of other public sector pension plans.



# Mission and Vision of the Canadian Forces Pension Plans

The mission of the Canadian Forces (CF) pension plans, referred to as the Canadian Forces pension plan (CFPP) and the Reserve Force pension plan (RFPP), or collectively as the “pension plans,” is to develop and deliver retirement and survivor benefits that recognize the contributions to Canada made by current and former Regular Force and Reserve Force members and their survivors. The pension plans are an important part of helping CF members achieve financial security in retirement, and a key component of the overall compensation package. The mission also intends to ensure that administrative expenses of the pension plans are comparable to those of similar pension plans and that they are managed efficiently and effectively. The assets of the pension plans are protected through compliance with applicable federal legislation and judicious investments chosen to ensure long-term sustainability.



**THE MISSION WILL BE ACHIEVED BY ENSURING THAT THE PENSION PLANS ARE SUSTAINABLY PROGRESSING TOWARD THE FOLLOWING STRATEGIC OUTCOMES, AS MEASURED BY A ROBUST PERFORMANCE MEASUREMENT FRAMEWORK:**

1. Members see the pension plans as a value-added part of their CF careers and the related services as helpful during life decisions;
2. Retiring CF members are confident that the pension plans will assist them in their transition from the CF; and
3. Members' survivors see the pension plans' benefits and related services as supportive in time of need.



## Annual Report of the Canadian Forces Pension Plans

# Introduction and Overview

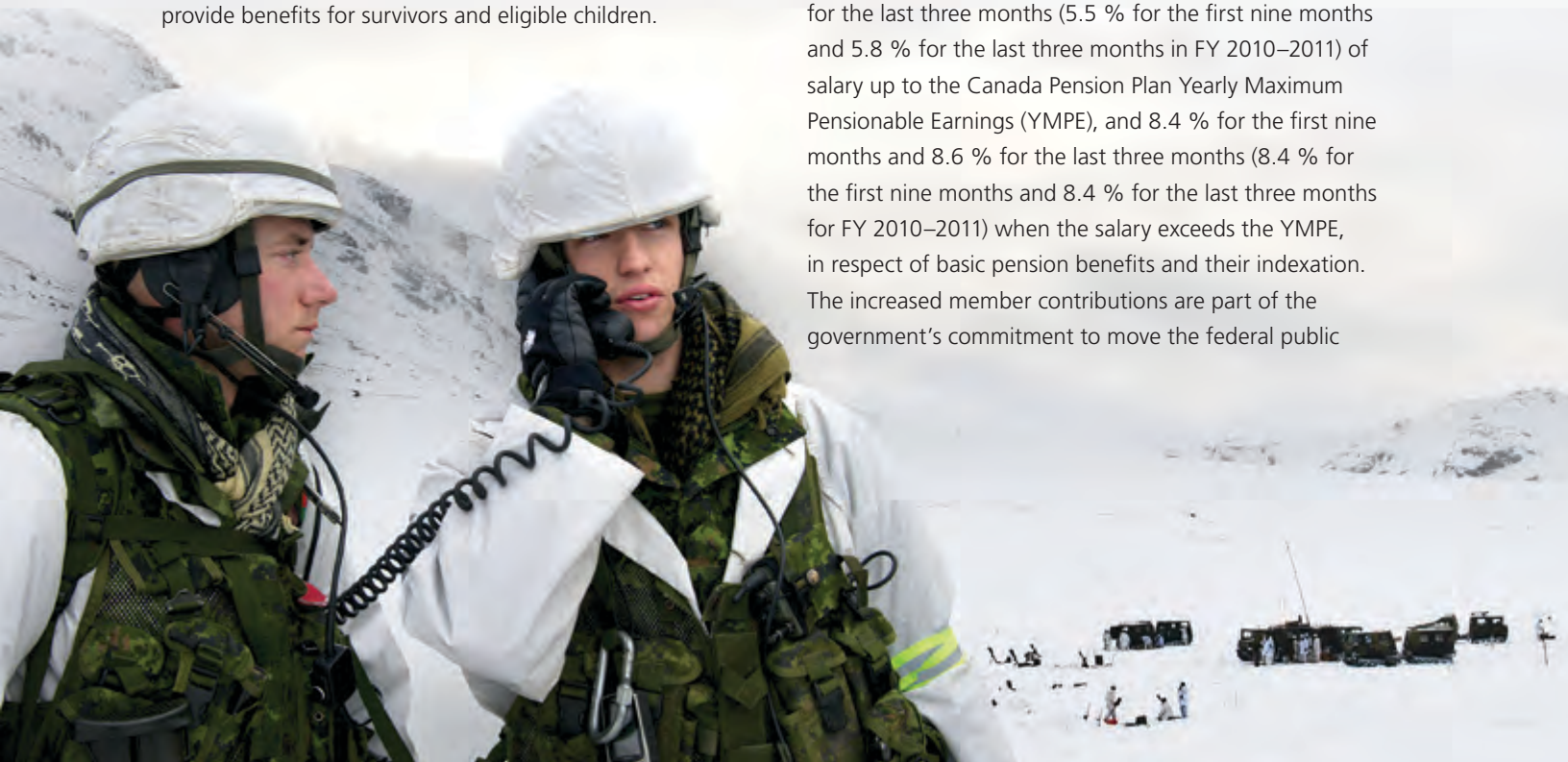
Pursuant to sections 57, 59.7 and 72 of the *Canadian Forces Superannuation Act* (the “Act”), the fiscal year (FY) 2011–2012 Canadian Forces Pension Plans Annual Report provides an overview of the financial status of the pension plans as at 31 March 2012, as well as information about their membership, administration, and benefits. All information provided is with respect to both the CFPP and the RFPP, the latter having come into force on 01 March 2007. Regulations provide for financial statements of the RFPP beginning with the FY ending 31 March 2008.

## Overview

Established in 1901 under the *Militia Pension Act*, the present CF pension plans are administered in accordance with the provisions of the Act and its supporting regulations. The CFPP covers all members of the Regular Force component of the CF. Reserve Force members who have sufficient qualifying service and pensionable earnings are members of either the CFPP or the RFPP, depending on their employment status and earnings. As of 31 March 2012, there were 71,873 active CFPP contributors and 21,511 RFPP participants. In the event of a contributor's death, the pension plans can provide benefits for survivors and eligible children.

The pension plans are defined as contributory defined benefit pension plans. A contributory plan is one to which both the employer and the employee make payments. A defined benefit plan is one in which the benefits payable on death, disability, termination of service, and retirement are specified in the plan document — in this case, the Act and the Regulations. The benefits are directly related to the employee's earnings and period of pensionable service.

For FY 2011–2012, CFPP members (Regular Force members and qualifying full-time members of the Reserve Force) contributed 5.8 % for the first nine months and 6.2 % for the last three months (5.5 % for the first nine months and 5.8 % for the last three months in FY 2010–2011) of salary up to the Canada Pension Plan Yearly Maximum Pensionable Earnings (YMPE), and 8.4 % for the first nine months and 8.6 % for the last three months (8.4 % for the first nine months and 8.4 % for the last three months for FY 2010–2011) when the salary exceeds the YMPE, in respect of basic pension benefits and their indexation. The increased member contributions are part of the government's commitment to move the federal public



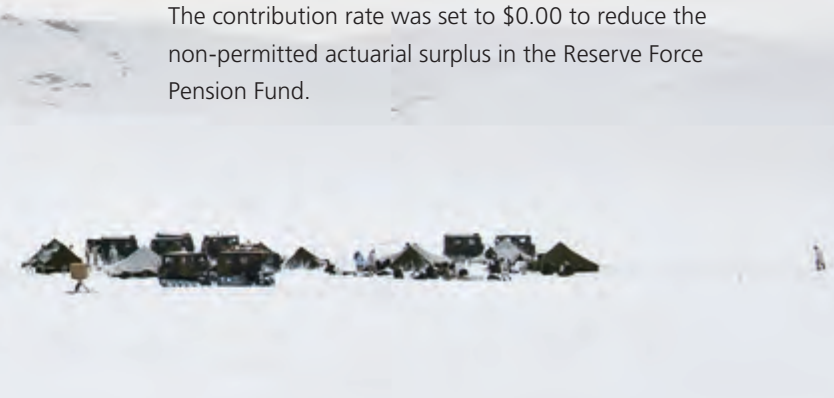




service pension plans closer to a 50-50 cost share between employees and the employer; this initiative is discussed more in the *Looking Forward* section. For the same year, part-time members of the Reserve Force who participated in the RFPP contributed 5.2 % for the year (5.2 % for FY 2010–2011) of salary in respect of basic pension benefits and their indexation.

Each year the Government as the employer contributes an amount that ensures sufficient future funds will be available related to the benefits earned by employees in respect of that year, as determined by the President of the Treasury Board. In FY 2011–2012, the employer contributions for the CFPP were \$2.50 for the first nine months and \$2.37 for the last three months (\$2.53 for the first nine months and \$2.50 for the last three months of FY 2010–2011) for every dollar contributed by the employee in respect of current service.

For the same year, the employer contributions for the RFPP were \$1.71 for the first seven months and \$0.00 for the last five months (\$1.74 for the first nine months and \$1.71 for the last three months of FY 2010–2011) for every dollar contributed by the employee in respect of current service. The contribution rate was set to \$0.00 to reduce the non-permitted actuarial surplus in the Reserve Force Pension Fund.



## PENSION BENEFITS UNDER THE CANADIAN FORCES PENSION PLAN

(Section 15 of the Act)

### Lifetime Pension

- $1.375 \% \times \text{total pensionable service} \times \text{average earnings up to the average Year's Maximum Pensionable Earnings (YMPE)}$
- $2.0 \% \times \text{total pensionable service} \times \text{average earnings over the average YMPE}$

**Annual bridge benefit paid until age 65, or until becoming eligible for a Canada Pension Plan/Québec Pension Plan disability pension**

- $0.625 \% \times \text{total pensionable service} \times \text{average YMPE or the average earnings (whichever is lower)}$

## PENSION BENEFITS UNDER THE RESERVE FORCE PENSION PLAN

(Sections 41/48 of the *Reserve Force Pension Regulations*)

### Annual lifetime pension

- $1.5 \% \times \text{total pensionable earnings (updated for wage growth)}$

**Annual bridge benefit paid until reaching age 65, or becoming eligible for a Canada Pension Plan/Québec Pension Plan disability pension**

- $0.5 \% \times \text{total pensionable earnings (updated for wage growth), up to the average Year's Maximum Pensionable Earnings}$



Generally, Regular Force members and qualified full-time members of the Reserve Force who retire with 25 years or the equivalent of 9,131 days or more of CF service (Regular Force Officers require up to 26 years of CF service until the year 2010, 25 years of CF thereafter) are eligible for an immediate annuity (s. 16.1 – s. 16.6 of the *Canadian Forces Superannuation Regulations*). In other circumstances, a member may require more or less pensionable service to receive an immediate annuity. An immediate annuity is based on the pension plan member's average salary during the best five consecutive years of pensionable earnings, times the number of years of pensionable service to a maximum of 35 years times 2 %, which includes a bridge benefit to age 65. The pension plans also provide for survivor benefits, deferred annuities, annual allowances, payments of transfer values, and the return of contributions with interest to those who do not qualify for an immediate annuity.

Generally, Reserve Force members who participate in the RFPP and who retire with at least 9,131 days of CF service are eligible for an immediate annuity based on the total pensionable service, age, and other factors (s. 43 of the *Reserve Force Pension Regulations*). In other circumstances, a participant may require more or less pensionable service to receive an immediate annuity. Benefits are determined

by a formula set out in the legislation (s. 41, s. 47 and s. 48 of the *Reserve Force Pension Regulations*). Unlike benefits payable under the CFPP, which are based on years of pensionable service and the best average five years of service earnings, an RFPP lifetime pension is based on cumulative pensionable earnings only. Those Reserve Force members with sufficient qualifying service are automatically converted to membership under the CFPP.

Annuities and member and survivor annual allowances are subject to cost-of-living increases pursuant to the Act. Applicable increases reflect the rise in the Consumer Price Index.

The *Special Retirement Arrangements Act* (SRAA) was enacted in 1994 to provide for the payment of the portion of pension benefits that cannot be paid from a registered pension plan due to *Income Tax Act* (ITA) restrictions. *Canadian Forces Superannuation Regulations* applicable to the provisions of the SRAA came into force on 01 May 1995. The SRAA created the Retirement Compensation Arrangement (RCA) for the CF, which provides for the portion of the pension benefit that exceeds the ITA limits for payments from a registered pension plan. CF members who reach certain income thresholds automatically contribute under the provisions of the RCA.





## Financial Statements Overview

This annual report presents the financial statements of the CFPP and the RFPP. Where comparative figures appear on a consolidated basis in this report, these are deemed to be unaudited.

The financial statements of the pension plans provide a comprehensive presentation of the pension plans' financial positions. These statements were prepared in accordance with the stated accounting policies of the pension plans, which are based on Canadian accounting standards for pension plans. The presentation and results using the stated accounting policies of the pension plans do not result in any significant differences from Canadian accounting standards for pension plans.

The Office of the Auditor General of Canada (OAG) audits the financial statements of the pension plan. In addition, there are also a number of corporate management reports used by senior management to monitor the investment performance, administration activities, liability position, and design features of the pension plans.

For the fiscal year ended 31 March 2012, the OAG issued an unmodified audit opinion on the financial statements of the CFPP. An unmodified opinion is the independent opinion of the OAG that the financial statements of the CFPP are presented fairly, in all material respects, based on the evidence gathered during their audit.

With regard to the RFPP, the pension plan was not audited for FY 2011–2012. Based on discussions between National Defence and the OAG, it was decided that, since an audit of FY 2011–2012 would result in the same observations as those of the audit of FY 2008–2009 for which a denial of audit opinion was issued, that the audit would resume once the management actions to respond to the key findings in the audit were well underway and could be assessed. The denial of an audit opinion issued by the OAG indicates that they were unable to gather sufficient evidence during their audit to issue an opinion indicating that the financial statements of the RFPP presented the accounts and financial position of the RFPP fairly, in all material aspects. Most significantly, the OAG was unable to comment on the estimated value of the pension obligation of the RFPP, as insufficient prior service election files had been completed

to accurately forecast the overall obligation. During the period leading up to the next audit pension resources will be focused on achieving the administrative improvements that have been planned so that audit observations can be addressed effectively, corrections to accounts in error can be made, and internal controls can be strengthened. It should be noted that the issues highlighted by the OAG in FY 2008–2009 relate to the accounting for Reservists who are members of the RFPP, and Reservists who qualify for membership within the CFPP. Audit observations do not relate to the accounting for full-time Regular Force members of the CFPP.

In respect of pensionable service accrued before 01 April 2000, contributions and benefit payments are recorded in the Canadian Forces Superannuation Account (the "Account") in the Public Accounts of Canada. The balance in the Account is credited with notional interest as if the amount were invested in a portfolio of the Government of Canada long-term bonds. Contributions made in respect of service before 01 April 2000 will continue to be credited with interest at the Government of Canada long-term bond rate. In FY 2011–2012, interest at the rate of 5.81 % per annum was paid by the employer on the balance. At the end of FY 2011–2012, the balance of the Account was \$46.269 billion, and does not include \$45.6 million in contributions receivable for past pensionable service.

Contributions and benefit payments in respect of pensionable service accrued after 31 March 2000 are recorded in either the Canadian Forces Pension Fund Account or the Reserve Forces Pension Fund Account in the Accounts of Canada. Contributions net of current benefits and administration expenses of the pension plans are regularly transferred to the Public Sector Pension Investment Board (PSPIB) for investment in capital markets to build assets to pay future benefits. The OAG and Deloitte & Touche LLP audit the financial statements of PSPIB.

The financial statements of the CFPP indicate that the CFPP liabilities exceeded CFPP assets by \$333 million in FY 2011–2012.

The financial statements of the RFPP indicate that the RFPP assets exceeded RFPP liabilities by \$116.7 million in FY 2011–2012.

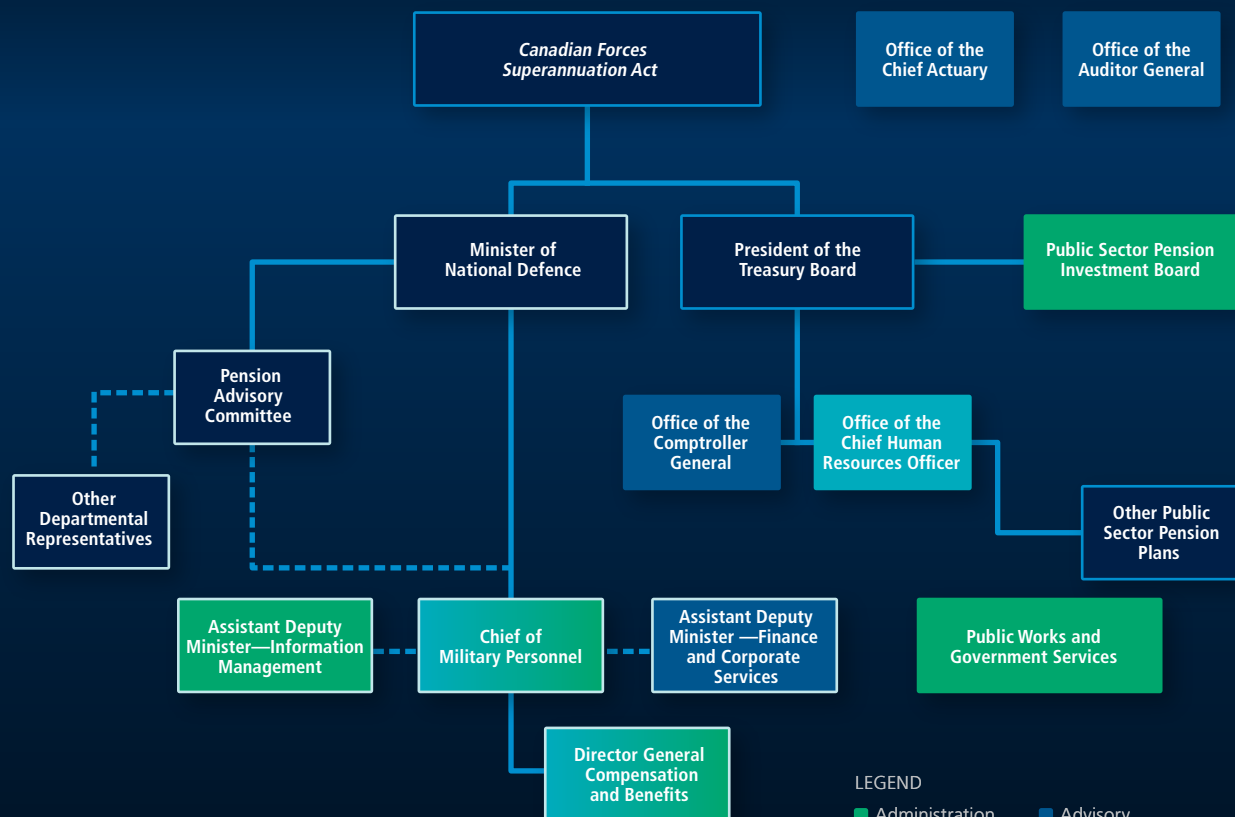


# Pension Plan Governance and Oversight

## Governance Structure and Primary Stakeholders

In accordance with the Act, the Minister of National Defence is responsible for the overall management of the pension plans, including the day-to-day administration and maintenance of the books of account. The President of the Treasury Board oversees the pension plans and is responsible for tabling actuarial valuations before Parliament. Responsibility for the integrity and objectivity of the financial statements of the pension plans rests jointly with both ministers.

### Overview of accountabilities under the *Canadian Forces Superannuation Act*



## Roles and Responsibilities

**Department of National Defence (DND):** The Minister of National Defence is responsible for the Pension Services and Pension Policy organizations. Pension Services is responsible for the administration of the pension plans, contribution and benefit calculations, financial analysis, program advice and interpretation, and preparation of the Annual Report of the Canadian Forces Pension Plans. Pension Policy is responsible for the analysis, design, and policy of the CF pension programs, including amendments to the Act and its regulations. Within the Department are support organizations that assist the Pension Services and Pension Policy organizations, as is the case with the maintenance, improvement, and upkeep of the pay and pension systems.

**Treasury Board of Canada Secretariat (TBS):** The Pension and Benefits Sector of TBS is responsible for the overall pension policy for the four major federal public sector pension plans. The Act requires the President of the Treasury Board to consult with the Minister of National Defence on funding matters. TBS provides general guidance to the Department of National Defence on the accounting for the pension plans through the Office of the Comptroller General.

**Public Works and Government Services Canada (PWGSC):** Under the direction of its Minister, the Specialized Services Division (SSD) of the Compensation sector of PWGSC is responsible for the management of the CF annuitant payroll function on behalf of the Department. As Receiver General for Canada, the Minister of PWGSC is responsible for the central treasury and payments functions. Additionally, PWGSC is the lead department for the Government of Canada Pension Modernization Project (GCPMP), which seeks to implement common pension administration system and business processes that can be adopted by the four major federal public sector pension plans (public service, CF, Reserve Force and Royal Canadian Mounted Police). The Department of National Defence is working with PWGSC to use the GCPMP solution for future military pension administration.

**Public Sector Pension Investment Board (PSPIB):** PSPIB is a Crown corporation that reports to Parliament through the President of the Treasury Board. In accordance

with the *Public Sector Pension Investment Board Act* and its Regulations, since 01 April 2000, employees' and employers' pension contributions net of benefit payments and administration expenses are transferred to PSPIB and are invested in a mix of Canadian and foreign equities, fixed income securities, and real estate. The relevant financial results of PSPIB are included in the pension plans' annual financial statements.

**Office of the Superintendent of Financial Institutions (OSFI):** As required by the *Public Pensions Reporting Act*, OSFI performs triennial actuarial valuations of the pension plans. These valuations, which are tabled in Parliament by the President of the Treasury Board, are used to compare the pension plans' assets and other accounts with its liabilities and estimate the contribution rates required to ensure the pension plans' ongoing financial sustainability. The last actuarial reports on the pension plans were conducted as at 31 March 2010. For accounting purposes, the triennial actuarial valuations are updated annually using management's best estimate assumptions, and actual data on annuitants and contributors provided by the Department.

**Office of the Auditor General (OAG):** The OAG is responsible for the annual audit of the pension plans' year-end financial statements in order to provide assurance that the financial statements are presented fairly, in accordance with Canadian GAAP and that the pension plans comply with the key legislative authorities that govern their activities.

**Canadian Forces Pension Advisory Committee (CFPAC):** The CFPAC is an advisory committee to the Minister of National Defence, comprised of ten members — one pensioner, three members representing active Regular Force contributors, one member representing Reserve Force personnel, and five other members — all appointed by the Minister. As of 31 March 2012, one position was vacant. This committee reviews and provides advice and recommendations to the Minister of National Defence on pension issues and considers any pension-related matters that the Minister may refer to it. The Chief of Military Personnel is the chair of the CFPAC. The membership of CFPAC as at 31 March 2012 can be found following the contact information at the end of this report.

# Report from Management

## Highlights

**Membership:** Membership in the pension plans has remained relatively constant, reflecting the overall state of the CF membership. During the year, 2,882 members of the Reserves qualified for the RFPP, with another 582 meeting the qualifying service threshold to be deemed members of the CFPP.

Membership Statistics as of 31 March 2012	
Population Group	Number of Participants
Retired members	86,760
Survivors	23,199
Serving members — CFPP	
Regular Force	67,702
Reserves	4,171
Serving members — RFPP	
Reserves	21,511

**Annuity Payments:** The average annual payment to annuitants was \$23,443, an increase of 2.1 % over the previous year. The average years in payment for each membership group are as follows:

	2008	2012
Annuitants (CFPP)	17.6	18.3
Annuitants (RFPP)	0.0	2.0
Survivors	13.5	14.0

The following represents annuities that have been in payment for more than 45 years:

	2008	2012
Annuitants (CFPP)	190	738
Survivors	147	262

### Releases and Pension Plan Membership Terminations:

The following benefits were processed during the year:

	CFPP	RFPP
New Annuities	2,251	132
Return of Contributions	717	242
Transfer Value	1,027	235

**Pension Divisions and Support Agreements:** Under the provisions of the *Pension Benefits Division Act* and the *Garnishment Attachment and Pension Diversion Act*, 582 support arrangements and settlements were processed, as compared to 533 during the previous year.

**Survivors' Pensions and Benefits:** The number of survivor's pensions increased from 23,636 in FY 2010–2011 to 23,946 in FY 2011–2012; an increase of 1.31 %.

**Death Benefits:** Death benefit payments of \$32.0 million were made during the year, on behalf of 1,711 members (serving and annuitants), compared to \$31.0 million made on behalf of 1,767 members during the previous year.



