Annual Report of the
Southern Boundary Restoration and Enhancement Fund and the
Northern Boundary and Transboundary Rivers Restoration and Enhancement Fund
for the year 2010.

Introduction

In June of 1999, the United States and Canada reached a comprehensive new agreement (the "1999 Agreement") under the 1985 Pacific Salmon Treaty. Among other provisions, the 1999 Agreement established two bilateral funds: the Northern Boundary and Transboundary Rivers Restoration and Enhancement Fund (Northern Fund); and the Southern Boundary Restoration and Enhancement Fund (Southern Fund). The purpose of the two funds is to support activities in both countries that develop improved information for fishery resource management, rehabilitate and restore marine and freshwater habitat, and enhance wild stock production through low technology techniques. The United States agreed to capitalize the Northern and Southern Funds in the amounts of $75 million U.S. and $65 million U.S. respectively. Canada also contributed CAN $500,000. The 1999 Agreement also established a Northern Fund Committee and a Southern Fund Committee, each comprised of three nationals from each country, to oversee investment of the Funds' assets and make decisions about expenditures on projects. Only the earnings from investments can be spent on projects.

Committee Members

Northern Fund Committee

Canada:

Mel Kotyk
Frank Quinn
Ron Fowler

United States:

Doug Mecum
David Bedford
Jim Bacon

Southern Fund Committee

Canada:

Don Radford
Don Hall
Mike Griswold

United States:

Larry Peck
Larry Rutter
"JP" Olney Patt

Executive Summary

- Total contributed capital (nominal) at year end was $US 140,065,000 or $CDN 209,796,000. Actual fund asset value at December 31st, 2010 was $US 182,387,000 or $CDN 181,402,000.

- Equity markets rallied in the fourth quarter of 2010 after a lackluster year. Bonds posted strong returns for the year. However, continued underperformance by the Fund's investment managers resulted in below-benchmark results again for 2010.

- In 2010 the Southern Fund Committee supported a total of 31 projects for U.S. $2.05 million.

- In 2010 the Northern Fund Committee supported a total of 26 projects for U.S. $1.8 million.

- U.S. $2 million was contributed to the Chinook Sentinel Stocks Program in 2010, U.S. $1 million each from the two Committees. In addition, a sum of Can $500,000 was paid to Canada and a first installment of U.S. $492,500 was paid to the United States in repayment for funds provided by the two governments in support of the Sentinel Stocks program in 2009.

- Total Fund project expenditures to date are $38.3M US, in support of 537 projects, as well as the Sentinel Stocks program.

- Northern and Southern Fund Committee members met jointly twice in 2010. In addition, the Northern Fund Committee met three times in separate session and the Southern Fund Committee met four times in separate session.

- For Canada, Mr. Mel Kotyk was appointed to the Northern Fund Committee, replacing Mr. David Einarson.

Investment Review

The Total Fund return for the first quarter of 4.0% was 0.1% below the benchmark return for the quarter, after deducting investment management fees. For the past twelve months, net of fee performance was below the strong benchmark return of 45.8% by a slightly larger amount: 1.6%. Weak security selection in the U.S. equity portfolio (BlackRock) was offset by strong picks in the non-North American equity portfolio (LSV).

In a disappointing second quarter on-going poor security selection in the U.S. equity portfolio (BlackRock) was again mitigated somewhat by stock picks in the global (Brandes) and foreign (LSV) portfolios. The Total Fund return of -9.4% was 0.2% below the benchmark return for the quarter and the market value of the Total Fund dropped by $19 million, resulting from

$16.5 million in capital losses, $3 million in net cash outflows and $0.5 million in investment income.

In the third quarter, the market value of the Fund increased by $16.5 million returning 11.4% which was 0.3% below the benchmark return for the quarter. BlackRock's performance was much improved within the U.S. equity portfolio, but stock selection overseas by LSV and Brandes particularly in the financial sector were weak. In addition, a slight overweight position in bonds at the beginning of the period was a drag on overall performance.

Equity markets rallied in the fourth quarter of 2010 after a lacklustre year. Bonds posted negative returns as yields moved up during the fourth quarter, but had strong returns for the year. The improved absolute returns were marred by continued underperformance by the Fund's investment managers, resulting in below-benchmark returns.

General economic conditions and consumer confidence improved in the fourth quarter of 2010, leading to improved results in sectors beyond commodities (especially gold) which were the key driver in 2010. Growth stocks (and managers) outperformed Value stocks, which was a contributing factor to weak results by the Fund's managers as they generally have a Value bias.

