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Executive Management

Definitions

With SEK 241.5 billion under management in virtually every asset class and all parts of the world, the Second AP Fund is one of northern Europe's largest pension funds. A secure and stable manager of assets, the Fund is tasked with an important assignment by the Swedish Government – minimizing the impact on future Swedish pensions that would derive from applying 'the brake'.

241.5

SEK billion Second AP Fund's capital assets, 2012.

12 975

SEK million disbursed by Second AP Fund (2009–2012) to cover shortfall in national pension system.

SEK million total return generated since the Fund's 2001 inauguration.

59

60

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/the Fund and, where space requires, AP2.

The Second AP Fund

The Second AP Fund is one of five buffer funds within the Swedish pension system, tasked with maximizing long-term return – and at low risk to pension disbursements. The Fund's consistent and responsible management has helped ensure that the return on portfolio assets is in line with its long-term commitments and compares well at the international level.

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. The Second AP Fund shall therefore adopt a long-term approach, with a view to securing the managed buffer capital over the long-term.

Strategic management model

The Fund's strategic management model is based on financial theory and incorporates long-term forecasts covering demographic, socio-economic and capital-market developments. The world has experienced several major stock market declines in recent years, but the Second AP Fund has performed well in comparison with similar funds, whether seen from a national or international viewpoint.

Efficient and sustainable portfolio management

The Second AP Fund is an attractive employer with some 60 staff. It employs some of the foremost in their respective fields, as portfolio managers, analysts and other specialists. Together, this workforce has created an efficient portfolio management structure. One consequence has been to ensure that the Fund's management costs are comparable to those of similar funds at an international level.

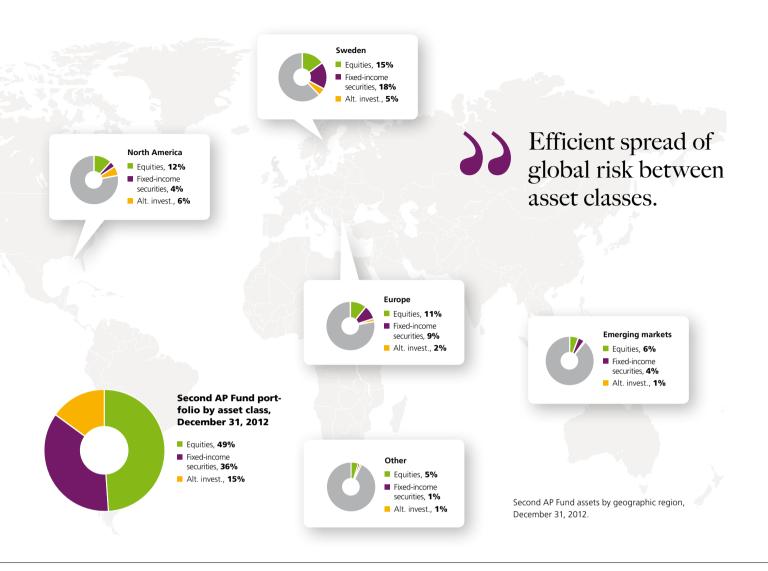
The Fund adopts an active approach to ethical and environmental issues, with a view to promoting sustainable investment. Long-term investment requires companies capable of long-term sustainability, enabling them to generate a solid return that can provide a secure buffer for future pensions.

Return on investment 2012

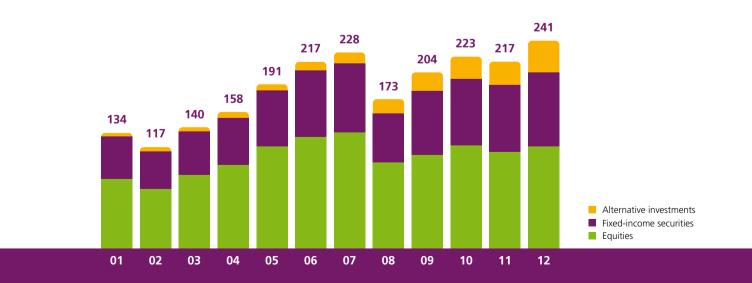
13.5%

The solid 2012 result means we are now in line with our long-term commitments.

> Eva Halvarsson, CEO, Second AP Fund. More in the Chief Executive's Review on page 2.



Fund capital performance, 2001–2012, SEK billion



2012 in brief

2012 proved a turbulent year on financial markets, a consequence of the ongoing global political and economic challenges. In this environment, the Second AP Fund achieved a return on investment of 13.5 percent for the total portfolio. The Fund carrying a positive absolute return on all asset classes, producing a net result of SEK 28.6 billion. Consequently, fund capital at the close of the year noted its highest level ever: SEK 241.5 billion.

The Fund's performance over the year means that its return is in line with the targeted average long-term annual real return of five percent.

The Second AP Fund's long-term strategy and ongoing efforts to diversify the portfolio have ensured a good spread of risk. During the year, a key element of this strategy has involved increased investment in private equity funds, foreign commercial real estate and forest-and-agricultural real estate, balanced by a simultaneous reduction of the Fund's holdings in Swedish equities. The Fund has also invested in alternative risk premiums, a new asset class that features low risk and low correlation with the equities market.

- The Funds assets under management totalled SEK 241.5
 (216.6) billion on December 31, 2012, against which net outflows to the national pension system were charged in an amount of SEK –3.8 (–1.2) billion.
- The Fund posted a net result for the year of SEK 28.6 (–4.6) billion
- The Fund's return on the total portfolio was 13.5 (–1.9) percent, excluding commission fees and operating expenses. Including these costs, the portfolio generated a return of 13.3 (–2.1) percent.
- Expense ratio for operating expenses remained low, totalling 0.07 (0.07) percent for the period.
- The relative return on the portfolio of listed assets, excluding alternative investments and costs, amounted to 1.1 (–0.3) percent.
- Return on alternative investments was 13.9 (8.4) percent.

Performance review since start

	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Fund capital, SEK m	241 454	216 622	222 507	204 290	173 338	227 512	216 775	190 593	158 120	140 350	117 090	133 493
Net result for the year, SEK m	28 620	-4 645	22 258	34 858	-55 058	8 718	24 506	29 568	16 119	20 693	-21 405	-5 005
Return on total portfolio, excl. commission fees and operating expenses, %	13.5	-1.9	11.2	20.6	-24.0	4.2	13.0	18.7	11.6	17.8	-15.3	-3.7
Relative return on listed assets, excl. alternative investments, commission fees and operating expenses, %	1.1	-0.3	0.8	0.7	-1.8	-0.4	0.2	0.2	-0.6	-0.5	-0.4	1.7
Active risk ex post, %	0.3	0.3	0.3	0.6	1.0	0.7	0.7	0.5	0.5	0.6	1.0	1.7
FX exposure, %	20	16	12	10	12	11	12	11	10	8	7	10
Share of external mandates (incl. investment in private equity companies), %	29	29	23	24	22	24	17	28	37	45	38	82

CHIEF EXECUTIVE'S REVIEW

More capital than ever

At the close of the year, we can state that the Second AP Fund's capital assets have never been greater. With a return of no less than 13.5 percent and fund capital amounting to SEK 241.5 billion, in spite of the continued turbulence on financial markets, we have demonstrated that our long-term strategy is working well. We shall continue with our systematic commitment to the build-up of a diversified and international portfolio, focused on the generation of a long-term return at balanced risk.

I am very proud of the way the Second AP Fund is handling its share of the national pension system's buffer capital. This longterm and systematic process, summarized in a partially revised strategy just over five years ago, is having an increasingly obvious impact. We are diversifying the portfolio and investing in new markets and asset classes. We are moving from listed to unlisted holdings, we choose to operate with partners rather than invest in funds and are increasing our exposure to markets that offer the best growth potential.

have invested in alternative risk premiums, a new asset class featuring low risk and low correlation to the equities market. Investments in more complex markets and assets often cost a bit more. But the important thing is that we generate a risk-adjusted net return (i.e. a return after the deduction of administrative expenses) which outperforms more traditional investments. The performance of our actively managed portfolio clearly demonstrates the efficacy of this approach. During 2012, our active investment strategies generated an additional 1.2 percent – or SEK 2.1 billion – in revenue.



We are diversifying the in new markets.

In 2012, this strategy generated a result of SEK 28.6 billion, corresponding to a return of just over 13 percent. This is in line with the level of growth on the Stockholm Stock Exchange – often used in comparison. In fact, on the one hand, just 11 percent of the Fund's capital is invested in Swedish equities and, on the other, as per our investment regulations, 30 percent of fund capital must be invested in fixed-income securities. Generally speaking, the percentage of Swedish assets in the portfolio has been reduced steadily. This is entirely reasonable, given the fact that the Swedish economy accounts for a mere 0.8 percent of combined global GDP, and that 90 percent of the national pension system is already exposed to the Swedish economy in the form of the contribution assets. Today, more than 40 percent of our capital is invested outside Europe. During the year, we increased our investments in private equity funds, foreign commercial real estate and forest-and-agricultural real estate. Furthermore, we

Buffer Fund Inquiry

"Sweden's pensioners deserve better!" This is the essential content of our response to the Swedish Government Buffert Fund Inquiry, which we submitted at the end of November. We feel there is potential for improvement with respect to the relaxation of investment regulations and in more clearly defining the way funds are monitored. Admittedly, these points were touched on in the report, but many parts suffered from serious weaknesses and in some cases appeared to be based on loose assumptions. Implementing such comprehensive change as that proposed would involve significant cost as well as risks and uncertainty, and the justification for such change is neither clear nor convincingly argued in the report. The idea that consolidating the management of pension assets in fewer funds will generate economies of scale lacks support in scientific research. The reverse, in fact. Research suggests that the reduction in costs that derives from increased size is nowhere near enough to counteract the negative consequences of such economies when managing an even larger volume of capital. It is also difficult to understand the argument that such consolidation would provide access to greater competence and simplify cooperation with major global investors. Today, the Second AP Fund has some of the market's foremost specialists and operates through a network of key



global investors, conducting joint investment on markets and in asset classes the world over.

It is sad that such a flawed report risks defining the agenda for the debate. The fact is that Sweden has a highly robust pension system, which many wish to emulate. Furthermore, through our global network, we know that many of the world's largest funds are actively engaged in discussions as to how their operations can best be reorganized into several elements to ensure that they function better. We can be proud of what we have already, but must naturally continue to strive for ongoing improvement.

Responsible investment process

One area in constant focus is our sustainability programme. We have both the expertise and the know-how needed to participate and promote improvements in sectors such as the environment, ethics and corporate governance. This work forms an important and integrated part of our investment process. We have been involved in establishing Principles for Responsible Agricultural Investment and, in partnership with some of the world's largest private equity companies, have placed the spotlight on ethical and environmental issues. Now, as the first Swedish player to be granted a licence for direct investment in

domestic Chinese equities, we are joining regional networks to enable us to play an active part in promoting corporate governance issues in Chinese companies.

Our primary and most important task is to build up a portfolio that can be adapted to all generations. Our vision of the country's long-term development with respect to employment, demography and wage levels naturally affects our current investment strategy. Our solid performance in 2012 means that we are now in line with our long-term commitments. Our strategy for achieving a solid return with balanced risk, through greater diversification, is proving increasingly successful. This would have been impossible without the profound commitment and competence of those who work at the Second AP Fund – and who strive for its consistent improvement. All to generate the best possible return for Sweden's pensioners!

Eva Halvarsson, CEO

The Swedish pension system – a robust model

When the current Swedish national pension system was introduced in 2001, it heralded an entirely new structure and new responsibilities for the AP funds or fund committees, as they were then known. The First, Second, Third and Fourth AP Funds, together with the Sixth AP Fund, were to act as buffer funds, thereby reducing the system's sensitivity to economic and demographic fluctuations.

In the Swedish national pension system, future pensions are determined by the level of each and everyone's individual income, based on income received over an entire working life. A key element 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.

A model to others

From a financial perspective, the Swedish pension system is considered robust, since it reflects the development of the economy as a whole. 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 pensions growth will decline.

The Swedish system is unique. So far, few countries have implemented the necessary reforms to their pension systems. The challenge is how such change can be implemented. Sweden launched its reformed pension system just over ten years ago. This makes Sweden an interesting example for many countries in Europe and other parts of the world.

Since 2001, the Second AP Fund has built up capital assets total-ling SEK 241 billion, making it one of northern Europe's largest pension funds. In international terms, the Swedish AP Funds are among the largest national pension funds in the world. As a percentage of GDP, only Saudi Arabia and Norway boast larger pension funds, while Japanese and Korean funds are roughly similar in size (source: OECD's report – Pension Markets in Focus, July 2011).

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. 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.

The size of pensions

The size of pension is determined by length of time worked and level of income, up to a predefined level. 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 and is maintained until parity is re-established within the pension system.

Brake applied sparingly

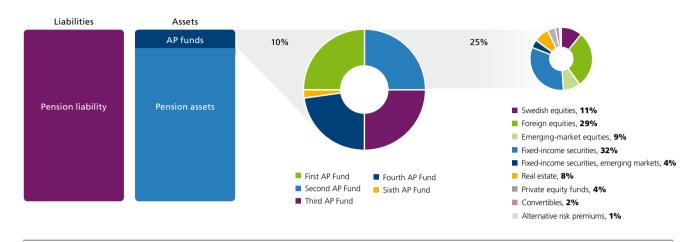
On a number of occasions in the past ten years, the strong performance of the AP funds' capital assets has obviated the need to activate the automatic balancing mechanism. It was not until 2008 that the brake was activated for the first time. Once applied, this impacted on pensions in 2010. The reason 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. The brake was applied yet again in 2009, in response to the sharp downturn in the economy and a rise in unemployment in the wake of the global financial crisis.

After the first net outflow in 2009, the following three years saw the AP funds disburse more in pension payments than was received in the form of contributions. As a consequence of a high level of new retirees over the next few years, this net out-flow is expected to continue for a considerable time. In practice, this means that the AP funds' assets are likely to decline. In 2012, net outflow amounted to SEK –3.8 billion, compared with SEK –1.2 billion in 2011.

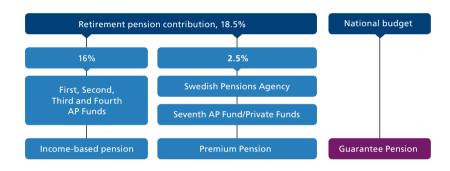
Pension system balance sheet

Buffer fund shares

Second AP Fund capital



The Swedish pension system



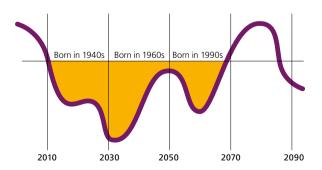
The national retirement pension comprises the following: an income-based pension, a premium pension and/or a guarantee pension. The pension is financed in the form of a levy of 18.5 percent on total income earned. Of this amount, 16 percent is used to finance annual disbursements (income-based pension) from the First, Second, Third and Fourth AP Funds, 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.

Automatic balancing mechanism

BR>1, higher indexing rate BR=1 Balance index BR<1, lower indexing rate

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. Once the balance ratio has regained a value in excess of 1, this triggers a more rapid upward adjustment than wage growth.

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 have exceeded contributions since 2009, when the large post-war generation of baby-boomers started to retire.

Clearly defined mission

As a buffer fund, the Second AP Fund's long-term mission is to maximize the return on pension assets under management, with a view to promoting strong growth in pension assets and thereby contributing to parity in the pension system, even when economic and demographic factors are in a state of flux. This is stated clearly in the Swedish National Pension Funds Act.

The AP funds' mandate includes 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 liquidity requirement associated with outflows from the funds.

Investment objective

The mission and objective, as described in the Act and its preliminary drafts, define clear principles that the AP funds shall observe in managing their pension assets. The purpose of each fund's investment activities, as determined by its board of directors, is to minimize the negative effect on pensions that would derive from applying the 'brake'. Based on an analysis in which portfolio choice is integrated with an assessment of how the pension system as a whole is likely to develop over the long term, the strategic portfolio selected will be the portfolio judged best able to contribute to achieving the defined investment objective.

The mission requires equal treatment of all generations, in compliance with the principle of 'generation neutrality'. For this reason, long-term commitments regarding return and risk, whether in relation to individual assets or the portfolio as a whole, are absolutely crucial when composing the strategic portfolio. Once finalized, the selected portfolio may be defined in terms of anticipated return on investment.

As instructed, the Second AP Fund has composed a portfolio that is expected to generate an average long-term annual real return of five percent.

Unfortunate confusion

Unfortunately, investment commitments and investment objectives often get mixed up in the public debate. The Fund's operational objective is the pension system and the anticipated effect of investment on pensions. The targeted return, which is defined as a percentage, is merely a description of the properties exhib-

ited by the long-term portfolio most likely to generate the greatest benefits in the form of pension disbursements.

In the past ten years, the Second AP Fund has generated a return of 108.2 percent, corresponding to an average annual return of 7.6 percent. Adjusted for inflation, this corresponds to an annual real return of 6.2 percent.