**Prior Service Elections:** Pension Services has received over 12,000 Reserve elections, from more than 9,000 members. Eligible Reserve members can elect under the CFPP or the RFPP, depending on their service and earnings. In addition, some RFPP participants become eligible for the CFPP, and they can further elect their earnings to be fully eligible for the CFPP, by way of a top-up election. A top-up election is a payment for the difference in the contribution rates between the CFPP and the RFPP. As at 31 March 2012, Pension Services has completed 1,402 elections.

**Pension Inquiries:** Approximately 78,303 contacts were made during the year, through email, telephone, or website inquiries. Of these contacts, there were 1,276 requests for formal estimates, an increase of 1.67 % over last year.

**Pension Administration Staffing:** As at 31 March 2012, 238 FTEs were employed in pension administration, compared to 213 at 31 March 2011.





## Successes

In the last fiscal year, Pension Services experienced a number of successes. They included a realignment of the organization to consolidate pension policy and administration under the Chief of Military Personnel, and continued solid fiscal management of the CFPP demonstrated by the unmodified opinion on the annual OAG audit. In addition, last year marked the approval by Treasury Board Ministers of the Military Pension Renewal (MPR) Project.

**Annual Audit of the Canadian Forces Pension Plan:** The CFPP received an unmodified audit for the 12<sup>th</sup> consecutive year, as has been achieved every year since the pension plan has been audited by the OAG. In spite of the additional challenges of incorporating qualifying Reserve Force members into the CFPP, addressing the changes that were introduced through the coming-into-force of pension reform that increased the type and complexity of benefits available to full-time CF members, and the increase in the number of releases processed, management was successful in maintaining the integrity of its books, accounts, systems, and processes for Regular Force members.

**Chief Financial Officer (CFO) Realignment:** In the summer of 2011, National Defence undertook a realignment of activities under the responsibility of the CFO, namely ADM(Fin CS). As part of this realignment, the responsibility for the Pension Services organization transferred from ADM(Fin CS) to the Chief of Military Personnel. This organizational change brings common leadership over pension administration and pension policy, allowing an easier transition to PWGSC under the MPR project, and giving one point of contact within the Department of National Defence for pension matters.

**MPR Project Approval:** In December 2011, the MPR Project was approved by Treasury Board Ministers. The approval marks a key milestone for the project, and provides the financial resources to support project implementation. With this approval, start up activities for the project began. While the project is still in the early stages, National Defence is committing both human and financial resources to the project to ensure its successful implementation over the coming years. With successful implementation, Pension Services aims to improve the service it provides to pension plan members and participants.





## Challenges

Pension Services has several ongoing challenges. They include the RFPP prior service election backlog, a key challenge for Pension Services, as well as ensuring adequate support for the MPR Project while maintaining service levels will also be a challenge.

**RFPP Prior Service Election Backlog:** The Office of the Auditor General conducted a financial statement audit for FY 2008–2009, and a performance audit in FY 2010–2011 on the implementation of the RFPP. These audits identified areas of improvement for the RFPP administration, primarily the prior service election backlog. The Performance Audit was summarized in the Chapter 3 of the OAG's Spring Report for 2011; the Standing Committee on Public Accounts selected this chapter to study, and met on 14 December 2011. In this meeting, the standing committee met with DND and OAG officials, to discuss the findings in the report and determine the way forward. More details on the Standing Committee on Public Accounts can be found on the House of Commons website.

In response, National Defence is committing resources to addressing the backlog, however the related problems will persist for the coming years. In particular, the OAG is not able to give an opinion on the RFPP financial statements until they are comfortable with the estimate of the pension obligation to the plan. The obligation cannot be faithfully estimated until more of the prior service elections are completed, presenting the Office of the Chief Actuary enough data on which to base estimates.

More importantly, since many Reservists have paper-based service records, Pension Services is not able to readily provide them with estimates of what their election will cost, and of the impact of an election on their pension benefit. These estimates can only be accurately made once the election is near completion and the service data has been entered into the pension system. In addition, some pension benefit payments for releasing members are being delayed, as the elections for these members have not been completed. Pension Services has prioritized files in attempt to meet service standards for released members, but many Reservists will still face delays until the prior service election backlog has been addressed.

**MPR Project Support:** The MPR project is a component of a government-wide approach to modernization of pension administration, the Government of Canada Pension Modernization Project (GCPMP). The MPR project is the military component of this government-wide initiative, which will move the CFPP and RFPP administrations to the new PWGSC system solution and administrative processes being implemented for the public service pension plan. For Pension Services, one challenge will be to ensure that resources are in place to support the MPR project while continuing to support ongoing operations. An investment of knowledge resources to support the MPR project is critical for the viability of the administration and pension processes and systems that support it. The long-term goal of the MPR project is to improve the services provided to pension plan members and participants, with a modernized system and business processes.



# Performance of the Pension Plans

## Assets and Investments

The pension plans are managed and accounted for as three distinct funds; however, they are administered as a single, integrated benefit pension plan for members. The following funds constitute the pension plans:

Fund Accounts of the pension plans (\$ millions)	Closing net assets	
	FY 2011–2012	FY 2010–2011
<b>Canadian Forces Pension Plan</b>		
Superannuation Account	46,315	46,041
Pension Fund	12,878	11,489
<b>Reserve Force Pension Plan (Unaudited)</b>		
Pension Fund (Unaudited)	381	335
<b>Total Funds Under Management</b>	<b>59,574</b>	<b>57,865</b>

The balance of the Canadian Forces Superannuation Account is credited with notional interest income on a quarterly basis, as if the amount were invested in a portfolio of Government of Canada long-term bonds. For the year ended 31 March 2012, the interest income credited to the Canadian Forces Superannuation Account by quarter was:

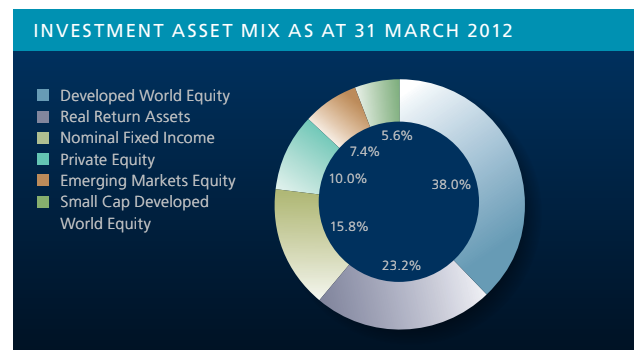
	Q1	Q2	Q3	Q4	Total
Interest income (\$ millions)	682	674	666	658	2,680
Rate (%)	1.48 %	1.46 %	1.44 %	1.43 %	5.81 %

## Investment Performance

The remaining pension funds are invested in private and public markets in accordance with the *Public Sector Pension Investment Board Act* (PSPIBA). Since 01 April 2000, the PSPIBA provides that net employer and employee pension contributions after expenses are transferred to PSPIB. PSPIB acts on behalf of the four major federal public sector plans by managing funds in the best interests of contributors and beneficiaries under the pension plans and by maximizing returns without undue risk of loss, taking into account the funding, policies, and requirements of the pension plans and the ability of those pension plans to meet their financial obligations.

PSPIB has the responsibility to determine the appropriate mix of investments for pension funds, select benchmark targets for each class of assets, and to strike an appropriate balance between risk and return for each asset class under its Statement of Investment Policies, Standards and Procedures (SIP&P).

Details of the current and target assets mix, and the current and benchmark returns for each class are included in the notes to the financial statements for each pension plan.



## Investment Rates of Return

The net assets managed by PSPIB on behalf of the CFPP and RFPP increased by \$1.190 billion, going from \$11.612 billion at the end of FY 2010–2011 to \$12.802 billion at the end of FY 2011–2012. The investment income reported by PSPIB for the CFPP and RFPP was \$374 million, in addition to net contributions received of \$846 million. PSPIB reported operating expenses of \$30 million. The investment income reflects a consolidated rate of return of 3.0 % in FY 2011–2012, compared to a return of 14.5 % in FY 2010–2011.

(\$ millions)	Fair value of net assets	Investment income			
		Realized	Unrealized	Operating Expenses	Net Income
Canadian Forces Pension Fund	12,438	473	(110)	29	334
Reserve Force Pension Fund	364	14	(3)	1	10

	PSPIB consolidated annual rate of return on investments (%)		PSPIB consolidated 5-year average rate of return on investments (%)	
	Fund	Benchmark	Fund	Benchmark
Canadian Forces Pension Fund	3.0	1.6	2.0	2.7
Reserve Force Pension Fund	3.0	1.6	2.0	2.7

The 3.0 % rate of return reported by PSPIB in FY 2011–2012 exceeded the policy benchmark rate of return by 1.4 %. For the past five fiscal years, PSPIB has recorded a compound annualized rate of return of 2.0 %, compared to the policy benchmark rate of return of 2.7 % over that same period.

Asset class	FY 2011–2012		5 year	
	Portfolio returns %	Benchmark returns %	Portfolio returns %	Benchmark returns %
<b>World equity</b>				
Canadian equity	(9.8)	(9.8)	1.0	1.1
Foreign equity				
US large cap equity	11.4	11.5	(3.3)	(0.9)
EAFE large cap equity	(2.7)	(3.2)	(5.7)	(6.2)
Small cap developed world equity	7.6	7.1	(2.1)	0.0
Emerging markets equity	(4.3)	(6.3)	2.4	1.7
Private equity	7.7	7.7	5.5	1.7
<b>Nominal fixed income</b>				
Cash & cash equivalents	1.2	0.9	2.0	1.8
Fixed income	10.1	9.4	5.9	5.7
<b>Real return assets</b>				
World inflation-linked bonds	15.3	15.3	4.1	4.1
Real estate	13.4	6.7	5.8	6.9
Infrastructure	2.7	9.6	3.5	5.6
Renewable resources (0.75 year) <sup>1</sup>	5.1	3.8	0.0	0.0
<b>Total return</b>	<b>3.0</b>	<b>1.6</b>	<b>2.0</b>	<b>2.7</b>

Except otherwise indicated, returns are time-weighted rate of return and have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute.

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

The total portfolio return includes the performance impact of asset-allocation and absolute-return strategies and is calculated gross of direct expenses. Hedging investment returns are netted against the return of the respective hedged assets for the Private Market asset classes, or included in Total Return, for the Public Markets.

1 The Renewable Resources asset class has existed for less than one year. The portfolio and benchmark returns presented are since inception.

Public market investments generated an overall return of 1.4 % this year. This return reflects the volatility in the markets, as demonstrated by the range of returns from a negative 9.8 % in Canadian equity to a positive 11.4 % in US large cap equity. Private equity generated a return equal to its benchmark return of 7.7 %

Fixed income investments generated a higher than normal 10.1 % return, as did world inflation-linked bonds at 15.3 %, reflecting the increased risk in the global bond market. Real estate generated strong returns of 13.4 %, exceeding the policy benchmark of 6.7 % for this asset class. A new asset class, renewable resources, also had strong returns of 5.1 %, exceeding the benchmark of 3.8 %.

Further details and analysis of the investment performance and the overall state of investment markets are available in the 2012 Annual Report of PSPIB (<http://www.pspib.ca>).

## Administrative Expenses

Consistent with the *Canadian Forces Superannuation Act*, expenses incurred by the Department of National Defence, PWGSC, OSFI and PSPIB for the administration of the pension plans are charged to the pension plans' accounts. Authority to charge expenses to the pension plans is approved annually by the Treasury Board Ministers. Administrative expenses incurred by PSPIB are charged directly to the funds of the four major federal public sector pension plans, and do not form part of the approved funding provided by the Treasury Board to the Department for administration of the CFPP and the RFPP.

The charging principles established by Treasury Board are the principal authority in determining the types of administrative expenses that can be charged to the CF pension plans. These principles provide general rules with examples, and are used for determining the chargeability of expenses for the public service pension plan, the RCMP pension plan, the CFPP, and the RFPP. The administrative expenses charged to the CFPP and RFPP are comprised of the following items:

**Department of National Defence:** Expenses directly attributable to administration of the pension plans including salaries, benefits, accommodation and other operating expenses as well as expenses related to services, such as information management/information technology, provided by other directorates in the Department are charged to the CFPP and RFPP. Expenses also include some fees that have been incurred with respect to the GCPMP. This project proposes transferring the pension plans' administration in phases to PWGSC, beginning in 2014.

**PWGSC and OSFI:** Administrative costs associated with the pension plans, including salaries and benefits, systems maintenance and development, and accommodations are charged to the CFPP and RFPP.

**PSPIB:** Salaries, benefits and other operating expenses, as well as external investment management fees incurred by PSPIB are charged to the public service pension plan, which is subsequently reimbursed by the RCMP pension plan, the CFPP and the RFPP.

While many aspects of the pension plans are administered jointly, the CFPP and the RFPP each issue independent financial statements. Where expenses incurred can be specifically attributed to the CFPP or RFPP, they are charged accordingly. For example, Salary Wage Envelope (SWE) costs for the Section 4 dealing exclusively with the processing of Reserve Force prior service elections are charged to the RFPP. Expenses which cannot be specifically attributed to one of the pension plans, such as office supplies, are prorated between each of the pension plans, based on an appropriate allocation method.



## ADMINISTRATIVE EXPENSE BY CATEGORY (SOURCE: DND FINANCIAL SYSTEM)

(\$ thousands)	2011-2012	2010-2011
<b>DND</b>		
Salaries	\$ 13,112	\$ 11,453
IT expenses	2,989	3,256
Other direct <sup>1</sup>	640	486
Employee benefits and overhead	4,970	4,438
<b>DND Total</b>	<b>21,711</b>	<b>19,633</b>
<b>PWGSC</b>		
Salaries	2,646	2,481
Employee benefits and overhead	1,003	961
Operating and maintenance	1,259	1,034
<b>PWGSC Total</b>	<b>4,908</b>	<b>4,476</b>
<b>MPR Project</b>		
DND MPR	146	212
PWGSC MPR	103	0
<b>MPR Project Total</b>	<b>249</b>	<b>212</b>
<b>OSFI – Actuarial Services</b>	<b>656</b>	<b>771</b>
<b>Actual administrative expense</b>	<b>\$ 27,524</b>	<b>\$ 25,092</b>
<b>Direct full-time equivalents</b>	<b>222</b>	<b>199</b>
<b>Indirect full-time equivalents</b>	<b>16</b>	<b>14</b>
<b>Total full-time equivalents</b>	<b>238</b>	<b>213</b>

1 Some 2010-2011 expenses, for pre-project activities, have been reclassified as MPR expenses, to match the current year presentation.





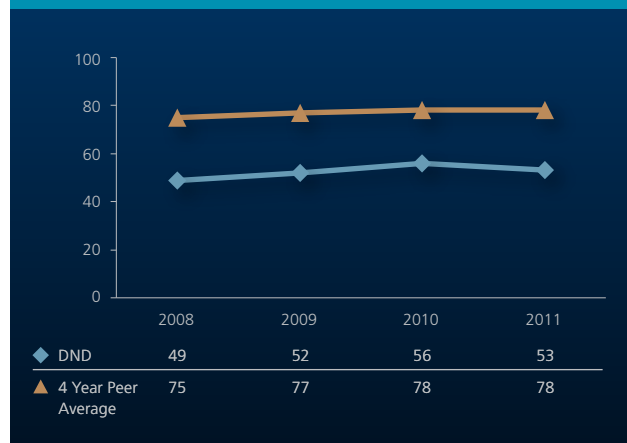
## Performance Measures

For the past eleven years, Pension Services has participated as a member of a benchmarking forum with CEM Benchmarking Inc. This organization assists pension plan administrators in improving pension services. Following pension reform and the Government of Canada's program of Modern Comptrollership, Pension Services adopted benchmarking to evaluate its pension administration services against similar Canadian, American and other worldwide pension organizations to compare costs, service provided and best practices. The results indicate that service scores remain significantly below those of Pension Services' peers, as improvements to services offered have not been made.

Industry best practice shows a strong correlation between investments in administration and service score. Pension Services' cost-per-file has shown a substantial increase over past years, caused by a change in the method used to calculate costs per member by CEM Benchmarking. With this change in methodology, and revisions to peers' costs, Pension Services' costs are now higher, on a per-member basis, than the median cost of peer pension service organizations. The increase in costs has been primarily to expand service to include Reservists in 2007. These increases have not added to service offerings, and as a result have not led to increased service levels.

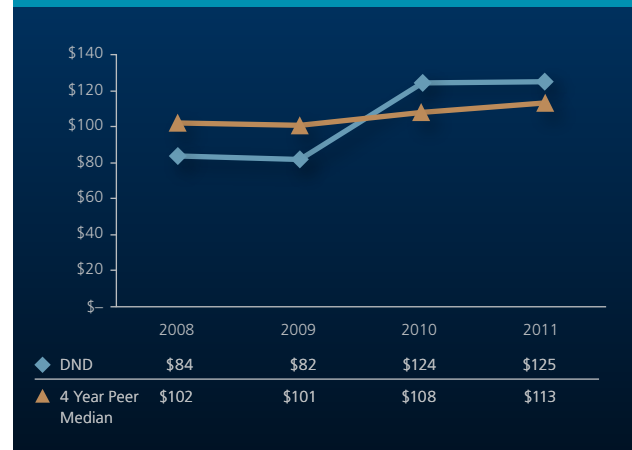
Pension Services has designed and implemented a performance measurement framework, aimed at ensuring improvement of performance over time and directing resources to priority areas of pension administration. The categories of the framework are linked directly to the CEM Benchmarking categories and organizational objectives. The performance measurement framework identifies when operational targets are not being met, allowing management to execute mitigation strategies. Using the framework for the past two fiscal years, management was able to see improvements in priority areas, and to target resources towards priority issues.

SERVICE SCORE HISTORY — 4 YEAR AVERAGE



Note: CEM Benchmarking has revised their scores from prior years. As a result, these scores do not match previously reported figures.

TOTAL ADJUSTED ADMINISTRATION COST PER ACTIVE MEMBER & ANNUITANT (VERSUS PEER AND ALL MEDIAN)



Note: CEM Benchmarking has revised their costs from prior years. As a result, these costs do not match previously reported figures.

Based on the results of the performance measurement framework in FY 2011–2012, overall performance in paying Regular Force annuities, providing pension estimates to Regular Force members, and paying survivor benefits met expectations for the year. All service activities for Reserve Force participants, in particular the processing of Reserve Force prior service elections, were still below expectations, as well as processing Regular Force prior service elections.

The performance measurement framework is being reviewed to monitor long-term performance objectives, as well as short-term operational requirements. This change will allow measures of long-term objectives more frequently and timelier than the annual CEM Benchmarking activity, as well as reviewing the impact that shifting resources to short-term priorities has on long-term objectives.

Major changes in performance are not expected until the implementation of the MPR project. It will provide the necessary infrastructure to add to current service offerings, which will improve the services to members.

The performance standard in calculating the benefit payments for normal Regular Force releases is nine to eleven weeks after receipt of the release message. For CFPP annuities, this standard was met 60 % of the time. In the case of Reserve Force members, the service standard is 32 to 36 weeks from receipt of the release message, due to the fact that a prior service election component is present in nearly all Reserve Force pensions. For RFPP annuities, this standard was met 11 % of the time. Based on these service standards, Pension Services still processes release cases below the industry best practice of 30 days to calculate and pay benefit payments, however it did meet this standard in 16 % of annuity cases. To meet this service standard more frequently, it will require significant process re-engineering, which will be undertaken during Pension Services' planned modernization efforts.

PWGSC is responsible for making recurring pension payments under a Memorandum of Understanding with Pension Services. Currently, PWGSC will issue the initial benefit payments within 30 calendar days from the receipt of the completed documentation from Pension Services. In 97 % of all cases, the initial payments were made within the set standard.



# Looking Forward

For the next few years, Pension Services will be in a state of transition, with focus on six key activities. These activities include reducing the backlog, transforming business practices through the MPR project, the impacts of pension reform, improving the control environment in response to audit recommendations, and improving the communications to pension plan members. The sixth activity is the ongoing operations of the pension plans' administration. Each area is discussed below.

**Election Backlog:** Pension Services had its most productive year to date, completing just over 700 pension elections during FY 2011–2012, building on the just over 400 election files completed in the previous year. These production gains were made possible by acquiring additional office space in the summer of 2010, hiring additional staff during fall of 2010, and successfully training the new staff during fall and winter of 2010–2011. Pension Services recognizes that there is still much work to be done, however they remain dedicated to demonstrating continuous improvement to better serve Reservists.

**MPR Project:** The MPR project was approved by Treasury Board Ministers in December 2011. With Treasury Board approval, ground work for the project began, including staffing a Project Management Office to oversee the

project, and drafting many planning and governance documents. The ultimate aim of the project is to improve the services levels for members, by improving the system and business processes used by Pension Services.

**Pension Reform:** Changes to the federal public sector pension plans were announced in the 2012 Federal Budget. These changes include a move towards a 50-50 cost share between employees and the government. To reach this goal, the contribution rates for employees will increase over time, while the government contribution rate will decline. The cost share recently moved from roughly 30-70 to 40-60. The employee and Government contribution rates for current service for the past four calendar years are as follows:

Calendar year	2009	2010	2011	2012
<b>Canadian Forces pension plan</b>				
Employee contribution (% of salary, less than YMPE)	5.20 %	5.50 %	5.80 %	6.20 %
Employee contribution rate (% of salary, greater than YMPE)	8.40 %	8.40 %	8.40 %	8.60 %
Government contribution rate (\$ per \$1.00 of employee contribution)	2.69	2.53	2.50	2.37
<b>Reserve Force pension plan</b>				
Employee contribution (% of salary)	4.90 %	5.20 %	5.20 %	5.20 %
Government contribution rate (\$ per \$1.00 of employee contribution) <sup>1</sup>	2.61	1.74	1.71	0.00

<sup>1</sup> In 2011, the RFPP government contribution was changed to \$0.00 effective November 2011.





**Control Environment:** The issues noted by the OAG in their audit of the RFPP were largely addressed during the previous year. In addition to these items, Pension Services has progressed with a continuous improvement approach to internal controls, by adding additional reviews through independent staff. The additional oversight allows a fresh look at files, in an attempt to identify errors earlier, when they have a lower impact on members. The controls also help report accurately on the pension plans' financial results, within the financial statements.

**Communications:** To help clarify information given to Members, the two websites for pensions (Pension Policy and Pension Administration) were consolidated in one location under Chief Military Personnel's website. The old websites had various cross links, and information updates were not always kept in-sync. With one website location, it will be easier for members to navigate the web to find information on their pension benefits.

**Ongoing Operations:** Staffing constraints within the Department of National Defence, caused by workforce reduction in the public service have impacted Pension Services' ability to fill vacant positions. In addition, operational resources are required to assist in delivery of the MPR project, reducing the available resources for ongoing operations. The performance measurement framework is being used to ensure that available resources are addressing management's priorities and to minimize the impact of resource constraints.

With these key priorities in mind, Pension Services is moving forward towards a future service delivery model, while continuing to make improvements for plan members and participants in the short-term.



# Contact Information

For additional information on the CF pension plans, you may consult the following websites:

Directorate of Canadian Forces Pensions Services	<a href="http://www.cmp-cpm.forces.gc.ca/pen/index-eng.asp">http://www.cmp-cpm.forces.gc.ca/pen/index-eng.asp</a>
Directorate of Pensions and Social Programs	<a href="http://www.cmp-cpm.forces.gc.ca/pen/index-eng.asp">http://www.cmp-cpm.forces.gc.ca/pen/index-eng.asp</a>
PSPIB	<a href="http://www.pspib.ca">http://www.pspib.ca</a>
Treasury Board of Canada	<a href="http://www.tbs-sct.gc.ca/">http://www.tbs-sct.gc.ca/</a>
Office of the Superintendent of Financial Institutions Canada	<a href="http://www.osfi-bsif.gc.ca">http://www.osfi-bsif.gc.ca</a>
CEM Benchmarking Inc.	<a href="http://www.cembenchmarking.com/">http://www.cembenchmarking.com/</a>
Public Service Pension Plan	<a href="http://www.tbs-sct.gc.ca/hr-rh/bp-rasp/pensions/reports-rapports-eng.asp">http://www.tbs-sct.gc.ca/hr-rh/bp-rasp/pensions/reports-rapports-eng.asp</a>
House of Commons Committees	<a href="http://www.parl.gc.ca/CommitteeBusiness">http://www.parl.gc.ca/CommitteeBusiness</a>

This report is also available at the following Internet site:

<http://www.cmp-cpm.forces.gc.ca/pen/pa-ap/ar-ra/index-eng.asp>

Comments or questions can be directed to the Internet site or to:

Directorate of Canadian Forces Pensions Services  
National Defence Headquarters  
Ottawa ON K1A 0K2

Telephone: 613-971-6623

Fax: 613-971-6041



# Members of the Canadian Forces Pension Advisory Committee

As at 31 March 2012

Rank	Name	Title	Organization Represented
Rear-Admiral	<b>Andrew Smith</b>	Chief of Military Personnel	Committee Chair
Major-General	<b>Alan Howard</b>	Assistant Chief of the Land Staff	Land Staff
Major-General	<b>Robert Bertrand</b>	Director General Financial Management	Finance and Corporate Services
Rear-Admiral	<b>Jennifer Bennett</b>	Chief Reserves & Cadets	Reserve Forces
Brigadier-General	<b>Neville Russell</b>	Director General Air Personnel	Air Staff
Commodore	<b>Lynn Bisson</b>	Director General Compensation and Benefits	Compensation and Benefits
Commodore	<b>John Newton</b>	Director General Naval Personnel	Maritime Staff
Colonel	<b>Vihar Joshi</b>	Deputy Judge Advocate General/ Military Justice and Administrative Law	Legal Branch
Chief Petty Officer, 1 <sup>st</sup> Class	<b>Robert Cleroux</b>	Canadian Forces Chief Warrant Officer	Non-commissioned members

At 31 March 2012, there was no CF pensioner representative. Chief Warrant Officer (retired) Raymond McInnis was named as the representative for CF pensioners as of 03 May 2012, for a three year term.