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Contributed capital and asset value of the individual Funds as of December 31st, 2010 stood as follows:

	Contributed Capital		Asset Value	
Northern:	$US 75,000,000	$CDN 112,388,000	$US 99,583,000	$CDN 99,045,000
Southern:	$US 65,000,000	$CDN 97,408,000	$US 82,804,000	$CDN 82,357,000

Note #1:
In 2003 a rescission of 0.65% applied to the FY 2003 appropriations reduced the final contribution to the Northern Fund by $US162,500 and to the Southern Fund by $US97,500. Thus the actual Contributed Capital is:

Northern:	$US 74,837,500
Southern:	$US 64,902,500

Note #2:

U.S. Dollar Exchange (noon) rate: per Royal Trust, December 31, 2010	0.9946	1.00543
U.S. Dollar Exchange (noon) rate: per Royal Trust, November 30, 2010	1.0264	0.97428
U.S. Dollar Exchange (noon) rate: per Royal Trust, December 31, 2009	1.0466	0.95547

2010 Project Funding

Northern Boundary & Transboundary Rivers Restoration & Enhancement Fund and Southern Boundary Restoration and Enhancement Fund

In 2010, with the gradual improvement in market conditions and in addition to fully funding the Chinook Sentinel Stocks Program, both Fund Committees were in a position to again offer financial support to their full complements of unfinished, on-going, multi-year projects that had been started in 2008 or earlier, but which had received no Northern or Southern Fund grant monies in 2009 due to the economic crisis. Neither Fund was able to issue a Call for Proposals for new projects in 2010.

The Southern Fund Committee supported a total of 31 on-going projects for U.S. $2.05 million; and the Northern Fund Committee supported a total of 26 on-going projects for U.S. $1.8 million.

In the seven years between 2004 and 2010 the Northern Fund has granted U.S. $19,087,747 to 234 projects. Similarly, between 2004 and 2010 the Southern Fund has granted U.S. $19,247,466 to 303 projects. Total Fund project expenditures to date are U.S. $38.3M, in support of 537 projects. The Sentinel Stocks program has been funded in addition to this in the amount of U.S. $2.9 million.

Joint Funding Initiatives

In 2008 the Northern and Southern Fund Committees approved motions to support the "Chinook Sentinel Stocks Program" with funds in the amount of $1M US each, per year, for a period of 5 years beginning in 2009. This commitment was dependent upon Fund performance given that the guarantee of interest income on the Fund in any given year is not assured. In January 2009 the value of the Fund stood at $127,130M US, some $13M US below the contributed capital sum. Neither Northern nor Southern Fund was therefore able to support the SSP financially in 2009. Given the unexpected circumstances, the U.S. and Canadian governments stepped in and provided funds to support the Program in its first year. In 2010 the Northern and Southern Funds repaid the Canadian government for their 2009 contribution to the Program in the amount of Can $500,000. The Funds also paid a first installment to the U.S. government in partial repayment for their 2009 contribution in the amount of U.S. $492,500. A second similar installment will be paid in 2011 to complete the repayment.

Joint Fund Committee Meetings

The Northern and Southern Fund Committees have agreed that given the congruent nature of their agendas and their decision to combine the funds into a single master account for investment management purposes, and the efficiencies involved with respect to interaction with the fund managers, it was appropriate to meet together as a Joint Fund Committee. Thus the Joint Fund Committee met in person on two occasions: April 21st and November 4th, 2010.

The Joint Committee's first meeting in 2010 was held on April 21st, 2010 at the PSC offices in Vancouver. Mr. Chris Kautzky of Hewitt Associates reported on Fund performance for 2009. He said that one year ago in April 2009, the state of the markets had been unclear. It wasn't certain at that time that the financial crisis had bottomed-out. In retrospect it now appeared that between March and the end of 2009 the Fund had posted positive returns, despite slowing somewhat in the fourth quarter. In the fourth quarter report from 2009 Mr. Kautzky reported that managers BlackRock, LSV and Brandes had all underperformed their benchmarks for the quarter. Brandes was significantly under for the year. The outperformance of LSV in the first quarter of 2010 was not enough to offset the continuing poor performances of BlackRock and Brandes. He provided an investment manager update on Brandes that rated their standing as moderately favourable and recommended that the Committee not consider replacing them. BlackRock had received a neutral rating pending improvements leading to outperformance. If BlackRock were to fail in this regard, Hewitt would lower the rating and further actions might be contemplated at that time. LSV had provided satisfactory performance and Hewitt had few concerns. Mr. Kautzky also discussed an analysis his firm had made of the Fund's fixed income holdings. Some further analysis was called for and a sub-committee of the Joint Fund Committee was proposed to oversee this work. He also discussed costs associated with a change to the investment strategy comprising a move into real estate and infrastructure. It was agreed that the sub-committee should also work with Mr. Kautzky on the move to these alternative asset classes.