Value-generation strategy

The Second AP Fund's strategy is based on a step-by-step approach to value generation: choice of strategic asset allocation, selection of index and active management.

This approach is based on a set of principles, or Investment Beliefs. These describe the Fund's view of how capital markets function, and the opportunities and potential they present for generating a solid 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 generation neutral long-term growth prospects for future pensions.

Benchmark index

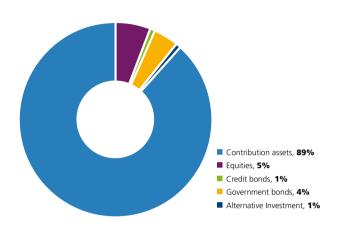
The Second AP Fund considers the choice of index to be part of the strategic investment process, where the index determines the investments selected for subsequent portfolio management,



More about the Fund's management strategy at www.ap2.se/en/Asset-management/Asset-Management/Asset-management-strategy/

Asset allocation, Swedish national pension system

(% of the Fund's share of pension system assets)



Strategic portfolio 2012

(% of Fund capital)



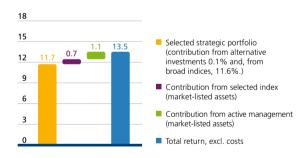
The Fund's first strategic portfolio

(% of Fund capital)



The upper pie chart at right shows the allocation of assets in the Second AP Fund's 2012 strategic portfolio, while the lower chart illustrates the first strategic portfolio, 2001. The above pie chart at left shows the same 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: Försäkringskassan (Social Insurance Office) and in-house calculations.

Second AP Fund value generation, %



Accumulated return, ten years, %



in-house and external. The Second AP Fund complements the broad and more traditional cap-weighted indices with more specialised indices.

Active portfolio management

The nature of the active portfolio management is determined by the Fund's choice of index. Internal and external management shall outperform the indices selected by the Second AP Fund. 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 (more on p. 16).

Continued focus on political and economic challenges

Looking back, 2012 was a year of continuing challenges on the financial markets, both political and economic. In spite of numerous positives, progress during the year was threatened by some large and ominously dark clouds.

The challenges faced in 2012 were not new. The issues and problems that arose, deriving to a great extent from political decisions and their consequences, were generally similar to those confronted in 2011. Unfortunately, this made them no easier to handle. On the financial markets, therefore, the focus on these challenges was more pronounced than normal.

Weakened economy

At the start of the year, the macroeconomic signals were fairly encouraging. During the spring, however, there was a marked decline in market activity, a trend that was maintained throughout most of the year. Much of the weakness noted in the global economy could be traced to declining demand in Europe, although demand from the USA was also weak. Again and again, economists were forced to downward revisions of their forecasts for global growth.



Financial markets have focused on political developments.

The main cause of this weakening was the austerities that had been (and are still being) implemented by many European governments. The purpose of these austerities has been to correct the budget deficits that have burdened so many countries. Parallel to these measures, structural changes are being introduced, in sectors such as pensions and taxation, to ensure that these economies function better in future.

A consequence of these austerities has been declining demand in emerging market economies, especially in Asia. This has led governments in many of the emerging economies to implement measures designed to stimulate growth. The effect of such measures has been limited, however. Nor have they been as comprehensive as those introduced after the financial crises of the autumn of 2008 and the spring of 2009.

The Swedish export industry has also been affected by the economic downturn in Europe, and weaker Asian demand, especially during the second half of the year. During the late autumn, a number of countries have shown signs of stabilisation or improvement. This said, the Swedish economy weakened later than most other countries. Consequently, both the level of redundancies and unemployment increased towards the close of the year.

Political decisions take centre stage

To a great extent, the financial markets focused their attention on political developments during the year. This led periodically to substantial fluctuations in the market. Early May saw a new election in Greece and a presidential election in France. In Greece, attention focused on whether the more reform-friendly parties would win or not. Had they failed to win, it is highly probable that Greece would have experienced still greater difficulty in financing their national debt – if possible. Even more important, a defeat at the polls could have led to a worsening of the crisis for the major members of the eurozone, specifically Spain and Italy. This would have jeopardized the entire structure of the European Monetary Union and the very existence of the euro. The Second AP Fund monitored developments closely. Prior to the May election, the Fund increased its strategic hedging ratio¹ against the euro, to counteract the risk that the situation might escalate.

The autumn also saw a presidential election in the USA. The result led to little significant shift in power, with a split majority in both houses, President Obama being re-elected. Following the election, attention immediately focused on the finance policy challenge that would arise at year-end ('the fiscal cliff'). This

challenge derived from the fact that the expiry of a range of temporary tax relief measures would coincide with the implementation of previously agreed economies. These measures were of such magnitude that – if nothing were done – the USA would immediately be plunged into recession. The negotiations continued right up to January 1, when both houses of the United States Congress passed a motion that solved the most acute problems, which involved tax hikes among other elements. Nevertheless, the deal was less comprehensive than many had hoped. It must be complemented by additional agreements concerning the tax system, the welfare system, federal outgoings and loan limits.

Key role of central banks

Quite apart from the political challenges, monetary policy decisions were of crucial importance during the year. At the beginning of the year, to guarantee the liquidity of the banking system, the ECB (European Central Bank) enabled banks to borrow at low fixed rates over a three-year period². After the summer, a new facility was created, OMT³, giving the ECB the ability to lower interest rates through the unlimited purchase of euroland government bonds. The plan is to try and avoid the sort of development experienced by Greece. However, this assumes that the country in question applies for assistance, while accepting implementation of a number of finance policy and structural reforms. The Second AP Fund considered the establishment of OMT a decisively positive factor in promoting the continued development of cooperation on the euro. Consequently, the Fund's strategic hedging ratio against the euro reverted to its original level.

Even the US central bank, the Federal Reserve, has pursued a monetary policy that has been geared to supporting the economy. As well as setting the policy rate close to zero, the Fed has played

an active role in several programmes designed to increase the banking system's available liquidity. After the summer break, the Fed also started to purchase mortgage-backed bonds to a total of USD 40 billion a month. This was intended to keep mortgage rates as low as possible, as a means of boosting the housing sector, which has been weak since 2007. The hope is that, in the long term, this will help to increase employment. The housing market is the key to US consumer behaviour and, if it can be improved, it will have a positive effect on the entire economy.

Looking ahead

Global economic growth will continue to be slow during 2013 – this in the wake of the austerities that continue to be implemented in many industrialised countries. Growth will continue to be driven by the emerging markets. Even so, there are numerous signs of an improvement in the economic climate. One such is the impression that the US housing market is experiencing a gradual recovery. Signals from Brazil, China and the rest of Asia indicate rising production, from relatively low levels, following a long period of inventory rundowns. For a more positive scenario to be realized, demand must really take off.

As usual, several risks threaten this more positive scenario. In the immediate future, one risk is that the negotiations on US finance policy decisions still to be resolved will drag out over time. There is also the risk that the situation in euroland could get worse again.

The Fund feels that the focus on political and economic challenges seen in recent years will continue in 2013 too. There does seem some hope of improved growth, however, especially if the rate at which austerities are implemented is reduced in the coming months.

- 1. That part of the Fund's foreign holdings that are hedged in Swedish kronor.
- 2. Long Term Refinancing Operation, LTRO.
- 3. Outright Monetary Transactions.

10-year government bond rates, %

Source: Macrobond

20

10

2010

2011

2012

2013

Greece

Ireland

Spain

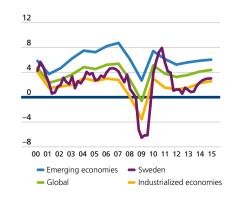
Portugal

Italy

Germany

GDP growth (annually adjusted), %

Source: IMF and Riksbanken

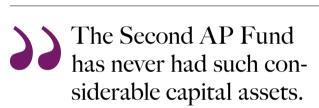


More capital for pensioners than ever before

The AP funds' portfolio management activities have made a positive contribution to the national pension system. Since its inauguration in 2001, the Second AP Fund has never had such considerable capital assets, which have increased by SEK 99.2 billion (net flows not included).

To contribute to maintaining or improving the balance in the pension system, the Fund's return must be higher than the income index which, since the buffer funds were established, has increased at an average annual rate of 3.2 percent.

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 factoring in the long-term prospects concerning the



financial markets. The work with the ALM model is designed to result in the creation of a portfolio that will minimize the impact of the automatic balancing mechanism on 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.

Controlled 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 indexlinked bonds. This means that the AP funds can and should accept a higher degree of risk in their portfolios. A degree of

controlled risk is also necessary if the funds are to be able to meet their targeted returns. This 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.

Ongoing diversification of the strategic portfolio

The Fund's long-term investment strategy and strategic portfolio has been under consistent development, ever since the Fund was started. A corner-stone of this process is to increase the spread of risk without compromising the potential future return. In 2007, the Fund intensified its efforts to achieve the long-term diversification of its investment strategy and, among other things, reduce its concentration on traditional equity markets, by introducing asset classes and strategies that fall outside traditional investment sectors. This change of course in investment strategy is long term and has taken several years to develop. This explains why the financial crisis that spread to the equity markets in 2008 had such a more dramatic impact on the portfolio than would have been likely today.

In 2012, the Fund's board of directors reached several decisions concerning the strategic portfolio, reflecting greater focus on alternative asset classes and strategies. The initial allocation to a tailored portfolio featuring alternative risk premiums was made at the start of the year. An analysis conducted in 2011 identified a number of systematic risk premiums on financial markets. These were considered able to enhance riskadjusted return and risk-diversification compared to traditional equities. These risk premiums are more or less common in many hedge funds and may therefore be seen as an alternative (and considerably cheaper) way to generate a hedgefond-type return, without having to invest in traditional hedge funds.

The strategies featured in the portfolio are linked to equitymarket volatility, reinsurance premiums for insurance companies, premiums associated with the corporate acquisitions and convertibles market, as well as strategies focused on the FX market and market for future dividends on corporate profits. Possible additional risk premiums may be added in future.

New asset classes

A decision to allocate part of the Fund's global portfolio of government bonds to a portfolio of alternative credits was also taken in 2012. This type of investment has arisen from the fact that the banks are experiencing difficulty in maintaining their role as lenders, especially to small and medium-sized businesses. This process is the consequence of a lack of capital caused by substantial credit losses and the more stringent capital cover and liquidity requirements. Consequently, the anticipated returns reflect not only the credit risks but the lack of liquidity and lending capacity. In the Fund's opinion, this situation may not be simply the result of the short-term functional failures of credit markets, but could well prove to be a longer term phenomenon that reflects underlying structural changes.

Asset class real estate has gained increasing significance in the past five years. This applies as much to investments in forest-and-agricultural real estate as in traditional commercial real estate outside Sweden. In terms of portfolios, the Fund's forest-and-agricultural assets contribute most to the diversification process, while the geographic spread of risk is more pronounced in traditional real estate. The strategic allocation increased by three percentage units in 2012, a third of which comprised forest-and-agricultural assets.

Another key area of focus in recent years has been investment in emerging markets. In 2012, as part of this strategic commitment, the Fund gained a licence as an approved foreign investor, granting the right to direct investment in China's domestic equities market. A procurement process to locate suitable portfolio managers was initiated during the autumn. The Fund is convinced that this will contribute to greater diversification of the portfolio, since a broader range of Chinese equities will ensure better exposure to future growth trends in the country.

A broad review of the Fund's strategic FX hedging policy resulted in a decision to increase its exposure to certain currencies. The main reason for lowering the currency hedge is changes in correlation patterns in recent years. In practice, this means that a weakening of the Swedish kronor has proved more typical of periods when stock markets have been in decline, and vice versa. Consequently, a higher level of FX exposure means a lower total portfolio risk than was previously the case.

A more short-term change in the strategic portfolio was made during the year, related to establishing a strategic FX hedge against the Fund's exposure to the euro. The risk of a sharp decline in the value of the euro, or possibly its total collapse, was periodically sufficiently feasible to justify a temporary protection for the portfolio, in the case of such an extreme event.

Choice of index

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. The choice of benchmark index is therefore integral to the portfolio management process.

In recent years, the Second AP Fund has chosen to use a variety of specialized indices that differ from the traditional cap-weighted indices. This is because a cap-weighted portfolio tends to award a higher weighting to those individual equities with the highest valuation, sometimes reflecting the fact that the share may be overvalued, and vice versa.

For this reason, the Second AP Fund therefore bases the composition of its portfolio partly on other methods. Examples of such methods include the equal weighting of Swedish companies in various size categories, GDP weighting of markets and weighting based on fundamental corporate factors (such as sales, dividend and profits) in the global equities portfolio. This is expected to lead to better diversification and a higher return in the long term.

Benchmark index for the strategic portfolio, Dec. 31, 2012

strategic portfolio, Dec. 31, 2012	Index				
Sweden	SBX: Stockholm Stock Exchange Benchmark Index SEW: 'Equal weight Sweden Index' CSRX: 'Carnegie Small Cap Return Index'				
Foreign equities*	MSCI GDP, MSCI World, MSCI World Value Weighted				
Emerging markets	MSCI Emerging Markets				
Swedish nominal fixed-income*	SHB Swedish All Bond				
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, JP Morgan GBI-EM Global Div.*				
Real estate	SFIX Svenskt Fastighetsindex				
Private equity	MSCI, World Local currency + 3 percent				
Convertibles	7 percent per annum				
Alternative risk premiums	MSCI World Local currency				
	Foreign equities* Emerging markets Swedish nominal fixed-income* Global government bonds Global credit bonds Government bonds in emerging markets Real estate Private equity Convertibles				

^{*} Adjusted index, adjusted after excluded companies and tax levels.

ACTIVE PORTFOLIO MANAGEMENT

Active portfolio management produces solid result

In 2012, the Fund's actively managed portfolio generated an excess return of 1.2 percent, or SEK 2.1 billion. All investment teams contributed to this positive performance. We gathered the heads of the different portfolio management units to discuss the year's achievements.

Some reasons for excess return

Anders: One reason for the strong growth noted in 2012 is the competence built up by the external mandates unit over time. With every year that passes, it is increasingly clear that we have identified and are using some of the foremost specialists in their particular investment sectors.

C-G: We have noted positive growth in virtually every asset class and have been able to generate an excess return by acting consistently in line with our structured investment processes. According to the Fund's long-term investment policy, we aim to increase diversification and exposure on emerging markets. This approach has also been adopted on the equities market, contributing to the net return for the year.

Tomas: At the close of 2011, our quantitative strategies unit launched a new version of its investment model, which has functioned even better than earlier versions. However, excess return is not generated by a computer. It's the investment concepts that we constantly test on the market. Over the years, we have explored more than a hundred.

Managing market challenges

Anders: It has been another dramatic year in terms of macroeconomic growth: worries about China, some optimism in the USA and continuing major problems for the European economies.

O-P: We have long been pessimistic about how the European debt crisis might be resolved and have predicted falling bond rates. This said, our international portfolio is measured against a traditional index, in which a country's total outstanding borrowings determine its weighting. This results in relatively high

weightings for debt-burdened countries such as Italy and Spain. Because of our limited exposure in these countries when market anxiety was most pronounced, we have generated a solid excess return while being able to maintain a low risk profile.

C-G: Yes, we have also found this strategy attractive and have been cautious about investing in companies that are significantly exposed to the European market. We identify stable companies with a clear growth strategy, exposed to markets that feature high GDP growth. The fact that we employ a fundamental approach and conduct own analyses of some 70 Swedish publicly-listed companies gives us an edge in this process.

Anders: Even in light of the fact that virtually all external mandates have exceeded their indices, the performance of the global equities portfolio, which posted an excess return of 5.4 percent for the year, stands out. These portfolio managers have generated a stable and solid excess return over several years now. They employ different but clearly defined investment strategies, which have proved equally valid, whether applied to weak or buoyant markets.

Tomas: The Fund's quantitatively managed global equities have also performed well. Several investment themes have functioned well, some of the best being factors based on companies' profitability, statistics on security lending and certain technical signals.

Locating new return-generating opportunities

O-P: We also see a number of new challenges arising from the current low interest rates. Although anticipating no major hikes in interest rates in the near term, there has been an increase in portfolio interest risk. With the average rate for our bond port-

folio at 1.6 percent, we must be on the alert and find new opportunities for generating a return. Among the available options, we are evaluating the new investment opportunities created by the current restructuring of the banking sector in the USA and Europe.

Anders: Absolutely right. Defining investment areas outside traditional asset classes is part of our strategy for enhancing return without increasing risk. In managing our external mandates, we have doubled the number of asset classes since 2007 without a significant increase in the allocation of capital. External managers are chosen for complex investments, where we lack the necessary resources. It is nevertheless the Fund's intention to gradually assume responsibility for the management of an increasing share of these investments in-house.

Tomas: And we shall continue to do this. Our own model for quantitative management can handle large volumes of capital at a fraction of the cost of equivalent external portfolio management services. It is also clear that the model functions well for an ever greater number of markets and asset classes. In 2013, we shall therefore take the next step and start in-house management of the Fund's investments on emerging markets. Our analysis demonstrates that our model will function just as well for the Turkish and Brazilian stock markets as for Stockholm's.