# Financial Statements of the Canadian Forces Pension Plan

For the Fiscal Year Ended 31 March 2012

Placeholder — Statement of Management Responsibility



Placeholder — Audit Report Page 1

Placeholder — Audit Report Page 2

## Statement of Financial Position

(Canadian \$ millions)	As at 31 March 2012	As at 31 March 2011	As at 01 April 2010
<b>Net assets and other accounts available for benefits</b>			
Assets			
Canadian Forces Pension Fund Account (Note 3)	\$ 281	\$ 38	\$ 38
Investments (Note 4)	13,565	11,852	9,523
Investment-related assets (Note 4)	243	287	123
Contributions receivable — post 31 March 2000 service (Note 6)	159	162	109
Other assets	13	10	9
Total assets	14,261	12,349	9,802
Liabilities			
Due to the public service pension plan (Note 7)	8	9	6
Other liabilities	22	12	9
Investment-related liabilities (Note 4)	1,353	839	533
Net assets	12,878	11,489	9,254
Other accounts			
Canadian Forces Superannuation Account (Note 3)	46,269	45,995	45,490
Contributions receivable — pre 01 April 2000 service (Note 6)	46	46	40
Other accounts	46,315	46,041	45,530
<b>Net assets and other accounts available for benefits</b>	<b>\$ 59,193</b>	<b>\$ 57,530</b>	<b>\$ 54,784</b>
<b>Pension obligations and excess (shortfall)</b>			
Pension obligations (Note 10)	\$ 59,526	\$ 55,529	\$ 52,413
Excess (shortfall) (Note 11)	(333)	2,001	2,371
<b>Pension obligations and excess (shortfall)</b>	<b>\$ 59,193</b>	<b>\$ 57,530</b>	<b>\$ 54,784</b>

Commitments and contingency (Notes 19 and 20)

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

## Statement of Changes in Net Assets Available for Benefits

Year ended 31 March

(Canadian \$ millions)	2012	2011
<b>Net assets and other accounts available for benefits, beginning of year</b>	<b>\$ 57,530</b>	<b>\$ 54,784</b>
<b>Increase in net assets and other accounts available for benefits:</b>		
Interest income on the Canadian Forces Superannuation Account (Note 3)	2,680	2,887
Investment income, excluding changes in fair values of investment assets and investment liabilities (Note 13)	276	219
Changes in fair values of investment assets and investment liabilities — realized and unrealized gains and losses (Note 13)	87	1,157
Employee contributions (Note 12)	328	327
Employer contributions (Note 12)	795	817
Actuarial funding adjustment (Notes 12, 14)	249	0
Transfers from other pension funds	9	5
<b>Total increase in net assets and other accounts available for benefits</b>	<b>4,424</b>	<b>5,412</b>
<b>Decrease in net assets and other accounts available for benefits:</b>		
Benefits paid (Note 15)	2,590	2,522
Refunds and transfers (Note 15)	121	102
Administrative expenses (Note 16)	50	42
<b>Total decrease in net assets and other accounts available for benefits</b>	<b>2,761</b>	<b>2,666</b>
<b>Net increase in net assets and other accounts available for benefits</b>	<b>1,663</b>	<b>2,746</b>
<b>Net assets and other accounts available for benefits, end of year</b>	<b>\$ 59,193</b>	<b>\$ 57,530</b>

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



## Statement of Changes in Pension Obligations

Year ended 31 March

(Canadian \$ millions)	2012	2011
<b>Pension obligations, beginning of year</b>	<b>\$ 55,529</b>	<b>\$ 52,413</b>
<b>Increase in pension obligations</b>		
Interest on pension obligations	3,320	3,287
Benefits earned	1,073	1,001
Changes in actuarial assumptions (Note 10)	1,984	872
Experience losses	257	534
Cost of new elections	86	61
Transfers from other pension funds	9	5
<b>Total increase in pension obligations</b>	<b>6,729</b>	<b>5,760</b>
<b>Decrease in pension obligations</b>		
Benefits paid (Note 15)	2,590	2,522
Refunds and transfers (Note 15)	121	102
Administrative expenses included in the service cost (Note 16)	21	20
<b>Total decrease in pension obligations</b>	<b>2,732</b>	<b>2,644</b>
<b>Net increase in pension obligations</b>	<b>3,997</b>	<b>3,116</b>
<b>Pension obligations, end of year</b>	<b>\$ 59,526</b>	<b>\$ 55,529</b>

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

## Notes to the Financial Statements

For the year ended 31 March 2012 (Canadian \$)

### 1. DESCRIPTION OF THE CANADIAN FORCES PENSION PLAN

The Canadian Forces pension plan (the pension plan), governed by Part I of the *Canadian Forces Superannuation Act* (the CFSA), provides pension benefits to all members of the Regular Force component and eligible members of the Reserve Force component of the Canadian Forces. Established in 1901 under the *Militia Pension Act*, the present day version of the pension plan is administered in accordance with the CFSA.

The main provisions of the Canadian Forces pension plan are summarized below.

#### (a) General

The pension plan is a contributory defined benefit plan covering all members of the Regular Force component and eligible members of the Reserve component of the Canadian Forces. Membership in the pension plan is compulsory for all members of the Regular Force regardless of length of service. Members of the Reserve Force component of the Canadian Forces contribute to the pension plan when they meet eligibility criteria.

The Government of Canada is the sole sponsor of the pension plan. The Minister of National Defence is the Minister responsible for the CFSA. The President of the Treasury Board has an oversight role in respect of the pension plan, including responsibility for tabling actuarial valuations before Parliament. The Department of National Defence (DND) is responsible for providing program management and the day-to-day administration of the pension plan. The Office of the Chief Actuary (OCA) within the Office of the Superintendent of Financial Institutions (OSFI) performs periodic actuarial valuations of the pension plan.

Until 01 April 2000, separate market-invested funds were not set aside to provide for payment of pension benefits. Instead, transactions relating to the pension plan were recorded in a Canadian Forces Superannuation Account created by legislation in the accounts of Canada. Pursuant to the CFSA, as amended by the *Public Sector Pension Investment Board Act*, contributions relating to service since 01 April 2000 are now recorded in the Canadian Forces Pension Fund (Pension Fund). An amount equal to contributions in excess of benefit payments and administrative costs is transferred regularly to the Public Sector Pension Investment Board (PSPIB) and invested in capital markets. PSPIB is a Crown corporation whose statutory objectives are to manage the funds transferred to it for investment and to maximize investment returns without undue risk of loss, having regard to the funding, policies and requirements of the four major public sector pension plans.

#### (b) Funding Policy

The Canadian Forces pension plan is funded from plan member and employer contributions. For the fiscal year, plan members contributed 5.8 per cent (2011 — 5.5 per cent) for the first nine months and 6.2 per cent (2011 — 5.8 per cent) for the last three months of pensionable earnings up to the maximum covered by the Canada Pension Plan or Quebec Pension Plan (CPP or QPP), and 8.4 per cent for the first nine months (2011 — 8.4 per cent) and 8.6 per cent for the last three months (2011 — 8.4 per cent) for the fiscal year of pensionable earnings above that maximum. The Government's contribution is made monthly to provide for the cost (net of pension plan member contributions) of the benefits that have accrued in respect of that month at a rate determined by the President of the Treasury Board. The cost of the benefits is determined based on actuarial valuations, which are performed triennially.

The CFSA provides that all pension obligations arising from the Canadian Forces pension plan be met by the Government. In the case of the Pension Fund, the CFSA requires that any actuarial deficit be dealt with by transferring equal instalments to the Pension Fund over a period of up to 15 years, commencing in the year in which the actuarial report is tabled in Parliament. It also allows any excess to be lowered

by reducing Government and pension plan member contributions. In addition, if there is an amount considered to be non-permitted surplus (refer to CFSA Section 55.4 (5) for definition of non-permitted surplus) related to the Pension Fund, no further Government pension contributions are permitted, while pension plan member contributions under the Pension Fund may be reduced and amounts from PSPIB may be transferred to the Consolidated Revenue Fund.

For service that pre-dates 01 April 2000, the CFSA further requires that any actuarial shortfall resulting from a lower balance in the Superannuation Account than the actuarial liability be addressed by increasing the Superannuation Account in equal instalments over a period of up to 15 years. It also allows the excess to be reduced by decreasing the Superannuation Account over a period of up to 15 years; however, if the balance of the Superannuation Account exceeds one hundred and ten per cent (110 per cent) of the amount required to meet the cost of the benefits payable, the excess amount must be reduced by decreasing the Superannuation Account annually over a period of up to 15 years.

(c) Benefits

The Canadian Forces pension plan provides pension benefits to members who retire with more than 25 years Regular Force service or, in special circumstances, with less service, to a maximum of 35 years. The benefits are determined by a formula set out in legislation; they are not based on the financial status of the pension plan. The basic benefit formula is 2 per cent per year of pensionable service multiplied by the average of the five consecutive years of highest paid service. Benefits are also coordinated with the CPP and QPP, and the resulting pension reduction factor for pension plan members reaching age 65, or earlier if totally and permanently disabled, has been lowered from a Level of 0.7 per cent for those turning age 65 in calendar year 2007 or earlier to 0.640 per cent for those turning age 65 in calendar year 2011. This reduction factor will be further reduced annually to 0.625 per cent for those turning age 65 in calendar year 2012 and later. Also, benefits are fully indexed to the increase in the Consumer Price Index.

Other benefits include survivor allowances, deferred annuities, annual allowances, transfer values, cash termination allowances or minimum benefits paid in the event of death. To reflect the *Income Tax Act* (ITA) restrictions on registered pension plan benefits, a separate Retirement Compensation Arrangement has been implemented to provide benefits that exceed the limits established in the ITA. Since this arrangement is covered by separate legislation, the net assets available for benefits and accrued pension benefits are not consolidated in these financial statements; however, condensed information is presented in Note 17.

## 2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These financial statements present information on the Canadian Forces pension plan on a going concern basis. They are prepared to assist plan members and others in reviewing the activities of the pension plan for the year, not to portray the funding requirements of the pension plan.

These financial statements are prepared in Canadian dollars, the plan's functional currency, in accordance with the accounting policies stated below, which are based on Canadian accounting standards for pension plans in Part IV of the Canadian Institute of Chartered Accountants (CICA) Handbook (Section 4600). Section 4600 provides specific accounting guidance on investments and pension obligations. For accounting policies that do not relate to either investments or pension obligations, the plan complies with International Financial Reporting Standards (IFRS) in Part I of the CICA Handbook commencing 01 April 2011. To the extent that IFRS in Part I is inconsistent with Section 4600, Section 4600 takes precedence. The presentation and results using the stated accounting policies do not result in any significant differences from Canadian accounting standards for pension plans.

The financial statements for the year ended 31 March 2012 were authorized for issue by the signatories on 25 March 2013.



(b) Changes in Accounting Policies

These financial statements are prepared based on Section 4600 — Pension Plans of the CICA Handbook. Prior to 01 April 2011, the financial statements were prepared on the basis of CICA Handbook Section 4100 — Pension Plans. As a result, the comparatives as at 01 April 2010 and 31 March 2011 have been restated. Management has elected to early adopt International Accounting Standard (IAS) 1, effective 01 January 2013, related to the Presentation of Financial Statements, on a prospective basis, commencing 01 April 2012. As a result, the pension plan does not need to present the related notes to the opening statement of financial position as at 01 April 2010.

**INVESTMENT ASSETS AND INVESTMENT LIABILITIES**

The measurement requirements under Section 4600 were applied consistently to the fair value of all investment assets and investment liabilities. The application of Section 4600 requirements has no impact on the values of either investment assets or investment liabilities.

Investment assets and investment liabilities are presented on a non-consolidated basis. As an investment company, PSPIB has been exempted from the IFRS requirement to consolidate its controlled investments. As a result, the pension plan financial statements of prior years are unchanged as investments continue to be stated at fair value and on a non-consolidated basis.

The following accounting policy has been revised upon implementation of Section 4600:

**ELIMINATION OF ACTUARIAL ASSET VALUE ADJUSTMENT**

As at 31 March 2011, on the basis of Section 4100, the actuarial asset value adjustment was included in the determination of the pension plan financial statement excess or shortfall. Per Section 4600, the actuarial asset value adjustment is no longer permitted. As a result, the tables below show the impact of the revised accounting policies on the prior years' Statement of Financial Position.

As at 31 March 2011:

(\$ millions)	As Previously Reported	Effect of Transition to CICA Section 4600	Revised Based on CICA Section 4600
<b>Net assets and other accounts available for benefits</b>			
Assets			
Canadian Forces Pension Fund Account (Note 3)	\$ 38	\$ 0	\$ 38
Investments (Note 4)	11,852	0	11,852
Investment-related assets (Note 4)	287	0	287
Contributions receivable — post 31 March 2000 service (Note 6)	162	0	162
Other assets	10	0	10
<b>Total assets</b>	<b>12,349</b>	<b>0</b>	<b>12,349</b>
Liabilities			
Due to the public service pension plan (Note 7)	9	0	9
Other liabilities	12	0	12
Investment-related liabilities (Note 4)	839	0	839
<b>Net assets</b>	<b>11,489</b>	<b>0</b>	<b>11,489</b>
Other accounts			
Canadian Forces Superannuation Account (Note 3)	45,995	0	45,995
Contributions receivable — pre 01 April 2000 service (Note 6)	46	0	46
Other accounts	46,041	0	46,041
<b>Net assets and other accounts available for benefits</b>	<b>57,530</b>	<b>0</b>	<b>57,530</b>
Actuarial asset value adjustment	(888)	888	0
<b>Actuarial value of net assets and other accounts available for benefits</b>	<b>\$ 56,642</b>	<b>\$ 888</b>	<b>\$ 57,530</b>
<b>Pension obligations and excess</b>			
Pension obligations (Note 10)	\$ 55,529	\$ 0	\$ 55,529
Excess (Note 11)	1,113	888	2,001
<b>Pension obligations and excess</b>	<b>\$ 56,642</b>	<b>\$ 888</b>	<b>\$ 57,530</b>

As at 01 April 2010:

(\$ millions)	As Previously Reported	Effect of Transition to CICA Section 4600	Revised Based on CICA Section 4600
<b>Net assets and other accounts available for benefits</b>			
Assets			
Canadian Forces Pension Fund Account (Note 3)	\$ 38	\$ 0	\$ 38
Investments (Note 4)	9,523	0	9,523
Investment-related assets (Note 4)	123	0	123
Contributions receivable — post 31 March 2000 service (Note 6)	109	0	109
Other assets	9	0	9
<b>Total assets</b>	<b>9,802</b>	<b>0</b>	<b>9,802</b>
Liabilities			
Due to the public service pension plan (Note 7)	6	0	6
Other liabilities	9	0	9
Investment-related liabilities (Note 4)	533	0	533
<b>Net assets</b>	<b>9,254</b>	<b>0</b>	<b>9,254</b>
Other accounts			
Canadian Forces Superannuation Account (Note 3)	45,490	0	45,490
Contributions receivable — pre 01 April 2000 service (Note 6)	40	0	40
Other accounts	45,530	0	45,530
<b>Net assets and other accounts available for benefits</b>	<b>54,784</b>	<b>0</b>	<b>54,784</b>
Actuarial asset value adjustment	(269)	269	0
<b>Actuarial value of net assets and other accounts available for benefits</b>	<b>\$ 54,515</b>	<b>\$ 269</b>	<b>\$ 54,784</b>
<b>Pension obligations and excess</b>			
Pension obligations (Note 10)	\$ 52,413	\$ 0	\$ 52,413
Excess (Note 11)	2,102	269	2,371
<b>Pension obligations and excess</b>	<b>\$ 54,515</b>	<b>\$ 269</b>	<b>\$ 54,784</b>



(c) Valuation of Assets and Other Accounts

The Canadian Forces Superannuation Account portrays a notional portfolio of bonds and is presented at the amount at which it is carried in the accounts of Canada.

In the case of the Pension Fund, the investments are held by PSPIB and allocated to the Canadian Forces pension plan. Investments, investment-related assets and investment-related liabilities are recorded at the date upon which PSPIB becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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.

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

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

The valuation methods of each asset class are described in Note 4 (a) and 4 (b).

(d) Transaction Costs

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

(e) Investment Management Fees

Investment management fees are directly attributable to the external management of assets on behalf of PSPIB. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSPIB or offset against distributions received from the investment (Note 4 (a) (ii)). Management fees are also incurred for certain public markets and alternative investments and are paid either directly by PSPIB or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 13).

## (f) Income Recognition

The investment income (loss) is allocated proportionately based on the asset value held in the pension plan account.

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

Interest on the Canadian Forces Superannuation Account is recognized on an accrual basis.

## (g) Contributions

Contributions for current service are recorded in the year in which the related payroll costs are incurred. Contributions for past service that are receivable over a period in excess of one year are recorded at the estimated net present value of the contributions to be received.

## (h) Benefits Earned, Benefits Paid, and Refunds and Transfers

Benefits are accrued as pensionable service accumulates. Benefits paid are recognized as a reduction of pension obligations, and net assets and other accounts available for benefits when paid.

Refunds and transfers are recognized at the moment the refund or transfer occurs; until that time they are presented with the net assets and other accounts available for benefits and with related pension obligations.

## (i) Translation of Foreign Currencies

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

## (j) Use of Estimates

The preparation of these financial statements based on Canadian accounting standards for pension plans requires management to make use of estimates and assumptions that affect the reported values of investment assets and investment liabilities, pension obligations, income and expenses, and related disclosures at the date of the financial statements.

In making estimates and using assumptions, management relies on external information and observable conditions where possible. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ significantly from the estimates and assumptions. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

## (k) Pension Obligations

The present value of pension obligations is calculated by using the projected benefit method prorated on services, based on management's best estimate assumptions.

### 3. CANADIAN FORCES SUPERANNUATION ACCOUNT AND CANADIAN FORCES PENSION FUND ACCOUNT

The Government of Canada has a statutory obligation to pay benefits relating to the pension plan. This pension obligation is to plan members and their beneficiaries. In order for the Government to track the transactions related to contributions, benefit payments, interest, and transfers, the Government established the Canadian Forces Superannuation Account (the Superannuation Account) and the Canadian Forces Pension Fund Account (Pension Fund Account) in the accounts of Canada. The accounts have no capacity to pay pensions. All cash receipts are deposited to and payments come from the Consolidated Revenue Fund (CRF).

#### **SUPERANNUATION ACCOUNT**

The Superannuation Account records transactions that relate to service prior to 01 April 2000. The Superannuation Account portrays a notional portfolio of bonds, and as such, does not hold any invested assets. The amount of interest credited on the account is as though net contributions were invested quarterly in 20-year Government of Canada bonds issued at prescribed rates and held to maturity.

#### **PENSION FUND ACCOUNT**

In 1999, legislation was amended to allow the Government of Canada to invest funds in capital markets in order to provide for the pension obligation. This legislation created the PSPIB to manage and invest amounts that are transferred regularly to it from the CRF related to service on or after 01 April 2000. The transactions are recorded in the Pension Fund Account. Unlike the Superannuation Account, the Pension Fund Account does not earn interest. The Pension Fund Account is merely a flow through account. At year-end, the balance in the Pension Fund Account represents net contributions awaiting imminent transfer to PSPIB. PSPIB investment assets and investment-related liabilities are reflected directly in the pension plan financial statements.

#### **RELATED PARTY — RESERVE FORCE PENSION FUND ACCOUNT**

The Canadian Forces Pension Fund Account is related, through common legislation (the CFSA), to the Reserve Force Pension Fund Account. Transactions with the Reserve Force Pension Fund Account related to member service and contributions are considered to be in the normal course of operations, in accordance with the s83 of the *Reserve Force Pension Plan Regulations* (RFPPR) and are recorded at the exchange amount as required by that section. For the year ended 31 March 2012, \$8,695,577 (2011 — \$3,585,956) was transferred between the fund accounts based on 1,309 former members of the Reserve Force pension plan (2011 — 306 former members) who transferred pensionable service between pension plans during the year. At the beginning of the year 4,082 members of Reserve Force were members of the Canadian Forces pension plan and a further 582 members of the Reserve Force pension plan (2011 — 619) became eligible for membership in the Canadian Forces pension plan during the year. The value of the pensionable service due between the pension plans is not estimable until such time as the cost of prior service elected under the provisions of the RFPPR is finalized, and as such, have not been included in the financial statements of the Canadian Forces pension plan.

#### 4. INVESTMENTS

##### (a) Investment Portfolio

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

	2012		2011	
(\$ millions)	Fair Value	Cost	Fair Value	Cost
<b>Public markets</b>				
Canadian equity	\$ 1,764	\$ 1,706	\$ 2,752	\$ 2,255
Foreign equity	3,132	2,894	2,527	2,306
<b>Private markets</b>				
Real estate	1,438	1,241	1,061	970
Private equity	1,193	1,017	1,010	878
Infrastructure	823	864	527	571
Renewable resources	72	72	0	0
<b>Fixed income</b>				
Cash and money market securities	462	462	500	500
Government and corporate bonds	2,461	2,408	1,572	1,581
Inflation-linked bonds	763	696	580	596
Other fixed income securities	1,230	1,108	1,106	1,064
<b>Alternative investments</b>	227	182	217	181
<b>INVESTMENTS</b>	<b>\$ 13,565</b>	<b>\$ 12,650</b>	<b>\$ 11,852</b>	<b>\$ 10,902</b>
<b>Investment-related assets</b>				
Amounts receivable from pending trades	\$ 121	\$ 121	\$ 136	\$ 136
Interest receivable	31	31	27	27
Dividends receivable	12	12	10	10
Derivative-related receivables	79	16	114	5
<b>Total investment-related assets</b>	<b>\$ 243</b>	<b>\$ 180</b>	<b>\$ 287</b>	<b>\$ 178</b>
<b>Investment-related liabilities</b>				
Amounts payable from pending trades	\$ (191)	\$ (191)	\$ (211)	\$ (211)
Interest payable	(5)	(5)	(4)	(4)
Securities sold short	(83)	(80)	(8)	(7)
Securities sold under repurchase agreements	(246)	(245)	(100)	(100)
Derivative-related payables	(71)	(15)	(39)	(5)
Capital debt financing (Note 8):				
Short-term	(174)	(174)	(137)	(137)
Long-term	(583)	(571)	(340)	(332)
<b>Total investment-related liabilities</b>	<b>\$ (1,353)</b>	<b>\$ (1,281)</b>	<b>\$ (839)</b>	<b>\$ (796)</b>
<b>NET INVESTMENTS</b>	<b>\$ 12,455</b>	<b>\$ 11,549</b>	<b>\$ 11,300</b>	<b>\$ 10,284</b>



(i) Public Markets

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

*Valuation Techniques*

Direct investments in Canadian and foreign equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators, which are derived from the fair value measurement of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, properties, as well as fund investments in the real estate sector. Real estate investments focus on properties, partnerships and companies operating in the office, retail, industrial, hospitality, and residential sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at 31 March 2012, the total amount of third party financing included as part of real estate contracted by direct investments controlled by PSPIB for the pension plan was \$514 million (2011 — \$411 million).

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

Infrastructure investments are comprised of direct equity positions and co-investments in various private entities and fund investments. Infrastructure investments focus on entities engaged in the management, ownership, or operation of assets in energy, transportation, and other regulated business. Infrastructure investments are accounted for net of all third-party financings. As at 31 March 2012, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSPIB for the pension plan was \$55 million (2011 — \$10 million).

Renewable resource investments are comprised of properties involving the production and harvesting of replenishable resources. As at 31 March 2012, renewable resources included one investment in timberlands.

*Valuation Techniques*

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

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

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

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

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

(iii) Fixed Income

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

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

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

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

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 18.

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

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

#### *Valuation Techniques*

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

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

ABTNs are measured at fair value whereby PSPIB relies on the valuation work performed by a recognized third-party expert. PSPIB ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads, and the underlying investments' terms to maturity. In addition to the values determined by the expert, PSPIB integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 18.

