



***Andra AP-fonden***  
Second Swedish National Pension Fund - AP2

Annual Report 2007

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Unless otherwise stated, the portfolio assets referred to in this report are "allocated exposures". In addition to booked fair values, these also refer to allocated (but not yet invested) liquidity for the specific class of asset, and the liquid funds held as collateral for positions already taken in derivative instruments. Classes of asset, derivative instruments and liquid funds are reported individually in the balance sheet at their fair values.

All monetary amounts are expressed in Swedish kronor and abbreviated as SEK k (thousand), SEK million or SEK m (million) and SEK billion or SEK bn (thousand million).

The 2007 Annual Report is available as a separate publication.

## Financial review

### **This is the Second AP Fund**

#### *Successful portfolio manager*

The Second Swedish National Pension Fund/AP2\* is a successful manager of national pension reserve assets. The Fund, which is based in Göteborg, is one of five 'buffer funds' in the publicly managed pension system.

#### *Future pensions – an important task*

The Second AP Fund's overall goal is to maximize the return of pension assets under management. At year-end 2007, the Fund's assets totalled SEK 227.5 billion.

#### *Innovative organization*

The Second AP Fund, established in 2001, is a young, innovative organization with a strong team spirit, entrusted with a responsible task. This makes it a stimulating place to work.

#### *Long-term investment horizon*

The Second AP Fund, whose board is appointed by the Swedish Government, manages a long-term portfolio based on effective risk management, which includes the support of analytical models developed in-house.

#### *Solid results*

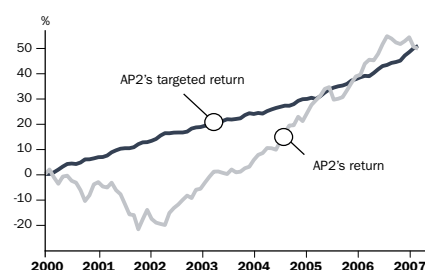
ROI (Return On Investment) has averaged 6.0 percent per annum, since 2001. The Fund's performance has therefore remained consistent with its average target return of 6.1 percent since the start.

\* The Second AP Fund is officially translated as the Second Swedish National Pension Fund/AP2. In body text, for convenience, this is shortened to the Second AP Fund and, in some cases, AP2.

## 2007 in brief

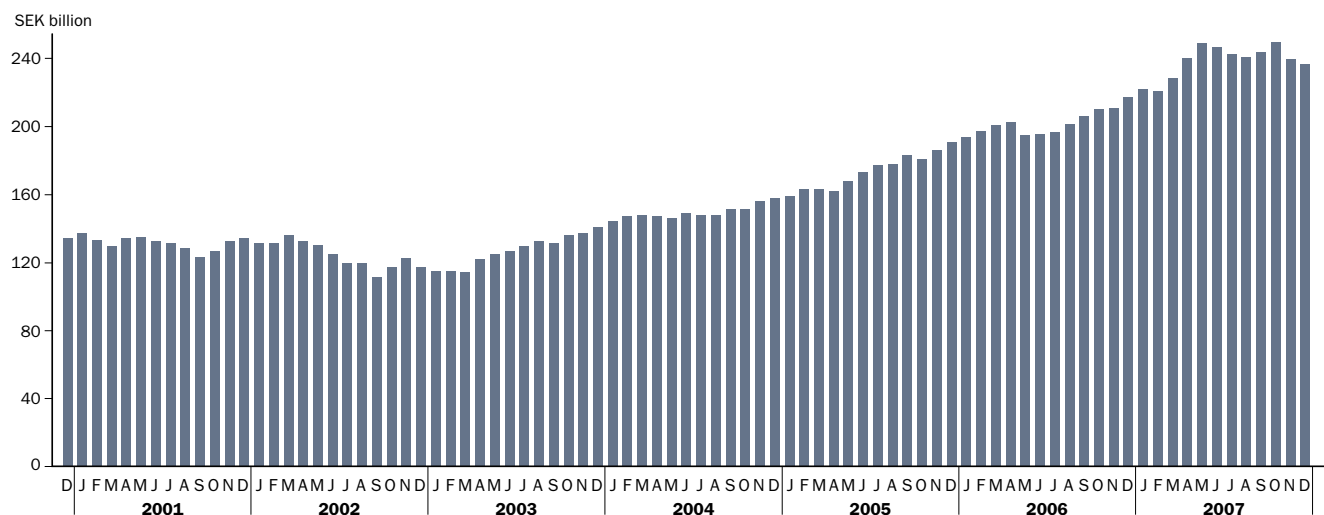
- Since its inception, and including net investment income for the twelve months ending December 31<sup>st</sup> 2007, the Second AP Fund has posted an annual average return on investment (ROI) of 6 percent. This is consistent with the average ROI considered essential for the Fund to fulfil its long-term responsibilities within the Swedish pension system.

Accumulated return, %



- The Fund's assets under management totalled SEK 227.5 billion as per December 31<sup>st</sup> 2007, an increase of SEK 10.7 billion compared with the preceding year. During the year, the Fund reported a net inflow of SEK 2 billion. Net profit for the year totalled SEK 8.7 billion.
- The Fund posted a return of 4.2 percent on the total portfolio, before commission fees and operating expenses. If these expenses are included, the portfolio generated a return of 4.0 percent.
- The Fund posted a relative return of -0.4 percent for market-listed assets, before commission fees and operating expenses, for 2007. This is largely attributable to rebalancing effects arising from the market's high volatility. A new rebalancing process has been initiated.
- The return on alternative investments was 13.4 percent.
- The growth in Fund capital is primarily attributable to the strong trend in global equities, yielding high returns on the Fund's investments in emerging and Asian markets, apart from Japan. Thanks to the Fund's relatively low exposure in foreign exchange (11 percent), especially in US dollars, where hedging is high, the weakening of the dollar has had only a limited effect on absolute return.

## Performance of capital assets since inauguration January 1<sup>st</sup> 2001, SEK billion



The Fund reported total assets under management, including inflows, of SEK 227.5 billion – an increase of SEK 10.7 billion since the start of the year. The net result was SEK 8.7 billion.

## The Second AP Fund in 2007

The Second AP Fund's reported assets at year-end totalled SEK 227.5 billion, an increase of SEK 10.7 billion on 2006. The Fund's portfolio return, excluding commission costs and operating expenses, amounted to 4.2 percent.

As per December 31st 2007, the Second AP Fund's capital assets were allocated as follows: 59.2 percent equities, 35.4 percent fixed-income securities and 5.4 percent alternative investments. The Fund's portfolio was thereby somewhat over-weighted in alternative investments compared with the strategic portfolio. This overweighting derives from the Fund's holdings in unlisted real estate. At year-end 2007, the Fund's assets were broadly exposed to the global market, featuring a well-diversified portfolio.

### Key events of the year

As of 2007, a new management organization has been introduced, comprising five units. These are Swedish Alpha Strategies, Global Alpha Strategies, Quantitative Strategies, External Managers and Tactical Asset Allocation. This new management organization is intended to establish a clearer division of portfolio management responsibilities, to create greater opportunities for adopting positions between asset classes and to define the distinction between absolute and relative management more clearly.

The share of the Fund's portfolio of equities managed according to quantitative models has risen from 47 to 51 percent. Quantitative management differs from "traditional" management in that the entire investment process is expressed in terms of mathematical models and statistical relationships. Its starting point is theme-based strategies and calculations for risk and transactional costs.

The focus on cost efficiency measures has continued. The Fund's level of costs and operational efficiency have been compared with similar companies and organizations of comparable size. The study indicates that the Fund's level of costs is normal,

with a good standard of operational efficiency, given its size, geographical distribution and degree of actively managed assets.

The Fund's strategic portfolio takes into account both the liability and assets side of the pension system, illuminating potential alternative scenarios. Broadly speaking, the portfolio has retained the same balance between equities and fixed-income instruments.

This strategic portfolio aims to generate an annualised long-term real return in excess of 4.5 percent.

The Fund continues the task of creating a geographically well-diversified portfolio in asset class private equity funds. During the year, the Fund has decided on a large number of investment proposals, both Swedish and global. New investment commitments have been made in nine funds.

The Fund continues to develop its role as an institutional investor. During 2007, the Fund was represented on seven election committees. Internal processes concerning the environmental and ethical spheres have been strengthened. A Joint Ethical Committee has been established in collaboration with the First, Third and Fourth AP Funds. The Fund has also published a separate Corporate Governance Report.

In February, the Second AP Fund became a member of the Pacific Pension Institute (PPI). The PPI is a member-driven, non-profit organization that assists pension funds, companies, financial institutions and trusts to carry out their management assignments, with a special emphasis on Asia and the Pacific region.

### Net result for the year

The Fund's portfolio return, excluding combined costs (commission costs and operating expenses), amounted to 4.2 percent. The relative return on market-listed assets, excluding combined costs, amounted to -0.4 percent, thereby underperforming against the Fund's benchmark portfolio. This may

largely be attributed to the impact of the markets' volatility on the rebalancing of the Fund's portfolio, i.e. the Fund's ability to replicate its benchmark indices.

Inflows for the year amounted to SEK 2.0 billion, of which SEK 1.0 billion in net payments from the National Social Insurance Board. The remaining inflows pertain to dividends from the "Liquidation Fund" and "Special Management Fund", which are managed by the First Swedish National Pension Fund (AP1) and Fourth Swedish National Pension Fund (AP4) respectively. The net result for the year amounted to SEK 8.7 billion.

Operating income comprises dividends, net interest income, net return on all assets, exchange gains/losses and commission costs.

The Fund's commission costs include fixed external portfolio-management fees and custodial expenses, amounting to SEK 168 billion. Performance-based charges for externally managed portfolios are included in the net result reported for each asset class.

The Fund's operating expenses amount to SEK 133 million, including personnel and other administration expenses.

#### Key events after the close of the report period

At the beginning of 2008, the financial markets have been marked by extreme volatility and dramatic declines.

Six-year review	02-12-31	03-12-31	04-12-31	05-12-31	06-12-31	07-12-31
Fund capital, SEK m	117 090	140 350	158 120	190 593	216 775	227 512
Net inflows from the National Social Insurance Board, the Liquidation Fund and the Special Management Fund, SEK m	5 002	2 567	1 651	2 905	1 676	2 019
Net profit for the year, SEK m	-21 405	20 693	16 119	29 568	24 506	8 718
Return on total portfolio per annum, before commission costs and operating expenses, %	-15.3	17.8	11.6	18.7	13.0	4.2
Return on total portfolio per annum, after commission costs and operating expenses, %	-15.4	17.7	11.4	18.5	12.8	4.0
Relative return per annum on listed assets before commission costs and operating expenses, %*	-0.4	-0.5	-0.6	0.2	0.2	-0.4
Active risk ex post	1.0	0.6	0.5	0.5	0.7	0.7
FX exposure, %	7	8	10	11	12	11
Under active (incl. enhanced) management, %	62	89	90	90	93	96
Under external management (incl. investments in private equity companies), %	38	45	37	28	17	24
Expense ratio, incl. commission costs, %	0.16	0.18	0.22	0.16	0.15	0.13
Expense ratio, excl. commission costs, %	0.11	0.09	0.08	0.07	0.06	0.06

An adjustment for the change in accounting principle for performance-based fees has been made in the 2004 figures for the income statement.

\* Relative return refers to the difference in return between a portfolio and its benchmark index.

## Financial market trends in 2007

2007 was a very turbulent year on financial markets. Following a four-to-five year period of strong growth on stock markets, the trend was broken during the second half of the year. Even though a broad industrial stock index (MSCI World) showed an upswing of more than 6 percent (in US dollars) in 2007, substantial declines were noted on most markets after the turn-around in July. In Sweden, the stock market's worth fell by almost 17 percent during the second half, one of the largest declines on world stock markets last year. Meanwhile, the equities markets in emerging countries remained buoyant, noting gains of more than 35 percent (in US dollars). Yet again, the Chinese stock market noted surprisingly vigorous growth, with an upswing of almost 100 percent.

### The credit system is being stress tested

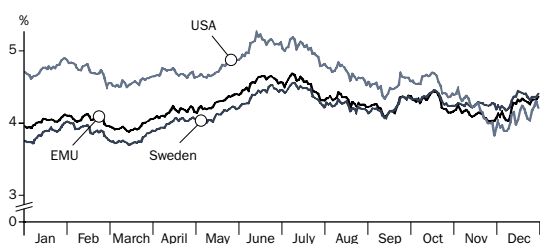
Stock market growth in 2007 was totally dominated by the crisis affecting the US credit market, first and foremost in the sub-prime home-loan market. One reason the crisis developed so dramatically was that it subjected the financial system to its first stability test, following the comprehensive changes that have been introduced on the capital market in the past 10 to 15 years. The market's concrete anxiety is combined with an uncertainty as to which players are actually carrying various credit risks and whether the system in general has become more, or less, robust. At the same time, the crisis affecting the capital market had an even broader impact, exacerbated by the reduced liquidity in the banking system which followed in its wake, as well as the risk posed to general economic growth by the decline of the housing market. The central banks were repeatedly forced to take extensive action to secure the fundamentals

of the banking system. For this reason, repo rates were also gradually lowered, especially in the USA, significantly earlier than originally planned by the central banks. There is good reason to expect further cuts in interest rates during 2008. Rising oil prices have fuelled inflation in several countries, although the underlying prospects of inflation in combination with a slowdown in growth still appear to offer opportunities for further relaxation of monetary policy, with particular reference to the USA.

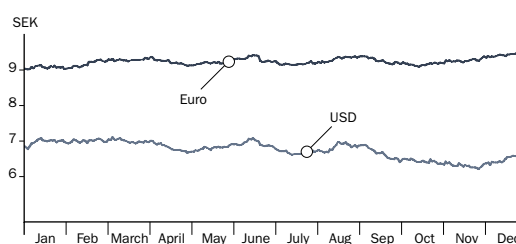
The US housing market was already heading into recession as early as the latter part of 2006, and this decline accelerated in conjunction with the credit crisis that struck twelve months later. The likelihood that the entire US economy would find itself in recession in 2008 also steadily increased during the autumn. The most forward-looking indicators pointed to a significant weakening of the US economy. European economic forecasts also predicted a weakening in the business cycle.

At the same time, however, growth in the emerging countries (and especially the Asian economies) seemed remarkably solid. Almost exactly a decade ago, the global economy was sent into a spin by the crisis in Asia. The feasibility of decoupling from the performance of the US economy in 2008 is a key factor in determining the prospects for the global economy in the coming year. It is clear that the intrinsic strength of the Asian economies is significantly improved compared to the mid-1990s. The Asian economies have reduced their foreign debt and their companies have stronger balance sheets now than they had ten years ago. The level of savings is universally high. Budget deficits are lower and most of the countries in the region enjoy significant balance-of-payment surpluses. Some countries have built up their foreign currency reserves to

10-year bond rates, 2007 (Source: EcoWin)



The Swedish krona against the Euro and US-dollar, 2007 (Source: EcoWin)



extremely high levels. Foreign exchange policies have become more flexible. Today, there is a much greater element of long-term direct foreign investment in the region, compared with the more short-term financing in foreign exchange provided by banks at the time of the Asian crisis. Economic growth in the region is not as single-mindedly export dependent as it was ten years ago.

However, if the financial crisis evolves into an economic recession in the USA and Europe, it is hardly realistic to believe that the Asian economies will remain unaffected. Despite the changes implemented in the past ten years, Asian economies are still dependent on export markets. For example, countries in Asia have a substantial balance-of-payments surplus with China, which in its turn remains dependent on demand from the Western economies.

### Controlled cuts in the US dollar rate

One positive aspect of the global macroeconomic picture is, however, the effect of what so far have been controlled cuts in the US dollar rate. In the past year, this has started to have an impact, boosting US exports and reducing the trade deficit. Over the past few quarters, foreign trade has helped shore up the US economy, partially compensating for the slowdown in the domestic economy. At the same time, increased domestic demand in Europe and Asia is a valuable driver for the global economy when the US consumer and construction sectors are wavering.

Up until the summer of 2007, risk premiums on virtually every financial market had been pressed to historically low levels. During the autumn, this trend was reversed and risk premiums rose again. This was particularly noticeable on markets pricing low-quality, high-risk loans. The credit risk premium charged on government securities in developing countries also rose, although not dramatically. For companies with good credit ratings, rate increases on the capital market were generally limited. The decline noted by the equities market may also be attributed to rising risk premiums, which had been low. Declining rates for government bonds, especially in the USA, represent the flip side of these high risk premiums.

