Second Swedish National Pension Fund Annual Report 2014

Andra AP-fonden
Second Swedish National Pension Fund - AP2

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With **SEK 293.9 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 long-term and responsible manager of assets, the Fund is tasked with an important assignment by the Swedish Government – minimizing the impact on future national pensions that would derive from applying 'the brake'.

Record amount in Fund capital

During 2014, the Second AP Fund generated a return of 13.3 percent on capital under management. Fund capital rose by SEK 29.2 billion, which means that pension capital has now doubled since the Fund's 2001 inauguration.

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Fund governance

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Sustainability audit

The purpose for the Fund's sustainability work is to create and protect values.

Risk management

The Fund's risk management strategy is based on the annual Asset Liability Model (ALM) study.

Unless otherwise stated, the portfolio assets referred to in this report are 'allocated exposures'. In addition to booked fair values, these also refer to allocated (but not yet invested) liquidity for the specific class of asset, and the liquid funds held as collateral for positions already taken in derivative instruments. Classes of asset, derivative instruments and liquid funds are reported individually in the balance sheet at their fair values. All monetary amounts are expressed in Swedish kronor and abbreviated as SEK k (thousand), SEK million or SEK m (million) and SEK billion or SEK bn (thousand million). Figures in parentheses refer to the preceding year.

^{*} The Second AP Fund is officially translated as the Second Swedish National Pension Fund/AP2. In body text, for convenience, this is shortened to the Second AP Fund and, where space requires, AP2.

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. A committed asset manager, the Fund invests worldwide. Consistent and responsible fund management has helped ensure that the return generated on portfolio assets has exceeded the Fund's long-term commitments.

The buffer funds account for 13 percent of the Swedish national pension system's total assets. In conjunction with the other buffer funds, the Fund is tasked with contributing to maintaining as high and consistent pension levels as possible, 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.

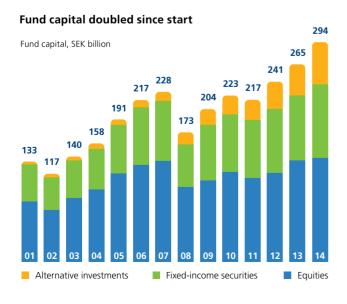
Strategic management model

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 over the last 10–15 years, but the Second AP Fund's return on investment compares well 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 a staff of more than 60. It employs some of the foremost in their respective fields, as portfolio managers, analysts and other specialists. Together, this workforce ensures efficient portfolio management, 72 percent of assets being managed in-house. One consequence has been that the Fund's management costs are lower than those of similar funds at an international level.

The Fund adopts an active approach to ethical, environmental and corporate governance issues, and has come far in making sustainability integral to portfolio management. 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.



By 201

By the first quarter of 2014, fund capital had doubled since the start in 2001, in spite of a financial crisis, an IT bubble and turbulent times on the financial markets.

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

2014 in brief

Consequent to the Second AP Fund's strong performance over the year, return on investment exceeded the anticipated long-term return. In the past five years, the Fund's average annual real return has totalled 8.7 percent and, over the past ten years, 6.1 percent. 2014 was a good year, especially with respect to the Fund's investments in non-listed and listed equities. For the sixth year in succession, net outflows to the pension system were negative and the Fund has now paid out a total of almost SEK 25 billion to cover the current shortfall in the pension system.

Fund capital

SEK 293.9 bn

The Fund's assets under management totalled SEK 293.9 (264.7) billion on December 31, 2014, against which net outflows to the national pension system were charged in an amount of SEK –5.1 (–6.9) billion.

Result

SEK 34.3 bn

The Fund posted a net result for the year of SEK 34.3 (30.1) billion.

Operating expenses

0.07 %

The expense ratio for operating expenses remained low, totalling 0.07 (0.07) percent for the year.

Return

Swedish equities

16.8%

Return on Swedish equities was 16.8 (27.2) percent.

Relative return

0.5 %

The relative return on the total portfolio, excluding alternative investments and costs, amounted to 0.5 (0.4) percent.

Total return

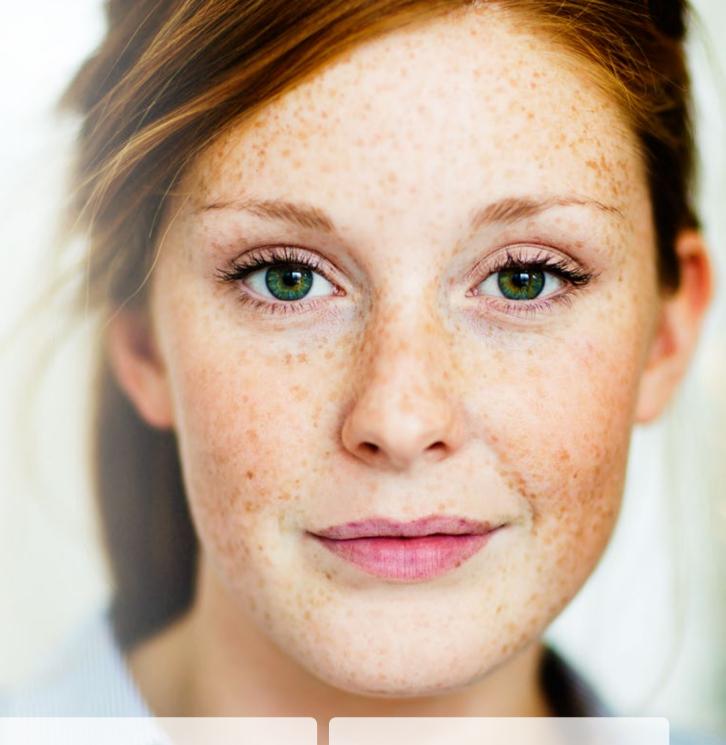
13.3 %

The Fund's return on the total portfolio was 13.3 (12.8) percent, excluding commission costs and operating expenses. Including these costs, the portfolio generated a return of 13.1 (12.7) percent.

Performance review since start

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Fund capital, SEK m	293 907	264 712	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 outflows to the Swedish Pensions Agency, SEK m	-5 120	-6 880	-3 788	-1 240	-4 041	-3 906	884	2 019	1 676	2 905	1 651	2 567	5 002	4 523
Net result for the year, SEK m	34 315	30 138	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, %	13.3	12.8	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, before alternative investments, commission fees and operating expenses, %1		0.4	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	0.3	0.3	0.6	1.0	0.7	0.7	0.5	0.5	0.6	1.0	1.7
FX exposure, %	24	23	20	16	12	10	12	11	12	11	10	8	7	10
Share of external mandates, %	28	25	29	29	23	24	22	24	17	28	37	45	38	82

¹ Relative return refers to the difference in return between a portfolio and its benchmark or reference index.



Average annual return over past five years

9.6%

Second AP Fund's average annual return over past five years.

Contribution to the national pension system 2014

SEK 34.3 bn

The Fund's net result of SEK 34.3 billion for the year further contributed to balancing the national pension system. In conjunction with the solid economic performance of international markets, this helped avoid the need to apply the automatic balancing mechanism, referred to as 'the brake', during 2014. More about the brake on pages 6–7.

CHIEF EXECUTIVE'S REVIEW

Record Fund capital

The Second AP Fund continues to grow. Our portfolio management activities generated a 13.3 percent return in 2014. Fund capital rose by SEK 29.2 billion, meaning that we have more than doubled the Fund's capital assets since our inauguration. Fourteen years on, today's Fund is a mature, efficient organization with a clearly defined investment strategy, well equipped to meet even more turbulent times.

By the first quarter of 2014, the Fund had doubled its capital since its inauguration. By this time, the SEK 134 billion we received in 2001 had grown to almost SEK 270 billion, in spite of the effects of a financial crisis, an IT bubble and the general turbulence of financial markets. This has symbolic significance for us and the nation's future pensioners, especially at a time when the relevance of Sweden's national pension funds is being questioned.

Ongoing internalization

During the year, we have consistently pursued our long-term strategy for managing a greater part of Fund capital in-house, including parts of the bond portfolio in emerging economies. The further development of the organization has facilitated this process, both in terms of competence and concerning issues such as investment strategy, culture and values. Internalization makes us more effective and ensures that we are well equipped, even when facing more turbulent times.

We have also increased investment in directly-owned real-estate companies, where we have a seat on the board and develop the companies with the benefit of direct knowledge of their business operations. As an owner, we impose considerable demands. The breadth of our portfolio places stringent demands on us and our competence in different forms of portfolio management – direct ownership, funds, listed companies and so on. The Fund has further enhanced its resources through recruitment and competence development.

Changes to portfolio

Notable major changes to the portfolio include an increased allocation to emerging countries, in compliance with our long-term strategy. We have increased the share of bonds by two percentage units and of equities by the same amount. The combined impact of these changes has made a positive contribution to the strong net result for the year. Furthermore, investments in alternative risk premiums have also been increased by two percentage units.

Review to improve oversight

The development of in-house resources in support of the Fund's portfolio management strategy has been especially noteworthy during 2014 – and we have achieved a lot! Many parts of the Fund have been engaged in conducting a comprehensive review of in-house routines. By documenting what we do, we preclude the risk of things

falling between two stools and ensure the long-term quality of our work. We have also developed our business system, procured a new system for managing and monitoring risk and initiated the procurement process for a new custodial bank.

New level of sustainability

Within the broader framework of our portfolio management strategy, we have progressed a step further with our sustainability programme. We have continued to invest in training in this field and recruited additional competence. Our new risk-management system will enable us to analyse ESG risks in the portfolio. The goal is to make sustainability an integral part of all analytical and investment processes.

To ensure that we focus on the appropriate areas and necessary measures, we are now introducing a comprehensive sustainability strategy. We choose to focus on areas where we feel we can really make a difference.

One example is the investment decisions we have taken related to the climate issue. In October, we decided that we would no longer invest in a total of 20 energy companies, 12 of which were coal-mining companies, with a view to reducing the financial risk inherent in fossil energy. The fundamental analyses on which this type of decision is based were initiated in the autumn of 2013 and conducted in-house, in collaboration with researchers and other experts. After addressing fossil energy, we shall be turning our analytical attention to other industries.

Ongoing at both global and local levels

The Second AP Fund continues to operate at both the global and local level. We participate in many networks and are engaged in an extensive interchange of expertise throughout the world. Typical of this collaboration is the Superannuation Fund, a New Zeeland pension fund, with which we have maintained contact over the past decade and which, in 2014, involved a number of competence exchanges. We are also active at the local level, although this does not involve direct investment, and cooperate closely with the School of Business, Economics and Law at the University of Gothenburg, as well as Chalmers Institute of Technology.

The Fund is clearly perceived to be an attractive employer, at both the international and local level. Several newly recruited employees have moved from London and other financial centres to join us here in Gothenburg. Our employees tend to stay with the Fund for a long time, where they enjoy ongoing personal and career development.

30 percent below average

During the autumn, we yet again received confirmation that we operate cost-efficiently. According to the independent analytical specialist CEM, the Fund's costs continue to be some 30 percent lower than the average reported for our benchmark group.

Risky proposals in Swedish pension reform

It is my considered opinion that Sweden's National Pension AP Funds work well and are cost effective. It is important that there are several independent funds, pursuing different strategies – which is how things are at present.

If implemented, the reforms proposed by the Pensions Group will reduce this spread of risk and the relative independence enjoyed by the AP Funds. For Sweden's pensioners, the reforms are going to cost more than they're worth, both in terms of lost return on investment and of the risk that future pension capital could be used for other ends.

One proposal is that the funds' administrative functions should be centralized. The Second AP Fund has a successful and complex organisation, in which administration and portfolio management work closely together and have been tailored for each other. This model has evolved over more than a decade and is a key element in the delivery of effective and successful portfolio management. Extracting a single aspect from this concept poses a significantly increased risk – rather like removing the leg from a stool. It's likely to collapse.

Outlook for 2015

The internalization process will continue in 2015 as the Fund handles an increasing percentage of its portfolio management activities in-house. This is cost-efficient and means that we can exploit the competence we have developed to the full. Increasing the degree of in-house portfolio management naturally leads to a rise in in-house costs, but is more than compensated by the greater fall in external costs, whose benefits we shall see over coming years.

Next year, we also plan to increase our allocation in domestic Chinese equities. As the first Swedish player, we were among the first on the scene, and are now taking the next step.

We are also preparing ourselves for revised investment regulations, on the assumption that they will in fact be implemented. It is important that we develop the portfolio in the best possible way for the future. Conceivably, this means we shall be investing a greater part of our capital in non-listed and real assets.

In December, in line with its mandate, the board finalized the composition of a forward-looking portfolio that, including active return, is expected to generate a long-term average annual real return of 4.5 percent. This represents a change from previous years, deriving from expectations of lower global interest rates over the long term.





The goal is to make sustainability an integral part of all analytical and investment processes.

Work on our sustainability strategy, which forms part of our portfoliomanagement strategy, continues. Diversity is an issue close to our heart and we are actively engaged in seeing that more women at senior management positions are appointed to executive managements and corporate boards. Our efforts in this area are based on the Second AP Fund's Female Representation Index. Our commitment on this issue is easily explained: we are determined not to lose out on access to valuable competence. I have written to the nomination committees of companies in which we hold an interest and challenged them to perform better in this respect. As an investor, we can also encourage these companies to be more transparent in their reporting procedures, to ensure that we are given more relevant information. This is something we can contribute as an investor, when in dialogue with our portfolio companies.

The Second AP Fund has been entrusted with an important mission by the Swedish people, a mission whose importance will in no way diminish in the years ahead. We are proud of this mission, for which we have great respect. We are determined to establish and maintain a consistently high level of confidence on the part of our ultimate employer, i.e. the people of Sweden. Every Fund employee is keen to achieve his/her absolute best and it is a privilege to work with such talented colleagues. I should like to express my warmest thanks to all of you for your efforts over the past year, while noting that we have an exciting period ahead of us!

Eva Halvarsson, CEO

PENSION SYSTEM

The Swedish pension system – a unique system

When the current Swedish national pension system was introduced in 2001, it heralded an entirely new structure and new responsibilities for the AP funds. The funds' role as a buffer within the pension system was defined. A direct correlation was established between the return on fund assets and growth in the value of the income-based pension. Today, the buffer funds account for 13 percent of the pension system's capital assets.

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 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 unique system

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 pension 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 almost fifteen 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 totalling SEK 293.9 billion, making it one of northern Europe's largest pension funds. In international terms, the Swedish AP funds are together among the largest national pension funds in the world.

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 13 percent of total pension assets. The 87 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/wage levels and retirement age.

Balancing the system

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 until parity is re-established within the pension system.

Net outflows expected to continue

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, or 'brake'. 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 difference between national pension contributions, which are paid to the AP Funds, and pension disbursements, which are financed from the Funds' capital assets), the AP funds have disbursed more in pension payments than they have received in the form of contributions. As a consequence of an anticipated 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.

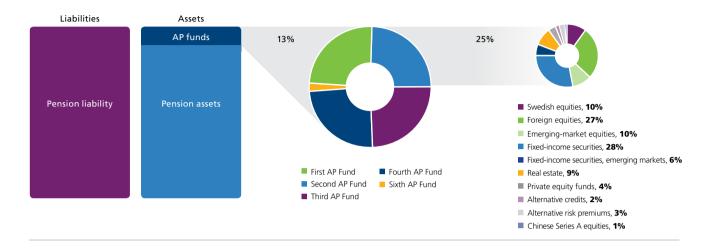
In 2014, net outflow amounted to SEK –5.1 billion, compared with SEK –6.9 billion in 2013.



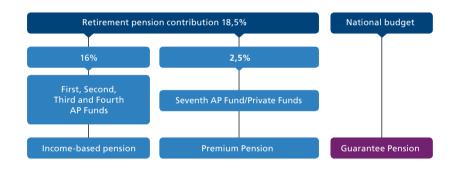
Pension system balance sheet

Buffer fund shares

Second AP Fund capital



The Swedish pension system



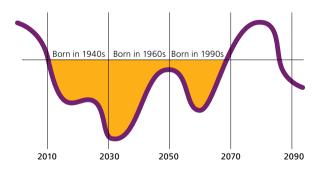
The national retirement pension comprises the following: an income-based pension, a premium pension and/ or a guarantee pension. The pension is financed in the form of a levy of 18.5 percent on total income earned. Of this amount, 16 percent is used to finance annual disbursements (income-based pension) 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 Balancing applied BR<1, lower indexing rate Year

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 in 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 are likely to exceed contributions after 2009, when the large post-war generation of baby-boomers started to retire.

ROBUST, GENERATION-NEUTRAL SYSTEM

Once the system is back in

The buffer funds improve pensions

Since the launch of the new Swedish pension system in 2001, the return on assets generated by the buffer funds has on several occasions meant that the automatic balancing system, or 'brake', did not have to be applied, avoiding a temporary decline in the level of pension disbursements. The Second AP Fund's average annual return since its inauguration has been 5.7 percent, which is higher than average income growth over the same period.