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

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

#### (iv) Alternative Investments

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

#### *Valuation Techniques*

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

#### (v) Amounts Receivable and Payable from Pending Trades

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

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

#### *Valuation Techniques*

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

#### (vi) Interest and Dividends Receivable

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

## (vii) Interest Payable

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

## (viii) Securities Sold Short

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

*Valuation Techniques*

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

## (ix) Securities Sold under Repurchase Agreements

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

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

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

*Valuation Techniques*

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

## (x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 4 (b).

## (xi) Capital Market Debt Financing

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

## (b) Derivative Financial Instruments

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

PSPIB uses the following types of derivative financial instruments:

## (i) Swaps

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



(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

*Valuation Techniques*

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

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

The derivatives portfolio as at 31 March is as follows:

INVESTMENTS	2012				2011			
(\$ millions)	Notional Value	Fair Value			Notional Value	Fair Value		
		Assets	Liabilities	Net		Assets	Liabilities	Net
<b>Equity and commodity derivatives</b>								
Futures	\$ 195	\$ 0	\$ 0	\$ 0	\$ 84	\$ 0	\$ 0	\$ 0
Total return swaps	1,574	25	(8)	17	1,079	37	0	37
Options:								
Listed-purchased	218	3	0	3	86	2	0	2
Listed -written	186	0	(2)	(2)	77	0	(4)	(4)
OTC-purchased	104	1	0	1	0	0	0	0
OTC-written	95	0	(2)	(2)	0	0	0	0
<b>Currency derivatives</b>								
Forwards	4,457	30	(36)	(6)	3,330	62	(24)	38
Futures	29	0	0	0	0	0	0	0
Swaps	182	1	(3)	(2)	326	4	(2)	2
Options:								
OTC-purchased	95	1	0	1	197	1	0	1
OTC-written	158	0	(1)	(1)	36	0	0	0
<b>Interest rate derivatives</b>								
Bond forwards	348	1	(1)	0	193	1	(1)	0
Futures	301	0	0	0	345	0	0	0
Interest rate swaps	1,463	5	(6)	(1)	3,416	3	(3)	0
Total return swaps	0	0	0	0	125	0	0	0
Swaptions	156	3	(1)	2	685	1	(1)	0
Options:								
Listed-purchased	1,593	1	0	1	1,041	1	0	1
Listed-written	1,608	0	(1)	(1)	1,463	0	(1)	(1)
OTC-purchased	154	3	0	3	0	0	0	0
OTC-written	744	0	(5)	(5)	0	0	0	0
<b>Credit derivatives<sup>1</sup>:</b>								
Purchased	233	5	(1)	4	81	1	(1)	0
Sold	113	0	(4)	(4)	80	1	(2)	(1)
<b>Total</b>	<b>\$ 14,006</b>	<b>\$ 79</b>	<b>\$ (71)</b>	<b>\$ 8</b>	<b>\$ 12,644</b>	<b>\$ 114</b>	<b>\$ (39)</b>	<b>\$ 75</b>

<sup>1</sup> Credit derivatives include credit default swaps and collateralized debt obligations. PSPIB, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

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

(\$ millions)	2012
Less than 3 months	\$ 8,026
3 to 12 months	3,426
Over 1 year	2,554
<b>Total</b>	<b>\$ 14,006</b>

(c) Fair Value Measurement

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

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

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

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

The fair value of financial instruments as at 31 March 2012, based on the methods described above is as follows:

(\$ millions)	As at 31 March 2012				
	Level 1	Level 2	Level 3	No level	Total Fair Value
<b>Public markets</b>					
Canadian equity	\$ 1,764	\$ 0	\$ 0	\$ 0	\$ 1,764
Foreign equity	2,942	157	33	0	3,132
<b>Private markets</b>					
Real estate	0	0	1,438	0	1,438
Private equity	0	0	1,193	0	1,193
Infrastructure	0	0	823	0	823
Renewable resources	0	0	72	0	72
<b>Fixed Income</b>					
Cash and money market securities	148	314	0	0	462
Government and corporate bonds	0	2,461	0	0	2,461
Inflation-linked bonds	0	763	0	0	763
Other fixed income securities	0	460	770	0	1,230
<b>Alternative investments</b>	0	168	59	0	227
<b>INVESTMENTS</b>	<b>\$ 4,854</b>	<b>\$ 4,323</b>	<b>\$ 4,388</b>	<b>\$ 0</b>	<b>\$ 13,565</b>
<b>Investment-related assets</b>					
Amounts receivable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ 121	\$ 121
Interest receivable <sup>1</sup>	0	0	0	31	31
Dividends receivable <sup>1</sup>	0	0	0	12	12
Derivative-related receivables	4	75	0	0	79
<b>Total investment-related assets</b>	<b>\$ 4</b>	<b>\$ 75</b>	<b>\$ 0</b>	<b>\$ 164</b>	<b>\$ 243</b>
<b>Investment-related liabilities</b>					
Amounts payable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ (191)	\$ (191)
Interest payable <sup>1</sup>	0	0	0	(5)	(5)
Securities sold short	(83)	0	0	0	(83)
Securities sold under repurchase agreements	0	(246)	0	0	(246)
Derivative-related payables	(3)	(66)	(2)	0	(71)
Capital debt financing:					
Short-term	0	(174)	0	0	(174)
Long-term	0	(583)	0	0	(583)
<b>Total investment-related liabilities</b>	<b>\$ (86)</b>	<b>\$ (1,069)</b>	<b>\$ (2)</b>	<b>\$ (196)</b>	<b>\$ (1,353)</b>
<b>NET INVESTMENTS</b>	<b>\$ 4,772</b>	<b>\$ 3,329</b>	<b>\$ 4,386</b>	<b>\$ (32)</b>	<b>\$ 12,455</b>

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

The fair value of financial instruments, as at 31 March 2011, based on the methods described above is as follows:

(\$ millions)	As at 31 March 2011				
	Level 1	Level 2	Level 3	No level	Total Fair Value
<b>Public markets</b>					
Canadian equity	\$ 2,741	\$ 11	\$ 0	\$ 0	\$ 2,752
Foreign equity	2,122	405	0	0	2,527
<b>Private markets</b>					
Real estate	0	0	1,061	0	1,061
Private equity	0	0	1,010	0	1,010
Infrastructure	0	0	527	0	527
<b>Fixed income</b>					
Cash and money market securities	113	387	0	0	500
Government and corporate bonds	0	1,572	0	0	1,572
Inflation-linked bonds	0	580	0	0	580
Other fixed income securities	0	389	717	0	1,106
<b>Alternative investments</b>	0	217	0	0	217
<b>INVESTMENTS</b>	<b>\$ 4,976</b>	<b>\$ 3,561</b>	<b>\$ 3,315</b>	<b>\$ 0</b>	<b>\$ 11,852</b>
<b>Investment-related assets</b>					
Amounts receivable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ 136	\$ 136
Interest receivable <sup>1</sup>	0	0	0	27	27
Dividends receivable <sup>1</sup>	0	0	0	10	10
Derivative-related receivables	4	110	0	0	114
<b>Total investment-related assets</b>	<b>\$ 4</b>	<b>\$ 110</b>	<b>\$ 0</b>	<b>\$ 173</b>	<b>\$ 287</b>
<b>Investment-related liabilities</b>					
Amounts payable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ (211)	\$ (211)
Interest payable <sup>1</sup>	0	0	0	(4)	(4)
Securities sold short	(8)	0	0	0	(8)
Securities sold under repurchase agreements	0	(100)	0	0	(100)
Derivative-related payables	(6)	(31)	(2)	0	(39)
Capital debt financing:					
Short-term	0	(137)	0	0	(137)
Long-term	0	(340)	0	0	(340)
<b>Total investment-related liabilities</b>	<b>\$ (14)</b>	<b>\$ (608)</b>	<b>\$ (2)</b>	<b>\$ (215)</b>	<b>\$ (839)</b>
<b>NET INVESTMENTS</b>	<b>\$ 4,966</b>	<b>\$ 3,063</b>	<b>\$ 3,313</b>	<b>\$ (42)</b>	<b>\$ 11,300</b>

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



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

There were no significant transfers between Level 1 and Level 2 during the year ended 31 March 2012 (no significant transfers during the year ended 31 March 2011)

#### *Level 3 Reconciliation*

The reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 is as follows:

For the year ended 31 March 2012:

(\$ millions)	Opening Balance	Purchases	Sales	Settlements <sup>1</sup>	Realized Gains	Unrealized Gains	Transfer out of Level 3	Closing Balance
Public markets	\$ 0	\$ 30	\$ (3)	\$ 0	\$ 0	\$ 6	\$ 0	\$ 33
Private markets	2,598	1,208	(437)	0	40	121	(4)	3,526
Fixed income	717	204	(190)	(43)	8	74	0	770
Alternative investments	0	57	0	0	0	2	0	59
Derivative-related receivables/ payables (net)	(2)	0	0	(1)	1	0	0	(2)
<b>Total</b>	<b>\$ 3,313</b>	<b>\$ 1,499</b>	<b>\$ (630)</b>	<b>\$ (44)</b>	<b>\$ 49</b>	<b>\$ 203</b>	<b>\$ (4)</b>	<b>\$ 4,386</b>

For the year ended 31 March 2011:

(\$ millions)	Opening Balance	Purchases	Sales	Settlements <sup>1</sup>	Realized Losses	Unrealized Gains	Transfer out of Level 3	Closing Balance
Private markets	\$ 2,401	\$ 451	\$ (422)	\$ 0	\$ (14)	\$ 185	\$ (3)	\$ 2,598
Fixed income	780	93	(152)	(37)	(15)	48	0	717
Derivative-related receivables/ payables (net)	(64)	40	(1)	0	(48)	71	0	(2)
<b>Total</b>	<b>\$ 3,117</b>	<b>\$ 584</b>	<b>\$ (575)</b>	<b>\$ (37)</b>	<b>\$ (77)</b>	<b>\$ 304</b>	<b>\$ (3)</b>	<b>\$ 3,313</b>

<sup>1</sup> Includes pension plan allocation adjustments.

#### *Level 3 Sensitivity Analysis*

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 4 (a) and 4 (b). Although such assumptions reflect PSPIB management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 2 per cent increase/decrease (2011 — 2 per cent increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios in the real estate sector and certain fund investments, where a sensitivity analysis is not possible given that the underlying assumptions used are not available to PSPIB. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 4 (a). With respect to private debt portfolios in the real estate sector, the fair value is obtained from third-party appraisers as described in Note 4 (a).

(d) Securities Lending and Borrowing Programs

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSPIB and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at 31 March 2012, PSPIB, on behalf of the pension plan, has re-invested \$335 million of collateral held (2011 — \$292 million).

The fair values of the allocated securities and collateral associated with the lending and borrowing programs as at 31 March are as follows:

(\$ millions)	2012	2011
<b>Securities lending</b>		
Securities lent	\$ 1,350	\$ 1,124
Collateral contractually receivable <sup>1</sup>	1,422	1,176
<b>Securities borrowing</b>		
Securities borrowed	83	8
Collateral contractually payable <sup>2</sup>	92	9

1 The minimum fair value of collateral required is equal to 102 per cent of the fair value of the securities lent.

2 The minimum fair value of collateral required is equal to 100 per cent of the fair value of the securities borrowed.

(e) Securities Sold and Collateral Pledged under Repurchase Agreements

Securities sold under repurchase agreements are described in Note 4 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSPIB does not sell, repledge or otherwise use collateral held.

On behalf of the pension plan, PSPIB pledged collateral under the repurchase agreements with a fair value of \$246 million at 31 March 2012 (2011 — \$100 million).

## 5. INVESTMENT RISK MANAGEMENT

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

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

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

### (a) Market Risk

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

Market risk management focuses on the following two key components:

#### *Policy Portfolio*

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSPIB invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation report of the pension plan. In the absence of other factors affecting the funding of the pension plan or changes to pension benefits under the pension plan, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

#### *Active Management*

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

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

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

#### *Measurement of Market Risk*

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

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

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

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

Total VaR at 31 March:

	2012	2011
Policy Portfolio VaR	21.7 %	22.4 %
Active VaR	2.6	2.2
<b>Total VaR (undiversified)</b>	<b>24.3</b>	<b>24.6</b>
Diversification effect	(1.6)	(2.9)
<b>Total VaR</b>	<b>22.7 %</b>	<b>21.7 %</b>

#### *Stress Testing*

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

#### (i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk as at 31 March 2012 are as follows:

(\$ millions)	Less than 1 year	1 to 5 years	5 to 10 years	Over 10 years	Other	Total
Government bonds	\$ 260	\$ 917	\$ 330	\$ 350	\$ 0	\$ 1,857
Corporate bonds	120	257	168	59	0	604
Inflation-linked bonds	0	201	190	372	0	763
Asset-backed securities	0	347	6	1	0	354
Private debt portfolios:						
Directly held	10	78	1	0	0	89
Held through funds <sup>1</sup>	0	0	0	0	355	355
<b>Total investments with significant exposure to interest rate risk</b>	<b>390</b>	<b>1,800</b>	<b>695</b>	<b>782</b>	<b>355</b>	<b>4,022</b>
Other investments <sup>2</sup>	0	0	0	0	894	894
<b>Total fixed income</b>	<b>\$ 390</b>	<b>\$ 1,800</b>	<b>\$ 695</b>	<b>\$ 782</b>	<b>\$ 1,249</b>	<b>\$ 4,916</b>

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

2 Consists of \$462 million in cash and money market securities and \$432 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

The terms to maturity of PSPIB's capital debt financing are disclosed in Note 8.

Alternative investments as well as derivative contract described in Note 4 (a) (iv) and Note 4 (b), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 5 (a).

(ii) Foreign Currency Risk

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



## (ii) Foreign Currency Risk (continued)

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

Currency	2012		2011	
(in millions of Canadian \$)	Fair value	% of total	Fair value	% of total
US Dollar (USD)	\$ 2,505	57.9 %	\$ 1,848	54.0 %
Euro (EUR)	514	11.9	464	13.6
British Pound (GBP)	339	7.8	259	7.6
Japanese Yen (JPY)	195	4.5	138	4.0
Brazilian Real (BRL)	175	4.0	172	5.0
Hong Kong Dollar (HKD)	130	3.0	129	3.8
Korean Won (KRW)	95	2.2	92	2.7
Australian Dollar (AUD)	78	1.8	60	1.7
Norwegian Krone (NOK)	66	1.5	20	0.6
Indian Rupee (INR)	37	0.9	27	0.8
Others	195	4.5	210	6.2
<b>Total net foreign currency</b>	<b>\$ 4,329</b>	<b>100.0 %</b>	<b>\$ 3,419</b>	<b>100.0 %</b>

PSPIB and its subsidiaries also had commitments, denominated in foreign currencies of \$1,249 million (1,094 million USD, 100 million EUR, 23 million South African Rands and 36 million BRL) which were not included in the foreign currency exposure table.

## (b) Credit Risk

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

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

As at 31 March 2012, the investment portfolio's maximum exposure to credit risk amounted to approximately \$4 billion (2011 — approximately \$3 billion). This amount excludes investments in distressed debts in the amount of approximately \$0.3 billion as at 31 March 2012 (2011 — approximately \$0.3 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 4 (d), 4 (e) and 5 (b), and the impact of guarantees and indemnities disclosed in Note 18.

As at 31 March 2012, the investment portfolio had a net notional exposure of \$32 million (2011 — \$51 million) to various tranches of collateralized debt obligations, of which approximately 61 per cent (2011 — approximately 44 per cent) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 18, to support potential margin calls on the ABTNs (Note 4 (a) (iii)).

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

PSPIB's concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the pension plan as at 31 March is as follows :

	2012	2011
Investment grade (AAA to BBB-)	98.2 %	97.9 %
Below investment grade (BB+ and below)	0.7	0.4
Not rated:		
Rated by a single credit rating agency	0.1	0.1
Not rated by credit rating agencies	1.0	1.6
<b>Total</b>	<b>100.0 %</b>	<b>100.0 %</b>

(i) Counterparty Risk

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

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

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSPIB to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSPIB to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the pension plan, PSPIB pledged securities with a fair value of \$1 million as collateral with respect to derivative contracts at 31 March 2012 (2011 — nil). Securities with a fair value of \$20 million were received from counterparties as collateral at 31 March 2012 (2011 — \$26 million). PSPIB does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 4 (d) and 4 (e) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

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

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

(c) Liquidity Risk

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

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

The terms to maturity of the notional amount of derivatives are disclosed in Note 4 (b).

*Financial Liabilities*

The fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at 31 March 2012 is as follows:

(\$ millions)	Less than 3 months	3 to 12 months	Over 1 year	Total
<b>Non-derivative-related financial liabilities<sup>1</sup></b>				
Amounts payable from pending trades	\$ (191)	\$ 0	\$ 0	\$ (191)
Interest payable	(4)	(1)	0	(5)
Securities sold short	(83)	0	0	(83)
Securities sold under repurchase agreements	(246)	0	0	(246)
Capital market debt financing	(161)	(13)	(583)	(757)
Accounts payable and other liabilities	(16)	0	(6)	(22)
<b>Total</b>	<b>\$ (701)</b>	<b>\$ (14)</b>	<b>\$ (589)</b>	<b>\$ (1,304)</b>

(\$ millions)	Less than 3 months	3 to 12 months	Over 1 year	Total
<b>Derivative-related financial instruments</b>				
Derivative-related receivables	\$ 29	\$ 33	\$ 17	\$ 79
Derivative-related payables <sup>1</sup>	(31)	(20)	(20)	(71)
<b>Total</b>	<b>\$ (2)</b>	<b>\$ 13</b>	<b>\$ (3)</b>	<b>\$ 8</b>

<sup>1</sup> Liabilities are presented in the earliest period in which the counterparty can request payment.

## 6. CONTRIBUTIONS RECEIVABLE

The contributions receivable as at 31 March are as follows:

(\$ millions)	2012	2011
Pre 01 April 2000 service:		
Employee contributions for past service elections	\$ 23	\$ 23
Employer's share of contributions for past service elections	23	23
<b>Total – pre 01 April 2000 service</b>	<b>46</b>	<b>46</b>
Post 31 March 2000 service:		
Employee contributions for past service elections	51	48
Employer's share of contributions for past service elections	108	114
<b>Total – post 31 March 2000 service</b>	<b>159</b>	<b>162</b>
<b>Total contributions receivable</b>	<b>\$ 205</b>	<b>\$ 208</b>

## 7. DUE TO THE PUBLIC SERVICE PENSION FUND ACCOUNT

The costs of operation of PSPIB are charged to the four plans for which PSPIB provides investment services, namely the public service pension plan, the Canadian Forces pension plan, the Reserve Force pension plan and the Royal Canadian Mounted Police pension plan. The direct costs of investment activities, such as external investment management fees and custodial fees, are allocated to each plan and their operating expenses are allocated on a quarterly basis based upon the asset value of each plan's investments under management.

In 2012, 19.4 per cent of the operating expenses were allocated to the Canadian Forces pension plan (2011 — 19.7 per cent). PSPIB initially charges all expenses to the Public Service Pension Fund Account, which is reimbursed quarterly by the other three plan accounts. As of 31 March 2012, \$8 million (2011 — \$9 million) was due to the Public Service Pension Fund Account from the Canadian Forces Pension Fund Account.

## 8. CAPITAL MARKET DEBT FINANCING

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

The maximum amount authorized by the Board of Directors for the capital market debt program is 7.5 per cent of the net investments plus all recourse debt outstanding of PSPIB. Under this limit, the short-term promissory note component cannot exceed \$3 billion.

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

(\$ millions)	2012		2011
	Capital amounts to be repaid	Fair Value	Fair Value
Short-term promissory notes, bearing interest between 1 % and 1.42 % and maturing within 31 and 364 days of issuance (31 March 2011 — 29 and 363 days)	\$ 174	\$ 174	\$ 137
Medium-term notes Series 1, bearing interest of 4.57 % per annum and maturing on 09 December 2013	193	203	205
Medium-term notes Series 2, bearing interest of 2.94 % per annum and maturing on 03 December 2015	135	139	135
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on 16 February 2015	67	68	0
Medium-term notes Series 4, bearing interest of 2.26 % per annum and maturing on 16 February 2017s	174	173	0
<b>Total</b>	<b>\$ 743</b>	<b>\$ 757</b>	<b>\$ 477</b>

The operating expenses by PSP Capital Inc. were allocated to the pension plan.

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

(\$ thousands)	2012	2011
Short-term promissory notes	\$ 2,454	\$ 1,745
Medium-term notes	13,483	10,235
<b>Total</b>	<b>\$ 15,937</b>	<b>\$ 11,980</b>

## 9. CAPITAL MANAGEMENT

The Canadian Forces pension plan capital consists of the actuarial funding excess or shortfall determined regularly by the actuarial valuation on a funding basis prepared by the OCA. The purpose of this valuation is to determine the financial position of the pension plan by testing its ability to meet obligations to current plan members and their survivors. Using various assumptions, the actuary projects the pension benefits to estimate the current value of the pension obligation, which is compared with the sum of the investment assets held by PSPIB, other accounts and the discounted value of future plan member contributions and Government of Canada credits related to past service elections. The result of this comparison is either an actuarial excess or an actuarial shortfall.

The objective of managing the capital position of the pension plan is to ensure that the sum of the balance of the Superannuation Account, which is maintained in the accounts of Canada, and the investments held by PSPIB, is sufficient to meet pension obligations.



## 10. PENSION OBLIGATIONS

### (a) Present Value of Pension Obligations

The present value of pension obligations is calculated by the OCA using the projected benefit method prorated on service, based on management's best estimate assumptions. Actuarial valuations for funding purposes are performed triennially. The most recent funding actuarial valuation of the Canadian Forces pension plan was conducted as of 31 March 2010, and tabled in Parliament on 25 October 2011. The effective date of the next required actuarial funding valuation will be as of 31 March 2013.

An actuarial valuation for accounting purposes is conducted annually using management's best estimate economic assumptions, demographic assumptions and base populations of the most recent funding actuarial valuation. The information in these financial statements is based on this annual valuation conducted as at 31 March 2012.

The assumptions used in determining the present value of pension obligations were developed with reference to short- and long-term forecasts of economic and demographic conditions, including estimates of future inflation, interest rates, expected return on investments, general wage increases, workforce composition, retirement rates, and mortality rates.

The discount rates used to measure the present value of the accrued benefit obligations, benefits earned and interest expense are:

The expected rates of returns on invested funds for post 31 March 2000 service; and

The expected weighted average of long-term bond rates for pre 01 April 2000 service.

The assumptions used in measuring the accrued benefit obligations and future benefit expense were as follows:

	2012		2011	
	Accrued benefit obligation	Future benefit expense	Accrued benefit obligation	Future benefit expense
Discount rates: <sup>1</sup>				
Post 31 March 2000 service	6.0 %	6.2 %	6.2 %	5.8 %
Pre 01 April 2000 service	4.8 %	6.0 %	5.2 %	6.5 %
Long-term rate of inflation	2.0 %		2.0 %	
Long-term general wage increase	2.7 %		2.9 %	

<sup>1</sup> The presentation of comparative discount rates for the accrued benefit obligations was changed to disclose flat weighted average discount rates; prior years disclosed the initial and ultimate discount rates.

### (b) Plan Amendments

During the year, no amendments were made to the Canadian Forces pension plan (2011 — nil).

## 11. EXCESS (SHORTFALL)

The funding valuation differs from that of the valuation performed for the purpose of these financial statements. Based on the CICA Section 4600, all investment assets and investment-related liabilities are to be measured at fair value, and the actuarial asset value adjustment previously allowed under Section 4100 in the determination of the pension plan financial statement excess or shortfall is no longer permitted. Therefore, for financial statement reporting, the excess/shortfall of the pension plan is based on the difference between the fair value of the plan net assets and other accounts available for benefits and the plan pension obligations.

For financial statement purposes, the value of net assets and other accounts available for benefits and the pension obligations are tracked separately for service prior to 01 April 2000 and after 31 March 2000.

Based on the accounting assumptions used in these financial statements, the breakdown is as follows:

As at 31 March 2012

(\$ millions)	Pre 01 April 2000	Post 31 March 2000	Total
Net assets and other accounts available for benefits	\$ 46,315	\$ 12,878	\$ 59,193
Pension obligations	44,436	15,090	59,526
<b>Excess (shortfall)</b>	<b>\$ 1,879</b>	<b>\$ (2,212)</b>	<b>\$ (333)</b>

As at 31 March 2011

(\$ millions)	Pre 01 April 2000	Post 31 March 2000	Total
Net assets and other accounts available for benefits	\$ 46,041	\$ 11,489	\$ 57,530
Pension obligations	42,566	12,963	55,529
<b>Excess (shortfall)</b>	<b>\$ 3,475</b>	<b>\$ (1,474)</b>	<b>\$ 2,001</b>

## 12. CONTRIBUTIONS

The contributions for the years ended 31 March are as follows:

(\$ millions)	2012	2011
From employees		
For current service	\$ 300	\$ 288
For past service	26	22
Change in contributions receivable	2	17
Sub-total – Employee contributions	328	327
From employer		
For current service	740	726
For prior service	60	49
Change in contributions receivable	(5)	42
Sub-total – Employer contributions	795	817
Actuarial funding adjustment (Note 14)	249	0
<b>Total contributions</b>	<b>\$ 1,372</b>	<b>\$ 1,144</b>

### 13. INVESTMENT INCOME

Investment income for the years ended 31 March is as follows:

(\$ millions)	2012	2011
Interest income	\$ 128	\$ 100
Dividend income	150	118
Other income	38	36
Dividend expense	(5)	(4)
Interest expense (Note 8)	(16)	(12)
Transaction costs	(12)	(11)
External investment management fees <sup>1</sup>	(7)	(8)
<b>Sub-total</b>	<b>276</b>	<b>219</b>
Net realized gains <sup>2</sup>	197	355
Net unrealized (losses) gains	(110)	802
<b>Investment income</b>	<b>\$ 363</b>	<b>\$ 1,376</b>

1 Consists of amounts incurred for investments in public markets that are paid directly by PSPIB (Note 2). This excludes investment fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of \$11 million for the year ended 31 March 2012 (2011 — \$16 million). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSPIB.

