



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

# **Second Swedish National Pension Fund/AP2**

## **Annual Report 2010**



**“When I’m a pensioner,  
I’ll go for walks, because  
you need to have fun and  
not just sit around.”**

**Fredrik, 6 years old**



The Second AP Fund asked a preschool class in Gothenburg what first came to mind when they heard the word 'pensioner', and what they thought they might do when they became pensioners. We should like to thank all of you for your many thoughtful replies and smart ideas and for the inspiration you have given us in producing this annual report.

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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). Figures in parentheses refer to the preceding year.

\*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, where space requires, AP2.

# 2010 in brief

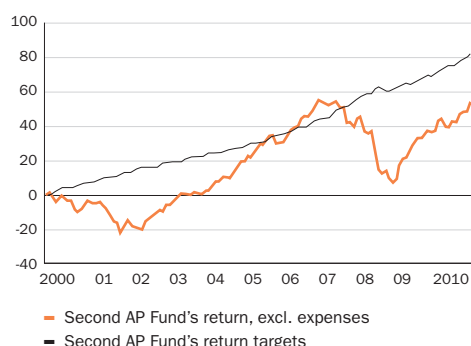
**The Second AP Fund's long-term strategy continued to generate a solid return in 2010. The net result for the year was SEK 22.3 billion. Return relative to benchmark index was 0.8 percent, excluding alternative investments and expenses. All asset classes outperformed respective benchmark indices. The Fund's high exposure in Swedish equities has also continued to contribute strongly to the positive absolute return in 2010.**

- The Second AP Fund's assets under management totalled SEK 222.5 (204.3) billion on December 31 2010, against which net outflows to the national pension system were charged in an amount of SEK - 4.0 (- 3.9) billion.
- The net result for the year amounted to SEK 22.3 (34.9) billion.
- The Fund's return on the total portfolio was 11.2 (20.6) percent, excluding commission fees and operating expenses. Including these expenses, the portfolio noted a return of 11.0 (20.3) percent.
- The Fund's active management posted an ongoing positive result. The relative return on the Fund's overall portfolio, excluding alternative investments, was 0.8 (0.7) percent, corresponding to SEK 1.4 billion.
- The Fund's low FX exposure of 12 percent was favourable, contributing positively to the net result.
- During the year, the Fund made its first investments in forest and agricultural real estate.

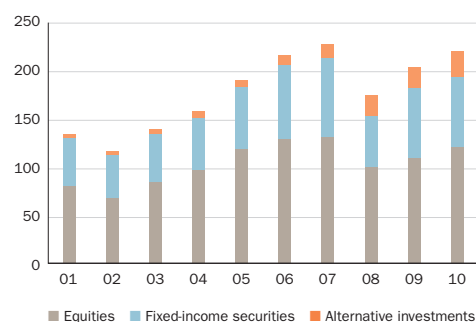
## Five-year review

	2010	2009	2008	2007	2006
Fund capital, SEK m	222 507	204 290	173 338	227 512	216 775
Net result for the year, SEK m	22 258	34 858	-55 058	8 718	24 506
Return on total portfolio, excl. commission fees and operating expenses, %	11.2	20.6	-24.0	4.2	13.0
Relative return on quoted assets, excl. alternative investments, commission fees and operating expenses, %	0.8	0.7	-1.8	-0.4	0.2
Active risk, ex post, %	0.3	0.6	1.0	0.7	0.7
FX exposure, %	12	10	12	11	12

## Accumulated return, %



## Fund's capital performance 2001-2010, SEK billion (including a net inflow of 13.3 billion to the Fund)



# This is the Second AP Fund

**The Second AP Fund is one of the buffer funds within the Swedish national pension system, tasked with maximizing the long-term return on pension assets under management, to ensure that pensions develop as strongly as possible.**

More than 50 percent of Second AP Fund's assets under management is invested in foreign equities and bonds. In all, the assets under management total SEK 222.5 billion, invested across a range of asset classes. The Second AP Fund numbers just over 50 staff; portfolio managers, analysts and other specialists in different areas.

## Long-term mission

The Second AP Fund is one of five buffer funds within the Swedish pension system. The Second AP Fund shall maximize long-term return at low risk. In conjunction with the other buffer funds, the Fund is tasked with maintaining reasonably consistent

pension levels, even during periods affected by peaks in the number of retirees, or by an economic downturn. These buffer funds jointly account for about ten percent of the total Swedish pension system.

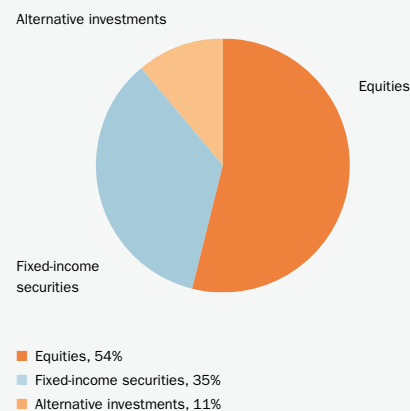
## Diversified portfolio

As a long-term investor, the Second AP Fund is better able to bear the risk posed by short-term fluctuations in the market. This mission also enables investment in a broader range of asset classes than many other market players.

## Ethics and the environment – a way to stay one step ahead

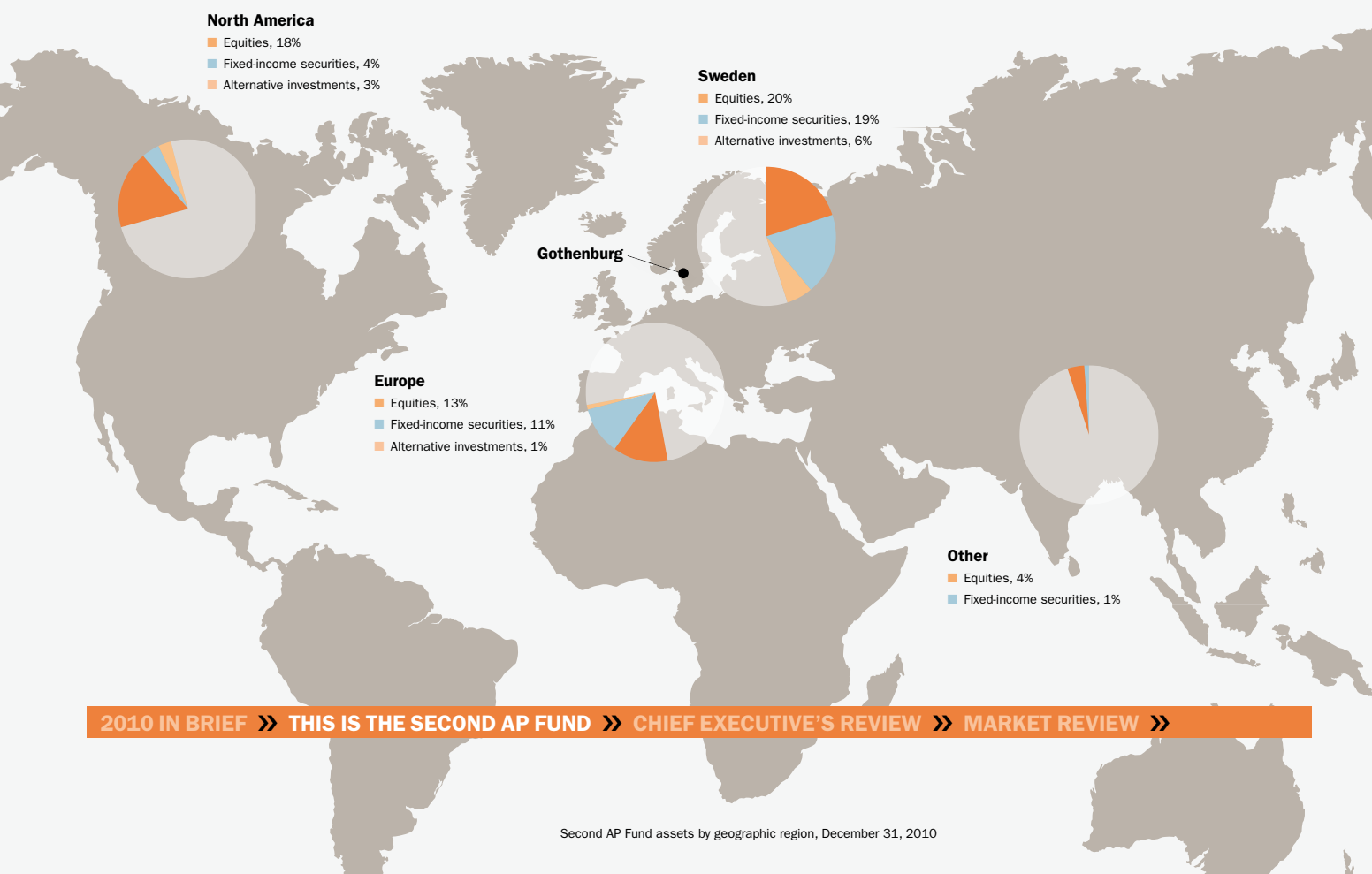
The Second AP Fund is actively engaged in its holdings with a view to creating long-term value. By its active engagement in issues such as ethics and the environment, the Second AP Fund can help its portfolio companies identify opportunities and risks at an early stage, thereby contributing to their improved performance.

Second AP Fund portfolio by asset class, December 31, 2010



## An international player in Gothenburg

The Second AP Fund is headquartered in Gothenburg, a city that boasts a venerable trading tradition and many successful export companies. This enhances the Second AP Fund's international perspective.



## Goal achieved with solid result

*For the second year in succession, the Second AP Fund has been able to generate a solid result, achieving a growth in the worth of its market assets in excess of the targeted real return of five percent. Equally pleasing is the fact that the active management of our assets has in two years contributed a total of SEK 2.6 billion.*

Following two years of considerable turbulence, 2010 proved somewhat calmer. Although the Swedish economy appears highly stable, the past year has witnessed some stormy times in the eurozone. We are also still waiting for a US recovery after the financial crisis. At the same time, the eastward shift in the global economy is becoming increasingly apparent.

### Strategic choice decisive

What we are seeing is the consequence of the long-term choices made by the Second AP Fund. Based on our in-house developed ALM model, we aim to create a portfolio that can best meet the requirements of our long-term mission: to maximize return at limited risk.

This long horizon offers opportunities unavailable to many fund managers, while at the same time requiring the pursuit of a consistent strategy to achieve the projected return. During times of considerable market turbulence, it can be tempting to make radical changes to this strategy, based on fleeting market trends.

What we have done – and do – is to subject our fundamental strategy to ongoing evaluation, testing it against the latest capi-

tal management theories and trends. This evaluation process naturally incorporates the lessons we have learned from the market situations we have experienced. In the current market situation, this working approach clearly demonstrates the importance of pursuing a consistent strategy, a strategy that has proved successful with respect to maintaining the high proportion of equities in the portfolio.

No strategy can function without competent staff, and our success derives from our top quality personnel, who are also good team players.

### Ongoing diversification

One of the most decisive factors in the success of our strategic portfolio is our step-by-step progress towards increased diversification. Having started with a portfolio of relatively simple composition, it now features a breadth that helps reduce volatility while increasing the opportunities for a solid return.

The most recent building blocks of this strategy are our investments in a number of funds focused on the forest and agricultural sectors. In an increasingly globalized world, growing numbers of asset classes tend to

follow the same growth curve. This is especially clear during downturns, something that was particularly evident during the financial crisis. Even so, covariance between forest and agricultural real estate and equities, for example, has so far been relatively low, which means that investments in these assets is expected to reduce volatility.

### Potential in Asia

As Asia's emerging markets continue to grow, so also does their share of the overall global economy. One consequence is that their share of the global equities market has also grown, to between 12 and 13 percent. If it is deemed important to follow such a trend, investors must increase their exposure to these emerging markets.

The Second AP Fund is planning to increase its strategic allocation to emerging markets. We believe this will contribute to diversification while improving opportunities for solid returns. This is essential to maintaining Sweden's national pensions.

### An active investor

We are actively engaged in observing and implementing the United Nations' Principles for Responsible Investment (PRI).

Concrete investments in forest and agricultural real estate, for example, have been preceded by a sustainability analysis, as part of the due-diligence process.

We also continue to participate in the AP funds' joint efforts through the Ethical Council, where we engage in spirited dialogues with a number of companies that are in contravention of international conventions. We are convinced that, as investors, we can make a difference by trying to influence corporate behaviour.

Here in Sweden, we also maintain our commitment to better corporate governance. We do this directly, through contact with the companies in which we invest and, indirectly, in other ways, as through the publication of reports such as our Female Representation Index. During the year, the debate about incentive schemes for key executives continued. Since the boards of the companies in question are those responsible for establishing relevant and reasonable incentive packages, we intensified our dialogues with the company boards concerning incentives during the first half of the year. We favour long-term incentive schemes where we feel such schemes can contribute to the company's long-term growth.

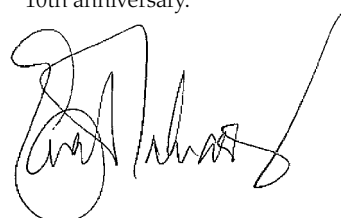
#### Looking ahead

The past year was the second year in succession where the buffer funds reported net outflows, to cover pension disbursements. This means that we have entered a new and

serious phase, which will continue for many years to come. Having previously contributed only to increasing the nation's pension assets, our role as a buffer fund is growing ever clearer. This places new demands, especially with respect to liquidity, if we are to meet future demand concerning pension disbursements, as and when required.

At the same time, we must continue to maximize the return on "our" portion of Sweden's pension assets. This is a task that all who work at the Second AP Fund take

extremely seriously, and of which we are very proud. We are looking forward to 2011, the year in which the Fund celebrates its 10th anniversary.



Eva Halvarsson  
CEO



## Challenges to economic recovery

*Following the turbulence that affected both the financial markets and economy in the early part of 2009, 2010 presented new challenges. During the year, the problem of government debt in Europe attracted the spotlight, as well as the stubbornly high level of unemployment in many countries.*

During 2009, the global economic scenario changed from what many had interpreted as a depression to a more normal post-recession recovery. The challenges of 2010 all derived from the years leading up to the financial crisis, when exaggerated lending fuelled a level of consumption that radically exceeded the available assets. Consequently, companies and private individuals, and in particular national governments, have been forced to review their balance sheets and cut their costs.

The turbulence affecting financial markets continued on and off throughout the year. This was especially true of countries with weak state finances. These sometimes sharp fluctuations in many cases derived either from uncertainty as to whether the economic recovery could be

maintained or anxiety over countries' ability to repay their debts.

### **Ongoing recovery**

The economic recovery that started some months into 2009 has continued, if slowly, due in part to the fact that in many places unemployment has remained at a stubbornly high level. This applies particularly to the USA, Europe and Japan. This picture is not the same everywhere, however. The recovery has been led by the emerging countries, mainly in Asia and South America, as well as by a number of the commodities-based economies. Sweden is also in a strong position compared to many other countries.

One of the contributing factors to last year's economic turnaround was the implementation of a whole range of financial and

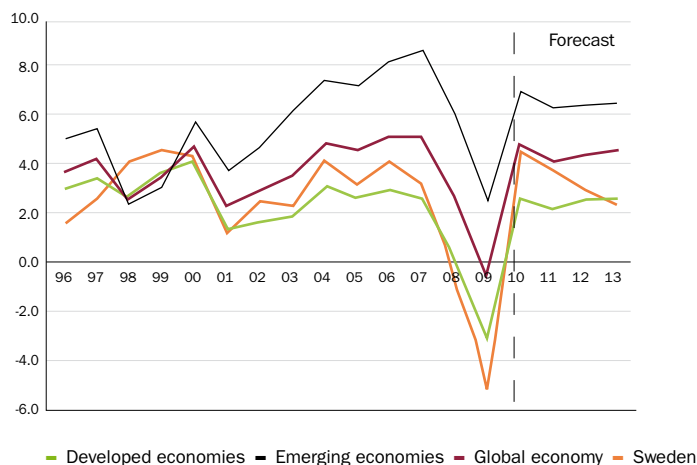
monetary policy measures to stimulate the economy. Given the growing budget deficits experienced by many of the most severely affected countries, these forms of financial stimulus will gradually peter out. The obvious and concrete effect will be that the rate of recovery in global growth will be slower than it might otherwise have been.

A continuing high level of unemployment and relatively low level of capacity utilization ensure that any inflationary tendencies will be minimal. This will allow the large central banks to maintain low base lending rates for a long time to come. Consequently, monetary policy will continue to fuel economic growth. For example, at the November meeting of America's central bank, the Federal Reserve, it was decided that the Fed should acquire the majority of the treasury bonds issued in the USA up

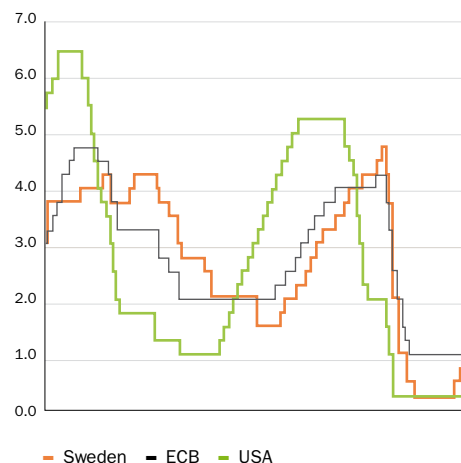


## GDP growth and base lending rates

GDP growth (annually adjusted, %)



Base lending rates



Source: IMF and Riksbanken (Swedish Central Bank)

until the summer. This measure is designed to give the US economy an additional boost.

### The challenges ahead

First and foremost, it is industry that has provided the driving force for this economic recovery, following the traditional pattern for an economic turnaround.

When the global industrial economy enters a calmer and more mature phase, however, growth will have to be sought elsewhere. At this point, it is important that domestic demand, i.e. corporate investment and household consumption, take over as the engine of growth. And this is also the area that poses the greatest challenges for the future.

One risk is that American unemployment levels could remain high, thereby making it difficult to get consumption moving again.

And should the housing market in the USA and Great Britain remain weak, this would also have a negative effect on economic growth.

In Europe, a solution to the government debt crisis is a priority if a recovery is to be sustained. At the time of writing, both Greece and the Republic of Ireland have sought and received support in the form of an aid package jointly established by the EU and the IMF. If anxiety over government debt issues regains ground, it might not affect only the financial markets, it could undermine consumer and corporate confidence. In the longer term, this could impact negatively on prospects of recovery.

As well as the risks, there is also the possibility that the economy could develop more favourably than expected. Given the fact that many companies have posted

strong profit growth, there is reason to look forward to increased investment, which should in turn lead to higher employment levels.

In Sweden's case, the picture is somewhat different, due largely to robust government finances. The Swedish economy is enjoying strong growth, with both the national accounts and market-confidence indicators pointing towards solid future growth. These indications are also supported by signs of a recovery in the labour market. This trend is expected to be sustained through 2011, although corporate investment and growth in consumer demand must drive the recovery in Sweden too.