The Joint Fund Committee then heard a presentation form Dr Jeff Koenings of the PSC's Habitat Scoping Committee. He discussed at length possible interactions between the soon to be formed Habitat Restoration Technical Committee and the Fund Committees. Fund Committee members were generally supportive and while many ideas were discussed, the area of most immediate interest was the provision of advice by the HRTC on habitat restoration priorities to the Committees at their Strategic Plan levels.

The meeting concluded with the Committees dealing with procedural matters including motions to approve the repayment of the U.S. Section for funds provided by the U.S. in 2009 to support the Sentinel Stocks program in its first year.

The other Joint Fund Committee meeting of the year was an in-person meeting held at the PSC offices in Vancouver on November 4th, 2010.

Mr. Chris Kautzky began by bringing the Committee up to date on developments at Hewitt Associates. The Firm had been successfully acquired by Aon and was now known as Aon Hewitt. Aon is one of the world's largest insurance and re-insurance brokers and has a very large human capital/consulting division – some 30,000 individuals.

Mr. Kautzky then turned to the Third Quarter Report. He said the Fund had performed better for the quarter and indeed the year reflecting an improvement in the equity markets in general. However, there were still on-going issues with the Fund's investment managers who had performed disconcertingly often in the third and fourth quartiles for the year and over the last four years. He said that BlackRock over four years had not delivered on their mandate to make a small increment of gain over the benchmark. He said LSV were right in line with the index for the quarter, but that over time they too had not met expectations. Brandes had been strong between 2003 and 2007, but were now 6% below the index and a significant concern. All of them had underperformed over a 4 to 5 year timeframe and the question should be raised about replacing some or all of them. Mr. Kautzky said Aon Hewitt had been doing their own evaluations and their most up to date ratings of LSV and Brandes were high. Both firms had stable teams and had stuck with their processes. Their performances had been below expectations, but the Aon Hewitt evaluation was also forward looking and they both still rated high. The BlackRock rating was the subject of an investment manager update that gave a neutral rating that could go lower. There were concerns about changes to the process and the people, including the leadership. There had been quite a few changes to the process and it was too early to tell how those would work out.

After hearing this analysis, the Committee heard presentations from the three investment managers in person. Following the presentations the Committee discussed their next steps.

The Committee felt that the performance of LSV had been acceptable under the circumstances.

The Committee agreed that Brandes had performed well four years ago, but the subsequent three years had been unsatisfactory. However the Committee felt they had been kept abreast of developments through regular quarterly reports; through annual in-person interviews with Brandes representatives and through special reports from Aon Hewitt. Although the policy of the Committee was to review performance after four years, that didn't mean the review should be limited to just a four year data set. If one "zoomed out" and looked at their performance over a longer period than 4 years, their performance was much better. Furthermore, if the Committee were to try and choose a new manager, they would look back over 20 years of performance, so Brandes should not be judged on the basis of the last 4 years alone – beside the fact that this included a time when the market had behaved very anomalously. Mr. Kautzky reminded the Committee that Brandes have always had their own unique strategy. They do not look like the index. One might expect their performance to be more volatile. Based on this discussion, the Committee chose not to replace Brandes at this time.

With respect to BlackRock, the Committee was in agreement that the firm had not delivered on their mandate to make a small increment of gain over the benchmark over time and therefore approved a motion to direct BlackRock to change the Fund's portfolio from the current alpha tilts product to a passive US strategy. The index of choice for such a strategy will be recommended by Aon Hewitt based on a review of alternatives; their historical performance characteristics and cost.

Mr. Kautzky then described the progress made over recent months by the small group of four Fund Committee co-chairs in developing recommended changes to the Fund's investment strategy. He described how he had re-run his efficient frontier analysis and developed a new alternative asset allocation strategy in a revised work plan. His feeling was that the new strategy offered a more balanced mix with a smaller percentage of overall assets being invested in alternatives. Volatility rises slightly over the earlier iteration, but is still considerably better than in the current asset allocation. He said the balance of the work plan described key aspects of both alternative asset classes and suggested a timeline for a transition. He stated that the small group both fully supported and wished to implement the new asset allocation strategy and the diversification of the portfolio into both real estate and infrastructure, with a clear preference to making the transition one at a time starting with real estate. There were no objections from the Committee to the small group proceeding with the implementation of the alternative asset allocation strategy as described in the work plan. On the subject of an analysis of the Fund's fixed income assets, the other task that the small group had been assigned, Mr. Kautzky said some analysis had been undertaken, further work was on-going and that the small group had no recommendation to bring to the Committee at this time.