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balance, pensions are adjusted The economic recovery and firm **application** of the brake have a posiupward at an accelerated pace tive effect. The buffer funds' strong performance further contributes to a until they regain parity with positive balance. In response, pensions are revalued upwards. the rate of income growth. Changes in system's balance, SEK m 120 -1912009 2010 The recovery of the financial The balance worsens as the 68 pension liability increases faster than markets helps improve the balance, contribution assets. Sharp falls on at the same time that the economic stock markets further worsen the slowdown affects the inflow of contribalance. The automatic balancing bution assets, having a negative impact. The brake is applied more firmly. -199

24975

SEK m has been paid out net by the Second AP Fund between 2009 and 2014 to balance the deficit in the pension system.

Why the brake is applied

Regardless of economic and demographic developments, the Swedish pension system is designed to ensure that national pension commitments are linked to the combined value of future contributions and buffer fund assets. The brake exists to guarantee this – to make sure the system's liabilities will not permanently exceed its assets. It brakes or reduces upward adjustment on the liability side of the system until it is once again in balance. There is a risk of having to apply the brake when:

- Employment declines (a change that can depend both on current age distribution and on the level of unemployment), causing a reduction in pension contributions.
- The retirement age falls, as greater numbers leave the labour market earlier than originally envisaged.
- The average life expectancy of pensioners rises, without a corresponding increase in pensionable age.
- The value of the AP funds' assets falls sharply, creating imbalance in the system.

Once the system is back in balance, pensions are adjusted upward at an accelerated pace until they regain parity with the rate of income growth. This means that the only people to suffer a lastingly negative effect when the brake is applied are those who are actually receiving a pension at the time.

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The return on buffer-fund investments and other factors make an equal contribution to strengthening the pension system. The pensions are revalued at a somewhat lower rate than the rise in contribution assets.

77 85

The pension liability increases, but more slowly than the inflow of contribution assets, which strengthens the balance. A negative return on the buffer funds' capital assets partially counteracts the improved balance.

2011 2012 2013

pensions and the pension liability
leads to a new weakening in the
balance. The continuing strong
performance of the buffer funds helps
counteract this weakening. Once

Sharp upward revaluation of pensions and the pension liability leads to a new weakening in the

Contributions from other factors

Contributions from buffer funds

-322

again, the brake is firmly applied.

THE MISSION

To act as a buffer fund

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.

Mission and 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 the 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 and risk.

Purpose linked to pension system

The Fund's purpose is linked to the pension system and the anticipated effect of investment on pensions. The targeted return, which is defined as a percentage, describes the properties exhibited by the long-term portfolio most likely to generate the greatest benefits in the form of pension disbursements.

As instructed, the Second AP Fund has composed a portfolio that, including active return, is expected to generate an average long-term real annual return of 4.5 percent. Due to expected lower global interest rates in the long term this assumption, from 2015, is lower than previously (5.0).

In the past ten years, the Second AP Fund has generated a return of 102.5 percent, corresponding to an average annual return of 7.3 percent. Adjusted for inflation, this corresponds to an annual real return of 6.1 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

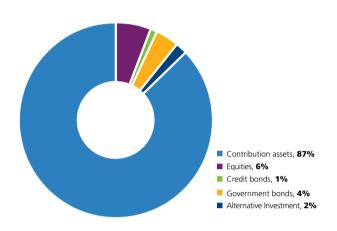
The Second AP Fund considers the choice of index to be part of the strategic investment process, where the index determines the investments selected for subsequent portfolio management, in-house and external. The Second AP Fund complements the broad and more traditional cap-weighted indices with more specialised indices.



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

Asset allocation, Swedish national pension system

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



Strategic portfolio 2014

(% of Fund capital)



The Fund's first strategic portfolio 2001

(% of Fund capital)



The upper pie chart at right shows the allocation of assets in the Second AP Fund's 2014 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 13 percent of the Swedish national pension system's combined assets. In other words, remaining 87 percent of pension system assets are in no way exposed to the financial markets.

Source: The Swedish Pensions Agency and in-house calculations.

Second AP Fund value creation, %



Accumulated return, ten years, %



Active management

The nature of the Fund's active management is determined by the index chosen. The intention is that 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

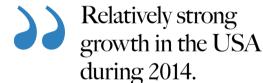
strategy combines cost efficiency with operational efficiency. These processes are in turn based on the Fund's pronounced result-oriented culture and ability to attract and develop its staff.

MARKETS

Global economic recovery continues

In the past year, the global economy has continued its gradual recovery in the wake of the global financial crisis and the imbalances that caused it. During the same period, stimulatory monetary policies have continued to support economic activity and maintain asset prices the world over.

This normalization process has progressed furthest in the USA, while the recovery has been much slower in Europe. This recovery has been staged from low levels of activity and the global economy is still a good way from full capacity utilization. A significant lack of global inflationary pressure means that the central banks are in no hurry to raise interest rates. In fact, they appear to feel the need to continue to stimulate the economy over the coming year too. The economic recovery should gain further momentum in 2015.



Following a cold-related slowdown at the start of the year, the US economy enjoyed relatively strong growth during the remaining months. GDP rose by more than two percent during 2014, while the unemployment rate fell steadily to less than six percent. In light of this, as planned, the Federal Reserve (the Fed) terminated its stimulus programme of buying government bonds in October. However, expectations of low inflation and a lack of wage inflation mean that the Fed has time to allow the economy to gain additional momentum before raising the base lending rate. At time of writing, the market anticipates no rise in this rate prior to the second half of 2015. The US dollar rose sharply against other currencies during the year, but the US economy is not particularly export dependent and strong domestic demand means that the USA looks as if it will be able to power the global economy next year as well.

Weaker growth in Europe

The economic performance of Europe over the past year has been far less favourable, with weak growth and such a low rate of inflation

that the threat of deflation could not be dismissed. GDP for the eurozone as a whole grew by less than one percent in 2014, unemployment levels remained stubbornly at more than 11 percent and inflation fell almost to zero at an annual rate. Nevertheless, reforms in major European states such as Italy and France moved slowly in the right direction. In October, the European Central Bank (ECB) published the result of the stress tests and "Asset Quality Review" it had conducted for the largest European banks. Italian banks were highlighted as being weaker than the rest, but generally speaking no major capital requirements were revealed and the whole exercise may hopefully provide grounds for considerable confidence in the European bank sector. During the autumn, the ECB implemented its Quantitative Easing (QE) programme, purchasing private fixed-income securities to stimulate the economy, following its lowering of the base lending rate to 0.05 percent in September. During the same period, expectations among market players grew that the ECB would extend its QE programme to include treasury securities, which had a negative impact on two-year interest rates in several eurozone countries. Growth in 2015 should be somewhat stronger, thanks to a less-restrictive fiscal policy, QE and the effects of a weaker currency.

Reforms in Japan

The rate of economic recovery in Japan was also relatively weak in 2014. Domestic demand fell after VAT was raised in April and exports failed to gain much momentum, despite a notably weaker yen. Prime Minister Abe's government nevertheless continues to work assiduously towards breaking the country's ingrained deflationary pattern and to make the economy more efficient by introducing structural reforms. The Japanese Central Bank aggressively increased its support purchasing of government bonds during 2014 and, towards the close of the year, Prime Minister Abe decided to postpone the increase in VAT planned for 2015 – to create conditions more favourable to getting the economy moving. Mr Abe's government was re-elected at the end of 2014 and in 2015 hopes to be able to complete negotiations with the USA and others concerning the Trans-Pacific

Partnership (TPP), a free-trade agreement covering the Asia- Pacific region. Success would provide a considerable boost to Japan's agenda for structural reform.

Low inflation in Sweden

In line with the overall global trend, inflation in Sweden was lower than expected in 2014, in spite of relatively solid domestic demand and an increase in employment levels. The Riksbank surprised the market in October by lowering the base rate to zero and postponing the first anticipated rise to mid-2016. The krona fell further against the US dollar following this decision. Explaining its decision, the Riksbank claimed it was responding to Sweden's low inflationary pressure, which continued despite solid growth in household consumption and the housing sector. Swedish exports have been inhibited by weak demand in Europe, although they could rise in 2015 if the eurozone's recovery strengthens.

Reforms in China aim at sustainable growth

During the year, the Chinese government continued its reform programme with a view to establishing more sustainable growth, although at a somewhat lower level than what we have become accustomed to over the past decade. In the longer term, these reforms aim to generate growth that is less dependent on real-estate and exports and more on domestic consumption and services. Credit growth in China was checked in 2014 and the real-estate sector cooled down, a key reason for the decline in demand for commodities such as iron and copper on global markets. Even so, the Chinese authorities showed themselves prepared to implement a number of financial and monetary-policy measures during the year, that were specifically focused on ensuring that growth would not suffer unduly from the effects of the reform process. This gradual readjustment of the Chinese economy will continue to form a key element of the global economic landscape for many years to come.

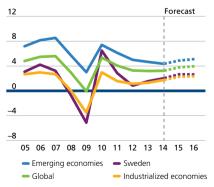
Relatively stable emerging markets

Generally, the economic situation on emerging markets was relatively stable during 2014. The slowdown in China negatively affected activity in a number of African and South American countries that relied heavily on commodities exports, while in contrast the US recovery favoured Mexico and Asian countries that were engaged in major exports of consumer products. The year was also notable for the number of political elections held by several of the largest emerging

countries. In Brazil, South Africa and Turkey, the incumbent governments were re-elected in spite of relatively weak economic growth, while opposition parties came to power in India and Indonesia. Especially notable was the new government in India, which won a resounding mandate to implement economic reforms. Welcomed by investors, it ensured that the Indian stock market was one of the year's big winners. There is a risk of some financial turbulence on emerging markets during 2015 as the Fed's first increase in the base rate approaches. From a macroeconomic perspective, however, a recovery in the US and Europe would favour emerging markets by increasing export demand.

On the financial markets, global bond rates continued to fall to record lows in 2014, while the global index for equities rose by some ten percent. The US dollar gained some ten percent against other key currencies, while there was a general decline in commodity prices, led by crude oil, which saw its price fall by no less than 50 percent during the year. The fall in the price of crude oil derives from a number of different factors. Increased production of shale oil in the US and the resumption of Libyan oil production coincided with reduced demand in China and Europe in 2014. Should these low oil prices continue, they will benefit companies and consumers in the world's major economies, improving the prospect that a global recovery could gain momentum in 2015.

GDP growth (annual), %



Source: IMF and Riksbanken

STRATEGY

Increased focus on alternative asset classes and strategies

The AP funds' portfolio management activities have made a positive contribution to the national pension system. The Second AP Fund has never had such considerable capital, which has more than doubled since the Fund's inauguration in 2001, rising by SEK 164 billion (net flows not included).

To contribute to maintaining or improving the balance in the pension system, the Fund's return must be at least higher than the income index which, since the buffer funds were established, has increased at an average annual rate of 3.1 percent. During the same period, the Fund's portfolio has generated an annual return on investment of 5.7 percent.

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.



Capital has more than doubled, rising by SEK 164 billion since the Fund's inauguration in 2001.

ALM model developed in-house

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 long-term prospects on the financial markets. The work with the ALM model is designed to create a portfolio that will minimize the impact of the automatic balancing mechanism on future pensions.

One of the fundamental demands made of the ALM model is that it should embrace both the overall development of the pension system and the factors affecting the return on the buffer funds' capital assets. The model's analytical horizon is 30-35 years.

The ALM model comprises three interlinked components:

- Scenario simulation: This component simulates the various growth trajectories for the asset classes in the Fund's portfolio, for Swedish inflation, for the capacity utilization rate and for salaries. Greatly simplified, the model consists of one part that describes the average anticipated growth of these variables and another part that describes numerous possible variations from this average. The ALM model is under continuous development and, in 2013, a major adjustment was made to better describe the covariance between the portfolio of assets and the underlying pension system.
- Calculation of the pension system's balance sheets and income statements: This component calculates the key ratios that are critical to pension system growth. Demographic scenarios are also factored into the equation.
- Optimization component: This component identifies the portfolio that best meets the overall objective. This is based on the other components of the ALM model.

The ALM model's most important key ratio is the balance ratio (the ratio between assets and pension liabilities). The balance ratio affects the degree to which pensions can be upwardly adjusted. If the balance ratio is less than one, i.e. if the system's assets are less than its liabilities, the brake is applied and pensions are upwardly adjusted at a lower rate than would otherwise have been the case. The higher the return generated on the AP funds' portfolios, the smaller the risk that the automatic balancing system will be activated.

Controlled risk

An important factor governing the composition of the strategic portfolio is the fact that the AP funds jointly account for 13 percent of the national pension system's combined assets. The largest part (87 percent) derives from the contribution assets, which can best be compared to index-linked bonds. This means that the AP funds can and should accept a higher degree of risk in their portfolios.

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

Long-term diversification of investment strategy

The Fund's long-term investment strategy and strategic portfolio has been subject to constant development from the start. 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.

Changes in the strategic portfolio

In 2014, the Fund's Board of Directors reached several decisions concerning the strategic portfolio, reflecting greater focus on alternative asset classes and strategies.

Increased allocation to alternative risk premiums

Towards the end of 2012, the Fund started to build up its own balanced portfolio of 'alternative risk premiums'. The strategies featured in the portfolio are linked to equity-market 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. Alternative risk premiums should help increase diversification and generate a higher risk-adjusted return, given that the portfolio is constructed to be less dependent on traditional equity-market risk. In 2014, the strategic allocation to this portfolio of alternative risk premiums was increased from one to three percent of the total portfolio.

Increased allocation to emerging markets

Dating from 2003, the Fund has increased its allocation to emerging markets on a number of occasions. The intention has been to secure a higher absolute and riskadjusted return for the portfolio. Both equities and bonds on emerging markets are expected to generate a higher long-term return than similar investments on mature markets. Emerging markets also help spread risk in the portfolio. In conjunction with the sharp fall in the prices of equities and bonds on emerging markets, the Fund increased its long-term strategic allocation to these markets. Subsequent to this change, 11 percent of Fund capital has been allocated to equities on emerging markets, six

percent being allocated to bonds on these same markets. This is a substantially greater share than the average percentage of capital allocated to these markets.

Expanded framework for non-listed real estate

Asset class real estate has gained increasing significance in the Fund's portfolio over the past years. This applies as much to investments in farmland and timberland 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 allocation to this sector is being increased as suitable investments are identified. In 2014, the Fund decided to expand the framework for such investments from 10 to 15 percent of the total portfolio.

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 and the strategic portfolio.

Since 2003, 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 weighting 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 less portfolio concentration and a higher risk-adjusted return over time. In 2014, the Fund extended the choice of indices relating to its allocation in foreign equities to encompass indices based on low-volatility equities and portfolios.

Active management

Active management is based on the assumption that market inefficiencies exist and that there are a number of assets that wrongly priced. By identifying these and utilizing the Fund's resilience, active portfolio managers can increase the return compared with portfolio management that is entirely index driven. For this reason, the Second AP Fund employs active elements in its portfolio management. This active management is employed both in-house and via external mandates. In 2014, actively managed portfolios generated 0.5 percent in excess return, equivalent to SEK 1.1 billion.

In-house portfolio management

The Second AP Fund has several asset classes under in-house management, concentrating resources on areas that it believes offer the greatest chance of success, based on the market, the available experience, the competence and the processes.

Some 72 percent of the Fund's assets, in the following asset classes, are managed in-house:

- Swedish equities
- · Foreign equities on developed markets
- Foreign equities on emerging markets
- Emerging-market bonds
- Swedish bonds
- Foreign government bonds on developed markets
- Tactical asset allocation
- Real estate (via directly-owned companies)
- Parts of the portfolio of alternative risk premiums.

The active management of Swedish equities during 2014 was conducted under two mandates. The larger mandate is aimed at a broad share index and the smaller at small caps. Swedish and foreign fixed-income securities are also actively managed in-house. Foreign equities and Swedish fixed-income securities are quantitatively managed too, involving the use of mathematical models to locate market inefficiencies.

External portfolio management

The majority of the Second AP Fund's external mandates are active and are expected to generate an active return and contribute to the diversification of the portfolio. The Fund employs external asset managers for asset classes and markets that offer good yield potential, as well as for asset classes and mandates where the necessary in-house resources are lacking.

During 2014, the Second AP Fund employed external managers for the following areas:

- Global equities
- · Government bond funds on emerging markets
- Global credit mandates
- Global TAA mandates
- Foreign equities on emerging markets
- Alternative investments (private equity funds, real estate funds, Chinese Series A equities and parts of the portfolio of alternative risk premiums).

The procurement of external fund managers is based on criteria such as investment style, quality and analytical approach, organizational structure, staffing and historical performance.