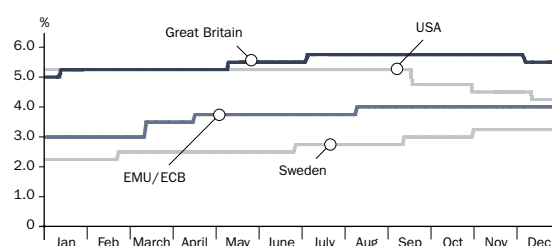
### Prospects for 2008

Prospects for 2008 are closely linked to the extent to which the global economy can, in spite of all these factors, avoid a dramatic recession, as well as ongoing developments in monetary and fiscal policy. Further cuts in interest rates and various forms of fiscal stimuli, combined with a limited reduction in corporate profits, could lay the foundations for the relatively undramatic development of stock markets, seen in the longer term. The risks that affected the outlook for financial markets at year-end 2007 are nevertheless considerable. If the market is to stabilize, anxiety about the uncertain credit situation must be reduced, to ensure that the global economy can avoid a general recession in 2008.

Index growth in Swedish kronor and local currencies, 2007

	SEK, %	Local currency, %
Dow Jones	-1.9	4.7
Nasdaq	1.2	8.0
STOXX 50	9.8	5.3
Nikkei	-9.6	-11.1
OMX	-5.7	-5.7

Official key rates, 2007 (Source: EcoWin)



## Structure and staff

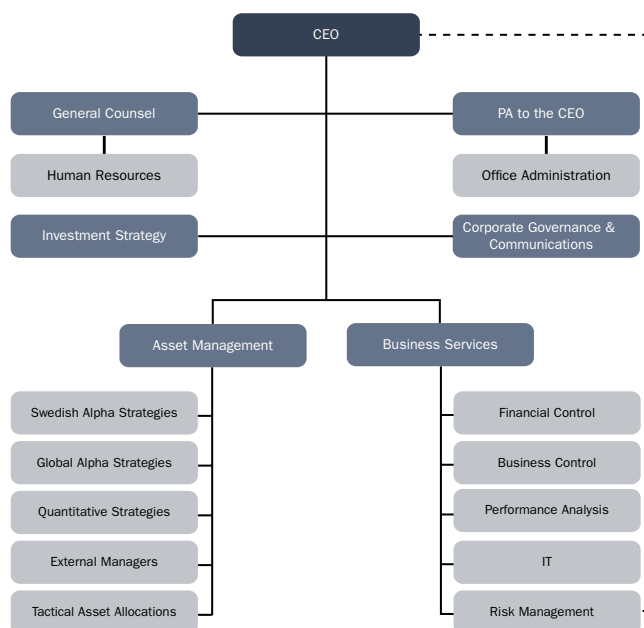
As of 2007, a new management organization was introduced. It comprises Swedish Alpha Strategies, Global Alpha Strategies, Quantitative Strategies and External Managers. A Tactical Asset Management Department was added during the autumn. This new management organization is intended to establish a clearer division of portfolio responsibilities, to create greater opportunities for adopting positions between asset classes and to define the distinction between absolute and relative management more clearly.

At year-end 2007, the Fund numbered 49 full-time staff (of which 19 women). The average age of Fund employees is 39 years, with a median age of 37 years and an age spread from 25 to 62 years. On average, members of staff have 15 years professional experience.

Eight employees left the Fund during 2007, and four new employees were recruited. A further four employees were recruited during January 2008. This high rate of personnel turnover pertained mainly to the first half of the year, at a time when dramatic growth on the financial markets was fuelling strong demand for qualified personnel. Absenteeism due to ill health was low: 1.17 percent.

A performance assessment system was developed during the year and linked to an incentive scheme that will apply from January 1st 2008. The new system will mean that each employee will be entitled to receive a bonus equivalent to two weeks' salary if the Fund achieves its over-performance target

(0.5 percent) and a further bonus equivalent to two weeks' salary if he/she achieves his/her personal goals. Those responsible for the Fund's active return are entitled to a maximum bonus equivalent to two months' salary in rolling payments (the system is presented on the Fund's website at [www.ap2.se](http://www.ap2.se)).



## Strategic asset allocation

The Second AP Fund's board of directors conducts an annual in-house appraisal of the focus chosen for the Fund's portfolio management policy. This process includes an ongoing review of the latest ALM (Asset Liability Modelling) study, which forms the basis of the board of directors' decision concerning the composition of the Fund's strategic portfolio. In 2001, during its first six months of operation, the Fund conducted a comprehensive reallocation of assets, involving the divestment of fixed-income instruments and purchase of foreign equities.

In 2002, on completion of the ALM study, and despite the market situation, the Fund's board of directors decided to continue to pursue its long-term asset allocation strategy, which involved maintaining a high proportion of equities. The adjustments made to the 2003 strategic portfolio represented a fine-tuning of asset class distribution on different markets and some changes in portfolio management style. The changes in the strategic asset allocation for 2004 were relatively minor. Alternative Investments became a new asset class comprising asset groups Real Estate, Private Equity Funds and Hedge Funds, and was expanded to comprise 5 percent of the Fund's

total assets. Consequently, asset classes Equities and Fixed Income Securities shrank by 1 percent each.

### Benchmark index, strategic portfolio, 2007

Part-portfolio	Index
<b>Equities</b>	
Sweden	42% SBX "Stockholm Stock Exchange Benchmark Index" 25% RAFI Sweden 23% OSX "Unweighted Sweden Index" 10% CSRX "Carnegie Small Cap Return Index"
Europe	MSCI Europe
North America	85% MSCI North America 15% RAFI North America
Japan	MSCI Japan
Asia excl. Japan	MSCI Pacific excl. Japan
Emerging markets	MSCI Emerging Markets
Real estate	SFIX Svenskt Fastighetssindex
Private-equity funds	11% per annum
<b>Fixed-income assets</b>	
Swedish nominal fixed-income securities	SHB Swedish All Bond
Inflation-linked bonds	SHB Index Linked
Foreign government bonds	Lehman Brothers Govt 1000 x Asia
Foreign credit bonds	Lehman Brothers Cred 1000 x Asia



The strategic portfolio for 2005 retained the same relative overall distribution of assets as for the preceding year, namely 59 percent equities, 36 percent fixed-income instruments and 5 percent alternative investments. Changes involved an increase in the degree of currency exposure (8 to 9 percent) and the adaptation of the Fund's hedging strategy to individual currencies. At the end of the first six months of the year, the strategic portfolio was adjusted, the allocation to hedge funds being cut from 1 percent to zero. At the same time, the allocation to global equities was increased by 1 percent.

The new model for Asset Liability Modelling (ALM), developed in association with Fraunhofer Chalmers Research Centre for Industrial Mathematics, increases the Fund's opportunities for developing its strategic portfolio and asset allocation. One concrete result of this new ALM activity was to raise the Fund's target for real return on investment, as of 2005, from 3.5 to 4.5 percent. In the Fund's strategic portfolio for 2006, the following changes were made to asset class fixed-income securities:

- Swedish inflation-linked bonds 2 percent, a reduction of 3 percent.
- Swedish nominal government bonds 19 percent, an increase of 3 percent.
- The option was created to invest up to 3 percent in asset class government bonds in emerging markets.

The following changes were introduced for equities-related asset classes:

- Equities in emerging markets 5 percent, an increase of 2 percent.
- Foreign equities 35 percent, a reduction of 2 percent.

Since July 1st 2006, the Second AP Fund has adopted fundamental indexing in managing its portfolio of North

American equities. Fundamental indexing focuses on increasing future return in relation to portfolio risk.

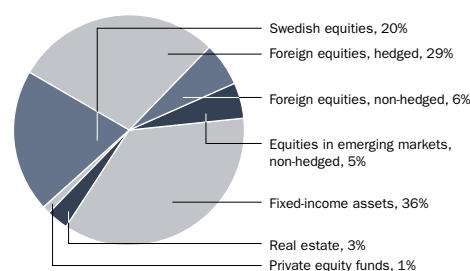
### Strategic portfolio 2007

As of February 1st 2007, fundamental indexing will also be used to manage a quarter of the Fund's portfolio of Swedish equities.

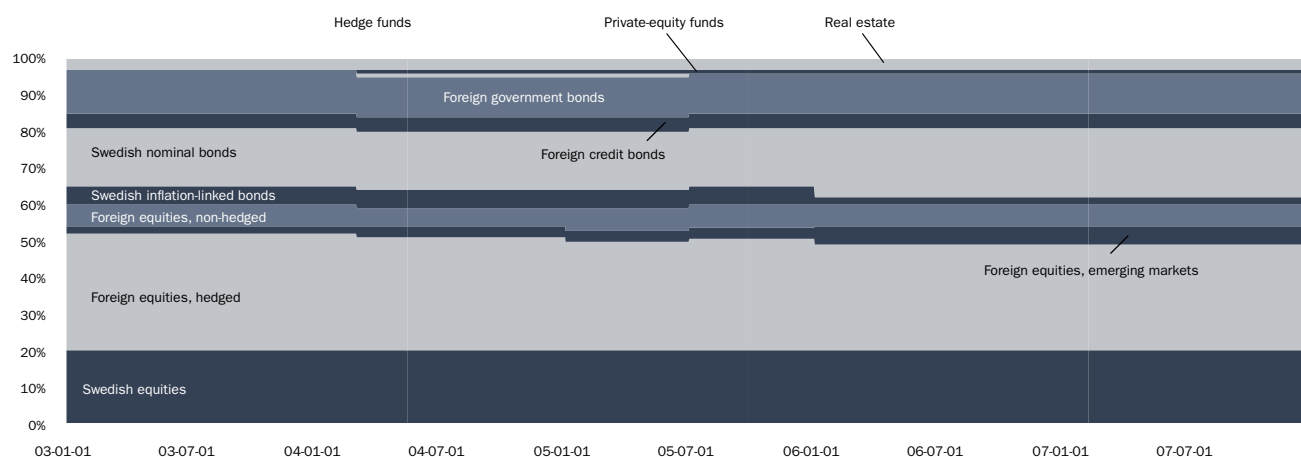
Fundamental indexing replaces traditional or cap-weighted fundamental portfolios. In cap-weighted portfolios, the stock market's valuation of individual asset classes has a significant impact on the relative allocation of equities within the portfolio. In fundamentally weighted portfolios, the "fundamental" structure is determined by the size of the individual portfolio companies in the "real" economy (net profits, dividends, sales and book values). In practice, this means a reduction in the portfolio's concentration on relatively highly valued equities (and therefore rated for a relatively modest future return) and an increase in the portion of lower valued equities. Historically, this type of fundamental portfolio has generated a higher return at a lower risk compared to a traditional cap-weighted index. This difference has proved especially significant during periods when market environments have been highly speculative, featuring grossly inflated valuations, as was the case around the start of the new millennium.

The Second AP Fund has invested 5 percent of the strategic portfolio in equities in emerging markets, which performed well in 2007.

Strategic portfolio 2007



Changes in composition of strategic portfolio 2003–2007



## The Fund's total portfolio

### Distribution of Fund assets

At year-end 2007, the Fund's capital assets totalled SEK 227.5 billion, an increase of SEK 10.7 billion over the year. These assets were distributed as follows:

- listed equities totalling SEK 134.6 billion, of which SEK 45 billion in Swedish equities and SEK 89.6 billion in foreign equities
- fixed-income securities, including liquidity, totalling SEK 80.6 billion
- holdings in unlisted real-estate equities, including subordinated debenture loans, totalling SEK 9 billion
- holdings in private-equity funds totalling SEK 3.4 billion, including liquidity (outstanding investment commitments of SEK 5.1 billion)

The growth in the Fund's capital is attributable to a net result of SEK 8 718 million and net flows of SEK 991 million within the national pension system. During the year, these net flows consisted partly of premium contributions and pension disbursements, amounting to a net of SEK 1 191 million, and

partly of expenses incurred for administering the pension system, charged against Fund assets in an amount of SEK 200 million.

To this must be added capital totalling SEK 1 028 million from the First AP Fund's Liquidation Fund and Fourth AP Fund's Special Management Fund. These two Funds manage unlisted securities which are gradually being liquidated. The First AP Fund's Liquidation Fund has finally been wound up, the last payments having been made in December 2007.

### Listed and unlisted assets

The Fund's portfolio features assets of varying liquidity. Most of these assets, 95 percent, are listed on the understanding that they will be traded on an active market, at rates consistent with actual and regularly implemented market transactions. The Fund's listed assets are considered as liquid assets, and are appraised and quoted daily. These liquid assets comprise equities, bonds, derivative instruments and foreign exchange.

For assets which lack an active market, several appraisal techniques may be adopted to determine true worth at a specific valuation date. This value is deemed to correspond to the market rate at which a trade between knowledgeable and mutually independent parties can be conducted. In the case of

### Growth in Fund capital, 2007

	SEK million
Fund capital brought forward	216 775
Pension contributions received	47 603
Pension disbursements	-46 412
Management fees	-200
Transferred from Liquidation and Special Management Funds	1 028
Net result for the year	8 718
<b>Fund capital carried forward</b>	<b>227 512</b>

### Composition of strategic portfolio, exposure and return as per December 31 2007

Asset class	Strategic portfolio, %	Exposure, %	Exposed value, billion	Return AP2, %	Return benchmark-portfolio, %	Active risk ex post*, %
Swedish equities	20	19.8	45.0	-3.1	-2.6	1.9
Foreign equities	40	39.4	89.6	8.3	8.0	1.7
Fixed-income securities, including liquidity and accrued interest	36	35.4	80.6	2.5	2.6	0.2
<b>Total listed assets, excluding commission costs and operating expenses</b>				<b>3.7</b>	<b>4.1</b>	<b>0.7</b>
Alternative investments	4	5.4	12.3	13.4	6.5	
<b>Total Fund capital, excluding commission costs and operating expenses</b>	<b>100.0</b>	<b>100.0</b>	<b>227.5</b>	<b>4.2</b>	<b>4.2</b>	

\* Historical outcome, 12 months rolling.

the Second AP Fund, these unlisted assets consist of real estate (3.9 percent of the total portfolio), private-equity funds (1.5 percent of the total portfolio), derivative instruments and some short-term fixed-income instruments. The appraisal technique chosen means that real-estate and private-equity funds are appraised at a lower periodicity than listed assets, and based on generally accepted principles for valuing true worth. In the case of unlisted derivative instruments, valuation is based on a theoretical model. At present, the model's sole subjective elements are the yield curves and the approach adopted for interpolation and extrapolation. During 2007, Fund exposure to this type of derivative instrument has been extremely limited.

To ensure that the ongoing monitoring and analysis of return and risk provides a true and accurate picture, all assets should be valued on the same occasion and at the same periodicity. Because the Fund has both listed and unlisted assets, this is not possible at present. The Fund's reported return shall therefore consist of the return generated on listed assets, valued on the basis of quoted share prices, and the return on unlisted assets, valued using the generally accepted models applied to respective market instruments.

Relative return, however, is measured against the performance of the market-quoted portfolio. In both instances,

this includes the Fund's variable costs for external portfolio management, commonly referred to as performance-based fees. The Fund's commission costs and operating expenses for 2007 are excluded, as per the appraisal model used by the Swedish Ministry of Finance.

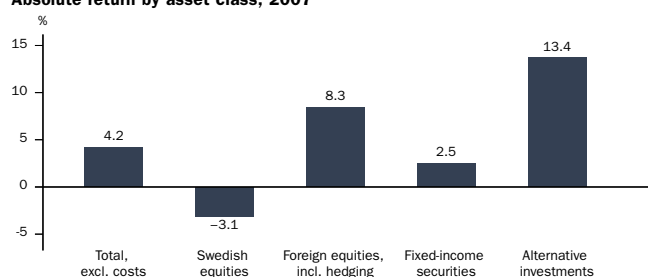
## Net result for the year

### Operating income

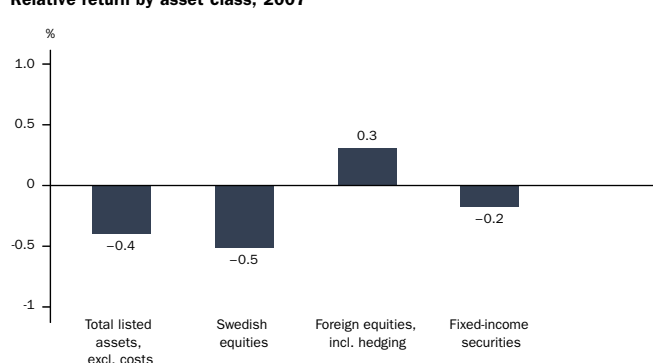
Operating income for the year 2007 amounted to SEK 8 851 million. This comprised net interest income, dividends received, net return per asset class, foreign exchange gains/losses and net commission costs. The largest income item – the net gain generated on quoted equities and participations – comprises both gains realized on the sale of equities as well as unrealized changes in the value of the stock portfolio on December 31<sup>st</sup> 2007.