Such fees, which generally vary between 0.1 per cent and 2.0 per cent of the total invested and/or committed amount, totaled \$23 million for the year ended 31 March 2012 (2011 — \$27 million).

2 Includes foreign currency losses of \$8 million for the year ended 31 March 2012 (2011 — gains of \$22 million).

### 14. ACTUARIAL ADJUSTMENTS

A triennial actuarial valuation as of 31 March 2010 for the Canadian Forces pension plan was tabled in Parliament on 25 October 2011. As a result of estimates from the OCA, an amount of \$249 million (2011 — nil) was credited to fund the shortfall in the Pension Fund Account. No adjustment to the Superannuation Account was required for the year ended 31 March 2012 (2011 — nil).

### 15. BENEFITS PAID, AND REFUNDS AND TRANSFERS

#### (a) Benefits Paid

The value of benefits paid for the years ended 31 March is as follows:

(\$ millions)	2012	2011
Retirement pension benefit payments	\$ 2,589	\$ 2,521
Minimum pension benefits	1	1
<b>Total benefit payments</b>	<b>\$ 2,590</b>	<b>\$ 2,522</b>

#### (b) Refunds and Transfers

The value of refunds and transfers for the years ended 31 March is as follows:

(\$ millions)	2012	2011
Returns of contributions and transfer value payments	\$ 67	\$ 42
Pension division payments	53	59
Transfers to other plans	1	1
<b>Total refunds and transfers</b>	<b>\$ 121</b>	<b>\$ 102</b>

## 16. ADMINISTRATIVE EXPENSES

The legislation provides for administrative expenses to be charged to the Canadian Forces pension plan. Annually, the Treasury Board approves the administrative expenses for DND, PWGSC, TBS, and the OCA. Administrative expenses incurred by PSPIB are also charged to the Canadian Forces pension plan.

DND, as the administrator and manager of the pension plan, recovers administrative expenses from the pension plan for the activities directly attributable to its administration. These costs include salaries and benefits, systems maintenance and development, accommodation and other operating costs of administering the pension plan within the department.

PWGSC, under a memorandum of understanding with DND, provides annuitant services to the Canadian Forces pension plan and the corresponding administrative costs are charged to the pension plan on a quarterly basis. These costs include salaries and benefits, systems maintenance and development, accommodation and other operating costs associated with the annuitant services for the pension plan.

The OCA provides actuarial valuation services. The costs related to these services are charged to the pension plan.

PSPIB charges plan-related operating expenses, salaries and benefits and other operating fees to the pension plan.

Administrative expenses, for the years ended 31 March, consist of the following:

(\$ millions)	2012	2011
DND		
Salaries and benefits	\$ 12	\$ 12
Operations and maintenance	3	3
<b>DND total</b>	<b>15</b>	<b>15</b>
PWGSC		
Salaries and benefits	4	3
Operations and maintenance	1	1
<b>PWGSC total</b>	<b>5</b>	<b>4</b>
<b>OCA – Actuarial fees</b>	<b>1</b>	<b>1</b>
<b>Subtotal – Government departments (included in the service cost)</b>	<b>21</b>	<b>20</b>
PSPIB		
Salaries and benefits	19	14
Operations and maintenance	8	7
Professional and consulting fees	2	1
Other	0	0
<b>PSPIB total</b>	<b>29</b>	<b>22</b>
<b>Total administrative expenses</b>	<b>\$ 50</b>	<b>\$ 42</b>

## 17. RETIREMENT COMPENSATION ARRANGEMENT

A separate Retirement Compensation Arrangement (RCA) Account has been established under the authority of the *Special Retirement Arrangements Act* to provide supplementary benefits to certain plan members. The RCA account provides for benefits in excess of those permitted under the *Income Tax Act* restrictions for registered pension plans.

Pursuant to the *Special Retirement Arrangements Act*, transactions pertaining to this arrangement, such as contributions, benefits and interest credits are recorded in the RCA Account, which is maintained in the accounts of Canada. The legislation also requires that the RCA Account be credited with interest quarterly at the same rates as those credited to the Canadian Forces Superannuation Account.

The RCA is registered with the Canada Revenue Agency (CRA) and a transfer is made annually between the RCA Account and CRA to either remit a 50 per cent refundable tax in respect of the net contributions and interest credits, or to be credited a reimbursement based on the net benefit payments.

Since this arrangement is covered by separate legislation, the balance in the RCA Account and related pension obligations are not consolidated in the financial statements of the Canadian Forces pension plan.

The following summarizes the financial position of the RCA Account that relates to the Canadian Forces pension plan as at 31 March:

(\$ millions)	2012	2011
<b>Net balance and pension obligations</b>		
Balance of account		
RCA account	\$ 308	\$ 287
Refundable tax receivable	297	275
<b>Subtotal</b>	<b>605</b>	<b>562</b>
Pension obligations	455	410
<b>Excess of the balance of the account over the pension obligations</b>	<b>\$ 150</b>	<b>\$ 152</b>

The actuarial assumptions used to value the pension obligations pertaining to the RCA Account are consistent with those used for the Canadian Forces pension plan in all respects, except that they take into consideration the impact of the refundable tax on the notional rate of return expected for the Account.

The following summarizes the changes in the RCA Account for the year ended 31 March:

(\$ millions)	2012	2011
<b>Increase</b>		
Contributions – employer	\$ 27	\$ 51
Contributions – employees	2	2
Interest income	18	18
Increase in refundable tax receivable	22	37
<b>Total – increase</b>	<b>69</b>	<b>108</b>
<b>Decrease</b>		
Benefits paid	4	3
Refundable tax remittance	22	37
<b>Total – decrease</b>	<b>26</b>	<b>40</b>
<b>Increase in the balance of the account</b>	<b>\$ 43</b>	<b>\$ 68</b>



Actuarial shortfalls found between the balance in the RCA Account and the actuarial liabilities are credited to the RCA Account in equal instalments over a period not to exceed 15 years. As a result of the triennial valuation of 31 March 2010, no adjustment was made to the RCA Account during the year (2011 — nil).

## 18. GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital inc. provided funding facilities of a maximum amount of \$969 million to support potential margin calls on the ABTNs, of which \$190 million has been allocated to the pension plan. As at 31 March 2012, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSPIB provided guarantees or indemnifications to third parties, the most significant of which are as follows:

As at 31 March 2012, PSPIB agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the pension plan could assume the obligation up to \$81 million (2011 — \$81 million) plus interest and other related costs. The loan matures in March 2015.

As at 31 March 2012, a wholly-owned subsidiary of PSPIB has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to \$195 million (2011 — \$195 million), of which \$38 million (2011 — \$38 million) may be allocated to the pension plan, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

## 19. COMMITMENTS

PSPIB 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 31 March, the portion of PSPIB's commitments that would be assumed by the Canadian Forces pension plan is as follows:

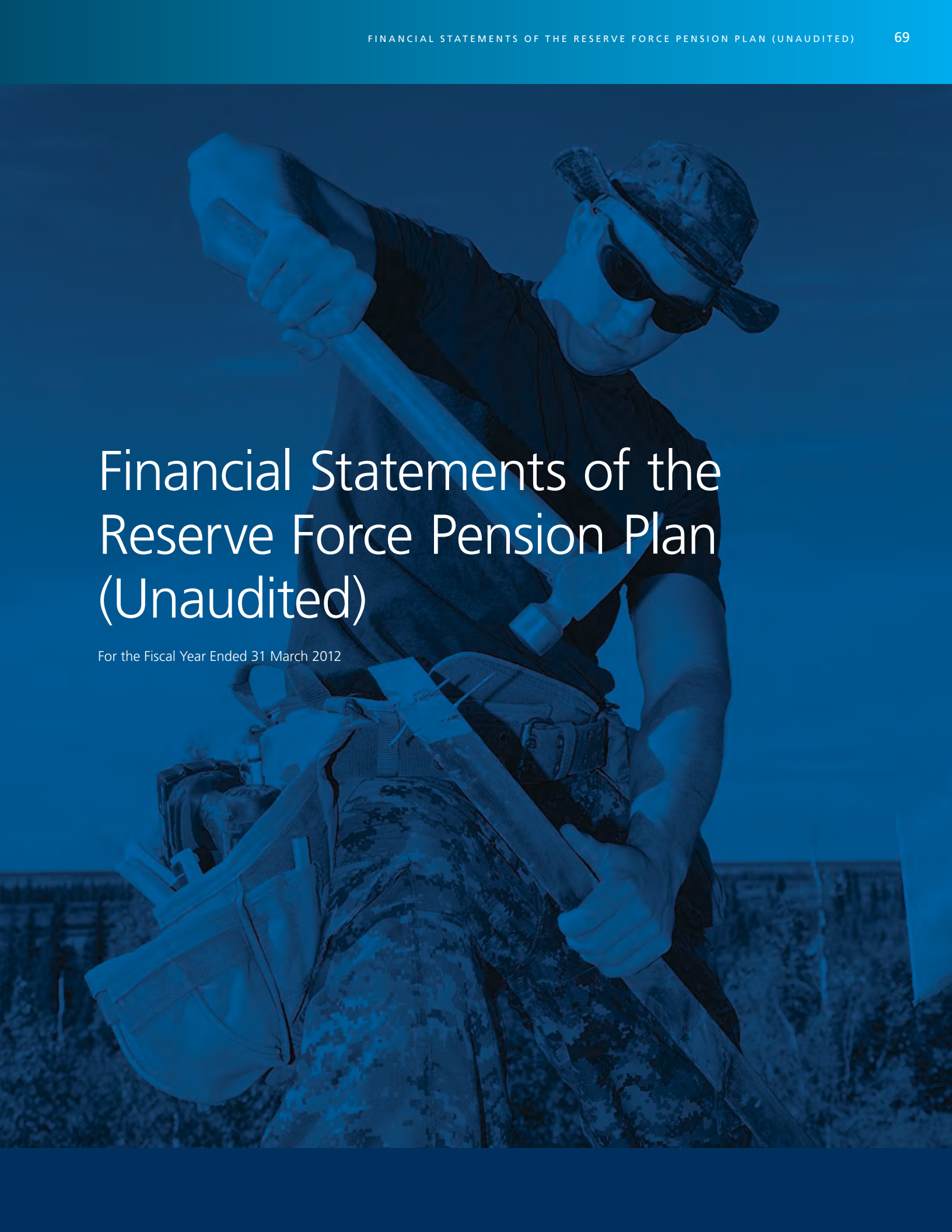
(\$ millions)	2012
Private equity	\$ 788
Real estate	290
Infrastructure	168
Other fixed income securities	112
<b>Total</b>	<b>\$ 1,358</b>

## 20. CONTINGENCY

In September 1999, the Public Sector Pension Investment Board Act (Bill C-78) was passed by Parliament, providing for improvements in the financial management of federal public service pension plans, including the Public Service (PSSA), RCMP (RCMPSA), and Canadian Forces (CFSA) superannuation plans. The new Act authorized the President of the Treasury Board to debit the accounts in order to reduce the amount of certain excess balances in the superannuation accounts. In late 1999, the major public service unions and pensioner associations launched three lawsuits against the Crown challenging the validity of the legislation. On 20 November 2007, the plaintiffs' actions were dismissed. In February 2008, all 3 plaintiffs appealed the decisions to the Ontario Court of Appeal. The appeal was heard in April 2010. On 08 October 2010, the Ontario Court of Appeal dismissed the plaintiffs' appeal. The plaintiffs applied for leave to appeal to the Supreme Court of Canada which granted leave to appeal on 05 May 2011. The appeal was heard on 09 February 2012. On 19 December 2012, the Supreme Court of Canada dismissed the appeal.

## 21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to comply with the implementation of the CICA Handbook Section 4600 — Pension Plans.



# Financial Statements of the Reserve Force Pension Plan (Unaudited)

For the Fiscal Year Ended 31 March 2012



## RESERVE FORCE PENSION PLAN

### Statement of Management Responsibility

The financial statements of the Reserve Force pension plan for the year ended 31 March 2012 have been prepared by the management of the Department of National Defence. These financial statements have been prepared in accordance with the accounting policies set out in Note 2 of the financial statements, which are based on Canadian accounting standards for pension plans. The presentation and results using the stated accounting principles do not result in any significant differences from Canadian accounting standards for pension plans, except where noted due to uncertainty or error. The financial statements include management's best estimates and judgments where appropriate. Where uncertainty or error exists in the preparation of financial statements, this has been disclosed and highlighted.

Responsibility for the integrity and fairness of the financial statements rests with the management of the Department of National Defence. This responsibility also extends to acknowledging where deficiencies, weaknesses or errors in processes have affected the integrity of financial statements. In the case of the Reserve Force pension plan, management does acknowledge that uncertainty in the measurement, control and reporting of the Reserve Force service and earnings has affected our ability to produce financial statements that are fair and reasonably free of error.

In support of its responsibility, management should develop and maintain books, records, internal controls and management practices designed to provide reasonable assurance as to the reliability of the financial information and to ensure that transactions are in accordance with the *Canadian Forces Superannuation Act* and regulations, as well as the *Financial Administration Act* and regulations. In this regard, and in acknowledgement of the identified deficiencies in our systems, processes and controls, management has developed an action plan to address shortcomings and implement the improvements required to provide this level of assurance.

Additional information, as required, is obtained from the Public Sector Pension Investment Board, which maintains its own records and systems of internal control to account for the funds managed on behalf of the Reserve Force Pension Plan in accordance with the *Public Sector Pension Investment Board Act* and regulations.

These financial statements have not been audited. The financial statements for the years ended 31 March 2008 and 2009 were audited by the Office of the Auditor General (OAG). The OAG issued a denial of opinion based on the uncertainty in actuarial valuation of accrued pension benefits due to the backlog of past service elections and internal control weaknesses. For this reason, and in anticipation of the expected timeframes to address the past service elections, the Department of National Defence has requested that the OAG not audit the financial statements to allow management sufficient time to implement required changes to reduce the backlog of past service election files and strengthen internal controls.

Approved by:



Major General R. Bertrand  
Acting Chief Financial Officer



Robert Fonberg  
Deputy Minister

Ottawa, Canada  
03 December 2012

## Statement of Financial Position

(Canadian \$ thousands)	As at 31 March 2012	As at 31 March 2011	As at 01 April 2010
<b>Net assets</b>			
Assets			
Reserve Force Pension Fund Account (Note 3)	\$ 9,724	\$ 5,027	\$ 4,315
Investments (Note 4)	397,229	339,327	241,523
Investment-related assets (Note 4)	7,107	8,223	3,131
Contributions receivable (Note 6)	6,800	6,400	0
Other assets	180	85	63
<b>Total assets</b>	<b>421,040</b>	<b>359,062</b>	<b>249,032</b>
Liabilities			
Due to the public service pension plan (Note 7)	221	241	114
Other liabilities	437	139	61
Investment-related liabilities (Note 4)	39,585	24,008	13,529
<b>Net assets</b>	<b>\$ 380,797</b>	<b>\$ 334,674</b>	<b>\$ 235,328</b>
<b>Pension obligations and excess</b>			
Pension obligations (Note 10)	\$ 264,130	\$ 222,882	\$ 169,882
Excess (Note 11)	116,667	111,792	65,446
<b>Pension obligations and excess</b>	<b>\$ 380,797</b>	<b>\$ 334,674</b>	<b>\$ 235,328</b>

Commitments (Note 18)

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

These financial statements are unaudited.



## Statement of Changes in Net Assets Available for Benefits

Year ended 31 March

(Canadian \$ thousands)	2012	2011
<b>Net assets, beginning of year</b>	<b>\$ 334,674</b>	<b>\$ 235,328</b>
<b>Increase in net assets:</b>		
Employee contributions (Note 12)	\$ 26,493	\$ 27,715
Employer contributions (Note 12)	30,411	44,522
Investment income, excluding changes in fair values of investment assets and investment liabilities (Note 13)	8,280	6,031
Changes in fair values of investment assets and liabilities — realized and unrealized gains and losses (Note 13)	2,521	32,728
<b>Total increase in net assets</b>	<b>67,705</b>	<b>110,996</b>
<b>Decrease in net assets:</b>		
Benefits paid (Note 15)	2,703	1,396
Refunds and transfers (Note 15)	11,503	4,405
Administrative expenses (Note 16)	7,376	5,849
<b>Total decrease in net assets</b>	<b>21,582</b>	<b>11,650</b>
<b>Net increase in net assets</b>	<b>46,123</b>	<b>99,346</b>
<b>Net assets, end of year</b>	<b>\$ 380,797</b>	<b>\$ 334,674</b>

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

These financial statements are unaudited.

## Statement of Changes in Pension Obligations

Year ended 31 March

(Canadian \$ thousands)	2012	2011
<b>Pension obligations, beginning of year</b>	<b>\$ 222,882</b>	<b>\$ 169,882</b>
<b>Increase in pension obligations:</b>		
Benefits earned	52,400	56,900
Cost of new elections	22,600	18,400
Interest on pension obligations	15,400	11,777
Changes in actuarial assumptions (Note 10)	6,100	(5,123)
<b>Total increase in pension obligations</b>	<b>96,500</b>	<b>81,954</b>
<b>Decrease in pension obligations:</b>		
Experience gains	34,500	17,874
Administrative expenses included in the service cost (Note 16)	6,546	5,279
Refunds and transfers (Note 15)	11,503	4,405
Benefits paid (Note 15)	2,703	1,396
<b>Total decrease in pension obligations</b>	<b>55,252</b>	<b>28,954</b>
<b>Net increase in pension obligations</b>	<b>41,248</b>	<b>53,000</b>
<b>Pension obligations, end of year</b>	<b>\$ 264,130</b>	<b>\$ 222,882</b>

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

These financial statements are unaudited.

## Notes to the Financial Statements

For the year ended 31 March 2012 (Canadian \$)

### 1. DESCRIPTION OF THE RESERVE FORCE PENSION PLAN

The Reserve Force pension plan (the pension plan), governed by Part I.1 of the *Canadian Forces Superannuation Act* (the CFSA), provides pension benefits to eligible members of the Reserve Force component of the Canadian Forces. Established in 1901 under the *Militia Pension Act*, the present day version of the pension plan is administered in accordance with the CFSA.

The main provisions of the Reserve Force pension plan are summarized below.

#### (a) General

The pension plan is a contributory defined benefit plan covering eligible members of the Canadian Forces Reserve Force as defined in the *National Defence Act*. Membership in the pension plan is compulsory for all eligible members, excluding those members who have sufficient full-time service to become eligible for membership in the Canadian Forces pension plan under Part I of the CFSA.

The Government of Canada is the sole sponsor of the pension plan. The Minister of National Defence is the Minister responsible for the CFSA. The President of the Treasury Board has an oversight role in respect of the pension plan, including responsibility for tabling actuarial valuations before Parliament. The Department of National Defence (DND) is responsible for providing program management and the day-to-day administration of the pension plan. The Office of the Chief Actuary (OCA) within the Office of the Superintendent of Financial Institutions (OSFI) performs periodic actuarial valuations of the pension plan.

Pursuant to the CFSA and the Regulations, transactions relating to service subsequent to 01 March 2007 are recorded in the Reserve Force Pension Fund (Pension Fund), where the excess of contributions over benefits and administrative costs is invested in capital markets through the Public Sector Pension Investment Board (PSPIB). PSPIB is a Crown corporation whose statutory objectives are to manage the funds transferred to it for investment and to maximize investment returns without undue risk of loss, having regard to the funding, policies and requirements of the four major public sector pension plans.

#### (b) Funding Policy

The Reserve Force pension plan is funded from plan member and employer contributions. For the fiscal year, plan members contributed 5.2 per cent (2011 — 5.2 per cent) for the year of pensionable earnings up to the maximum 66 2/3 times the defined benefit limit specified by the *Income Tax Act*. The Government's contribution is made monthly to provide for the cost (net of pension plan member contributions) of the benefits that have accrued in respect of that month at a rate determined by the President of the Treasury Board. The cost of the benefits is determined based on actuarial valuations, which are performed triennially.

The CFSA provides that all pension obligations arising from the Reserve Force pension plan be met by the Government. In the case of the Pension Fund, the CFSA requires that any actuarial deficit be dealt with by transferring equal instalments to the Pension Fund over a period of up to 15 years, commencing in the year in which the actuarial report is tabled in Parliament. It also allows any excess to be lowered by reducing Government and pension plan member contributions. In addition, if there is an amount considered to be non-permitted surplus (refer to CFSA Section 55.4 (5) for definition of non-permitted surplus) related to the Pension Fund, no further Government pension contributions are permitted while pension plan member contributions under the Pension Fund may be reduced and amounts from PSPIB may be transferred to the Consolidated Revenue Fund.

(c) Benefits

The Reserve Force pension plan provides pension benefits to members based on the total pensionable service and total pensionable earnings during the service period. The benefits are determined by a formula set out in the legislation; they are not based on the financial status of the pension plan. The basic benefit formula is 1.5 per cent multiplied by indexed pensionable earnings. Benefits are also coordinated with the CPP and QPP, and qualifying members are eligible for a bridge benefit of 0.5 per cent multiplied by indexed pensionable earnings to the maximum of the five-year average yearly maximum pensionable earnings until they become eligible for the CPP or QPP, normally at age 65. Also, benefits are fully indexed to the increase in the Consumer Price Index.

Other benefits paid include survivor allowances, deferred annuities, annual allowances, transfer values, cash termination allowances or minimum death benefits paid in the event of death.

## 2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These financial statements present information on the Reserve Force pension plan on a going concern basis. They are prepared to assist plan members and others in reviewing the activities of the pension plan for the year, not to portray the funding requirements of the pension plan.

These financial statements are prepared in Canadian dollars, the plan's functional currency, in accordance with the accounting policies stated below, which are based on Canadian accounting standards for pension plans in Part IV of the Canadian Institute of Chartered Accountants (CICA) Handbook (Section 4600). Section 4600 provides specific accounting guidance on investments and pension obligations. For accounting policies that do not relate to either investments or pension obligations, the plan complies with International Financial Reporting Standards (IFRS) in Part I of the CICA Handbook commencing 01 April 2011. To the extent that IFRS in Part I is inconsistent with Section 4600, Section 4600 takes precedence. The presentation and results using the stated accounting policies do not result in any significant differences from Canadian accounting standards for pension plans.

The financial statements for the year ended 31 March 2012 were authorized for issue by the signatories on 25 March 2013.

(i) Error Correction

The error correction pertains to an overstatement in the balance of the Reserve Force Pension Fund Account, for an accrual for transfers to the Canadian Forces Pension Fund Account that was made, but never reversed for actual transfers. The error affected the balance of the Reserve Force Pension Fund Account, net assets, and excess. The effect of the error correction has been shown, along with the effects of the change in accounting policy, in Note 2 (b).

(b) Changes in Accounting Policies

These financial statements are prepared based on Section 4600 — Pension Plans of the CICA Handbook. Prior to 01 April 2011, the financial statements were prepared on the basis of CICA Handbook Section 4100 — Pension Plans. As a result, the comparatives as at 01 April 2010 and 31 March 2011 have been restated. Management has elected to early adopt International Accounting Standard (IAS) 1, effective 01 January 2013, related to the Presentation of Financial Statements, on a prospective basis, commencing 01 April 2012. As a result, the pension plan does not need to present the related notes to the opening statement of financial position as at 01 April 2010.

**INVESTMENT ASSETS AND INVESTMENT LIABILITIES**

The measurement requirements under Section 4600 were applied consistently to the fair value of all investment assets and investment liabilities. The application of Section 4600 requirements has no impact on the values of either investment assets or investment liabilities.

Investment assets and investment liabilities are presented on a non-consolidated basis. As an investment company, PSPIB has been exempted from the IFRS requirement to consolidate its controlled investments. As a result, the pension plan financial statements of prior years are unchanged as investments continue to be stated at fair value and on a non-consolidated basis.

The following accounting policy has been revised based on Section 4600.