Benchmark index for the	strategic portfolio, December 31, 2014	Index				
Equities	Sweden	SBX: Stockholm Stock Exchange Benchmark Index SEW: 'Equal Weighted Sweden Index' CSRX: 'Carnegie Small Cap Return Index'				
	Foreign equities	MSCI World GDP Weighted ¹ , MSCI World ¹ , MSCI World Minimum Volatility Weighted ¹ , MSCI World Value Weighted ¹ , MSCI World Risk Weighted ¹				
	Emerging markets	MSCI Emerging Markets ¹				
Fixed-income assets	Swedish nominal fixed-income	SHB Swedish All Bond ⁴				
	Global government bonds	Barclays Global Government ²				
	Global credit bonds	Barclays Global Credit ⁵				
	Government bonds in emerging markets	JP Morgan EMBIGD, JP Morgan GBI-EM Global Div ³				
Alternative investments	Swedish real estate	SFIX Svenskt Fastighetsindex				
	Foreign real estate	7 percent				
	Farmland and timberland investments	8 percent				
	Private equity	MSCI World Local currency + 3 percent				
	Alternative credits	Barclays Global Government ² + 4 percent				
	Alternative risk premiums	MSCI World Local currency				
	Chinese Series A equities	MSCI, China A				

¹ Adjusted index: adjusted after excluded companies and tax levels.

² Adjusted index: excluding Japan and developing countries as per MSCI.

³ Adjusted index: weighting of individual countries may not exceed 15 percent and they may not have a credit rating lower than BBB.

⁴ Adjusted index: excluding bonds with a maturity of more than 20 years, and Kommuninvest.

⁵ Adjusted index: excluding Japan and developing countries as per MSCI, as well as markets where issued volume is less than USD 500 million.



PRIVATE EQUITY

Promising brands generate capital

From the start, the Second AP Fund has invested in non-listed companies via funds. Well diversified geographically and by sector, the portfolio's primary exposure is to the North American market. Over the past year, a number of promising brands have helped contribute to the Swedish national pension system.

Right from the start, the Second AP Fund formulated a strategy for investment in non-listed companies via private equity funds, also referred to as venture-capital funds. This strategy means investing globally, building up the portfolio step by step.

This investment in private equity funds is intended to create diversification towards the Fund's listed assets, generating a higher return over time.

The Fund's investment regulations restrict investment in non-listed assets to a maximum five percent of total assets. In recent years, the Fund's exposure in such assets has been just under five percent. Investment in non-listed companies may only be made via funds and, by year-end 2014, these assets were distributed among 36 different portfolio managers and 78 funds.

The private equity funds are decisive investors that work actively together with the companies' managements. These funds employ a clearly-defined strategy for adding value to their portfolio companies, with a view to their long-term development as profitable businesses.

Each fund invests in some 20 companies. Seen as a whole, the Second AP Fund's portfolio is well diversified in terms of geographical distribution and business sector.

Venture-capital companies make up 13 percent of the Second AP Fund's private equity portfolio. The term 'venture' implies an investment in projects where a fully-developed business model may not always exist. Commonly, the investment is made in new ideas or small immature companies. They are looking for investors who are interested in the long-term development of the company, who understand the business and can actively contribute to the company, which fits in well with the Fund's business profile and operating approach.

The Second AP Fund has been active in global networks for investors from an early stage and, over time, has established a strong brand

presence. One such example is ILPA, which numbers close to 300 members around the world, the Fund being the first representative on the board not to come from North America. Good, long-term relations are decisive for access to relevant funds.

Over a year, the Fund participates in some 200 meetings with new and established fund contacts, receiving more than twice as many investment proposals. About ten of these result in an investment decision.

Each decision is preceded by a comprehensive analysis and risk assessment. The Second AP Fund always makes stringent demands, both before and after the actual investment, concerning institutional support and reporting, sustainability aspects, corporate governance and more.

Investments made in private equity funds are normally in the USD 30–50 million range. These funds are active over a period of ten to twelve years, although the majority of the return is generated during the latter part of the period, emphasizing the importance of a long-term approach.

The bulk of Fund investment is in North America, which is also the largest market, especially when it comes to venture funds. A considerable percentage of these funds are based in Silicon Valley, a global centre for cutting-edge technology, where the flow of ideas is endless and which is home to many experienced entrepreneurs. These days, the Second AP Fund is aware of a growing number of promising investment opportunities in Asia, in sectors such as e-trading, technology and life sciences.

The Fund's portfolio features, and has earlier featured, a range of promising brands, several of which have generated substantial returns for the Swedish national pension system.

BRANDS FEATURED IN THE SECOND AP FUND'S PORTFOLIO



Airbnb – An international web-based marketplace for the subletting and booking of private accommodation around the world.

JAWBONE®

Jawbone – Global leader in development of 'consumer technology' in the form of activity armbands and mobile speakers.



Synexus – Recruits and treats patients in connection with clinical trials and supplies base data from its own research centres.



Hunter Boot Ltd – Manufactures wellington boots, hunting boots and field boots. Hunter is a global leader in waterproof footwear.



Square – A global leader in mobile payments. Founded by Jack Dorsey, who also founded Twitter.

NETFLIX

Netflix Inc. – Internet TV provider, that enables subscribers to stream TV programmes and films direct on their TVs, computers and mobile units.



Soraa – Development of new technology in LED lighting. The company was founded by Shuji Nakamura, the 2014 Nobel Prizewinner in Physics.



Fender – A world-leading US manufacturer of stringed instruments and amplifiers.



SolarCity – American fullservice company that markets and installs solar panels, primarily for residential housing.



EAT – British food supplier that cooks and serves fresh takeaway food. Collaborates with local charity partners to redistribute food left over at the end of each day.



Duck Duck Moose – Creates pedagogical mobile applications for children.











Facebook – A social networking service that brings people together the world over.

stripe

Stripe – Provides services that enable users to receive and make payments online



vipshop.com – Operates as an online retailer of various brands in China.



ASTON MARTIN

Aston Martin – Designs and manufactures sports and luxury cars.



IMS Health – One of the world's leading providers of market information to the pharmaceutical and healthcare industries.



Alibaba Group Holding Ltd – Develops e-trading, onlinepayments, business-to-business marketplaces and cloud companies in China and internationally.



Moncler – A European company that designs and markets mainly leisurewear. In the past few years, has developed from a small company to a globally-recognized fashion label.



WhatsApp – A company that has developed messaging functions (apps) for mobile phones. Sold to Facebook for more than USD 19 billion – a record for this type of company.

IN-HOUSE PORTFOLIO MANAGEMENT

In-house portfolio management offers many benefits

The Second AP Fund manages the greater part of its assets in-house, 72 percent, a percentage that is on the increase. During the year, assets including government bonds issued by emerging countries were transferred for management in-house. The continuing success and cost-efficiency of this in-house portfolio management has been confirmed by an independent survey.

Since the management of portfolio assets in-house became part of management strategy in 2012, the Fund has gradually transferred an increasing percentage of its investment portfolio to in-house management. At year-end 2014, 72 percent of the portfolio was managed in-house, corresponding to SEK 212 billion. In compliance with the investment regulations, at least ten percent of the Fund's assets must be managed under external mandates. The primary motivation for increasing the degree of in-house management is mainly due to terms of lower costs.

According to independent analytical specialist CEM, which evaluates the Second AP Fund's cost effectiveness, the Fund's costs continued to be some 30 percent lower than CEM's benchmark group. (More on the following page).

In addition to lower costs, in-house portfolio management offers a number of other benefits. These include a good degree of transparency and day-to-day insight into the portfolio, simplifying risk assessment and the monitoring of changes in benchmark index. Managing more aspects in-house and being able to monitor asset classes in several parts of the world also provides a useful global perspective. This in turn develops a fingertip feeling that gives the Fund's tactical allocation team an additional strength.

Attracting competence

The growing percentage of portfolio assets being managed in-house presents something of a challenge. For one thing, it places severe demands on the competence and systems supporting the portfolio management team. The Fund's advanced in-house portfolio management is at the forefront of its field in the Nordic countries and, in some respects, at an international level too. This contributes to the Fund's status as a stimulating and attractive workplace. Employees benefit from considerable skills development and stay a long time.

There is keen interest from job applicants, even internationally. The Fund attracts new staff with impressive qualifications and from varied backgrounds. Many, for example, are post graduates in economics, mathematics and engineering.

During the year, the Emerging Markets portfolio team was expanded to prepare for the reversion of externally managed assets planned. The team was established in 2013, when the Fund initiated in-house trading in assets on emerging markets.

The Quantitative Management portfolio team, responsible for handling the majority of the Fund's portfolio of global equities on both industrialized and emerging markets, has been well established for more than ten years now and is constantly expanding. Using mathematical and statistical techniques to locate and define patterns in market pricing, the quantitative model for portfolio management can detect positions of potential value. These techniques and models are developed in-house and subject to constant refinement.

Systems for in-house portfolio management

The Second AP Fund's experience and maturity is a condition of successful in-house portfolio management. In addition to a high degree of competence, the systems currently employed by the Fund, including control and monitoring processes, are well established and relatively insensitive to varying volumes. Extremely high demands are placed on the methodology, accessibility and quality of data and on a fundamental grasp of the portfolio-management process. Once the organization is ready in terms of systems and competence, a number of tests will be conducted before additional assets are placed under in-house management. The actual transfer of such assets will be conducted according to a well-established method, which has been shown to work well.

Preparing the next phase

The Second AP Fund's long-term strategy involves increased diversification of the portfolio, including investment in emerging markets. In 2013, a number of steps were taken towards implementing the in-house management of portfolio assets in more than 20 different emerging markets. Management of this portfolio of emerging-market equities was brought in-house at the end of the same year.

The Second AP Fund is one of first institutional investors in Sweden to establish in-house management of a portfolio of government bonds issued by developing countries. During 2014, in an initial phase, the Fund brought assets in the form of bonds issued in developed countries' currencies, for example US dollars under in-house management. The increased management of assets in-house has led to a rise in the volume of in-house transactions in foreign currencies, equities and bonds. The existing systems have proved able to handle the increased volume.

In all other respects, 2014 has largely been notable for the preparations in the run-up to 2015, when the Fund plans to take the next step in concentrating its assets under in-house management.

The percentage of portfolio assets placed under in-house management will continue to rise.

Continued cost-efficient and successful in-house portfolio management

The Second AP Fund has the competence and the effective systems necessary to manage an ever greater share of Fund capital in-house. As well as lower costs, this effectiveness is about creating the control systems and key ratios needed to achieve still better portfolio management and results. This is a field in which the Fund is at the very forefront.

Since 2004, the Second AP Fund has collaborated with the company Cost Effectiveness Measurement Inc. (CEM), to evaluate the Fund's effectiveness. In its analysis, CEM takes into account the volume of assets under management, the degree of assets under active management and the relative allocations for each asset class. The Fund's costs are compared with those of a group of global pension funds of approximately the same size and with portfolios of a similar composition. The result of the most recent analysis, pertaining to 2013, the Second AP Fund's portfolio management continues to be successful and cost-efficient. The level of costs is still considered competitive in 2014, although affected by the fact that the costs incurred in conjunction with the, not yet, terminated external mandates coincide with the costs for the build-up of the in-house capacity required to manage the capital recovered from these mandates.

The Second AP Fund's level of costs is some 30 percent lower than that of the benchmark group, mainly attributable to the fact of a significantly lower level of assets under external management. One consequence of the Fund's long-term internalization strategy is that large sums invested in global markets can now be managed cost-effectively in-house within the framework of the Fund's quantitative management team. For example, the cost of the in-house management of equities on emerging markets is substantially lower, compared to when managed under external mandates.



INTEGRATING SUSTAINABILITY INTO PORTFOLIO MANAGEMENT

Sustainability report

The Second AP Fund's sustainability programme comprises the environment, ethics and corporate governance. The purpose for the Fund's sustainability work is to create and protect values. As an asset manager, the Fund is determined to address a range of factors involving the environment, ethics and corporate governance, as they either provide a better basis for analysis and investment decisions or promote diversification. The Fund shall also generate confidence by promoting a solid ethical and environmental approach while also contributing to the development of sound practice in fund management issues.

By actively addressing and integrating environmental, ethical and corporate governance issues in its asset management, the Second AP Fund can generate value. The term that the Fund uses to embrace these issues is sustainability. Investors also use the acronym ESG (Environmental, Social and Governance).

The Fund believes sustainability to be important, convinced that a commitment to sustainability issues can generate and protect value. Integrating sustainability factors into analyses and investment processes generates broader and better decision data.

The Second AP Fund's framework

The Second AP Fund is a state agency whose operations are governed by the National Pension Insurance Funds (AP Funds) Act (2000:192). One of the AP Funds' key tasks is to maximize return while maintaining a low level of risk. The investment strategy shall accommodate the impact of pension disbursements while addressing the level of reserves that will be required to service these outflows. The AP Funds shall take ethical and environmental concerns into account, but without hampering the overall aim of an enhanced return on investment. Business and economic policy considerations are to be ignored.

Corporate governance policy

The Second AP Fund's operational approach to sustainability and corporate governance issues is based on the Fund's governance policy and its ten investor principles. These principles comprise structural matters, corporate governance, the environment – and ethics. The governance policy also defines the Fund's core values, and details the guidelines and initiatives to which the Fund is a signatory, or which it employs in pursuing its sustainability aims. This governance policy is determined annually by the Board of Directors and is published on the Fund's website at www.ap2.se

The Second AP Fund's engagement in corporate governance issues is founded on regulations and guidelines such as the OECD's Guidelines for Multinational Enterprises and Principles of Corporate Governance, the UN's Global Compact, the Swedish Companies Act and the Swedish Code for Corporate Governance.

The governance policy also describes the principles to which the Second AP Fund subscribes and that it is employed as a framework in its efforts to promote sustainability, both within its portfolio management organization and in a range of governance activities.

The Second AP Fund supports and actively promotes implementation of the UN-backed Principles for Responsible Investment (PRI). It signed up to these Principles as early as 2006, when they were first established. PRI provides various instruments and activites to support investors in implementing the Principles and to facilitate cooperation between investors.

Farmland Principles included in PRI

The Second AP Fund has also undertaken to implement the Principles for Responsible Investment in Farmland. These were drawn up by the Second AP Fund in association with a group of international investors, all of which are PRI signatories. As of 2014, PRI has acquired administrative responsibility for the Principles, which will be included in the 2015 PRI report. The Principles provide institutional investors who invest in agricultural assets with a framework for dealing with environmental, ethical and governance issues. They are also intended to increase transparency in connection with such investments. Read more in the Second AP Fund's Sustainability and Corporate Governance Report for 2013/2014, www.ap2.se

Organization 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 ownership group featuring members of the Fund's executive management, the head of Swedish equities and the sustainability analyst.

This group is responsible for the strategic and operational aspects of the Fund's corporate governance activities. The ownership group targets and drafts action plans and monitors progress on an ongoing basis. At every board meeting, a report on the Fund's governance, ethics and environmental activities is submitted to the Board of Directors.



The Fund is convinced that a man that a responsible long-term approach to the environment, ethics and corporate governance adds value to its portfolio companies.

Environmental and ethical core values

When it comes to the environmental and ethical aspects of business activities, the Second AP Fund's core values are based on principles that highlight

- commitment
- action
- change

with a view to making a difference. The Fund strives to make a difference by working proactively for sustainable development in areas that promote a high long-term return on investment, while at the same time becoming actively involved in companies where problems have been identified, been deemed as significant and are well substantiated. This is a responsible and ethical approach.

Part of the Swedish State's core values

As part of the Swedish national pension system, the Second AP Fund's principles of engagement, active ownership and change are based on the same core values as those espoused by the Swedish State. Democracy, the belief that all men and women are equal, the individual's right to freedom and respect and the importance of sustainable development are all in compliance with the terms of the Swedish Constitution Act.

Conventions Sweden has signed

The core values of the Swedish State are also given expression through the international conventions to which Sweden has been a signatory, including conventions concerning the environment, human rights, labour rights, corruption and inhuman weapons. These values are further reflected in the support Sweden provides to initiatives such as the UN's Global Compact and the OECD's Guidelines for Multinational Enterprises, as well as Sweden's stated position on human rights issues. In conjunction with the core values espoused by the Swedish State, these international conventions provide the Fund with powerful instruments in its focus on environmental and ethical considerations.

In its work, the Second AP Fund operates on the assumption that all conventions to which Sweden is a signatory shall be observed and afforded equal importance. This position is also supported by

the decisions made and statements issued by various UN agencies, which note that human rights are universal, indivisible, mutually dependent and interrelated and may not be assigned different orders of importance. The Fund believes that the companies must themselves be responsible for ensuring that international conventions are not contravened, irrespective of whether these are directed at sovereign states, individuals, companies or organizations. Furthermore, this responsibility shall apply even when countries in which the companies operate are signatories to conventions or feature less stringent legislation.

New sustainability strategy

During the year, the Second AP Fund has started working on developing a more comprehensive strategy for sustainability, to define and better utilize resources and thereby realize the Fund's vision: worldclass portfolio management. The Fund's overall objective is that sustainability must form an integral part of all analytical and decision processes. This process has been ongoing in a structured form for a couple of years now and will take a few more years to achieve.

Focus areas

To obtain the best possible result from the sustainability work, the Fund will decide on some focus areas which it considers essential to achieve a better long-term return. The idea is to focus the Fund's resources on a number of areas that define its commitment in areas of financial relevance. For each focus area the Fund will establish both short and long-term goals, as well as implement measures to attain these goals.