A management charge of SEK 70 million was made against operating income for performance-based fees paid to external portfolio managers. This cost, incurred when an external portfolio manager generates a return over and above the agreed target, has a direct impact on the net result reported for each asset class, as per current accounting principles.

**Absolute return by asset class, 2007**



**Relative return by asset class, 2007**



Commission costs pertaining to fixed fees of SEK 152 million to external portfolio managers, as well as custodial expenses of SEK 16 million, were charged against operating income.

### Operating expenses

Operating expenses totalled SEK 133 million. Reported as a ratio of average Fund capital over the twelve months, this corresponds to a costs level (management fees excluding commission costs) of 0.06 percent, which is unchanged compared with the preceding year.

If commission costs are included, this results in a Fund management cost equivalent to 0.13 percent (0.15 percent) of total capital. For an assessment of the Fund's cost efficiency compared with other pension funds, see section entitled 'Stable organization in a changing world'.

### Return

The growth in Fund capital in 2007 may primarily be attributed to the strong performance of global equities, where Fund investments in emerging and Asian markets, apart from Japan, have noted a high return. The Fund's relatively limited

currency exposure, especially in US dollars (where the hedging ratio is high) has ensured that the decline in the US dollar rate has had only a limited impact on absolute return.

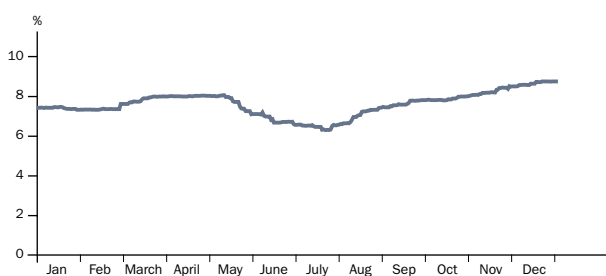
The Fund posted a return of 4.2 percent on its total portfolio (listed and unlisted holdings) in 2007, before commission fees and operating expenses. The performance-based element of the fees paid for the discretionary external management of quoted assets has been charged against this return. The reported relative return on listed assets, before commission fees and operating expenses, amounted to -0.4 percent.

The negative result noted for the Fund's relative return derives largely from the rebalancing effects attributable to high market volatility.

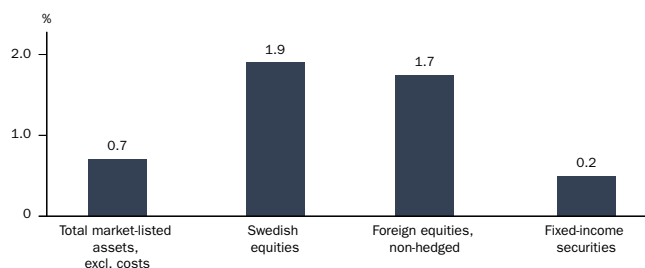
### Risk analysis 2007

The Fund's active risk utilization was in line with the preceding year. The level of active risk (ex post) for the Fund's market-listed assets was 0.7 percent at year-end, excluding commission and operating expenses. The active risk is concentrated to several mandates, including the external GTAA (Global Tactical Asset Allocation) mandates, the in-house OSX port-

Volatility, portfolio of listed assets 2007



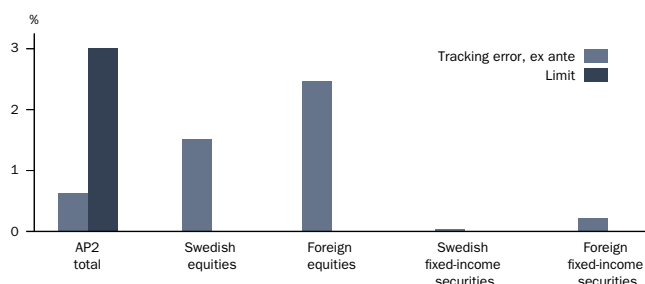
Active risk by asset class, 2007



Sharpe ratio, 2007



Risk limits, active risk



folio and the equity mandates focused on emerging markets and global equities. The variation in the level of risk utilization between these asset classes is considerable. The level of active risk reported for Swedish and foreign equities was 1.9 and 1.7 percent respectively.

Volatility for the Fund's total and strategic portfolios increased during the year, from 7.4 and 7.7 percent to 8.7 and

8.7 percent. The Fund reported negative Sharpe and information ratios for 2007.

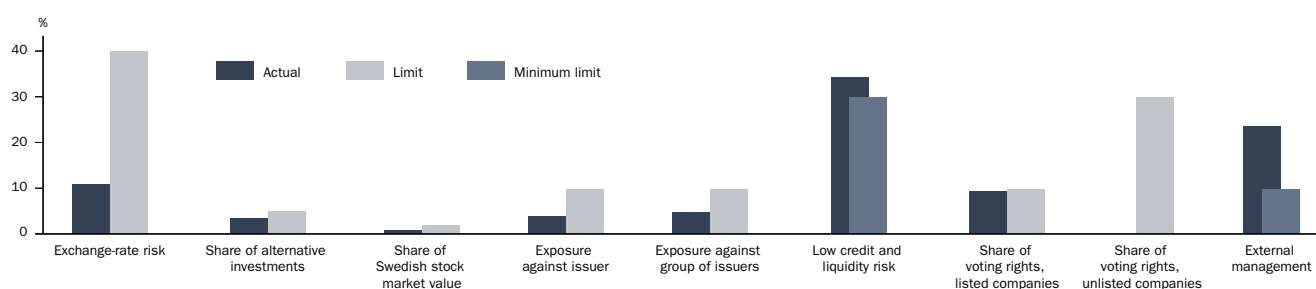
A review of limits stipulated by the Fund's investment regulations shows that risk utilization is well within the defined parameters.

#### Risk-adjusted return for total portfolio, valued by year

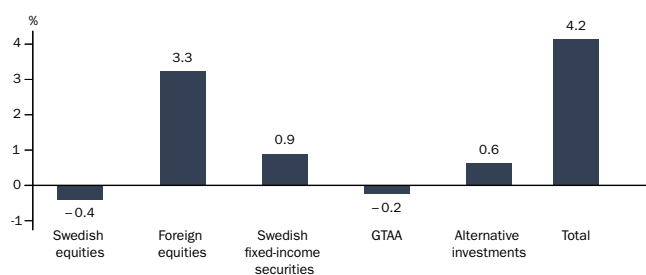
	2001		2002		2003		2004		2005		2006		2007	
	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio	AP2	Strategic portfolio
Return, %	-3.2	-5.4	-15.3	-15.7	17.8	18.5	11.6	12.0	18.7	17.8	13.0	11.8	4.2	4.2
Standard deviation, %	9.7	10.2	13.0	13.1	8.6	8.6	5.8	5.7	4.8	4.7	7.4	7.7	8.7	8.7
Active risk ex post, %	1.7	-	1.0	-	0.6*	-	0.5*	-	0.5*	-	0.7*	-	0.7*	-
Information ratio	1.0	-	0.5	-	neg.	-	neg.	-	0.3	-	0.3	-	neg.	-
Sharpe ratio	neg.	-	neg.	-	1.7	-	1.6	-	3.4	-	1.2	-	neg.	-

\* Total market-listed portfolio, excluding commission costs and operating expenses

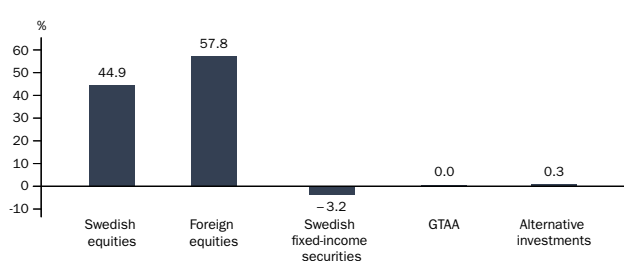
#### Limits as per investment regulations



#### Attribution total portfolio, absolute return including alternative investments



#### Attribution of risk, absolute risk



## Growth in portfolio of listed assets 2007

The new portfolio management model introduced during the year establishes a distinct difference between return generated by the Fund's exposure to a specific market ('beta' return) and the surplus return generated against the benchmark portfolio ('alpha' return). This new working approach means that the Fund's various investment teams manage several asset classes. The following section reviews absolute return per asset class, while active return is, measured and presented per investment team under Active Management.

### Swedish equities

	2002	2003	2004	2005	2006	2007
Exposed value, SEK billion	22.8	28.4	32.8	40.8	43.5	45.0
Absolute return, %	-36.7	34.4	19.0	36.6	29.5	-3.1
Relative return, %	-0.9	-1.6	-1.2	-2.9	0.6	-0.5
SIXRX, %	-	34.2	20.8	36.3	28.1	-2.6
Share active management, %	100	100	94	100	100	100
Share external management, %	50	56	27	18	10	6
Active risk ex post, %		1.3	1.3	1.6	2.9	1.9

The Swedish equity portfolio is subject to long-term appraisal based on a combination of four separate elements, each assigned its own benchmark index. The total index consists of a cap-weighted element (42 percent), benchmarked against the SBX index; an equally-weighted element (23 percent), benchmarked against the OSX index; a cap-weighted small cap element (10 percent), benchmarked against the CSRX index, and a fundamental index (25 percent), benchmarked against RAFI, Sweden.

In all, the management of Swedish equities has generated an absolute return of -3.1 percent against a benchmark index of -2.6 percent. The Fund's benchmark index is consistent with the performance of a broad Swedish index (SIXRX), which generated a return of -2.6 percent. Since the SIXRX demonstrated a higher return during the first half, the Fund's selected

benchmark was effective during the second half of 2007. The favourable outcome noted during the second half of the year derives primarily from the benchmark's low exposure to Ericsson, compared with the SIXRX.

Swedish equities, managed by the Fund's Swedish Management and Quantitative Management teams, as well as by external small cap funds, noted a combined market value of SEK 45 billion as per December 31<sup>st</sup> 2007.

The holdings were well diversified among large listed companies. The majority of the portfolio has been under active/enhanced management throughout the year, with limited active risk. The active level of risk assigned to these Swedish mandates, measured as tracking-error, amounted to 1.9 percent. The majority of this active risk relates to the portfolio in which the Fund exercises more active governance and/or in response to topical growth trends.

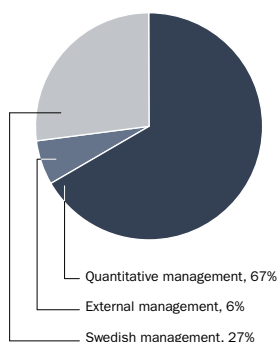
### Foreign equities

	2002	2003	2004	2005	2006	2007
Exposed value, SEK billion	46.1	56.7	63.8	77.5	85.7	89.6
Absolute return, %	-24.9	22.5	11.5	22.9	16.4	8.3
Relative return, %	0.3	-1.0	-0.3	2.0	2.5	0.3
MSCI AC World, %	-	22.6	10.6	20.0	13.0	7.2
Share of active management, %	37	78	80	82	89	92
Share of external management, %	64	82	77	53	27	39
Active risk ex post, %		1.3	0.9	0.7	1.0	1.7

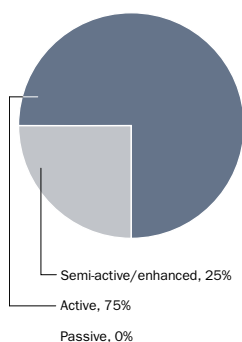
The Fund's holdings in foreign equities, which are managed against the MSCI regional index and a fundamental index in North America, are organized by geographical region: North America, Europe, Asia/Pacific and emerging markets. In line with the Fund's strategic asset allocation policy, European, Japanese, Asia/Pacific stocks and emerging markets, have an overweight, while North America has a corresponding underweight compared to equity market's cap weighting.

Management of foreign equities has generated a combined

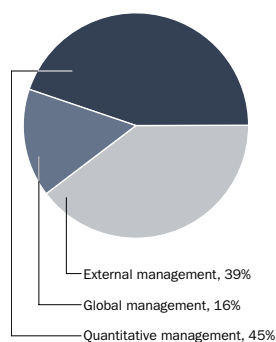
Swedish equities under management, as per investment team



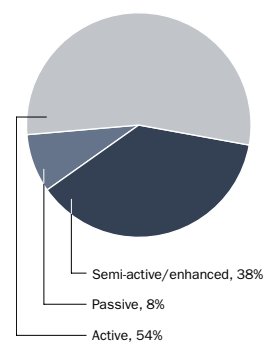
Management style, Swedish equities



Foreign equities under management, as per investment team



Management style, foreign equities



absolute return of 8.3 percent during the year, compared with an MSCI World index, regionally adjusted and hedged by the Fund, that generated 8.0 percent. During the same period, the broad-based MSCI All Countries index generated a return of 7.2 percent. This solid relative return is primarily attributable to the performance of externally managed global mandates.

Foreign equities are managed in-house by the Global Management and Quantitative Management teams, but are also managed under a number of external mandates, focused on global management and the management of equities on emerging markets. Consequently, management of investments on the US market is handled exclusively in-house, utilizing fundamental indexing or the Fund's own quantitative investment models. Quantitatively managed mandates are also operated in Japan, the rest of Asia and in Europe.

As per December 31<sup>st</sup> 2007, the combined market worth of the Fund's holdings in foreign equities totalled SEK 89.6 billion, 92 percent of which was under active management. The level of active risk assigned to foreign holdings is 1.7 percent.

#### Swedish and foreign fixed-income securities

	2002	2003	2004	2005	2006	2007
Exposed value including liquidity, SEK billion	43.4	50.4	54.6	65.1	77.4	80.6
Absolute return, %	8.9	5.3	7.3	4.3	0.8	2.5
Relative return, %	0.0	-0.1	-0.3	0.0	0.0	-0.2
Share of active management, %	88	98	94	93	91	99
Share of external management, %	9	10	8	8	10	15
Active risk ex post, %		0.2	0.2	0.4	0.3	0.2

Management of the Fund's fixed income securities and foreign exchange assets, conducted in-house as well as externally, is based on broad management of Swedish and global bonds. The Fund's in-house management focuses on areas where it is able to conduct index-linked management at low cost, or on active management of assets in areas where it sees opportunities

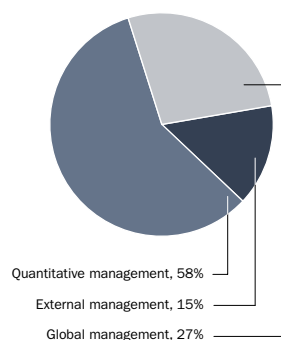
for outperforming its own benchmark index. A quantitatively managed fixed-income mandate was implemented during the year. The Fund will also focus on external mandates with higher risk and higher potential returns, as well as specialised in-house mandates.

The fixed income portfolio primarily consists of Swedish nominal and inflation-linked bonds, benchmarked against the SHB index, and internationally traded government securities and credit bonds, benchmarked against the Lehman index. The market worth of the Fund's fixed income holdings, including liquidity, totalled SEK 80.6 billion as per December 31<sup>st</sup> 2007. Foreign fixed-income holdings totalled SEK 34.3 billion. The return on assets under management for 2007, which at 2.5 percent somewhat below index, was adversely affected by the underperformance of external credit mandates.

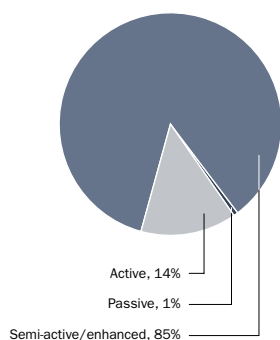
As per December 31<sup>st</sup> 2007, the duration of the portfolio was 4.8 years, an increase compared to the preceding year. National issuers accounted for 46 percent of the fixed-income portfolio. As per December 31<sup>st</sup> 2007, 86 percent of the portfolio was placed in fixed-income securities, rated from AA- to triple A (AAA). At year-end 2007, nominal and inflation-linked government bonds accounted for 43 percent of the total value of the fixed-income portfolio.

The Fund has been engaged to only a limited degree in active foreign exchange trading, where forward positions are taken to benefit from anticipated movement in the relative values of foreign currencies. The management of these assets has had a favourable impact on the Fund's overall return. By year-end 2007, more than SEK 8 billion in assets were being managed against the Second AP Fund's credit bond benchmark, where all securities were investment grade, i.e. rated higher than BBB-.