**ELIMINATION OF ACTUARIAL ASSET VALUE ADJUSTMENT**

As at 31 March 2011, on the basis of Section 4100, the actuarial asset value adjustment was included in the determination of the pension plan financial statement excess or shortfall. Per Section 4600, the actuarial asset value adjustment is no longer permitted.

As a result of the change to Section 4600 and the error correction, the tables below shows the impact of the revised accounting policies on the prior years' Statement of Financial Position.



As at 31 March 2011:

(\$ thousands)	As Previously Reported	Effect of Transition to CICA Section 4600	Error Correction	Revised per Section 4600
<b>Net assets</b>				
Assets				
Reserve Force Pension Fund Account (Note 3)	\$ 5,748	\$ 0	\$ (721)	\$ 5,027
Investments (Note 4)	339,327	0	0	339,327
Investment-related assets (Note 4)	8,223	0	0	8,223
Contributions receivable (Note 6)	6,400	0	0	6,400
Other assets	85	0	0	85
Total assets	359,783	0	(721)	359,062
Liabilities				
Due to the public service pension plan (Note 7)	241	0	0	241
Other liabilities	139	0	0	139
Investment-related liabilities (Note 4)	24,008	0	0	24,008
<b>Net assets</b>	<b>335,395</b>	<b>0</b>	<b>(721)</b>	<b>334,674</b>
Actuarial asset value adjustment	(27,000)	27,000	0	0
<b>Actuarial value of net assets</b>	<b>\$ 308,395</b>	<b>\$ 27,000</b>	<b>\$ (721)</b>	<b>\$ 334,674</b>
<b>Pension obligations and excess</b>				
Pension obligations (Note 10)	\$ 222,882	\$ 0	\$ 0	\$ 222,882
Excess (Note 11)	85,513	27,000	(721)	111,792
<b>Pension obligations and excess</b>	<b>\$ 308,395</b>	<b>\$ 27,000</b>	<b>\$ (721)</b>	<b>\$ 334,674</b>

As at 01 April 2010:

(\$ thousands)	As Previously Reported	Effect of Transition to CICA Section 4600	Error Correction	Revised per Section 4600
<b>Net assets</b>				
Assets				
Reserve Force Pension Fund Account (Note 3)	\$ 5,036	\$ 0	(721)	\$ 4,315
Investments (Note 4)	241,523	0	0	241,523
Investment-related assets (Note 4)	3,131	0	0	3,131
Contributions receivable (Note 6)	0	0	0	0
Other assets	63	0	0	63
Total assets	249,753	0	(721)	249,032
Liabilities				
Due to the public service pension plan (Note 7)	114	0	0	114
Other liabilities	61	0	0	61
Investment-related liabilities (Note 4)	13,529	0	0	13,529
<b>Net assets</b>	<b>236,049</b>	<b>0</b>	<b>(721)</b>	<b>235,328</b>
Actuarial asset value adjustment	(9,450)	9,450	0	0
<b>Actuarial value of net assets</b>	<b>\$ 226,599</b>	<b>\$ 9,450</b>	<b>\$ (721)</b>	<b>\$ 235,328</b>
<b>Pension obligations and excess</b>				
Pension obligations (Note 10)	\$ 169,882	\$ 0	\$ 0	\$ 169,882
Excess (Note 11)	56,717	9,450	(721)	65,446
<b>Pension obligations and excess</b>	<b>\$ 226,599</b>	<b>\$ 9,450</b>	<b>\$ (721)</b>	<b>\$ 235,328</b>

(c) Valuation of Assets

The investments of the Pension Fund are held by PSPIB and allocated to the Reserve Force pension plan. Investments, investment-related assets and investment-related liabilities are recorded at the date upon which PSPIB becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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.

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

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

The valuation methods of each asset class are described in Note 4 (a) and 4 (b).

(d) Transaction Costs

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

(e) Investment Management Fees

Investment management fees are costs directly attributable to the external management of assets on behalf of PSPIB. Management fees incurred for investments in private markets and certain debt portfolios are paid by the investment directly, through capital contributions by PSPIB or offset against distributions received from the investment (Note 4 (a) (ii)). Investment management fees are also incurred for certain public markets and alternate investments and are paid either directly by PSPIB or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 13).

(f) Income Recognition

The investment income (loss) is allocated proportionately based on the asset value held in the pension plan account.

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments, and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year to adjust investments to fair value. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), as well as private market distributions from pooled funds, limited partnerships or from direct investments and co-investments. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSPIB already has committed and delegated funds.

(g) Contributions

Contributions for current service are recorded in the year in which the related payroll costs are incurred. Contributions for past service that are receivable over a period in excess of one year are recorded at the estimated net present value of the contributions to be received.

(h) Benefits Earned, Benefits Paid, and, Refunds, and Transfers

Benefits are accrued as pensionable service accumulates. Benefits paid are recognized as a reduction of pension obligations and net assets when paid.

Refunds and transfers are recognized at the moment the refund or transfer occurs; until that time they are presented with the net assets and with related pension obligations.

(i) Translation of Foreign Currencies

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

(j) Use of Estimates

The preparation of these financial statements based on Canadian accounting standards for pension plans requires management to make use of estimates and assumptions that affect the reported values of investment assets and investment liabilities, pension obligations, income and expenses, and related disclosures at the date of the financial statements.

In making estimates and using assumptions, management relies on external information and observable conditions where possible. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ significantly from the estimates and assumptions. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

(k) Pension Obligations

The present value of pension obligations is calculated by using the projected benefit method prorated on services, based on management's best estimate assumptions.

### 3. RESERVE FORCE PENSION FUND ACCOUNT

The Government has a statutory obligation to pay benefits relating to the pension plan. This pension obligation is to plan members and their beneficiaries. In order for the Government to track the transactions related to contributions, benefit payments, interest, and transfers, the Government established the Reserve Force Pension Fund Account in the accounts of Canada. The account has no capacity to pay pensions. All cash receipts are deposited to and payments come from the Consolidated Revenue Fund (CRF).

Pension transactions are recorded in the Reserve Force Pension Fund Account. The Reserve Force Pension Fund Account does not earn interest, as it is merely a flow through account. At year end, the balance in the Reserve Force Pension Fund Account represents net contributions awaiting imminent transfer to PSPIB. PSPIB investment assets and investment-related liabilities are reflected directly in the pension plan financial statements.

#### RELATED PARTY — CANADIAN FORCES PENSION FUND ACCOUNT

The Reserve Force Pension Fund Account is related, through common legislation (the CFSA), to the Canadian Forces Pension Fund Account. Transactions with the Canadian Forces Pension Fund Account related to member service and contributions are considered to be in the normal course of operations, in accordance with the s83 of the *Reserve Force Pension Plan Regulations* (RFPPR) and are recorded at the exchange amount as required by that section. For the year ended 31 March 2012, \$8,695,577 (2011 — \$3,585,956) was transferred between the fund accounts based on 1,309 former members of the Reserve Force pension plan (2011 — 306 former members) who transferred pensionable service between pension plans during the year. At the beginning of the year 4,082 members of Reserve Force were members of the Canadian Forces pension plan and a further 582 members of the Reserve Force pension plan (2011 — 619) became eligible for membership in the Canadian Forces pension plan during the year. The value of the pensionable service due between the pension plans is not estimable until such time as the cost of prior service elected under the provisions of the RFPPR is finalized, and as such, have not been included in the financial statements of the Reserve Force pension plan.

#### 4. INVESTMENTS

##### (a) Investment Portfolio

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

	2012		2011	
(\$ thousands)	Fair Value	Cost	Fair Value	Cost
<b>Public markets</b>				
Canadian equity	\$ 51,632	\$ 52,862	\$ 78,794	\$ 67,062
Foreign equity	91,648	82,727	72,337	63,941
<b>Private markets</b>				
Real estate	42,091	40,083	30,390	31,511
Private equity	34,909	28,534	28,925	23,779
Infrastructure	24,109	25,436	15,086	16,513
Renewable resources	2,122	2,122	0	0
<b>Fixed income</b>				
Cash and money market securities	13,787	13,787	14,287	14,287
Government and corporate bonds	72,005	70,080	45,013	44,994
Inflation-linked bonds	22,309	20,094	16,616	16,881
Other fixed income securities	35,982	32,419	31,669	30,474
<b>Alternative investments</b>	6,635	759	6,210	478
<b>INVESTMENTS</b>	<b>\$ 397,229</b>	<b>\$ 368,903</b>	<b>\$ 339,327</b>	<b>\$ 309,920</b>
<b>Investment-Related Assets</b>				
Amounts receivable from pending trades	\$ 3,554	\$ 3,554	\$ 3,886	\$ 3,886
Interest receivable	902	902	780	780
Dividends receivable	336	336	279	279
Derivative-related receivables	2,315	458	3,278	156
<b>Total Investment-Related Assets</b>	<b>\$ 7,107</b>	<b>\$ 5,250</b>	<b>\$ 8,223</b>	<b>\$ 5,101</b>
<b>Investment-Related Liabilities</b>				
Amounts payable from pending trades	\$ (5,584)	\$ (5,584)	\$ (6,043)	\$ (6,043)
Interest payable	(137)	(137)	(117)	(117)
Securities sold short	(2,425)	(2,345)	(240)	(207)
Securities sold under repurchase agreements	(7,186)	(7,160)	(2,847)	(2,847)
Derivative-related payables	(2,090)	(464)	(1,101)	(133)
Capital debt financing (Note 8):				
Short-term	(5,088)	(5,088)	(3,916)	(3,916)
Long-term	(17,075)	(16,728)	(9,744)	(9,542)
<b>Total investment-related liabilities</b>	<b>\$ (39,585)</b>	<b>\$ (37,506)</b>	<b>\$ (24,008)</b>	<b>\$ (22,805)</b>
<b>NET INVESTMENTS</b>	<b>\$ 364,751</b>	<b>\$ 336,647</b>	<b>\$ 323,542</b>	<b>\$ 292,216</b>

## (i) Public Markets

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

*Valuation Techniques*

Direct investments in Canadian and foreign equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators, which are derived from the fair value measurement of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

## (ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, properties, as well as fund investments in the real estate sector. Real estate investments focus on properties, partnerships and companies operating in the office, retail, industrial, hospitality, and residential sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at 31 March 2012, the total amount of third party financing included as part of real estate contracted by direct investments controlled by PSPIB for the pension plan was \$15,037 thousand (2011 — \$11,778 thousand).

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

Infrastructure investments are comprised of direct equity positions and co-investments in various private entities and fund investments. Infrastructure investments focus on entities engaged in the management, ownership, or operation of assets in energy, transportation, and other regulated business. Infrastructure investments are accounted for net of all third-party financings. As at 31 March 2012, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSPIB for the pension plan was \$1,612 thousand (2011 — \$285 thousand).

Renewable resource investments are comprised of properties involving the production and harvesting of replenishable resources. As at 31 March 2012, renewable resources included one investment in timberlands.

*Valuation Techniques*

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



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

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

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

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

(iii) Fixed Income

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

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

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

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

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 17.

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

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

#### *Valuation Techniques*

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

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

ABTNs are measured at fair value whereby PSPIB relies on the valuation work performed by a recognized third-party expert. PSPIB ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads, and the underlying investments' terms to maturity. In addition to the values determined by the expert, PSPIB integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 17.

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

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

#### (iv) Alternative Investments

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

#### *Valuation Techniques*

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable.

#### (v) Amounts Receivable and Payable from Pending Trades

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

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

#### *Valuation Techniques*

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

#### (vi) Interest and Dividends Receivable

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

#### (vii) Interest Payable

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

(viii) Securities Sold Short

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

*Valuation Techniques*

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

(ix) Securities Sold under Repurchase Agreements

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

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

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

*Valuation Techniques*

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

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 4 (b).

(xi) Capital Market Debt Financing

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

(b) Derivative Financial Instruments

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

PSPIB uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

## (iii) Forwards

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

## (iv) Options

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

## (v) Warrants and Rights

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

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

## (vi) Collateralized Debt Obligations

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

*Valuation Techniques*

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

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

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

INVESTMENTS	2012				2011			
(\$ thousands)	Notional Value	Fair Value			Notional Value	Fair Value		
		Assets	Liabilities	Net		Assets	Liabilities	Net
<b>Equity and commodity derivatives</b>								
Futures	\$ 5,718	\$ 0	\$ 0	\$ 0	\$ 2,398	\$ 0	\$ 0	\$ 0
Total return swaps	46,073	737	(244)	493	30,891	1,064	(1)	1,063
Warrants and rights	6	3	0	3	12	11	0	11
Options:								
Listed-purchased	6,371	84	0	84	2,466	69	0	69
Listed -written	5,453	0	(59)	(59)	2,204	0	(106)	(106)
OTC-purchased	3,040	33	0	33	0	0	0	0
OTC-written	2,797	0	(52)	(52)	0	0	0	0
<b>Currency derivatives</b>								
Forwards	130,411	880	(1,047)	(167)	95,329	1,762	(675)	1,087
Futures	856	0	0	0	0	0	0	0
Swaps	5,310	19	(100)	(81)	9,323	135	(61)	74
Options:								
OTC-purchased	2,770	29	0	29	5,628	32	0	32
OTC-written	4,627	0	(36)	(36)	1,019	0	(10)	(10)
<b>Interest rate derivatives</b>								
Bond forwards	10,167	21	(19)	2	5,536	29	(15)	14
Futures	8,836	0	0	0	9,867	0	0	0
Interest rate swaps	42,802	150	(169)	(19)	97,808	78	(92)	(14)
Total return swaps	0	0	0	0	3,599	0	(1)	(1)
Swaptions	4,561	85	(33)	52	19,635	35	(17)	18
Options:								
Listed-purchased	46,619	19	0	19	29,805	36	0	36
Listed-written	47,059	0	(26)	(26)	41,876	0	(39)	(39)
OTC-purchased	4,511	87	0	87	0	0	0	0
OTC-written	21,764	0	(134)	(134)	0	0	0	0
<b>Credit derivatives<sup>1</sup>:</b>								
Purchased	6,815	157	(51)	106	2,331	17	(21)	(4)
Sold	3,297	11	(120)	(109)	2,278	10	(63)	(53)
<b>Total</b>	<b>\$ 409,863</b>	<b>\$ 2,315</b>	<b>\$ (2,090)</b>	<b>\$ 225</b>	<b>\$362,005</b>	<b>\$ 3,278</b>	<b>\$ (1,101)</b>	<b>\$ 2,177</b>

<sup>1</sup> Credit derivatives include credit default swaps and collateralized debt obligations. PSPIB, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

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

(\$ thousands)	2012
Less than 3 months	\$ 234,853
3 to 12 months	100,260
Over 1 year	74,750
Total	\$ 409,863

(c) Fair Value Measurement

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

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

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

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



The fair value of financial instruments as at 31 March 2012, based on the methods described above is as follows:

(\$ thousands)	As at 31 March 2012				
	Level 1	Level 2	Level 3	No level	Total Fair Value
<b>Public markets</b>					
Canadian equity	\$ 51,632	\$ 0	\$ 0	\$ 0	\$ 51,632
Foreign equity	86,098	4,590	960	0	91,648
<b>Private markets</b>					
Real estate	0	0	42,091	0	42,091
Private equity	0	0	34,909	0	34,909
Infrastructure	0	0	24,109	0	24,109
Renewable resources	0	0	2,122	0	2,122
<b>Fixed income</b>					
Cash and money market securities	4,599	9,188	0	0	13,787
Government and corporate bonds	0	72,005	0	0	72,005
Inflation-linked bonds	0	22,309	0	0	22,309
Other fixed income securities	0	13,465	22,517	0	35,982
<b>Alternative investments</b>	0	4,921	1,714	0	6,635
<b>INVESTMENTS</b>	<b>\$ 142,329</b>	<b>\$ 126,478</b>	<b>\$ 128,422</b>	<b>\$ 0</b>	<b>\$ 397,229</b>
<b>Investment-related assets</b>					
Amounts receivable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ 3,554	\$ 3,554
Interest receivable <sup>1</sup>	0	0	0	902	902
Dividends receivable <sup>1</sup>	0	0	0	336	336
Derivative-related receivables	103	2,212	0	0	2,315
<b>Total investment-related assets</b>	<b>\$ 103</b>	<b>\$ 2,212</b>	<b>\$ 0</b>	<b>\$ 4,792</b>	<b>\$ 7,107</b>
<b>Investment-related liabilities</b>					
Amounts payable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ (5,584)	\$ (5,584)
Interest payable <sup>1</sup>	0	0	0	(137)	(137)
Securities sold short	(2,425)	0	0	0	(2,425)
Securities sold under repurchase agreements	0	(7,186)	0	0	(7,186)
Derivative-related payables	(85)	(1,945)	(60)	0	(2,090)
Capital debt financing:					
Short-term	0	(5,088)	0	0	(5,088)
Long-term	0	(17,075)	0	0	(17,075)
<b>Total investment-related liabilities</b>	<b>\$ (2,510)</b>	<b>\$ (31,294)</b>	<b>\$ (60)</b>	<b>\$ (5,721)</b>	<b>\$ (39,585)</b>
<b>NET INVESTMENTS</b>	<b>\$ 139,922</b>	<b>\$ 97,396</b>	<b>\$ 128,362</b>	<b>\$ (929)</b>	<b>\$ 364,751</b>

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

The fair value of financial instruments, as at 31 March 2011, based on the methods described above is as follows:

(\$ thousands)	As at 31 March 2011				
	Level 1	Level 2	Level 3	No level	Total Fair Value
<b>Public markets</b>					
Canadian equity	\$ 78,477	\$ 317	\$ 0	\$ 0	\$ 78,794
Foreign equity	60,736	11,601	0	0	72,337
<b>Private markets</b>					
Real estate	0	0	30,390	0	30,390
Private equity	0	0	28,925	0	28,925
Infrastructure	0	0	15,086	0	15,086
<b>Fixed income</b>					
Cash and money market securities	3,250	11,037	0	0	14,287
Government and corporate bonds	0	45,013	0	0	45,013
Inflation-linked bonds	0	16,616	0	0	16,616
Other fixed income securities	0	11,172	20,497	0	31,669
Alternative investments	0	6,210	0	0	6,210
<b>INVESTMENTS</b>	<b>\$ 142,463</b>	<b>\$ 101,966</b>	<b>\$ 94,898</b>	<b>\$ 0</b>	<b>\$ 339,327</b>
<b>Investment-related assets</b>					
Amounts receivable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ 3,886	\$ 3,886
Interest receivable <sup>1</sup>	0	0	0	780	780
Dividends receivable <sup>1</sup>	0	0	0	279	279
Derivative-related receivables	108	3,155	15	0	3,278
<b>Total investment-related assets</b>	<b>\$ 108</b>	<b>\$ 3,155</b>	<b>\$ 15</b>	<b>\$ 4,945</b>	<b>\$ 8,223</b>
<b>Investment-related liabilities</b>					
Amounts payable from pending trades <sup>1</sup>	\$ 0	\$ 0	\$ 0	\$ (6,043)	\$ (6,043)
Interest payable <sup>1</sup>	0	0	0	(117)	(117)
Securities sold short	(240)	0	0	0	(240)
Securities sold under repurchase agreements	0	(2,847)	0	0	(2,847)
Derivative-related payables	(145)	(898)	(58)	0	(1,101)
Capital debt financing:					
Short-term	0	(3,916)	0	0	(3,916)
Long-term	0	(9,744)	0	0	(9,744)
<b>Total investment-related liabilities</b>	<b>\$ (385)</b>	<b>\$ (17,405)</b>	<b>\$ (58)</b>	<b>\$ (6,160)</b>	<b>\$ (24,008)</b>
<b>NET INVESTMENTS</b>	<b>\$ 142,186</b>	<b>\$ 87,716</b>	<b>\$ 94,855</b>	<b>\$ (1,215)</b>	<b>\$ 323,542</b>

<sup>1</sup> No fair value hierarchy classification is required for these items.

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

There were no significant transfers between Level 1 and Level 2 during the year ended 31 March 2012 (no significant transfers during the year ended 31 March 2011)

### Level 3 Reconciliation

The reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 is as follows:

For the year ended 31 March 2012:

(\$ thousands)	Opening Balance	Purchases	Sales	Settlements <sup>1</sup>	Realized Gains	Unrealized Gains (Losses)	Transfer out of Level 3	Closing Balance
Public markets	\$ 0	\$ 880	\$ (92)	\$ 0	\$ 12	\$ 160	\$ 0	\$ 960
Private markets	74,401	36,134	(12,948)	0	1,176	4,596	(128)	103,231
Fixed income	20,497	6,066	(5,630)	(1,271)	255	2,600	0	22,517
Alternative investments	0	1,672	0	0	0	42	0	1,714
Derivative-related receivables/payables (net)	(43)	0	0	(18)	17	(16)	0	(60)
<b>Total</b>	<b>\$ 94,855</b>	<b>\$ 44,752</b>	<b>\$ (18,670)</b>	<b>\$ (1,289)</b>	<b>\$ 1,460</b>	<b>\$ 7,382</b>	<b>\$ (128)</b>	<b>\$ 128,362</b>

For the year ended 31 March 2011:

(\$ thousands)	Opening Balance	Purchases	Sales	Settlements <sup>1</sup>	Realized Losses	Unrealized Gains	Transfer out of Level 3	Closing Balance
Private markets	\$ 60,906	\$ 34,026	\$ (28,598)	\$ 0	\$ (425)	\$ 8,800	\$ (308)	\$ 74,401
Fixed income	19,793	7,045	(8,765)	(2,489)	(399)	5,312	0	20,497
Derivative-related receivables/payables (net)	(1,627)	2,400	(70)	0	(1,270)	524	0	(43)
<b>Total</b>	<b>\$ 79,072</b>	<b>\$ 43,471</b>	<b>\$ (37,433)</b>	<b>\$ (2,489)</b>	<b>\$ (2,094)</b>	<b>\$ 14,636</b>	<b>\$ (308)</b>	<b>\$ 94,855</b>

<sup>1</sup> Includes pension plan allocation adjustments

### Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 4 (a) and 4 (b). Although such assumptions reflect PSPIB management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 2 per cent increase/decrease (2011 — 2 per cent increase/decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios in the real estate sector and certain fund investments, where a sensitivity analysis is not possible given that the underlying assumptions used are not available to PSPIB. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 4 (a). With respect to private debt portfolios in the real estate sector, the fair value is obtained from third-party appraisers as described in Note 4 (a).

#### (d) Securities Lending and Borrowing Programs

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

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSPIB and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at 31 March 2012, PSPIB, on behalf of the pension plan, has re-invested \$9,803 thousand of collateral held (2011 — \$8,348 thousand).

The fair values of the allocated securities and collateral associated with the lending and borrowing programs are as follows as at 31 March:

(\$ thousands)	2012	2011
<b>Securities lending</b>		
Securities lent	\$ 39,490	\$ 32,192
Collateral contractually receivable <sup>1</sup>	41,621	33,676
<b>Securities borrowing</b>		
Securities borrowed	2,425	240
Collateral contractually payable <sup>2</sup>	2,700	254

1 The minimum fair value of collateral required is equal to 102 per cent of the fair value of the securities lent.

2 The minimum fair value of collateral required is equal to 100 per cent of the fair value of the securities borrowed.

(e) **Securities Sold & Collateral Pledged under Repurchase Agreements**

Securities sold under repurchase agreements are described in Note 4 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSPIB does not sell, repledge or otherwise use collateral held.

On behalf of the pension plan, PSPIB pledged collateral under the repurchase agreements with a fair value of \$7,186 thousand at 31 March 2012 (2011 — \$2,847 thousand).

## 5. INVESTMENT RISK MANAGEMENT

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

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

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

(a) Market Risk

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

Market risk management focuses on the following two key components:

*Policy Portfolio*

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSPIB invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation report of the pension plan. In the absence of other factors affecting the funding of the pension plan or changes to pension benefits under the pension plan, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

*Active Management*

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

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

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

*Measurement of Market Risk*

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

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

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

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

Total VaR as at 31 March is as follows:

	2012	2011
Policy Portfolio VaR	21.7 %	22.4 %
Active VaR	2.6	2.2
<b>Total VaR (undiversified)</b>	<b>24.3</b>	<b>24.6</b>
Diversification effect	(1.6)	(2.9)
<b>Total VaR</b>	<b>22.7 %</b>	<b>21.7 %</b>

#### Stress Testing

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

#### (i) Interest Rate Risk

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

The terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at 31 March 2012:

(\$ thousands)	Less than 1 year	1 to 5 years	5 to 10 years	Over 10 years	Other	Total
Government bonds	\$ 7,595	\$ 26,837	\$ 9,656	\$ 10,246	\$ 0	\$ 54,334
Corporate bonds	3,523	7,506	4,915	1,727	0	17,671
Inflation-linked bonds	1	5,882	5,534	10,892	0	22,309
Asset-backed securities	2	10,160	172	15	0	10,349
Private debt portfolios						
Directly held	296	2,284	35	0	0	2,615
Held through funds <sup>1</sup>	0	0	0	0	10,376	10,376
<b>Total investments with significant exposure to interest rate risk</b>	<b>11,417</b>	<b>52,669</b>	<b>20,312</b>	<b>22,880</b>	<b>10,376</b>	<b>117,654</b>
Other investments <sup>2</sup>	0	0	0	0	26,429	26,429
<b>Total fixed income</b>	<b>\$ 11,417</b>	<b>\$ 52,669</b>	<b>\$ 20,312</b>	<b>\$ 22,880</b>	<b>\$ 36,805</b>	<b>\$ 144,083</b>

<sup>1</sup> Due to the nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

<sup>2</sup> Consists of \$13,787 thousand in cash and money market securities and \$12,642 thousand in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

The terms to maturity of PSPIB's capital debt financing are disclosed in Note 8.