# The Swedish pension system – globally recognized

*The Second AP Fund is one of five buffer funds within the Swedish national pension system. During times of favourable economic and demographic development, the Fund shall build up a buffer, to cope with outflows when large cohorts retire. In the coming years, net outflows will rise. This will place increasingly stringent demands on the Fund's liquidity.*

The Swedish pension system is designed so that future pensions are determined by the level of each and everyone's individual income, based on income received over an entire working life. One important component of the new pension system is the automatic balancing mechanism, or 'brake'. This ensures that pensions are adjusted upward more gradually at times when liabilities exceed assets. The design of this pension system is unique and, from a financial perspective, is judged to be robust, since it reflects the development of the economy as a whole rather than pledging a specific pension level. If the economy goes well, with strong growth and a higher proportion of the population in work, pensions and salaries grow at the same rate. If the economy

performs less well, with fewer in work, there is a risk they will decline.

In spite of the fact that many parts of Europe face similar challenges, with high numbers of retirees and relatively speaking fewer numbers in work, few countries have implemented the necessary reforms to their pension systems. Nevertheless, developments in several of the eurozone countries over the past year demonstrate the need for change. For example, nobody believes any longer that Greece can sustain a system that guarantees pensions that exceed 100 percent of the final salary. The problem is how such change should be implemented.

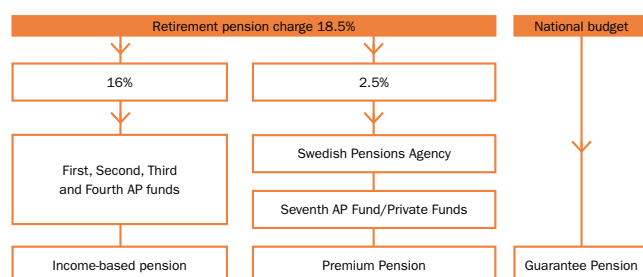
Sweden was quick to reform its national pension system, a system that has attracted considerable international attention.

## The buffer funds' mission

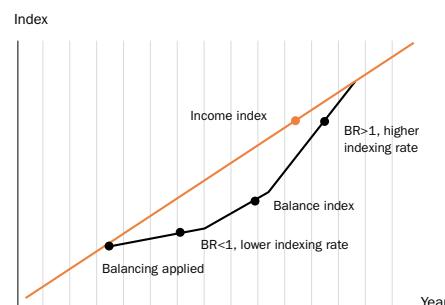
The AP funds are tasked with maximizing long-term return on the pension assets under management, to ensure that the impact of automatic balancing on pensions will be as mild as possible.

The national retirement pension comprises an income-based pension, a premium pension and/or a guarantee pension. Income-based pension contributions are transferred to the system's buffer funds: the First, Second, Third and Fourth AP funds. Each fund receives a quarter of these pension contributions and finances a quarter of pension disbursements. The Sixth AP Fund is also considered a buffer fund, but differs from the others in certain respects, different investment regulations being one. The role of the

### The Swedish pension system



The national retirement pension comprises the following: an income-based pension, a premium pension and/or a guarantee pension. The pension is financed in the form of a levy of 18.5 percent on total income earned. Of this amount, 16 percent is used to finance pension disbursements for the year (income-based pension), while 2.5 percent is invested, to generate interest in an individual premium pension account. There is also a guarantee pension, funded by the State.



The balance ratio (BR) represents the system's assets divided by combined pension liability. If the balance ratio is less than 1, balancing is applied. This means that pension liability and pensions are adjusted upwards only by wage growth multiplied by the balance ratio. This process continues until parity is re-established.

Source: Swedish Social Insurance Administration

buffer funds is to even out extended periods of surplus or deficit within the system.

### Rising disbursements

When the new pension system was introduced in 2001, it received a capital injection of SEK 536 billion, allocated equally between the four large buffer funds. Since then, growth in the funds' assets under management has been mainly attributable to the positive impact of their portfolio management activities, although the fact that pension contributions have exceeded disbursements has also contributed. For many years to come, however, disbursements will exceed contributions, making it highly probable that the buffer funds will shrink over the next 20 years.

In all, the buffer funds account for about 10 percent of total pension assets. The other 90 percent derives from the combined value of contribution assets. These mirror the value of future pension contributions. The size of these contribution assets is determined primarily by levels of employment salary and wage levels, and retirement age.

### Calculating pensions

The size of pension is determined by length

of time worked and level of income. Furthermore, an upward adjustment is made to account for the mean rise in income. However, for pensions to be optimally adjusted upwards, the system must be in balance, with pension assets equal to or in excess of pension liabilities. Contribution assets and the AP funds' combined capital assets shall at least equal accumulated pension liability.

Where liabilities are greater than assets, automatic balancing is applied. This slows the upward adjustment of pensions until parity is re-established within the pension system.

### Back in surplus

Thanks to the strong performance of the AP funds' capital assets, it was not until 2008 that automatic balancing had to be applied for the first time. Once applied, this impacted on pensions in 2010. The reason the brake had to be activated was the sharp decline noted by global stock markets in 2008, as well as the significant upward adjustment of pensions and pension entitlements over the preceding years. To reduce the direct impact of applying the brake, the Swedish Parliament decided that the balancing process should be extended over a period of three years instead of just one, as before.

The brake had to be reapplied in 2009, which will have an impact on pensions in 2011. This time, however, it was the general economic trend that triggered the mechanism. Rising unemployment, leading to reduced contributions, coincided with a high level of new retirees.

During 2010, the growth noted by the buffer funds capital assets helped strengthen the balance in the pension system.

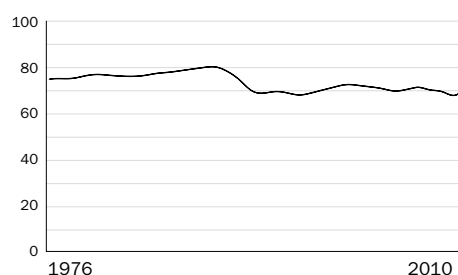
### Liquidity

The buffering role of the AP funds will become increasingly distinct over the next few years. 2009 was the first year in which the funds reported a net outflow of capital. High levels of new retirees over the coming years mean that this net outflow is expected to continue for a considerable time. In practice, this means that the funds' capital assets will shrink.

To address the situation, the AP funds will have to focus still more on liquidity. As well as maximizing their return on invested assets, they must also plan for pension disbursements, as required by the system.

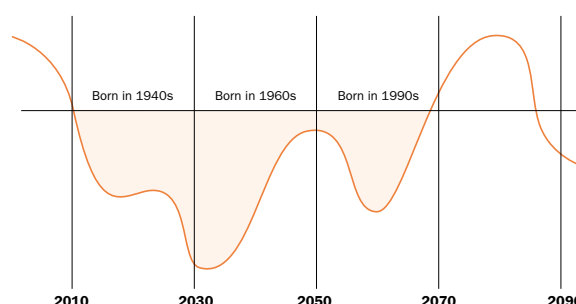
In 2010, the net outflow amounted to SEK 4.0 billion, as compared to SEK 3.9 billion in the preceding year.

Employment trends in Sweden 1976-2010, %



A consistent and high level of employment is essential in maintaining the stability of the Swedish pension system. A lower level of employment in comparison to previous years impacts negatively on the size of pension payments. Employment growth has a more dramatic impact in terms of balancing the national pension system and size of pensions than inflation, real growth and the return on the AP funds' invested assets. Source: Statistics Sweden

Impact of retirement peaks on pension system



When baby-boomers retire, they create a demand for a buffer in the pension system. The system's disbursements are likely to exceed contributions after 2010, when the large post-war generation of baby-boomers retire.

## The Second AP Fund – value generation

*As a buffer fund, the Second AP Fund's long-term mission is to maximize the return on pension assets under management, thereby contributing to parity in the pension system, even when economic and demographic factors are in a state of flux.*

### Long-term objective

In compliance with its mandate, the Second AP Fund defines its long-term objective as the generation of a total real average return of five percent per annum.

### Strategy for value generation

The AP funds' mandate includes the maximization of return while maintaining a low level of risk. The investment strategy shall make provision for the impact of pension disbursements as well as the li-

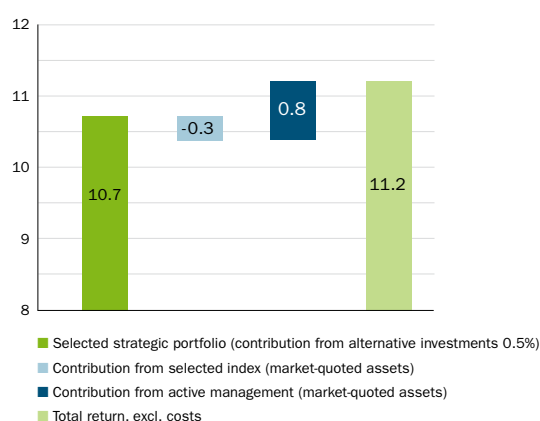
quidity requirement associated with outflows from the funds. The Second AP Fund's strategy is based on a step-by-step approach to value generation: choice of strategic asset allocation, benchmark index and active management.

The Second AP Fund strategic approach is based on a set of principles, or Investment Beliefs. These describe the Fund's view of the basic dynamics of capital markets and the opportunities they present for generating a return on investment.

### Strategic asset allocation

The Second AP Fund's strategic portfolio is determined with the support of an in-house developed Asset Liability Model (ALM), which takes into account long-term developments in the pension system and on financial markets. This ensures that the mix of different asset classes that comprise the strategic portfolio represents those investments the Fund considers offer the best long-term growth prospects for future pensions (more on p. 14).

Second AP Fund value generation, %

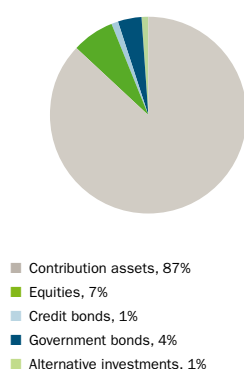


Real and targeted return, 2006-2010 %

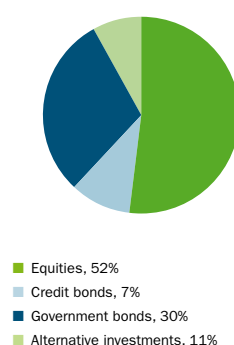


## Asset allocation, Second AP Fund and pension system as a whole

**Asset allocation, Swedish national pension system**  
(% of the Fund's share of pension system assets)



**Second AP Fund's asset allocation in the strategic portfolio** (% of Fund's capital assets)



The chart at right shows the allocation of assets in the Second AP Fund's strategic portfolio. The chart at left shows the allocation of assets for the pension system as a whole, taking into account that the AP funds' answer for just over 10 percent of the Swedish national pension system's combined assets. In other words, about 90 percent of pension system assets are in no way exposed to the financial markets.

Source: Swedish Social Insurance Administration and in-house calculations.

### Benchmark index

The choice of strategic portfolio, i.e. the relative exposure to the equity and fixed-income security markets and other investment areas, primarily contributes to the Fund's value generation and capital growth. The choice of benchmark index is also important to the establishment of value-generating portfolio management.

The Second AP Fund considers the choice of index to be part of the strategic investment process, where the index determines the investments selected for subse-

quent portfolio management, in-house and external. The Second AP Fund complements the broad and more traditional cap-weighted indices with more specialised indices. Over time, a traditional cap-weighted portfolio tends to award a higher weighting to the individual securities with the highest valuation, and a lower weighting to those with the lowest valuation. In the long term, this leads to a return drag (more on p. 15).

### Active management

Finally, active management also contributes

to value generation. The nature of this active management is determined by the Fund's choice of index. Internal and external management shall outperform the indices selected by the Second AP Fund (more on p. 16). Whether working with the strategic portfolio or active management, both are equally dependent on efficient processes. The Fund's strategy combines cost efficiency with operational efficiency. These processes are in turn based on the Fund's pronounced result-oriented culture and ability to attract and develop its staff.

## Continued diversification of strategic portfolio

**The strategic portfolio comprises the specific mix of asset classes that the Fund deems will generate the greatest benefit with respect to the long-term growth of future pensions. Over time, the Second AP Fund believes that approximately 90 percent of the return on invested assets will derive from the composition of the strategic portfolio, the remaining 10 percent coming from active management.**

To determine how the pension system is likely to develop in the long term, and how the Fund's selection of portfolio assets affects its balance, the Second AP Fund employs an Asset Liability Model (ALM). Developed in-house, this model includes assumptions about demographic and general economic development, as well as the long-term prospects concerning the financial markets. The ALM model is an important tool for designing an investment policy that will minimize the expected impact of the automatic balancing mechanism on future pensions.

### Important to accept risk

An important factor governing the composition of the strategic portfolio is the fact that the AP funds jointly account for no more than 10 percent of the national pension system's combined assets. The largest part (90 percent) derives from the 'contribution assets', which can best be compared to index-linked bonds. This means that the AP funds can and should accept a higher degree of risk in their portfolios.

A larger degree of controlled risk is also necessary if the AP funds are to be able to meet their objectives. This, for example, is why the Second AP Fund has invested in equities and credit bonds, which offer potentially higher returns although incurring a higher risk compared to securities such as government bonds.

### Diversification

As the economy becomes more globalized, diversification – i.e. "avoiding putting all your eggs in the same basket" – gains increasing

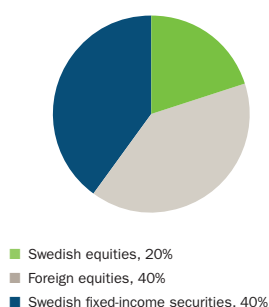
importance. This is because globalization results in a greater degree of covariance among asset classes and, sometimes, between different asset classes. This also increases the risk of broad variations in portfolio value. Over the years, the Second AP Fund's portfolio has become increasingly diversified.

In 2010, the Second AP Fund broadened its portfolio by investing in three funds that invest in forest and agricultural real estate. This asset class is expected to demonstrate relatively little covariance with equities, for example, which helps to diversify risk within the portfolio. Prior to all these investments, a comprehensive analysis has been conducted to determine the position of these funds on sustainability issues.

The survey of the AP funds conducted by McKinsey, commissioned by the Swedish Government, shows that the changes the Second AP Fund introduced in its strategic portfolio have generated an added value of SEK 20 billion during the period July 1, 2001 to December 31, 2009.

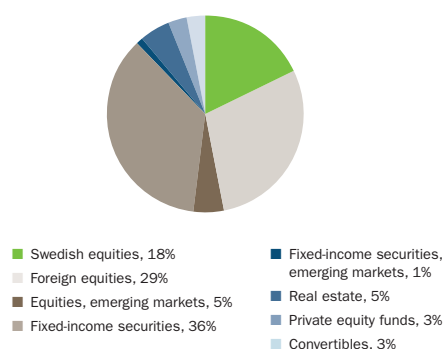
### The Second AP Fund's strategic portfolio

The Fund's first strategic portfolio



The composition of the Fund's first strategic portfolio was relatively simple. The various asset classes were limited to Swedish equities, foreign equities and Swedish fixed-income securities.

Current strategic portfolio, normal weightings



Today's strategic portfolio features much greater spread, with more asset classes and alternative indices. This change exposes the Fund to a greater number of yield sources than previously, adding considerable value.

## Index a vital tool

**The choice of benchmark index is integral to the management process. The index determines the investment choice within an asset class, thereby affecting the return the Second AP Fund is able to generate over the long term.**

In recent years, the Second AP Fund has chosen to use a variety of specialised indices that differ from the more traditional cap-weighted indices. This is because a cap-weighted portfolio tends to award a higher weighting to those individual securities with the highest valuation, which can sometimes be the same as overvaluation, and vice versa.

For this reason, the Second AP Fund therefore bases the composition of its portfolio partly on other methods. Examples of

such alternative weighting methods include the equal weighting of Swedish companies in various size categories, GDP weighting of markets in the global equities portfolio and weighting based on fundamental corporate factors (such as sales, dividend and profits) in the Swedish and global equities portfolio.

Weighting the portfolios using other methods breaks the link between the price of an asset and its allocated weight in the portfolio. This serves to reduce the narrow concentration these portfolios exhibit in certain asset classes and markets, which is expected to lead to better diversification and a higher return in the long term.

The indices chosen form part of the strategic portfolio. The table below lists the benchmark indices for the 2010 strategic portfolio. There have been no major changes compared to the preceding year.

**“When I’m a pensioner, I’ll just sit on the balcony.”**

**Tuva, 6 years old**



### Benchmark index for strategic portfolio 2010

		Index
Equities	Sweden	SBX 'Stockholm Stock Exchange Benchmark Index', RAFI Sverige OSX: 'Unweighted Sweden Index' CSRX: 'Carnegie Small Cap Return Index'
	Foreign equities	MSCI GDP FTSE RAFI Global, MSCI World
	Emerging markets	MSCI Emerging Markets
Fixed-income securities	Swedish nominal fixed-income	SHB Swedish All Bond
	Index-linked bonds	SHB Index Linked
	Global government bonds	Barclays GA Govt 1000, excluding Japan
	Global credit bonds	Barclays GA Cred 1000, excluding Japan
	Government bonds in emerging markets	JP Morgan EMBIGD
Alternative investment	Real Estate	SFIX Svenskt Fastighetsindex
	Private Equity	11% per annum
	Convertibles	7% per annum

## Active asset management generates higher return

**Active asset management is based on the assumption that the market is not fully efficient, with assets that temporarily are incorrectly valued. By identifying these market inefficiencies, an active portfolio manager can increase return compared with exclusively index-governed management. For this reason, the Second AP Fund's portfolio management features active elements.**

The Second AP Fund's conducts active asset management both in-house and via external fund managers.

### In-house asset management

The Second AP Fund manages some asset classes in-house, focusing resources on sectors which it deems offer the greatest potential for success based on market conditions, experience, competence and processes. The Fund manages the following asset classes in-house:

- Swedish equities
- Foreign equities on developed markets
- Swedish bonds
- Foreign government bonds on developed markets
- Tactical allocation.

The active management of Swedish equities is conducted within the framework of two mandates. The larger mandate is focused on a broad equity index and the smaller on the small-cap sector. Swedish and foreign equities, as well as Swedish fixed-income securities, are managed using quantitative strategies, which involve the use of mathematical models to identify market inefficiencies.

### External management

The Second AP Fund employs external fund managers for asset classes and markets with the potential for solid returns, yet where the Fund lacks the requisite in-house resources. In 2010, the Second

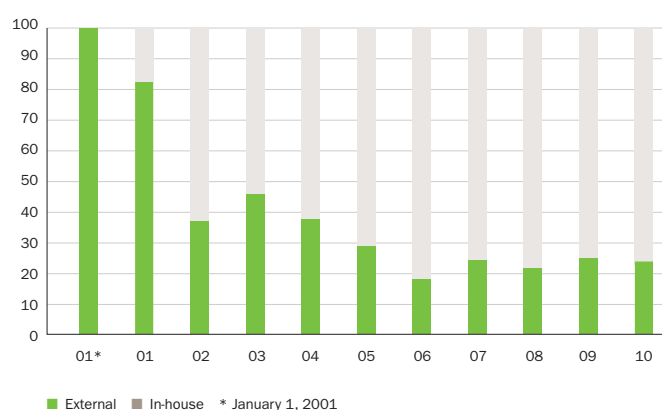
AP Fund employed external managers within the following sectors:

- Global equities
- Swedish small-cap
- Bond funds on emerging markets
- Global credit mandates
- Global TAA mandates
- Foreign equities on emerging markets
- Alternative investments (private equity funds, forest and agricultural real estate funds and convertibles).