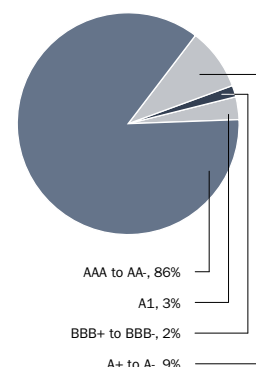
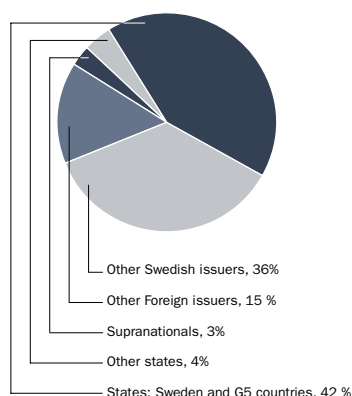
Fixed-income securities under management, as per investment team



Management style, fixed-income securities



Issuers



## Growth in Alternative Investments 2007

The Fund has gathered its investments in asset groups real estate and private equity funds, which account for 5.4 percent of the Fund's total capital, under asset class Alternative Investments. Real estate, corresponding to 3.9 percent of the Fund's total capital assets, accounts for the largest share of Alternative Investments, with private equity funds accounting for approximately 1.5 percent of the Fund's investments. Alternative Investments noted a 13.4-percent return on investment.

### Private-equity funds

The law requires that Swedish AP funds may only invest in unlisted equities indirectly, via private equity funds, mutual funds or their equivalent. The strategy adopted by the Second Swedish National Pension Fund/AP2 is to create a geographically well-diversified portfolio of private equity funds. During the year, the Fund has made commitments concerning investments in nine new funds operated by fund managers identified earlier, who have now established new funds. These new investments, which represent an excellent complement to the Second AP Fund's current investments, are: TPG Star (SEK 323 million), TPG Credit (SEK 194 million), Sun Capital V (SEK 168 million), Lyceum II (SEK 322 million), Resolute Fund II (SEK 323 million), New Mountain III (SEK 323 million),

Mid Europe III (SEK 472 million), TCV VII (SEK 162 million) and TPG Asia V (SEK 323 million). In conjunction with the undertakings made in previous years, this brought the Fund's total investment commitment to SEK 8.9 billion. Actual investments to date total SEK 3.8 billion, excluding management expenses, of which SEK 1.5 billion in 2007. The market value of these investments totalled SEK 3.4 billion. Since its inception, the Fund has repaid SEK 1.4 billion (excluding management expenses). Private-equity funds noted a 5.5-percent return on investment for the year.

Fees paid for the management of unlisted assets, where reimbursement is permitted prior to profit sharing and is deemed likely, are capitalized and reported as a receivable below other assets in the balance sheet. See also the Fund's accounting and valuation principles, page 30.

Since the Fund's inception, a total of SEK 247 million has been paid out in the form of management fees for Fund investments in private-equity funds. Of this sum, SEK 86 million has been written off directly.

Management fees paid as per December 31<sup>st</sup> 2007, amounting to SEK 91 million, are reported in the balance sheet as "Other receivables".

### Investments and commitments, private-equity funds, SEK million

Fund	Vintage year	Venture capital	Buyout	Special situations	Other	FX	Original investment commitments in agreed FX	Initially invested amount, SEK m
Mature funds								
EQT Northern Europe KB (EQT III)	2001		x			EUR	20 000 000	160
Swedestart Life Science KB	2001	x				SEK	25 000 000	18
Swedestart Tech KB	2001	x				SEK	25 000 000	15
Carnegie Fund II BiotechBridge	2002	x				EUR	5 488 173	44
Nordic Capital V	2003		x			EUR	50 000 000	435
EQT Expansion fund	2003				x	EUR	30 000 000	200
Cevian Capital	2003				x	EUR	33 802 735	286
CVC European Equity Partners IV	2005		x			EUR	35 500 000	255
Nordic Capital VI	2005		x			EUR	50 000 000	315
Immature funds								
Pathway Private Equity Fund IX (fond i fond)	2004	x	x	x		USD	150 000 000	741
Carlyle Riverstone Renewable Energy Infrastructure fund I	2005					USD	20 000 000	71
Carlyle Riverstone Global Energy Fund III	2005					USD	30 000 000	127
Pathway Private Equity Fund IXB (fond i fond)	2005	x	x	x		USD	250 000 000	413
Thomas H Lee Equity Fund VI	2006		x			USD	35 000 000	84
TPG Partners V	2006		x			USD	45 000 000	175
Magenta	2006		x			EUR	20 000 000	19
Carlyle Europe Partners III	2006		x			EUR	50 000 000	32
TPG Star	2007	x				USD	50 000 000	51
TPG Credit	2007			x		USD	30 000 000	181
Sun Capital V	2007			x		USD	26 000 000	9
Lyceum II	2007		x			GBP	25 000 000	0
Resolute fund II	2007		x			USD	50 000 000	48
New Mountain fund III	2007		x			USD	50 000 000	18
Mid Europa fund III	2007		x			EUR	50 000 000	64
TCV VII	2007	x				USD	25 000 000	0
TPG Asia	2007		x			USD	50 000 000	0
<b>Total investment since start</b>								<b>3 761</b>
<b>Fair value, total</b>								<b>3 388</b>



## Real estate

Unlisted real-estate holdings, comprising a 25-percent participation in AP Fastigheter Holding AB and a 50-percent participation in NS Holding AB (Norrporten), are managed in-house by the Second AP Fund.

The Second AP Fund's investments in real estate are designed to generate a solid direct return on investment and contribute to a satisfactory diversification of risk in the total portfolio.

AP Fastigheter is owned jointly by the First to Fourth Swedish National Pension (AP) funds and has a concentrated and attractively located portfolio of real-estate holdings in the Stockholm, Göteborg and Uppsala areas. The company owns and manages some 175 properties, totalling about 1.9 million square metres of floor space, at a combined estimated market value of SEK 40 billion.

Norrporten is owned jointly (50/50) by the Second AP Fund and the Sixth AP Fund. The company continued its strategic expansion during the year and has established a new market area in Hamburg, while expanding its real-estate portfolio in

Copenhagen. Norrporten owns and manages some 135 properties, totalling approximately 1 million square metres of floor space. These properties have a combined estimated market value in the region of SEK 15 billion.

The Norrporten holdings have developed favourably, with a SEK 145 million increase in market value and interest income from debenture loans of SEK 191 million.

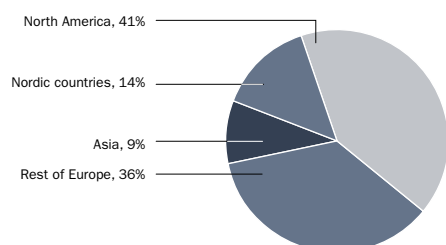
The Fund's holding in AP Fastigheter has also developed favourably, noting a SEK 390 million gain in market value, with dividends received of SEK 319 million and interest income from debenture and promissory note loans of SEK 181 million.

The market values of the portfolios of real estate held by AP Fastigheter and Norrporten, including promissory notes and debenture loans, were reported as SEK 5 017 million and SEK 3 942 million respectively.

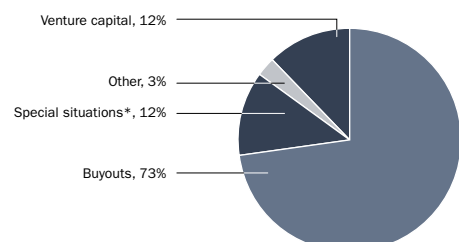
Return on investment totalled 15.4 percent, of which AP Fastigheter 21 percent and Norrporten 9 percent.

Andra & Sjötte Fastigheter AB has made no investments yet.

**Holdings in private-equity funds, geographical focus**



**Holdings in private-equity funds, by investment style**



\* 'Special situations' comprises investments in industry funds and funds that invest in troubled companies.

### Unlisted real-estate holdings Dec 31<sup>st</sup> 2007

#### AP Fastigheter Holding AB, amounts in SEK m

<b>Equities</b>	
Acquisition value	721
Valuation	2 115
(of which affecting operating result 2007: 390)	
<b>Fair value as per Dec 31<sup>st</sup> 2007</b>	<b>2 836</b>
<b>Total dividend 2001–2007</b>	<b>1 355</b>
(of which in 2007: 319)	

#### Debenture and promissory note loans, incl. accrued interest

Debenture and promissory note loans, incl. accrued interest per Dec 31 <sup>st</sup> 2007	2 181
<b>Total interest income 2001–2007</b>	<b>702</b>
(of which in 2007: 181)	

#### NS Holding AB, amounts in SEK m

<b>Equities</b>	
Acquisition value	811
Valuation	1 329
(of which affecting operating result in 2007: 145)	
<b>Fair value as per Dec 31<sup>st</sup> 2007</b>	<b>2 140</b>

#### Subordinated debenture loans incl. accrued interest

Subordinated debenture loans incl. accrued interest as per Dec 31 <sup>st</sup> 2007	1 802
<b>Total interest income 2001–2007</b>	<b>760</b>
(of which in 2007: 191)	

#### Andra & Sjötte Fastigheter AB, amounts in SEK m

<b>Equities</b>	
Acquisition value	2
<b>Fair value as per Dec 31<sup>st</sup> 2007</b>	<b>0</b>

## Active management

With a view to improving the prospects of generating a better relative return, a new management model for the Second AP Fund was introduced in January 2007. The model involves reorganization into different investment teams – Swedish, Global, Quantitative and External Management – in which respective portfolio managers will be presented with many investment opportunities in several asset classes. This working approach also establishes a clear difference between return generated by the Fund's exposure to a specific market ('beta' return) and overperformance against the benchmark portfolio ('alpha' return). Risk is focused on a number of active management mandates. Quantitative management has an important role to play with respect to broad 'beta' management, but is also geared towards distinct overperformance targets. A Tactical Asset Allocation team was established in the autumn.

### Swedish Management

Active management is conducted in both Swedish equities and fixed-income securities. Active management of Swedish assets has contributed 0.05 percent to the Fund's relative return. This is largely attributable to the securities selected.

### Global Management

Global Management comprises in-house management of equities and fixed-income investments outside Sweden. It has contributed -0.08 percent to the Fund's relative return, primarily attributable to the securities selected.

### Quantitative Management

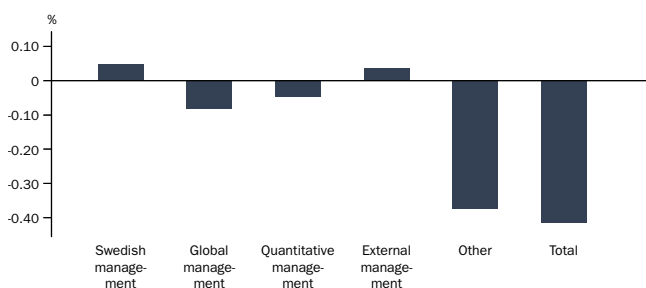
Quantitative management is gaining an increasingly important role in the Fund's investment activities. This form of portfolio management is applied to Swedish and global equities, as well as to Swedish fixed-income securities, under both passive and semi-active management. Quantitative Management's resources have been strengthened during the report period. Internal quantitative management has posted a neutral result, although the products managed as per the external fundamental index have underperformed.

### External Management

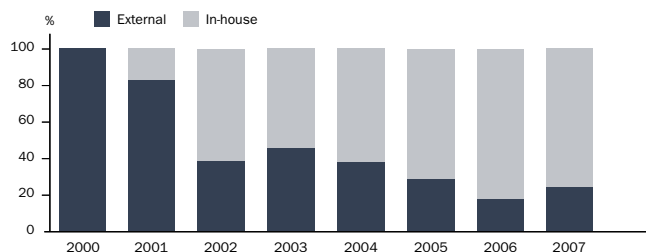
The Second AP Fund conducts part of its total management responsibilities with the assistance of external fund managers. During the year, assets under external management have been concentrated to a limited number of fund managers that practise an active management style, as established by the Fund's new investment strategy. As at December 31<sup>st</sup> 2007, 24 percent of the Fund's assets were under external management. The share of externally managed assets under active management was 100 percent.

During 2007, two external mandates have been active within the framework of the Fund's tactical allocation. The Fund's GTAA (Global Tactical Asset Allocation) mandates are based on an investment process in which several positions are driven by different investment themes, where positions are taken between different national and regional segments on the global equities and bond market. Similarly, large numbers

Attribution of relative returns on listed assets, per investment team, %



Relative distribution, in-house and external management



of tactical positions are taken on global FX markets. These two external mandates account for a significant portion of the Fund's active risk utilization, and therefore have a considerable impact on relative return. Tactical allocation during the year has had a negative impact on the Fund's relative return.

External fund managers are employed in sectors, asset classes or strategies where they are deemed capable of making a positive contribution to relative return. Assets under external management have contributed 0.03 percent to the Fund's relative return.

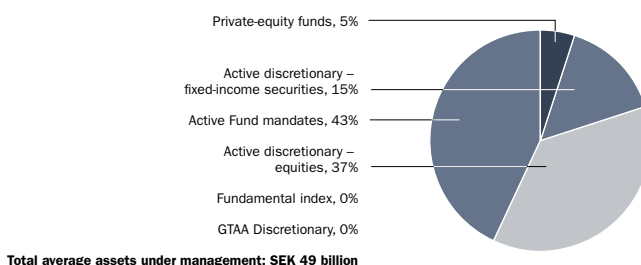
#### *Contract negotiation and selection criteria*

When selecting external portfolio managers, the Fund utilizes a number of predetermined selection criteria, such as investment style, analytical quality, organizational structure, staffing and yield history. Qualitative and quantitative factors are subjected to thorough analysis, both during the negotiations and, if selected, during ongoing portfolio management.

#### *Cost of external management*

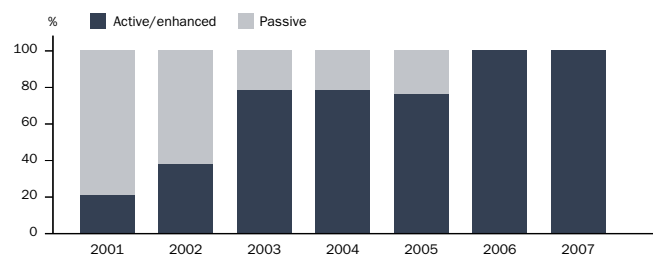
The amount of assets under active external management averaged 100 percent during 2007. The degree of active risk accepted, and selection of market, to a great extent determine the cost of managing assets. The Fund's external management mandates, excluding alternative investments, have been focused both on increasing the level of active risk and the result in 2007. The cost of placing market-listed assets under external management is partly fixed and partly performance-based. In 2007, the fixed cost was SEK 145 million and the variable performance-based element totalled SEK 70 million. If management fees for alternative investments are included, this brings the Fund's combined fixed costs for external management to SEK 152 million. This is equivalent to 0.24 percent of the average capital assets under external management during 2007, including fundamental index mandates. The Fund compares the ongoing cost for external management of capital assets with those for similar

#### **Assets under external management, per management style**

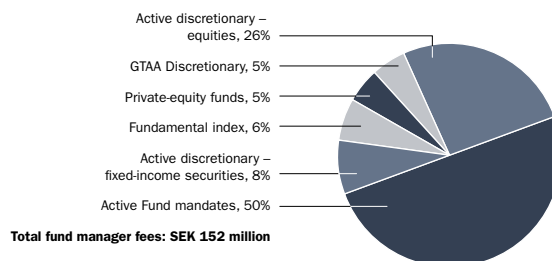


GTAA-mandates have no allocated capital, as their exposure is in the form of derivatives.

#### **External management, passive/active management style**



#### **Management fees, by management style**



market players. Among other aspects, a fair and just comparison must take into account the volume of assets under management, the degree of in-house management and the style of management chosen in terms of active versus passive, equities versus fixed-income securities and varying amounts of unlisted asset classes. Current external portfolio managers are listed in Note 4.

### Tactical Asset Allocation

The team for Tactical Asset Allocation was established in the autumn of 2007, but adopted no tactical positions during 2007. External mandates for tactical asset allocation are reported under External Management.

### Other

In conjunction with the transition to a new management strategy, 'rebalancing' and 'slippage' effects are reported in a new manner. Rebalancing effects arise when the Fund's portfolios are to be reweighted to benchmark index, and 'slippage' effects arise when hedging instruments fail to correspond precisely to the Fund's selected benchmark. During the report period, this has resulted in a negative contribution of -0.36 percent, a consequence of the market's high volatility during the year and daily rebalancing by the Fund.

A new rebalancing process has been initiated, by which the portfolio will be rebalanced at specific intervals.