Integrating sustainability into portfolio management

The Second AP Fund believes that a responsible long-term approach to the environment, ethics and governance enhances the value of companies. This is why corporate governance, ethics and the environment issues also play an important role in the Fund's asset management activities, as they provide a more comprehensive basis for analyses and investment decisions. By encouraging portfolio companies to address ethical and environmental issues, the Second AP Fund can help them identify opportunities and risks - at an early stage that have a long-term effect on return. For a detailed description of how the Fund is integrating sustainability into its portfolio management activities, see the Sustainability and Corporate Governance Report 2013/2014 at www.ap2.se

To create better understanding and awareness of sustainability issues among its staff, the Second AP Fund arranges regular seminars and training sessions. This is important in facilitating the integration of sustainability factors in the Fund's everyday activities.

The portfolio's carbon footprint

As early as 2009, the Second AP Fund conducted an extensive project to analyse its portfolio's carbon footprint. By gathering data from all the companies in the portfolio, based on its holdings in each company, it was possible to calculate the total carbon footprint

generated by its combined holdings. For the Fund this analysis contributed to a more profound understanding of the cost of carbon emissions. If companies are forced to pay for their emissions, this will impact on their profits and cash flow. The stock market will value these companies by the impact the costs are expected to have on future profits.

The Second AP Fund has once again analysed and calculated the portfolio's carbon footprint. The Fund's equity holdings represent 2 204 000 tonnes tCO₂e, which approximates to 17 tCO₂e per million Swedish kronor in invested assets. This analysis is based on data from MSCI pertaining to the carbon emissions released by portfolio companies in 2013. The Fund has decided to use data detailing the companies' direct emissions and indirect emissions from purchased energy (Scope 1 and 2 according to Greenhouse Gas Protocol, www.ghgprotocol.org). The calculated carbon footprint has been based on the Fund's participating interest in portfolio companies as of December 31, 2014.

Since no established standards yet exist for calculating carbon footprints, there are considerable discrepancies in the way fund managers choose to calculate and present such footprints. Such discrepancies also arise because estimates have to be made about non-reporting companies, while no data at all is available from others. There are also challenges associated with the risk of double-counting emissions, as when those from power utilities are calculated twice: as direct emission generated by the power utility and as indirect emission for the company purchasing the electricity. Another aspect is whether responsibility for carbon emissions should be assigned exclusively to its equity holdings or should also be offset against its liabilities.

The following table presents the carbon footprint for the Second AP Fund's portfolio of listed equities, both when companies' total carbon emissions are assigned exclusively to the equity holding and

when dispersed between equities and liabilities. The Second AP Fund has elected to employ different ratios in reporting the portfolio's carbon intensity to show the complexity of calculating carbon intensity.

The Second AP Fund hopes eventually to be able to present a carbon footprint that comprises all asset classes. The Fund has initiated a dialogue with fund managers about the feasibility of calculating carbon storage and carbon emissions. New Forests, one of the Fund's asset managers focused on timberland investment, has calculated the total carbon stock for its forest assets. The Second AP Fund's share is 5 147 601 tCO₂e. However, this figure relates to the amount of carbon stored in the trees, not the amount absorbed during a year.

The Fund has also invested in green bonds that finance projects which, among other things, help cut carbon emissions.

Over several years now, through its membership of the CDP (Carbon Disclosure Project), the Second AP Fund has required the world's largest publicly quoted companies to report on their greenhouse gas and other related data on how they are tackling the challenge of climate change.

Fossil energy

Since the autumn of 2013, the Second AP Fund has had an in-house working committee dedicated to addressing questions relating to fossil energy and climate change. During the year, the group has been engaged in gathering data on market opinion about future development in the price of energy, society's energy requirement and technological advances, as well as on the various climate policy measures currently being implemented in different parts of the world. This work is intended to provide a basis for the Fund's approach to investments in fossil energy.

Second AP Fund's carbon footprint

	of greenh	s' emissions ouse gases 1 and 2)			Carbon intensi	ty in relation to comp	Carbon intensity	
	(tCO ₂ e) ¹	Adjusted for compa- nies' debt ² (tCO ₂ e)		for Fund portfolio for ata which CO ₂ e data is	Based on port- folio weight (tCO ₂ e/USD m) ³	Based on Fund's participation right (tCO ₂ e/USD m) ⁴	Based on Fund's participation right, debt-ad- justed emissions (tCO ₂ e/USD m) ⁴	in relation to the Fund's investment based on participa- tion right, debt-ad- justed emissions (tCO ₂ e/SEK m) ⁵
AP2 portfolio of listed equities	3 621 000	2 204 000	92.82	127 562	226	243	199	17.28
MSCI All Country World Index					208	237	198	14.86

- ¹ CO₂e (carbon equivalent) is a unit of measure that enables a comparison between the climate impact of different greenhouse gases.
- ² The company's emissions multiplied by the ratio 'market value/enterprise value'.
- ³ The sum of portfolio weightings multiplied by the ratio 'corporate carbon emissions/turnover'.
- ⁴ The sum of the Fund's share of portfolio-company emissions, divided by the sum of the Fund's share of these companies' turnover.
- ⁵ The sum of the Fund's share of its portfolio-company emissions, divided by the total market value of the Fund's holdings in listed equities.

Source: MSCI ESG Research/The Second AP Fund

Fossil energy is a vital commodity in contemporary society and will continue to be so for some considerable time. Conversion to a low-carbon society has already started and it is not unlikely that the demand for fossil energy may well decline, in the wake of new regulations, economic controls and/or technological advances. There is a risk that the oil and gas extracted from high cost projects could become unprofitable. The Second AP Fund has identified eight energy companies with a high relative exposure to high-cost projects. The Fund believes such assets could be at risk of being stranded, and that this risk not yet is priced in the market. Companies with significant holdings in coal mines have also been identified as posing a risk, given that coal is the most carbon intensive energy source. For this reason, the Second AP Fund has decided that it will no longer invest in a total of 20 energy companies, 12 of which are involved in coal production. Work on determining the climate risks associated with the Fund's investments will continue.

Corporate governance

A considerable portion of the Second AP Fund's capital is invested in Swedish and foreign equities, making the Fund a significant share-holder. The Fund is also non-political and independent, both in terms of ownership and of its special status among Swedish agencies regulated by law, allowing it to act as a committed and long-term investor.

Shareholder commitment and interest in a company's long-term development is a crucial requirement for better value growth. As a long-term investor, the Second AP Fund fulfils an important function on the world's capital markets. Consequently, the Fund is actively engaged in promoting good corporate governance, high ethical standards and an enlightened environmental approach, as well as best practice within asset management. In its contacts with publicly quoted companies, the Second AP Fund is active in the run-up to and during Swedish and foreign AGMs, as well as engaging in dialogue with the boards and executive managements of portfolio companies.

In Sweden, the Second AP Fund is mainly in dialogue with companies in which it is one of the largest shareholders or in which it has invested the most capital. In the case of companies outside Sweden, the Fund mainly addresses ethical and environmental issues via the Ethical Council. Other shareholder issues of special interest to the Fund, when related to foreign companies, are handled in collaboration with selected investors.

The Second AP Fund also promotes good corporate governance by collaborating with other investors on matters of principle and through active participation in the development of policies, regulations and standards.

Corporate governance in Swedish companies

The Fund has holdings in some 250 Swedish companies. 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 52 AGMs of Swedish publicly quoted companies during 2014. The Second AP Fund and other institutional investors have for many years enjoyed a positive and constructive dialogue with Swedish publicly quoted companies, which have included many of the issues raised at AGMs.

Issues in focus

During the year, the Second AP Fund has maintained its focus on remuneration issues and engaged in a number of dialogues with corporate boards, concerning the formulation of incentive programmes, with a view to promoting improvements. For several years now, the Second AP Fund has stressed the importance of increasing the number of women on the boards of publicly quoted 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.

During this year's AGM season, the Fund has placed special emphasis on diversity and, in particular, on the percentage of women on corporate boards. The Fund has both questioned companies' nomination committees before their AGMs, as well as commenting at AGMs. Among other things, the Fund has stressed that the Swedish Corporate Governance Code states that a nomination committee shall declare how it plans to achieve balanced gender distribution over time, but that in many instances this is notably lacking in many companies. Read about the Second AP Fund's annual Women's Index at www.ap2.se

In the run-up to the AGM season, the Fund has also written letters to nomination committees in Swedish companies with a view to encouraging them to better motivate their nominations.

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 2014 AGM season, the Second AP Fund was represented on the nomination committees of Opus Group and Ratos, as chair, as well as on those of Kungsleden, Semcon and Flexenclosure. Prior to the start of the 2015 AGM season, the Fund is represented on the nomination committees of Opus Group, as chair, as well as on those of Kungsleden, Tele2, FormPipe and Midsona.

Corporate governance in foreign companies

Since 2008, to improve the governance of its foreign investments, and in cooperation with the First, Third and Fourth AP Funds, the Second AP Fund has operated a joint electronic voting platform, based on the AP Funds' governance policies. Most issues are managed automatically via the voting platform, with the exception of matters such as remu-

neration issues, which are forwarded to the funds for individual assessment. Each fund decides individually as to how it will vote.

On foreign markets the Fund mainly votes in the following eleven countries: Australia, Canada, France, Germany, Great Britain, Italy, Japan, the Netherlands, Spain, Switzerland and the USA. The criteria for determining the companies in which the Fund should exercise its voting rights derive mainly from the MSCI global index. There are other criteria too, such as when the Fund is engaged in a dialogue on a specific issue with a company and/or when the Fund has submitted a shareholder proposal for consideration by the AGM.

During 2014, the Second AP Fund exercised its vote at 491 AGMs. In 2015, the Fund will expand this number to some 750 companies. The Fund employs an external party for the practical voting process and submits a written vote (proxy voting) using the electronic voting platform.

Letters to foreign companies

During 2014, with a view to further improving communication with its foreign portfolio companies, the Second AP Fund has written letters to 50 of these companies, clarifying the Fund's 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 the boards on specific proposals. In several cases, these letters have resulted in further contact with the companies in question, sometimes by letter but also in the form of teleconferences. Further details of how the Second AP Fund voted on specific issues may be found at www.ap2.se/en/corporate-governance-/corporate-governance-reports/

Ethical Council

The Ethical Council is a collaboration between the First, Second, Third and Fourth AP Funds, which was launched 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. 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

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.

Effective from 2015, the Second AP Fund signed a green lease with its landlord Hufvudstaden. This means that Hufvudstaden and the Second AP Fund will draft action plans to reduce the environmental impact of the premises. This will include the exclusive use of 'green' electricity and the implementation of measures to reduce energy consumption and improve waste management.

Environmental data

	2014	2013
In-house environmental indicators		
Electricity, kWh	151 500	173 000
Renewable electricity, %	100	100
Copy paper, purchased (A4), kg	991	880
No. of sheets printed	279 800	311 000
Business trips		
Rail travel between Gothenburg and Stockholm, %	78	81
Emissions of greenhouse emissions from:		
Domestic rail travel, tonnes CO ₂ e	0	0
Domestic air travel, tonnes CO ₂ e	9	9
International air travel, tonnes CO ₂ e	158	153

Stakeholder dialogues

The Second AP Fund maintains ongoing dialogues with a number of stakeholder groups that are either affected by or have an impact on the Fund's activities. The Fund conducts these dialogues partly itself and partly via the AP Funds' Ethical Council. The aspects reported in compliance with GRI guidelines have been selected to reflect the Fund's assessment of stakeholder expectations and its own priorities. During 2015, the Fund plans to implement a more systematic approach to stakeholder dialogues, as well as introducing a materiality analysis. More about the Fund's dialogues in the Sustainability and Corporate Governance Report 2013/2014.

A selection of stakeholder dialogues during 2014

Stakeholder	Type of dialogue	Reporting
Swedish Parlament and Government	Individual meetingsExternal audit	 Government's annual evaluation
Other investors	 Knowledge exchange Cooperation on company dialogues Cooperation on joint initiatives 	 Website Sustainability and Corporate Governance Report
Portfolio companies	AGMsIndividual meetingsLetters	 Website Sustainability and Corporate Governance Report
Local and global community (e.g. stakeholder organizations, students, general public)	Individual meetingsRoundtable discussionsSurveysInterviews	• Reports • Website
Employees	 Meetings Daily dialogue Employee interview	• Staff survey
Media	MeetingsDaily dialogueEmployee interview	Media coverage

GRI reporting

For 2014 the Second AP Fund has chosen to report on sustainability inspired by the Global Reporting Initiative's (GRI). The Report contains general standard disclosure from the GRI Sustainability Reporting Guidelines as well as the sector appendix Financial Services (FS). The report covers the Fund's in-house operations. The Fund intends to develop this reporting process over the coming years. The report is not subjected to special examination by the Fund's auditors.

GRI-index, The Second AP Fund 2014 General standard disclosure

Indicator	Description	Page	Comments				
Strategy and analysis							
G4-1	Statement by CEO	2–3					

Organizational profile

G4-3	Organization's name	Outsid cover	e
G4-4	The most important brands, products and/or services	4–5, 8–9	AP2 markets no products or services. The Fund manages pension assets in the Swedish national pension system.

Indicator	Description	Page	Comments
G4-5	Localization of organiza- tion's head office	Outside cover	2
G4-6	Number of countries in which the organization is active	www. ap2.se	AP2's sole office in Gothenburg but invests globally.
G4-7	Ownership structure and business form	71–72	
G4-8	Markets in which the organization is active	www. ap2.se	
G4-9	The size of the reporting organization	Flap, 50, 58	
G4-10	Number of employees	50, 58	
G4-11	Percentage of staff covered by collective bargaining agreements	59	
G4-12	Description of organization's supply chain	4, 5, 8	This will be developed in future.
G4-13	Notable changes during report period	13, 14	
G4-14	Description of and how the organization complies with the Duty of Care principle	39–44	

Indicator	Description	Page	Comments
G4-15	Externally developed eco- nomic, environmental and social declarations, princi- ples or other initiatives that the organization subscribes to or supports	21–25	Sustainability and Corporate Govern- ance Report, www.ap2.se, www.ethicalcouncil.com
G4-16	Membership of organizations and/or national/international lobby organizations	www. ap2.se	Sustainability and Corporate Govern- ance Report, www.ethicalcouncil com
	aspects identified and fluence can be exerted		
G4-17	Units that form part of the organization's financial reporting	54, 55, 26	
G4-18	Description of process for defining report content and boundaries	26	
G4-19	Account of all material aspects identified	26	
G4-20	Description of boundary for each material aspect within the organization	26	
G4-21	Description of boundary for each material aspect outside the organization	26	
G4-22	Explanation to impact of changes in information supplied in earlier reports and reasons for such changes	54–55	Pre-economic data, otherwise irrelevant
G4-23	Notable changes made since previous report period	54–55	Pre-economic data, otherwise irrelevant
Stakehol	der commitment		
G4-24	Stakeholder groups with which the organization has contact	26	
G4-25	Principle for identification and selection of stakeholders	26	
G4-26	Procedures for communication with stakeholders	26	
G4-27	Key areas and issues raised through communication with stakeholders	26	
Reporting	g profile		
G4-28	Reporting period	27	Jan 1–Dec 31 2014
G4-29	Date for publication of the latest report		This is AP2's first sustainability report inspired by GRI
G4-30	Reporting cycle		Financial year is calendar year

Indicator	Description	Page	Comments
G4-31	Contact for reporting issues and content		www.ap2.se
G4-32	Statement of content in compliance with GRI's Core reporting level and report on external corroboration	26–28	
G4-33	Statement of organiza- tion's policy and proce- dures for external corroboration of report		Has not been audited by third party.
Governar	ıce		
G4-34	Account of organization's	71_73	Fund's governance

Governa	nce		
G4-34	Account of organization's corporate governance	71–73	Fund's governance report, governance policy, www.ap2.se
Ethics an	d integrity		
G4-56	Organization's values, principles, standards and norms	48–49	

Specific standard disclosure

Indicator	Description	Page	Comments
Economy			
DMA	Dislosure on management approach	4–8	AP2 manages the assets of the Swedish national pension system
G4-EC1	Direct economic value and distribution	52	
G4-EC2	Economic impact and other risks and oppor- tunities affecting the organization's activi- ties as a result of climate change	23	
Energy			
DMA	Dislosure on manage- ment approach		
G4-EN3	Energy consumption	26	
Emissions	i		
DMA	Dislosure on manage- ment approach		
G4-EN15	Energy-direct emissions of greenhouse gases (Scope 1)	23	
G4-EN16	Energy-indirect emissions of greenhouse gases (Scope 2)	23	

Indicator	Description	Page	Comments
Working	conditions		
DMA	Dislosure on management approach		
G4-LA1	No. of employees and personnel turnover	50, 58	
G4-LA2	Benefits for permanent staff	48–50	
G4-LA3	On parental leave	49	
G4-LA6	Injuries, absenteeism and fatal accidents	50	Absences reported. No injuries or accidents during the year.
G4-LA12	Composition of decision-making groups	58, 74, 75	

Human	riahts

		J	
D	MA	Dislosure on manage- ment approach	Ägarpolicy, Hållbarhets- och ägarstyrningsrapport.
G	64-HR1	Investment decisions that include demands for human rights	AP2's governance policy based on the international conventions to which Sweden is a signatory. Sustainability and Corporate Governance Report, Ethical Council Report

Anti-corruption

711111 00111	ар поп		
DMA	Dislosure on manage- ment approach	39–44	
G4-SO4	Communication and training	48	Training has been carried out but the number of hours has not been recorded
G4-SO5	Incidences of corruption		No incidences of corruption

Financial services sector

Product portfolio

DMA	Dislosure on manage- ment approach	
FS6	Product portfolio	12–14

Indicator	Description	Page	Comments
Follow-up)		
DMA	Dislosure on manage- ment approach		
Active go	vernance		
DMA	Dislosure on manage- ment approach	21–25	Hållbarhets- och ägarstyrningsrapport, www.ap2.se
FS10	Companies with which the organization has interacted on environmental or social issues	21–25	Ethical Council Annual Report, www.ethicalcouncil.com
FS11	Assets whose selection involves an assessment of environmental or social criteria	21–25	Sustainability and Corporate Governance Report, Ethical Council Report www.ethicalcouncil.com

Result and performance 2014

As of December 31, 2014, Fund capital totalled SEK 293.9 billion, the highest total since the Fund started. Investments in equities and fixed-income securities continued to perform well in 2014, and the Fund reports a net result of SEK 34.3 billion for the year.