The selection and procurement process for external fund managers is based on criteria such as investment style, quality and analytical methods, organization, staffing and historical return on assets under management.

In 2010, assets under active management generated 0.8 percent, corresponding to an active return of SEK 1.4 billion in market worth. The externally managed mandates contributed 56 percent to the positive result, while assets under in-house management contributed 44 percent.

In-house and external asset management, %





## Risk management – part of the job

**The return target set by the Second AP Fund assume an acceptance of controlled risk. The level of risk accepted should be calculated in advance and should subsequently be controlled. The Second AP Fund therefore places a clear emphasis on risk budgeting and risk management with regard to the strategic portfolio and its active management of assets.**

The Second AP Fund's target of a five-percent total real return means that the Fund must be prepared to accept risk in its management of assets. However, this risk must be controlled.

The broad parameters governing the Second AP Fund's exposure to risk are determined by the Swedish Parliament. The

Fund's interpretation of these parameters is detailed in its investment and risk policy, as well as in other regulatory documents.

Risk budgeting is an integral element of the asset management organization. Follow up and control is handled by the Risk Management Department, which forms part of Business Services. This organizational separation of functions ensures the independence essential to efficient control. The Fund's risk management also comprises Compliance, which is responsible for ensuring that the legal and ethical aspects of risk are managed correctly.

The purpose of active risk budgeting is to establish a balance between exposure to active risk and the prospects of higher returns. Given the link between risk and return, it is important to ensure that there

are always opportunities for risk exposure in areas that the Second AP Fund believes offer the greatest potential return. The risk budgeting process establishes return targets and risk limits for those units within the Fund that are responsible for management of the Fund's 50–60 mandates.

Risk Management has overall responsibility for the monitoring and analysis of both financial and operative risks. In conducting its active and preventive risk analyses, the Second AP Fund employs stress tests and risk model evaluation. Market risk is monitored at Fund level, by asset class and mandate. The Risk Management function is also responsible for developing guidelines and risk models, as well as providing support to the Fund's executive management and asset managers.

**“A pensioner is an old bloke who doesn't like giving children sweets at Halloween.”**

**Johan, 6 years old**



# Result and performance 2010

*As of December 31 2010, Fund capital totalled SEK 222.5 billion. All asset classes in the Fund's portfolio contributed to the reported gain of SEK 22.3 billion. Fund capital was negatively affected by the net outflows to the national pension system.*

Fund capital was affected by two factors, the net result for the year and net flows within the pension system. In 2010, Fund capital noted a net gain of SEK 18.2 billion, deriving from the positive result of SEK 22.3 billion, against which negative net outflows of SEK -4.0 bil-

lion from the pension system were charged. Capital flows consisted partly of contribution payments to the system and pension disbursements from it, amounting to a net of SEK -3 784 million, and partly of the cost of administering the national pension system,

which is charged against Fund capital in an amount of SEK -257 million, representing an increase of SEK 26 million compared with the preceding year. For the second year in succession since the pension system was launched, the net of inflows and outflows was negative.

## Fund capital performance 2010, SEK million

Fund capital brought forward	204 290
Pension contributions received	51 267
Pension disbursements	-55 051
Administration contribution	-257
Net result for the year	22 258
Fund capital carried forward	222 507

The Fund capital noted a net gain of SEK 18.2 billion.

## Second AP Fund's absolute return in 2010, %



The return for the total portfolio, excluding expenses, amounted to 11.2 percent in 2010.

## Composition of strategic portfolio, exposure and return as per December 31, 2010

Asset class	Strategic portfolio, %	Exposure, %	Exposed value, billion	Absolute return, %	Relative return, %	Active risk ex post*, %
Swedish equities	18.0	20.2	44.9	27.8	0.8	0.5
Foreign equities	34.0	33.7	75.0	5.2	0.4	0.5
Fixed-income securities, including liquidity and accrued interest	37.0	34.7	77.2	0.5	0.5	0.3
<b>Total quoted assets, excluding alternative investments and costs</b>				<b>10.7</b>	<b>0.8</b>	<b>0.3</b>
Alternative investments	11.0	11.4	25.4	15.1		
<b>Total Fund capital, excluding commission fees and operating expenses</b>	<b>100.0</b>	<b>100.0</b>	<b>222.5</b>	<b>11.2</b>		

\* Historical outcome, 12 months rolling.

## Net result for the year

*The net result of SEK 22.3 billion derived primarily from investment in quoted equities, with Swedish equities once again noting the most robust performance. The Fund's currency hedge also made a significant contribution, a consequence of the strengthening of the Swedish krona during the year.*

### Operating income

Operating income comprises direct return as well as net return per asset class, foreign exchange gains/losses and net commission fees.

Direct return, in the form of net interest income and dividends received, totalled SEK 5 408 million for the year. Net interest income includes income from securities loans in an amount of SEK 20 million.

The net result for quoted equities comprises both unrealized and realized gains/losses, and totalled SEK 15 042 million, including expenses for performance-based fees. The Fund's portfolios of Swedish equities, featuring vigorous market growth of more than 27 percent, in combination with the Fund's holdings in emerging markets which have yielded a return of almost 13 percent, contributed to this solid result.

The net result for unquoted equities, which totalled SEK 2 135 million, is largely attributable to unrealized changes in the value of real estate and private equity funds.

The net result for fixed-income assets totalled SEK 1 262 million, positively affected by the Fund's holdings in credit bonds, convertibles and fixed-income securities exposed to emerging markets.

The Fund's trade in derivatives posted a positive net result of SEK 1 292 million, where investment in derivatives exposed to emerging markets and GDP-weighted share indices had the greatest impact.

Management expenses in the form of

performance-based fees, totalling SEK 189 million for 2010, have been charged against the net result for externally managed assets. This cost arises when an external portfolio manager generates a return over and above the agreed target, having a direct impact on the net result reported for each asset class, as per current accounting principles.

Commission fees pertaining to fixed external management fees of SEK 187 million, as well as custodial fees of SEK 9 million, were charged against operating income.

### Fund expenses

The Fund's total expenses include in-house expenses in the form of operating expenses, fixed external portfolio management expenses and custodial fees. Variable expenses related to performance-based contracts and management fees reported as part of the acquisition value are charged against the net result for each asset class, as described in Note 4 on page 44. The Fund's operating expenses and commission fees, expressed as an expense ratio, amounted to 0.17 (0.18) percent for 2010.

A global cost-efficiency comparison with other pension funds demonstrates that the Second AP Fund is highly cost efficient, which is commented on in greater detail on page 37.

### Operating expenses

Operating expenses totalled SEK 160 (150) million. Reported as a ratio of average

Fund capital over the twelve months, this corresponds to a cost level (expense ratio excluding commission fees) of 0.08 (0.08) percent.

### External management expenses

The degree of active risk adopted and the market selected have a major impact on the cost of managing the Fund's capital. During 2010, an active focus was adopted for the capital assets under external management and, by year-end, SEK 52 billion was being managed under external mandates, including unquoted assets. This corresponds to 23 percent of the Fund's entire capital.

The cost for the external management of market-quoted assets partly comprises a fixed element and, for certain assignments, a performance-based element. In 2010, the fixed cost amounted to SEK 182 million and the variable performance-based element to SEK 189 million. If the management fee for private equity funds is included, the combined fixed cost for external management of the Fund's assets was SEK 187 million.

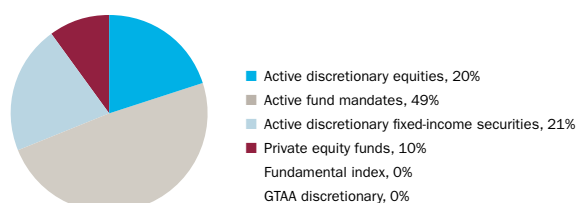
### Securities lending

Like other players in long-term asset management, the Second AP Fund conducts securities lending. These loans primarily involve foreign equities and are made to parties of high credit worthiness that provide collateral equivalent to approximately

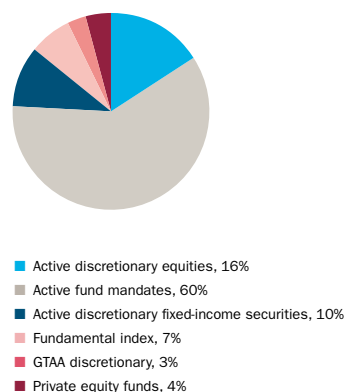
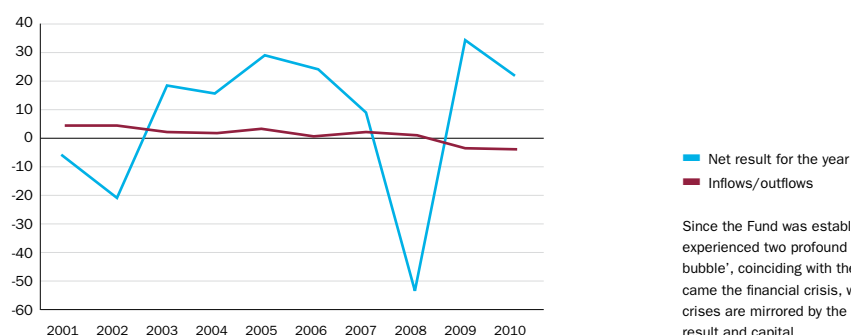
**Externally managed capital by management style**

Total average capital under management, SEK 60 billion

The fundamental index mandate, managed in-house, is based on an external model portfolio. The GTAA mandates have no allocated capital, as their exposure is in the form of derivatives.

**Management fees by management style**

Total management fees, SEK 187 million

**Fund performance and flows, 2001-2010, SEK billion**

Since the Fund was established, the market has experienced two profound crises. First came the 'IT bubble', coinciding with the launch of the Fund, and then came the financial crisis, which peaked in 2008. These crises are mirrored by the sharp swings in the Fund's net result and capital.

105 percent of the market worth of the securities loaned. Both loans and securities management are administered by the Fund's custodial bank. Since autumn 2008, the Fund has reduced the volume of equities loaned, to reduce the risk of incurring losses in underlying securities.

In 2010, revenues from security lendings totalled SEK 20 million. This income contributed positively to the Fund's relative return and is reported as interest income in the income statement.

**Brokerage commission**

Commission (a brokering commission) is paid on the 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 classes, commission is reported as a deductible item under 'Net result for quoted equities and participations', see note 2 on page 44.

Commission fees paid in 2010 totalled

SEK 47 million. Of these costs, 9 percent derived from commission paid to the Fund's external managers, the remainder to the Fund's in-house portfolio management organisation. Costs amounted to 0.05 percent of the total trading volume.

The following five counterparts (listed in alphabetical order) received commissions corresponding to approximately 56 percent of total commission payments: Credit Suisse, Deutsche Bank, Goldman Sachs, Nomura and Svenska Handelsbanken.

## Portfolio return

The return on the total portfolio for 2010, excluding commission fees and operating expenses but including performance-based fees, was 11.2 percent. All asset classes in which the Fund invests contributed to this solid return.

The most significant contribution to the return generated by the quoted asset classes in which the Fund invests came from Swedish equities. This is attributable to the Fund's relatively substantial exposure to the robust growth enjoyed by the Stockholm Stock Exchange over the year. Foreign equities represented the next best-performing asset class. Due to the fact that the Second AP Fund hedges a high proportion of its investments in foreign equities, the strengthening of the Swedish krona in 2010 had no negative

effect on the return generated by these investments.

Investments in Swedish bonds noted a positive but relatively low return, a consequence of low interest rates. The return noted on foreign government securities and credit bonds was higher, attributable in part to the fact that the entire exposure had been hedged.

When market conditions change during the year, the Fund to some extent adjusts its exposure in certain asset classes, a practice known as tactical allocation. These adjustments also contributed favourably to the overall return on investment.

Unquoted asset classes also noted solid growth during the year. Real estate, private equity funds and the portfolio of convertibles all made positive contribu-

tions to the Fund's total return.

The Fund's hedging policy is designed to reduce risk in its portfolio of assets. Due to the strengthening of the Swedish krona during the year, this policy had an overall positive effect on return.

Over the past five years, the Fund has generated a return on investment of 19.9 percent, which translates into an average return of 3.7 percent per annum. Less a deduction for inflation, this corresponds to an annual real return of 2.0 percent. Despite the robust market growth of the past two years, this fails to meet the Fund's targeted real return of 5 percent per annum. This is, of course, primarily attributable to the highly negative impact of the 2008 financial crisis on global stock markets and, consequently, on the Fund's portfolio.

### Risk adjusted return for total portfolio, measured by year

	2010		2009		2008		2007		2006	
	AP2	Strat. portfolio	AP2	Strat. portfolio	AP2	Strat. portfolio	AP2	Strat. portfolio	AP2	Strat. portfolio
Return, %	11.2	9.7	20.6	20.7	-24.0	-22.2	4.2	4.2	13.0	11.8
Standard deviation, %	8.4	8.3	12.0	12.2	19.1	19.2	8.7	8.7	7.4	7.7
Active risk, ex post*, %	0.3	-	0.6	-	1.0	-	0.7	-	0.7	-
Information ratio	2.7	-	1.3	-	neg	-	neg	-	0.3	-
Sharpe ratio	1.1	-	1.9	-	neg	-	neg	-	1.2	-

\* Total market-quoted portfolio, excl. commission fees and operating expenses.

### Contribution to absolute and relative return, %

	Contribution to absolute return, %	Contribution to relative return, %
Swedish equities	5.5	0.2
Foreign equities	2.0	0.1
Fixed-income assets, including liquidity and accrued interest	0.2	0.2
GTAA	0.3	0.3
Overlay	0.1	
FX Hedge	2.6	
<b>Total market-quoted assets excl. alternative investment and implementation effects</b>	<b>10.7</b>	<b>0.8</b>
Implementation effects*		-0.1
<b>Total market-quoted assets excl. alternative investment and incl. implementation effects</b>	<b>10.7</b>	<b>0.8</b>
Alternative investments	0.5	
<b>Total assets, excl. commission fees and operating expenses</b>	<b>11.2</b>	

\* Result effects to maintain exposure to the strategic portfolio.

## Portfolio of quoted assets, 2010

*The portfolio of market-quoted assets comprises Swedish and foreign equities, Swedish and foreign fixed-income securities, tactical allocation and FX management. In 2010, this portfolio generated a total return of SEK 19.4 billion, or 10.7 percent. All asset classes outperformed benchmark indices.*

### Swedish equities

Investments in Swedish equities performed very well during the year. The portfolio generated a return of 27.8 percent and outperformed benchmark index by 0.8 percent. The Fund's fundamental-oriented focused asset management team enjoyed a successful year, outperforming index by 2.2 percent, with limited risk. The Fund's index-related quantitative management of Swedish equities also outperformed benchmark. Its in-house management of small caps is still under development and failed to outperform index. This was to some extent compensated for by the performance of small caps under external mandates, which noted a positive relative return.

### Foreign equities

Foreign equities generated a return of 5.2 percent, including FX hedging. The Fund itself invests in foreign equities, managed according to quantitative strategies. During the second half of the year, an improved model was introduced for risk management, which contributed to an excellent result and a positive relative return for the full twelve months. Global equities under external management noted mixed results, although generally also outperforming benchmark index. Overall relative return on the management of foreign equities was 0.4 percent.

### Swedish and foreign fixed-income securities

Adopting a similar approach as in the management of its Swedish equities, the Fund manages its portfolio of fixed-income securities through active management, based on fundamental as well as quantitative strategies. Both outperformed index. Total return on the management of Swedish fixed-income securities was 2.4 percent, relative return being 0.2 percent.

The Fund conducts in-house management of foreign government securities. These investments are fully hedged. The return in 2010 was -4 percent, 0.9 percent better than benchmark index.

During the year, the Fund adopted a conservative approach to bond investment in those countries most adversely affected by the debt crisis. For the greater part of the year, the Fund has held no investments in Greek or Portuguese government securities, and maintained a low level of exposure in Irish securities. The Fund's portfolio investments in Spanish and Italian bonds have also been significantly underweighted, although this was adjusted during the autumn and the Fund is now positioned as the reference portfolio in these countries. The Fund's underweighting in these markets contributed favourably to the relative return on

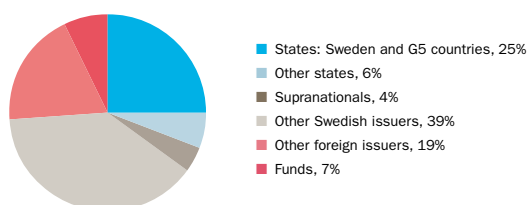
its management of fixed-income securities during the year.

The management of foreign bonds on credit and emerging markets is conducted by external asset managers under mandates issued by the Second AP Fund. The results achieved by the credit bond managers during the year were mixed and, generally speaking, they failed to reach their targeted indices. The managers of fixed-income securities on emerging markets enjoyed a very good year, generating a solid relative return. These mandates generated a joint return of 0.5 percent.

### Tactical allocation and FX management

Throughout the year, the Fund varies its market exposure in the various asset classes that comprise the strategic portfolio, to adjust it to current conditions on the financial markets. This process is handled both in-house and under external mandate. All performed well during the year, jointly contributing SEK 492 million to the Fund's total return.

The Fund's FX management team is responsible for the portfolio's FX exposure, but is also tasked with active management mandates. These generated a result of SEK 42 million.