### Income and expenses, external management, listed assets, SEK million

	Active and enhanced mandates	Passive mandates	Total listed assets
Income, gross	1 784		1 784
Deduction, performance-based fees	-70		-70
<b>Net</b>	1 714	-	<b>1 714</b>
Fixed management fees	-145		-145
<b>Net contribution</b>	1 569	-	<b>1 569</b>
Capital assets under management as per Dec. 31 <sup>st</sup> 2007 (excluding overlay mandate)	53 618	-	53 618

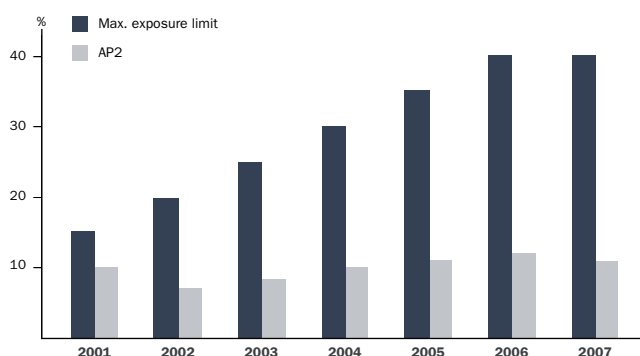
### Income and expenses, external management, unlisted assets, SEK million

	Unlisted assets
Income, gross	212
Repayment of management fees in conjunction with profitable exit	15
Management fees reported as commission expense	-7
<b>Net contribution</b>	<b>220</b>
Receivables in form of management fees, unlisted assets	91
Capital assets under management as per Dec. 31 <sup>st</sup> 2007	
Invested, fair value	3 388
Original commitment	8 870

## FX exposure

At year-end 2007, 11.1 percent of the Fund's assets were exposed in foreign currency, a slight increase compared with the strategic portfolio but significantly lower than the 40 percent maximum set for the Fund's currency exposure. Assets exposed in foreign currency, found mainly in the foreign fixed-income and equities portfolios, have been hedged by means of forward exchange contracts. See graph at right for Fund's currency exposure since its inception in 2001, compared with the statutory limit.

**Statutory exposure limit, compared with the Second AP Fund's currency exposure, 2001-2007**



### Currency exposure

Dec. 31<sup>st</sup> 2007, equivalent in SEK million

	USD	GBP	EUR	JPY	CHF	Other	Total
Equities and participations	38 835	10 859	22 121	6 090	4 711	8 369	90 985
Bonds and other fixed-income securities	12 646	2 188	15 079	0	0	2 164	32 077
Other assets and liabilities, net	851	92	967	183	80	584	2 757
Derivative instruments excl. FX derivatives	24	-12	198	-61	-8	-33	108
FX derivatives	-43 381	-10 428	-29 094	-5 111	-1 085	-11 572	-100 671
<b>Currency exposure, net</b>	<b>8 975</b>	<b>2 699</b>	<b>9 271</b>	<b>1 101</b>	<b>3 698</b>	<b>-488</b>	<b>25 256</b>

Currency exposure is reported as per the Fund's true management of FX risk, which means that it is based on local currency at the trading location, and not the currency pertaining at the company's registered office.

## Changes in exposure via derivative instruments

According to the guidelines established in the Fund's Strategic plan for 2007, derivative instruments may be used to improve the effectiveness of portfolio management, create added value, achieve lower trading costs and reduce risk. Forward contracts may only be issued if secured by a holding in the same asset class. During the year, derivative instruments have been employed especially in the following areas:

- FX derivatives for managing the Fund's currency exposure, forward contracts and options.
- Share derivatives – mainly in the form of standardized equity forwards – for effective rebalancing of the portfolio and when adopting a position in tactical asset allocation.
- Interest-rate derivatives – mainly standardized interest-rate forwards – for rebalancing, tactical asset allocation and for management of the Fund's interest risk. Limited use of interest-rate options, to position the Fund against interest risk.

- Within the frame of the Fund's GTAA mandates, positions are adopted with the assistance of derivative instruments. The mandates are authorized to act with the assistance of short and long positions in the permitted asset classes. However, the mandates do not permit the adoption of a net long position.

Exposure in derivative instruments is reviewed and analysed on an ongoing basis, as with other types of instruments. Share and interest-rate derivatives are preferably traded on standardized markets with cleared products, which means that the counterparty risk is against the clearing institution. Trading in the FX market's derivative instruments is not standardized or cleared, creating possible credit and supply risks for the Fund in trading with other parties. The board of directors approves and limits the parties that the Fund uses for non-standardized and cleared products.

In the case of OTC trading, the Fund requires standardized contracts, such as ISDA contracts.

## Management mandates in listed securities and funds

Equity mandates	Style	ROI, %	Under/over-performance against index, %
<b>Europe</b>			
SAM, fund*	Active	6.3	3.4
AP2 in-house	Enhanced	8.2	0.2
<b>North America</b>			
AP2 in-house, RAFI index	Enhanced	-4.2	-2.6
AP2 in-house	Enhanced	1.9	0.2
<b>Japan</b>			
AP2 in-house	Passiv	-9.7	-0.2
<b>Emerging markets</b>			
AiG Globa, fund	Active	31.8	0.2
Legg Mason, fund*	Active	6.1	-0.9
Merrill Lynch, fund	Enhanced	31.4	-0.3
Genesis, fund	Active	24.4	-7.3
Pictet, fund*	Active	14.3	-4.8
StateStreet, fund	Active	34.8	3.2
<b>Global equity mandates</b>			
MFS	Active	4.8	1.3
Carnegie	Active	21.2	17.8
Franklin Templeton	Active	3.6	0.2
Generation, fund*	Active	-1.2	-1.1
AP2 in-house	Active	2.2	-1.3
<b>Pacific, excluding Japan</b>			
AP2 in-house	Passive	24.2	-0.2
<b>Swedish OSX mandates</b>			
Enter Select Fokus. fund*	Active	13.8	0.0
Fokus 1 AP2	Active	0.6	-1.6
Fokus 2 AP2	Active	-5.6	-7.9
<b>Swedish SBX mandates</b>			
AP2 in-house, Quantportfolio	Enhanced	-4.4	-0.6
AP2 in-house, Quantportfolio Long-term	Enhanced	-3.7	0.1
AP2 in-house	Active	-0.0	-0.1
<b>Swedish RAFI mandate</b>			
AP2 in-house, Quantportfolio*	Enhanced	-12.1	-0.7
<b>Swedish CSX mandates, small caps</b>			
SEB Sverige Small Caps, fund*	Active	9.5	1.1
SEB Sverige ChansRisk, fund	Active	-4.0	2.9
Carlson Sverige Small Caps, fund	Active	-5.5	1.4
Robur Small Caps, fund	Active	-5.1	1.7
Lannebo Small Caps, fund	Active	-5.9	0.9
Handelsbanken Small Caps, fund	Active	-5.2	1.6
AP2 in-house	Active	-5.3	1.6

\* Has not been under management during the entire 12 months.

Fixed-income mandates	Style	ROI, %	Under/over-performance against index, %
<b>Swedish nominal fixed-income mandates</b>			
AP2 in-house, Quantportfolio	Enhanced	2.3	0.0
AP2 in-house*	Active	0.4	0.3
<b>Swedish inflation-linked mandates</b>			
AP2 in-house*	Active	-0.7	0.1
AP2 in-house, Quantportfolio*	Enhanced	4.2	0.0
<b>Global management/fixed income</b>			
Rogge	Active	5.0	0.7
<b>Global management/government securities</b>			
AP2 in-house	Active	3.1	-0.2
<b>Global management/credit</b>			
Franklin Templeton	Active	-1.7	-3.4
Vanguard. fund*	Active	-2.4	-0.4
Stone Harbor, fund*	Active	-0.3	-4.7
<b>GTAA mandates</b>			
	Style		Return, SEK m
IPM/First Quadrant	Active		219.6
Goldman Sachs	Active		-586.4
Goldman Sachs, fund*			-211.4

\* Has not been under management during the entire 12 months.

## Stable organization in a changing world

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At the Second AP Fund, responsibility for review, analysis and control lies with Business Support. Activities concerning portfolios managed in-house and under external mandates, as well as interaction between the Fund's portfolios, are subject to daily analysis. Reporting, involving economic reports and reviews of analyses of risk utilization and return, is conducted both in-house and externally.

In the case of the Fund's strategic allocation activities, the review process is linked to the asset class, with reference to the strategic portfolio and its related benchmark index. The Second AP Fund's portfolio structure derives from the Strategic Plan's long-term reference portfolio and its listed and unlisted asset classes. Appraisal of the combined management of listed and unlisted assets is conducted in reference to the strategic portfolio and an evaluation of the individual asset class against its respective benchmark index.

Ongoing management is conducted in new teams without restrictions between one asset class and another. Instead, the day-to-day decisions taken by portfolio managers are based on the implementation of different management styles, focused on clear 'alpha' and 'beta' targets.

Analysis and provision of reports on the ongoing management of the portfolio shall be conducted in a comparable manner, whatever the style of management utilized. Since the Second AP Fund's benchmark is expressed in asset classes, analysis and reporting is conducted for both asset class and team. The current management structure requires that measurements can be made by contribution analysis both in monetary and percentage terms. Organizing portfolio management according to different management styles does not change the principle of daily reports or the way in which results are calculated in general.

In addition to the report process, follow-up and support is conducted via meetings and highly accessible systems support.

### **Risk management**

The Second AP Fund's Risk Management team conducts risk control and risk analysis of the Fund's market-quoted assets, as well as acting in an advisory capacity to the Fund's executive and portfolio management. The team's responsibilities also include stress test analyses and monitoring of operative risk.

To achieve a solid return on assets under management means accepting a certain degree of risk. It is important, however, to ensure that the risk taken is calculated in advance and monitored afterwards. Follow-up of investment regulations, limits and financial risks is handled on a daily basis. The Fund's absolute and relative risk is monitored and analysed. Absolute risk is monitored with the help of the Sharpe ratio and volatility measurements. Relative risk is measured in terms of ex ante active risk and information ratio.

During the year, the Fund implemented its new risk system. This risk system enables both historic and forward analysis and monitoring of the Fund's combined market risk. These risk calculations are based on Value at Risk (VaR). The system permits advanced simulation for calculating alternative risk outcomes by means of stress tests and scenario analyses.

### **Attribution analysis**

The reports and analyses generated in-house are designed to support the decision-making process by promoting an understanding of the factors and positions that have contributed to portfolio performance and determined the level of risk utilized.

Attribution analysis is therefore an important and central

part of the evaluation process. The analysis aims to clarify how and where performance is generated in relation to the Fund's risk utilization, both in terms of absolute and relative risk. It is conducted in several dimensions, for both absolute and relative return, as well as for the level of risk utilisation. The analysis defines the extent to which the portfolio has contributed to performance and risk utilisation. Performance attribution is employed partly to clarify the differences in return between the Fund's portfolio of assets and the strategic benchmark portfolio, and partly to explain the contribution to absolute return on investment. The analytical process is conducted at several levels: for the total portfolio, between and within each asset class and at the portfolio level. The contribution made, in terms of individual securities as well as sectors, regions and currencies, is analysed at each level.

To adjust follow-up in line with team management requirements and the clearly defined targets expressed in monetary terms per team, the attribution process is now the same, whether the mandate has a benchmark or not. Consequently, the Fund demands that internal reports and analyses for in-house/external mandates fulfil the same requirements as for mandates featuring 'beta' and even strictly 'alpha' elements.

### Resource allocation

The Fund's allocation of human resources and costs is subject to ongoing analysis. These analyses are intended to evaluate resource utilization in relation to results, in pursuit of still greater efficiency.

The Second AP Fund strives for and conducts cost-efficient fund management that has been analysed and authenticated by internationally respected firms of market analysts. In 2005, the

Fund initiated cooperation with Cost Effectiveness Measurement Inc (CEM), a Canadian company with many years experience of analysing pension funds similar to the Second AP Fund. This cooperation is intended to provide relevant ongoing comparative data that can be used to benchmark the Fund's asset management performance, taking into account the volume of capital under management, its allocation by asset class and degree of active management, as well as the portfolio's geographic spread. A comprehensive analysis of the Fund's performance in 2006 was conducted during 2007, demonstrating that the Fund has maintained a normal level of costs, with cost-efficient management. The graph below shows the Fund's income growth (relative return) in relation to actual costs (relative added cost) over the period 2004-2006, and illustrates the significant improvement in the Fund's position, compared to its benchmark group.

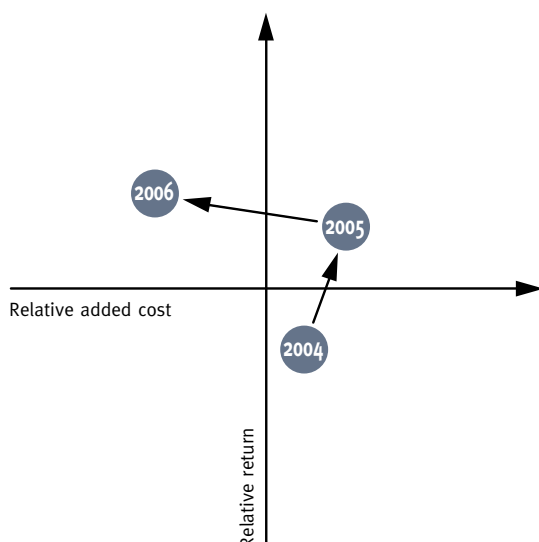
One key area to monitor is transaction costs, direct as well as indirect. Direct costs refer to commissions, clearing costs and taxes. These are monitored from a number of different perspectives, such as the distribution between parties and the levels agreed. Indirect costs provide a means to measure and gain an idea of trading efficiency. This monitoring process, which is ongoing and conducted at regular intervals, involves what is known as a TCA analysis (Trade Cost Analysis). This compares the Fund's direct and indirect transaction costs with a large group of comparable funds, to match its performance against a relevant benchmark.

### Commission

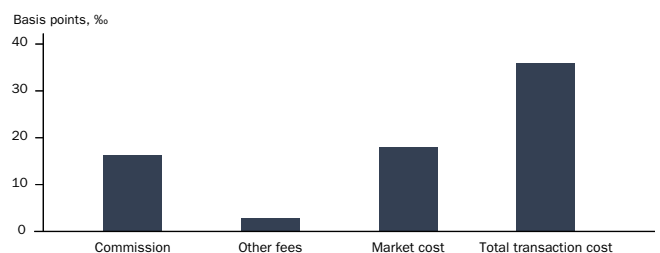
Commission (a brokering commission) is paid on purchase and sale of equities and participations. When buying and selling other asset categories, the transaction cost is limited strictly to the difference between the buy and sell rate, known as the "spread". To establish comparability between different asset categories, commission is reported as a deductible item under the net result for listed equities and participations.

Commission fees paid in 2007 totalled SEK 105 million (SEK 109 million). Of these costs, 18 percent derives from commission paid to the Fund's external managers, the remainder to the Fund's in-house portfolio management organization.

### Towards greater cost efficiency



### TCA analysis, an example





Costs amounted to 0.07 percent of the total trading volume.

The following five counterparts have received commissions corresponding to 50 percent of commission payments (in alphabetical order): Carnegie, Citigroup, Goldman Sachs, Morgan Stanley and SHB.

### Securities loan programme

In 2006, the Fund initiated a securities loan programme, focused mainly on its holdings in global equities. During 2007, the programme generated income totalling SEK 49 million.

### Key indicators

To further enhance the efficiency of its operations, the Second AP Fund has developed a model to monitor key indicators. The intention is to create better decision data for improved operational control. A number of key indicators have been defined and target values will be established during 2008. Follow-up and evaluation will be conducted on a monthly basis and will include return, costs and level of risk utilized.

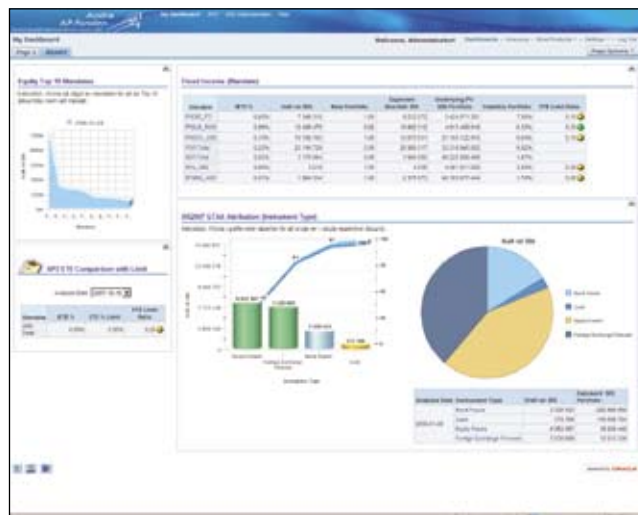
### Systems environment and IT security

Right from the start, the Second AP Fund invested in an advanced IT platform and in a fully integrated Front/Middle/Back Office portfolio management system. Since its implementation, this system has been progressively expanded and upgraded with additional functions, to meet the increasingly demanding and constantly changing performance requirements. The system has been designed to provide a high degree of automation and to optimise business processes, whether initiated by the Fund's in-house portfolio managers or by external managers. To satisfy the additional requirements deriving from cooperation with external managers, the basic system was complemented with a web-based system for the import of external managers' trades. External managers are responsible for the entire business process within the parameters of their respective mandates, from execution to settlement and reporting.