Fund capital is affected by two factors, the net result for the year and net flows within the pension system. In 2014, Fund capital increased by a net of SEK 29 195 (23 258) million, deriving from the positive result of SEK 34 315 (30 138) million, against which net outflows to the pension system were charged in an amount of SEK –5 120 (–6 880) million. Capital flows consisted partly of contribution payments to the system and pension disbursements from it, amounting

to a net of SEK –4 896 (–6 650) million, and partly of the cost of administering the pension system, which was charged against Fund capital in an amount of SEK –224 (–230) million. For the sixth successive year since the pension system was launched, the net of inflows and outflows to the pension system from the AP Funds was negative. Consequently, the Second AP Fund has paid out a total of almost SEK 25 billion to cover the current deficit in the pension system.

Fund capital performance 2014, SEK million

	2014	2013
Fund capital brought forward	264 712	241 454
Pension contributions received	58 880	56 839
Pension disbursements	-63 776	-63 489
Administration contribution	-224	-230
Net result for the year	34 315	30 138
Fund capital carried forward	293 907	264 712

Composition of strategic portfolio, exposure and return as per December 31, 2014 and December 31, 2013

	Strat portfo		Exposu	ıre, %	Exposed SEK		Absol return		Relat return		Active ex post	
Asset class	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Swedish equities	10.0	11.0	10.1	11.4	29.7	30.3	16.8	27.2	1.2	1.2	0.8	0.5
Foreign equities	37.0	38.0	37.3	39.7	109.6	105.2	26.7	18.4	0.9	0.4	0.4	0.4
Fixed-income securities, including liquidity and accrued interest	34.0	34.0	33.3	32.9	97.9	86.9	14.4	-0.9	-0.1	-0.1	0.4	0.3
Total listed assets, excluding commission fees and operating expenses	81.0	83.0	80.7	84.0	237.2	222.4	13.5	12.7	0.5	0.4	0.3	0.3
Alternative investments	19.0	17.0	19.3	16.0	56.7	42.3	12.1	13.4				
Total Fund capital, excluding commission fees and operating expenses	100.0	100.0	100.0	100.0	293.9	264.7	13.3	12.8				

^{*} Historical outcome, 12 months rolling

Net result for the year

The net result was SEK 34.3 billion and is primarily a reflection of a buoyant stock market, the positive performance of the Fund's fixed-income portfolio in the wake of falling interest rates, and significant foreign-exchange gains.

Operating income

Operating income comprises direct return as well as net result per asset class, foreign-exchange gains/losses and commission fees. Direct return, in the form of net interest income and dividends received, totalled SEK 7 695 (6 745) million for the year. The net result for listed equities comprises both unrealized and realized gains/losses, and totalled SEK 10 437 (24 753) million, including expenses for performance-based fees but excluding foreign-exchange effects. This result derives from the high return generated on the Fund's portfolios of Swedish and foreign equities. The portfolio of foreign equities generated a total return of 26.7 percent, while the Fund's portfolio of Swedish equities noted a return of 16.8 percent.

The net result for non-listed equities totalled SEK 3 081 (3 679) million and is attributable to unrealized gains in the value of the Fund's non-listed portfolio of real estate and to both realized and unrealized gains on its holdings in private equity funds.

The net result for fixed-income securities totalled SEK 2 916 (–1 913) million, a result that derived primarily from the high return generated on the Fund's holdings in foreign government securities, holdings in foreign credit bonds and its in-house management of fixed-income securities on emerging markets.

The Fund's trade in derivatives posted a positive net result of SEK 577 (–278) million, investment in derivatives exposed to emerging markets having the greatest impact.

As a consequence of the weakening of the Swedish krona in 2014, the Fund's exposure in foreign exchange (FX) had a positive impact on the reported net result for foreign exchange assets. The Fund's ongoing hedging of parts of the portfolio of exchange assets during the year has had a negative effect on the net result. The reported net of foreign-exchange gains/losses, where the exchange gain on foreign holdings (SEK 26.8 billion) and the exchange loss associated with the negative impact of currency hedging (SEK –16.7 billion) are reported together, amounted to SEK 10 090 (–2 425) million. More details of the Fund's FX exposure on page 45.

Management costs in the form of performance-based fees, totalling SEK 88 (74) million for 2014, 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, which has 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 267 (230) million, as well as custodial expenses of SEK 19 (15) million, were charged against operating income.

Fund's total 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 56. The Fund's operating expenses and commission fees, expressed as an expense ratio, were unchanged at 0.17 (0.17) percent for 2014. The level of costs is an effect of the Fund's investment strategy, where asset classes and markets that are believed to offer the prospect of solid returns and for which the Fund lacks the necessary in-house resources are managed under external mandates.

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 pages 19 and 47.

Operating expenses

Operating expenses totalled SEK 195 (178) million. Reported as a ratio of average Fund capital over the twelve months, this corresponds to an unchanged cost level (expense ratio excluding commission fees) of 0.07 (0.07) percent.

External management costs

Management costs are to a large extent determined by the volume of Fund capital, the percentage of assets under external management and the degree of active risk adopted, as well as the asset class selected.

During 2014, the approach adopted for Fund capital under external management was mainly active and, by year-end, SEK 81 (65) billion was being managed under external mandates, including non-listed assets. This corresponds to 28 (25) 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 2014, the fixed cost amounted to SEK 262 (226) million and the variable performance-based element to SEK 88 (74) 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 267 (230) million. The increase partly reflects the demands made by the greater volume of Fund capital under management and partly the effect of a weaker krona, but is also attributed to the increased capital allocation to externally-managed

alternative risk premiums, Chinese Series A equities and alternative credits. Furthermore, the fact that the AP Funds have been liable to pay VAT on foreign acquisitions since 2012 has also increased costs. As the AP Funds are not entitled to reclaim VAT payments, this VAT registration requirement constitutes an implicit increase in the Fund's overall costs.

Custodial expenses

The internalization process, which continued during the year, has had an impact on the volume of custodial assets. Assets previously managed via external funds or derivatives, where custodial expenses have been included in fund fees, have been transferred to in-house management during the year. This transfer, combined with the rise in value of all assets, has led to higher custodial expenses in 2014. Custodial expenses are also affected by the type of asset deposited with the custodial bank. Assets exposed to emerging markets, for example, are relatively expensive to place on deposit. The Fund's custodial expenses totalled SEK 19 (15) million in 2014.

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, listed equities and participations (see note 2 on page 56). Commission fees paid in 2014 totalled SEK 98 (70) million. Of these costs, 5 (4) percent derived from commission paid to the Fund's external managers, the remainder to the Fund's in-house portfolio management organisation. Costs amounted to 0.04 (0.05) percent of the total trading volume. The following five counterparts (listed in alphabetical order) received commissions corresponding to approximately 71 percent of total commission payments: Credit Suisse, Deutsche Bank, Goldman Sachs, Instinet and JP Morgan.

Contribution to absolute return, %

Asset class	2014	2013
Swedish equities	1.8	2.9
Foreign equities	9.9	7.0
Fixed-income securities, incl. liquidity and accrued interest	4.7	-0.3
GTAA	0.1	0.1
Overlay	-0.1	-0.1
FX Hedge	-5.2	1.1
Alternative Investments	2.1	2.1
Total assets, excl. commission fees and operating expenses	13.3	12.8

Contribution to relative return, %

Asset class	2014	2013
Swedish equities	0.15	0.14
Foreign equities	0.39	0.21
Fixed-income securities, incl. liquidity and accrued interest	-0.20	0.02
GTAA	0.16	0.17
Total market-listed assets excl. alternative investment and implementation effects	0.50	0.54
Implementation effects*	-0.02	-0.13
Total market-listed assets excl. alternative investment and incl. implementation effects	0.48	0.41

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

Portfolio return

The return on the total portfolio for 2014 was 13.3 percent, excluding commission fees and operating expenses but including performance-based fees.

Foreign equities posted the highest return of any asset class, at 26.7 percent (in Swedish kronor and excluding FX hedging effects). Swedish equities posted a return of 16.8 percent. In response to the fall in interest rates over the year, fixed-income securities generated a remarkably high return of 14.4 percent. Alternative investments, i.e. real estate, private equity funds, alternative credits, alternative risk premiums and Chinese Series A equities, generated a return of 12.1 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 represented during the year. Constituting a large share of the portfolio, foreign equities made the largest contribution to the overall result, amounting to 9.9 percent. Swedish equities contributed 1.8 percent and fixed-income securities 4.7 percent, of which foreign bonds accounted for 3.7 percent. Alternative investments contributed 2.1 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. The weakening of the Swedish krona during the year impacted negatively on the portfolio of listed assets by –6.3 percent. Due to the fact that the Fund does not hedge its entire exposure in foreign exchange, this negative effect

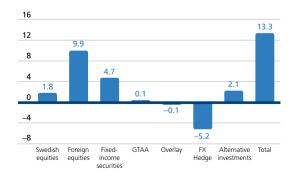
on overall return was more than compensated by the rise in the value of its foreign exchange assets.

The Fund's real estate portfolio, including forest and agricultural real estate, generated a return of 11.2 percent over the year. The return on private equity investments was 17.0 percent, while the portfolio of alternative risk premiums generated 3.2 percent. During the year, the allocation to alternative risk premiums was increased by two percentage points to three percent of the strategic portfolio, a combination of management strategies that are primarily intended to promote greater portfolio diversification.

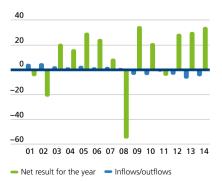
The Fund's portfolio of alternative credits mainly comprises listed corporate loans intended for short-term investment, but also includes high-yield credit bonds. Of these, the majority feature floating interest rates and therefore fail to benefit from the falling interest rates that have favoured the bond portfolio. The portfolio posted a return of 4.4 percent.

Towards the close of 2013, the Fund initiated its management of equities in the domestic Chinese market. In view of the fact that opportunities for adding or withdrawing assets from this portfolio are subject to certain administrative constraints, it has been classified under alternative investments. The portfolio generated a return of no less than 59.1 percent. Over the past five and ten years respectively, the Second AP Fund has generated an average return on invested assets of 9.6 and 7.3 percent per annum. Less inflation, this is equivalent to an annual real return of 8.7 percent over five years and 6.1 percent over ten.

Contributions to the total portfolio, absolute return 2014, %



Fund performance and flows, 2001-2014, 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 recent years the world's stock markets have once again noted solid growth. These crises have been mirrored by the Fund's fluctuating net result and capital over its first fourteen years of operation.

Relative growth for portfolio of listed assets

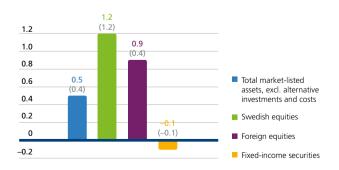
The Fund's portfolio of market-listed securities comprises Swedish and foreign equities, Swedish and foreign fixed-income securities, tactical allocation and FX management. In 2014, the listed portfolio posted a positive return of 13.5 percent. Total relative return, i.e. active return minus implementation effects (costs arising in connection with rebalancing and transactions that are not attributable to active management) was 0.5 percent. Of these costs, a figure of minus two basis points is attributable to implementation effects, in spite of the fact that the Fund implemented relatively substantial reweightings of the portfolio during the year.

Over the past five years, the Fund's active return has averaged 0.6 percent per year. For four of these five years, the active return has been positive. Over the same period, implementation effects have averaged –0.1 percent. Thereby, the average relative return has been 0.5 percent. The Fund's in-house target for relative return is 0.5 percent per year.

Swedish equities

The portfolio of Swedish equities outperformed benchmark index by 1.2 percent. The portfolio of fundamental-focused large caps outperformed the market index by 1.2 percent and 0.8 percent for the portfolio matched against a value-weighted index. The Fund's management of small cap investments proved successful yet again, generating an excess return of 3.8 percent. The Fund manages all Swedish equities in-house.

Relative return per asset class 2014 (2013), %



Foreign equities

Management of the portfolio of foreign equities produced a positive active result of 0.9 percent. The quantitative in-house management of these equities has been conducted against several different benchmark indices, none of which are capital-weighted, and which on average outperformed index by more than one percent. The in-house management of emerging-market equities, initiated at the start of 2013, generated an active return of 1.1 percent.

Swedish and foreign fixed-income securities

Management of fixed-income securities produced a combined active return of -0.1 percent. The in-house management of Swedish fixed-income securities, employing a fundamental focus that targeted higher interest rates, underperformed against index by 1.3 percent. The Fund's active return on its quantitative management of fixed-income securities was positive for the eighth year in succession, at 0.1 percent. The portfolio of foreign government securities under in-house management, like the portfolio of Swedish government securities, was focused on higher interest rates and underperformed against index by 1.6 percent.

Apart from a single exception, the portfolios of credits managed under external mandates posted negative active returns during the year, while the portfolio as a whole outperformed index by 0.2 percent.

During 2014, the management of emerging-market bonds, issued in US dollars, has been conducted in-house a well as by external portfolio managers. The remaining external mandates were terminated early in the summer and all these assets are now managed in-house. The portfolios posted a joint active return of –0.9 percent, much of which was attributable to transition costs. This in-house management has been passive during 2014, but is expected to be active in 2015.

The management of emerging-market bonds in local currencies is conducted by external managers. The absolute return on these portfolios was high during the year – index (excluding FX hedging) posted a return of 14 percent – but managers were unable to outperform index. Their joint active return was –0.2 percent.

Tactical allocation and FX

The Fund's in-house tactical allocation activities delivered a positive result of SEK 183 million. In-house FX trading during the year delivered a result of SEK 54 million. The externally managed GTAA mandates continued to make a positive contribution, SEK 74 million to the active return.