In the last agenda item of the meeting Mr. Mackay reminded the Committee of the steps taken so far by Fund staff in reaction to a proposal from the Yukon Panel co-chairs that Fund staff and the PSC Secretariat take an administrative role in the delivery of the Yukon River Salmon Restoration and Enhancement Fund. He described the feedback received from the Commissioners following a presentation on the subject given at the Executive Session of the Commission in Kamloops in October. The key items of feedback were that the standards of the SFC and NFC not be compromised; staff scheduling for SFC and NFC activities not to be affected; all appropriate costs to be borne by the Yukon Panel, and; the US Department of the Interior to be kept in the loop via the offices of the US Fish and Wildlife Service. Following a brief discussion the Committee agreed that the Commission Secretariat and its Fund staff should take on administration of the Yukon Fund's projects.

Northern Fund Committee Meetings

The Northern Fund Committee met three times during 2010.

April 21st, 2010

- The potential for funding in 2011.
- Status of on-going projects in 2011.
- Spending Policy review.
- Target spending amounts based on the most recent financial information.
- Special projects worth considering if a general call be deemed unfeasible.

May 11th, 2010 (via telephone conference call).

- A second review of the status of the on-going projects to be funded in 2011.

September 30th, 2010 (via telephone conference call)

- Tahltan Lake egg-take project.
- Establishment of a "date of record" to sequester project funds, to be September 30th annually.

Southern Fund Committee Meetings

The Southern Fund Committee met four times during 2010.

January 13th, 2010

- Final review and approval of on-going projects for 2010.
- Coho FRAM proposal information item.

February 10th, 2010

- Approval of the Southern Panel coho FRAM proposal.
- Potential for repayment of US support to SSP in 2009, information item.
- Fraser River sockeye scientific workshop in Nanaimo, information item.

April 21st, 2010

- 2011 Call for Proposals. Notional target amount. Limited scope – habitat restoration. Grant amounts capped at $200,000.

September 30th, 2010 (via telephone conference call)

- First round selection of project concepts to be invited to proceed to stage two.
- On-going project status and review.
- Communication strategy re: call for proposals.
- Report on progress of S. Fund reps on investment structure sub-committee.

2010 Call for Proposals for projects in 2011/12

The effects of the 2008/09 global financial crisis and subsequent weak investment climate had a strongly negative effect on Northern and Southern Fund investments. Gradual gains in the Funds' value were realized starting in the second quarter of 2009, although by April 2010 the financial positions of the two Funds had not fully recovered.

In April 2010 the Northern Fund Committee determined that up to $1.89M US might be available in 2011 to support projects. However, the Committee limited use of available funding to support for a suite of on-going multi-year projects funded by the Northern Fund in the year or years before 2011. There was no Northern Fund Call for Proposals for new projects starting in 2011.

Also in April, 2010 the Southern Fund Committee forecast that approximately $2.3M US might be available for projects in 2011. Due to the relatively modest amount of funding, the Call for Proposals for the 2011 year was strictly limited to (i) proposals to continue on-going projects (i.e. multi-year projects funded by the SFC in 2010) and (ii) new, on-the-ground projects designed to benefit wild stocks of salmon by improving the quality or quantity of their habitat. The Southern Fund received 18 project concepts requesting $1.1 M US. During the first round review process in late September the Southern Fund Committee short-listed 9 proposals to move to the second stage requesting $335,073 US. Southern Fund technical reviews took place in early December 2010. Final project selection is expected to take place in February, 2011.

Despite weak capital markets and stock market volatility, the Fund Committees remain confident their investment policies and principles will, over the long run produce a steady and substantial stream of funding for projects in both countries.

Project Audit

The accounting firm KPMG was hired in 2010 to undertake an audit of selected project financial records. KPMG was directed to examine 13 projects and to tie their financial accounting back to the financial summaries provided with each project's final report. The projects chosen were a representative sample from the organizations that the Fund commonly grants funds to including DFO, ADFG, CRITFC, WDFW, NOAA and others. Specified procedures were applied to the projects and two different techniques used to select invoice items for back-up checks depending on the type and size of the project. With only one exception, no discrepancies had been found between reported costs and back-up invoices.

KPMG also provided Fund staff with a number of performance improvement points that have since been developed into a series of management responses that will sustain and enhance proponent compliance with contract financial obligations and maintain rigor in accountability for grant funds.

Committee Appointments

Mr. Mel Kotyk was appointed by Canada to the Northern Fund Committee early in 2009, replacing Mr. David Einarson.