IT security is one of the Fund's strategic priorities. The level of preparedness is high, due to an ongoing commitment to continuity and disruption planning. The technology is designed to ensure that the Fund's business-critical systems can immediately be brought on line in the event of crisis or catastrophe. These systems are duplicated (fully redundant), offering

external access via a 'reserve site', while maintaining stringent data security standards.

### Data Warehouse



The new system makes generating customized reports easy.

In the autumn of 2006, work started on the creation of a Data Warehouse and Business Intelligence system. The system is being implemented successively over a number of years, in the form of several subsidiary projects. The idea is to consolidate several data sources, to provide the Fund's various decision-makers with a broad and easily accessible view of the situation, and to enable the generation of customized reports with inbuilt flexibility. At the same time, the systems are being overhauled to guarantee the quality of the data generated, to simplify access authorization and to review data flows with a view to achieving a higher degree of automation.

The intention is to provide the decision-maker with a complete picture, enabling faster and better decisions and creating more time for analysis, and development of the Fund's operations. The new system also enhances operational reliability and accessibility to underlying systems, while reducing pressure on the business support function.

## Corporate governance

The Second AP Fund's involvement in corporate governance issues is intended to contribute to value creation within the Fund. Active governance and the Fund's commitment to governance issues aim to improve prospects for a higher long-term return on assets under management.

During 2007, the Second AP Fund exercised its voting rights at the AGMs of 52 listed Swedish companies. In a single instance, the Fund voted against a proposal presented by the board to its AGM. At an extraordinary general meeting called by Mandator, the Second AP Fund voted in favour of an alternative to the proposal tabled by the board. It failed to gain a majority, however.

### Joint Ethical Council

The Joint Ethical Council has been established in collaboration between four AP Funds: the First, Second, Third and Fourth AP Funds. Each Fund has a representative on the Council. The aim of the Council is to jointly promote favourable change at foreign companies associated with infringement of international conventions on environmental and human rights, including the ILO (International Labour Organization) core conventions and the UN's Universal Declaration of Human Rights.

### Second AP Fund's participation in nomination committees 2006–2007

The Fund has been represented on the nomination committees of seven companies: Artimplant (chairman); Elanders; Haldex; Meda; SCA; Oriflame and Volvo (co-opted). In companies in which the Second AP Fund was represented on the nomination committee, the percentage of female board members was

24.3 percent, compared with 23.6 percent in 2006. The average for quoted companies in Sweden is 19.9 percent.

### Voting at foreign AGMs in 2007

During the year, the Second AP Fund has exercised its voting rights at the AGMs of 36 foreign companies. The selection was based on the size of the Fund's holding, in connection with the work of the AP Funds' Joint Ethical Council, or in collaboration with foreign networks of investors.

### Protecting shareholders' rights

The Second AP Fund works in collaboration with networks of other investors to protect the rights of minority shareholders. During the year, the Fund has been engaged in several initiatives. These have included proposals to permit shareholders to nominate members to the boards of companies in the USA, and to vote on corporate remuneration schemes in the USA.

### Excluded companies

Wal-Mart and Singapore Technologies have been excluded from the Second AP Fund's investment universe. Singapore Technologies is able to manufacture landmines, in breach of conventions concerning the production of landmines which have been signed by Sweden. The Second AP Fund has taken a stand concerning claims about Wal-Mart's breaches of human rights related to working conditions.

The Second AP Fund's work on governance issues during the period 2006/2007 has been presented in a separate report published in September 2007. This report may be downloaded from the website at [www.ap2.se](http://www.ap2.se), or ordered directly from the Fund.





Income statement, balance sheet and  
notes for the financial year 2007

# Income statement

Amounts in SEK million	Note	January–December 2007	January–December 2006
<b>Operating income</b>			
Net interest income	1	2 583	893
Dividends received		3 609	3 440
Net result, listed equities and participations	2.4	3 790	22 070
Net result, unlisted equities and participations	3	755	1 743
Net result, fixed-income assets		-763	-1 362
Net result, derivative instruments		-346	-38
Net result, exchange gain/loss		-609	-1 947
Commission expenses, net	4	-168	-164
<b>Total operating income</b>		<b>8 851</b>	<b>24 635</b>
<b>Operating expenses</b>			
Personnel expenses	5	-72	-74
Other administration expenses	6	-61	-55
<b>Total operating expenses</b>		<b>-133</b>	<b>-129</b>
<b>NET RESULT FOR THE YEAR</b>		<b>8 718</b>	<b>24 506</b>

# Balance sheet

Amounts in SEK million	Note	Dec. 31 2007	Dec. 31 2006
<b>ASSETS</b>			
Equities and participations			
Listed	7	130 966	128 673
Unlisted	8	8 273	6 234
Bonds and other fixed income assets	9	84 927	75 442
Derivative instruments	10	1 076	3 087
Cash and bank balances		2 453	2 142
Other assets	11	120	488
Prepaid expenses and accrued income	12	1 896	1 722
<b>TOTAL ASSETS</b>		<b>229 711</b>	<b>217 788</b>
<b>FUND CAPITAL AND LIABILITIES</b>			
<b>Liabilities</b>			
Derivative instruments	10	1 938	485
Other liabilities	13	46	211
Accrued expenses and deferred income	14	215	317
<b>Total liabilities</b>		<b>2 199</b>	<b>1 013</b>
<b>Fund capital</b>			
	15		
Fund capital at beginning of year		216 775	190 593
Net payments to the national pension system		991	1 568
Transferred from special management fund and liquidation fund		1 028	108
Net profit for the year		8 718	24 506
<b>Total fund capital</b>		<b>227 512</b>	<b>216 775</b>
<b>TOTAL FUND CAPITAL AND LIABILITIES</b>		<b>229 711</b>	<b>217 788</b>
<b>Memorandum items</b>			
Other assets pledged	16	7 659	5 999
Investment commitments	17	5 136	4 604

## Accounting and valuation principles

The annual report shall be prepared in accordance with the “Act concerning National Pension Funds (2000:192)” and implemented in line with generally accepted accounting principles. In conformity with the current regulations applying to comparable financial companies and institutions, the First – Fourth AP Funds have drafted and implemented joint accounting and valuation principles.

### Transaction-date accounting

Transactions on the money and bond market, equities market and currency market are reported in the balance sheet on the transaction date, which is to say the date on which the significant rights and thereby risks are transferred between parties. The claim on or debt to the other party, between transaction date and settlement day, is reported under “Other assets” or “Other liabilities”.

### Foreign exchange

Assets and liabilities in foreign currency are reported at the closing day rate. Changes in the value of assets and liabilities in foreign currency are separated into that part attributable to the change in value of the asset or liability in local currency, and that part attributable to the change in the exchange rate. Both realized and unrealized changes in value arising from changes in exchange rates are reported under “Net result, exchange gain/loss”.

### Equities and participations

Equities and participations are calculated at their fair value. In the case of equities listed on an authorised exchange, this normally means the latest price paid in local currency on the final trading day of the year: otherwise, the latest bid rate.

Unlisted holdings are valued in accordance with EVCA or equivalent principles. Generally speaking, holdings shall be assigned a fair value, based on a conservative and consistent estimate.

### Bonds and other fixed-income securities

Bonds and other fixed-income assets are calculated at their fair value. The fair value of fixed-income securities is normally determined by the latest bid rate on the final trading day of the year: otherwise, the bid rate for the preceding day.

Where such instruments are not traded on an active market, and where no quoted market rates are available, the instrument shall be valued with the support of generally accepted theoretical models, where cash flows are discounted, based on yield graphs.

Net capital gains/losses derive from the difference between the average accrued acquisition value and the market value. The accrued acquisition value is the net present value of future payments, where the discount rate is the compound interest at the time of acquisition. This means that acquired premiums or discounts are accrual accounted over the security’s remaining term, or until the next adjustment in the interest rate. Changes in the accrued acquisition value are reported as interest income.

### Buy-backs

In a true buy-back transaction, also known as a repurchase agreement, the asset is still reported in the balance sheet and the payment received is reported as a liability. The sold security is reported as a pledged asset among memorandum items in the balance sheet. The difference between spot payment and forward rate is accrual accounted over the term and reported as interest.

### **Derivative instruments**

Derivative instruments are calculated at their true value. In cases where such instruments are not traded on an active market, and where no quoted market rates are available, the instrument shall be valued with the support of generally accepted theoretical models, where input data consists exclusively of observable market data. These models may contain subjective assumptions, whereby the changes in their parameters can have a major impact on the result. Derivative contracts with a positive market value on the balance sheet date are reported as investment assets, while transactions with a negative market value are reported as liabilities. The difference arising between the forward rate and the spot rate on exchange forwards is straight-line accounted over the term of the forward contract, and is reported as interest.

### **Securities lending**

Securities on loan remain in the balance sheet and are disclosed as assets pledged under "Memorandum items". Premiums received and accrued are reported as interest income.

### **Items entered directly against Fund capital**

Contributions to and disbursements from the pension system, as well as transfers from the Special Management Fund and the Liquidation Fund, owned jointly by the First – Fourth AP Funds, are entered directly against Fund capital.

### **Performance based fees to external portfolio managers**

The performance-based fee, which is only paid out if the portfolio manager attains a return on investment in excess of the

agreed level, is reported in the income statement under net result per asset class.

### **Commission costs**

Commission costs are reported in the income statement as a deduction under operating income. These comprise direct transaction costs such as custodial fees and fixed fees to external portfolio managers.

Fees paid for the external management of unlisted assets, where reimbursement is permitted prior to profit sharing and is deemed likely, are reported as a receivable below other assets in the balance sheet.

### **Operating expenses**

All expenses incurred, excluding brokerage commissions, performance-based fees to external portfolio managers and commission costs, are reported under operating expenses.

Investments in equipment, with in-house developed and externally purchased software, are booked on current account.

Due to the fact that the Second AP Fund is exempt from VAT, not being considered a commercial operation, it lacks the right to recover VAT payments made. VAT paid and for which provision has been made in the accounts is reported together with the respective cost item.

### **Income tax**

The AP Funds are exempt from all income tax on investments in Sweden. Tax liability on investments outside Sweden varies from country to country.

## Notes to the income statement and balance sheet

### NOTE 1 Net interest income/expense

Amounts in SEK million	January–December 2007	January–December 2006
<b>Interest income</b>		
Bonds and other fixed-income assets	3 748	3 044
Derivative instruments	919	967
Other interest income	118	112
<b>Total interest income</b>	<b>4 785</b>	<b>4 123</b>
<b>Interest expenses</b>		
Derivative instruments	-1 951	-2 904
Other interest expenses	-251	-326
<b>Total interest expenses</b>	<b>-2 202</b>	<b>-3 230</b>
<b>Net interest income/expense</b>	<b>2 583</b>	<b>893</b>

### NOTE 2 Net result, listed equities and participations

Amounts in SEK million	January–December 2007	January–December 2006
Gross earnings, listed equities and participations	3 948	22 221
Less brokerage commission	-105	-126
Less performance-based fees	-53	-25
<b>Net result, listed equities and participations</b>	<b>3 790</b>	<b>22 070</b>

### NOTE 3 Net result, unlisted equities and participations

Amounts in SEK million	January–December 2007	January–December 2006
Capital gains, net	138	379
Unrealized changes in value	617	1 364
<b>Net result, unlisted equities and participations</b>	<b>755</b>	<b>1 743</b>

Unrealized changes in value include management fees of SEK 15 million, refunded in 2007.

### NOTE 4 Commission expenses

Amounts in SEK million	January–December 2007	January–December 2006
External portfolio management fees, listed assets	145	141
External portfolio management fees, unlisted assets	7	7
Other commission expenses, including custodial expenses	16	16
<b>Total commission expenses</b>	<b>168</b>	<b>164</b>

Commission expenses do not include performance-based expenses. During the year, performance-based expenses amounted to SEK 70 million (SEK 41 million) and reduce the net gain for respective asset classes. External portfolio management fees for unlisted assets are reported under commission expenses in so far as the contracts do not permit repayment prior to profit sharing in conjunction with future profitable exits.

During 2007, a total of SEK 82 million (SEK 58 million) has been paid in management fees for unlisted assets. Of these, a sum of SEK 75 million (SEK 51 million) is deemed likely to be repaid in conjunction with future profitable exits, and has therefore been reported in the balance sheet under "Other assets". During the year, a sum totalling SEK 15 million (SEK 38 million) has been repaid in conjunction with profitable exits.



**Distribution of Fund capital between external mandates and in-house portfolio management as per Dec. 31<sup>st</sup> 2007 (SEK million)**

	Mandate	Benchmark index	Average capital under management 2007	Market-value as per Dec. 31 <sup>st</sup> 2007*	% of fund capital	External management-expense
External discretionary mandates						
Equity mandates						
Active management						
	Carnegie	Global equities	MSCI World	5 152	6 496	
	Franklin Templeton	Global equities	MSCI World	5 684	7 168	
	MFS	Global equities	MSCI World	7 389	8 480	
	Research Affiliates	Sweden - Equities, model portfolio	FTSE RAFI Sweden	**	**	
	Research Affiliates	North America – Equities, model portfolio	FTSE RAFI North America	**	**	
Total			18 225	22 144	11	50
Fixed income mandates						
Active management						
	Franklin Templeton	Global credit mandate	Lehman Credit, ex Asia	3 673	3 810	
	Rogge	Global aggregated fixed-income mandate	Lehman Global, ex Asia	3 760	3 862	
Total			7 433	7 672	3	12
GTAA mandates						
Active management						
IPM/First Quadrant and Goldman Sachs						8
Total external discretionary mandates			25 658	29 816	14	70
Investments in listed external funds						
Unit trusts		as per respective fund		17 464	16 455	
Fixed-income funds		as per respective fund		3 365	3 996	
Total investments in listed external funds			20 829	20 451	9	75
Investments in private-equity funds						
Unlisted equities and participations						
in private-equity funds		Private Equity		2 514	3 351	
Total investments in private-equity funds			2 514	3 351	1	7
TOTAL EXTERNAL CAPITAL ASSETS UNDER MANAGEMENT, AND MANAGEMENT EXPENSES			49 001	53 618	24	152
In-house mandates						
Listed equities and participations		Equity		SBX, OSX, CSX, MSCI World		
Fixed-income mandates		Fixed income		SHB		
		Fixed income		Lehman		
Cash and bank balances				242		
Unlisted equities in associated companies, incl. subordinated debentures				8 959		
Total capital assets managed in-house				173 893		
Other assets and liabilities				1		
TOTAL FUND CAPITAL				227 512		
				100		

\* Market value including allocated liquidity, derivative instruments and accrued interest.

\*\* Capital under management of in-house organization based on external fundamental index (model portfolio)

**NOTE 5 Personnel costs**

Amounts in SEK k	January–December 2007		January–December 2006	
	Men	Women	Men	Women
<b>Average no. of employees</b>	<b>33</b>	<b>19</b>	<b>34</b>	<b>18</b>
<b>No. of employees, Dec. 31 *</b>	<b>30</b>	<b>19</b>	<b>35</b>	<b>19</b>
<b>No. of persons in Executive Management Group, Dec. 31</b>	<b>4</b>	<b>2</b>	<b>5**</b>	<b>2</b>

\* At year-end 2007, the Fund had 49 full-time employees.

\*\* Of whom one received compensation on termination of employment in 2006.