O-P: At the same time, it is important to spread risk between different types of asset management. This is why there is also a need for active management based on fundamental strategies. In this way, we complement each other.

The importance of thorough preparation

C-G: In our in-house management of Swedish equities, we adopt a value-oriented approach and conduct a thorough analysis of all holdings. We have ongoing contact and hold regular meetings with the companies, as well as meeting their customers. One question we ask ourselves constantly, which yields essential answers, is "How satisfied are the customers?"

O-P: I agree: a profound understanding of what we are investing in is the key to success. In recent years, we have conducted many visits in the crisis economies of southern Europe, which have provided vital insights and enabled us to make successful decisions.

Anders: Meeting those in whom we invest is also a self-evident necessity for those of us involved in the management of external mandates. We spend a lot of time visiting our various portfolio managers in different parts of the world, to be able to assess systems, business control, ethical principles and their ability to generate a return.

Tomas: Although we employ mathematical models to process large volumes of data, it is our capacity for coming up with good investment ideas that determines our ability to outperform index (or not). We test and evaluate ideas constantly, read quantities of research literature and thoroughly analyse our actions when we underperform.

The above discussion featured the following participants:

Claes-Göran Lyrhem (C-G)
Head of Equities

Anders Strömblad
Head of External Managers

Tomas Morsing
Head of Quantitative Strategies

Ole-Petter Langeland (O-P)Head of Fixed-Income Securities

The Second AP Fund's asset management organization is tasked with ensuring that the Fund invests efficiently in compliance with its strategic allocation. Furthermore, the Fund's portfolio managers utilize active elements to generate excess return compared to the strategic portfolio, as covered in the above discussion.

THE SECOND AP FUND'S NETWORK

Collaboration creates value

In recent years, the Second AP Fund has engaged in a number of partner-based agreements with some of the world's largest investors. It is involved in a range of international collaborations and networks, with the intention of affecting long-term share value and encouraging the development of more responsible investment.

One of the clearest indications of the Second AP Fund's increasing globalization is the way in which the strategic portfolio's composition has changed over the years. When the Fund was inaugurated in 2001, Swedish equities and bonds constituted the predominant assets. Since then, this share has steadily declined and, at year-end 2012, comprised a mere 29 percent of the portfolio. The Fund plans to continue to increase its international commitment over the next few years, both with respect to investment and participation in various networks and organizations. The platform and principles established by the Fund for its work in areas such as corporate governance provide the foundation for its investment in new markets and new asset classes.

Collaboration with individual investors

In recent years, the Second AP Fund has engaged in a number of partner-based collaboration agreements with some of the world's largest investors to invest in alternative assets.

One such example is the Fund's agricultural investments, entered into in association with US pension fund TIAA-CREF, the British Columbia Investment Management Corporation and Caisse de dépôt et placement du Québec, which have established a company for joint agricultural investment (more on page 29). In association with TIAA-CREF and Texas Teachers, the Second AP Fund jointly owns another agricultural company, Teays River Investments.

A further example is the US real-estate company US Office Holdings, in which the Fund became a part owner in 2012. The company is owned jointly by the state-owned South Korean pension fund NPS and by a subsidiary of the US real-estate company Tishman Speyer. In addition to three direct-owned properties, US Office Holdings, in partnership with the Government of Singapore Investment Corporation, also owns the real estate company PPI (Prime Plus Investments Inc), which owns 12 properties. The real-estate portfolio totals 15 modern properties in a number of US cities.

Since 2011, the Fund is, together with the First AP Fund, joint owner of Cityhold Property, focused on investment in European real estate.

Extensive network in private equity

The Second AP Fund also participates in promoting development within private equity companies, by networking with other investors and through dialogue with the asset management organizations that implement the investments. It has built up a global network in this sector and has close relations with many of the best investment teams in the USA, Europe and Asia. Acting within the framework of the Principles for Responsible Investment (PRI), the Second AP Fund has been involved with a number of private equity companies in a project intended to promote the joint establishment of better principles to address ethical and environmental issues relating to investments in and ownership of companies.

Membership and initiatives

Environmental and ethical issues are important elements of the Fund's investment process. The Second AP Fund is both a member of and provides support to various Swedish and international initiatives within this area. It was one of the first signatories to the UN's Principles for Responsible Investment (PRI). The Carbon Disclosure Project is another initiative supported by the Second AP Fund, a project in which some hundred major fund managers demand that the world's largest publicly-listed companies provide reports on their greenhouse emissions and how they are addressing the climate challenge.

International collaboration

Much of the Second AP Fund's international collaboration is conducted under the aegis of established organizations. It was an early member of the ICGN (International Corporate Governance Network), an international organization dedicated to coordinating the efforts of institutional investors concerning corporate governance issues.

The strategy for increasing the Fund's share of investments on emerging markets also involves seeking collaboration and participation in memberships to promote corporate governance issues on these markets. In 2012, the Fund became a member of the ACGA (Asian Corporate Governance Association), which is registered in Hong Kong.

The Principles for Responsible Agricultural Investment (PRAI)



Collaboration on responsible agricultural investments

The Second AP Fund has played an active role in drafting principles for investment in agriculture, aimed at promoting sustainability and transparency in this asset class. The work on these agricultural principles has mainly been carried out by the Fund's sustainability analyst, Christina Olivecrona. She also conducts the Fund's sustainability analyses, which form a key element in its evaluation of agricultural real estate.



In September 2011, in association with a group of international investors, the Second AP Fund launched the Principles for Responsible Agricultural Investment (PRAI). All signatories undertake to observe these principles and to submit annual report on their progress. These agricultural principles will be further refined by input from investors and through the comments of other interested parties. By yearend 2012, 19 investors had signed up to the principles and, during the autumn, the first reports were presented.

"For the Second AP Fund, these agricultural principles provide both a framework for evaluating potential new portfolio managers and when monitoring the performance of current managers. At present, we have two joint-owned companies that invest in agricultural real estate, Teays River Investments and TIAA-CREF Global Agriculture, both of which have implemented these principles in their business operations," states Jessika Ingvarsson, responsible for Fund assets in forest-and-agricultural real estate.

The Second AP Fund's investments in agricultural real estate are conducted via companies that are owned jointly with the Fund, allowing the Fund greater freedom to act more long term. By year-end 2012, both companies had invested in some 50 agricultural properties in Australia, Brazil and the USA, amounting to a total acreage of some 134 000 hectares.

"TIAA-CREF is a leading US pension insurance organization, with about USD 400 billion under management and the world's largest platform for agricultural investment.

Cooperation with TIAA-CREF provides us with access to a highly competent organization, one which subscribes to the same values when it comes to issues such as sustainability," adds Jessika.

Both the Second AP Fund and TIAA-CREF have already submitted their first reports on their implementation of and progress with the agricultural principles. More at www.ap2.se

THE SECOND AP FUND'S STAFF

Few thought it possible

Misgivings over the possibility that recruiting the appropriate competence could be difficult as a result of deciding to establish the Second AP Fund in Gothenburg proved entirely unfounded. Today's Second AP Fund is an employer that has attracted some of the foremost in their respective fields and which conducts successful asset management in virtually all asset classes and all parts of the world.

The Second AP Fund's ability to recruit new staff, retain them and contribute to their development is essential in achieving the Fund's long-term objective. Since its inauguration in 2001, the Second AP Fund has enjoyed rapid development and of all the AP funds has had the largest or second largest volume of capital assets under management. Today, the Second AP Fund is a pronounced knowledge-based organization, where the specialist competencies, creativity and commitment of its staff are critical to a successful result.

Crucial competence development

Of the Fund's capital assets 71 percent are managed in-house, involving a growing number of asset classes and strategies, placing considerable demands on competence in different investment sectors, as well as on business services and risk management skills. All members of staff are offered ongoing skills development within their individual fields of competence. Another important key to success is team development and always working together as a single unit. In 2012, an employee survey was conducted for the third time. Based on the results, each department has continued to work towards improvement in the targeted areas. The Fund's corporate culture shall be defined by personal responsibility and individuality, within the broader framework of a strong team spirit. Ethical behaviour is an important part of this corporate culture, forming a natural element in the new corporate values defined for the Fund during the year.

Leadership training

Strong leadership is a key competitive tool in promoting the development and motivation of members of staff. The Second AP Fund's strategy defines the skills, attitudes and responsibilities that managers within the organization are expected to possess. This leadership strategy is assessed, providing the basis for the drafting of an individual development plan for each manager.

Health and flexible working hours

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.

The Fund considers it important that its workforce should reflect diversity in terms of background, experience, age and gender. It 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 2012, two men and three women took parental leave at different times during the year.

Remuneration

Competitive levels of remuneration play an important role in attracting new and retaining current staff. Comparative statistics covering specific positions at relevant and comparable organizations in the financial sector are published annually by an independent agency. The point of departure is that the Fund's remuneration levels shall be close to the median, compared to the reference group. The Second AP Fund's incentive programme, apart from the CEO and other members of the Fund's executive management, entitles employees to a potential maximum variable remuneration equivalent to two months' salary, assuming certain criteria are met. The programme, presented on our website at www.ap2.se, is performance-linked to long-term targets. A number of employees that had attained their individual targets were awarded variable remuneration in 2012.

Personnel-related benefits

As a manager of pension assets, the Fund is entrusted with an important task. This places stern demands on our ability to act with sound judgement in our day-to-day activities and that we conduct our work in a fully transparent manner. These issues are discussed often within the Second AP Fund. We share a common set of values and observe clearly defined policies concerning our professional behaviour.

In the light of the attention that was focused on the AP funds' personnel benefits during the summer of 2012, it was decided that a new review of all personnel-related policies should be conducted to determine whether any aspects required additional clarification. Furthermore, the chairs of all AP funds agreed to implement a harmonization of the broad framework pertaining to personnel-related benefits. More at www.ap2.se

Focus on internal mobility

As a global fund manager operating across a broad range of asset classes, the Second AP Fund fosters many specialist roles and creates many career opportunities. 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, and Chalmers Institute of Technology, enabling them to offer students opportunities of temporary employment on specific projects, trainee positions and temporary employment during summer vacations. This has created a recruitment base for future employees, who in the long-term can grow into new roles. Ten of the Fund's current members of staff have come direct from studies at the School of Business or Chalmers.

At year-end 2012, the Fund numbered 60 full-time employees, 38 percent of whom were women. Women also accounted for 29 percent of the Fund's executive management. The average age of employees was 42, as was the median age. Personnel turnover remained low during the year, with two leaving and four new staff being recruited.

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 has been recertified yearly since then. 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 and from carbon dioxide emissions in conjunction with travel. In-house goals have been established based on the Fund's 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.

Balancing career and family

Since 2012, Olle Eriksson has headed the Second AP Fund's Performance Management department. His new responsibilities coincided with the birth of his second child. Just prior to Christmas, therefore, Olle started his paternity leave, which will extend until after the summer.

"I have been at the Fund for ten years now and enjoy working here. IThe Fund has an open corporate culture, focused on considerable personal responsibility and a robust team spirit."

Olle graduated from Karlstad University with a degree in mathematical economics. In conjunction with further mathematical studies at Gothenburg University, he applied for and gained a summer job at the Second AP Fund.

"This was at what was then the new department of Performance Measurement. In spite of the fact that it was a completely new world for me, my skills were well suited to the task. This made it a no-brainer when I was offered the chance to remain and help to build up the department. Since then it has been an exciting and instructive journey, featuring ten years of dramatic change in the wider world, and a constant debate on the issue of return."

"In conjunction with a restructure of the Fund in 2011, I was offered the opportunity to take over as head of the department. Since then, I and my staff have continued to refine our analytical approach, to ensure that we stay at the forefront in our field."

Now, however, Olle is embarking on another journey. Together with his children, Olle will continue to develop to return ready to tackle new challenges at the Second AP Fund.

A growing global portfolio of real estate

As a complement to the Fund's Swedish, unlisted real-estate holdings, and as part of the continued diversification of the strategic portfolio, the Second AP Fund has been investing in real estate in other parts of the world since 2011.

"We wanted to begin by investing in commercial real estate on liquid and stable long-term markets in Europe, such as London, Paris or Hamburg. Initially, we looked at the possibility of investing via a real-estate fund but, since none satisfied our investment criteria, we decided



Investment in real estate estate - an ongoing diversification of the strategic portfolio.

to form a joint real-estate company, Cityhold Property AB, with the First AP Fund," explains Helena Olin, who heads real-estate investment at the Second AP Fund.

The Second AP Fund's goal is to invest € 250 million in step with the rate at which Cityhold Property makes its investments. With a 50-percent debt-equity ratio and an equally large investment by the First AP Fund, the company's total investments could rise to as much as € 1 billion. The first investments were made in 2012, comprising

three modern commercial properties at central locations in London

During the year, the Fund finalized a new strategy for investments in real estate made outside Europe.

"Towards the close of 2012, we continued the process of complementing the real-estate portfolio and increasing its diversification. We invested a total of USD 325 million in the American real-estate company US Office Holdings, equivalent to 41 percent of its total equity," Helena adds.

US Office Holdings is owned jointly by state-owned South Korean pension fund NPS and by a subsidiary of the US real-estate company Tishman Speyer. In addition to three direct-owned properties, US Office Holdings, in partnership with the Government of Singapore Investment Corporation, also owns the real estate company PPI (Prime Plus Investments Inc), which owns 12 properties. The real-estate portfolio totals 15 centrally located commercial properties with a combined market worth in excess of USD 1.8 billion. Some 70 percent of the portfolio's total worth consists of real estate in New York, San Francisco, Seattle and Beverly Hills.

"Through this investment, in collaboration with other long-term investors that have extensive local competence and experience, we shall be able to invest in a mature and transparent market with true growth potential. After these two investments, it is now time to take the next step in diversifying the real-estate portfolio. One option we are considering is the possibility of investing in unlisted real estate on emerging markets," concludes Helena.

ALTERNATIVE INVESTMENTS

New routes to a solid return

Globalization of the economy promotes closer interlinking within asset classes and sometimes even between different asset classes. This also increases the risk of more widespread changes in value. To counteract this trend, the composition of the Second AP Fund portfolio is becoming increasingly diversified.

The Second AP Fund continually assesses opportunities for investing parts of the portfolio in investment sectors outside the traditional publicly-listed asset classes. In recent years, the Fund's alternative investments have grown rapidly, amounting to 15.1 percent (12.4) of the Fund's combined capital assets by year-end 2012. These investments are designed to achieve a long-term return on a level with or substantially in excess of the anticipated return on publicly-listed equities, depending on the type of investment. They should also help to spread risk, thanks to low correlation with the Fund's other assets. The return generated on the Fund's alternative investments in 2012 was 13.9 percent.

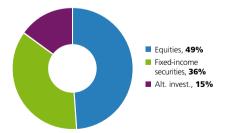
Why private equity funds

The Second AP Fund, as a long-term investor, is able to benefit from the fact that certain investments generate a higher return because of their lower liquidity. The Fund's investments in private equity funds provide one such example. Studies show that a relatively modest number of private equity funds can yield a large part of the excess return. The Fund's long-term and systematic efforts in building up a portfolio of investments with some of the best fund managers in the sector have proved successful. By year-end 2012, the Fund's holdings were distributed between 27 different investment teams and 56 funds. In 2012, the return on investment was 17.1 percent and, since its establishment in 2001, investments in private equity funds have contributed SEK 2.7 billion to the Fund's total worth, excluding the currency hedge.

Why convertibles

Convertibles are affected by the performance of both equities and credits, but provide a useful safeguard when stock prices are falling. The portfolio was established in the spring of 2009 to

Strategic portfolio, December 31 2012, %



During 2012, investment increased, especially in foreign commercial real estate and agricultural real estate. Also, a new asset class, alternative risk premiums, was introduced. In 2013, the portfolio will be expanded to include investments in alternative credits and Chinese equities.

benefit from the extreme situation that arose concerning valuations, in the wake of the financial crisis. These holdings, which overall have a relatively low risk profile, are actively managed by four external fund managers who apply different management styles. Since the portfolio was established in 2009, it has generated a total return of 31.6 percent and, in 2012, a return of 12.4 percent.

Why conventional real estate

By investing directly in real estate, the Fund is able to generate a solid, long-term direct return and improve risk spread in its total portfolio. Its unlisted real-estate holdings comprise holdings in Swedish real-estate companies Vasakronan (25 percent equity interest) and Norrporten (50 percent equity interest), together with Cityhold Property (50 percent equity interest), for investments mainly in commercial real estate in major European cities. Since autumn 2012, the Fund also has a 41-percent interest in American real-estate company US Office Holdings.