Swedish equities	2014	2013	2012	2011	2010
Exposed value, SEK billion	29.7	30.3	27.0	30.8	44.9
Absolute return, %	16.8	27.2	16.3	-13.3	27.8
Relative return, %	1.2	1.2	0.4	-0.5	0.8
SIXRX, %	15.8	28.0	16.5	-13.5	26.7
Share of external management, %	0	0	0	9	5
Active risk ex post, %	0.8	0.5	0.4	0.7	0.5
Foreign equities	2014	2013	2012	2011	2010
Exposed value, SEK billion	109.6	105.2	91.3	81.2	75.0
Absolute return, %	26.7	18.4	12.9	-8.2	5.2
Relative return, %	0.9	0.4	1.4	-0.1	0.4
MSCI AC World, %	27.6	21.9	10.8	-5.0	6.6
Share of external management, %	12.6	14	26	26	26
Active risk ex post, %	0.4	0.4	0.4	0.5	0.5
Fixed-income securities	2014	2013	2012	2011	2010
Exposed value incl. liquidity, SEK billion	97.9	86.9	86.7	77.7	77.2
	14.4	-0.9	5.4	6.8	0.5
Absolute return, %	0.4	0.4			0.5
Relative return, %	-0.1	-0.1	1.0	-0.6	
Relative return, % Share of external management, % Active risk ex post, %	-0.1 37 0.4	-0.1 32 0.3	1.0 30 0.4	31 0.4	0.3
Relative return, % Share of external management, % Active risk ex post, % Five-year review	37	32	30	31	22
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million	37 0.4 2014	32 0.3 2013	30 0.4 2012	31 0.4 2011	22 0.3 2010
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital	2014 293 907	32 0.3 2013 264 712	30 0.4 2012 241 454	2011 216 622	22 0.3 2010 222 507
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency	2014 293 907 -5 120	32 0.3 2013 264 712 -6 880	30 0.4 2012 241 454 -3 788	2011 216 622 -1 240	22 0.3 2010 222 507 -4 041
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency Net result for the year	2014 293 907	32 0.3 2013 264 712	30 0.4 2012 241 454	2011 216 622	22 0.3 2010 222 507
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency	2014 293 907 -5 120	32 0.3 2013 264 712 -6 880	30 0.4 2012 241 454 -3 788	2011 216 622 -1 240	22 0.3 2010 222 507 -4 041
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency Net result for the year Annual return, % Annual return on total portfolio before commission fees and operating expenses Annual return on total portfolio after commission fees and operating expenses	2014 293 907 -5 120 34 315	2013 2013 264 712 -6 880 30 138	2012 241 454 -3 788 28 620	2011 2011 216 622 -1 240 -4 645	22 0.3 2010 222 507 -4 041 22 258
Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency Net result for the year Annual return, % Annual return on total portfolio before commission fees and operating expenses Annual return on total portfolio after commission fees and operating expenses Annualized return after commission fees and operating expenses, 5 years	2014 2014 293 907 -5 120 34 315	2013 2013 264 712 -6 880 30 138	30 0.4 2012 241 454 -3 788 28 620	2011 2011 216 622 -1 240 -4 645	22 0.3 2010 222 507 -4 041 22 258
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Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency Net result for the year Annual return, % Annual return on total portfolio before commission fees and operating expenses Annual return on total portfolio after commission fees and operating expenses Annualized return after commission fees and operating expenses, 5 years Annualized return after commission fees and operating expenses, 10 years Risk, %	37 0.4 2014 293 907 -5 120 34 315 13.3 13.1	32 0.3 2013 264 712 -6 880 30 138 12.8 12.7	30 0.4 2012 241 454 -3 788 28 620 13.5 13.3	31 0.4 2011 216 622 -1 240 -4 645 -1.9 -2.1 0.6	22 0.3 2010 222 507 -4 041 22 258 11.2 11.0 3.5
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Relative return, % Share of external management, % Active risk ex post, % Five-year review Fund capital, flows and result, SEK million Fund capital Net outflows to the Swedish Pensions Agency Net result for the year Annual return, % Annual return on total portfolio before commission fees and operating expenses Annual return on total portfolio after commission fees and operating expenses Annualized return after commission fees and operating expenses, 5 years Annualized return after commission fees and operating expenses, 10 years Risk, % Standard deviation ex-post, total portfolio¹ Standard deviation ex-post, market-listed portfolio Sharpe ratio ex-post, daily market-listed portfolio	37 0.4 2014 293 907 -5 120 34 315 13.3 13.1 9.4 7.1	32 0.3 2013 264 712 -6 880 30 138 12.8 12.7 10.8 7.0 9.3 5.7 2.1	30 0.4 2012 241 454 -3 788 28 620 13.5 13.3 2.4 7.4	31 0.4 2011 216 622 -1 240 -4 645 -1.9 -2.1 0.6 4.3	22 0.3 2010 222 507 -4 041 22 258 11.2 11.0 3.5 4.2
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 $^{^{\}mbox{\tiny 1}}$ Calculated over ten-years' quarterly returns.

Alternative investments

The Second AP Fund has gathered its investments in non-listed real estate equities (including farmland and timberland investments), private equity funds, alternative risk premiums, alternative credits and the domestic Chinese equities market under asset class Alternative Investments.

Alternative Investments jointly account for 19.3 percent of total Fund assets under management. Real estate represents the largest share, including farmland and timberland investments (10.1 percent of total Fund assets). This largest share is followed by private equity funds (4.8 percent), alternative risk premiums (2.6 percent), alternative credits (2.1 percent), Chinese equities (0.7 percent) and the market value from hedging alternative investments (–1.0 percent).

The overall return on alternative investments for the year was 12.1 (unhedged 24.8) percent. Alternative investments apart from Chinese equities are hedged to 100 percent. In light of the weakening of the Swedish krona during 2014, the result of FX hedging (included in all result data) was sharply negative.

Private equity funds

For the private equity industry, 2014 has been a year dominated by divestments to strategic buyers and several stock market flotations, leading to a substantial inflow of capital to investors.

The level of private equity funds' total undertakings has risen steadily in recent years. As of November 2014, the industry had joint undertakings amounting to USD 428 billion. The number of funds has declined and, instead, the size of existing funds has increased.

The largest divestments to strategic buyers during the year were CPP and KKR's sale of Alliance Boots to Walgreen, followed by Apollo's sale of Athlon Energy to Encana and TH Lee's sale of Acosta to Carlyle. The sale that attracted the most market attention was Seguoia's sale of Whatsapp to Facebook.

Alibaba's listing on NASDAQ in August marked the year's largest market flotation, with IMS Health's April listing as second largest.

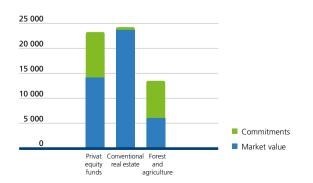
The Second AP Fund's portfolio was notable for a high degree of activity throughout. As well as many investments, the private equity funds also completed a large number of divestments and IPOs (Initial Public Offerings). The funds' portfolio companies have enjoyed solid profit growth.

The Second AP Fund made 15 new investments in 2014, comprising commitments of totally SEK 3.5 billion. These new undertakings represent a useful complement to the Fund's existing portfolio.

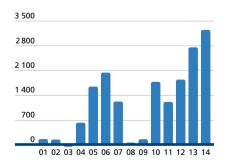
As of December 31 2014, the Fund's investment commitments totalled SEK 25.6 billion. Since its inauguration in 2001, the Fund has invested SEK 16.6 billion (including management fees), of which SEK 2.1 billion in 2014. Although the portfolio is still at a relatively early stage in its development, a growing number of the private equity investments may be considered mature. Since the start, SEK 10.4 billion has been reimbursed.

The return on investment in private equity funds was 17.0 (unhedged 37.6) percent for 2014, the market worth of the portfolio amounting to SEK 14.1 billion at year-end, excluding FX hedge. Fees paid for the management of non-listed 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 54.

Non-listed alternative investments, classified according to market worth and commitments remaining, SEK million



Annual result, from the Fund's holdings in conventional real-estate companies since start (ex FX hedge), SEK million



Conventional real estate

The Fund's non-listed 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. All these investments focus on high-quality conventional real estate, centrally located in real-estate markets with good liquidity. The portfolio has been complemented by two smaller investments in real-estate funds, one in Asia and one in Poland, in line with the Second AP Fund's long-term aim of gradually increasing the exposure to emerging markets.

By investing in real estate, the Fund generates a solid long-term direct return on investment and contributes 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 185 properties, totalling some 2.5 million square metres of floor space, with a total market worth of SEK 92 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 Swedish cities that enjoy solid growth (Luleå, Umeå, Sundsvall, Örebro, Jönköping and others), but also has real estate in Stockholm, Copenhagen and Hamburg. Norrporten owns and manages 124 properties, totalling 1.2 million square metres of floor space, with a total market value of SEK 26 billion.

In the past four 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 company focused primarily on investment in real estate in major European cities. To date, the company has acquired three centrally located office properties in London and two office properties in central Munich and Hamburg. The portfolio has a total market worth of SEK 9 billion. During the autumn, an agreement was signed to acquire an additional property in central Hamburg.

Together with state-owned South Korean pension fund NPS and the real-estate company Tishman Speyer, the Fund has joint interests in the American real-estate companies US Office Holdings and Core Office. The companies own real estate both directly and jointly. This real-estate portfolio consists of 18 centrally located office properties, three of which were acquired during the year, spanning a joint floor space of some one million square metres. These properties are currently valued at SEK 38 billion. Seventy percent of the portfolio's market worth consists of real estate on both the east and west coasts of the USA, in New York, San Francisco, Seattle and Los Angeles. Twenty-five percent of the portfolio's market worth derives from real estate located in Chicago.

In 2013 the Second AP Fund invested in Gateway Real Estate Fund IV (Gaw), which invests in real estate in East Asia, mainly in China. Six properties have been acquired so far, five in China and one in Japan. Investment in this fund helps diversify the Second AP Fund's portfolio, reducing risk through investment in a range of different properties across a broader geographical area.

In June 2014, the Second AP Fund invested in an additional realestate fund, Hines Poland Sustainability and Income Fund, which invests in office properties and logistical facilities in Warsaw and Cracow. Two office properties were acquired in Warsaw during the autumn.

The return generated on the Second AP Fund's investments in conventional real estate was 11.2 (unhedged 16.2) percent.

Farmland and timberland investments

In 2010, the Second AP Fund made its first investments in farmland and timberland, as part of its strategy for diversifying the overall portfolio. These investments are both considered to generate a stable return, in light of the fact that the underlying trend towards increased urbanization and improved welfare, in combination with a growing global population, is increasing demand for forest and agricultural products. Both asset classes are also deemed to be relatively insensitive to cyclical fluctuations, added to the fact that covariance with other asset classes – such as equities – is considered to be low.

Today, the portfolio of farmland and timberland comprises of nine different funds/companies, with joint investment commitments total-ling SEK 12.9 billion as at December 31 2014. When choosing its fund managers, the Second AP Fund considers it important that they subscribe to the same values of long-term, responsible and sustainable investment. The Fund has elected to invest in agricultural real estate in the form of joint ventures with other investors, a form that suits the Fund's long-term approach to these investments. The farmland investments are so far located in Australia, Brazil and the USA. The main focus is grain production on large-scale, high quality farm-

land, in countries that possess clearly-defined legal structures, where agricultural production is effective and not dependent on state grants or other forms of support. In 2014, the Fund made a new investment in farmland in the form of a joint venture with TIAA-CREF.

The Second AP Fund's forest investments are located mainly in the USA and Australia and focus on conventional forest management for the production of traditional pulpwood and saw timber, featuring a careful balance between softwood and hardwood. The majority of these investment commitments are structured as funds. As a complement to these investments, the Second AP Fund has also invested in a company engaged in forest investments in Latin America and Europe, where production is geared partly towards biomass. During 2014, the Fund invested in a new timberland company focused on traditional forest investment in the USA.

All the funds/companies in which the Second AP Fund has invested are clearly focused on the sustainable, responsible ownership and management of their real estate investments and on the certification of their operations (SFI, FSC and AFS).

In 2014, the Fund generated a return of 13.9 (unhedged 38.0) percent on investments in farmland and 6.7 (unhedged 23.9) percent on timberland investments.

Alternative credits

For some years now, the global economy and financial markets have been undergoing a debt restructuring process that has adverse effects on general economic growth and on the financial institutions' ability to maintain their normal function as lenders and intermediaries in the financial markets. For this reason, the Second AP Fund has allocated two percent of its strategic portfolio to investments in credit opportunities that, for example, can arise in connection with the imposition of increased capital coverage requirements on banks (which reduces their lending ability). These investment possibilities derive as the result of several knock-on effects from changes in regulations and increased capital coverage requirements. One example is that bank lending shifts from small and medium-sized companies to the largest corporations.

The Second AP Fund's investment mission is long-term, providing the stability needed to benefit from prevailing market conditions. The full worth of the value created can only be realized when the securities and credits mature, requiring the investments to be retained for their full term.

The average term for the credits that dominate the investments selected in the credit market segment (loans to companies) is shorter than for the more common bonds that institutional investors these days have large exposure towards. Shorter terms and, not uncommonly, FRNs (floating rate notes), mean that sensitivity to potential hikes in interest rates from the currently extremely low levels is less.

A number of the investment strategies mentioned above target the types of assets defined as non-listed, a type of asset in which the Second AP Fund has only limited freedom to invest, due to the current legislation affecting non-listed investments. Even though the restriction to market-listed structures somewhat limits the investment choice, both the breadth and depth in the choice of these listed investments is adequate to enable the Fund to generate the investment opportunities it seeks.

The anticipated return is in line with the Fund's long-term assumptions concerning the return on equities, seven-eight percent. With an anticipated return at this level, the investment contributes to an increased, absolute and risk-adjusted, return in the long term.

Since the portfolio was established, the Second AP Fund has conducted ongoing investment in corporate credits by utilizing external fund managers that apply broad and in-depth credit analyses. By about the close of the first half of 2014, the portfolio was fully invested.

The return for 2014 was 4.4 (unhedged 23.3) percent. The level of return was negatively affected, mainly during the autumn, by outflows from this type of assets, among other factors. The quality of the Fund's investments in credit opportunities remains good.

Alternative risk premiums

Alternative risk premiums shall contribute to increased diversification and generate higher risk-adjusted return, since the portfolio is constructed to be less dependent on traditional stock market risk. The strategies adopted by the portfolio are linked to stock market volatility, premiums for reinsuring insurance companies, premiums associated with the market for corporate acquisition and convertibles as well as strategies focused on the FX market and the market for future dividends on corporate profits. Other possible risk premiums may be added later. The return for 2014 was 3.2 (unhedged 19.6) percent.

Chinese Series A equities

In 2012, the Second AP Fund was awarded a QFII (Qualified Foreign Institutional Investor) licence, followed by a permit to invest an amount equivalent to USD 200 million in 2013. Trading in Chinese Series A equities was initiated in November 2013, mandates being issued to two fund managers, APS and Cephei. The Second AP Fund has allocated one percent of the strategic portfolio to invest-

ments in Chinese Series A equities, current exposure corresponding to 0.7 percent. In these investments, the Fund seeks exposure to the structural development of the market and the portfolio strategies adopted involve an agnostic approach to MSCI China A gross, the Chinese benchmark index. The index is considered ineffective and notable for high volatility, which makes a high relative deviation in relative terms likely. Absolute return for 2014 was 59.1 percent.

RISK MANAGEMENT

Stable risk in a changeable world

Sweden's Riksdag has formulated clear guiding principles as to how the AP Funds shall interpret their task as fund managers. The AP Funds shall adopt financial risk in an effective manner with a clear focus on future pensions. Apart from a few constraints, the funds have been awarded considerable freedom in selecting appropriate risk and investment strategies, independent of one another. The selected strategy shall be neutral with regard to the generations involved and shall ensure the maintenance of pension disbursements.

The starting point for the Second AP Fund's investment strategy and financial risk is that the AP Funds are only able to influence future pensions to the extent that their portfolio management activities impact on the pension system's automatic balancing mechanism. The Board of Directors has therefore concretized the Fund's goal for its asset management activities as minimizing the consequences to future pensions of activating the automatic balancing mechanism. It is the primary risk that determines the way in which investment strategy is formulated, rather than the selected portfolio's risk profile. By far the greatest portion of financial risk adopted by the Second AP Fund in its portfolio management operations derives from its long-term exposure to financially motivated risk premiums, as expressed by the strategic portfolio.

The financial risk is thus directly linked to the Fund's assessment of the development of the total pension system over the coming decades. This is subject largely to factors outside the Fund's control, such as demography, immigration, employment levels, economic growth and so on. The financial risk is also governed by the Fund's assessment of the financial markets' long-term prospects for generating a return. A key point when determining the choice of strategy is that the AP Funds, compared to the Swedish national pension system as a whole, are of relatively limited size. Their limited size means that the funds are forced to adopt a significant level of financial risk. However, this also means that the financial risk adopted will have less of an effect on the pension system.

The long-term allocation of assets and spread of risk that the Second AP Fund deems will minimize negative effects on future pensions features a relatively high proportion of higher-risk assets. This means that the value of the portfolio, from one time to another, is expected to show a higher variation than if the allocation had been more defensive. A guiding principle governing the development of the Second AP Fund's long-term investment strategy is to diversify risk in the portfolios where possible, without compromising on the requirement for a high return. In this way, the Fund hopes to minimize the

risk of a negative trend in pensions over the long term, while at the same time limiting the portfolio's short-term risk as far as possible.

The long-term orientation the Fund chooses for its portfolio may be characterized in a several ways. One way is to describe it as an allocation of assets between different assets and strategies. Another way is to describe it in terms of anticipated future returns. A third way is in terms of the portfolio's expected risk profile, which plays a key factor in achieving the overall objective – to minimize the risk of lowering the level of future pensions – which is the mission the AP Funds have been tasked with.

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 overall 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 levels of exposure to risk are specified in 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 long-term 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

The Fund's Board of Directors has established the target of a 0.5-percent excess return, over and above the return determined for the strategic portfolio. In generating this return, the board has specified that the active risk (tracking error) in managing the portfolio shall not exceed three percent.

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The purpose of the risk budget is to allocate excess return targets and limits for active risk between the Fund's portfolio management teams, to achieve the most effective risk utilization: in other words, to maximize the Fund's information ratio. The idea of a risk budget is to delegate targets and resources among departments. Within the framework of the respective active-risk mandates, therefore, heads of department are responsible for allocating the return and risk targets among the departments mandates. The target and active risk is defined in the 'Investment Guidelines' for each mandate.

The risk budget is drafted annually. Senior portfolio managers draft a proposal which is presented to the Fund's executive management for approval.