**Salaries and remuneration**

Chairman of the Board	100	100
CEO	2 853	2 598
Board of Directors, excl. Chairman	425	425
Executive Management Group, excl. CEO <sup>1)</sup>	9 505	10 686
Other employees	30 564	31 143
<b>Salaries and remuneration, total</b>	<b>43 447</b>	<b>44 952</b>

<sup>1)</sup> Of which costs incurred in connection with reduction in executive management, excl. CEO - 3 321

**Variable remuneration**

CEO	-	-
Executive Management Group, excl. CEO	-	-
Other employees	-	-

**Variable remuneration, total** - -

**Remuneration to Members of the Board, in addition to directors' fees** - -

**Pension costs (incl. special employer's contribution)**

CEO	896	887
Executive Management Group, excl. CEO <sup>2)</sup>	2 627	2 961
Other employees	7 207	9 007
<b>Pension costs, total</b>	<b>10 730</b>	<b>12 855</b>

<sup>2)</sup> Of which costs incurred in connection with reduction in executive management, excl. CEO - 777

**Payroll overhead**

Chairman	11	26
CEO	951	843
Board of Directors, excl. Chairman	110	137
Executive Management Group, excl. CEO <sup>3)</sup>	3 137	2 347
<b>Other employees</b>	<b>10 087</b>	<b>11 363</b>
<b>Total payroll overhead</b>	<b>14 296</b>	<b>14 716</b>

<sup>3)</sup> Of which costs incurred in connection with reduction in executive management, excl. CEO - 1 081

**Other personnel costs** 3 207 2 050

**Total personnel costs** 71 680 74 573

**Costs in connection with personnel reductions in 2006**

A charge of SEK 5 180 k was booked against personnel costs for the preceding financial year, 2006, pertaining to payments made in connection with termination of employment and release from working commitments, incl. severance pay. These personnel reduction costs were booked as an expense in 2006, but were paid out in part during 2007.

**Pensions**

In the CEO's contract of employment, the Fund undertakes to pay pension benefits and health insurance up to a pensionable age of 65 years, in the form of an annual premium corresponding to 25 percent of the gross salary. Other senior executives come under the terms of the retirement benefit agreement between BAO (The Employers' Organization of the Swedish Banking Institutions) and Finansförbundet (The Union of Financial Sector Employees).

**Severance-pay agreement**

Where the contract of employment is terminated by the Fund, the CEO is entitled to a severance payment equivalent to eighteen months' salary, in addition to salary paid during the six-month period of notice, less income from an eventual new appointment. The severance payment is calculated according to the cash monthly salary received at the end of the notice period. Other senior executives are not entitled to severance pay.

**Drafting and decision process**

Directors' fees are determined by the Swedish Government. The Presiding Committee, which serves as the Fund's remuneration committee, determines the CEO's salary and discusses remuneration for the Fund's executive management.

**Other directorships held by Members of the Board**

See page 44.

**Absence due to illness**

In 2007, absence attributable to illness at the Second AP Fund was 1.17 percent, calculated as a percentage of total days lost to illness against total normal working hours for all employees. Absence due to illness was 1.54 percent for male employees and 0.62 percent for female employees.

**NOTE 6 Other administrative expenses**

Amounts in SEK million

January–December 2007

January–December 2006

Rental expenses	6	4
Information and IT expenses	32	26
Purchased services	8	12
Other expenses	15	13
<b>Total other administrative expenses</b>	<b>61</b>	<b>55</b>

“Purchased services” includes fees to auditors amounting to SEK 1.6 million (SEK 1.4 million).

**Audit assignments**

KPMG	1.29	1.14
Öhrlings PricewaterhouseCoopers	0.33	0.21

**Other assignments**

KPMG	-	0.09
Öhrlings PricewaterhouseCoopers	-	-

**Summa** **1.62** **1.44**

**NOTE 7 Listed equities and participations <sup>1)</sup>**

Amounts in SEK million

	Dec. 31 <sup>st</sup> 2007		Dec. 31 <sup>st</sup> 2006	
	Fair value	Acquisition-value	Fair value	Acquisition-value
Swedish equities	40 576	35 389	41 846	28 846
Foreign equities	75 217	71 769	69 370	63 461
Participations in Swedish funds	2 679	951	4 529	1 566
Participations in foreign funds	12 494	6 830	12 928	7 947
<b>Total listed equities and participations</b>	<b>130 966</b>	<b>114 939</b>	<b>128 673</b>	<b>101 820</b>

<sup>1)</sup> The 20 largest Swedish and foreign shareholdings, by value, are listed on page 40. A complete list of Swedish holdings may be found on the Fund's website at [www.ap2.se](http://www.ap2.se)

**Five largest shareholdings on the OMX Stockholm Stock Exchange**

Name	Number	Fair value	Capital, %	Voting rights, %
Volvo A	29 132 145	3 146	1.37	3.54
Volvo B	1 463 701	159	0.07	0.02
Hennes & Mauritz B	7 087 504	2 789	0.86	0.42
Nordea Bank	23 589 659	2 548	0.9	0.9
Ericsson B	124 137 880	1 884	0.8	0.46

**Five largest foreign shareholdings**

Name	Number	Fair value
Nestlé	356 826	1 060
Exxon Mobil Corp	1 535 790	930
Total	1 680 859	903
E.on	619 447	852
General Electric Co	3 513 222	842

## NOTE 8 Unlisted equities and participations

Amounts in SEK million	Corp. reg.	No. of equities	Dec. 31 <sup>st</sup> 2007		Acquisition value
			Participation right, capital, %	Participation right, votes, %	
Swedish equities and participations					
Andra & Sjötte Fastigheter AB	556694-3022	2 500	50	50	2
AP Fastigheter Holding AB	556650-4196	1 000 000	25	25	721
NS Holding AB	556594-3999	1 819 884	50	50	81
EQT Northern Europe KB (EQT III)	969670-3405		1		66
Swedestart Life Science KB	969675-2337		5		17
Swedestart Tech KB	969674-7725		3		11
Foreign equities and participations					
Carlyle Europe partners III			1		32
Carlyle Riverstone Renewable Energy Infrastructure Fund I			3		71
Carlyle Riverstone Global Energy and Power Fund III			1		127
Carnegie Fund II BiotechBridge			29		44
Cevian Capital			22		46
CVC European Equity Partners IV			0.6		199
EQT Expansion Capital I			16		101
Lyceum II			10		0
Magenta			7		19
Mid Europa Fund III			3		64
New Mountain Partners III			1		18
Nordic Capital V			3		352
Nordic Capital VI			3		315
Pathway Private Equity Fund IX			99.5		697
Pathway Private Equity Fund IXB			99.5		410
Resolute Fund II			1		48
Sun Capital V			0.4		9
TCV VII			1		0
Thomas H Lee Equity Fund VI			0.6		84
TPG Asia			1		0
TPG Credit			6		181
TPG Partners V			0.3		174
TPG Star			5		51
Total unlisted equities and participations					4 670
Total fair value					8 273

The fair value reported above corresponds to the fair value under "Unlisted equities and participations" and the management fees reported in the balance sheet under "Other assets". Management fees reported in the balance sheet amounted to SEK 91 million as per December 31<sup>st</sup> 2007.

## NOTE 9 Bonds and other fixed-income securities

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007		Dec. 31 <sup>st</sup> 2006	
	Fair value	Acquisition value	Fair value	Acquisition value
<b>Swedish State</b>	<b>20 205</b>	<b>20 022</b>	<b>22 356</b>	<b>21 806</b>
Swedish municipalities	76	78	-	-
Swedish mortgage institutions	25 861	26 107	18 570	18 740
<b>Other Swedish issuers</b>				
Finance companies	667	685	1 635	1 645
Non-finance companies	3 994	3 283	3 918	3 356
Foreign states	14 603	14 761	14 283	15 172
Other foreign issuers	17 021	17 824	9 461	10 018
Deposits	2 500	2 502	5 219	5 226
<b>Total</b>	<b>84 927</b>	<b>85 262</b>	<b>75 442</b>	<b>75 963</b>
Index-linked bonds	4 138	3 705	3 530	3 024
Other bonds	68 490	69 867	61 274	62 857
Treasury bills	-	-	500	500
Commercial papers	953	953	1 290	1 289
Unlisted promissory notes	2 000	2 000	2 000	2 000
Unlisted convertible debentures	1 777	1 067	1 629	1 067
Participations in Swedish index-linked funds	-	-	-	-
Participations in foreign index-linked funds	5 069	5 168	-	-
Deposits	2 500	2 502	5 219	5 226
<b>Total</b>	<b>84 927</b>	<b>85 262</b>	<b>75 442</b>	<b>75 963</b>

**NOTE 10** Derivative instruments

Amounts in SEK million		Face value*	Dec. 31 <sup>st</sup> 2007 Derivative instruments with positive fair value	Derivative instruments with negative fair value
<b>Currency-related instruments</b>				
Options	Held	189	4	
	Pledged	189		4
Forward contracts		164 224	852	1 843
<b>Total</b>		<b>164 602</b>	<b>856</b>	<b>1 847</b>
of which cleared		-		
<b>Equities-related instruments</b>				
Forward contracts		6	-	86
<b>Total</b>		<b>6</b>	<b>-</b>	<b>86</b>
of which cleared		6		
<b>Fixed-income instruments</b>				
Options	Held	9	1	
	Pledged	5		0
Swaps		100		1
Forward contracts		8 968		4
<b>Total</b>		<b>9 082</b>	<b>1</b>	<b>5</b>
of which cleared		8 968	-	
<b>Other financial instruments</b>				
Other instruments		44	219	-
<b>Total</b>		<b>44</b>	<b>219</b>	<b>-</b>
of which cleared		-		
<b>Total derivative instruments</b>			<b>1 076</b>	<b>1 938</b>

\* Face value refers to the number of contracts multiplied by the contract amount for the derivative instruments' absolute amount. The amount thereby includes both forward contracts purchased and sold, gross. Refer to page 21 for a description of the types of derivative instrument employed and the risks that can be managed with derivatives.

**NOTE 11** Other assets

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
Incoming payments, unsettled transactions	27	454
Incoming payments, management fees for unlisted assets	91	31
Other receivables	2	3
<b>Total</b>	<b>120</b>	<b>488</b>

During the year, fees totalling SEK 82 million (SEK 58 million) have been paid for the external management of unlisted assets. Of this sum, SEK 75 million (SEK 51 million) is deemed likely to be repaid in connection with profitable exits and has therefore been booked under 'Other assets'. As per Dec. 31<sup>st</sup> 2007, therefore, receivables in the form of management fees due for unlisted assets amounted to SEK 91 million. During the year, SEK 15 million (SEK 38 million) has been repaid in connection with profitable exits.

**NOTE 12** Prepaid expenses and accrued income

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
Interest income accrued	1 751	1 594
Refunds	22	14
Dividends accrued	91	82
Other prepaid expenses and accrued income	32	32
<b>Total</b>	<b>1 896</b>	<b>1 722</b>

**NOTE 13** Other liabilities

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
Outgoing payments, unsettled transactions	38	192
Accounts payable	6	17
Other liabilities	2	2
<b>Total</b>	<b>46</b>	<b>211</b>

**NOTE 14** Deferred income and accrued expenses

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
Management fees	94	56
Accrued interest expenses on currency forwards	101	237
Other accrued expenses	20	24
<b>Total</b>	<b>215</b>	<b>317</b>

**NOTE 15** Fund capital

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
<b>Opening Fund capital</b>	<b>216 775</b>	<b>190 593</b>
<b>Net inflows to the national pension system</b>		
Pension contributions received	47 603	45 906
Pension disbursements to National Social Insurance Board	-46 405	-44 033
Transfer of pension entitlements to EC	-8	-6
Adjustment of pension entitlements re. previous years	1	0
Administration contribution to National Social Insurance Board	-200	-299
<b>Total payments to the national pension system, net</b>	<b>991</b>	<b>1 568</b>
Transferred from the First AP Fund's Liquidation Fund	961	63
Transferred from the Fourth AP Fund's Special Management Fund	67	45
<b>Total payments to the national pension system, net</b>	<b>1 028</b>	<b>108</b>
<b>Net result for the year</b>	<b>8 718</b>	<b>24 506</b>
<b>Closing Fund capital</b>	<b>227 512</b>	<b>216 775</b>
Investment assets, First AP Fund's Liquidation Fund	-	3 643
Investment assets, Fourth AP Fund's Special Management Fund	305	489

Copies of the annual reports of the Liquidation Fund and Special Management Fund are available on request from the First and Fourth AP Funds respectively.

**NOTE 16** Other pledged assets

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
Collateral for futures	757	618

**Securities on loan for which guarantees have been secured\***

Securities on loan	6 902	5 381
<b>Total</b>	<b>7 659</b>	<b>5 999</b>

\* Guarantees secured for pledged securities: 7 242 (5 643).

**NOTE 17** Commitments

Amounts in SEK million	Dec. 31 <sup>st</sup> 2007	Dec. 31 <sup>st</sup> 2006
<b>Commitments regarding future payments</b>		
Investment commitments, unlisted holdings	5 136	4 604
<b>Total</b>	<b>5 136</b>	<b>4 604</b>

The administration report, income statement, balance sheet and notes for 2007 have been approved by the Board of Directors.

Göteborg, February 7<sup>th</sup>, 2008

Anders Jansson

Gunnar Larsson  
Chairman

Bo Dockered  
Deputy Chairman

Märtha Josefsson

Clas Nykvist

Roland Svensson

Eva Persson

Lillemor Smedenvall

Ylva Thörn

Auditors' report for the Second AP Fund  
(Corp. reg.: 857209-0606)

We have audited the annual accounts, the accounting records and the administration of the board of directors of the Second AP Fund for the financial year 2007. The Fund's Annual Report is included in the printed version of this document on pages 1–39. These accounts and the administration of the Fund and the application of the Swedish National Pensions Act are the responsibility of the board of directors. Our responsibility is to express an opinion on the annual accounts and the administration based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Sweden. Those standards require that we plan and perform the audit to obtain reasonable assurance that the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and their application by the board of directors, as well as evaluating the overall presentation of information in the annual accounts. We believe that our audit provides a reasonable basis for our opinion set out below.

The annual accounts have been prepared in accordance with the Swedish National Pensions Act and, thereby, give a true and fair view of the company's financial position and results of operations in accordance with generally accepted accounting principles in Sweden. The statutory administration report is consistent with the other parts of the annual accounts.

In performing this audit, we have found no reason for qualifications regarding the annual accounts, the income statements and balance sheets included therein, the accounting records or the inventory of assets, or otherwise regarding the Fund's management by the board of directors.

We recommend that the income statement and balance sheet be adopted.

Göteborg, February 7<sup>th</sup>, 2008.

Anders Bäckström  
*Authorised Public Accountant*  
*Appointed by the*  
*Swedish Government*

Göran Jacobsson  
*Authorised Public Accountant*  
*Appointed by the*  
*Swedish Government*

## Shares, participations and fixed-income securities

### The Second AP Fund's 20 largest Swedish shareholdings <sup>1)</sup>

Name of company	Share of equity, %	No. of equities	Fair value, SEK m	Share of voting rights, %	Sector
Volvo A	1.37	29 132 145	3 146.3	3.54	Industrials
Volvo B	0.07	1 463 701	158.8	0.02	Industrials
Hennes & Mauritz B	0.86	7 087 504	2 788.9	0.42	Consumer Discretionary
Nordea Bank	0.90	23 589 659	2 547.7	0.90	Financials
Ericsson B	0.80	124 137 880	1 884.4	0.46	IT
TeliaSonera	0.66	30 562 784	1 849.0	0.66	Telecoms
Meda A	6.38	16 526 809	1 322.1	6.38	Healthcare
Svenska Handelsbanken A	0.99	6 358 194	1 316.1	0.99	Financials
Sandvik	0.05	11 313 808	1 258.7	0.05	Industrials
Investor A	0.06	440 349	62.9	0.12	Financials
Investor B	1.03	7 797 878	1 146.3	0.22	Financials
Swedbank A	1.31	6 564 980	1 201.4	1.31	Financials
SEB A	1.02	6 815 335	1 127.9	1.05	Financials
SCA A	0.16	1 117 906	132.2	0.65	Commodities
SCA B	1.14	8 009 333	917.1	0.47	Commodities
Atlas Copco A	0.54	6 596 911	636.6	0.76	Industrials
Atlas Copco B	0.34	4 212 114	371.7	0.05	Industrials
AstraZeneca	0.09	3 371 342	933.9	0.09	Healthcare
Scania A	0.07	530 648	89.1	0.12	Industrials
Scania B	0.61	4 895 396	753.9	0.11	Industrials
Tele2 B	1.26	6 000 465	777.1	0.71	Telecoms
SKF B	1.51	6 633 601	726.4	0.77	Industrials
Lindab International	6.17	4 855 032	714.9	6.17	Industrials
SSAB A	0.98	3 049 862	536.8	1.27	Commodities
SSAB B	0.20	657 557	104.6	0.03	Commodities
Alpha Laval	1.56	1 743 986	634.8	1.56	Industrials

### The Second AP Fund's 20 largest foreign shareholdings <sup>1)</sup>

Name of company	No. of equities	Fair value, SEK m	Sector
Nestlé	356 826	1 059.7	Consumer Staples
Exxon Mobil Corp	1 535 790	930.0	Energy
Total	1 680 859	902.8	Energy
E.on	619 447	852.2	Utilities
General Electric Co	3 513 222	841.7	Industrials
Roche Holding	576 767	644.6	Healthcare
GlaxoSmithKline	3 896 041	641.1	Healthcare
ABB Ltd	3 255 069	602.8	Industrials
Procter & Gamble Co	1 218 339	578.1	Consumer Staples
Novartis	1 596 445	566.4	Healthcare
Siemens	537 537	553.0	Industrials
Microsoft Corp	2 384 797	548.7	Information Technology
UBS	1 816 111	543.5	Financials
BP	6 818 712	539.5	Energy
British American Tobacco	2 098 490	530.5	Consumer Staples
Vodafone Group	20 743 701	501.2	Telecom Services
Johnson & Johnson	1 102 203	475.2	Healthcare
Altria	914 770	446.9	Consumer Staples
Sanofi-Aventis	747 936	445.1	Healthcare
Electricite De France	568 617	437.9	Utilities

<sup>1)</sup> The above table of Second AP Fund shareholdings lists the 30 largest Swedish holdings and 20 largest foreign holdings, by worth. "Swedish shareholdings" also includes companies that have changed their legal domicile after merging with a foreign company, as with AstraZeneca. Share of capital and voting rights for shareholdings listed principally on foreign exchanges in no case exceeds 0.3% and is therefore not reported.