Why forest-and-agricultural real estate

Forest-and-agricultural real estate assets are expected to yield a stable and, in the long term, solid return. This derives from a perception that the underlying trend towards increased urbanisation and better general welfare will increase the demand for forest-and-agricultural products. Both asset classes are also relatively insensitive to fluctuations in the economy and serve as excellent means of spreading portfolio risk. During the year, the Fund extended its undertakings in joint-owned company TIAA-CREF Global Agriculture, concerning investments in agricultural estate in Australia, Brazil and the USA. Furthermore, investment

in the Teays River agricultural fund has been substantially increased and reconstituted as a directly-owned company. The total return on the Fund's unlisted real-estate holdings, including forest-and-agricultural real estate, amounted to 12.4 percent in 2012. Since the Fund's start, these investments have contributed SEK 10.8 billion to its total market value.

Why alternative risk premiums

Alternative risk premiums are expected to contribute to greater diversification and a higher risk-adjusted return due to the fact that they are virtually immune to traditional stock-market risk. Several of these risk premiums commonly feature in the portfolio strategies utilized by many hedge funds. Rather than looking for and investing in these funds, the Second AP Fund is building up its own portfolio. Towards the end of 2012, the Fund started to invest in a balanced portfolio based on five different strategies – including a volatility strategy, dividend forwards and arbitrage in connection with corporate acquisitions.

Why Chinese equities

The next major phase in China's rapid economic development is expected to be a phase of domestic consumer-driven growth. The Second AP Fund is the first Swedish investor to be awarded a licence for direct investment in domestic Chinese equities. This enables the Fund to build a portfolio featuring broader exposure to the domestic economy, including small companies and companies focused on the consumer sector. Investment in these equities will be initiated via external asset managers during the second half of 2013.

Result and performance 2012

As of December 31, 2012, Fund capital totalled SEK 241.5 billion, the largest volume of Fund capital ever recorded. All asset classes have noted a positive absolute return, and the Fund reports a net result of SEK 28.6 billion.

Fund capital is affected by two factors, the net result for the year and net flows within the pension system. In 2012, Fund capital increased by a net of SEK 24 832 million, deriving from the positive result of SEK 28 620 million, against which net outflows from the pension system were charged in an amount of SEK –3 788 million. Capital flows consisted partly of contri-

bution payments to the system and pension disbursements from it, amounting to a net of SEK –3 568 million, and partly of the cost of administering the national pension system, which was charged against Fund capital in an amount of SEK –220 million. For the fourth successive year since the pension system was launched, the net of inflows and outflows was negative.

Fund capital performance 2012, SEK million

Fund capital carried forward	241 454
Net result for the year	28 620
Administration contribution	-220
Pension disbursements	-59 009
Pension contributions received	55 441
Fund capital brought forward	216 622

Composition of strategic portfolio, exposure and return as per December 31, 2012

Asset class	Strategic portfolio, %	Exposure, %	Exposed value, billion	Absolute return, %	Relative return, %	Active risk ex post*, %
Swedish equities	11.0	11.2	27.0	16.3	0.4	0.4
Foreign equities	38.0	37.8	91.3	12.9	1.4	0.4
Fixed-income securities, including liquidity and accrued interest	36.0	35.9	86.7	5.4	1.0	0.4
Total listed assets, excluding commission fees and operating expenses				13.4	1.1	0.3
Alternative investments	15.0	15.1	36.5	13.9		
Total Fund capital, excluding commission fees and operating expenses	100.0	100.0	241.5	13.5		

^{*} Historical outcome, 12 months rolling.

Net result for the year

The net result of SEK 28.6 billion reflects the high return noted by all asset classes within the Fund's portfolio.

Operating income

Operating income comprises direct return as well as net return per asset class, foreign exchange gains/losses and commission fees. Direct return, in the form of net interest income and dividends received, totalled SEK 9 610 (9 545) million for the year. The net result for listed equities comprises both unrealized and realized gains/losses, and totalled SEK 15 557 (–15 025) million, including expenses for performance-based fees. This result derives from the high return generated on the Fund's portfolios of Swedish and foreign equities. The portfolio of Swedish equities generated a total return of 16.3 percent, while the Fund's portfolio of foreign equities noted a return of 12.9 percent.

The net result for unlisted equities totalled SEK 2 657 (1 509) million and is largely attributable to unrealized changes in the value of real estate and the realized return on private equity funds.

The net result for fixed-income securities totalled SEK 3 848 (2 002) million, with positive contributions from all categories of such securities. Government bonds on emerging markets posted the highest return reported for this asset class.

The Fund's trade in derivatives posted a positive net result of SEK 1 241 (–1 736) million, where investment in derivatives exposed to emerging markets had the greatest impact.

Currency hedging of the Fund's portfolio had a highly positive impact on the net result, due mainly to strengthening of the Swedish kronor against a number of other currencies. The reported net of currency gains/losses totalled SEK –3 921 (–571) million.

Management costs in the form of performance-based fees, totalling SEK 60 (99) million for 2012, 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 charges of SEK 193 (200) million, as well as custodial expenses of SEK 10 (10) 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 and custodial charges. 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 42. The Fund's operating expenses and commission fees, expressed as an expense ratio, amounted to 0.16 (0.17) percent for 2012.

A global cost-efficiency comparison with other pension funds demonstrates that the Fund is highly cost efficient, which is commented on in greater detail on page 36.

Operating expenses

Operating expenses totalled SEK 169 (159) 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 0.07 (0.07) percent.

External management costs

The degree of active risk adopted and the market selected have a major impact on the cost of managing the Fund's capital. During 2012, an active focus was adopted for the capital assets under external management and, by year-end, SEK 70 billion was being managed under external mandates, including unlisted assets. This corresponds to 29 percent of the Fund's entire capital.

The cost for the external management of market-listed assets partly comprises a fixed element and, for certain assignments, a performance-based element. In 2012, the fixed cost amounted to SEK 189 million and the variable performance-based element to SEK 60 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 193 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 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 adopted a conservative approach to the volume of equities loaned. In 2012, revenues from security loans totalled SEK 27 million. This income contributed positively to the Fund's relative return and is reported as interest income in the income statement.

Brokerage commission

A brokerage commission is paid on the purchase and sale of equities and participations. When buying and selling other asset classes, 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 listed equities and participations (see note 2 on page 42).

Commission fees paid in 2012 totalled SEK 57 million. Of these costs, 2 percent derived from commission paid within the Fund's external management, the remainder to the Fund's in-house portfolio management organisation. Costs amounted to 0.04 percent of the total trading volume.

The following five counterparts (listed in alphabetical order) received commissions corresponding to approximately 67 percent of total commission payments: Credit Suisse, Deutsche Bank, Goldman Sachs, SEB and Swedish Handelsbanken.

Contribution to absolute and relative return, %

	Contribution to absolute return, %	Contribution to relative return, %
Swedish equities	2.5	0.1
Foreign equities	5.4	0.6
Fixed-income securities, incl. liquidity and accrued interest	2.3	0.4
GTAA	0.1	0.1
Overlay	0.1	
FX Hedge	3.0	
Total market-listed assets excl. alternative investment and implementation effects	13.4	1.15
Implementation effects*		-0.07
Total market-listed assets excl. alternative investment and incl. implementation effects	13.4	1.1
Alternative investments	0.1	
Total assets excl. commission fees and operating expenses	13.5	

^{*} Result effects to maintain exposure to the strategic portfolio.

Portfolio return

The return on the total portfolio for 2012, excluding commission fees and operating expenses but including performance-based fees, was 13.5 percent. This makes it the fourth best year, with regard to the reported percentage returns per year, since the Fund's inauguration.

All asset classes – Swedish and foreign equities, Swedish and foreign fixed-income securities and alternative investments – noted a positive return for the year. Swedish equities posted the highest return, 16.3 percent, followed by alternative investments, i.e. real estate, private equity funds, convertibles and alternative risk premiums, which generated a return of 13.9 percent. Foreign equities noted a 12.9 percent return (in Swedish kronor and excluding the year's positive effects of FX hedging). Fixed-income securities, excluding FX hedging of foreign bonds, generated a combined return of 5.4 percent.

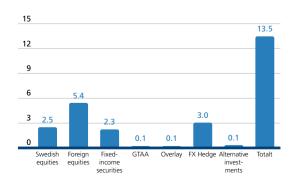
The contribution made by different asset classes to the total result depends both on the return generated and on the relative percentage of portfolio value they represent during the year. Constituting the largest share of the portfolio, foreign equities made the largest contribution to the overall result, amounting to 5.4 percent. Swedish equities contributed 2.5 percent and fixed-income securities 2.3 percent. Alternative investments, which account for a smaller percentage of the total portfolio, contributed 0.1 percent.

The Fund's FX hedging policy is designed to mitigate portfolio risk. To achieve this, the Fund implements a systematic FX hedging programme, with a view to reducing variation in portfolio worth over the long term. Furthermore, special circumstances can trigger the implementation of active FX hedging decisions. The uncertain situation in the eurozone countries, in conjunction with the Greek elections during the late spring, induced the Fund to hedge its entire exposure to the euro. After the European Central Bank ((ECB) decided to offer unlimited financing for government loans within the framework of the OMT programme, the Fund reverted to the normal FX hedging ratio applied to the European currency. This FX hedge had a fairly significant impact on the Fund's return. Including the decision to hedge the Fund's entire euro exposure during the summer, the hedge contributed 3.0 percent to overall return.

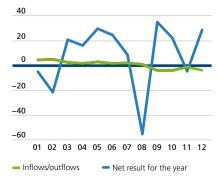
The Fund's real estate portfolio generated a return on investments of 12.4 percent over the year. The return on private equity investments was 17.1 percent, while the portfolio of convertibles generated 12.4 percent. Investment in alternative risk premiums was initiated towards the end of the year, with limited exposure to risk.

Over the past ten years, the Second AP Fund has generated a return of 108.2 percent, corresponding to an average return of 7.6 percent per year. After adjustment for inflation, this corresponds to an annual real return of 6.2 percent.

Contributions to the total portfolio, absolute return 2012, %



Fund performance and flows, 2001–2012, 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, followed by the financial crisis, which peaked in 2008. During 2011, the financial markets were sharply affected by debt crises in different parts of the world, although in 2012 the world's stock markets once again produced strong growth. These crises are mirrored by strong fluctuations in the Fund's net result and capital over its first twelve years.

Portfolio of listed assets

The Fund's portfolio of market-listed securities comprises Swedish and foreign equities, Swedish and foreign fixed-income securities, tactical allocation and FX management. In 2012, the listed portfolio posted a positive return of 13.4 percent. Total relative return was 1.1 percent. Implementation effects accounted for -0.07 percent of this total. Furthermore, the relative result was also very evenly distributed over the year.

Swedish equities

The portfolio of Swedish equities outperformed benchmark index by 0.4 percent. Most of this excess return was generated by the Fund's in-house fundamental-focused portfolio management team. At the start of the year, all external mandates for the management of Swedish small cap portfolios were terminated. This coincided with the launch of a new in-house model for investment in Swedish small caps. This achieved a positive result and outperformed index by 3.1 percent. The portfolio of Swedish equities' combined contribution to the total relative return was 0.1 percent.

Foreign equities

Management of the portfolio of foreign equities produced a solid relative result of 1.4 percent. Whether under quantitative in-house management or external mandate, the Fund's portfolios of equities in both industrialized and emerging markets generated a positive relative return. The management of foreign equities contributed 0.6 percent to the total relative return in the Fund's portfolio.

Swedish and foreign fixed-income securities

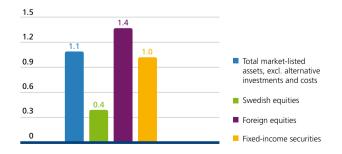
Management of fixed-income securities produced a combined relative return of 1.0 percent. This is a particularly satisfying result, given the continued volatility of the fixed-income market in 2012, in the wake of the eurocrisis. The combined contribution to the Fund's relative return was 0.4 percent.

The Fund's in-house fundamental-focused management of Swedish fixed-income securities outperformed index by 0.5 percent, while the relative return on the Fund's quantitative management was 0.2 percent. The latter risk-adjusted result is excellent. The in-house managed portfolio of foreign government securities outperformed index by 1.9 percent. The externally managed portfolio of credits contributed to the Fund's total return, thanks to reduced credit spreads during the year. The active return on these was also generally positive. Emergingmarket bonds also performed well, and several mandates produced returns of between 10 and 15 percent. Management of these assets also produced a broadly positive relative return.

Tactical allocation and FX

The Fund's in-house tactical allocation and FX trading activities led to breakeven for the year. The externally managed GTAA mandates continued to make a positive contribution to the overall result.

Relative return per asset class 2012, %



Swedish equities

	2012	2011	2010	2009	2008
Exposed value, SEK billion	27.0	30.8	44.9	37.4	30.8
Absolute return, %	16.3	-13.3	27.8	52.8	-42.0
Relative return, %	0.4	-0.5	0.8	1.4	-1.7
SIXRX, %	16.5	-13.5	26.7	52.5	-39.1
Share of external management, %	0	9	5	7	7
Active risk ex post, %	0.4	0.7	0.5	1.1	1.9

Foreign equities

	2012	2011	2010	2009	2008
Exposed value, SEK billion	91.3	81.2	75.0	71.1	68.9
Absolute return, %	12.9	-8.2	5.2	25.0	-29.5
Relative return, %	1.4	-0.1	0.4	-0.2	-1.2
MSCI AC World, %	10.8	-5.0	6.6	22.3	-27.1
Share of external management, %	26	26	26	26	28
Active risk ex post, %	0.4	0.5	0.5	1.1	2.0

Fixed-income securities

	2012	2011	2010	2009	2008
Exposed value incl. liquidity, SEK billion	86.7	77.7	77.2	74.5	57.3
Absolute return, %	5.4	6.8	0.5	2.5	16.6
Relative return, %	1.0	-0.6	0.5	0.7	-1.3
Share of external management, %	30	31	22	24	20
Active risk ex post. %	0.4	0.4	0.3	0.6	0.5

Five-year review

	2012	2011	2010	2009	2008
Fund capital, SEK million	241 454	216 622	222 507	204 290	173 338
Net inflows from the Swedish Pensions Agency and Special Management Fund, SEK million	-3 788	-1 240	-4 041	-3 906	884
Net result for the year, SEK million	28 620	-4 645	22 258	34 858	-55 058
Annual return on total portfolio before commission fees and operating expenses, %	13.5	-1.9	11.2	20.6	-24.0
Annual return on total portfolio after commission fees and operating expenses, %	13.3	-2.1	11.0	20.3	-24.1
Expense ratio, incl. commission fees, %	0.16	0.17	0.17	0.18	0.16
Expense ratio, excl. commission fees, %	0.07	0.07	0.08	0.08	0.08
Standard deviation ex-post, market-listed portfolio, %	6.4	10.0	8.4	12.0	19.1
Standard deviation ex-post, total portfolio, %	5.8	_	_	_	_
Sharpe ratio ex-post. market-listed portfolio	1.9	neg	1.1	1.9	neg
Sharpe ratio ex-post, total portfolio	2.0	_	_	_	_
Annualized return after commission fees and operating expenses, 5 years, %	2.4	0.6	3.5	4.9	3.3
Annualized return after commission fees and operating expenses, 10 years, %	7.4	4.3	4.2	_	_

Alternative Investments 2012

The Second AP Fund has gathered investments in unlisted real estate equities (including forest-and-agricultural real estate), private equity funds, alternative risk premiums and convertibles featuring targeted absolute returns under asset class Alternative Investments.

These assets jointly account for 15.1 percent of total Fund assets under management. Real estate represents the largest share, accounting for 7.5 percent of total Fund assets. Then come private equity funds and convertibles (4.0 and 2.3 percent), forest-and-agricultural real estate (0.9 percent) and alternative risk premiums 0.4 percent.

The overall return on alternative investments was 13.9 percent for the year.

Convertibles

Since 2009, the Second AP Fund has allocated some two to three percent of its assets to a global portfolio of 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.

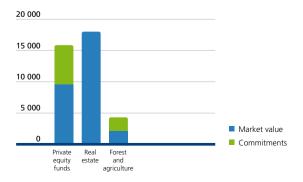
During 2012, many global stock markets noted positive growth and the assumption was that convertibles, which are defensive in character, would generate a return weaker than might be expected from broad investment in equities. However, the portfolio of convertibles generated a return of 12.4 percent. Since it was established in 2009, the portfolio has generated a total return of 31.6 percent.

Private equity funds

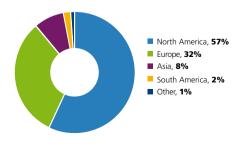
The past year has been notable for a limited number of major transactions and a relatively greater number of small and medium-sized corporate deals. Private equity funds have conducted the divestment of several substantial corporate assets, but mainly to strategic buyers and not in the form of IPOs. New funds have had difficulty in attracting capital, and we have seen several fund managers reduce the size of their newly established funds. Each transaction is taking longer, demanding some resilience on the part of fund managers. Generally speaking, the North American market has been much more buoyant than those in Europe and Asia.