**Distribution of the Fund's fixed-income portfolio, by issuer group**

**Swedish equities**

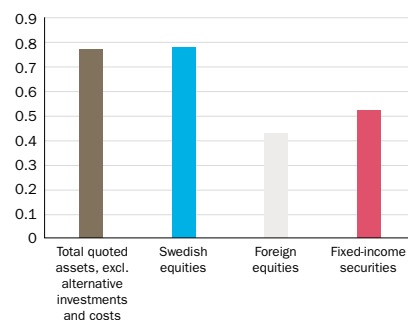
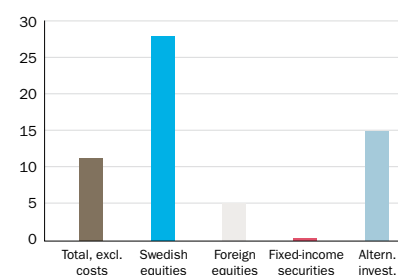
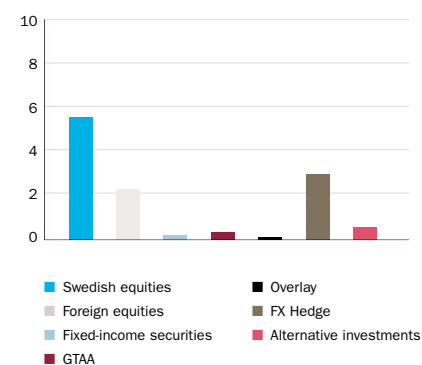
	2010	2009	2008	2007	2006
Exposed value, SEK billion	44.9	37.4	30.8	45.0	43.5
Absolute return, %	27.8	52.8	-42.0	-3.1	29.5
Relative return, %	0.8	1.4	-1.7	-0.5	0.6
SIXRX, %	26.7	52.5	-39.1	-2.6	28.1
Share of ext. management, %	5	7	7	6	10
Active risk ex post, %	0.5	1.1	1.9	1.9	2.9

**Foreign equities**

	2010	2009	2008	2007	2006
Exposed value, SEK billion	75.0	71.1	68.9	89.6	85.7
Absolute return, %	5.2	25.0	-29.5	8.3	16.4
Relative return, %	0.4	-0.2	-1.2	0.3	2.5
MSCI AC World, %	6.6	22.3	-27.1	7.2	13.0
Share of ext. management, %	26	26	28	39	27
Active risk ex post, %	0.5	1.1	2.0	1.7	1.0

**Fixed-income securities**

	2010	2009	2008	2007	2006
Exposed value including liquidity, SEK billion	77.2	74.5	57.3	80.6	77.4
Absolute return, %	0.5	2.5	16.6	2.5	0.8
Relative return, %	0.5	0.7	-1.3	-0.2	0.0
Share of ext. management, %	22	24	20	15	10
Active risk ex post, %	0.3	0.6	0.5	0.2	0.3

**Relative return per asset class 2010, %**

**Absolute return per asset class 2010, %**

**Attribution total portfolio 2010, absolute return, incl. alternative investments, %**


## Alternative investments, 2010

*The Second AP Fund has gathered investments in unquoted real-estate equities and private equity funds, together with convertibles featuring targeted absolute returns, under asset class alternative investments. Investments in forest and agricultural real estate were added in 2010.*

These assets jointly account for 11 percent of total Fund assets under management. Real estate represents the largest share, accounting for 5 percent of total Fund assets. Convertibles and private equity funds account for approximately 3 percent each, while investments in forest and agricultural real estate account for just 0.05 percent. The overall return on alternative investments was 15 percent for the year.

### Private equity funds

The recovery experienced by the private equity market during the second half of 2009 continued in 2010. This increased activity involved the acquisition of portfolio companies as well as preparations for the sale and stock market introduction of companies.

The Second AP Fund's portfolio featured a high degree of investment activity, irrespective of the individual fund's strategy or geographic focus. Furthermore, these funds implemented a number of divestments. Even so, many funds postponed embarking on more comprehensive sales processes, pending more reliable evidence that the positive trend would prove enduring.

During the challenging years of 2008 and 2009, the Fund's portfolio companies were largely successful in balancing substantial declines in volume by reducing costs. In fact, the Second AP Fund's portfolio contains funds whose portfolio companies now have the same or higher combined

operating profits than they did prior to the financial crisis. Some of these funds' portfolio companies have also considerably expanded their workforces, compared to just a few years ago.

During the year, the Second AP Fund made three new investments. All were made in funds with which the Fund already has an established relationship. These new investment commitments, which are an appropriate complement to the Second AP Fund's current investment portfolio, have been made in funds managed by HIG, Sequoia Capital and Riverstone.

As of December 31, 2010, the Fund's total investment commitment was SEK 13.7 billion. Since its inception in 2001, the Fund has made investments of some SEK 8.7 billion (including asset management fees), of which SEK 1.9 billion in 2010. Although the portfolio is still at a relatively early stage of its development, growing numbers of its private equity investments may be considered mature. So far, the Fund has repaid SEK 1.4 billion since its start. The return on private equity funds was 15 percent in 2010, the market worth of the portfolio amounting to SEK 7.2 billion, excluding FX hedge. Fees paid for the management of unquoted assets, where reimbursement is permitted prior to profit sharing and is deemed likely, are reported as part of the acquisition value of such assets. See also the Fund's accounting and valuation principles on page 42.

### Convertibles

Since 2009, the Second AP Fund has invested about three percent of its assets in convertibles. This exposure to convertibles improves the spread of the Fund's overall portfolio and is an investment that generates an absolute return. This asset class is affected by the performance of both equities and credits, but provides good protection when share prices are falling. The Fund's holdings, which feature a generally low-risk profile, are managed actively under four external mandates, operating with different management styles.

The defensive nature of the portfolio and asset class helped to ensure that the decline noted during the early summer was relatively limited. Over the full twelve months, the Fund's holdings in convertibles generated a return of 10.7 percent. A buoyant stock market, falling interest rates and a good credit spread contributed favourably to portfolio growth. The top performers were low credit-rated convertibles.

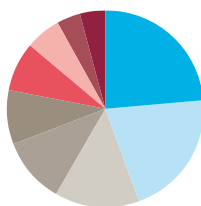
### Real estate

The Fund's unquoted real-estate holdings consist of a 25-percent interest in Vasa-kronan Holding AB and a 50-percent interest in NS Holding AB (Norrporten).

The Second AP Fund's investments in real estate generate a solid long-term direct return on investment and contribute to a satisfactory spread of risk in the total portfolio.



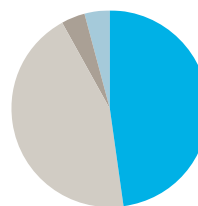
Investments in private equity funds, by sectors, %



Health Care, 24%  
 Consumer Staples, 21%  
 Energy, 14%  
 Industry, 11%  
 IT, 9%  
 Telecom, 8%  
 Finance, 6%  
 Commodities, 4%  
 Power and water etc., 3%

The portfolio of companies held by private equity funds is over-weighted against defensive sectors such as health care.

Investments in private equity funds, by geographical market, %



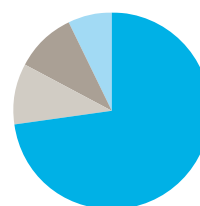
North America, 48%  
 Europe, 44%  
 Asia, 4%  
 Other, 4%

The Second AP Fund's investments in private equity funds feature a good geographic spread.

Unquoted real-estate holdings, December 31 2010, SEK million

<b>Vasakronan Holding AB</b>	
<i>Equities</i>	
Acquisition value	1 221
Valuation	1 828
(of which affecting operating result 2010: 1 077)	
Fair value as per December 31 2010	3 049
Total dividend 2001-2010	1 674
(of which in 2010: -)	
<b>Promissory note loans, incl. accrued interest</b>	
Promissory note loans, incl. accrued interest per December 31 2010	3 955
Total interest income 2001-2010	1 750
(of which in 2010: 366)	
<b>NS Holding AB</b>	
<i>Equities</i>	
Acquisition value	811
Valuation	1 624
(of which affecting operating result in 2010: 161)	
Fair value as per December 31 2010	2 435
<b>Subordinated debenture loans incl. accrued interest</b>	
Subordinated debenture loans incl. accrued interest as per December 31 2010	2 244
Total interest income 2001-2010	1 328
(of which in 2010: 172)	
<b>Andra &amp; Sjötte Fastigheter AB</b>	
<i>Equities</i>	
Acquisition value	2
Fair value as per December 31 2010	1

Original investment commitments, private equity funds, %



Buyout funds, 73%  
 Index-linked funds, 10%  
 Venture capital funds, 10%  
 Sector-specific funds, 7%

The great majority of private equity funds in which the Second AP Fund has invested invest in mature and large companies.

Income and expenses for external management of unquoted assets 2010, SEK million

Gross income	509
Management fees paid and booked	-134*
Management fees paid and reported as commission fees	-5
<b>Net contribution</b>	<b>370</b>
Assets under management, market worth, December 31 2010	7 274
Invested capital, December 31 2010	7 396
Investment commitments, December 31 2010	14 694

\* Taken up as income under the net result for asset class in conjunction with valuation.

**Five year review**

	2010	2009	2008	2007	2006
<b>Fund capital, flows and result, SEK million</b>					
Fund capital	222 507	204 290	173 338	227 512	216 775
Net inflows from National Social Insurance Board/ RFV and Special Management Fund	-4 041	-3 906	884	2 019	1 676
Net result for the year	22 258	34 858	-55 058	8 718	24 506
<b>Return, %</b>					
Return on total portfolio before commission fees and operating expenses	11.2	20.6	-24.0	4.2	13.0
Return on total portfolio after commission fees and operating expenses	11.0	20.3	-24.1	4.0	12.8
Relative return on quoted assets before commission fees and operating expenses	0.8	0.7	-1.8	-0.4	0.2
<b>Risk, %</b>					
Active risk ex post	0.3	0.6	1.0	0.7	0.7
<b>Share of management costs as % of assets under management</b>					
Share of management expenses incl. commission fees, %	0.17	0.18	0.16	0.13	0.15
Share of management expenses excl. commission fees, %	0.08	0.08	0.08	0.06	0.06
FX exposure, %	12	10	12	11	12
External asset management (incl. investments in private equity companies), %	23	24	22	24	17

Vasakronan, which is owned jointly by the First, Second, Third and Fourth AP funds, has a concentrated and attractively located portfolio of real-estate holdings in the Stockholm, Gothenburg, Öresund and Uppsala areas. The company owns and manages more than 220 properties, totalling some 2.8 million square metres of floor space.

The Fund's holding in Vasakronan noted a gain in market value of SEK 1 077 million, as well as interest gains on promissory note loans of SEK 366 million. As of December 31, 2010, the total reported market worth of the Second AP Fund's holding in Vasakronan, including promissory note loans, amounted to SEK 7 004 million.

Norrporten is owned jointly (50/50) by the Second AP Fund and the Sixth AP Fund. The company manages an extensive

portfolio of projects. In 2010, for example, the company initiated the building of the Örebro Legal Centre, at a projected cost of approximately SEK 500 million. Norrporten's market growth is solidly positive. The company owns and manages some 140 properties, totalling approximately 1.1 million square metres of floor space.

In 2010, the Fund's holding has generated a SEK 161 million gain in market value and interest income on debenture loans of SEK 172 million. As of December 31, 2010, the total reported market worth of the Second AP Fund's holding in Norrporten, including debenture loans, amounted to SEK 4 679 million.

The combined return on the Fund's unquoted real-estate holdings in 2010 totalled 17.4 percent.

### Forest and agricultural real estate

During the year, the Second AP Fund made its first investments in forest and agricultural real estate by investing in three funds – an agricultural fund in the USA, a forest fund in the USA and a forest fund in Australia/New Zealand.

The choice of funds has been based on a thorough analysis of both industry and fund manager, with a view to securing a balanced return with limited risk.

Both forest and agricultural real estate are deemed to generate a stable return, given that the underlying trend towards increased urbanization and continued economic progress will increase the demand for forest and agricultural products. Both asset classes are also considered relatively insensitive to economic fluctuations, while covariance with other asset classes, such as equities, is deemed to be low.

## Regard for environment without compromise on high return target

*The AP funds' mission is to maximize long-term return on the pension assets under management, at low risk, to ensure the best possible growth in pensions. The AP funds shall pay no regard to commercial or economic-policy considerations. Attention shall be paid to environmental and ethical considerations, without compromising the overall target of a high return on investment.*

A large part of the Second AP Fund's assets are placed in equities in Swedish and foreign companies, making the Fund a significant shareholder. The active involvement and commitment of a shareholder is essential to a company's long-term development. The Fund therefore adopts an active shareholder role to ensure good corporate governance and thereby contribute to value growth.

The Second AP Fund's shareholder activities involve active participation in Swedish and foreign annual general meetings (AGMs), as well as engagement in dialogue with the boards of directors and executive managements of the Fund's portfolio companies. During 2010, issues on which the Second AP Fund adopted an active stance included remuneration to senior executives and increased diversity in the composition of the boards of publicly quoted companies.

The Second AP Fund's operative involvement in corporate governance issues is based on its nine principles of corporate governance. These principles comprise structural issues, as well as corporate governance, environmental and ethical issues.

### Exercising voting rights at AGMs

In all, the Second AP Fund exercised its voting rights at the AGMs of more than 50 Swedish publicly-quoted companies

in 2010. The number of foreign AGMs at which the Fund exercised its voting rights rose from the preceding year's total of approximately 250 to more than 440 in 2010.

### Remuneration issues

Among other things, the Fund's corporate governance policy notes that responsibility for the formulation of appropriate remuneration systems shall devolve upon the boards of individual companies. These remuneration systems shall promote the sustainable development of these portfolio companies. It is important that each remuneration programme continues to be judged individually. During the year, the Second AP Fund engaged in a number of dialogues with company boards concerning the formulation of incentive schemes, in the hope of achieving improvements. The Second AP Fund voted against board proposals concerning guidelines for remuneration to key executives, as well as a number of proposed incentive schemes, among which that proposed by Lundin Petroleum, since these schemes lacked any performance requirement. The Second AP Fund also voted against proposals relating to remuneration issues at about 40 percent of the foreign AGMs at which it exercised its voting rights.

### Nomination committees

In the run-up to the 2010 AGM season, the Fund was represented on the nomination committees of seven companies: Boliden, Meda, Hexagon, Haldex, Kungsleden, Lundin Petroleum and Opus Prodox. Prior to the 2011 AGM season, the Fund is represented on a single nomination committee: Opus Prodox.

### Board composition

The Second AP Fund stresses the importance of increasing the proportion of women on company boards, and takes this into account when participating in the nomination process. The Fund also believes that each nomination committee should present a concrete plan to ensure the satisfactory composition of its board in terms of gender, age, background, experience and competence. During the spring, the Second AP Fund conducted its annual survey of the percentage of women on the boards and executive managements of Sweden's publicly-quoted companies. The survey showed that the number of women on corporate boards had increased to 22.2 percent, the highest level recorded since the survey was initiated in 2003. However, the proportion of women on executive managements has fallen to 13.8 percent. The Fund is engaged in an

ongoing dialogue with companies concerning the issue of board composition.

### Ethics and the environment

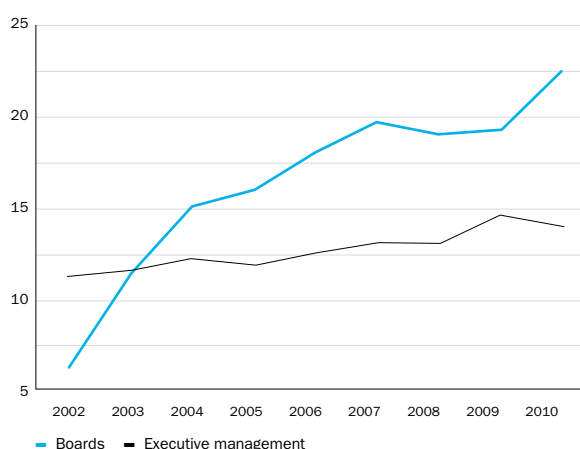
The Ethical Council of the National Swedish Pension Funds was established in 2007 and published its third annual report in the spring of 2010. The Ethical Council focuses on monitoring and analysing the foreign portfolio holdings of the AP funds', to ensure that portfolio companies are not party to the infringement of international conventions to which Sweden is a signatory.

The Ethical Council operates on the assumption that all conventions to which Sweden is a signatory are of equal importance and must therefore be observed. This standpoint is also supported in the resolutions passed and statements made by the various agencies of the UN, which stress the fact that human rights are universal, inalienable, mutually dependent, mutually related and cannot be assigned any order of preference.

The Council has established a process for monitoring all foreign portfolio investments. The AP funds select some 10-15 companies, which are placed on a 'dialogue list', in the hope that they can be persuaded to establish routines to prevent new incidents or infringements of international conventions. As a final resort, the Ethical Council can recommend that a fund exclude the company in question.

See [www.etikradetapfonderna.se](http://www.etikradetapfonderna.se)

Women in executive positions and on boards, %



The percentage of women on the boards of publicly-quoted companies is on the rise and is currently at 22.2 percent, after having been just below 20 percent for some years now. The greatest percentage is found in the major companies, while smaller companies are still dragging their heels. The percentage of women in executive positions has fallen to 13.8 percent, however.

### Göteborg Award

The internationally recognized 'Göteborg Award for Sustainable Development', of which the Second AP Fund is a sponsor, was presented for the eleventh year in succession in autumn 2010. The Award was presented to Ken Sherman, an oceanographer and marine biologist from the USA, and Randall Arauz, who chairs the environmental organization PRETOMA, in Costa Rica. The award-winners are both distinguished individuals who have in their respective ways made major contributions to developing a sustainable relationship with the marine environment. More at [www.goteborgaward.com](http://www.goteborgaward.com)

### Memberships and initiatives

The Second AP Fund is both a member and supporter of numerous Swedish and international initiatives in the areas of sustainability and ethics. The Fund was one of the founding signatories of the UN's Principles for Responsible Investment (PRI). Within the framework of PRI, the Second

AP Fund has participated with a number of private equity companies in a project aimed at jointly developing better principles for addressing ethical and environmental issues in connection with investment in and ownership of portfolio companies. More at [www.unpri.org](http://www.unpri.org)

The Second AP Fund is a member of the Carbon Disclosure Project, an initiative supported by some hundred major investors who demand that the world's largest private equity companies report on their emission of greenhouse gases, as well as other data pertaining to their management of the climate challenge. This data is also to be stored in a joint database.

Other organizations of which the Second AP Fund is a member include the International Corporate Governance Network (ICGN), the Institutional Investors Group on Climate Change (IIGCC), the European Corporate Governance Institute, Swesif and Sweden's SNS Corporate Governance Network.

# Market worth of assets

## Market-quoted assets

Most of the Fund's assets (92 percent) are quoted assets. This means that they are traded on an active market, at rates that represent actual and frequent market transactions. The Fund's quoted assets are appraised and quoted daily. These liquid assets comprise equities, bonds, derivative instruments and foreign exchange.

For so-called OTC derivatives, valuation is based either on theoretical modelling or on a valuation provided by an external party. Where the Fund's holdings in foreign exchange contracts and inter-

est swaps are concerned, the valuation is based on theoretical modelling, where at present the only subjective elements are the interest curves selected and the method used to calculate and estimate future values (interpolation and extrapolation). The same method is employed for deposits and short-term certificates.

In the case of other OTC derivatives, valuations are determined exclusively by external parties, with no subjective input from the Fund.

At the year-end 2010, the Fund's portfolios contained a few outstanding structured OTC derivatives.

During periods when the market lacks the liquidity for quoted securities, an appraisal involves an increased element of subjectivity. Such conditions can lead to dramatic differences in bid and offer rates, which may even vary considerably from one market player to another. In such situations, the Second AP Fund is conservative in its bidding approach.

If an asset is to be deregistered, the market rates quoted by alternative trading posts shall be taken into consideration. In such a situation, each individual security shall be assessed independently.