A complete list of the Second AP Fund's Swedish holdings may be found on the Fund's website at [www.ap2.se](http://www.ap2.se). A complete list of foreign holdings may be ordered from the Second AP Fund.



## Second AP Fund holdings in unit trusts

Unit trusts, Swedish	No. of equities, participations	Fair value, SEK m
SHB Småbolagsfond	1 030 905	534
Robur Småbolagsfond Sverige	16 348 353	726
Lannebo Småbolagsfonder	23 499 017	695
Carlson Småbolagsfond	285 300	374
SEB Sverige Småbolag Chans/Risk	3 628 508	352

Foreign unit trusts, five largest holdings	No. of equities, participations	Fair value, SEK m
Merrill Lynch Emerging Markets	24 134 553	3 280
AiG Global Emerging Markets	1 003 623	3 456
Genesis Emerging Markets	8 963 493	2 594
StateStreet Emerging Markets	356 534	2 829
Generation	1 050 985	1 073

## Second AP Fund holdings in bonds and other fixed income securities

### Swedish nominal bond portfolio, five largest holdings

Bond	Fair value, SEK m
Swedish Government 1041	2 542
Swedish Government 1046	2 384
Swedish Government 1047	2 359
Swedish Government 1045	2 177
Swedish Government 1051	1 860

### Swedish index-linked bond portfolio, five largest holdings

Bond	Fair value, SEK m
Swedish Government 3105	1 520
Swedish Government 3104	1 067
Swedish Government 3102	981
Swedish Government 3106	505
Swedish Government 3001	79

### Global credit portfolio, five largest holdings

Bond	Fair value, SEK m
Eksportfinans A/S 5.5% 2017-06-26	205
Danske Bank Bankcertifikat	200
Landwirtschaft Rentenbank 4.875% 2014-01-10	182
Oesterreich Kontrollbank 4.75% 2012-10-16	135
Oesterreichische Bundesbahne 4.875% 2022-06-27 EMTN	122

### Global government bond portfolio, five largest holdings

Bond	Fair value, SEK m
Germany 3.5% 2011-10-14	513
France 4% 2014-10-25	460
Germany 4% 2016-07-04	459
France 3.75% 2021-04-25	448
Germany 4.5% 2013-01-04	434

Detailed information about Second AP Fund holdings in fixed income securities may be ordered from the Fund.

## Second AP Fund governance report

To comply with the Swedish Code of Corporate Governance, Swedish quoted companies are required to submit a corporate governance report.

The Code is considered to set the tone for what shall be considered good practice for corporate players on the Swedish stock market. This Fund governance report has derived inspiration from the Code of Corporate Governance, while also taking into account the special characteristics that apply to the Second AP Fund.

Like the other AP Funds, AP2 is a state agency. Even so, the difference between the AP Funds and other state agencies is considerable. The greatest difference is that the AP Funds enjoy a high degree of independence from the Swedish Government, because their operations are almost exclusively governed by law and the Government thereby has no provision in law to exercise control over them.

### The Board

The Board of Directors of the Second AP Fund, which is appointed by the Swedish Government, comprises nine members. Two are appointed in accordance with proposals submitted by organizations that represent employees' interests, two in accordance with proposals submitted by organizations that represent employers' interests. The Chairman and Vice Chairman are appointed by the Government, selected from the members of the Board not put forward by employer or employee organizations. Each director shall be appointed on the basis of his/her individual ability to enhance the management of the Fund. No changes have been made to the composition of the Board during 2007.

To date, the Government has chosen to implement twelve month mandate periods for Board Members, whereby current appointments remain in effect until the Fund's balance sheet and income statement for 2007 have been adopted.

The Board has full and undivided responsibility for the operations of the Fund, within the parameters established by the Swedish Parliament concerning the organization of the Fund and management of its assets. In instances where the work of the Board falls outside the terms of the Law Governing the Swedish National Pension Funds, it is governed by the rules of procedure annually adopted by the Board.

Fees and other remuneration paid to Board Members are

determined by the Swedish Government. The remuneration paid per annum amounts to SEK 100 000 for the Chairman, SEK 75 000 for the Vice Chairman and SEK 50 000 for the other Members of the Board.

### The work of the Board

The Board of the Second AP Fund considers its primary task to be the establishment of operational targets, the recruitment and evaluation of the CEO and the taking of decisions concerning broad strategic issues, such as the composition of the Fund's strategic portfolio. To ensure that the Board's decisions are implemented, that intrinsic risks are managed and that the Fund's operations are in all other respects conducted in an appropriate manner, effective control and follow-up are essential.

During the year, the Board has held six ordinary meetings, of which one of greater duration, at which broad strategic issues were addressed. In addition to Board Members, Board meetings may be attended by the Fund's CEO and relevant Fund employees, either in an advisory role as experts, or to submit a report on a given issue. The CEO's performance is evaluated once a year, at a meeting the CEO does not attend. The Board's strategy meeting was held in Oslo, and included visits to Norway's Bank Investment Management, the Ministry of Finance and the Joint Ethical Council.

### Fund targets

The Fund's overall target is a real return of at least 5 percent per annum, seen over time, including an active average return of 0.5 percentage units per annum.

### New strategic portfolio

A new strategic portfolio has been approved for 2008.

### Discussion about performance, governance issues and costs

The Fund's management performance is reviewed at every Board meeting. The Board regularly discusses governance issues, the strategic allocation of assets and investments in private-equity funds, and has held six meetings during the year.

Cost trends are considered on a quarterly basis, and the Board regularly reverts to the issue of the Fund's cost efficiency. An evaluation of the Board's performance was conducted

at the start of the year. In addition to carrying out its annual responsibilities concerning the adoption of the end-of-year accounts, budget, strategic plan and strategic portfolio in 2007, the Board also confirmed a decision to institute a performance-based system of remuneration for the Fund's employees, with effect from January 1st 2008.

### **Attendance**

All nine Members attended one of the Board meetings, two of the meetings were attended by eight Members, two by seven Members and five were present at one of the meetings.

### **Board Committees**

The Board has established a Remuneration Committee. The Remuneration Committee consists of the Chairman, the Vice Chairman and the CEO.

The Remuneration Committee is an executive organ of the Board, tasked with considering levels of remuneration for the Fund's CEO and executive management. Decisions reached by the Remuneration Committee are submitted for consideration by the Board at its next meeting.

### **Audit**

The Second AP Fund's auditors are appointed by the Government. Currently, responsibility for the audit is shared by Anders Bäckström, KPMG, and Göran Jacobsson, Öhrlings PricewaterhouseCoopers. The appointment is for three years, up until adoption of the Fund's income statement and balance sheet in 2008.

KPMG manages the day-to-day auditing. KPMG and Öhrlings PricewaterhouseCoopers are also responsible for conducting the audits of other AP Funds. Anders Bäckström is responsible for coordinating the audits of the AP Funds.

### **Inspection of administration and accounts**

The auditors' assignment includes inspection of current business operations, the administration of the Fund, the annual accounts and the annual report. The auditors express their opinion of the annual accounts and administration, based on their audit. This assignment also includes an assessment to determine that the accounts of the Second AP Fund have been prepared in compliance with generally accepted accounting and valua-

tion principles, and that they provide a true and fair picture of the Fund's financial position.

The audit for 2007 also comprised an audit of the Fund's investments in private equity companies, including a follow-up of investments and disposals during the year.

A study of counterparty risk was also conducted. This study forms part of a joint audit programme that embraces all Swedish National Pension Funds.

The auditors submit a report on their audit. They make an oral report direct to the Board at least once a year, as well as submitting written reports concerning their audit of the annual accounts and administration.

In addition to these responsibilities, the auditors submit an oral report to the Ministry of Finance once a year.

### **Internal control**

The Board has ultimate responsibility for the Fund's internal control. In the Fund's risk policy, the Board has established frameworks and guidelines for the overall allocation of responsibilities, risks, risk limits and routines to monitor and control that such guidelines are observed.

The Risk Management Department ensures that these risk parameters are respected. Implementing this risk control process ensures that the organization, both as a whole and in its individual elements, keeps within the specified limits and observes the restrictions and instruction that apply.

Ongoing internal control of the Fund's financial and operational risks is handled by the Risk Management Department. Risk Management is organizationally independent of functions that are engaged in active trading decisions.

This risk control process is based on the generation of effective and transparent risk reports and analyses. Reporting to the Fund's executive management is conducted on a daily basis, while regular updates are submitted to the Board at its meetings.

## Board of Directors



The Board of Directors of the Second AP Fund, December 31<sup>st</sup> 2007. Members of the Board are appointed by the Swedish Government. They are appointed on the basis of their competence to promote the Fund's management of its portfolio.

*Lower row, from left:*

**Gunnar Larsson**

Chairman since 2000.

Chairman of the board of Tholin & Larsson-Gruppen AB. Directorship on the board of Norrporten AB. Former authorised public accountant and Municipal Commissioner for Göteborg. Born 1940.

**Märtha Josefsson**

Member of the Board since 2003.

Independent investment consultant. Former Investment Director at DnB Asset Management and Carlson Investment Management AB. Directorships on several boards, including Anoto, Fabege, Luxonen, Telelogic, Skandia Funds, Uppsala Nya Tidning and Öresund. B.A. Born 1947.

*Upper row, from left:*

**Eva Persson**

Member of the Board since 2004.

Member of Volvo's executive management, with responsibility for legal affairs, taxation and security, and Secretary to the board of AB Volvo. Directorship on the board of Handelsbanken Region Väst. Board member of the Industry and Commerce Stock Exchange Committee. LL.B. Born 1953.

**Roland Svensson**

Member of the Board since 2000.

Former President and CEO of Coop Norden AB and KF Ekonomisk förening. Industrial advisor, Accent Equity Partners. LL.B. Forest owner. Born 1941.

**Lillemor Smedenwall**

Member of the Board since 2006.

Chairman of Finansförbundet. Vice Chairman of TCO Development AB. Directorships on the boards of TCO (Confederation of Professional Employees) and Sparinstitutens Pensionskassa (SPK). Born 1950.

**Anders Jansson**

Member of the Board since 2005.

President and CEO of Stena Metall AB. Formerly president of Volvo Car Finance, head of Global Trading at Handelsbanken Markets, and president of Volvo Group Finance. Born 1957.

**Bo Dockered**

Vice Chairman since 2000.

Chairman of the boards of AB Trav and Galopp and Sveaskog AB. Honorary Doctor of Agronomy (Dr.h.c. Agronomy) and farmer. Born 1941.

**Ylva Thörn**

Member of the Board since 2000.

President, Swedish Municipal Workers' Union. Chairman of The Public Services International. Directorships on several boards, including LO (The Swedish Trade Union Confederation) and Riksbbyggen. Assistant nurse. Born 1954.

**Clas Nykvist**

Member of the Board since 2000.

Controller, Swedish Building Workers' Union. Directorships on several boards, including Folksam Spar AB. Born 1948.

## Executive management

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### **Fund management, Second AP Fund**

*From left:*

Martin Jonasson, General Counsel, born 1964

Tomas Franzén, Chief Investment Strategist (CIS), born 1957

Eva Halvarsson, CEO, born 1962

Directorships on the boards of AP Fastigheter AB,  
Andra & Sjötte Fastigheter AB and Göteborg University.

Carl Rosén, Head of Corporate Governance and  
Communications, born 1959

Poul Winslöv, Chief Investment Officer (CIO), född 1966

Lena Smeby-Udesen, Chief Financial Officer (CFO), born 1961

## Auditors

Anders Bäckström,  
Authorised Public Accountant, KPMG

Göran Jacobsson,  
Authorised Public Accountant,  
PricewaterhouseCoopers

# Definitions

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## **Absolute return on investment**

The return generated on a portfolio or portfolios of assets, measured in kronor or percent, of the original invested amount.

## **Absolute risk**

Variation in absolute return. Measured as a standard deviation on absolute return. Also known as “volatility”.

## **Active/passive management**

Active: Where portfolio management may deviate from the benchmark portfolio, to generate an active return. Passive: Where portfolio management exactly matches the benchmark portfolio.

## **Alpha and Beta**

A positive Alpha value is the additional return the investor gains as a reward for having taken a greater risk than merely following the market as a whole, via normal index. A positive Alpha return therefore means that the Fund has beaten its index.

Beta simply describes market exposure. Exposure to different markets is determined by the composition of the strategic portfolio.

## **ALM study**

Asset Liability Modelling. An analytical model used to determine the Fund's benchmark portfolio. The study, which is revised on a continual basis, is designed to determine the optimal composition for the different classes of asset under Fund management, to ensure that it satisfies the Fund's long-term commitment to the collective requirements of the Swedish national pension system. The judgements based on this analysis shall take into account demographic changes as well as general economic trends.

## **Benchmark index**

Index based on the Second AP Fund's strategic portfolio, against which the Fund's management performance is measured.

## **Credit risk and counterpart risk**

“Credit risk” refers to the risk that an issuer may become insolvent or be awarded a lower credit rating. “Counterpart risk” refers to the risk that the other party may be unable to meet its business obligations.

## **Discretionary mandate**

A mandate that is limited and specific to a single portfolio manager. The alternative to discretionary management is management in a fund, where several managers invest jointly in the same mandate.

## **Enhanced index mandate**

Management of assets at low risk, with a targeted return of between 0.5 and one percent above index.

## **Fair value**

Fair value is defined as the amount for which an asset may be transferred or a debt settled, between parties who are mutually independent and who have a vested interest in completing the transaction. Normally speaking, this means that listed assets are valued at the buying-rate (market value) and that the fair value of unlisted assets is estimated with the help of generally accepted valuation models.

## **Information ratio**

A gauge of risk-adjusted relative return. Measured as relative return, divided by tracking error/active risk.

## **Interaction**

Interaction is a consequence of the interplay between a strict allocation of assets and a strict choice of securities.

## **Liquidity risk**

“Liquidity risk” refers to the risk that securities cannot be converted into cash, because of reduced access to or demand from the market, which either precludes the purchase or sale of such securities, or would require their sale at a loss.

## **Market risk**

The market risks most relevant to the Second AP Fund are share-price risk, interest-rate risk and currency risk.

## **Operational risk**

“Operational risk” refers to the risk that an error or stoppage in operations could lead to economic loss or reduced credibility.

## **Overlay mandate**

An active asset management mandate that is separated from the underlying portfolios. In an overlay mandate, forward contracts or other derivative instruments are used instead of underlying equities and bonds. Overlay mandates are normally “long-short” mandates, which do not affect the size of the total portfolio of investments under management. The Fund's GTAA mandates are typical examples of an overlay mandate.

## **Quantitative management**

Portfolio management that focuses on exposing incorrect market pricing with the help of a mathematical model.

## **Relative return**

The difference in return generated by a portfolio and its benchmark index.

## **Sharpe ratio**

A gauge of risk-adjusted return. Measured as the portfolio's absolute return less risk-free interest, divided by the standard deviation on absolute return.

## **Strategic portfolio**

The Second AP Fund's strategic portfolio is determined annually by the Board of Directors and confirms the Fund's decision on strategic asset allocation. It also serves as the benchmark portfolio in the day-to-day management of the Fund's capital assets.

## **Tracking error/Active risk**

The variation in relative return. Often measured as standard deviation on the relative return.





***Andra AP-fonden***  
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