Alternative investments as well as derivative contract described in Note 4 (a) (iv) and Note 4 (b), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 5 (a).



(ii) Foreign Currency Risk

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

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

Currency	2012		2011	
(in thousands of Canadian \$)	Fair value	% of total	Fair value	% of total
US Dollar (USD)	\$ 73,305	57.9 %	\$ 52,917	54.0 %
Euro (EUR)	15,025	11.9	13,297	13.6
British Pound (GBP)	9,919	7.8	7,422	7.6
Japanese Yen (JPY)	5,720	4.5	3,948	4.0
Brazilian Real (BRL)	5,133	4.0	4,909	5.0
Hong Kong Dollar (HKD)	3,812	3.0	3,702	3.8
Korean Won (KRW)	2,768	2.2	2,618	2.7
Australian Dollar (AUD)	2,282	1.8	1,704	1.7
Norwegian Krone (NOK)	1,941	1.5	582	0.6
Indian Rupee (INR)	1,083	0.9	785	0.8
Others	5,714	4.5	6,011	6.2
<b>Total net foreign currency</b>	<b>\$ 126,702</b>	<b>100.0 %</b>	<b>\$ 97,895</b>	<b>100.0 %</b>

PSPIB and its subsidiaries also had commitments, denominated in foreign currencies of \$36,553 thousand (32,007 thousand USD, 2,930 thousand EUR, 682 thousand South African Rands, and 1,050 thousand BRL) which were not included in the foreign currency exposure table.

(b) Credit Risk

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

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

As at 31 March 2012, the investment portfolio's maximum exposure to credit risk amounted to approximately \$125 million (2011 — approximately \$89 million). This amount excludes investments in distressed debts in the amount of approximately \$7.9 million as at 31 March 2012 (2011 — approximately \$8.4 million). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 4 (d), 4 (e) and 5 (b), and the impact of guarantees and indemnities disclosed in Note 17.

As at 31 March 2012, the investment portfolio had a net notional exposure of \$948 thousand (2011 — \$1,453 thousand) to various tranches of collateralized debt obligations, of which approximately 61 per cent (2011 — approximately 44 per cent) of the underlying dollar exposure was rated “Investment grade”, as well as funding facilities, as described in Note 17, to support potential margin calls on the ABTNs (Note 4 (a) (iii)).

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

PSPIB’s concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the pension plan was as follows as at 31 March:

	2012	2011
Investment grade (AAA to BBB–)	98.2 %	97.9 %
Below investment grade (BB+ and below)	0.7	0.4
Not rated:		
Rated by a single credit rating agency	0.1	0.1
Not rated by credit rating agencies	1.0	1.6
<b>Total</b>	<b>100.0 %</b>	<b>100.0 %</b>

(i) Counterparty Risk

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

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

As a credit mitigation technique, the ISDA Master Agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSPIB to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSPIB to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the pension plan, PSPIB pledged securities with a fair value of \$15 thousand as collateral with respect to derivative contracts at 31 March 2012 (2011 — nil). Securities with a fair value of \$589 thousand were received from counterparties as collateral at 31 March 2012 (2011 — \$762 thousand). PSPIB does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 4 (d) and 4 (e) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

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

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

(c) Liquidity Risk

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

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

The terms to maturity of the notional amount of derivatives are disclosed in Note 4 (b).

*Financial Liabilities*

The fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities is as follows as at 31 March 2012:

(\$ thousands)	Less than 3 months	3 to 12 months	Over 1 year	Total
<b>Non-derivative-related financial liabilities<sup>1</sup></b>				
Amounts payable from pending trades	\$ (5,584)	\$ 0	\$ 0	\$ (5,584)
Interest payable	(119)	(18)	0	(137)
Securities sold short	(2,425)	0	0	(2,425)
Securities sold under repurchase agreements	(7,186)	0	0	(7,186)
Capital market debt financing	(4,699)	(389)	(17,075)	(22,163)
Accounts payable and other liabilities	(313)	0	(124)	(437)
<b>Total</b>	<b>\$ (20,326)</b>	<b>\$ (407)</b>	<b>\$ (17,199)</b>	<b>\$ (37,932)</b>

(\$ thousands)	Less than 3 months	3 to 12 months	Over 1 year	Total
<b>Derivative-related financial instruments</b>				
Derivative-related assets	\$ 848	\$ 961	\$ 506	\$ 2,315
Derivative-related liabilities <sup>1</sup>	(895)	(582)	(613)	(2,090)
<b>Total</b>	<b>\$ (47)</b>	<b>\$ 379</b>	<b>\$ (107)</b>	<b>\$ 225</b>

<sup>1</sup> Liabilities are presented in the earliest period in which the counterparty can request payment.

## 6. CONTRIBUTIONS RECEIVABLE

The pension plan has contingent amounts due arising from a large number of requests for past service elections that have been received and acknowledged, but not processed. The pension plan has received and processed the following prior service elections as at 31 March:

Prior service elections under RFPP by processing status	2012	2011
Received	12,264	11,090
In progress	692	358
Completed	1,402	757
Pending	10,170	9,975

The contributions receivable as at 31 March are as follows:

(\$ thousands)	2012	2011
Employee contributions for past service elections	\$ 3,700	\$ 3,400
Employer's share of contributions for past service elections	3,100	3,000
<b>Total contributions receivable</b>	<b>\$ 6,800</b>	<b>\$ 6,400</b>

## 7. DUE TO THE PUBLIC SERVICE PENSION FUND ACCOUNT

The costs of operation of PSPIB are charged to the four plans for which PSPIB provides investment services, namely the public service pension plan, the Canadian Forces pension plan, the Reserve Force pension plan and the Royal Canadian Mounted Police pension plan. The direct costs of investment activities, such as external investment management fees and custodial fees, are allocated to each plan and their operating expenses are allocated on a quarterly basis based upon the asset value of each plan's investments under management.

In 2012, 0.6 per cent of the operating expenses were allocated to the Reserve Force pension plan (2011 — 0.5 per cent). PSPIB initially charges all expenses to the Public Service Pension Fund Account, which is reimbursed quarterly by the other three plan accounts. As of 31 March 2012, \$221 thousand (2011 — \$241 thousand) was due to the Public Service Pension Fund Account from the Reserve Force Pension Fund Account.

## 8. CAPITAL MARKET DEBT FINANCING

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

The maximum amount authorized by the Board of Directors for the capital market debt program is 7.5 per cent of the net investments plus all recourse debt outstanding of PSPIB. Under this limit, the short-term promissory note component cannot exceed \$3 billion.

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

(\$ thousands)	2012		2011
	Capital amounts to be repaid	Fair Value	Fair Value
Short-term promissory notes, bearing interest between 1 % and 1.42 % and maturing within 31 and 364 days of issuance (31 March 2011 — 29 and 363 days)	\$ 5,097	\$ 5,088	\$ 3,916
Medium-term notes Series 1, bearing interest of 4.57 % per annum and maturing on 09 December 2013	5,648	5,941	5,885
Medium-term notes Series 2, bearing interest of 2.94 % per annum and maturing on 03 December 2015	3,954	4,080	3,859
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on 16 February 2015	1,977	1,977	0
Medium-term notes Series 4, bearing interest of 2.26 % per annum and maturing on 16 February 2017	5,084	5,077	0
<b>Total</b>	<b>\$ 21,760</b>	<b>\$ 22,163</b>	<b>\$ 13,660</b>

The operating expenses of PSP Capital Inc. were allocated to the pension plan.

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

(\$ thousands)	2012	2011
Short-term promissory notes	\$ 73	\$ 49
Medium-term notes	399	286
<b>Total</b>	<b>\$ 472</b>	<b>\$ 335</b>

## 9. CAPITAL MANAGEMENT

The Reserve Force pension plan capital consists of the actuarial funding excess or shortfall determined regularly by the actuarial valuation on a funding basis prepared by the OCA. The purpose of this valuation is to determine the financial position of the pension plan by testing its ability to meet obligations to current plan members and their survivors. Using various assumptions, the actuary projects the pension benefits to estimate the current value of the pension obligation, which is compared with the sum of the investment assets held by PSPIB and the discounted value of future plan member contributions and Government credits related to past service elections. The result of this comparison is either an actuarial excess or an actuarial shortfall.

The objective of managing the capital position of the pension plan is to ensure that the investments held by PSPIB are sufficient to meet pension obligations.

## 10. PENSION OBLIGATIONS

### (a) Present Value of Pension Obligations

The present value of pension obligations is calculated by the OCA using the projected benefit method prorated on service and management's best estimate assumptions. Actuarial valuations for funding purposes are performed triennially. The most recent funding actuarial valuation of the Reserve Force pension plan was conducted as of 31 March 2010, and tabled in Parliament on 25 October 2011. The effective date of the next required actuarial funding valuation will be as of 31 March 2013.

An actuarial valuation for accounting purposes is conducted annually using management's best estimate economic assumptions, demographic assumptions and base populations of the most recent funding actuarial valuation. The information in these financial statements is based on this annual valuation conducted as at 31 March 2012.

The assumptions used in determining the present value of pension obligations were developed with reference to short- and long-term forecasts of economic and demographic conditions, including estimates of future inflation, interest rates, expected return on investments, general wage increases, workforce composition, retirement rates, and mortality rates.

The discount rates used to measure the present value of the accrued benefit obligations, benefits earned and interest expense are the expected rates of returns on invested funds.

The assumptions used in measuring the accrued benefit obligations and future benefit expense were as follows:

	2012		2011	
	Accrued benefit obligation	Future benefit expense	Accrued benefit obligation	Future benefit expense
Discount rates <sup>1</sup>	6.0 %	6.2 %	6.2 %	5.8 %
Long-term rate of inflation	2.0 %		2.0 %	
Long-term general wage increase	2.7 %		2.9 %	

<sup>1</sup> The presentation of comparative discount rates for the accrued benefit obligations was changed to disclose flat weighted average discount rates; prior years disclosed the initial and ultimate discount rates.

(b) Plan Amendments

During the year, no amendments were made to the Reserve Force pension plan (2011 — nil).

## 11. EXCESS (SHORTFALL)

The funding valuation differs from that of the valuation performed for the purpose of these financial statements. Based on the CICA Section 4600, all investment assets and investment-related liabilities are to be measured at fair value, and the actuarial asset value adjustment previously allowed under Section 4100 in the determination of the pension plan financial statement excess or shortfall is no longer permitted. Therefore, for financial statement reporting, the excess/shortfall of the pension plan is based on the difference between the fair value of the plan net assets and other accounts available for benefits and the plan pension obligations.

## 12. CONTRIBUTIONS

The contributions for the years ended 31 March are as follows:

(\$ thousands)	2012	2011
From employees		
For current service	\$ 16,757	\$ 18,079
For past service	9,436	6,236
Change in contributions receivable	300	3,400
Sub-total — Employee contributions	26,493	27,715
From employer		
For current service	18,246	32,548
For prior service	12,065	8,974
Change in contributions receivable	100	3,000
Sub-total — Employer contributions	30,411	44,522
<b>Total contributions</b>	<b>\$ 56,904</b>	<b>\$ 72,237</b>



### 13. INVESTMENT INCOME

Investment income for the years ended 31 March is as follows:

(\$ thousands)	2012	2011
Interest income	\$ 3,835	\$ 2,770
Dividend income	4,461	3,239
Other income	1,144	968
Dividend expense	(139)	(106)
Interest expense (Note 8)	(472)	(335)
Transaction costs	(363)	(295)
External investment management fees <sup>1</sup>	(186)	(210)
<b>Sub-total</b>	<b>8,280</b>	<b>6,031</b>
Net realized gains <sup>2</sup>	5,743	9,959
Net unrealized (losses) gains	(3,222)	22,769
<b>Investment income</b>	<b>\$ 10,801</b>	<b>\$ 38,759</b>

1 Consists of amounts incurred for investments in public markets that are paid directly by PSPIB (Note 2). This excludes investment fees related to certain pooled fund investments classified under alternative investments, primarily related to performance, in the amount of \$314 thousand for the year ended 31 March 2012 (2011 — \$470 thousand). This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSPIB.

Such fees, which generally vary between 0.1 per cent and 2.0 per cent of the total invested and/or committed amount, totaled \$672 thousand for the year ended 31 March 2012 (2011 — \$781 thousand).

2 Includes foreign currency losses of \$281 thousand for the year ended 31 March 2012 (2011 — gains of \$577 thousand).

### 14. ACTUARIAL ADJUSTMENTS

A triennial actuarial valuation as of 31 March 2010 for the Reserve Force pension plan was tabled in Parliament on 25 October 2011. As a result of estimates from the OCA, a reduction of the employer's share of contributions will occur to reduce the non-permitted surplus in the Reserve Force Pension Fund, beginning in November 2011 (2011 — no adjustment).

### 15. BENEFIT PAYMENTS, REFUNDS AND TRANSFERS

#### (a) Benefit Payments

The value of benefit payments for the years ended 31 March is as follows:

(\$ thousands)	2012	2011
Retirement pension benefit payments	\$ 2,550	\$ 1,316
Minimum pension benefits	153	80
<b>Total benefit payments</b>	<b>\$ 2,703</b>	<b>\$ 1,396</b>

#### (b) Refunds and Transfers

The value of refunds and transfers for the years ended 31 March is as follows:

(\$ thousands)	2012	2011
Returns of contributions and transfer value payments	\$ 2,807	\$ 819
Transfers to the Canadian Forces pension plan	8,696	3,586
<b>Total refunds and transfers</b>	<b>\$ 11,503</b>	<b>\$ 4,405</b>

## 16. ADMINISTRATIVE EXPENSES

The legislation provides for administrative expenses to be charged to the Reserve Force pension plan. Annually, the Treasury Board approves the administrative expenses for DND, PWGSC, and the OCA. Administrative expenses incurred by PSPIB are also charged to the Reserve Force pension plan.

DND, as the administrator and manager of the pension plan, recovers administrative expenses from the pension plan for the activities directly attributable to its administration. These costs include salaries and benefits, systems maintenance and development, accommodation and other operating costs of administering the pension plan within the department.

PWGSC, under a memorandum of understanding with DND, provides annuitant services to the Reserve Force pension plan and the corresponding administrative costs are charged to the pension plan on a quarterly basis. These costs include salaries and benefits, systems maintenance and development, accommodation and other operating costs associated with the annuitant services for the pension plan.

The OCA provides actuarial valuation services. The costs related to these services are charged to the pension plan.

PSPIB charges plan-related operating expenses, salaries and benefits and other operating fees to the pension plan.

Administrative expenses, for the years ended 31 March, consist of the following:

(\$ thousands)	2012	2011
DND		
Salaries and benefits	\$ 5,623	\$ 4,323
Operations and maintenance	664	691
<b>DND total</b>	<b>6,287</b>	<b>5,014</b>
PWGSC		
Salaries and benefits	65	66
Operations and maintenance	22	20
<b>PWGSC total</b>	<b>87</b>	<b>86</b>
Military Pension Renewal (MPR) project		
DND MPR expenses	26	38
PWGSC MPR expenses	19	0
<b>MPR project total</b>	<b>45</b>	<b>38</b>
<b>OCA — actuarial fees</b>	<b>127</b>	<b>141</b>
<b>Subtotal — Government departments (included in the service cost)</b>	<b>6,546</b>	<b>5,279</b>
PSPIB		
Salaries and benefits	541	351
Operations and maintenance	222	175
Professional and consulting fees	61	40
Other	6	4
<b>PSPIB total</b>	<b>830</b>	<b>570</b>
<b>Total administrative expenses</b>	<b>\$ 7,376</b>	<b>\$ 5,849</b>

## 17. GUARANTEES AND INDEMNITIES

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

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

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

PSP Capital inc. provided funding facilities of a maximum amount of \$969 million to support potential margin calls on the ABTNs, of which \$4,840 thousand has been allocated to the pension plan. As at 31 March 2012, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSPIB provided guarantees or indemnifications to third parties, the most significant of which are as follows:

As at 31 March 2012, PSPIB agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the pension plan could assume the obligation up to \$1,375 thousand (2011 — \$1,375 thousand) plus interest and other related costs. The loan matures in March 2015.

As at 31 March 2012, a wholly-owned subsidiary of PSPIB has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to \$195 million (2011 — \$195 million), of which \$1,088 thousand (2011 — \$1,088 thousand) may be allocated to the pension plan, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

## 18. COMMITMENTS

PSPIB 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 31 March, the portion of PSPIB's commitments that would be assumed by the Reserve Force pension plan, as at 31 March is as follows:

(\$ thousands)	2012
Private equity	\$ 23,041
Real estate	8,512
Infrastructure	4,913
Other fixed income securities	3,264
<b>Total</b>	<b>\$ 39,730</b>

## 19. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to comply with the implementation of the CICA Handbook Section 4600 — Pension Plans.





# Annexes

# Account Transaction Statements

## Canadian Forces Superannuation Account (Unaudited)

The Canadian Forces Superannuation Account records contributions received, benefits paid, and other transactions for members under Part I of the *Canadian Forces Superannuation Act* for service prior to 01 April 2000. The balance of the account is credited with interest as if the balance were invested in long-term government bonds.

The following table provides information on the transactions in the account for the years ended 31 March:

(Thousands of dollars)	2012	2011
<b>REVENUES</b>		
Contributions — current service	\$ 27	\$ 1
Contributions — elected service	2,945	3,274
Transfers from PSSA and RCMPA	(6)	6
Interest	2,679,672	2,886,559
Government contributions	2,972	3,275
Repayment of annuity	1,360	1,709
Undeliverable payments	(1,018)	1,018
<b>Total of revenues</b>	<b>2,685,952</b>	<b>2,895,842</b>
<b>EXPENDITURES</b>		
Payments of annuities, annual allowances and indexation	2,360,851	2,332,591
Pension benefit division payments	33,102	40,772
Minimum benefit payments	737	192
Cash termination allowances	0	13
Return of contributions	(91)	(8)
Interest on return of contributions	(1)	11
Transfers to PSSA	243	123
Transfers to RCMPA	29	46
Transfer value	2,472	2,387
Administration costs	14,727	14,602
<b>Total of expenditures</b>	<b>2,412,069</b>	<b>2,390,729</b>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>\$ 273,883</b>	<b>\$ 505,113</b>
Balance as of 01 April 2011	45,995,262	
Excess for FY 2010–2012	273,883	
<b>BALANCE AS OF 31 MARCH 2012</b>	<b>\$ 46,269,146</b>	



## Canadian Forces Pension Fund (Unaudited)

The Canadian Forces Pension Fund Account records contributions received, benefits paid, and other transactions for members under Part I of the *Canadian Forces Superannuation Act* for service after 31 March 2000. The net contributions are transferred to the Public Sector Pension Investment Board for investment on a monthly basis.

The following table provides information on the transactions in the account for the years ended 31 March:

(Thousands of dollars)	2012	2011
<b>OPENING BALANCE</b>	\$ 37,744	\$ 38,045
<b>REVENUES</b>		
Contributions — current service	299,698	287,740
Contributions — elected service	23,281	18,168
Government contributions	797,315	772,420
Transfers from PSSA and RCMP SA	122	0
Rollovers from RFPF	8,696	3,586
Repayment of annuity	18	1
Undeliverable payments	20	16
Actuarial liability adjustment	249,000	0
<b>Total of revenues</b>	1,378,150	1,081,931
<b>EXPENDITURES</b>		
Payments of annuities, annual allowances and indexation	228,516	189,823
Pension benefit division payments	19,406	18,799
Minimum benefit payment	903	556
Return of contributions	1,151	1,480
Interest on return of contributions	84	72
Transfers to PSSA and RCMP SA	638	383
Transfer value	63,584	37,809
Administration costs	6,252	5,211
<b>Total of expenditures</b>	320,534	254,133
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	\$ 1,057,616	\$ 827,798
Transfers to Public Sector Pension Investment Board	814,864	828,099
<b>CLOSING BALANCE</b>	\$ 280,496	\$ 37,744

## Reserve Force Pension Fund (Unaudited)

The Reserve Force Pension Fund Account records contributions received, benefits paid, and other transactions for participants under Part I.1 of the *Canadian Forces Superannuation Act*. The net contributions are transferred to the Public Sector Pension Investment Board for investment on a monthly basis.

The following table provides information on the transactions in the account for the years ended 31 March:

(Thousands of dollars)	2012	2011
<b>OPENING BALANCE</b>	\$ 5,027	\$ 4,315
<b>REVENUES</b>		
Contributions — current service	16,757	18,079
Contributions — elected service	9,436	6,236
Government contributions	30,311	41,522
<b>Total of revenues</b>	56,504	65,837
<b>EXPENDITURES</b>		
Payments of annuities, annual allowances and indexation	2,550	1,316
Minimum benefit payments	153	70
Return of contributions	72	80
Interest on return of contributions	18	8
Rollovers to CFPF	8,696	3,586
Transfer value	2,718	741
Administration costs	6,545	5,279
<b>Total of expenditures</b>	20,752	11,080
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	\$ 35,752	\$ 54,757
Transfers to Public Sector Pension Investment Board	31,055	54,045
<b>CLOSING BALANCE</b>	\$ 9,724	\$ 5,027

## Regular Force Death Benefit Account (Unaudited)

Death benefits are payable to members of the Regular Forces out of the Death Benefit account, under Part II of the *Canadian Forces Superannuation Act*. Benefits payable are equal to twice the member's salary (rounded up to the nearest increment of \$250), and reduced by 10% annually for each year after the age of 60.

During the year, \$31.8 million in death benefit payments were made on behalf of 1,711 members (serving and annuitants). The details of the account for the years ended 31 March are as follows:

(Thousands of dollars)	2012	2011
<b>REVENUES</b>		
Contributions by participants	\$ 16,553	\$ 16,546
Government contributions <sup>1</sup>	2,023	1,977
Single premiums payable by the Government in respect of elective participants who became entitled to a basic benefit of \$5,000 without contributions	528	461
Interest	11,135	12,103
<b>Total of revenues</b>	<b>30,239</b>	<b>31,087</b>
<b>EXPENDITURES</b>		
Benefits paid in respect of participants who at the time of death were members of the Canadian Forces or who were elective participants	31,830	31,306
<b>Total of expenditures</b>	<b>31,830</b>	<b>31,306</b>
<b>SHORTFALL OF REVENUES OVER EXPENDITURES</b>	<b>\$ (1,591)</b>	<b>\$ (219)</b>
Balance as of 01 April 2011	\$ 191,894	
Shortfall for FY 2010–2012	(1,591)	
<b>BALANCE AS OF 31 MARCH 2012</b>	<b>\$ 190,303</b>	

<sup>1</sup> Where a single premium has not been paid, government contributions are one-twelfth of benefits paid.

## Retirement Compensation Arrangement Account (Unaudited)

The Retirement Compensation Arrangement (RCA) Account has been established under the authority of the *Special Retirement Arrangements Act* to provide supplementary benefits to certain pension plan members. The RCA account provides for benefits in excess of those permitted under the *Income Tax Act* restrictions for registered pension plans. In order to contribute to the RCA, a member must earn in excess of \$148,000.00 during calendar year 2012 (\$142,800.00 in 2011). This account is discussed in Note 17 of the Financial Statements of the Canadian Forces pension plan.