## Value hierarchy

Fair value is defined as the amount for which an asset may be transferred or a debt settled, between knowledgeable parties who are mutually independent and have a vested interest in completing the transaction. The Fund's holdings

are therefore divided into three different levels and classified, based on the input data used at the time of valuation. The Second AP Fund classifies its assets at fair value, as per the hierarchy shown below.

Fair value hierarchy, SEK million	Level 1	Level 2	Level 3	Total fair value
Equities	108 938	10 918	50	119 906
Bonds	70 826	6 233	0	77 059
Cash/Derivatives	4 180	2 880	0	7 060
Alternative investments	0	0	18 628	18 628
<b>Total assets valued at fair value, via the income statement</b>	<b>183 944</b>	<b>20 031</b>	<b>18 678</b>	<b>222 653*</b>

\* The difference to reported fund capital refers to posts that are unrelated to financial investments, such as interim posts and other assets/liabilities.

Level 1: Quoted rates (unadjusted) on active markets for identical assets or liabilities.

Level 2: Other input data than the quoted rates in Level 1, which for the specific asset or liability is either directly (excl. rates) or indirectly (deduced from rates) observable.

Level 3: Input-data for an asset or a liability that is not based on observable market data (non-observable input-data).

### Alternative investments

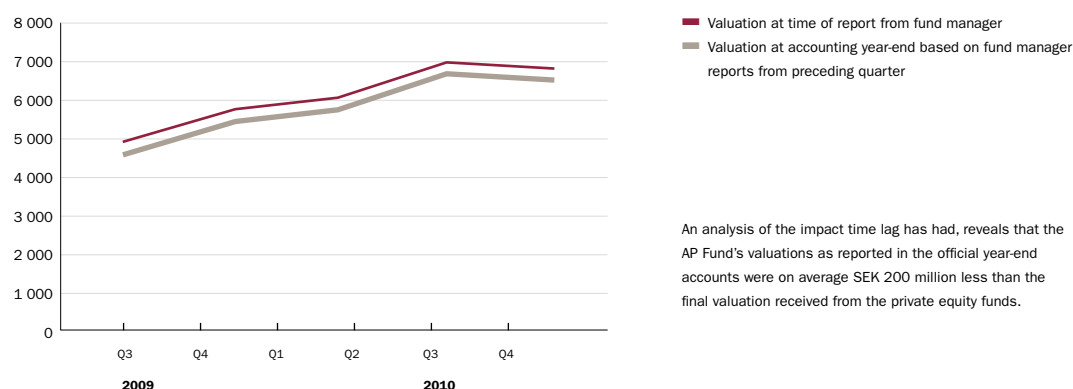
For assets not valued on an active market, a number of different valuation techniques are employed to determine a fair value at the time of valuation. The fair value is deemed as corresponding to the market rate at which a transaction between knowledgeable, mutually independent parties can be executed. In the case of the Second AP Fund, these non-market-quoted assets comprise unquoted real estate (5 percent of the total portfolio), private equity funds (3 percent of the total portfolio) and OTC derivatives.

Private equity funds are valued in compliance with the principles established by IPEV (International Private Equity and Venture Capital Valuation Guidelines) or comparable valuation principles that are common to the entire industry and based on recognized methods. The valuation of holdings is based on the latest interim reports from the respective private equity funds. Interim reports are normally received within 90 days from the close of the quarter. This means that the valuation of the Fund's holdings at year-end 2010 derived from the valuation of the private

equity funds as per September 30, 2010 adjusted for inflows/outflows during the fourth quarter. This valuation method has been applied consistently since the start of the Second AP Fund.

An analysis of the impact this time lag has had since September 2009, reveals that the AP Fund's valuations as reported in the official year-end accounts were more than SEK 200 million less than the final valuations that had been received from the private equity funds.

Validation of valuations within Private Equity, SEK million



# Controlled risk

*A high return is inextricably linked to risk. The Second AP Fund and the other buffer funds are therefore tasked with accepting a certain degree of risk. This risk shall be assessed in advance and subsequently possible to control.*

## Portfolio risk 2010

The Second AP Fund reports low exposure to active risk for the portfolio as a whole in 2010. The portfolios in which the Fund chose exposure to a high degree of risk have generated a solid return. The level of active risk to which the Fund's total portfolio of quoted equities was exposed, measured over 12 months, continued to decline in 2010. At year-end 2010, it totalled 0.3 percent. The greatest decline was noted by asset class foreign equities, which saw a reduction in exposure to risk from 1.1 to 0.5 percent. This is largely attributable to reduced volatility for this asset class.

The information ratio for the entire portfolio of quoted equities reached a historic high of 2.7. This derived from an excellent active return in 2010 and a continuing reduction in active risk.

The Fund's Sharpe ratio remains strong and was 1.1 at the close of 2010, a decline compared to the preceding year. The duration of the fixed-income portfolio was 4.7 years as of December 31, corresponding to a decline of approximately 0.4 years compared with the preceding year.

## Four levels of regulation

The degree of risk the Second AP Fund and the three other large buffer funds may bear is decided by the Swedish Parliament, which determines the parameters governing the funds' exposure to risk. The Second AP Fund's interpretation of these parameters is defined in its Risk Policy, which is determined by the board of directors. The CEO's

document 'Guidelines for Investment' contains still more detailed instructions for the management and monitoring of risks. For individual management mandates, parameters defining acceptable levels of exposure to risk are specified in the form of an 'Investment Guideline'.

The starting point for the Second AP Fund's risk process is the annual ALM study, which is based on a number of assumptions concerning market growth and risk levels.

## Three collaborative risk functions

The Fund's ongoing risk management is conducted by three independent but collaborative functions.

### Risk budgeting

Risk budgeting is conducted within the broader framework of asset management and involves distributing the calculation and allocation of the Fund's total active risk among different management teams. Mathematical models are used to develop risk profiles as decision data for strategic allocations and support for the individual management teams.

### Compliance

Compliance is responsible for ensuring that the legal and ethical risk aspects are managed correctly, in compliance with current rules and regulations. The job includes the establishment of guidelines describing how the various responses are to be implemented, as well as ensuring compliance with all rules and guidelines.

External regulations include legislation and regulations that apply specifically to the AP funds, as well as other regulations affecting the capital market, such as those applied to flagging. In-house codes of conduct address areas such as employees' private securities transactions and ensuring that external fund managers observe the terms of their contracts.

## Risk Management

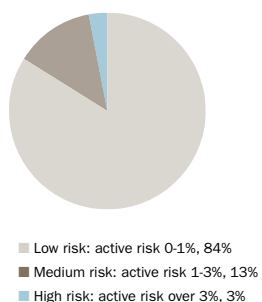
Risk Management is responsible for the monitoring and analysis of the Fund's financial risks. This function is operationally separate from the asset management organization, ensuring complete independence. It is also responsible for developing guidelines and risk models, as well as providing advice and support to the Fund's executive management and portfolio management teams.

The financial risks that fall within Risk Management's remit primarily comprise market risk, credit risk, liquidity risk and operative risk.

### Market risk

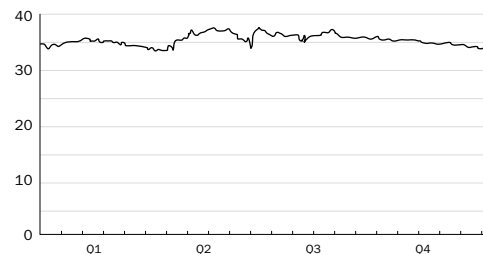
Market risk refers to the risk that fair value or future cash flows from a financial instrument will vary due to changes in market rates. Market risk in the day-to-day asset management process is measured in absolute terms and relative to the benchmark portfolio. The market risks most relevant to the Second AP Fund are share price risk, interest risk and exchange rate risk.

Allocation of active risk, %



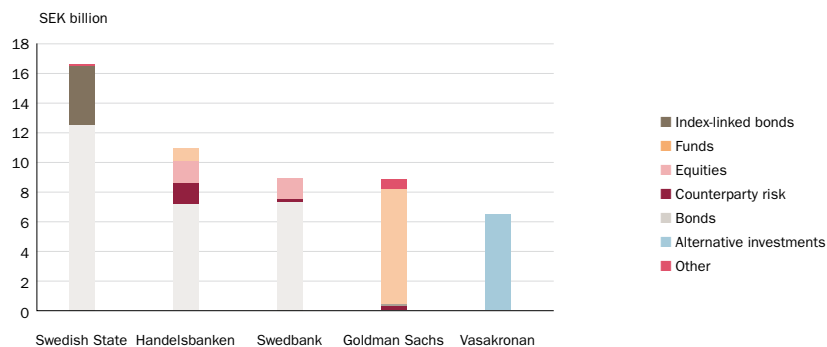
Allocation of Fund's active risk, based on mandates.

Liquidity risk 2010, %



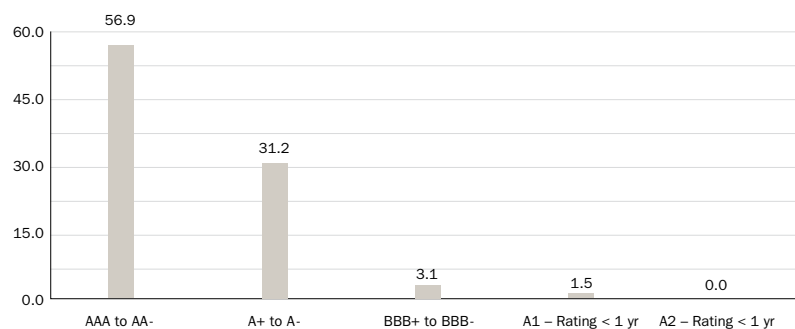
30 percent rule: share of fixed-income securities with low credit and liquidity risk.

Exposure to issuer



Total exposure to the five largest issuer groups.

Credit quality, %



Allocation of Fund's fixed-income assets by rating category.



The Second AP Fund analyses and monitors market risk at fund level, by asset class and per mandate. In this process, the Fund relies on a number of different tools and methods: risk attribution, stress tests and scenario analyses. It also conducts ongoing ad hoc analyses to illuminate the level of risk borne by different parts of the portfolio. Furthermore, the Fund conducts back testing of risk models, as well as the assessment and review of the limit structure.

#### **Credit risk**

Credit risk refers to the risk of loss arising from a creditor's failure to fulfil a credit commitment. In its turn, this credit risk comprises:

- Counterparty risk – the risk that a counterparty in an OTC transaction may become insolvent and unable to fulfil its commitments.
- Issuer risk – the risk that an issuer may become insolvent and unable to fulfil its commitments.
- Liquidation risk – the risk that the counterparty may be unable to fulfil the contract when payment is due.
- Concentration risk – the risk posed when large, important or substantial volumes and/or commitments are concentrated among a limited number of issuers or to a specific sector or geographical area.

Ways in which the Second AP Fund limits credit risk in the fixed-income portfolio include statutory credit checks and exposure limits. The starting point is an agreed interest-rate index for the strategic portfolio. This index is then used to define the parameters determining permitted deviations in terms credit risk limits as per credit rating.

The Fund's counterparty risk is monitored and analysed on a daily basis. Each new counterparty is subject to a credit check, followed by subsequent continual evaluation of all current relationships. The purpose and nature of the specific business relationship is always the starting point for this process.

Issuer risk is not limited to the risk that the issuer may become insolvent. Losses may often arise long before a declaration of bankruptcy. The Second AP Fund limits issuer risk by establishing credit-risk limits, for individual issuers as well as groups of issuers. This is achieved, for example, by limiting the total credit risk posed by issuers with different credit ratings.

The liquidation risk is minimized by automatically checking the purchase and sale of equities and bonds with reference to the broker/counterparty. Special attention is paid to possible deviations, which can quickly be corrected. Payment and execution of the transaction is executed simultaneously.

The Second AP Fund manages concentration risk by analyzing relative distribution, in terms both of geographical region and industry, as well as the distribution between issuers/issuer groups. The most influential factor in managing concentration risk is the choice of benchmark index.

#### **Liquidity risk**

Liquidity risk refers to the risk that securities cannot be converted into cash at the appointed time without incurring a substantial loss or considerable cost. The AP funds must also be prepared to transfer funds to the Swedish Social Insurance Administration.

The Fund's liquidity risk is limited in compliance with the Swedish National Pension Funds' Act, according to which no less than 30 percent of the Fund's assets shall be placed in rights to claim at low credit and liquidity risk, and that a maximum of five percent of the Fund's total assets may be invested in private equity funds.

#### **Operative risk**

Operative risk refers to the risk of losses arising from inappropriate or unsuccessful in-house processes, human error, incorrect systems or external events. The Second AP Fund identifies operative risks using a variety of analytical methods and tools – includ-

ing self-assessment, process analysis, risk indicators and workshops.

The assessment of identified operative risks is then based on determining the likelihood of their happening and the potential consequences. Based on this analysis, the risks are allocated priorities and an action plan is drafted.

#### **Analytical principles**

Risk measured as Value at Risk (VaR) for the Second AP Fund's total portfolio of quoted assets amounted to SEK 1 954 million at year-end, calculated at a confidence level of 95 percent over a day. Equities pose the greatest potential risk, but the Fund's portfolio of quoted assets is well diversified.

One way credit risk in the Fund's fixed-income portfolio can be illuminated is through the allocation of holdings by rating category. As shown in the table below, 88 percent of the Fund's fixed-income holdings are rated from AAA to A- by S & P (Standard & Poor's).

One factor limiting the liquidity risk is the 30-percent rule (external investment regulations for AP1 to AP4, which state that at least 30 percent of the funds' total assets must be invested in securities with a low credit and liquidity risk). During 2010, the Fund's share has been around 35 percent. The Fund's fixed-income portfolio features a duration of 4.7 years. The duration spread among different mandates was between 3.6 and 7.9 years, as of December 31, 2010.

**Risk measured as Value at Risk (VaR) for AP2's total portfolio of quoted assets, 2010**

SEK million	VaR (95%, 1 day)
Equity risk	2 192
Exchange risk	210
Interest risk	198
Diversification	-646
Total AP2	1 954

The Value at Risk (VaR) measure means that there is a 95 percent likelihood that the Second AP Fund will incur a loss of no more than SEK 2 billion in a single day in absolute terms.

## FX exposure and derivative instruments

### FX exposure

The Second AP Fund's exposure in foreign exchange (FX) is a risk factor that can have an impact on the worth of all asset classes traded in currencies other than the Swedish krona.

The degree of total FX exposure is low, which was beneficial in 2010.

Totalling 10 percent at the start of 2010, the Fund's FX exposure was gradually increased over the rest of the year. The euro hedge also increased during the year.

By year-end, 12 percent of the Fund's portfolio was exposed in foreign currency. The largest part was the Fund's exposure in USD and euros. The low FX exposure has been favourable, due to strengthening of the Swedish krona against the major currencies.

The Fund reported a negative result on FX transactions for its total portfolio (including currency hedge), amounting to a foreign-exchange loss of SEK -2 525 million. Combined FX losses, including interest gains/losses on FX contracts, totalled SEK -2 411 million.

### Use of derivative instruments

Derivative instruments are the primary means of hedging the Fund's portfolios.

They also contribute to more efficient asset management, create added value and reduce risk. The employment of derivative instruments is governed according to the Fund's business plan. Restrictions include the injunction that call options and forward contracts may only be issued if adequate collateral is available in the form of holdings in underlying assets.

During 2010, derivative instruments have principally been utilized in the following areas:

- Foreign exchange derivatives – forward contracts and options – for managing the Fund's FX exposure.
- Equity derivatives – mainly standardized equity-index forward contracts – for efficient rebalancing of the portfolio and when adopting positions in tactical asset allocation.
- Interest derivatives – mostly standardized interest forwards and interest-rate swaps – for rebalancing, tactical asset allocation and managing the Fund's interest risk. Limited utilization of interest options to position the Fund in respect of interest risk.
- Structured derivatives – not strictly

exposed to a single asset class – such as dividend forwards. These derivatives are utilized to generate relative return.

- The adopting of positions within the framework of the Fund's GTAA mandates is handled with the help of derivatives. These mandates are able to act freely with the help of short and long positions in the permitted asset classes. This said, these mandates are not allowed a net long position.

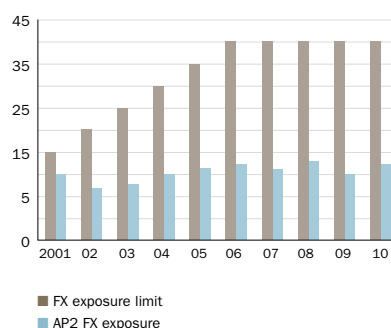
Exposure in derivative instruments is subject to ongoing monitoring and analysis. Equity and interest derivatives are traded mainly on standardized markets in cleared products, which is why counterparty risks are limited to the clearing institute. Trading in currency and credit market derivative instruments is not standardized. Consequently, both counterparty and delivery risks exist with respect to the Fund's counterparties. The CEO approves and determines limits for those counterparties the Fund utilizes for non-standardized products and the exposure is subject to ongoing monitoring. For OTC trading, the Fund requires standardized contracts, such as ISDA contracts.

FX exposure, equivalent in SEK million

December 31, 2010	USD	GBP	EUR	JPY	CHF	Other	Total
Equities and participations	36 664	4 923	18 505	5 695	2 005	5 364	<b>73 156</b>
Bonds and other fixed-income securities	21 573	1 876	11 030	0	0	1 415	<b>35 894</b>
Other assets and liabilities, net	956	239	1 234	86	183	473	<b>3 171</b>
Derivative instruments, excl. FX derivatives	8 015	4	-2 255	3	-1	-11	<b>5 755</b>
FX derivatives	-49 580	-5 741	-22 080	-6 888	-828	-6 911	<b>-92 028</b>
<b>FX exposure, net</b>	<b>17 628</b>	<b>1 301</b>	<b>6 434</b>	<b>-1 104</b>	<b>1 359</b>	<b>330</b>	<b>25 948</b>

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

Statutory exposure limit, compared with the Second AP Fund's FX exposure, 2001-2010, %



## Competence-driven organization

*The Second AP Fund's ability to attract new staff, to retain them and to contribute to their development is a prerequisite for achieving the established long-term goals. The Fund strives to offer an innovative and stimulating work environment, where employees enjoy a high degree of individual responsibility and personal involvement.*

The Second AP Fund strives consistently to offer its staff opportunities for personal development, to recruit the right people and develop the leadership qualities. In an organization that comprises a large number of employees with highly specific abilities, it is important to cater for individual skills requirements and development potential, while simultaneously promoting the development of teamwork. Members of staff are offered ongoing skills development within their individual fields of competence.

The Second AP Fund's corporate culture shall be defined by personal responsibility and individuality within the broader framework of a vigorous team spirit. Operations rely on teamwork, based on joint goals. This said, there is also considerable room for individuality and personal responsibility.