The Second AP Fund's portfolio noted considerable activity, irrespective of the funds' strategies or geographic focus. As well as a large number of investments, the funds also carried out a significant number of divestments and IPOs, including Three Rivers (sold by Riverstone to a strategic buyer), Starbev

Unlisted alternative investments, classified according to investments completed and commitments, SEK billion



Investments in private equity funds by geographic market, %



(sold by CVC to a strategic buyer), Talaris (sold by Carlyle Europe to a strategic buyer), Splunk (an IPO managed by TCV), M&C (sold by Lyceum to a strategic buyer).

Profit growth in the funds' portfolio companies has been good. In spite of the market's funding difficulties, especially in Europe, the companies have encountered no problems in attracting funding, and several mature loans have been renegotiated on more attractive terms.

The Second AP Fund made eleven new investments in 2012, involving commitments of approximately SEK 2.3 billion. These new investments, which provide an excellent complement to the Fund's current portfolio, were made in funds managed by Ares, Investindustrial, TPG, Riverstone, Khosla, Lyceum, Sun, HIG, Seguoia and KPCB.

A number of attractive investment opportunities in funds with both the experience and characteristics sought by the Second AP Fund had to be rejected, in light of the statutory five-percent limit imposed concerning the Fund's total capital exposure to private equity funds. As of December 31 2012, the Fund's total investment commitment was SEK 17.0 billion. Since the start 2001, SEK 12.5 billion (including management fees) has been invested, of which SEK 1.6 billion in 2012. Although the portfolio is still at a relatively early stage of its development, a growing number of its private equity investments may be considered mature. So far, the portfolio has repaid SEK 5.9 billion since its start. The return on investment in private equity funds

was 17.1 percent at year-end 2012, the market worth of the portfolio amounting to SEK 9.4 billion, excluding FX hedge. Fees paid for the management of unlisted 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 (page 40).

Real estate

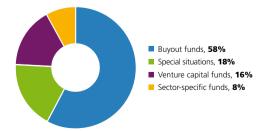
The Fund's unlisted real-estate holdings consist of a 25-percent interest in Vasakronan Holding AB, a 50-percent interest in NS Holding AB (Norrporten) and Cityhold Property AB, as well as a 41-percent interest in US Office Holdings LP.

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.

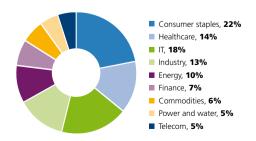
Vasakronan, which is owned jointly by the First, Second, Third and Fourth AP funds, is Sweden's largest real-estate company with a concentrated and attractively located portfolio of real estate holdings in the Stockholm, Gothenburg, Öresund and Uppsala areas. The company owns and manages more than 220 properties, totalling some 2.8 million square metres of floor space, with a total market worth of SEK 84 billion.

Norrporten is owned jointly (50/50) by the Second AP Fund and the Sixth AP Fund. The company's portfolio of real estate consists mainly of commercial properties (offices) in mid-sized

Original investment commitments in private equity funds, %



Investments in private equity funds, by sector



Swedish cities that enjoy solid growth (Luleå, Umeå, Sundsvall, Örebro, Jönköping and others). Norrporten also has real estate in Stockholm, Copenhagen and Hamburg. It owns and manages some 130 properties, totalling some 1.1 million square metres of floor space, with a total market worth of SEK 25 billion. Furthermore, this value growth in the Fund's Swedish real estate portfolio means that it has increased its share of the Fund's total worth to approximately 5.5 percent.

In the past two years, the Fund has been investing in real estate outside Sweden. In 2011, in association with the First AP Fund, the Second AP Fund established Cityhold Property AB, a real estate investment company, focused primarily on real estate in London, Paris and Munich. To date, the company has acquired three centrally located office properties in London, comprising a total of 50 000 square metres of floor space, with a market value in excess of SEK 5 billion.

During 2012, the Fund acquired a 41-percent interest in US Office Holdings, an American real estate company, owned jointly by the state-owned South Korean pension fund NPS and the real-estate company Tishman Speyer. In addition to three direct-owned properties, US Office Holdings, in partnership with the Government of Singapore Investment Corporation (GIC), also owns the real-estate company PPI (Prime Plus Investments Inc). The real-estate portfolio comprises 15 centrally located office properties, with floor space totalling 830 000 square metres. US Office Holdings' total market value exceeds

SEK 12 billion. Of this, 70 percent consists of real estate on both the east and west coasts of the USA, in New York, San Francisco, Seattle and Beverly Hills. Another 20 percent of the portfolio's value derives from real estate located in Chicago.

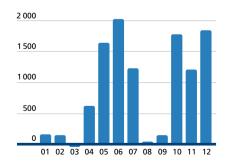
The total return on the Fund's unlisted real estate holdings (including forest-and-agricultural real estate) amounted to 12.4 percent for 2012, representing about 8 percent of Fund assets.

Forest-and-agricultural real estate

In 2010, the Second AP Fund made its first investments in forest -and-agricultural real estate by investing in an agricultural fund in the USA and in two forest funds – one in the USA and one in Australia/New Zealand. In 2011, a significant step was taken by establishing a joint venture with TIAA-CREF, for investment in agricultural real estate in Australia, Brazil and the USA. These investments mainly involve commercial-scale grain production on high quality agricultural real estate in countries with clearly defined legal structures, where agricultural production is efficient and independent of state subsidies and other forms of support. The Second AP Fund feels it is essential that the fund managers it selects subscribe to the same values concerning a long-term view and the importance of responsible and sustainable investment.

In 2012, no new investments were made in agricultural real estate. However, the Fund increased its investment commitments from USD 250 million to USD 450 million in the joint

Annual result, unlisted real-estate companies since start, SEK million



Income and expenses for external management of unlisted assets 2012, SEK million

Gross income	967
Management fees paid and booked as acquisition value	-145*
Management fees paid and reported as commission expense	s –4
Net contribution	818
Assets under management, market worth Dec. 31, 2012	11 438
Invested capital, Dec. 31, 2012	11 485
Investment commitments, original, Dec. 31, 2012	21 195

^{*} Accounted for under the net result for asset class in conjunction with valuation.

venture with TIAA-CREF. In addition to this, the Second AP Fund's American agricultural fund, Teays River, was reformed during the spring as a joint-venture, owned by the major investors in the fund. In conjunction with this incorporation process, the Second AP Fund increased its investment commitments from USD 50 million to USD 100 million. By investing via companies, the Second AP Fund is better able to act more long term than via funds, whose investment horizon is often more limited.

In September 2011, the Second AP Fund, in partnership with a group of international investors, launched the Principles for Responsible Agricultural Investment (PRAI), with a view to improving sustainability, transparency and responsibility for investments in agriculture. The Second AP Fund's progress on implementing these principles is described in its Corporate Governance Report, which was published in autumn 2012.

No new investments in forest real estate were made during the year. However, the funds in which the Second AP Fund had previously invested did make a number of investments. These funds are clearly focused on the sustainable and responsible ownership and management of forest real estate. The American fund has secured full SFI (Sustainable Forestry Initiative) certification for all the forest real estate it has acquired, and most of the forest real estate acquired by the Australian fund has been FSC (Forest Stewardship Council) and/or AFS (Australian Forestry Standard) certified.

Investment in forest-and-agricultural real estate constitutes part of the Second AP Fund's strategy for diversifying the total portfolio. Both forest-and-agricultural real-estate assets are expected to yield a stable return. This derives from a perception that the underlying trend towards increased urbanisation and better general welfare in combination with an increase in population will increase the demand for forest-and-agricultural products. Both asset classes are also relatively insensitive to fluctuations in the economy, while correlation with other asset classes, such as equities, is considered to be low.

An active investor, we build value

A large part of the Second AP Fund's capital assets is placed in equities in Swedish and foreign companies, making the Fund a significant investor. The engagement and involvement of shareholders is crucial to the long-term development of companies, contributing to better value growth. For this reason, the Fund is an active investor, with a view to promoting good corporate governance, robust ethics and a sustainable environmental approach, as well as the development of best practice concerning capital management issues.

In its work with the environment, ethics and corporate governance, the Second AP Fund's overall objective, both as investor and fund manager, is to create value.

As a major investor, the Second AP Fund actively participates in the run-up to and during Swedish and foreign AGMs, while maintaining a dialogue with the boards and executive managements of its portfolio companies. The Second AP Fund's operational approach to corporate governance issues is based on its nine investor principles. These principles comprise structural matters, corporate governance, the environment and ethics.

In Sweden, the Second AP Fund focuses first and foremost on governance issues in companies where it is one of the largest shareholders, and in companies where it has most capital invested. In companies outside Sweden, the Fund concentrates on ethical and environmental issues, operating through the joint Ethical Council of the AP Funds. Work concerning other governance issues at foreign portfolio companies involves cooperation with selected partners in addressing items of key importance to the Fund.

The Fund shall further promote good corporate governance by collaborating with other investors on matters of principle and through active participation in the drafting of policies, regulations and standards.

The Fund's corporate governance tools

The Second AP Fund's engagement in corporate governance issues is founded on regulations and conventions such as the OECD's Guidelines for Multinational Enterprises and Principles of Corporate

Governance, the United Nations Global Compact and Principles for Responsible Investment (PRI), the Swedish Companies Act and the Swedish Code for Corporate Governance. Since their establishment, the Fund has supported the UN's Principles for Responsible Investment (PRI). The Fund also supports the Principles for Responsible Agricultural Investment (PRAI), which it has established in association with a group of international investors. These principles provide guidelines as to how institutional investors in agriculture should address environmental, ethical and corporate governance issues.

Organisation and responsibilities

The Second AP Fund's board of directors determines guidelines and policies pertaining to governance issues, entrusting day-to-day management of these issues to the Fund's CEO. The CEO is backed by an investor group featuring members of the Fund's executive management, the head of equities and the Fund's sustainability analyst. This group is responsible for the strategic and operational aspects of these activities.

The investor group targets and drafts action plans and monitors progress on an ongoing basis. At least once a year, a report on the Fund's governance activities is submitted to the board of directors.

Issues in focus

During the report period, the Second AP Fund maintained its focus on remuneration issues, conducting a number of dialogues with the boards of portfolio companies concerning the formulation of incentive programmes, with a view to achieving improvements.

These discussions included a dialogue about 'matching equities', since the Fund feels that such equities should clearly be performance linked.

For several years now, the Second AP Fund has stressed the importance of increasing the number of women on the boards of publicly listed companies, and duly observes this principle when participating in the nomination process. The Fund also feels that nomination committees should draft a concrete plan to attain the most appropriate board composition, with respect to gender, age, background, experience and competence. More about the Fund's annual Female Representation Index at www.ap2.se

Voting at AGMs

The AGM is the primary forum in which shareholders are able to exercise their influence. Being able to exercise your voting right as a shareholder at the AGM is one of the most important opportunities available for influencing a company. This is why the Second AP Fund is active at both Swedish and foreign AGMs.

The Fund has holdings in some 250 Swedish companies. It has decided that it is impractical to attempt to attend and vote at the AGMs of all the companies represented in its portfolio of Swedish equities.

The Second AP Fund exercised its voting rights at a total of 48 AGMs of Swedish publicly listed companies during 2012. The Second AP Fund and other institutional investors have for many years enjoyed a positive and constructive dialogue with Swedish publicly listed companies, which have included discussions about many of the issues raised at AGMs.

During the year, the Fund exercised its voting rights by proxy at 500 foreign AGMs held by 488 different companies. The Fund voted against proposals concerning remuneration issues in 62 percent of these foreign companies.

In 2012, with a view to further improving communication with its foreign portfolio companies, the Second AP Fund, in collaboration the First, Third and Fourth AP funds, has written letters to some 50 of these companies, clarifying the funds' views on active governance and the importance of exercising voting rights.

In these letters, the Fund has also explained why it was unable to support the recommendations of certain boards on specific proposals. In several cases, these letters have resulted in further contact with the companies in question, sometimes by letter but also by phone. Further details of how the Second AP Fund voted on specific issues may be found at www.ap2.se

Nomination committees

The Second AP Fund favours having a representative on the nomination committees of portfolio companies, as this provides a valuable opportunity to exercise investor influence. The Fund practices a policy of accepting all invitations to participate in the nomination process. Prior to the start of the 2012 AGM season, the Second AP Fund was represented on the Opus Prodox nomination committee, as chair, as well as on Lundin Petroleum's nomination committee. In the run-up to the 2013 AGM season, the Fund will once again be represented on Opus Prodox' nomination committee, as chair, as well as on the Melker Schörling AB nomination committee.

Ethical Council

The Ethical Council is a joint council that was formed by the First, Second, Third and Fourth AP Funds in 2007. It monitors and analyses the AP Funds' portfolios of foreign equities, to prevent companies from contravening international conventions to which Sweden is a signatory. The work of the Ethical Council is based on the principles of engagement, active ownership and change, with the aim of making a difference. The Ethical Council identifies companies that can be linked to the violation of a convention and act concretely to persuade companies to deal with documented breaches of conventions and to implement systems and measures to prevent

future violations. The Ethical Council also works proactively to prevent violations by initiating a dialogue with individual companies, as well as by a range of initiatives focused on different industries or specific issues.

Dialogues are one of the Ethical Council's essential instruments in influencing companies. The Council believes that active ownership is the best way to achieve change. Even if the funds sell their holdings, this fails to eliminate the problem, and the violations continue. As an absolutely final resort, the Ethical Council can recommend that the fund in question exclude a company from its investment universe, when the prospects of making a difference seem hopeless. In 2012, the Second AP Fund chaired the Ethical Council. More at www.ethicalcouncil.com

Collaboration with other investors

In addition to cooperating with the other AP funds through the Ethical Council, the Second AP Fund is both a member of and actively supports various Swedish and international initiatives focused on the environment, ethics and corporate governance. The Fund also collaborates with other investors on influencing new legislation, mainly within the field of corporate governance. These forms of collaboration are becoming increasingly important as a means to influence and effect change and thereby improve share value over the long term. Further details of the Second AP Fund's memberships and initiatives at www.ap2.se

Integration in portfolio management

The Fund is convinced that a positive long-term approach to the environment, ethics and corporate governance enhances a company's value. Portfolio companies shall operate in compliance with regulations, conventions and the relevant legislation and shall also work proactively to achieve a healthy relationship with society at large. The Second AP Fund favours companies that are members of the United Nations Global Compact and that actively implement its principles, incorporating them as a natural part of their everyday operations. Portfolio companies shall also observe the OECD's Guidelines for Multinational Enterprises and Principles of Corporate Governance.

For these reasons, the Second AP Fund integrates corporate governance, ethics and environmental concerns into its capital management strategy, in the knowledge that this provides a sounder basis for analysis and investment decisions. During the year, a model for integrating these factors was developed for the active in-house management of Swedish equities.

Annual Corporate Governance Report

More detailed information on the Fund's corporate governance activities and its actions at AGMs will be presented in conjunction with the release of the Fund's yearly Corporate Governance Report. More at www.ap2.se

Important to accept risk

To achieve its targeted returns, the Fund must embrace financial risk in managing its portfolio. Financial risk is the single most important resource that the Fund has at its disposal. However, this adoption of risk must be formulated as effectively as possible. It is crucial that the risk is calculated in advance and that it is subject to careful control and evaluation. Placing realized return in relation to risk yields key data concerning portfolio optimization. As far as possible, the analysis shall ensure that accepted risk and targeted risk are one and the same.

Controlling risk

The selected level of risk is determined by three parameters. The risk policy, which is determined by the board of directors, prescribes the parameters governing the Fund's exposure to risk. The CEO's document 'Guidelines for Investment' contains still more detailed instructions for the management and monitoring of financial risks. For individual 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, based on a number of assumptions concerning market growth and risk levels for different asset classes, and which is a key tool in formulating the strategic portfolio.

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, which are responsible for the 50–60 mandates handed by the Fund. Mathematical models are used to develop risk profiles as decision data for strategic allocations and support for the individual management teams.

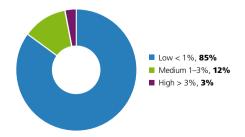
Compliance

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.

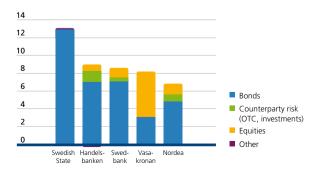
Risk Management

Risk Management is responsible for the monitoring and analysis of the Fund's financial risks. This function is operationally separate

Allocation of active risk, %



Exposure to issuer, SEK billion



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 Fund's risks

The most significant risks to which the Fund may be subjected can be divided into financial and operative risks. The financial risks primarily comprise market risk, credit risk and liquidity 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. 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 counterpart 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 counterpart 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.

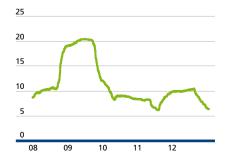
The Second AP Fund manages concentration risk by analysing relative distribution, in terms both of geographical region and industry, as well as the distribution between issuers/issuer groups. The most influential factor in managing concentration risk is the choice of benchmark index.

Liquidity risk

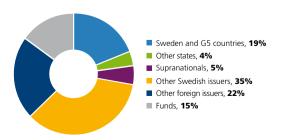
Liquidity risk refers to the risk that securities cannot be converted into cash at the appointed time without incurring a substantial loss or considerable cost. The AP funds must also be prepared to transfer funds to the Swedish Social Insurance Administration.