The following table provides information on the transactions in the account for the years ended 31 March:

(Thousands of dollars)	2012	2011
<b>REVENUES</b>		
Contributions — current service	\$ 2,172	\$ 2,423
Contributions — elected service	0	0
Interest	17,608	17,969
Government contributions	27,358	50,822
Actuarial liability adjustment	0	0
Undeliverable payments	0	0
<b>Total of revenues</b>	<b>47,138</b>	<b>71,214</b>
<b>EXPENDITURES</b>		
Payments of annuities, annual allowances and indexation	3,342	2,623
Pension benefit division payments	311	60
Return of contributions	0	2
Interest on return of contributions	0	0
Transfer value RCA	610	462
<b>Total of expenditures</b>	<b>4,263</b>	<b>3,147</b>
<b>Refundable tax remitted to the Canada Revenue Agency</b>	<b>22,074</b>	<b>37,089</b>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>\$ 20,801</b>	<b>\$ 30,978</b>
Balance as of 01 April 2011	\$ 286,772	
Excess for FY 2010–2012	20,801	
<b>BALANCE AS OF 31 MARCH 2012</b>	<b>\$ 307,573</b>	

# Statistical Information

Expenditures under the *Public Service Pension Adjustment Act* Paid to Pensioners of the *Defence Services Pension Continuation Act*

Recipients	Amount
For the year ended 31 March 2012	(in thousands of dollars)
31	\$ 5

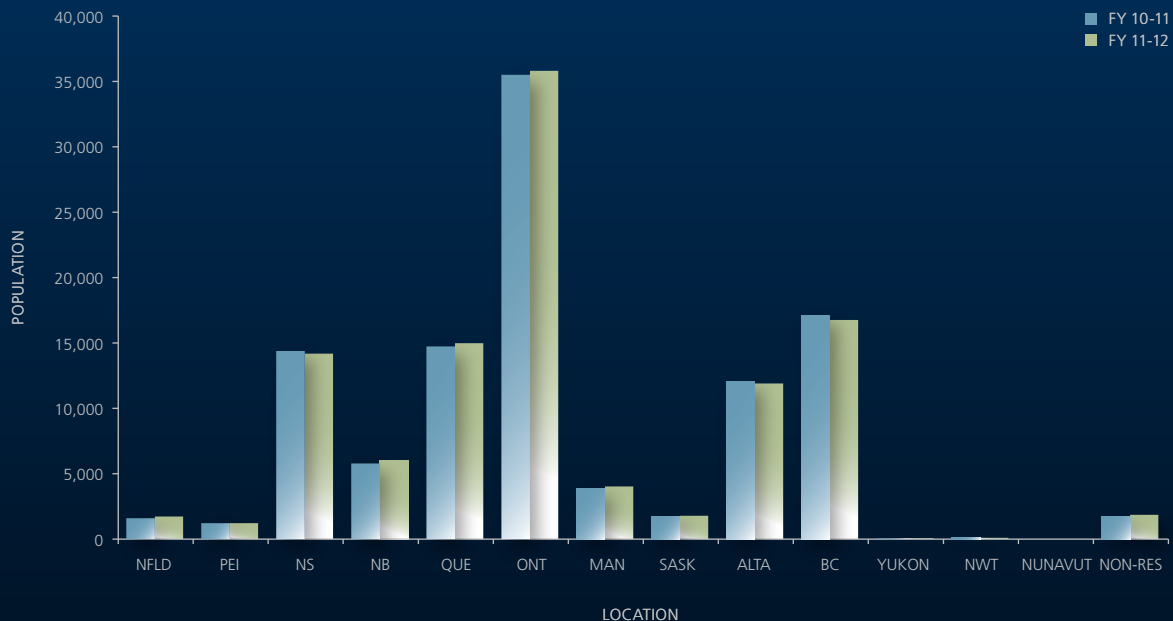
Expenditures under the *Supplementary Retirement Benefits Act* Paid to Pensioners of the *Defence Services Pension Continuation Act*

Recipients	Amount
For the year ended 31 March 2012	(in thousands of dollars)
211	\$ 3,881

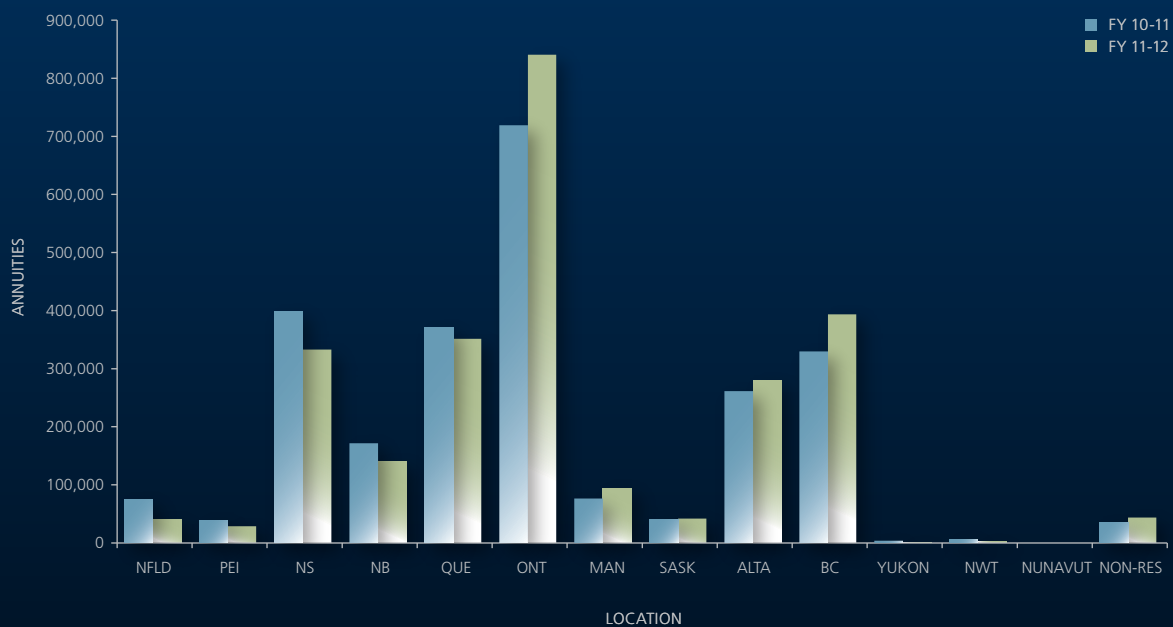
Number of Recipients under *Defence Services Pension Continuation Act* and *Canadian Forces Superannuation Act*

	FY 2011–2012	FY 2010–2011
<b><i>Defence Services Pension Continuation Act (DSPCA)</i></b>		
Pensions	118	137
Surviving spouses' allowances	93	109
<b>Total under the DSPCA</b>	211	246
<b><i>Canadian Forces Superannuation Act (CFSA)</i></b>		
Annuities CFPP	86,505	86,224
Annuities RFPP	255	123
Surviving spouses' allowances	23,199	22,855
Children's allowances	747	781
<b>Total under the CFSA</b>	110,706	109,983
<b>Total under the DSPCA and the CFSA</b>	110,917	110,229
<b>Number of CFPP contributors as of 31 March</b>	71,873	72,314
<b>Number of RFPP participants as of 31 March</b>	21,511	21,525

## GEOGRAPHICAL DISTRIBUTION OF ANNUITANTS UNDER THE CFSA

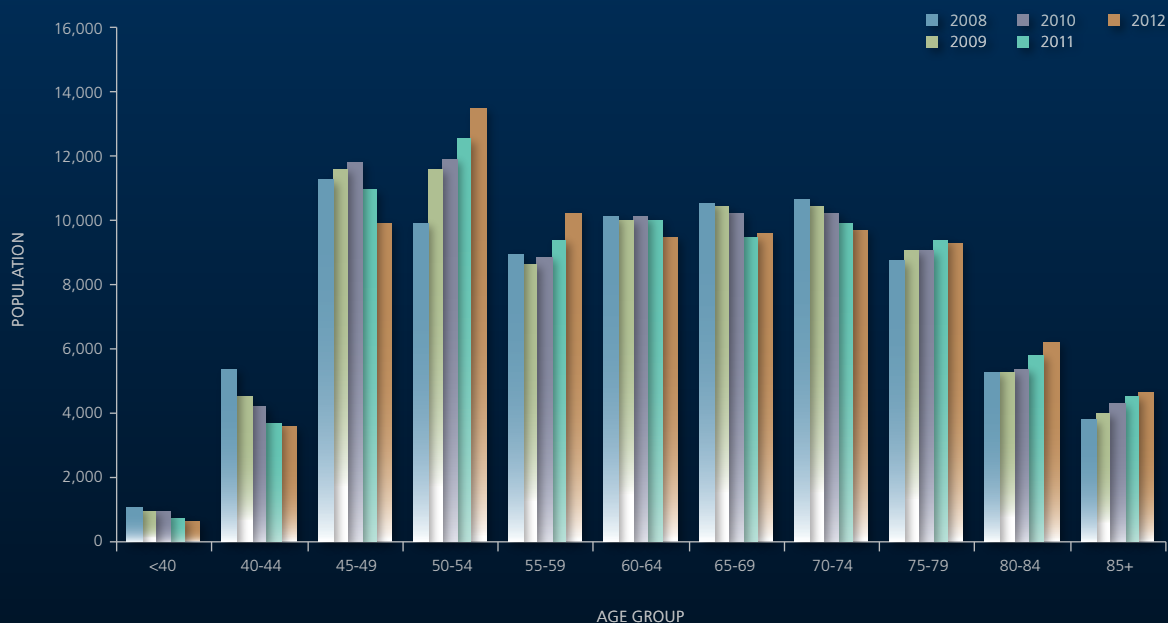


## GEOGRAPHICAL DISTRIBUTION OF ANNUITIES PAID UNDER THE CFSA (IN THOUSANDS OF DOLLARS)

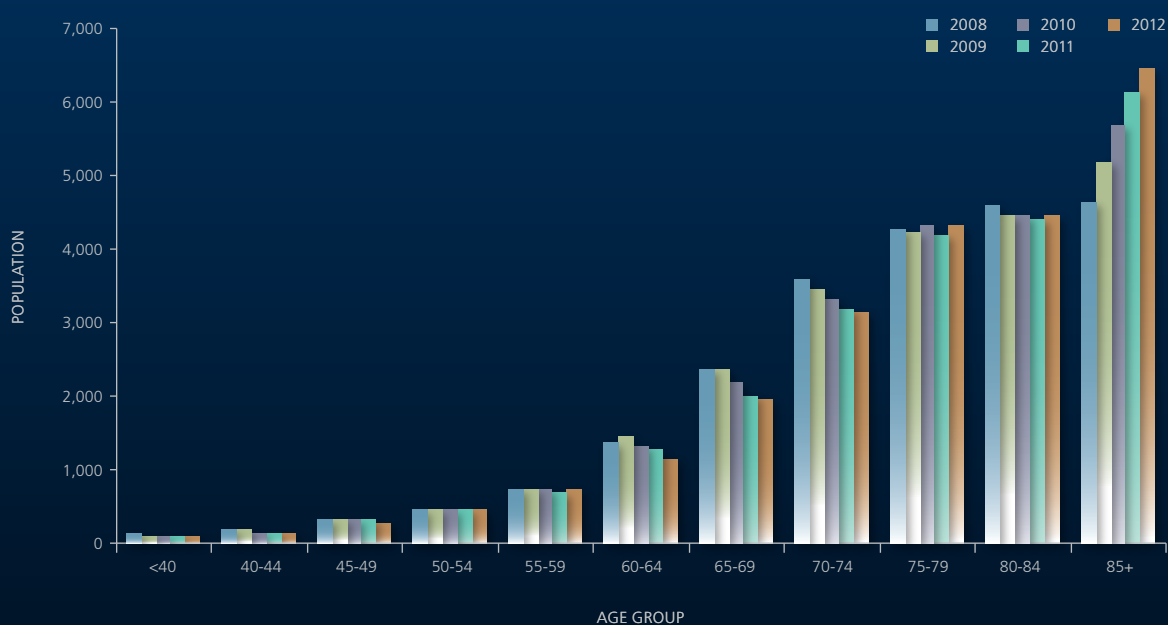




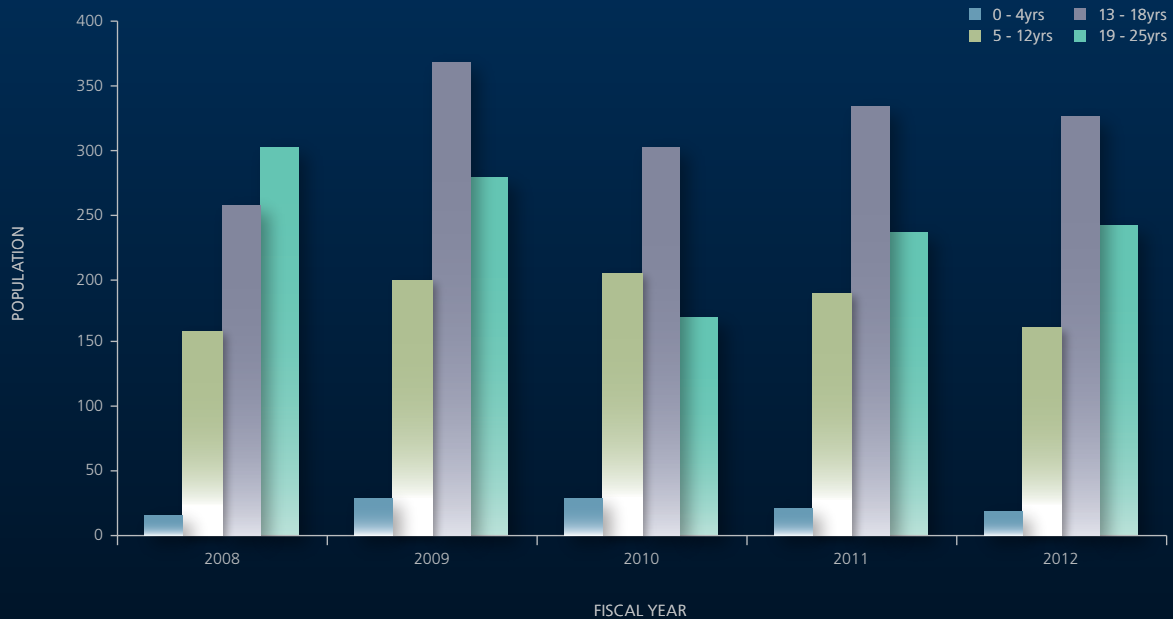
## NUMBER OF RETIRED MEMBERS BY AGE GROUP IN RECEIPT OF AN ANNUITY



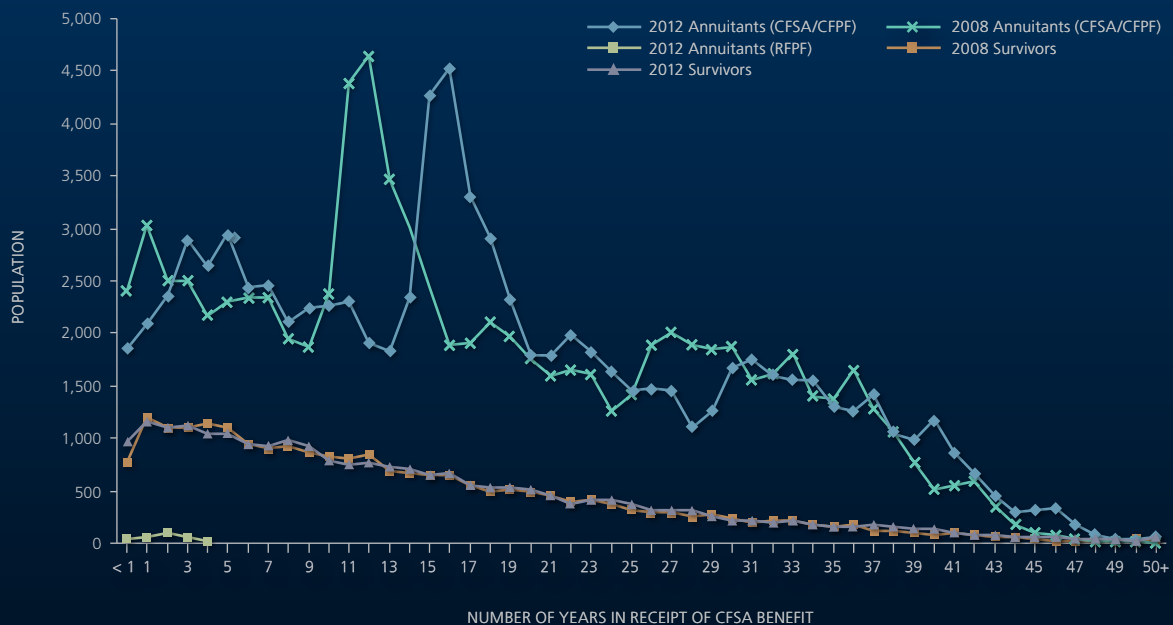
## NUMBER OF SURVIVING SPOUSES BY AGE GROUP IN RECEIPT OF AN ANNUAL ALLOWANCE



## NUMBER OF CHILDREN BY AGE GROUP IN RECEIPT OF AN ANNUAL ALLOWANCE



## CFSA PAYMENT PERIOD



# Glossary of Terms

**Actuarial assumptions:** estimates used by actuaries of rates of return on pension plan assets, retirement age, mortality rates, future salary levels, and other factors when carrying out an actuarial valuation.

**Actuarial valuation:** an actuarial report that provides information on the financial condition of a pension plan such that the future contribution of the pension scheme and its funding level can be clearly understood.

**Annual allowance:** an annuity that is reduced because it is taken before eligibility for an immediate annuity. In the Canadian Forces pension plan, a plan member is eligible for a reduced pension when they are age 50 or older, with at least two years of pensionable service. This type of benefit is only an option when the member is not eligible for an immediate annuity.

## Annuities:

**Immediate annuity:** benefit payable to pension plan members who retire at any time after reaching sufficient number of years of pensionable service or Canadian Forces Service; it is calculated according to the following basic pension formula:

- **CANADIAN FORCES PENSION PLAN:**  
 2 % times  
 Number of years of pensionable service  
 (maximum 35 years) times  
 Average salary for the 5 consecutive years  
 of highest-paid service.
- **RESERVE FORCE PENSION PLAN:**  
 1.5 % times  
 Total pensionable earnings (updated for wage growth)  
 plus  
 Bridge benefit (payable until age 65) 0.5 % times  
 Total pensionable earnings (updated for wage growth),  
 up to the average YMPE.

**Deferred annuity:** benefit available to certain pension plan members who retire before reaching sufficient number of years of pensionable service or Canadian Forces service to qualify for an immediate annuity; this benefit is calculated using the same formula as an immediate annuity, but payment of an unreduced annuity is deferred until age 60 (a reduced annuity, or annual allowance, may be taken after age 50).

**Asset backed term note (ABTN):** long-term notes that are secured by a pool of assets such as real estate, auto loans, or other commercial assets.

**Asset backed commercial paper (ABCP):** short-term corporate securities, typically with a maturity of less than one year, issued by a bank or other conduit, which are backed by assets such as real estate, auto loans, or other commercial assets.

**Benefits earned:** the cost of benefits for service provided by members during the fiscal year.

**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.

**Canada Pension Plan (CPP):** a mandatory earnings-related pension plan implemented 01 January 1966, to provide basic retirement income to Canadians between the ages of 18 and 70 who work in all the provinces and territories, except in the province of Québec, where the QPP is operated for persons who work in that province.

**Canadian Forces Pension Fund Account:** an account established to record transactions relating to service provided by members on or after 31 March 2000.

**Canadian Forces Superannuation Account:** an account established by the *Canadian Forces Superannuation Act* to record transactions relating to service prior to 01 April 2000.

**Canadian Forces Superannuation Act:** the legislation that provides pensions for members of the Canadian Forces.

**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.

**Children's annual allowance:** dependant children who are under age 18 or children between 18 and 25 may receive allowances if they are enrolled in school or other educational institution full-time (s. 18 and s. 25 of the Canadian Forces Superannuation Regulations and s. 68 of the Reserve Force Pension Regulations). The allowance is equal to a fraction of the pension plan member's pension for each eligible dependant child, to a specified maximum. The fractions and limits are set out, by pension plan, in the Canadian Forces Superannuation Regulations and the Reserve Force Pension Regulations.

**Collateralized debt obligations (CDOs):** a type of asset backed security that is constructed from a portfolio of fixed-income assets. CDOs are usually divided into several risk levels and corresponding interest payments. Any losses are applied first to the lowest risk ratings, before moving up in seniority.

**Coming into Force (CIF):** a term for 01 March 2007, when amendments to the *Canadian Forces Superannuation Act* and new regulations under Pension Modernization became effective. The term is also often used to describe the system, process, and organizational changes that were made at that time to support the new legislation.

**Consumer Price Index (CPI):** a measure of price changes produced by Statistics Canada on a monthly basis. The CPI measures the retail prices of a "shopping basket" of about 300 goods and services including food, housing, transportation, clothing, and recreation. The index is "weighted," meaning that it gives greater importance to price changes for some products than others—more to housing, for example, than to entertainment—in an effort to reflect typical spending patterns. Increases in the CPI are also referred to as increases in the cost of living.

**Contributions:** a sum paid by the employer (Government of Canada) and Canadian Forces members to fund future retirement benefits; each year, the government, as the employer, contributes amounts sufficient to fund the future benefits earned by members in respect of that year, as determined by the President of the Treasury Board.

**Contributions receivable:** amount owing to the pension plan in respect of service provided by members up to the date of the financial statements.

**Currency risk:** the risk that the value of investments purchased in foreign currency will fluctuate due to changes in exchange rates.

**Defined benefit pension plan:** a type of registered pension plan that promises a certain Level of pension, usually based on the pension plan member's salary and years of service; the Canadian Forces pension plan and the Reserve Force pension plan are defined benefit pension plans.

**Derivatives:** financial contracts that derive their value from an underlying asset or index, such as an interest rate or foreign currency exchange rate. 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.

**Elective service:** any period of qualifying employment, either in the Canadian Forces Reserve Forces, Public Service, or Royal Canadian Mounted Police that occurred before the employee became a contributor to either the Canadian Forces pension plan or Reserve Force pension plan; under certain conditions, the pension plan member may be able to count these periods of prior service as pensionable service.

**Excess (shortfall):** the financial status of the pension plan; a positive amount indicates that the pension plan's net assets and other accounts available for benefits exceed pension obligations, while a negative amount means that pension obligations exceed net assets and other accounts available for benefits.

**Experience gains and losses:** the difference between what has occurred and what was anticipated in the actuarial valuations.

**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.

**Indexation:** automatic adjustment of pensions in accordance with changes in the Consumer Price Index in order to maintain their purchasing power.

**Minimum benefit:** a benefit equal to the payment of the Canadian Forces pension plan member's pension for a period of five years; if the Canadian Forces pension plan member or his or her eligible survivors have not received, in total, pension payments equal to five times the amount of the Canadian Forces pension plan member's annual basic pension, the balance in the form of a lump sum becomes payable to his or her designated beneficiary or, if none, to his or her estate. Minimum benefits under the Reserve Force pension plan are subject to the provisions of the *Reserve Force Pension Regulations*.

**Net assets and other accounts available for benefits:** the cash, receivables, investments, and other accounts net of liabilities available for benefits expected to be paid in the future; for the purposes of this definition, the pension plan's liabilities do not include accrued pension benefits.

**Past service:** service provided by members prior to the start of the current fiscal year.

**Pensionable service:** periods upon which the plan member's lifetime retirement benefits are based, including any periods of elective service, regardless of whether he or she has paid fully for those service periods.

**Pension obligations:** the present value of benefits earned by members under the pension plan for pensionable service to date.

**Public Sector Pension Investment Board:** a crown corporation established on 01 April 2000, under the *Public Sector Pension Investment Board Act* whose mandate is to invest the employer's and employees' pension contributions for the four major public sector pension plans in the financial markets.

**Québec Pension Plan (QPP):** a pension plan, similar to the Canada Pension Plan, that covers persons working in the province of Québec, which is administered by the Régie des rentes du Québec.

**Return of contributions:** benefit available to certain pension plan members who retire before reaching sufficient number of years of pensionable service to qualify for an immediate or deferred annuity under the Canadian Forces pension plan; it comprises employee contributions, plus interest if applicable.

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

**S&P 500 Composite 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 and Poor's Company selects stocks for inclusion in the index.

**Statement of Investment Policies, Standards and Procedures ("Policy" or SIP&P):** a written investment policy approved by the Public Service Pension Investment Board's Board of Directors, and reviewed at least annually, relating to each pension plan fund. 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 PSPIB has on behalf of the pension plans through its investments.

**Supplementary death benefit:** decreasing term life insurance benefit equal to twice the annual salary of the pension plan member; coverage decreases by 10 per cent per year starting at age 61; a minimum amount of coverage (\$5,000) is provided at no cost to the pension plan member at age 65 for pension plan members entitled to an immediate annuity, and is maintained for life.

**Survivor:** the person of the same or opposite sex who, at the time of the contributor's death and before his or her retirement:

- was married to the contributor (pension plan member) when the contributor reach age 60; or
- was cohabitating in a relationship of a conjugal nature with the contributor for at least one year and, if the contributor was over age 60, had cohabited continuously with the contributor since before the contributor reached age 60.

**Survivor allowance:** a pension benefit that is paid to the spouse of a pension plan member who dies. Under the Canadian Forces pension plan, the benefit is payable when the pension plan member has two or more years of service.

**Transfer value:** the present value of a pension plan member's earned pension in today's dollars, payable as a lump-sum if the member is under age 50 with two or more years of service. The calculation is based on a set of actuarial assumptions which include economic and demographic assumptions.

**Value-at-Risk (VaR):** a method used to measure market risk. VaR is the maximum loss not exceeded within a given probability (defined as the "confidence level"), over a given period of time.

**Year's Maximum Pensionable Earnings (YMPE):** the maximum amount of earnings that the Government sets each year and uses to calculate contributions and pensions under the Canada Pension Plan/Québec Pension Plan. Annual changes to this amount are based on increases in the average Canadian wages.