### Organization

The Second AP Fund is a knowledge-based organization, where the specialist competencies, skill and commitment of its staff are decisive to a successful result. 27 employees work in Asset Management, mostly as portfolio managers or analysts. The strategy adopted by the Asset Management organization is based on focus, simplicity and flexibility. 77 percent of capital assets are managed in-house, the remaining percentage being handled by external fund managers. In compliance with the AP funds' investment regulations, at

least ten percent of the Fund's capital assets shall be managed externally. Assets may also be placed under external management if the Fund determines it lacks the requisite in-house resources.

Business Services totals a staff of 16, comprising functions such as Business Control, Financial Control, Performance Analysis, IT and Risk Management. Additional functions are General Counsel, HR, Communications and Corporate Governance, as well as other executive functions.

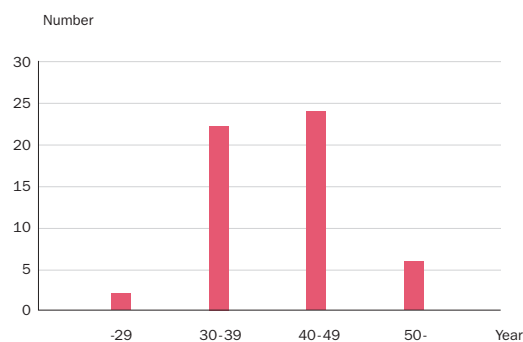
### Leadership training a competitive tool

Good leadership is a key competitive tool

in promoting the development and motivation of members of staff. The Second AP Fund embraces a leadership strategy that defines the skills, attitudes and responsibilities that managers within the organization are expected to possess. This leadership strategy is assessed annually, involving the identification and measurement of four roles. This assessment then provides the basis for the drafting of an individual development plan for each manager.

In 2010, the Fund conducted its first staff survey ever. The purpose of the survey was to acquire a comprehensive impression of staff views on the way the

Age distribution



**“When I’m a pensioner, I’ll go to the library and do some cooking, because it’s such fun.”**

**Olivia, 6 years old**



Fund functions, thereby gaining a better understanding of areas for improvement. Based on the results of the survey, targets have been established for improvements both in the Fund as a whole as well as in individual departments.

#### **Recruitment**

The Second AP Fund strives first and foremost to recruit from within the organization and to encourage internal mobility. In this way, specialist skills and expertise can better be utilized. For a number of years, the Fund has cooperated with the School of Business, Economics and Law at the University of Gothenburg, enabling it to offer students practical subjects for their graduate theses, opportunities of temporary employment on specific projects, trainee positions and temporary employment during summer vacations. This has served to establish a recruitment base for future employees, who in the long-term can grow into new roles.

At year-end 2010, the Fund had 54 full-time employees, 41 percent of whom were women. Women also accounted for half the Fund’s executive management. The average age was 41 years and the median age was 40 years. There was limited turnover in personnel during the year, with three leaving and five new staff being recruited.

#### **Staff opportunities**

Exercise and good health are a crucial aspect of the Fund’s corporate culture, and all employees are therefore offered a fitness-activity subsidy and regular medical check-ups. Absence due to illness was extremely low during the year, at a mere 0.68 percent.

The Second AP Fund enables men and women to combine work with family responsibilities by offering flexible working hours and working under one’s own responsibility. The Fund also encourages employees to utilize their entitlement to parental leave. In 2010, three men and six women took parental leave at different times during the year.

#### **Remuneration issues**

Competitive levels of remuneration are an important aspect of the ability to attract, motivate and retain staff. In 2010, the Second AP Fund’s incentive programme comprised all members of staff, apart from the CEO, the other members of the Fund’s executive management and the head of Risk Management. This programme means that all other employees are potentially entitled to a maximum in variable remuneration equivalent to two months’ salary. The programme is linked partly to the result for the current year, and partly to long-term targets. This system is presented on our website at [www.ap2.se](http://www.ap2.se)

#### **In-house environmental programme**

The Fund works in a number of ways to highlight and minimize the environmental impact of its own activities. The introduction of an in-house environmental management system therefore seemed entirely logical. Based on the Gothenburg City environmental certification programme, the Fund gained certification in January 2009 and was recertified during the year. The system applies the same fundamental concepts as implemented by the major ISO 14001 and EMAS standards systems, but is better suited to smaller organizations.

The in-house environmental audit shows that the greatest environmental impact caused by the Second AP Fund’s own business activities derives from the consumption of electrical energy (lighting, office equipment and white goods), from computer-and-screen related manufacturing and waste issues, from carbon dioxide emissions in conjunction with travel and from the consumption of natural resources in the form of paper for printouts and copying. In-house goals have been established with the introduction of an updated environmental policy. The Fund’s in-house environmental programme is managed by a specially appointed environmental group, and environmental training is ongoing for all members of staff.

## Efficiency involves more than costs

*The Fund must constantly ask itself how it can generate the most value from each investment. What distinguishes successful from less successful organizations is the ability to combine fundamental long-term strategy with day-to-day operations.*

### Our long-term mission

The Second AP Fund is tasked with a long-term mission, which defines all Fund strategies, including its efficiency strategy. The strategic decision made at the Fund's inception, which involved inclusion of a high degree of transparency and uncompromising flexibility, has resulted in three key principles that govern our ongoing progress:

- Every invested resource shall generate the highest possible return.
- It shall be possible to measure efficiency objectively, using key ratios and external benchmark groups.
- It shall be possible to adopt both long-term and short-term perspectives in assessing efficiency.

The Fund's operational approach to improving efficiency has involved the definition of focus areas on a yearly basis.

### Learning cost efficiency from the best – CEM

Since 2004, Fund operations and management costs have been compared with a universe of internationally-active pension funds. These analyses have been conducted in collaboration with Cost Effectiveness Measurement Inc. (CEM), a globally active benchmarking firm. CEM provides an objective picture of the situation and ana-

lyzes the cost of the Fund's combined asset management activities, taking into account the size of the assets under management, their allocation per asset class and the degree of active management involved.

The CEM analysis concludes that, since 2006, the Second AP Fund's costs have been below the average achieved by comparable global pension funds and that, as a result of the Fund's choice of strategic portfolio, the total return on investment has been highly competitive over the years.

### TCA highlights visible and invisible costs

All forms of asset management involve both direct and indirect transaction costs. Direct costs comprise brokerage commissions, clearing costs and any taxes due. Indirect costs, such as market impact, offer a means of measuring and determining trading efficiency. The Fund monitors these types of cost on an ongoing basis, conducting so-called Trade Cost Analyses (TCAs), which focus on large transactions.

For several years now, the Fund has compared its transaction costs with other large global fund managers, as a means of measuring its own efficiency, as well as a way of learning from the best in the business. Measurements have also been conducted by external parties, to ensure the objectivity of these analyses.

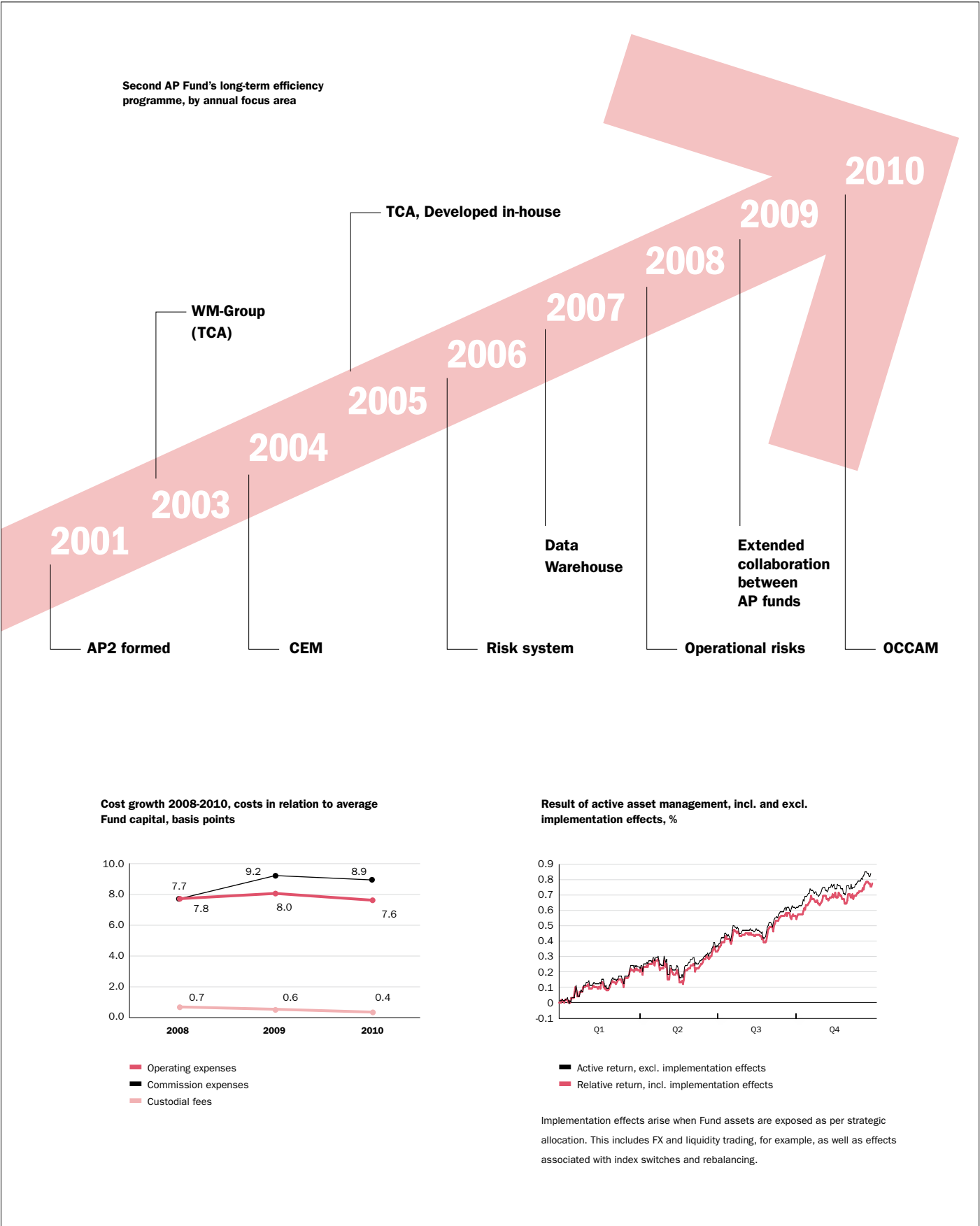
### Data Warehouse creates efficient decision data

To meet flexibility and efficiency requirements, the Fund has over a number of years developed and built a so-called Data Warehouse. The Data Warehouse functions as an umbrella for all underlying systems, providing both quality assurance and enabling integration of information from different systems and data sources. The majority of analytical and report-generation processes are handled by the Data Warehouse, making it a key element of the Fund's decision support system.

### How to establish reliability and confidence

All business activities involve various types of operational risk: asset management is no exception. When the Fund was first established, a number of strategic choices were made. These included the decision to maintain a high degree of control and precision in analyzing the Fund's processes, both to minimize unnecessary labour and to reduce the operational risks. The implementation of processes featuring a minimal manual element releases time and energy for what is essential – the creation of value.

The Second AP Fund has developed its own toolbox to identify, assess and eliminate actual or potential operational risks. Any risks identified as a result of



this process are addressed within the framework of the Fund's annual business planning process. The result of this process is then submitted in a report to the Fund's auditors and board of directors.

### **Fund's cost development over time**

The Fund's costs partly comprise in-house operating expenses and partly commission fees, including external asset management and custodial fees. The size and growth of commission fees is largely attributable to the portfolio's market worth and Fund strategy concerning the volume of assets under external management and the degree to which they are actively managed.

The Second AP Fund is engaged in a staff-intensive business activity, which means that the majority of in-house operating expenses derive from staff costs. The other significant expense item is IT which, as well as computer hardware and software, involves expenses intimately connected with the asset management process, such as index expenses, information systems and stock market fees. The trend of overall costs since 2008 is illustrated by the graph on the preceding page and demonstrates that the Fund has succeeded in increasing the efficiency of its in-house operations, despite a rise in the share of assets under in-house management, as well as implementing a range of projects and investments.

### **Implementation effects and rebalancing**

The fact that the credit market is occasionally subject to a high degree of volatility places special demands on flexibility, to enable adjustments in mandate and invest-

ment focus. Fund assets shall be exposed to the markets in an efficient manner, as per the strategic portfolio, and shall be re-balanced during major fluctuations in the market. Given the fact that asset classes constantly interact in a manner that can seldom be forecast, this requires a well developed approach and competence.

The costs and revenues attributable to the exposure and rebalancing of the strategic portfolio are referred to as implementation effects. These effects can derive from forward positions, the management of foreign exchange and weight deviations between indices. One way of measuring the efficiency and flexibility of the organization and its processes is to study the implementation effects with the clearly defined ambition of minimizing their negative effect on the portfolio's return.

During 2010, these implementation effects have been charged against relative return in an amount of 0.07 percent.

### **Continued collaboration between AP funds**

In creating a Swedish pension system that featured four equally large buffer funds, one of the basic intentions was to promote a better spread of risk and to stimulate beneficial competition between the funds. There was also some concern that a joint fund, by virtue of its sheer size, might have a negative impact on the way the Swedish capital market operates.

This said, the four large buffer funds have collaborated closely from the start in areas where this has been considered beneficial to the growth of the nation's pension assets. Areas in which the AP funds collaborate include:

- Environmental and ethical issues, via the joint Ethical Council
- Tax issues, accounting and valuation issues
- Joint legal issues
- A joint voting platform.

The funds also benefit from the ongoing exchange of know-how and expertise mainly between their administrative functions.

In 2010, the AP funds conducted a number of joint studies concerning the potential for closer collaboration on specific areas as well as the possibility of merging the four funds' administrative organizations. These studies concluded that some potential for collaboration did exist, mainly in custodial banking services and portfolio management systems. However, it was also felt that more extensive collaboration or a merger would involve excessive establishment costs, as well as incurring major operational risks.

With a view to intensifying current collaboration, the AP funds therefore decided during the year to establish a special forum for collaboration, to reduce costs within the framework of the present organizations through increased transparency and a coordination of joint interests. This collaboration will nevertheless be constructed so as not to restrict competition between the funds. Currently, the main areas of collaboration are:

- Custodial banking relations
- IT strategy issues
- Outsourcing
- Portfolio systems
- Systems support for unquoted assets and document management systems.

## Income statement

Amounts in SEK million	Note	January-December 2010	January-December 2009
<b>Operating income</b>			
Net interest income	1	2 973	2 491
Dividends received		2 435	2 526
Net result, quoted equities and participations	2	15 042	27 288
Net result, unquoted equities and participations	3	2 135	-803
Net result, fixed-income assets		1 262	2 022
Net result, derivative instruments		1 292	3 322
Net result, exchange gain/loss		-2 525	-1 656
Commission expenses, net	4	-196	-182
<b>Total operating income</b>		<b>22 418</b>	<b>35 008</b>
<b>Operating expenses</b>			
Personnel expenses	5	-93	-87
Other administration expenses	6	-67	-63
<b>Total operating expenses</b>		<b>-160</b>	<b>-150</b>
<b>NET RESULT FOR THE YEAR</b>		<b>22 258</b>	<b>34 858</b>



# Balance sheet

Amounts in SEK million	Note	December 31, 2010	December 31, 2009
<b>ASSETS</b>			
Equities and participations			
Quoted	7	111 066	101 615
Unquoted	8	12 759	9 651
Bonds and other fixed-income assets	9	85 589	81 600
Derivative instruments	10	9 707	9 709
Cash and bank balances		2 599	2 400
Other assets	11	28	12
Prepaid expenses and accrued income	12	1 845	1 825
<b>TOTAL ASSETS</b>		<b>223 593</b>	<b>206 812</b>
<b>FUND CAPITAL AND LIABILITIES</b>			
<b>Liabilities</b>			
Derivative instruments	10	912	2 354
Other liabilities	13	92	52
Deferred income and accrued expenses	14	82	116
<b>Total liabilities</b>		<b>1 086</b>	<b>2 522</b>
<b>Fund capital</b>			
	15		
Fund capital at beginning of year		204 290	173 338
Net payments to the national pension system		-4 041	-3 906
Net profit for the year		22 258	34 858
<b>Total fund capital</b>		<b>222 507</b>	<b>204 290</b>
<b>TOTAL FUND CAPITAL AND LIABILITIES</b>		<b>223 593</b>	<b>206 812</b>
<b>Pledged assets, contingent liabilities and commitments</b>			
	16		
Other assets pledged and comparable securities		1 710	1 984
Investment commitments		7 028	8 130

# 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, on the understanding that the assets in which the Fund's capital is invested shall be booked at market value. On this basis, the First, Second, Third and Fourth AP funds have drafted and implemented joint accounting and valuation principles, as applied and summarized below. The accounting and valuation principles are unchanged from the preceding year.

The AP funds' accounting and valuation principles are being gradually adjusted to comply with the international IFRS accounting standard. Since the IFRS standard is currently undergoing extensive revision, this adjustment process has focused on the IFRS 7 information requirement during the year. Full compliance with the IFRS standard would not essentially affect the reported net result and capital assets. Compared with the current IFRS standard, the following significant differences have been identified.

When appraising the value of financial instruments, the AP funds base their appraisal on the market quotation per selected index (often mid-rate), as opposed to the bid and offer rate. Transaction costs, like brokerage commissions, are reported in the income statement under the net result per asset class. The cost of the brokerage commission is specified in a note.

The valuation of unquoted equities and participations is based on the fund administrator's appraisal. In view of the fact that this appraisal may involve a time-lag of one to three months, the funds make provision for anticipated cash flows during this period. The relevant sensitivity analy-

ses may be found in the annual report.

No consolidated financial statements are drawn up.

## Transaction-date accounting

Transactions in securities and derivative instruments 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'. Other transactions, especially transactions involving unquoted equities, are reported in the balance sheet as per settlement day, in line with generally accepted market practice.

## Net accounting

Net accounting is applied to the Fund's liquid assets, buy-backs and derivative instruments, where there is a real right of set-off for assets and liabilities, and where the intention is simultaneous liquidation.

## Foreign exchange (FX)

Transactions in foreign exchange are booked at the rate applied on the transaction date. 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, and that part attributable to the change in the exchange rate.

## Holdings in subsidiaries/ associated companies

In compliance with the Swedish National Pension Funds Act, equities in subsidi-

aries/associated companies are recorded at their fair value. There is no requirement to draw up consolidated financial statements.

## Valuation of financial instruments

All Fund investments are calculated at their fair value, whereby realized and unrealized changes in value are reported in the income statement. In cases where reference below is made to the selected index supplier, refer to the section entitled "Index a vital tool" in the annual report for information about current indices. For a description of how fair value is determined for the Fund's numerous investments, see below.

## Quoted equities and participations

Equities and participations traded on a regulated market or trading platform, are calculated at fair value. Fair value is based on the official market rate applied on the balance-sheet date, according to the Fund's selected index supplier, often mid-rate.

Holdings not included in the index are valued at the quoted rates observable in an active market. Commissions paid are taken up as income under 'Net result, quoted equities'.