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.

Volatility in listed portfolio past five years, %



Allocation of Fund's fixed-income securities portfolio, by issuer group



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 – including self-assessment, incident log, 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.

Portfolio risk 2012

The Second AP Fund reports a low active risk for the total portfolio for 2012. Portfolios where the Fund has chosen a higher-risk profile have in most cases generated a solid return. The level of active risk on the Fund's total listed portfolio, measured over twelve months, declined somewhat during 2012. At year-end 2012, it was at 0.3 percent. The level of active risk noted for asset classes Swedish and

foreign equities declined from 0.7 percent to 0.4 percent and 0.5 percent to 0.4 percent respectively. The level of active risk for fixed-income securities remained virtually unchanged at 0.4%. Covariance with respect to the active return on asset classes in the listed portfolio remained low over the year. This indicates a good risk spread. The volatility of the listed portfolio declined during the year, from 10.0 to 6.4 percent, mainly a consequence of reduced market volatility. The information ratio for the total listed portfolio rose sharply to 4.2 during 2012. This derived from an improved relative return and a reduction in active risk. The Sharpe ratio for the Fund's listed portfolio rose during the year, due to an improved absolute return, rising to 1.9 by year-end. The duration calculated for the portfolio of fixed-income investments was 4.7 years as per December 31, which corresponds to an approximate decrease of 0.1 years compared with the preceding year. Fund exposure to Portugal, Ireland, Italy, Greece and Spain in equities and bonds remains limited. Exposure as per December 31 amounted to 3.0 percent of Fund capital.

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. In connection with the Fund's application of the Asset Liability Model (ALM) in its work with the strategic portfolio, the board of directors decided to increase the degree of strategic FX exposure in response to the change in the correlation relationship. By the end of the year, 20 percent of the Fund's portfolio was exposed in

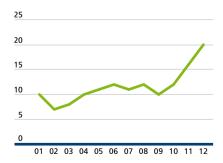
foreign currency. The largest part was the Fund's exposure in USD and euros. The Fund's FX hedging had a highly positive impact on the result, primarily attributable to the strengthening of the Swedish krona against several other currencies. The Fund reported an overall negative result on FX transactions for its total portfolio (including interest gains/losses on FX contracts), amounting to a foreign-exchange loss of SEK –0.6 billion.

FX exposure, equivalent in SEK million

December 31, 2012	USD	EUR	CHF	NOK	JPY	Other	Total
Equities and participations	52 918	20 906	1 821	651	8 506	11 880	96 682
Bonds and other fixed- income securities	31 702	10 599	_	128	_	4 154	46 583
Other assets and liabilities, net	3 810	948	14	20	-1 348	202	3 646
Derivative instruments excl. FX derivatives	9 028	219	-4	_	-1 346	1	7 898
FX derivatives	-58 913	-23 748	-540	239	-6 939	-16 911	-106 812
FX exposure, net	38 545	8 924	1 291	1 038	-1 127	-674	47 997

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.

FX exposure, growth since start, %



Resilience, participation and competence produce results

Since 2009, Fund strategy has focused clearly on diversification, with regard to both new markets and new asset classes. This diversification strategy, even more obviously than before, has placed considerable demands on the in-house organization's ability to implement complex strategies efficiently. Right from the start in 2001, security and flexibility have been the Fund's by-words in designing all in-house processes. Seen historically, this has made rapid reallocations between the Fund's in-house and externally



Calculating costs in isolation gives an all too simplistic picture.

managed portfolios possible. Consequently, it has been feasible to utilize risk premiums of a temporary nature and to implement a newly constituted strategic portfolio in a cost-efficient manner – while consistently maintaining a controlled level of operational risk.

It is this platform of efficient processes, featuring a combination of advanced IT-support and a high level of in-house competence, which has enabled the successful implementation of the Second AP Fund's complex strategic portfolio in 2012. Implementing the Fund's diversification strategy has required resilience and foresight, as in terms of organization – with the necessary investments in IT-systems – and investment in the development of in-house competence.

The Second AP Fund's current organization is the result of a more than ten-year build-up of and focus on competence and innovation. Thanks to in-house recruitment and the potential for career development within the Fund, a great many members of staff have chosen to remain with the Fund over the years. We believe our success comes from our employees, who experience and are motivated by their individual participation in the Fund's broad objectives. In every context, however great the individual responsibility, "team spirit rules".

Cost-efficient management

For a fund manager in general, and a global pension fund in particular, determining an appropriate cost level is a complex process. Calculating costs in isolation gives an all too simplistic picture. The costs level should form part of the broad canvas instead of being seen as the primary criterion of valuation. This means adopting a holistic view, involving an assessment of revenue and risks as well as costs. It is cost-efficiency that needs to be in the spotlight.

An established method for measuring and comparing the cost efficiency of pension funds from an international perspective has been developed by CEM (Cost Effectiveness Measurement Inc.). The method enables a comparison that takes into account several factors that have a decisive impact on the overall cost of managing a fund: the volume of assets under management, the degree of assets under active management and external mandate, and the relative allocations for each class of asset. In the study, a pension fund's costs are compared with those of an international group of fund managers of approximately the same size and with a portfolio of similar composition. The Second AP Fund has participated in CEM's annual benchmark study since 2004 and results confirm that the Second AP Fund has conducted its portfolio management activities in a consistently successful and cost-efficient manner.

Swedish studies initiated by the AP funds (Occam) as well as Expertgruppen for Studier i Offentlig Ekonomi (ESO) and the Swedish Government Buffer Capital Inquiry (SOU 2012:53) also conclude that today's AP funds are efficient, with low potential for economies within the parameters currently defined for today's agreed and established levels of operative risk. In international terms, the level of costs is deemed low and, in a number of cases – measured as an expense ratio – actually lower than some considerably larger pension funds. The Second AP Fund deems that cost-efficiency has been achieved, without any compromise on transparency or long-term investment in improved administration.

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 investment focus. Fund assets shall be exposed to the markets in an efficient manner, as per the strategic portfolio, and shall be rebalanced during major fluctuations in the market. The constant interaction

between asset classes requires competence and a well-developed approach.

The costs and revenues attributable to the implementation 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.

In 2012, these implementation effects have been charged against relative return in an amount of –0.07 percent.

VAT

As of 2012, the AP funds became VAT registered. Consequently, VAT is now liable on services charged from outside Sweden. Since the funds are not entitled to claim refunds on VAT paid, this VAT registration has led to a direct increase in the Fund's costs for such services.

Cooperation with the other AP funds

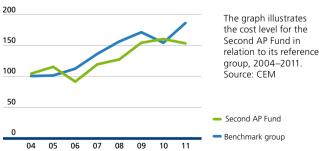
The decision to create four separate buffer funds was partly a way to spread risk by enabling all four funds to manage their capital assets independently, and partly a way to stimulate healthy competition between them. However, these objectives do not prevent the funds from cooperating in areas that offer economies of scale and a more efficient utilization of resources. During 2012, in addition to cooperation within the framework of the Ethical Council, the Second AP Fund's cooperation with



...results confirm that the Second AP Fund has conducted its portfolio management activities in a consistently successful and cost-efficient manner.

other AP funds has focused primarily on staff-related issues such as remunerations and benefits. One consequence has been the establishment of a joint policy on remuneration, staff benefits, expense accounts and business travel. The funds have also cooperated on a number of legal questions, such as tax issues and new regulations governing the financial markets. The funds have also conducted joint inquiries on issues such as the consequences and implementation of the new rules governing the clearing of certain types of derivative in the USA and Europe, tax regulations in the USA and new rules pertaining to blanking and the adoption of short positions in equities and government bonds.

Cost efficiency of Second AP Fund, compared with international pension funds, 2004–2011, indexing



Income statement

Amounts in SEK million	Note	January–December 2012	January–December 2011
Operating income			
Net interest income	1	6 647	6 569
Dividends received		2 963	2 976
Net result, listed equities and participations	2	15 557	-15 025
Net result, unlisted equities and participations	3	2 657	1 509
Net result, fixed-income securities		3 848	2 002
Net result, derivative instruments		1 241	-1 736
Net result, exchange gain/loss		-3 921	-571
Commission expenses, net	4	-203	-210
Total operating income		28 789	-4 486
Operating expenses			
Personnel expenses	5	-101	-90
Other administration expenses	6	-68	-69
Total operating expenses		-169	-159
NET RESULT FOR THE YEAR		28 620	-4 645

Balance sheet

Amounts in SEK million	Note	December 31 2012	December 31 2011
ASSETS			
Equities and participations			
Listed	7	109 747	105 062
Unlisted	8	25 412	15 487
Bonds and other fixed income assets	9	92 224	86 613
Derivative instruments	10	10 260	7 993
Cash and bank balances		2 987	2 295
Other assets	11	184	9
Prepaid expenses and accrued income	12	1 740	1 858
TOTAL ASSETS		242 554	219 317
FUND CAPITAL AND LIABILITIES			
Liabilities			
Derivative instruments	10	873	2 614
Other liabilities	13	119	16
Accrued expenses and deferred income	14	108	65
Total liabilities		1 100	2 695
Fund capital	15		
Fund capital at beginning of year		216 622	222 507
Net payments to the national pension system		-3 788	-1 240
Net profit for the year		28 620	-4 645
Total fund capital		241 454	216 622
TOTAL FUND CAPITAL AND LIABILITIES		242 554	219 317
Pledged assets, contingent liabilities and commitments	16		
Other Assets pledged and comparable collateral		1 879	1 802
Commitments		8 650	7 911

Accounting and valuation principles

The Second Swedish National Pension Fund, corporate identity number 857209-0606, is one of the buffer funds of the Swedish National Pension System, based in Gothenburg, Sweden. The annual report for fiscal 2012 was approved by the Board of Directors on February 6, 2013. The income statement and balance sheet shall be adopted by the Swedish Government.

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 to 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 average market rate), as opposed to the bid and offer rate.

Transaction costs, like brokerage commissions, are reported as part of the acquisition value of financial instruments, which are reported at their fair value, via the result.

No consolidated financial statements or cash flow analyses 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 unlisted 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.

FX conversion

Transactions in foreign exchange are converted into Swedish kronor at the rate applied on the transaction date. On the accounting date, assets and liabilities in foreign currency are converted into Swedish kronor at closing day rates.

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. The exchange rate differential arising due to the change in the exchange rate is reported in the income statement under Net result, exchange gain/loss.

Equities in subsidiaries/associated companies

In compliance with the Swedish National Pension Funds Act, equities in subsidiaries/associated companies are recorded at their fair value. Fair value is determined by the same methods applied to unlisted equities and participations. 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. Consequently, realized and unrealized gains/losses per asset class are included under Net result. In cases where reference below is made to the selected index supplier, refer to page 11 of 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.

Listed equities and participations

In the case of equities and participations traded on a regulated market or trading platform, fair value is based on the official market rate applied at the balance-sheet date, according to the Fund's selected index supplier, often the average market rate. Holdings not included in the index are valued at the listed rates observable in an active market. Commissions paid are taken up as income under Net result, listed equities.

Unlisted equities and participations

As regards equities and participations not traded on a regulated market or trading platform, fair value is 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 assigned by the fund administrator is incorrect, the received value is 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, such as discounted cash-flow, net asset value method.

The valuation of unlisted real estate equities is based on the net asset value method, in as far as the equity has not been the subject of transactions on a resale market.

Bonds and other fixed-income securities

For bonds and other fixed-income assets, 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 listed rates observable in an active market. In cases where such instruments are not traded on an active market, and where no reliable listed market rates are available, the instrument shall be valued with the support of generally accepted theoretical models, whereby cash flows are discounted according to an appropriate valuation scale.

Interest calculated according to the effective interest method, based on accrued acquisition value, is reported as interest income. 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 – and are reported as interest income.

Derivative instruments

Where derivative instruments are concerned, fair value is based on their listed rates at year-end. In cases where such instruments are not traded on an active market, and where no reliable listed market rates are available, the instrument shall be valued with the support of generally accepted theoretical models, where input data consists exclusively of observable market data.

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 orward 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, while premiums received are reported as interest income in the income statement. 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. In other instances, collateral received is reported not in the balance sheet, but separately, under Memorandum items. The net worth of securities on loan and their collateral is also reported under this heading.

Items entered directly against Fund capital

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

Commission expenses

Commission expenses 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-listed 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.

Commissions and fees paid for the external management of unlisted assets, where reimbursement is permitted prior to profit sharing and is deemed likely, are reported as acquisition expenses and are therefore included in the unrealized result. In other cases, they are reported as commission costs.

Operating expenses

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

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

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. As of 2012, the Second AP Fund became VAT registered. Consequently, VAT is now liable on services charged from outside Sweden. The Fund is 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

Net interest income/expense		
Amounts in SEK million	JanDec. 2012	Jan.–Dec. 2011
Interest income		
Bonds and other fixed-income securities	3 337	2 992
Derivative instruments	4 471	4 953
Other interest income	60	63
Total interest income	7 868	8 008
Interest expenses		
Derivative instruments	-1 186	-1 381
Other interest expenses	-35	-58
Total interest expenses	-1 221	-1 439
Net interest income/expense	6 647	6 569

Net result, listed equities and participations				
Amounts in SEK million	Jan.–Dec. 2012	Jan.–Dec. 2011		
Net result, listed equities and participations	15 614	-14 958		
less brokerage commission	-57	-67		
Net result, listed equities and participations	15 557	-15 025		

Net result, unlisted equities and participations						
Amounts in SEK million	Jan.–Dec. 2012	Jan.–Dec. 2011				
Capital gains, net	748	914				
Unrealized changes in value*	1 909	595				
Net result, unlisted equities and participations	2 657	1 509				

^{*} Unrealized changes in value include management fees of SEK 172 million, refunded in 2012.

Commission expenses, net		
Amounts in SEK million	Jan.–Dec. 2012	Jan.–Dec. 2011
External portfolio management fees, listed assets	189	195
External portfolio management fees, unlisted assets	4	5
Other commission expenses including custodial expenses	10	10
Total commission expenses	203	210

Commission expenses do not include performance-based expenses. During the year, performance-based expenses amounted to SEK 60 (99) million and reduce the net gain for respective asset classes. External portfolio management fees for unlisted assets are reported under commission expenses in so far as the contracts do not permit repayment prior to profit sharing in conjunction with future profitable exits.

During 2012, a total of SEK 149 (169) million has been paid in management fees for unlisted assets. Of these, SEK 145 (164) 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.

cont. Note 4

Distribution of Fund capital between external mandates and in-house portfolio management as per December 31, 2012, SEK million

In-house management Listed equities and partici Fixed-income mandates ir in alternative investments Cash and bank balances Unlisted equities in associ including subordinated de TOTAL CAPITAL ASSETS	ated companies, ebentures S UNDER IN-HOUSE MANAGEME	SHB, Barclays		111 18 523 171 933	71	
Listed equities and partici Fixed-income mandates ir in alternative investments Cash and bank balances Unlisted equities in associ including subordinated de	ated companies, ebentures			18 523	71	
Listed equities and partici Fixed-income mandates ir in alternative investments Cash and bank balances Unlisted equities in associ	ated companies,	SHB, Barclays				
Listed equities and partici Fixed-income mandates ir in alternative investments Cash and bank balances		SHB, Barclays		111		
Listed equities and partici Fixed-income mandates ir in alternative investments	5	SHB, Barclays		111		
Listed equities and partici Fixed-income mandates ir	5			60 506		
				60.506		
In-house management	pations	SBX, SEW, CSRX, MSCI		92 793		
	mandates					
TOTAL CAPITAL ASSETS	UNDER EXTERNAL MANAGEMENT	Γ AND MANAGEMENT EXPENSE	S 70 209	69 521	29	193
Investments in unlisted	private equity funds, forest-and-a	gricultural real estate	10 675	11 438	5	4
Total investments in lis	ted external funds	he selected and	40 391	38 172	16	151
GTAA funds		as per respective fund	2 071	2 058		
Equity funds Fixed-income funds		as per respective fund as per respective fund	19 445 18 875	17 217 18 897		
Investments in listed ex	kternal funds	as now respective fund	10.445	17 217		
Total external discretion	nary mandates		19 143	19 911	8	38
First Quadrant						6
Active management						
GTAA mandates						
Total			12 957	13 369	5	29
Standish	Global credit mandate	Barclays Global Agg Develop credit ex Japan	4 573	4 665		
Pimco	Global Credit mandate	Barclays Global Agg Develop credit ex Japan	3 843	3 915		
Dimaga	Global credit mandate	Develop credit ex Japan	4 541	4 789		
Rogge	Global credit mandate	Barclays Global Agg				
Fixed-income mandates Active management						
Total			6 186	6 542	3	3
MFS	Global equities	MSCI World	6 186	6 542		
Active management						
-	mandates					
-		Benchmark index	capital under management 2012	2012* Market value	% of Fund capital	management expense
Mandate External discretionary of Equity mandates			Average capital under	December 31 2012*	% of	management

^{*} Market value including allocated liquidity, derivative instruments and accrued interest.