Compliance

Compliance is responsible for ensuring that the legal and ethical aspects are managed correctly, in compliance with current rules and regulations. The main task of the compliance function is to spread awareness throughout the organization of the regulations that, in the broadest sense, are important to the Fund. This can be done in a number of different ways, not least by ensuring that in-house rules, policies and guidelines are established and firmly rooted in the organization. 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 and operative risks. This function is operationally separate from the asset management organization, ensuring complete independence. It is also responsible for developing guidelines and risk models, as well as providing advice and support to the Fund's executive management and portfolio management teams.

The 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. In the day-to-day portfolio management process market risk 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 of credit risk limits as per credit rating. To determine the credit risk, the Fund employs median ratings from rating agencies Standard & Poor's, Moody's and FitchRatings. When a rating is available from two institutes only, the lowest rating is selected. If a rating is available from just one institute, the judgement is based on this alone. The Fund also has credit risks in fixed-income funds and alternative assets (alternative credit funds).

The Fund's counterparty risk is monitored and analysed on a daily basis. Each new counterparty is subject to a credit check, followed by continual evaluation of all current relationships. The purpose and nature of the specific business relationship is always the starting point. As well as the counterparty risk associated with deposits and noncleared derivatives (OTC derivatives), there is a risk concerning cleared transactions against clearing institutes, although this is minimal.

Issuer risk is not limited to the risk that the issuer may become insolvent. Losses 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 different groups of issuers based on credit ratings per security.

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 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

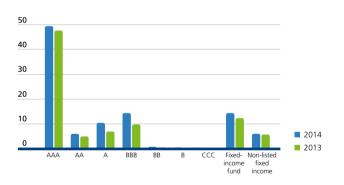
Liquidity risk refers to the risk that securities cannot be converted into cash at the appointed time without incurring a substantial loss or considerable cost. The AP Funds must also be prepared to transfer funds to the Swedish Pensions Agency.

The Fund's liquidity risk is limited by the Swedish National Pensions Funds Act that requires that 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. The liquidity risk on the liability side, which is very small, consists of derivative debts.

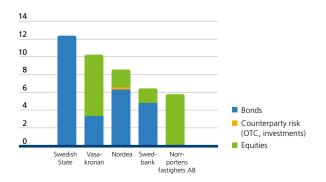
Duration 2014



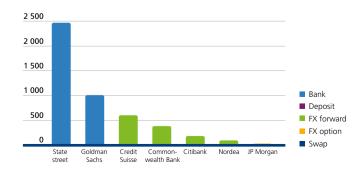
Credit risk, SEK billion



Exposure to issuer, SEK billion



Counterparty risk, SEK million



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.

In the spring of 2014, in association with external consultants, the Fund conducted a process review of its management activites. The objective was to describe all processes and identify the risks in one of the Fund's primary processes – portfolio management – and to propose strategies for improvement. Furthermore, processes and risks were identified in the interface to the primary process, portfolio management, and improvements were proposed. The project was concluded with the drafting of proposed models for process management, process organization and working methods. This processmanagement approach was implemented in the autumn. Processmanagement meetings concerning the monitoring and development of existing and new processes, which are attended by all process managers, are held twice a year. The process review of portfolio management was initiated in January 2014 and completed in June of the same year.

The Fund's point of departure must be to work continually with these processes and monitor any associated risks, as well as ensuring that operations are conducted in compliance with the agreed processes. Process development requires a working approach that is flexible as well as formally defined.

Portfolio risk 2014

The Second AP Fund reports a continuing low level of active risk for the total portfolio in 2014. 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, rose somewhat during 2014. At year-end 2014, it was at 0.29 (0.25) percent. The level of active risk noted for asset class Swedish equities rose from 0.5 percent to 0.8 percent, while the level for asset class foreign equities remained virtually unchanged, at 0.4 percent. The level of active risk for fixed-income securities rose to 0.4 (0.3) percent by year-end. Covariance between the relative

returns on asset classes in the market-listed portfolio remained low over the year, indicating a good risk spread in the Fund's portfolio.

The volatility of the listed portfolio, calculated over the twelve months, remained unchanged at 5.7 percent for the year.

The information ratio for the total listed portfolio increased somewhat, amounting to 1.7 (1.6) by year-end. The Sharpe ratio for the Fund's listed portfolio rose during the year, due to an improved absolute return, rising to 2.2 (2.1) by year-end.

The duration calculated for the portfolio of fixed-income investments was 4.9 (4.4) years as per December 31, which corresponds to an approximate increase of 0.5 years compared with the preceding year. This increase derives from asset class foreign government bonds and global credits, which have increased duration by about 0.2 years during 2014. The remaining asset classes note smaller changes compared to the total fixed-income portfolio. The share of duration that derives from maturity segment 0–10 years has changed from 82 to 74 percent in the past year.

The credit quality of the fixed-income portfolio has changed somewhat during the year. The Fund has a triple-A (AAA) share of 48 (54) percent) and a triple-B (BBB) share of 14 (11) percent. The reduction in the triple-A share share is attributable to the increase of the triple-B share in the Corporate Index.

The concentration risk between the Second AP Fund's portfolio of listed equities and private equity funds varies somewhat. Private equity funds feature the greatest exposure to North America, 51 (48) percent, while the portfolio of listed equities' greatest exposure is to Europe, 37 (47) percent. They also differ with respect to sector diversification, finance being the largest industry represented in the portfolio of listed equities, at 24 (24) percent, while the largest sector for private equity funds is IT, at 22 (17) percent.

Fund exposure to Portugal, Ireland, Italy, Greece and Spain in equities and bonds remains limited. Exposure as per December 31 amounted to 2.0 (2.9) percent of the Fund's total capital, Greece's share accounting for 0.05 percent. The Fund's exposure to Russia and the Ukraine is low, being 0.6 percent and 0.02 percent respectively of the Fund's total capital. Following a US court ruling, Argentina was prevented from paying interest to bondholders of its restructured debt, issued in US dollars. Consequently, these bonds were declared in technical default during the year. The Fund's holdings constitute 0.02 percent of Fund capital and these bonds are still included in the Fund's benchmark index.

A sensitivity analysis of the Fund's Value-at-Risk (VaR) forecast for the total portfolio highlights equities as having the greatest VaR, at SEK 1.8 (1.7) billion. The analysis also shows good diversification in the portfolio.

MSCI's risk system RiskManager3 is used to calculate VaR. VaR is calculated for the Fund's total portfolio, including alternative investments, for a confidence interval of 95 percent over a day, based on historic simulation. The historic period employed is one year, with daily data.

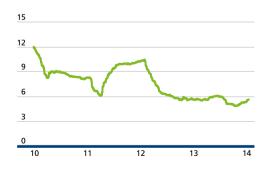
Based on the VaR calculation, there is a 95-percent likelihood that the Second AP Fund will lose no more than SEK 1.9 billion in absolute terms over a day, per year-end.

For asset classes that are classified as alternative investments and that lack daily quoted rates, the Fund employs proxies. The proxies for these asset classes are as follows. For asset class Private Equity: S&P Listed Private Equity Index, Bloomberg: SPLPEQTR. For asset class Real Estate: Carnegie Real Estate Index, Bloomberg: CRERX and for Convertibles: 50 percent MSCI World/50 percent JP Morgan Global Bond Index.

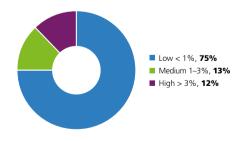
Risk calculated as Value at Risk (VaR) for the Second AP Fund's total portfolio

SEK million	2014 VaR (95%,1 day)	2013 VaR (95%,1 day)
Share risk	1 754	1 715
Exchange rate risk	699	690
Interest risk	187	148
Diversification	-718	-909
Total, Second AP Fund	1 922	1 644

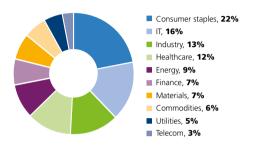
Volatility in listed portfolio past five years, %



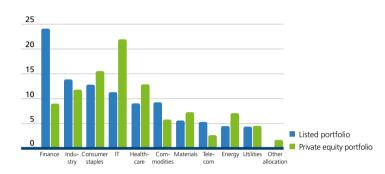
Allocation of active risk, %



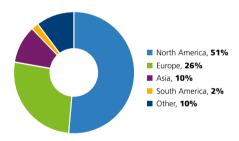
Investments in private equity funds by sector, %



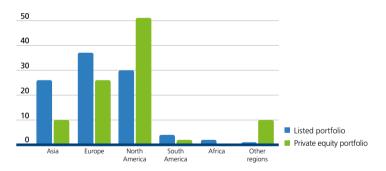
Sector concentration: listed portfolio compared with private equity portfolio 2014, %



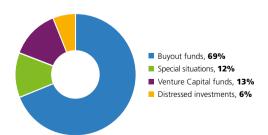
Investments in private equity funds by region, %



Regional concentration: listed portfolio compared with private equity portfolio 2014, %



Original investment commitments in private equity funds, %



FX exposure

The degree of 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. By the end of the year, 24 (23) percent of the Fund's portfolio was exposed in foreign currency. The largest part was the Fund's exposure in USD, HKD and euros. The Fund's hedging policy is determined by the Board of Directors and is part of the portfolio optimization process. This policy aims to reduce portfolio risk, and a systematic FX hedging

programme is actively managed. The portfolio's total FX exposure in 2014 has had a positive net impact on the result, reflecting the steady weakening of the Swedish krona against other currencies. The hedging programme has had a negative impact on the net result. The Fund reported an overall positive result on FX transactions for its total portfolio, including hedging (and interest gains/ losses on FX contracts), amounting to SEK 10.4 (–1.3) billion.

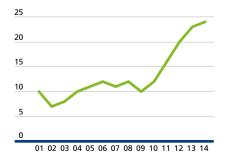
FX exposure 2014 and 2013, equivalents in SEK million

December 31, 2014	USD	HKD	EUR	KRW	TWD	JPY	Other	Total
Equities and participations	69 079	7 369	14 268	4 072	3 358	9 735	33 152	141 033
Bonds and other fixed-income securities	46 997	_	13 353	_	_	_	4 729	65 079
Other assets and liabilities, net	1 732	65	1 113	_	12	155	851	3 928
Derivative instruments excl. FX derivatives	743	-1	-42	_	_	-8	-8	684
FX derivatives	-87 461	-1 348	-24 056	-76	-76	-6 898	-21 649	-141 564
FX exposure, net	31 090	6 085	4 636	3 996	3 294	2 984	17 075	69 160

December 31, 2013	USD	EUR	JPY	HKD	KRW	Other	Total
Equities and participations	53 559	21 333	9 929	3 516	2 346	24 237	114 920
Bonds and other fixed-income securities	31 376	10 041	_	_	_	3 531	44 948
Other assets and liabilities, net	1 248	1 892	152	67	_	492	3 851
Derivative instruments excl. FX derivatives	7 032	1 092	42	_	_	-7	8 159
FX derivatives	-64 667	-22 161	-6 720	-641	7	-16 784	-110 966
FX exposure, net	28 548	12 197	3 403	2 942	2 353	11 469	60 912

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, %



Statutory limit for FX exposure is 40 percent.

COSTS

In-house management cuts costs

Today's Second AP Fund is the result of more than a decade's accumulation of, and focus on, competence and innovation. During the year, the Fund has continued the internalization process started in 2012.

In an increasingly complex investment environment, the management of a portfolio of emerging-market assets in-house has made, and continues to make, demands on broad competence. Changing global factors, such as country-specific regulations and growing geopolitical instability, require ever more stringent control and monitoring of the Fund's flows and positions. For these reasons, a focus area targeted by the Fund in 2014 has been the need to minimize risks in the transaction chain. Continuing development of the portfolio management system during the year has enabled full automation of the transaction flow from portfolio simulation to completion of a transaction.

In line with its diversification strategy, the Fund has established a more global and diversified non-listed portfolio, both with respect to the number of investments and counterparties. To meet the demands of an increased investment volume and expanded administrative requirement, the Fund has focused additional attention on improving the efficiency of in-house processes associated with this type of investment.

Cooperation with the other AP funds

The Second AP Fund is a global player and, over the years, has developed its collaboration with other investors in every part of the world. The Fund places considerable importance on this collaboration with other institutional fund managers, as a means of enhancing and broadening its own competence and is constantly on the lookout for potential partners, internationally as well as in Sweden.

Since 2007, the Second AP Fund has been collaborating with the First, Third and Fourth AP funds to monitor and analyse the AP Funds' foreign portfolio assets regarding possible infringements of international conventions to which Sweden is a signatory. This process is conducted within the framework of the AP funds' joint Ethical Council (www.etikradet.se). As well as working together within the Ethical Council, the AP funds also collaborate on tax, legal, accounting, risk and valuation issues.

During the report period, the Second AP Fund has been collaborating with the Third AP Fund on a joint procurement process for custodial services, a process to be completed during 2015. Another joint project has been launched in collaboration with the First, Fourth and

Seventh AP funds, to determine the impact of clearing OTC deriva-

Another form of cooperation focuses on promoting an interchange of competence and expertise with similar players, concerning areas of mutually relevant interest. During 2014, a structured exchange programme was developed and launched in cooperation with the New Zealand Superannuation Fund. The areas of initial focus were the procurement of custodial services, systems and the evaluation process for selecting managers for external mandates. In conjunction with the joint negotiations about custodial services, the Fund has also engaged in an exchange of expertise with the Third AP Fund concerning operational processes.



The Fund is constantly on the lookout for potential partners, internationally as well as in Sweden.

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 mandates, 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, according to the latest analysis, which covers 2013, the Second AP Fund's portfolio management continues to be successful and costefficient. The level of costs is still considered competitive in 2014, although affected by the fact that costs incurred in conjunction with the termination of external mandates coincide with the costs of building up in-house capacity to manage capital from these mandates. The Second AP Fund's costs level is some 30 percent lower than that reported for the benchmark group, mainly attributable to the fact that the Second AP Fund has a significantly lower percentage of assets under external management. One consequence of the Fund's long-term internalization strategy is that large sums invested in global markets can now be managed cost-efficiently in-house, within the framework of the Fund's quantitative management. For example, the cost of managing equities on emerging markets in-house is substantially lower than when managed under external mandates.

Seen over the past five-year period, return in absolute terms has been excellent, when compared to the benchmark funds.

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.

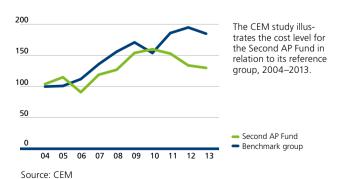
The Second AP Fund employs a floating strategic benchmark index and the actual portfolio is adjusted daily to replicate this. The strength of this management model is that the Fund's total capital is fully exposed on a daily basis.

The costs and revenues attributable to strategic changes in the benchmark index, known as 'transitions', and the ongoing rebalancing of the strategic portfolio, are referred to as 'implementation effects'. In 2014, these implementation effects totalled –0.02 percent. The low cost derives from increased internalization, generally low volatility and the availability of more effective decision data for the daily rebalancing process.

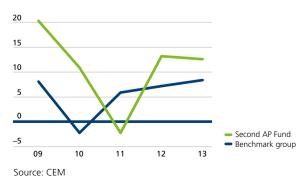
VAT

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. In 2014, these costs amounted to SEK 21 million.

Cost-efficiency comparison with international pension funds 2004–2013, indexing



Absolut return per year compared with benchmark group in Europe, %



ATTRACTIVE EMPLOYER

A workplace with possibilities

The Second AP Fund's ability to recruit new staff, retain them and contribute to their development is essential in achieving its long-term objective. Part of the Fund's long-term strategy is to use its own resources to build up still more professional and costefficient portfolio management.

The Second AP Fund is an archetypal knowledge-driven organization, where the specialist competencies, creativity and commitment of its staff are critical to a successful result. As a manager of buffer capital, the Fund is tasked with an important mission. This places considerable demands on the Fund's good judgement in its day-to-day operations, and the need for transparency in carrying out its duties. These issues are often the subject of internal discussion within the Second AP Fund. The Fund subscribes to a joint code of values and has clearly established internal policies that govern its professional behaviour.

Culture and values

The Second AP Fund is an employer with motivated and committed staff. The Fund's corporate culture is notable for encouraging personal responsibility and individuality within the broader framework of a strong team spirit. Ethical behaviour is an important element of this corporate culture and forms a natural part of the Fund's values system.

During the year, the Fund has continued the process of building a robust corporate culture and strengthening its joint values. The values on which this culture is built are the creation of long-term value, responsibility, respect and consistent improvement.

This process is intended to clarify and promote consensus around the Fund's values and to establish the principle that these values should provide guidance in the Fund's day-to-day operations. During 2014, the Fund has agreed on behaviours, linked to these values, and has also conducted a survey to determine how well it lives up to these same values. They are also integrated into the Fund's business plan.

Ongoing internalization

Part of the Fund's long-term strategy is the steady build-up of still more professional and cost-efficient portfolio management, relying on its own in-house resources. The process of internalizing the Fund's portfolio management activities has continued within the

parameters of this broader strategic framework throughout the year. Seventy-two percent of the Fund's capital assets are managed inhouse, involving a growing number of asset classes and strategies, placing considerable demands on its competence in different investment sectors, as well as on its business services and risk and performance analysis (more on page 18).