## Unquoted equities and participations

Equities and participations not traded on a regulated market or trading platform are calculated at fair value, based on the valuation made by the counterparty or other external party. This valuation is updated once the new valuation has been received and adjusted for eventual cash flows up to the end of the accounting period. In cases where the Fund has good reason to believe that the value is incorrect, the received value may be adjusted. This valuation shall follow IPEV (International Private Equity

and Venture Capital Valuation) guidelines or similar valuation principles, first and foremost being based on transactions with third parties, although other valuation techniques may also be employed.

#### **Bonds and other fixed-income securities**

Bonds and other fixed-income assets are calculated at their fair value. Fair value is based on the official market rate (usually the bid rate) applied on the balance-sheet date, according to the Fund's selected index supplier. Holdings not included in the index are valued at the quoted rates observable in an active market. In cases where such instruments are not traded on an active market, and where no reliable quoted market rates are available, the instrument shall be valued with the support of generally accepted valuation models, whereby cash flows are discounted according to an appropriate valuation scale.

Net capital gains/losses derive from the difference between the average accrued acquisition value and the market/fair 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. These premiums or discounts are reported as interest income.

#### **Derivative instruments**

Derivative instruments are calculated at their fair value, based on their quoted rates at year-end. In cases where such instruments are not traded on an active market, and where no reliable quoted market rates are available, the instrument shall be valued with the support of generally

accepted valuation models, where input data consists exclusively of observable market data.

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.

#### **Buy-backs**

In a true buy-back transaction, also known as a repurchase agreement, the asset sold 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.

#### **Securities lending**

Securities on loan are reported in the balance sheet at their fair value. Collateral received for securities lent consists of securities and cash. In cases where the Second AP Fund has rights of disposal over the cash received as collateral, this is reported in the balance sheet as an asset and a corresponding liability. The value of securities on loan, together with collateral for these, is entered under 'Pledged assets, contingent liabilities and commitments'. Premiums received are reported as interest income.

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

Contributions to and disbursements from the pension system are entered directly against Fund capital.

#### **Commission expenses**

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, as well as fixed fees for market-quoted funds. The performance-based fee, which is paid out if the portfolio manager attains a return on investment in excess of the agreed level, where profit-sharing is applied, is reported as a deductible item under net result per asset class in the income statement.

Fees paid for the external management of unquoted assets and participations, where reimbursement is permitted prior to profit sharing and is deemed likely, are included in the unrealized result. In other cases, they are reported as commission expenses.

#### **Operating expenses**

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

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

#### **Income tax**

The AP Funds are exempt from all income tax on investments in Sweden.

The tax some countries levy on dividends, as well as withholding tax, is net accounted in the income statement under respective income classes.

Because it is not considered a commercial operation, the Second AP Fund is exempt from VAT, and therefore not entitled to recover invoiced VAT. VAT paid and for which provision has been made in the accounts is reported together with the respective cost item.

# Notes to the income statement and balance sheet

## NOTE 1 Net interest income/expense

Amounts in SEK million	January-December 2010	January-December 2009
<b>Interest income</b>		
Bonds and other fixed-income assets	2 843	2 774
Derivative instruments	529	888
Other interest income	44	103
<b>Total interest income</b>	<b>3 416</b>	<b>3 765</b>
<b>Interest expenses</b>		
Derivative instruments	-415	-1 233
Other interest expenses	-28	-41
<b>Total interest expenses</b>	<b>-443</b>	<b>-1 274</b>
<b>Net interest income/expense</b>	<b>2 973</b>	<b>2 491</b>

## NOTE 2 Net result, quoted equities and participations

Amounts in SEK million	January-December 2010	January-December 2009
Net result, quoted equities and participations	15 089	27 343
less brokerage commission	-47	-55
<b>Net result, quoted equities and participations</b>	<b>15 042</b>	<b>27 288</b>

## NOTE 3 Net result, unquoted equities and participations

Amounts in SEK million	January-December 2010	January-December 2009
Capital gains, net	51	35
Unrealized changes in value*	2 084	-838
<b>Net result, unquoted equities and participations</b>	<b>2 135</b>	<b>-803</b>

\* Unrealized changes in value include management fees of SEK 62 million, refunded in 2010.

## NOTE 4 Commission expenses, net

Amounts in SEK million	January-December 2010	January-December 2009
External portfolio management fees, quoted assets	182	165
External portfolio management fees, unquoted assets	5	6
Other commission expenses, including custodial expenses	9	11
<b>Total commission expenses</b>	<b>196</b>	<b>182</b>

Commission expenses do not include performance-based expenses. During the year, performance-based expenses amounted to SEK 189 (SEK 60) million and reduce the net gain for respective asset classes. External portfolio management fees for unquoted 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 2010, a total of SEK 139 (SEK 140) million has been paid in management fees for unquoted assets. Of these, SEK 134 (SEK 134) million pertains to agreements concerning repayment of management fees paid prior to profit-sharing on sale of assets. These are reported as part of the asset's acquisition value.

**Distribution of Fund capital between external mandates and in-house portfolio management as per December 31, 2010 (SEK million)**

	Mandate	Benchmark index	Average assets under management 2010	Market-value as per Dec. 31 2010*	% of Fund capital	External management expense
<b>External discretionary mandates</b>						
Equity mandates						
Active management						
	Carnegie	Global equities	MSCI World	2 668	2 753	
	MFS	Global equities	MSCI World	5 302	5 605	
	Fundamental index managem.	Sweden - Equities, model portf.	FTSE RAFI Sweden	**	**	
	Fundamental index managem.	Global - Equities, model portf.	FTSE RAFI Global	**	**	
<b>Total</b>			<b>7 970</b>	<b>8 358</b>	<b>4</b>	<b>40</b>
Fixed-income mandates						
Active management						
	Rogge	Global credit mandate	Barclays Global Agg Develop credit ex Japan	9 425	4 804	
	Pimco	Global credit mandate	Barclays Global Agg Develop credit ex Japan	4 249	4 151	
	Standish	Global credit mandate	Barclays Global Agg Develop credit ex Japan	2 109	2 061	
<b>Total</b>			<b>15 783</b>	<b>11 016</b>	<b>5</b>	<b>19</b>
GTAA mandates						
Active management						
	IIPM/First Quadrant					5
<b>Total external discretionary mandates</b>			<b>23 753</b>	<b>19 374</b>	<b>9</b>	<b>64</b>
<b>Investments in quoted external funds</b>						
	Equity funds	as per respective fund	17 399	12 658		
	Fixed-income funds	as per respective fund	10 595	10 261		
	GTAA funds	as per respective fund	1 855	1 951		
<b>Total investments in quoted external funds</b>			<b>29 849</b>	<b>24 870</b>	<b>11</b>	<b>118</b>
<b>Investments in unquoted private equity funds and forest and agricultural real estate</b>			<b>6 407</b>	<b>7 274</b>	<b>3</b>	<b>5</b>
<b>TOTAL ASSETS UNDER EXTERNAL MANAGEMENT AND MANAGEMENT EXPENSES</b>			<b>60 009</b>	<b>51 518</b>	<b>23</b>	<b>187</b>
<b>In-house mandates</b>						
	Quoted equities and participations	SBX, SEW, CSX, MSCI World		96 942		
	Fixed-income mandates, incl. convertibles in altern. investments	SHB, Barclays		61 518		
	Cash and bank balances			-155		
	Unquoted equities in associated companies, incl. subordinated debentures			12 685		
<b>TOTAL ASSETS UNDER IN-HOUSE MANAGEMENT</b>				<b>170 990</b>	<b>77</b>	
<b>Other assets and liabilities</b>				<b>-1</b>		
<b>TOTAL FUND CAPITAL</b>				<b>222 507</b>	<b>100</b>	

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

\*\* Assets under management of in-house organization based on an externally-managed model portfolio with a fundamental index.

**NOTE 5 Personnel costs**

Amounts in SEK k

January-December 2010

January-December 2009

	Men	Women	Men	Women
<b>Average no. of employees</b>	<b>30</b>	<b>24</b>	<b>31</b>	<b>21</b>
<b>No. of employees, December 31*</b>	<b>32</b>	<b>22</b>	<b>31</b>	<b>22</b>
<b>No. of persons in Executive Management Group, December 31</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
* At year-end 2010, the Fund had 54 full-time employees.				
<b>Salaries and remuneration</b>				
Chairman of the Board		101		100
CEO		2 792		2 689
Board of Directors, excl. Chairman		390		369
Executive Management Group, excl. CEO		9 583		9 100
Other employees		35 921		34 113
<b>Salaries and remuneration, total</b>		<b>48 787</b>		<b>46 371</b>
<b>Variable remuneration</b>				
CEO		-		-
Executive Management Group, excl. CEO		-		-
Other employees		4 725		3 719
<b>Variable remuneration, total</b>		<b>4 725</b>		<b>3 719</b>
<b>Remuneration to Members of the Board, in addition to directors' fees</b>		-		-
<b>Pension costs</b> (incl. special employer's contribution)				
CEO		1 289		1 282
Executive Management Group, excl. CEO		3 840		4 749
Other employees		14 522		12 541
<b>Pension costs, total</b>		<b>19 651</b>		<b>18 572</b>
<b>Payroll overhead</b>				
Chairman of the Board		10		10
CEO		893		863
Board of Directors, excl. Chairman		124		106
Executive Management Group, excl. CEO		3 106		2 970
Other employees		12 833		12 001
<b>Total payroll overhead</b>		<b>16 966</b>		<b>15 950</b>
<b>Other personnel costs</b>		<b>2 933</b>		<b>2 758</b>
<b>Total personnel costs</b>		<b>93 062</b>		<b>87 370</b>

**CEO**

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. 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. Benefits received by the CEO amount to SEK 50 k.

**Executive Management Group**

Salaries, other remuneration and pension contributions (including special employer's contribution) for the Fund's Executive Management Group for 2010 totalled SEK 13 424 k (13 849). Salaries and other remuneration are disclosed as follows: Executive A, SEK 2 316 k (1 632); Executive B, SEK 1 912 k (1 799); Executive C, SEK 2 001 k (1 975); Executive D, SEK 1 889 k (1 855); Executive E, SEK 1 466 k (1 839). Pension contributions, including special employer's contribution, are disclosed as follows: Executive A, SEK 805 k (1 790); Executive B, SEK 1 100 k (921); Executive C, SEK 724 k (721); Executive D, SEK 676 k (585); Executive E, SEK 535 k (732). In addition to salary, other remuneration and pension contributions, the Fund's Executive Management Group has received the following benefits: Executive A, SEK 32 k (129); Executive B, SEK 70 k (68); Executive C, SEK 65 k (66); Executive D, SEK 63 k (69); Executive E, SEK 55 k (33).

Members of the Fund's Executive Management Group are not covered by the terms of the programme for performance-based variable remuneration. Senior executives come under the terms of the retirement benefit agreement between BAO (The Employers' Organization of the Swedish Banking Institutions) and JUSEK/CR/CF (SACO), The Swedish Confederation of Professional Associations. Swedish Government guidelines specify six months' notice and eighteen months' severance pay for senior executives.

Senior executives of the Second AP Fund, who were appointed before these Government guidelines came into force, are entitled to twelve months' notice without severance pay. These terms have not been renegotiated, as this would incur higher costs for the Fund.

**Salary swap**

All employees are offered the opportunity to swap part of their salary for an additional pension benefit.

**Variable remuneration**

The Board of Directors has approved a programme for variable remuneration in line with the Swedish Government's guidelines. In 2010, the Second AP Fund's incentive programme comprised all staff apart from the CEO, other members of the Executive Management Group and the head of Risk. This incentive programme meant that all other members of staff were entitled to a maximum of two months' salary in variable remuneration. The programme is linked partly to the result for the current financial year, partly to long term goals. This variable remuneration may only be paid out when the Fund reports a positive return. The extent of the programme is presented on the Fund's website at [www.ap2.se](http://www.ap2.se)

**Drafting and decision process**

Directors' fees are determined by the Swedish Government. The Board determines the CEO's salary and the guidelines applied in remunerating the Fund's senior executives.

**Other directorships held by Members of the Board** See page 56.

**Absence due to illness**

In 2010, absence attributable to illness at the Second AP Fund, calculated as a percentage of total days lost to illness against total normal working days for all employees, was 0.68 percent. No Fund employee was off sick for more than 60 days. Absence due to illness was 0.67 percent for male employees and 0.70 percent for female employees.

**NOT 6 Other administrative expenses**

Amounts in SEK million	January-December 2010	January-December 2009
Rental expenses	5	5
Information and IT expenses	39	38
Purchased services	9	6
Other expenses	14	14
<b>Total other administrative expenses</b>	<b>67</b>	<b>63</b>

**Fees to auditors**

Audit assignments		
Ernst & Young	1.35	1.12
Accounting activities in addition to audit assignments		
Ernst & Young	0.25	0.40
<b>Total remuneration to Ernst &amp; Young</b>	<b>1.60</b>	<b>1.52</b>

**NOT 7 Quoted equities and participations**

Amounts in SEK million	December 31, 2010		December 31, 2010	
	Fair value	Acquisition- value	Fair value	Acquisition- value
Swedish equities	42 818	30 220	35 572	28 670
Foreign equities	53 577	53 027	51 130	51 278
Participations in Swedish funds	2 357	976	2 778	1 412
Participations in foreign funds*	12 314	9 391	12 135	8 312
<b>Total quoted equities and participations</b>	<b>111 066</b>	<b>93 614</b>	<b>101 615</b>	<b>89 672</b>
* of which participations in mixed funds	1 972	1 652	1 808	1 652

The 20 largest Swedish and foreign shareholdings, by value, are listed on pages 52-53.

A complete list of Swedish and foreign 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	28 980 427	3 409	1,36	1,13
Ericsson	34 631 924	2 706	1,06	0,62
Nordea Bank	34 197 097	2 502	0,84	0,84
Hennes & Mauritz	9 241 053	2 070	0,59	0,38
Atlas Copco	11 562 737	1 901	0,94	0,96

**Five largest foreign shareholdings**

Name	Number	Fair value
AstraZeneca	3 996 841	1 235
ABB	7 486 027	1 133
Nestlé	1 506 380	598
Exxon Mobil	1 158 300	569
Banco Santander	6 011 100	431

**NOT 8 Unquoted equities and participations**

Amounts in SEK million, December 31, 2010	Corp. reg.	No. of equities	Participation right, capital, %	Participation right, votes, %	Start year	Acquisition value
<b>Swedish equities and participations</b>						
Andra & Sjötte Fastigheter AB	556694-3022	5 000	100	100		2
Vasakronan Holding AB	556650-4196	1 000 000	25	25		1 221
NS Holding AB	556594-3999	1 819 884	50	50		811
EQT Northern Europe KB (EQT III)	969670-3405		1		2001	67
Swedestart Life Science KB	969675-2337		5		2001	18
Swedestart Tech KB	969674-7725		3		2001	10
<b>Foreign equities and participations</b>						
AG Real Value Fund			10		2010	99
Ares Corporate Opportunities Fund III			1		2008	196
Carlyle Asia Growth Partners IV			5		2008	91
Carlyle Europe Partners III			0.9		2006	228
Carlyle Riverstone Global Energy and Power Fund III			0.8		2005	163
Carlyle Riverstone Global Energy and Power Fund IV			0.8		2008	209
Carlyle Riverstone Renewable Energy Infrastructure Fund I			3		2005	140
Carlyle Riverstone Renewable and Alternative Energy Fund II			2		2008	177
CVC European Equity Partners IV			0.6		2005	214
CVC European Equity Partners V			0.5		2008	224
EQT Expansion Capital I Fund			16		2003	98
Generation IM Climate Solutions Fund			5		2008	156
H.I.G. Bayside Loan Opportunity Fund II			5		2010	56
Khosla Ventures III			4		2009	131
Lyceum Capital Fund II			10		2008	97
Mid Europa Fund III			3		2007	243
New Forests Australia New Zealand Forest Fund			9		2010	22
New Mountain Partners III			1		2007	140
Nordic Capital V			3		2003	385
Nordic Capital VI			3		2006	443
Nordic Capital VII			1		2008	218
Pathway Private Equity Fund IX			99		2004	787
Pathway Private Equity Fund IXB			99		2005	1 082
Pathway Private Equity Fund IXC			99		2008	270
R/C Pattern Energy Feeder			5		2010	85
Resolute Fund II			1		2007	97
Sequoia Capital 2010			2		2010	16
Sun Capital Partners V			0.4		2007	64
TCV VII			1		2007	56
Thomas H Lee Equity Fund VI			0.4		2006	155
TPG Asia V			1		2007	151
TPG Credit Strategies Fund			6		2007	206
TPG Partners V			0.3		2006	250
TPG Partners VI			0.3		2008	122
TPG Star			4		2007	230
<b>Total unquoted equities and participations</b>						<b>9 430</b>
<b>Total fair value</b>						<b>12 759</b>



**NOTE 9 Bonds and other fixed-income securities**

Amounts in SEK million	December 31, 2010		December 31, 2009	
	Fair value	Acquisition value	Fair value	Acquisition value
Swedish State	14 165	13 774	15 354	14 608
Swedish municipalities	276	278	225	218
Swedish mortgage institutions	24 311	24 510	20 295	19 827
Other Swedish issuers				
Financial companies	3 045	3 052	3 023	2 924
Non-finance companies	6 415	6 218	6 489	6 413
Foreign states	9 232	9 542	9 402	9 143
Other foreign issuers	26 945	26 580	24 712	23 707
Deposits	1 200	1 200	2 100	2 100
<b>Total</b>	<b>85 589</b>	<b>85 154</b>	<b>81 600</b>	<b>78 940</b>
Inflation-linked bonds	4 125	3 765	3 943	3 559
Other bonds	62 981	64 314	58 641	57 372
Certificates	499	499		
Unquoted promissory notes	3 625	3 625	4 250	4 250
Unquoted convertible debentures	2 220	2 016	2 089	2 016
Participations in foreign index-linked funds	10 939	9 735	10 577	9 643
Deposits	1 200	1 200	2 100	2 100
<b>Total</b>	<b>85 589</b>	<b>85 154</b>	<b>81 600</b>	<b>78 940</b>
of which valued according to theoretical modelling	1 700		2 100	

**NOTE 10 Derivative instruments**

Amounts in SEK million, December 31, 2010		Face value*	Derivative instruments with positive fair value	Derivative instruments with negative fair value
<b>Currency-related instruments</b>				
Options	Held	1 201	4	
	Pledged	1 093		2
Forward contracts		217 368	1 673	725
<b>Total</b>		<b>219 662</b>	<b>1 677</b>	<b>727</b>
of which cleared		—		
<b>Equities-related instruments</b>				
Forward contracts		2 725	15	0
<b>Total</b>		<b>2 725</b>	<b>15</b>	<b>0</b>
of which cleared		2 725		
<b>Index-linked instruments</b>				
Options	Held	27	3	2
	Pledged	81	3	3
FRA/Forward contracts		104 722	25	43
<b>Total</b>		<b>104 830</b>	<b>31</b>	<b>48</b>
of which cleared		104 825		
<b>Other financial instruments</b>				
Other instruments		6 727	7 984	137
<b>Total</b>		<b>6 727</b>	<b>7 984</b>	<b>137</b>
of which cleared		—		
<b>Total derivative instruments</b>			<b>9 707</b>	<b>912</b>
of which valued according to theoretical modelling			1 677	727

\* 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 34 for a description of the types of derivative instruments employed and the risks that can be managed with derivatives.