Personnel cost

	JanDec. 2012		JanDec. 2011	
Gender distribution	Men	Women	Men	Women
Average no. of employees	37	22	35	24
Employees, December 31*	37	23	34	24
No. of persons in Executive Management Group, December 31	5	2	1	3
aroup, becember 31	2	2	4	ر

^{*} At year-end 2012, the Fund had 60 full-time employees.

Total personnel costs	101 251	90 394
Other personnel costs	2 482	3 064
Total payroll overhead	17 948	15 784
Other employees	13 402	11 438
Executive Management Group, excl. CEO	3 510	3 256
Board of Directors, excl. Chair	95	128
CEO	909	931
Chair of the Board	32	31
Payroll overhead	24 203	21 356
Pension cost, total	24 285	21 598
Executive Management Group, excl. CEO Other employees	4 968 17 978	16 078
 -	4 968	4 155
(incl. special employer's contribution) CEO	1 339	1 365
Remuneration to Members of the Board, in addition to directors' fees Pension costs (incl. special employer's contribution)	-	-
Variable remuneration, total	1 734	-
Other employees	1 734	
Executive Management Group, excl. CEO		
CEO	_	
Variable remuneration		
Salaries and remuneration, total	54 802	49 948
Other employees*	40 734	36 391
Executive Management Group, excl. CEO	10 829	10 114
Board of Directors, excl. Chair	305	427
CEO	2 834	2 916
Chair of the Board	100	100
Salaries and remuneration		
Amounts in SEK k	JanDec. 2012	JanDec. 2011

^{*}of which costs incurred in connection with staff reductions SEK 290 (-).

Board of Directors

Fees paid to the Board are determined by the Swedish Government. This remuneration is paid yearly in the following amounts: to the Chair, SEK 100 000; to the Vice Chair, SEK 75 000 and to each of the other directors, SEK 50 000. No fees have been paid for committee work carried out by board members.

CEC

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 59 k.

Executive Management Group

Salaries, other remuneration and pension contributions (including special employer's contribution) for the Fund's executive management for 2012 totalled SEK 15 797 k (14 269). Salaries and other remuneration are disclosed as follows: Chef A, SEK 2 602 k (2 541); Executive B, SEK 1 261 k; Executive C, SEK 2 262 k (2 106); Executive D, SEK 1 965 k (1 942); Executive E, SEK 1 506 k (1 489); Executive F, SEK 1 234 k. Pension contributions, including special employer's contribution, are disclosed as follows: Executive A, SEK 970 k (819); Executive B, SEK 702 k; Executive C, SEK 889 k (799); Executive D, SEK 759 k (655); Executive E, SEK 803 k (799); Executive F, SEK 844 k. In addition to salary, other remuneration and pension contributions, the Fund's executive management has received the following benefits: Executive A, SEK 32 k (0); Executive B, SEK 49 k; Executive C, SEK 60 k (62); Executive D, SEK 58 k (62); Executive E, SEK 59 k (54); Executive F, SEK 3 k.

Members of the Fund's executive management 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 2012, 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.

Drafting and decision process

The Board determines the CEO's salary and the guidelines applied in remunerating the Fund's senior executives.

Government guidelines

For a number of years now, the Second AP Fund has participated in the HRS/Towers Watson salary and benefits survey. The purpose of this survey

is to report on the market rate for salaries and benefits paid to different staff categories, based on data supplied by the participating companies. The Second AP Fund has used this statistical data to compare remuneration levels for all its employees. In 2012, the levels of remuneration provided by the Fund were compared with 15 other players in the financial sector, including Swedish pension fund AMF, the other AP funds, Riksbanken (Swedish Central Bank), Kammarkollegiet (Swedish Legal, Financial and Administrative Services Agency) and Riksgälden (Swedish National Debt Office). The Fund's remuneration policy is based on the idea that the level of remuneration should be close to the median for the reference group employed in the HRS/Towers Watson salary and benefits survey. The Board considers that the levels of remuneration paid to senior executives,

as well as to other members of the Fund's staff, are reasonable, well balanced, competitive and appropriate, featuring clearly defined upper limits and contributing to solid business ethics and a healthy organizational culture. These levels of remuneration are not salary-inflationary in relation to comparable institutions, but are moderate in character and fall well within the parameters prescribed by the Board concerning staff remuneration. The Board is satisfied that the Fund is in compliance with Swedish Government guidelines on remuneration, apart from the above mentioned exceptions regarding the period of notice. More information at www.ap2.se

For other directorships held by Members of the Board, see page 58.

Other administrative expenses

Amounts in SEK million	Jan.–Dec. 2012	Jan.–Dec. 2011
Rental expenses	5	5
Information and IT expenses	40	41
Purchased services	10	10
Other expenses	13	13
Total other administrative expenses	68	69
Fees to auditors		
Audit assignments		
Ernst & Young	0.76	1.06
Accounting activities in addition to audit assignments		
Ernst & Young	0.09	0.28
Total remuneration to Ernst & Young	0.85	1.34

Equities and participations, listed

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Swedish equities	27 080	29 403
Foreign equities	63 395	56 105
Participations in Swedish funds	-	2 833
Participations in foreign funds*	19 272	16 721
Total listed equities and participations	109 747	105 062
* of which participations in mixed funds	2 056	2 098

The 20 largest Swedish and foreign shareholdings, by value, are listed on pages 53–55.

A complete list of Swedish and foreign holdings may be found on the Fund's website at www.ap2.se

Equities and particip

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Equities in Swedish associated companies	11 391	6 205
Equities in foreign associated companies	3 664	234
Equities in other unlisted Swedish companies	23	68
Equities in other unlisted foreign companies	10 334	8 980
Total unlisted equities and participations	25 412	15 487

cont. Note 8								
Amounts in SEK million	Corp. reg.	Registered office	No. of equities	Participation right capital/votes, %	Dec. 31 2012 Fair value	Dec. 31 2011 Fair value	Equity	Result
Swedish equities and participations, associated and subsidiary companies								
Andra & Sjätte Fastigheter AB	556694-3022	Gothenburg	5 000	100	1	1	1*	0*
Cityhold Property AB	556845-8631	Stockholm	2 820 342	50	1 116	3	6*	-19*
NS Holding AB	556594-3999	Sundsvall	1 819 884	50	5 143	2 476	1 985*	230*
Vasakronan Holding AB	556650-4196	Stockholm	1 000 000	25	5 131	3 725	20 524**	3 025**
Foreign equities and participations, associated and subsidiary companies								
U.S Office Holding L.P.	N	lew York, USA		41	2 583	_		
TIAA -CREF Global Agriculture LLC	N	lew York, USA		23	1 081	234		

Amounts in SEK million	Registered office	Capital participation, %	Dec. 31 2012 Acquisition value	Dec. 31 2011 Acquisition value
Other unlisted Swedish equities and participations				
EQ Northern Europe KB	Stockholm	1	64	72
Swedstart Life Science KB	Stockholm	5	10	10
Swedstart Tech KB	Stockholm	3	9	8
Five largest holdings in other unlisted foreign equities and participations				
Pathway Private Equity Fund IXB	USA	99	1 142	1 153
Pathway Private Equity Fund IX	USA	99	666	737
Pathway Private Equity Fund IXC	USA	99	646	456
Nordic Capital VI	Jersey	3	424	429
Nordic Capital V	Jersey	3	371	370

^{*}Refers to figures published as per Dec. 31, 2011. **Refers to figures published as per Dec. 31, 2012.

A complete list of Swedish and foreign unlisted shareholdings is available on the Fund's website at www.ap2.se

Bonds and other fixed-income securi

	Dec. 31 2012	Dec. 31 2011
Amounts in SEK million	Fair value	Fair value
Swedish State	10 862	11 101
Swedish municipalities	1 150	257
Swedish mortgage institutions	17 034	22 127
Other Swedish issuers		
Financial companies	9 948	3 049
Non-financial companies	3 838	6 044
Foreign states	8 130	7 541
Other foreign issuers	39 582	34 994
Deposits	1 680	1 500
Total	92 224	86 613
Real interest bonds	_	2 169
Other bonds	65 919	59 755
Certificates	1 939	_
Unlisted loans	3 781	3 625
Unlisted convertible debentures	_	2 355
Participations in foreign fixed-income funds	18 905	17 209
Deposits	1 680	1 500
Total	92 224	86 613
of which valued in compliance with theoretical model valuation	3 619	1 500

1()∎

Derivative instruments

		Dec. 31 2012		Dec. 31 2011		
	Nominal	Fair value,	Fair value,	Nominal	Fair value,	Fair value,
Amounts in SEK million	amount*	positive	negative	amount*	positive	negative
Equities-linked instruments						
Options, held	0	17	-	_	-	-
Options, pledged	0	-	0	-	-	-
Forward contracts	7	37	0	6	40	0
Other instruments	6 505	7 123	-	6 855	6 522	0
Total	6 512	7 177	0	6 861	6 562	0
of which cleared	8			6		
Interest-linked instruments						
Options, held	_	-	-	62	_	31
Options, pledged	180	24	23	158	30	_
FRA/futures	129 529	26	13	73 534	18	7
Swaps	1 000	12	_	300	1	0
Total	130 709	62	36	74 054	49	38
of which cleared	129 700			73 745		
Currency-linked instruments						
Options, held	400	3	_	352	2	-
Options, pledged	1 247	-	1	295	0	_
Futures	207 093	3 018	836	157 617	1 380	2 576
Total	208 740	3 021	837	158 264	1 382	2 576
of which cleared	-			-		
Total derivative instruments	345 961	10 260	873	239 179	7 993	2 614

^{*} 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.

Trading in options is limited. All derivatives with negative fair values have a maturity of less than twelve months. Pledged put options are part of the Fund's strategy for reducing total risk. The net position of put options features a limit on maximum loss. In the case of currency options sold, we are always required to meet the commitments specified in the options contract, i.e. once we have sold a currency option, the buyer is entitled to utilize the option, whether favourable or not in comparison to the current rate. Where other put options are concerned, the Fund is not subject to any requirements regarding delivery.

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 2012, 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 interestrate 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 permitted to
 adopt 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.

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Incoming payments, unsettled transactions	180	5
Other receivables	4	4
Total	184	9

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Interest income accrued	1 621	1 722
Dividends accrued	57	71
Restitutions	36	30
Other prepaid expenses and accrued income	26	35
Total	1 740	1 858

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Outgoing payments, unsettled transactions	104	6
Accounts payable	8	8
Other liabilities	7	2
Total	119	16

Total	108	65
Other accrued expenses	21	19
Accrued interest expenses on currency forwards	50	5
Accrued external management fees	37	41
Amounts in SEK million	Dec. 31 2012	Dec. 31 2011

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Opening Fund capital	216 622	222 507
Net inflows to the national pension system		
Pension contributions received	55 441	53 895
Pension disbursements to the Swedish Pensions Agency	-59 005	-54 919
Transfer of pension entitlements to EC	-5	-2
Adjustment of pension entitlements re. previous years	1	-1
Administration contribution to the Swedish Pensions Agency	-220	-213
Total payments to the national pension system, net	-3 788	-1 240
Net result for the year	28 620	-4 645
Closing Fund capital	241 454	216 622

Pledged assets, contingent liabilities and commitments

Amounts in SEK million	Dec. 31 2012	Dec. 31 2011
Other pledged assets and comparable collateral		
Securities on loan for which guarantees have been secured in the form of securities and cash*	1 434	1 326
Securities pledged in connection with exchange-cleared derivatives	445	476
Total	1 879	1 802
Commitments		
Commitments regarding future payments, unlisted holdings	8 650	7 842
Commitments regarding future investments, listed fixed-income holdings	_	69
	8 650	7 911

^{*} Guarantees secured for pledged securities: SEK 1 490 (1 397) million.

Valuation of Fund capital - Market-listed assets

The great majority of the Fund's assets are market-listed, which means that they are traded on an active market at rates that reflect actual and regular market transactions. The Fund's market-listed assets are valued on a daily basis at listed market rates and comprise equities, bonds, derivatives and foreign exchange (FX).

In the case of so-called OTC derivatives, the appraisal is based either on theoretical modelling or on a valuation by an outside party. Where the Fund's holdings in FX forward contracts and interest swaps are concerned, the appraisal is based on theoretical modelling, where at present the only subjective elements are the interest curves selected and the methods adopted in calculating and forecasting future values (interpolation and extrapolation). The same methods are applied for deposits, short-dated certificates and similar instruments.

When it comes to other OTC derivatives, the appraisal is handled exclusively by external parties, without subjective input from the Fund. At year-end 2012, the Fund's portfolios contained only a few outstanding structured OTC derivatives.

At times when the market lacks the liquidity necessary for market-listed papers, a higher degree of subjectivity is required in the valuation process. At such times, the market exhibits sharp differences in bid and offer rates, leading even to marked differences between one market player and another. At times like these, the Second AP Fund adopts a conservative approach to appraisal.

Should an asset be deregistered, the market rates listed by alternative trading centres shall be taken into consideration. In such instances, each individual security is appraised separately.

Valuation of Fund capital – Alternative investments

For assets not valued on an active market, various appraisal techniques are applied in the calculation of fair value at the valuation date.

Fair value is deemed to be the market rate at which a transaction between informed and mutually independent parties can be completed. In the case of the Second AP Fund, these non-market-listed assets consist of unlisted real estate assets (eight percent of the total portfolio), private equity funds (four percent of the total portfolio) and OTC derivatives.

Private equity funds are appraised in accordance with the IPEV Guidelines (International Private Equity and Venture Capital Valuation) or equivalent valuation principles, which are jointly-endorsed and established

Validation of valuations in Private equity, SEK million



An analysis of the impact on the result arising from the time-lag reveals that the Second AP Fund's valuations in its official annual accounts are in all essential respects lower than the values cited in the final reports submitted by managers of private equity funds.

methods within the industry. Valuation of holdings is based on the most recent interim reports published by individual private equity funds. Interim reports are normally available within 90 days of the last quarterly financial statement. This means that Fund holdings valued at year-end 2012 were based mainly on an appraisal of private equity funds made on September 30, 2012, adjusted for in- and outflows during the fourth quarter. This method of appraisal has been applied consistently by the Second AP Fund, right from the start.

An analysis of the relative impact of this time-lag since September 2009 reveals that the Fund's valuation, as shown in the official year-end accounts, has in all essential respects been lower than the value declared in the final report submitted by the private equity fund managers. A third-party assessment of market growth during the fourth quarter of 2012 confirms that private equity funds in the Fund's key geographic markets enjoyed continuing positive growth during the final quarter.

Fair-value

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

For this reason, the Fund's holdings are sorted at three different levels and classified according to the in-data used for the appraisal. 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	104 275	10 525	46	114 846
Bonds	81 663	6 303	0	87 966
Cash/derivatives	5 055	5 248	0	10 303
Alternative investments	0	0	28 412	28 412
Total assets valued at fair				

value via the income statement 190 993 22 076 28 458 241 527*

- **Level 1:** Listed rates (unadjusted) on active markets for identical assets or liabilities.
- **Level 2:** In-data other than the listed rates cited in Level 1, which are observable for the asset or liability either directly (excluding rates) or indirectly (derived from rates).
- **Level 3:** In-data for the asset or liability which is not based on observable market data (non-observable in-data).

Level 3 primarily features the Fund's holdings in private equity funds and unlisted real estate, where the appraisal is not based on observable market data. A ten-percent change in the value of these holdings would have a one-percent impact on total Fund capital.

Change during the year in Level 3, SEK million

Purchases	3 914
Divestments	_
Change in value	2 995
Reclassification between level 2 and 3	_
Total	6 909

^{*} The difference compared to reported Fund capital refers to items unrelated to financial investments, such as interim items and other assets/liabilities.

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Financial risk

The Second AP Fund's risk, measured ex ante as Value at Risk (VAR) for the portfolio of listed assets, amounted to SEK 1 375 million at year-end 2012, calculated at a 95-percent confidence level and one-day interval. Equity risk poses the greatest risk, but the Fund's portfolio of listed assets is well diversified.

Risk measured as Value at Risk (VaR) for the Second AP Fund's total listed portfolio, 2012

Total, Second AP Fund	1 375
Diversification	-865
Interest risk	184
FX risk	401
Equity risk	1 655
SEK million	VaR (95%,1 day)

The Value at Risk measure means that there is a 95 percent probability that the Second AP Fund will lose no more than SEK 1.4 billion in a day in absolute terms.

The credit risk in the Fund's portfolio of fixed-income securities is revealed, among other things, by the allocation of holdings per rating category. The diagram shows that 77 percent of the Fund's fixed-income holdings are rated from AAA to A-, according to S & P (Standard & Poor's). Other parts consist of the Fund's investment in fixed-income funds.

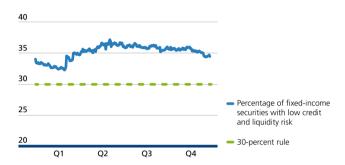
Credit quality, %



Allocation of Fund's fixed-income securities per rating category.