**NOTE 11** Other assets

Amounts in SEK million	December 31, 2010	December 31, 2009
Incoming payments, unsettled transactions	24	10
Other receivables	4	2
<b>Total</b>	<b>28</b>	<b>12</b>

**NOTE 12** Prepaid expenses and accrued income

Amounts in SEK million	December 31, 2010	December 31, 2009
Interest income accrued	1 729	1 695
Dividends accrued	49	56
Restitutions	42	47
Other prepaid expenses and accrued income	25	27
<b>Total</b>	<b>1 845</b>	<b>1 825</b>

**NOTE 13** Other liabilities

Amounts in SEK million	December 31, 2010	December 31, 2009
Outgoing payments, unsettled transactions	83	41
Accounts payable	6	8
Other liabilities	3	3
<b>Total</b>	<b>92</b>	<b>52</b>

**NOTE 14** Deferred income and accrued expenses

Amounts in SEK million	December 31, 2010	December 31, 2009
Accrued external management fees	41	54
Accrued interest expenses on currency forwards	18	39
Other accrued expenses	23	23
<b>Total</b>	<b>82</b>	<b>116</b>

**NOTE 15** Fund capital

Amounts in SEK million	December 31, 2010	December 31, 2009
<b>Opening Fund capital</b>	<b>204 290</b>	<b>173 338</b>
<b>Net inflows to the national pension system</b>		
Pension contributions received	51 267	50 678
Pension disbursements to the Swedish Pensions Agency	-55 050	-54 348
Transfer of pension entitlements to EC	-1	-5
Adjustment of pension entitlements re. previous years	0	0
Administration contribution to the Swedish Pensions Agency	-257	-231
<b>Total payments to the national pension system, net</b>	<b>-4 041</b>	<b>-3 906</b>
<b>Net result for the year</b>	<b>22 258</b>	<b>34 858</b>
<b>Closing Fund capital</b>	<b>222 507</b>	<b>204 290</b>

**NOTE 16** Pledged assets, contingent liabilities and commitments

Amounts in SEK million	December 31, 2010	December 31, 2009
<b>Other pledged assets and comparable collateral</b>		
Securities on loan for which guarantees have been secured in the form of securities and cash*	1 371	1 703
Securities pledged in connection with exchange-cleared derivatives	339	281
<b>Total</b>	<b>1 710</b>	<b>1 984</b>
* Guarantees secured for pledged securities: SEK 1 444 (1 764) million.		
<b>Commitments</b>		
Commitments regarding future payments, unquoted holdings	6 927	7 552
Commitments regarding future investments, quoted fixed-income holdings	101	571
Outstanding promise of guarantee for new share issue	-	7
	<b>7 028</b>	<b>8 130</b>

The administration report, income statement, balance sheet and notes for 2010 have been approved by the Board of Directors.

**Gothenburg, February 10, 2011**

Marie S. Arwidson  
Chairman

Sven Björkman  
Vice Chairman

Anders Jansson

Roland Svensson

Märtha Josefsson

Jeanette Hauff

Ola Alfredsson

Lillemor Smedenvall

Lasse 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 2010. The Fund's Annual Report is included in the printed version of this document on pages 18-51. 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 any significant comments made by the board in its review of the accounts, together with an 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.

Gothenburg, February 14, 2011.

Anna Peyron  
Authorised Public Accountant  
Appointed by the Swedish Government

Lars Bonnevier  
Authorised Public Accountant  
Appointed by the Swedish Government

# Equities, participations and fixed-income securities

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

Company name	Share of equity, %	No. of equities	Fair value, SEK m	Share of voting rights, %	Sector
Volvo A	0.33	7 142 172	821	0.87	Industrials
Volvo B	1.03	21 838 255	2 588	0.26	Industrials
Ericsson (LM) B	1.06	34 631 924	2 706	0.62	IT
Nordea Bank	0.84	34 197 097	2 502	0.84	Financials
Hennes & Mauritz B	0.59	9 241 053	2 070	0.38	Consumer discretionary
Atlas Copco A	0.65	8 085 015	1 372	0.93	Industrials
Atlas Copco B	0.29	3 477 722	529	0.03	Industrials
Sandvik	0.11	13 707 365	1 797	0.11	Industrials
Svenska Handelsbanken A	1.13	7 071 783	1 520	1.13	Financials
SEB A	1.17	25 589 704	1 436	1.18	Financials
TeliaSonera	0.6	26 768 046	1 427	0.6	Telecoms
Swedbank A	0.96	11 129 042	1 044	0.97	Financials
Swedbank Preferensaktie	0.32	3 681 328	353	0.31	Financials
Investor A	0.02	153 580	21	0.04	Financials
Investor B	1.15	8 849 387	1 273	0.25	Financials
SKF B	1.43	6 518 525	1 249	0.76	Industrials
SCA A	0.06	424 208	45	0.27	Commodities
SCA B	1.6	11 273 715	1 197	0.69	Commodities
Scania B	0.8	6 362 935	984	0.14	Industrials
Skanska B	1.7	7 184 012	958	1.15	Industrials
Electrolux B	1.45	4 478 690	855	1.15	Consumer discretionary
Tele2 B	1.31	5 855 640	817	0.92	Telecoms
Assa Abloy B	1.18	4 306 460	816	0.8	Industrials
Boliden	1.62	4 437 150	607	1.62	Commodities
Alfa Laval	0.94	3 970 657	563	0.94	Industrials

## Second AP Fund's holdings in unit trusts

Swedish unit trusts	No. of equities, participations	Fair value, SEK m	Foreign unit trusts	No. of equities, participations	Fair value, SEK m
SHB Småbolag	1 386 109	815	Trilogy Emerging Market	104 271	1 031
Lannebo Småbolagsfonder	21 389 318	803	Barclays GTAA	98 695	990
Carlson Småbolag	482 767	739	Wellington Emerging Market Debt	11 742 789	967
			Bridgewater GTAA	76 700	962
<b>Foreign unit trusts</b>			Advent Global Phoenix High Grade Convertible Fund	1 000 104	743
Morgan Stanley Convertible Bond Fund	16 379 088	3 353	CQS Archipelago Convertible Bond Strategies Fund	100 201	728
Generation Global Equity Fund	2 513 758	2 935	AllianceBernstein Legacy Securities	85 000 000	678
Vanguard Fixed Income Fund	2 735 511	2 769	AQR Convertible Opportunities Bond Fund	78 700	649
State Street Emerging Market Enhanced	31 549 264	2 616	Carnegie World Wide Asia Equity Fund	444 128	61
Genesis Emerging Market	5 475 561	1 990			
Wellington Emerging Market	10 651 126	1 729			
Stone Harbor Emerging Market Debt	1 188 131	1 051			

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

Company name	No. of equities	Fair value, SEK m	Sector
ABB	7 486 027	1 133	Industrials
AstraZeneca	3 996 841	1 235	Health Care
Nestlé	1 506 380	598	Consumer Staples
Exxon Mobil	1 158 300	569	Energy
Banco Santander	6 011 100	431	Financials
Apple	195 600	424	Information Technology
Daimler	896 280	410	Consumer Discretionary
Siemens	487 540	408	Industrials
British American Tobacco	1 543 786	400	Consumer Staples
Allianz	496 196	398	Financials
Chevron	634 201	389	Energy
Vodafone	21 607 600	377	Telecommunication Services
Eni	2 515 350	371	Energy
Total	1 032 690	369	Energy
General Electric	2 955 000	363	Industrials
Telefonica	2 205 050	338	Telecommunication Services
Microsoft	1 769 900	332	Information Technology
AT&T	1 658 000	327	Telecommunication Services
BASF	568 880	306	Materials
Procter & Gamble	695 419	301	Consumer Staples

<sup>1)</sup> The above table of Second AP Fund shareholdings lists the 20 largest Swedish holdings and 20 largest foreign holdings, by worth. The Fund's capital shares and voting rights in the foreign companies listed in the above table in no instance exceed 0.3 percent, and are therefore not reported.

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

**Second AP Fund holdings in bonds and other fixed-income securities****Swedish nominal bonds, five largest holdings**

Bond	Fair value, SEK m
Stadshypotek AB 1573	3 237
Spintab Swedmortgage AB 176	3 168
Swedish Government 1052	2 500
Swedish Government 1047	2 376
Spintab Swedmortgage AB 182	2 229

**Global credits, five largest holdings**

Bond	Fair value, SEK m
Bundesobligation 157	150
Credit Suisse First Boston 4.75%	116
European Investment Bank 4.75%	101
Morgan Stanley Dean Witter 7.3 %	99
Metlife Global Funding I 5.125%	94

**Swedish inflation-linked bonds, five largest holdings**

Bond	Fair value, SEK m
Swedish Government 3104	1 182
Swedish Government 3105	1 096
Swedish Government 3102	980
Swedish Government 3106	527
Swedish Government 3107	271

**Global government bonds, five largest holdings**

Bond	Fair value, SEK m
Internatl Bank Recon Dev-Global 3.5%	256
Germany (Federal Republic) 3.75%	242
Eksportfinans A/S 5.5%	227
Kommunalbanken A/S 2.25%	213
Kredit Fuer Wiederaufbau 3.875%	196

Detailed information about Second AP Fund holdings in fixed-income securities may be found on the Fund's website at [www.ap2.se](http://www.ap2.se)

## Second AP Fund governance report

To comply with the Annual Accounts Act and 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, Second AP Fund 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.

Eva Persson resigned her seat on the Board in March 2010. In June 2010, the Swedish Government decided on a new Board, involving a number of changes. Marie S. Arwidson was appointed the new Chairman, succeeding Gunnar Larsson, who has chaired the Board since the Fund's inauguration. Jeanette Hauff and Lasse Thörn were also appointed new Members of the Board. Clas Nykvist and Ylva Thörn resigned their seats. In August, the Government decided to appoint Ola Alfredsson to a new seat on the Board. 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 2010 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 Swedish National Pension Funds Act, 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 most important tasks assigned to the Board of the Second AP Fund involve 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 held six ordinary meetings, one being of greater duration, at which broad strategic issues were addressed, with special emphasis on the investment strategy. As well as Board Members, Board meetings are attended by the Fund's CEO and the Secretary to the Board. Other Fund employees may also participate, in an advisory role as experts or to submit a report on a given issue. The CEO's performance is evaluated once a year. The CEO does not attend this meeting.

### Fund targets

The Fund's overall target is a real return of at least five percent per annum, seen over time.

### New strategic portfolio

A new strategic portfolio has been approved for 2011.

### Discussion about performance, governance issues and costs

The Fund's management performance is reviewed at every Board meeting. The Board regularly discusses fundamental

governance issues, the strategic allocation of assets and investments in private equity funds and real estate.

Cost trends are considered on a quarterly basis, and the Board regularly reverts to the issue of the Fund's cost efficiency. Its annual responsibilities also include decisions concerning the adoption of the end-of-year accounts, the budget, business plan and strategic portfolio.

#### Board Committee

The Board has established a Remuneration Committee. The Remuneration Committee consists of the Fund's Chairman and Vice Chairman. The CEO is normally co-opted to meetings of the Remuneration Committee. The CEO is not present when the Committee determines his/her remuneration.

The Remuneration Committee is a drafting committee for the Board, tasked with considering the level of remuneration for the CEO, establishing guidelines for the remuneration of the Fund's executive management and determining issues related to incentive programmes for Fund employees.

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 Anna Peyron and Lars Bonnevier from Ernst & Young, who were appointed on April 22, 2010. Ernst & Young is also tasked with conducting the audits of the other AP funds, and Anna Peyron has furthermore

been appointed to coordinate the audits of all AP funds.

The appointment applies until adoption of the Fund's income statement and balance sheet for 2010.

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

The auditors' assignment includes inspection of current business operations, the administration, 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 valuation principles jointly determined by the AP funds, and that they provide a true and fair picture of the Fund's financial position.

The audit has also involved an examination of the Fund's guidelines on remuneration in compliance with the Swedish Government guidelines on remuneration to key executives and employees, and compliance with these. A separate statement has been submitted, see Second AP Fund website at [www.ap2.se](http://www.ap2.se)

#### Internal control

The Board has ultimate responsibility for the Fund's internal control. In the Fund's risk policy, the Board has established fram-

eworks 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, as a whole and in its individual elements, keeps within the specified limits and observes the restrictions and instructions that apply.

Ongoing internal control of the Fund's financial and operational risks is handled by the Risk Management Department. The Department 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 Member	Attendance/total meetings, 6	Comments
Marie S. Arwidson	4/4	(app. Jun 2010)
Sven Björkman	6/6	
Anders Jansson	5/6	
Roland Svensson	6/6	
Märtha Josefsson	5/6	
Lillemor Smedenwall	4/6	
Jeanette Hauff	4/4	(app. Jun 2010)
Lasse Thörn	4/4	(app. Jun 2010)
Ola Alfredsson	2/3	(app. Aug 2010)
Gunnar Larsson	2/2	(res. Jun 2010)
Ylva Thörn	1/2	(res. Jun 2010)
Clas Nykvist	2/2	(res. Jun 2010)
Eva Persson	1/1	(res. Mar 2010)

## Board of Directors

The board of Directors of the Second AP Fund, December 31, 2010. 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.

From left:

**Märtha Josefsson** Member of the Board since 2003. Independent investment consultant. Directorships on several boards, including Fabege, Luxonen, Opus Group, Skandia Funds, Öresund and WWF Sweden. Member of several investment committees. B.A. Born 1947.

**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. Forest owner. LL.B. Born 1941.

**Lillemor Smedenwall** Member of the Board since 2006. Chairman of Finansförbundet. 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.

**Marie S. Arwidson** Chairman since 2010. Managing Director of the Swedish Forest Industries Federation. Directorship on the board of the Swedish Transport Administration. Directorships on the boards of the International Chamber of Commerce Sweden and the Royal Swedish Academy of Engineering Sciences. M.Sc. (Econ). Born 1951.

**Lasse Thörn** Member of the Board since 2010. Head of the Labour & Collective Law Unit of the Swedish Municipal Workers' Union. Vice Chairman of the Swedish Church Staff Pension Fund. Member of the board of KPA Livförsäkring. Born 1960.

**Jeanette Hauff** Member of the Board since 2010. Active at Gothenburg University's School of Business, Economics and Law. Savings Advisor at Skandia. L.Econ. Born 1965.

**Ola Alfredsson** Member of the Board since 2010. CEO of Kockums AB. Born 1964.

**Sven Björkman** Vice Chairman since 2009. Former head of SEB Region Väst. Born 1949.





## Executive management

From left:

**Tomas Franzén** Chief Investment Strategist (CIS). Employed since 2001. Born 1957.

**Lena Smeby-Udesen** Chief Financial Officer (CFO). Employed since 2001. Born 1961.

**Martin Jonasson** General Counsel. Employed since 2001. Born 1964.

**Eva Halvarsson** CEO. Other directorships: Vasakronan AB, Norrporten AB, Börssällskapet, Finans-kompetenscentrum and the Swedish Corporate Governance Board. Vice Chancellor of Gothenburg University. Employed since 2006. Born 1962.

**Hans Fahlin** Chief Investment Officer (CIO). Employed since 2010. Born 1957.

**Ulrika Danielson** Head of Communications & HR. Employed since 2009. Born 1965.

### Auditors

**Anna Peyron** Authorised Public Accountant, Ernst & Young.

**Lars Bonnevier** Authorised Public Accountant, Ernst & Young.



# Definitions

## Absolute return on investment

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

## Active return

Asset management adopts deviations from the benchmark index to add value. The result is reported as active return.

## Active/passive management

*Active management:* Asset management adopts deviations from the benchmark index to add value.

*Passive management:* Asset management strives for a return equal to the benchmark index.

## Alpha and Beta

*Alpha:* 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:* 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 strategic 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 change as well general economic trends.

## Benchmark index

The index that constitutes the Second AP Fund's strategic portfolio, against which the Fund's management performance is measured.

## Credit risk and counterparty risk

*Credit risk:* Refers to the risk that an issuer may become insolvent or be awarded a lower credit rating.

*Counterparty risk:* Refers to the risk that the other party may be unable to meet its business obligations.

## Credit spread

The yield difference arising from the difference in creditworthiness between two otherwise comparable bonds.

## Discretionary mandate

A mandate that is limited and specific to a single investor. The alternative to discretionary management is traditional fund management.

## Duration

A measure of interest risk that yields an asset-relative change in value with an interest adjustment of one percentage unit.

## Enhanced mandate

Mandate managed at a low level of risk to reflect index, driven by quantitative models.

## 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.

## FX forward

A derivative instrument involving a contract to purchase a currency at an agreed future date at a predetermined rate of exchange.

## GTAA

Global Tactical Asset Allocation mandate.

A mandate that applies a TAA strategy on a global basis.

## Implementation effects

Contributions to the overall return that derive from implementation of the strategic portfolio and index switches.

## Implicit volatility

The forecast volatility of an asset class.

## Information ratio

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

## Interest swap

A contract between two counterparties, in which one interest flow is exchanged for another. Normally, the undertaking given by one party to pay a fixed rate of interest is exchanged for the other party's undertaking to pay a floating rate of interest.

## IPEV

International Private Equity and Venture Capital Valuation Guidelines.

## ISDA contract

International Swaps and Derivatives Association. An ISDA contract is a standard contract for the regulation of trading in derivatives between two counterparties.

## 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.

## MSCI index

International equity indices managed by Morgan Stanley Capital International.

## Operative risk

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

## Quantitative management

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

## Relative return

Portfolio return compared to return on Fund's strategic portfolio. The return is cleared of commission and operating costs.

## S&P 500

Standard & Poor's 500 composite index. A cap-weighted index of 500 American companies, selected on the basis of a number of different factors, including size, liquidity and industrial sector.

## 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.

## SIXRX

Six Return Index. A cap-weighted share index, reflecting average growth on the Stockholm Stock Exchange, including dividends.

## Strategic portfolio

The Second AP Fund's strategic portfolio is determined by the Board of Directors and defines the Fund's strategic asset allocation.

## TAA

Tactical Asset Allocation. An active management strategy focused on over-performance in diverse asset classes.

## Tracking error/Active risk

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

## Value at Risk, VaR

A measure of risk that indicates the maximum loss, based on a given confidence level, that a portfolio may incur over a given period. VaR is normally calculated at a confidence level of 95 percent, and a ten-day interval.

**“When I’m a pensioner,  
I’ll paint pictures and  
catch butterflies.”**

**Oskar, 6 years old**





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