The liquidity risk is limited, among other things, by the 30-percent rule (external investment regulations for AP1-AP4, which specify that a minimum 30 percent of the funds' total capital shall be invested in securities with a low credit and liquidity risk). In 2012, the Fund's share was about 35 percent. The Fund's fixed-income portfolio has duration of 4.7 years. The spread in duration between different mandates varies from 3.5 to 7.4 years as at December 31, 2012.

Liquidity risk, %



Gothenburg, February 6, 2013

Marie S. Arwidson <i>Chair</i>	Sven Björkman <i>Vice Chair</i>	Anders Jansson
Helén Källholm	Jeanette Hauff	Ola Alfredsson
Lenita Granlund	Ulrika Boëthius	Niklas Johansson

Our audit report was submitted on February 6, 2013

Jan Birgerson
Authorized Public Accountant
Appointed by the Swedish Government

Peter Strandh
Authorized Public Accountant
Appointed by the Swedish Government

Auditors' report

For the Second Swedish National Pension Fund, corporate identity number 857209-0606

Report on the annual accounts

We have audited the annual accounts of the Second Swedish National Pension Fund for the year 2012. The annual accounts of the fund are included in the printed version of this document on pages 21–51.

Responsibilities of the Board of Directors and the Managing Director for the annual accounts

The Board of Directors and the Managing Director are responsible for the preparation and fair presentation of these annual accounts in accordance with the Swedish National Pension Funds Act, and for such internal control as the Board of Directors and the Managing Director determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing and generally accepted auditing standards in Sweden. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the fund's preparation and fair presentation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors and the Managing Director, as well as evaluating the overall presentation of the annual accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinions

In our opinion, the annual accounts have been prepared in accordance with the Swedish National Pension Funds Act and present fairly, in all

material respects, the financial position of the Second Swedish National Pension Fund as of 31 December 2012 and of its financial performance for the year then ended in accordance with the Swedish National Pension Funds Act. The statutory administration report is consistent with the other parts of the annual accounts.

We therefore recommend the income statement and balance sheet to be adopted.

Report on other legal and regulatory requirements

In addition to our audit of the annual accounts, we have also audited the inventory of the assets managed by the Second Swedish National Pension Fund. We have also audited if there are any remarks against the Board of Directors and the Managing Directors administration under the Second Swedish National Pension Fund for the year 2012.

Responsibilities of the Board of Directors and the Managing Director
The Board of Directors and the Managing Director are responsible for the
annual accounts, and for administration of the fund's assets according to
the Swedish National Pension Funds Act.

Auditor's responsibility

Our responsibility is to express an opinion with reasonable assurance from the result of our audit and inventory of the assets managed by the fund and the administration in general. We conducted the audit in accordance with generally accepted auditing standards in Sweden.

As a basis for our opinion on the inventory of the assets we have audited the fund's statement of assets and a sample of supporting documents.

As a basis for our opinion concerning discharge from liability, in addition to our audit of the annual accounts, we examined significant decisions, actions taken and circumstances of the fund in order to determine whether any member of the Board of Directors or the Managing Director is liable to the fund. We also examined whether any member of the Board of Directors or the Managing Director has, in any other way, acted in contravention of the Swedish National Pension Funds Act.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions.

Opinions

The audit has not given rise to any remarks regarding the inventory of the assets or otherwise regarding the administration.

Stockholm 6 February 2013

Jan Birgerson Authorized Public Accountant Appointed by the Government Peter Strandh Authorized Public Accountant Appointed by the Government

Equities, participations and fixed-income securities

The Second AP Fund's 20 largest Swedish shareholdings*

Company name	Share of equity, %	No. of equities	Market value (SEK m)	Share of voting rights, %	Sector
Assa Abloy B	0.79	2 937 542	714	0.54	Industrials
Atlas Copco A	0.41	5 050 283	900	0.57	Industrials
Atlas Copco B	0.24	2 990 584	473	0.03	Industrials
Autoliv Inc SDB	1.27	1 209 183	523	1.27	Consumer discretionary
Electrolux B	1.13	3 494 755	596	0.91	Consumer discretionary
Ericsson (LM) B	0.63	20 944 833	1 364	0.37	IT
Getinge B	1.03	2 429 769	535	0.66	Healthcare
Hennes & Mauritz B	0.45	7 490 425	1 682	0.22	Consumer discretionary
Investor A	0.01	58 922	10	0.02	Financials
Investor B	0.70	5 372 156	913	0.15	Financials
Nordea Bank	0.49	20 044 846	1 245	0.49	Financials
Sandvik	0.80	10 096 529	1 045	0.80	Industrials
SCA A	0.05	329 967	47	0.21	Commodities
SCA B	0.52	3 631 973	512	0.24	Commodities
Scania B	0.37	2 969 321	399	0.07	Industrials
SEB A	0.83	18 149 825	1 003	0.84	Financials
SKF B	0.92	4 211 959	687	0.50	Industrials
Swedbank A	0.74	8 402 607	1 067	0.74	Financials
Swedish Match	0.97	2 006 107	438	0.97	Consumer discretionary
Svenska Handelsbanken A	0.50	3 161 340	735	0.51	Financials
Tele2 B	0.75	3 343 829	392	0.53	Telecoms
TeliaSonera	0.48	20 999 186	925	0.48	Telecoms
Volvo A	0.28	5 956 318	532	0.85	Industrials
Volvo B	0.54	11 526 751	1 024	0.16	Industrials

^{*} The above table lists the Second AP Fund's 20 largest holdings in Swedish equities, by worth.

A complete list of the Second AP Fund's holdings may be found on the Fund's website at www.ap2.se

Second AP Fund's holdings in unit trusts

Name	No. of equities, participations	Fair value, SEK m
State Street Enhanced Emerging Market Fund	81 921 733	6 436
Morgan Stanley Convertible Bond Fund	16 460 941	3 353
BlackRock Emerging Markets Index Sub-Fund	32 332 529	2 650
Ashmore Sivac Emerg Mark Investm Grade Local Curr	3 046 644	2 045
Vanguard US Invest Grade Cr Ind Ins Usd Shs	1 936 935	2 004
Genesis Emerging Markets Class A	5 475 561	1 980
BNY Mellon Emerg Mark Local Curr Invest Grade Debt	298 973 499	1 978
Stone Harbor Emerging market Debt	1 561 071	1 664
Investec Emerging Markets Investment Grade Debt	12 471 649	1 661
Stone Harb Invest Grade Emerg Mark Local Curr Debt	2 006 496	1 354
Generation Im Global Equity Fund Class I 20071201	1 013 489	1 264
Wellington Emerging Market Equity	7 757 064	1 115
Bridgewater GTAA Fond	75 115	1 115
Generation Im Global Equity Fund Class A 20090401	896 012	1 104
Vanguard Euro Investment Grd Bd INS EUR Shs	600 240	960
Blackrock Global Ascent	98 695	894
Trilogy Emerging Markets Fund	105 592	888
Wellington Opportunistic Emerging Markets Debt	8 377 061	843
Advent Global Phoenix High Grade Convertible Fund	1 000 301	752
AQR Emerging Equities Fund	1 070 000	745
CQS Archipelago Convertible Bond Strategies Fund	100 604	741
AQR Convertible Opportunities Bond Fund	1 016 260	713
Generation Im Global Equity Fund Class I 20090401	290 582	365
Generation Im Asia Fund	492 402	338
GAM FCM Cat Bond Inc. Institutional 2012 series 10	500 000	335
GAM FCM Cat Bond Inc. Institutional 2012 series 11	500 000	331
AQR Merger Arbitrage fund	500 000	331
Vanguard UK Invest Grade Bd Index Fund INS GBP shs	223 229	171
Bridgewater GTAA Fond Major Market 1100-031	5 655	47

The Second AP Fund's 20 largest foreign shareholdings*

Company name	No. of equities	Market value (SEK m)	Sector
ABB Ltd	5 408 493	725	Industrials
Anheuser-Bush Inveb Sa Act	530 880	299	Consumer discretionary
Apple Inc	167 900	582	IT
AstraZeneca	1 706 575	524	Healthcare
Banco Santander S.a	7 563 700	396	Financials
BASF	592 650	362	Commodities
Bayer	773 701	477	Healthcare
Chevron Corp	399 100	281	Energy
Disney (Walt) Common	857 948	278	Consumer discretionary
Enel	11 760 700	317	Commodities
ENI	3 700 650	582	Energy
Exxon Mobil Corp	854 200	481	Energy
Linde	288 318	327	Commodities
Nestlé	921 431	392	Consumer discretionary
Oracle Corp	1 405 682	305	IT
Sanofi	566 390	347	Healthcare
Siemens	491 490	347	Industrials
Telefonica	3 416 500	300	Telecoms
Total	1 006 840	337	Energy
Toyota Motor Corp	985 400	297	Consumer discretionary

^{*} The above table lists the Second AP Fund's 20 largest holdings in foreign equities, by worth.

The Fund's capital shares and voting rights in the foreign companies listed in the above table in no instance exceed 0.24 percent, and are therefore not reported.

A complete list of the Second AP Fund's holdings may be found on the Fund's website at 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 6	2 639
Swedish Government 1052	2 603
Swedish Government 1047	2 541
Swedbank Hypotek AB	2 161
Spintab Swedmortgage AB 166	2 089

Global government bonds, five largest holdings

Bond	Fair value, SEK m
Denmark (Kingdom of) 3,165	314
BTPS 5	230
US Treasury N/B	228
DBR 2	193
France O.A.T. 3	192

Global credits, five largest holdings

Bond	Fair value, SEK m
Danske Bank A/S 3	322
Instit Crdt Ofcl Ico 4	219
Kommunalbanken AS	215
Rabobank 2	208
Danske Bank A/S 2	204

Detailed information about Second AP Fund holdings in fixed-income securities is available on the Fund's website at www.ap2.se

Second AP Fund governance report

To comply with the Annual Accounts Act and the Swedish Code of Corporate Governance, Swedish listed 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 Chair and Vice Chair 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.

In May 2012, the Swedish Government decided on a new Board, involving the following changes: Märtha Josefsson, Lasse Thörn and Lillemor Smedenvall left the Board of Directors and Niklas Johansson, Ulrika Boëthius and Lenita Granlund were appointed new Members. 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 2012 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 Chair, SEK

75 000 for the Vice Chair and SEK 50 000 for the other Members of the Board. No fees have been paid for committee work conducted by Board Members. The Swedish Government has nevertheless determined that payments amounting to SEK 100 000 in total may be made for committee work.

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, as well as two extraordinary meetings, at which broad strategic issues were addressed, with special emphasis on investment strategy, macroeconomic developments and the Buffer Fund Inquiry. 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 is committed to minimising the consequences that derive from activation of the automatic balancing mechanism, by generating a solid return on invested capital. To meet this requirement, the Second AP Fund has composed a portfolio that is expected to generate an average annual real return of five percent over the long term.

Strategic portfolio

A new strategic portfolio has been approved for 2013.

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 year-end 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 Chair and Vice Chair. 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.

During autumn 2011, the Board resolved to establish a Risk Committee. The Risk Committee, whose members are appointed by the Board, shall advise, monitor and provide support to the Board concerning the Fund's risk control and risk management activities. The Risk Committee shall comprise at least two Members of the Board, as well as the Fund's CEO and the Head of Risk and Performance Management.

The Risk Committee is not authorized to make decisions on behalf of the Board or Fund, except in those cases where such authority has been delegated by the Board. The responsibility of the Board and its individual directors is on no way reduced by the establishment of the Risk Committee or its duties. The operations of the Committee, which meets six times a year, are conducted according to an agenda determined by the Board on an annual basis. During 2012, among other activities, the Risk Committee conducted a broad review concerning the definition and monitoring of financial risks, discussed the operative risks and a number of proposed alternative investments. The Fund's latest risk status was also discussed at each of these meetings.

Audit

The Second AP Fund's auditors are appointed by the Government. Current responsibility for the audit is shared by Jan Birgerson and Peter Strandh, from Ernst & Young, who were appointed on May 31, 2012. Ernst & Young is also tasked with conducting the audits of the other AP funds, and Jan Birgerson 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 2012.

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 the Second AP Fund website at 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 frameworks and guidelines for the overall allocation of responsibilities, risks, risk limits and routines to monitor and control that such guidelines are observed.

The Risk Management Department ensures that these risk parameters are respected. Implementing this risk control process ensures that the organization, 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	Comments
Marie S. Arwidson	7/8	
Sven Björkman	7/8	
Anders Jansson	6/8	
Märtha Josefsson	2/2	Left after April
Lillemor Smedenvall	1/2	Left after April
Lasse Thörn	2/2	Left after April
Jeanette Hauff	8/8	
Ola Alfredsson	6/8	
Helén Källholm	8/8	
Lenita Granlund	4/6	Started in June
Ulrika Boëthius	6/6	Started in June
Niklas Johansson	6/6	Started in June

Board of Directors











Marie S. Arwidson

Chairman since 2010. Sc. (Econ). Managing Director of the Swedish Forest Industries Federation. Directorships on the boards of the International Chamber of Commerce Sweden and the Royal Swedish Academy of Engineering Sciences. M. Born 1951.



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

Helén Källholm

Member of the Board since 2011. Managing Director of Svenska kyrkans arbetsgivarorganisation (Church of Sweden Employers' Federation). Directorship on the board of Svenska Kyrkans Trygghetsråd. Born 1957.

Jeanette Hauff

Member of the Board since 2010. L.Econ. Active at Gothenburg University's School of Business, Economics and Law. Savings Advisor at Skandia. Directorship on the board of Svenska Försäkringsföreningen. Born 1965.

Lenita Granlund

Member of the Board since 2012. Negotiations Secretary for Svenska Kommunalarbetarförbundet (Swedish Municipal Workers' Union). Vice Chair KOM-KL Omställningsfonden and LO-TCO Rättsskydd AB. Directorships on the boards of Sunt Arbetsliv, Riksbyggen Bospar, AFA's KL-delegation, KPA Pensionsförsäkring, Fastighetsbolaget Polstjärnan and a deputy member of the board of Prevent. Born 1962.





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



Niklas Johansson

Member of the Board since 2012. BA, MBA. Chair of Apoteket and Telia's Pension Fund. Directorship on the board of Catella AB. Born 1961.



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 thandelsbanken Markets, and President of Volvo Group Finance. Directorships on the boards of Stena Drilling and Stena Adactum. Born 1957.



Ulrika Boëthius

Member of the Board since 2012. Chair of Finansförbundet (The Financial Sector Union of Sweden). Directorships on the boards of TCO (Confederation of Professional Employees), NFU (Nordic Financial Unions), Cefin (Centre for Banking and Finance at KTH). Born 1961.

Executive management



Ola Eriksson

Head of IT, Business Control and Accounts. Employed since 2001. Born 1965.

Tomas Franzén Chief Investment

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

Hans Fahlin

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

Ulrika Danielson

Head of Communication & HR. Employed since 2009. Born 1965.

Eva Halvarsson

CEO. Employed since 2006. Other directorships: Vasakronan AB, Norrporten AB, FinansKompetens-Centrum and the Swedish Corporate Governance Board. Vice Chancellor of Gothenburg University. Born 1962.

Henrik Westergård

Head of Performance and Risk Management. Employed since 2012. Born 1973.

Martin Jonasson

General Counsel. Employed since 2001. Born 1964.

Auditors

Jan Birgerson, Authorized Public Accountant, Ernst & Young. Peter Strandh, Authorized 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/Passive management

Active management: Portfolio management actively deviates from the benchmark index to add value.

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

Active risk/Tracking error

The variation in relative return. Often measured as standard deviation on the relative return. Active risk is calculated using daily data to determine relative return.

Alpha/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.

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 asset classes 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

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

Credit/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 assetrelative change in value with an interest adjustment of one percentage unit.

Enhanced mandate

Index-linked management mandate with a low level of active risk, 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 contract

A derivative instrument involving a contract to purchase foreign currency at some 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 active risk/tracking error.

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

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

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

Ouantitative 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 cleard of commission and operating expenses.

S&P 50

Standard & Poor's 500 composite index. A capweighted share index of 500 US companies. Selection is based on size, liquidity and industrial sector, among other factors.

Sharpe ratio

A gauge of risk-adjusted return. Measured as the portfolio's absolute return less risk-free interest (SSVX 12 months), divided by the standard deviation on absolute return.

SIX RX

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 annually by the Board of Directors and confirms the Fund's decision on strategic asset allocation.

TAA

Tactical Asset Allocation. A portfolio management strategy focused on overperformance in diverse asset classes.

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 for a ten-day interval.



At the close of the year, we can state that the Second AP Fund's capital assets have never been greater. With a return of no less than 13.5 percent and fund capital amounting to SEK 241.5 billion, in spite of the continued turbulence on financial markets, we have demonstrated that our long-term strategy is working well.

Eva Halvarsson, CEO, Second Swedish National Pension Fund/AP2