Exchanging competence

All members of staff are offered ongoing skills development within their individual fields of competence. During the year, the in-house training of staff on sustainability issues has continued, with a view to increasing everyone's competence in this area.

The Second AP Fund places great importance on collaboration with other investors, internationally as well as in Sweden. During the year, the Fund has engaged in exchanging competencies with a number of different investors, primarily members of the Fund's business network. This includes collaboration with the New Zealand Superannuation Fund, Generation Investment Management and TIAA-CREF.

Leadership training

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

Health and diversity

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. Each employee's health is also monitored in conjunction with the annual employee appraisal. The Second AP Fund supports activities that help inspire and stimulate a healthier lifestyle.

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. In 2014, five men and no women took parental leave at some point during the year.

All employees are covered by the terms of the collective bargaining agreement between BAO (The Employers' Organization of the Swedish Banking Institutions) and SACO (The Swedish Confederation of Professional Associations).

Remuneration

To be able to recruit and retain the right staff, the Second AP Fund strives to remunerate its employees at a level that is motivating and consistent with the industry at large.

Board's area of responsibility

The Board of Directors of the Second AP Fund determines the guidelines for remuneration to senior executives. These guidelines are reviewed annually by the Board and shall be compatible with Swedish Government guidelines pertaining to terms of employment as applied at the AP funds. These guidelines address the actual decision-making process as well as the construction and appraisal of appropriate and reasonable remuneration within the Fund. The Board ensures that the remuneration paid to the Chief Executive and other senior executives is consistent with the Board's guidelines.

Guidelines for remuneration

The total remuneration paid to leading executives should be reasonable and well balanced. It should also be 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.

The remuneration shall comprise a fixed basic salary, performance-based variable remuneration (not applicable to the Fund's executive management), pension and benefits.

The Board's follow-up

For more than a decade, the Second AP Fund has participated in the annual salary and benefits survey conducted by Towers Watson, a firm of independent analysts. This annual survey generates compara-



The Fund considers it important that its workforce should reflect diversity in terms of background, experience, age and gender.

tive statistics for individual positions held at relevant and comparable organizations in the financial industry. 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 2014, the levels of remuneration provided by the Fund were compared with some 15 other players in the financial sector, including Swedish pension fund AMF, other AP funds, Riksbanken (Swedish Central Bank) and Kammarkollegiet (Swedish Legal, Financial and Administrative Services Agency).

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 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 period of notice. Nevertheless, the combined costs incurred in connection with a dismissal are well within the limits defined in the Swedish Government guidelines. More information on at www.ap2.se

Performance-based variable remuneration

The Board of Directors approves a programme for variable remuneration in line with the Swedish Government's guidelines. The Second AP Fund's incentive programme comprises all staff apart from the CEO and other members of the Executive Management Group. This incentive programme means that all other members of staff are entitled to a maximum of two months' salary in variable remuneration.

The programme is linked to long-term goals calculated over three and five years. This variable remuneration may only be paid out when the Fund reports a positive total return. In 2014, a variable remuneration was paid to all employees entitled to a bonus. More about the programme at www.ap2.se

Recruiting talent

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. Eleven of the Fund's current members of staff have come direct from studies at the School of Business or Chalmers.

Collaboration with the academic world

For the Second AP Fund, active participation in the latest research in the financial sector is a self-evident necessity. As well as carrying out their own research, Fund employees also attend conferences at which research results are presented. More about the research in which Fund employees are participating at www.ap2.se

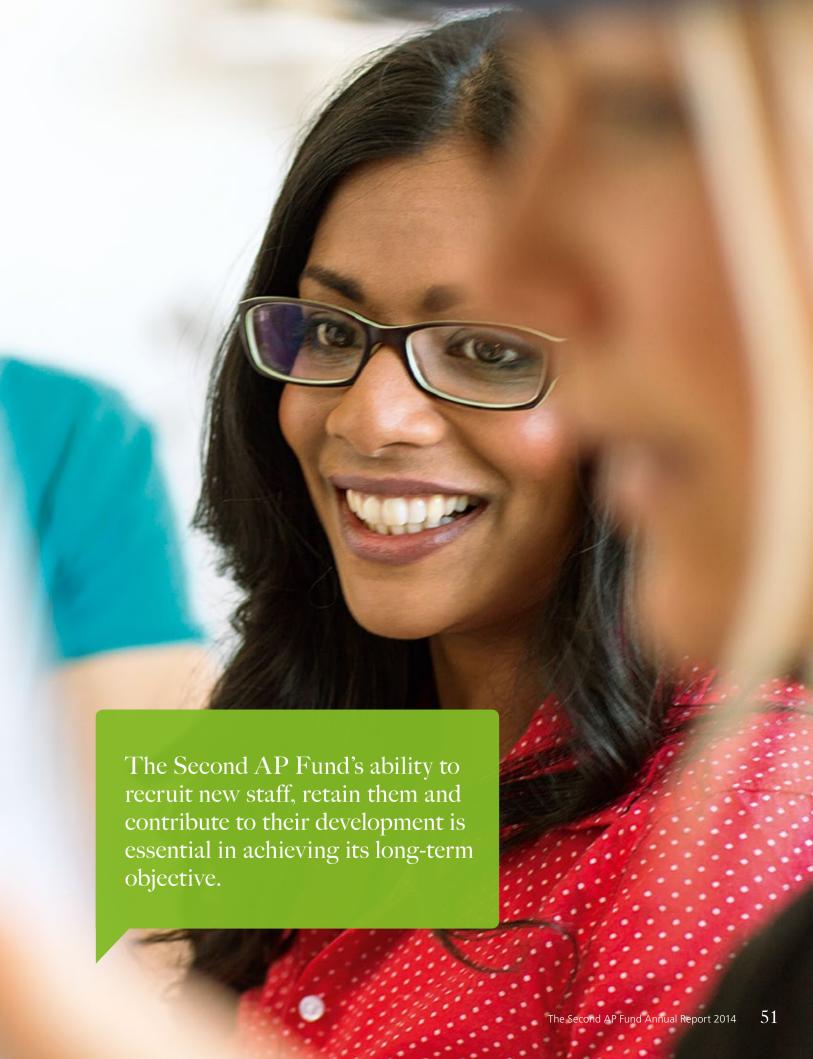
For some years now, the Second AP Fund's CIO (Chief Investment Officer), Hans Fahlin, has chaired Inquire Europe. This is a cooperative, non-profit professional organization which was formed in Europe in 1990. The Group was established to bring together leading academic researchers and investment professionals interested in understanding and developing quantitative solutions to financial and investment problems.

The Fund's CIS (Chief Investment Strategist), Tomas Franzén, chairs the international EDHEC-Risk Institute, a research council that forms part of the world's leading centres for risk research in the field of financial management. An active interchange of expertise and ideas with the financial industry is essential in ensuring that researchers are able to conduct relevant research.

Eva Halvarsson is Vice Chair of the board of Gothenburg University, as well as a member of the advisory board of the School of Business, Economics and Law and GU Holding.

Staff statistics

	2014	2013
No. of permanent staff	63	59
Female staff, %	38	37
Female staff in executive management, %	29	29
Average age, years	43	43
Median age, years	44	43
Personnel turnover, %	1.7	8.3
Absence due to illness, %	1.08	2.47



Income statement

Amounts in SEK million	Note	January–December 2014	January–December 2013
Operating income			
Net interest income	1	2 948	3 428
Dividends received		4 747	3 317
Net result, listed equities and participations	2	10 437	24 753
Net result, non-listed equities and participations	3	3 081	3 679
Net result, fixed-income assets		2 916	-1 913
Net result, derivative instruments		577	-278
Net result, exchange gain/loss		10 090	-2 425
Commission expenses, net	4	-286	-245
Total operating income		34 510	30 316
Operating expenses			
Personnel expenses	5	-118	-112
Other administration expenses	6	–77	-66
Total operating expenses		-195	-178
NET RESULT FOR THE YEAR		34 315	30 138

Balance sheet

Amounts in SEK million	Note	December 31, 2014	December 31, 2013
ASSETS			
Equities and participations			
Listed	7	147 040	129 335
Non-listed	8	39 782	30 508
Bonds and other fixed-income assets	9	109 451	91 279
Derivative instruments	10	2 360	9 631
Cash and bank balances		4 818	2 383
Other assets	11	97	951
Prepaid costs and accrued income	12	1 540	1 656
TOTAL ASSETS		305 088	265 743
FUND CAPITAL AND LIABILITIES			
Liabilities			
Derivative instruments	10	9 728	946
Other liabilities	13	1 378	20
Deferred income and accrued expenses	14	75	65
Total liabilities		11 181	1 031
Fund capital	15		
Fund capital at beginning of year		264 712	241 454
Net payments to the national pension system		- 5 120	-6 880
Net result for the year		34 315	30 138
Total Fund capital		293 907	264 712
TOTAL FUND CAPITAL AND LIABILITIES		305 088	265 743
Pledged assets, contingent liabilities and commitments	16		
Other assets pledged and comparable collateral		10 552	5 075
Commitments		21 725	8 650

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 year 2014 was approved by the Board of Directors on February 17, 2015. 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 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 and IFRS 13 information requirement. Full compliance with the IFRS standard would not essentially affect the reported net result and capital assets. Compared with the current IFRS standard, the only significant difference is that no consolidated financial statements or cash flow analyses have been drawn up. The accounting principles pertaining to the net accounting of unsettled receivables and liabilities, buy-backs and derivative instruments have been adjusted in compliance with IFRS (IAS 32) regulations. These changes only affect items listed under 'Derivative instruments' in the asset and liability sides of the balance sheet. Comparative figures for the preceding year have been recounted. Other accounting and valuation principles remain unchanged compared with the preceding year.

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 non-listed equities, are reported in the balance sheet as per settlement day, in line with generally accepted market practice.

Net accounting

Financial assets and liabilities are net accounted in the balance sheet when there is a legal right of set-off and an intention to effect a net payment or to liquidate the asset and pay the liability simultaneously.

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 non-listed 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 14 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.

Non-listed 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.

The valuation of non-listed participations 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.

The valuation of non-listed real-estate equities is based on the material value method, in as far as the equity has not been the subject of transactions on a resale market. In 2013, a method for the valuation of holdings in non-listed real-estate companies was developed to secure a correct valuation of fair value. Consequently, as of 2013, deferred tax liabilities have been determined at the value applied to the actual property transactions, as distinct from the value reported in the accounts of the real-estate companies. This change in the method applied to the calculation of fair value affects the net result as of 2013, see Note Net result, non-listed equities and participations.

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 balancesheet date are reported as investment assets, while transactions with a negative market value are reported as liabilities. The difference arising between the forward rate and the spot rate on exchange forwards is straight-line accounted over the term of the forward contract, and is reported as interest.

Buy-backs

In a true buy-back transaction, also known as a repurchase agreement, the asset sold is still reported in the balance sheet and the payment received is reported as a liability. The sold security is reported as a

pledged asset among memorandum items in the balance sheet. The difference between spot payment and forward rate is accrual accounted over the term and reported as interest.

Securities lending

Securities on loan are reported in the balance sheet at their fair value, while premiums received are reported as interest income in the income statement. Collateral received for securities lent consists of securities and/or 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 expenses 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 profitsharing is applied, is reported as a deductible item under net result per asset class in the income statement.

Management fees paid for non-listed equities and participations, 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 custodial 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 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

Amounts in SEK million	JanDec. 2014	JanDec. 2013
Interest income		
Bonds and other		
fixed-income securities	2 564	2 248
Derivative instruments	568	4 458
Other interest income	70	89
Total interest income	3 202	6 795
Interest expenses		
Derivative instruments	-238	-3 318
Other interest expenses	-16	-49
Total interest expenses	-254	-3 367
Net interest income/expense	2 948	3 428

Net result, listed equities and par	ticipations	
Amounts in SEK million	Jan.–Dec. 2014	Jan.–Dec. 2013
Net result, listed equities and participations	10 535	24 823
less brokerage commission	-98	-70
Net result, listed equities and participations	10 437	24 753

Net result, non-listed equities and	l participations	
Amounts in SEK million	JanDec. 2014	JanDec. 2013
Capital gains, net	876	565
Unrealized changes in value*	2 205	3 114
Net result, non-listed equities and participations	3 081	3 679

* Unrealized changes in value include refunded management fees amounting to SFK 221 (138) million.

A method for appraising the value of holdings in non-listed real-estate companies was implemented in 2013 with a view to securing an estimate of their fair value. See the Fund's accounting and valuation principles page 54. This adjusted method for calculating fair value has affected the net result for the year in an amount of SEK 328 (969) million. The impact on the net result is primarily attributable to the Fund's interest in Vasakronan.

Commission expenses net		
Amounts in SEK million	Jan.–Dec. 2014	JanDec. 2013
External portfolio management fees, listed assets	262	226
External portfolio management fees, non-listed assets	5	4
Other commission expenses including custodial expenses	19	15
Total commission expenses	286	245

Commission expenses do not include performance-based expenses. During the year performance-based expenses amounted to SEK 88 (74) million and reduced the net gain for respective asset classes. External portfolio management fees for non-listed assets are reported under commission expenses in so far as the contracts do not permit repayment prior to profit sharing in conjunction with future

During 2014 a total of SEK 177 (161) million has been paid in management fees for non-listed assets. Of these SEK 172 (157) 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, 2014, SEK million

Mandate		Benchmark index	Average capital under management 2014	Market value December 31 2014*	% of Fund capital	External management expense
External discretionary	v mandates					3
Equity mandates	, manuates					
Active management						
MFS	Global equities	MSCI World	7 678	5 498		
APS	Chinese equities	MSCI China A	713	998		
Cephei	Chinese equities	MSCI China A	692	1 051		
Total			9 083	7 547	3	44
Fixed-income mandates						
Active management						
Rogge	Global credit mandate	Barclays Global Credit	6 360	13 589		
Pimco	Global credit mandate	Barclays Global Credit	7 005	_		
Standish	Global credit mandate	Barclays Global Credit	7 709	8 780		
Total			21 074	22 369	8	40
Total external discretion	onary mandates		30 157	29 916	11	84
	-					
Investments in listed	external funds					
Equity funds		as per respective fund	8 259	9 892		
Fixed-income funds		as per respective fund	24 561	25 145		
GTAA funds		as per respective fund	1 354	1 409		
Total investments in l	isted external funds		34 174	36 446	12	178
Investments in non-list	ted private equity funds, farmland	d and timberland	12 925	15 063	_	
			12 323	15 005	5	5
	TS UNDER EXTERNAL MANAGEN	1ENT				
TOTAL CAPITAL ASSET AND MANAGEMENT E		1ENT	77 256	81 425	28	267
AND MANAGEMENT E	exPENSES at mandates		77 256	81 425		
AND MANAGEMENT E In-house managemen Listed equities and parti	et mandates cipations	MENT SBX, SEW, CSRX, MSCI Wor	77 256			
In-house managemen Listed equities and parti Fixed-income mandates	et mandates icipations		77 256	81 425 121 999 60 867		
In-house managemen Listed equities and parti Fixed-income mandates Cash and bank balances	et mandates icipations	SBX, SEW, CSRX, MSCI Wor	77 256	81 425		
	expenses It mandates Icipations Is sociated companies,	SBX, SEW, CSRX, MSCI Wor	77 256	81 425 121 999 60 867		
In-house managemen Listed equities and parti Fixed-income mandates Cash and bank balances Non-listed equities in as	expenses It mandates Icipations Is associated companies, debentures	SBX, SEW, CSRX, MSCI Wor	77 256	81 425 121 999 60 867 -791		
In-house managemen Listed equities and parti Fixed-income mandates Cash and bank balances Non-listed equities in as including subordinated of	expenses It mandates Icipations Is associated companies, debentures	SBX, SEW, CSRX, MSCI Wor	77 256	81 425 121 999 60 867 -791		
In-house managemen Listed equities and parti Fixed-income mandates Cash and bank balances Non-listed equities in as including subordinated of	expenses It mandates Icipations Is associated companies, debentures ITS UNDER IN-HOUSE	SBX, SEW, CSRX, MSCI Wor	77 256	81 425 121 999 60 867 -791 30 407	28	

 $^{{\}color{red}^{*}} \ {\color{blue} Market value including allocated liquidity, derivative instruments and accrued interest.} \\$

		2014			2013	
Number of employees	Total	Men	Women	Total	Men	Women
Average number of employees	62	38	24	60	38	22
Number of employees, December 31*	63	39	24	59	37	22
Number of persons in Executive Management Group, December 31	7	5	2	7	5	2

* At year-end 2014, the Fund had 63 employees.

				costs incl.	
Personnel costs in SEK k, 2014	Salaries and remuneration	Variable remuneration	Pension costs	special employer's contribution	Total
·					
Chair of the Board	115			37	152
CEO	3 211	_	1 356	1 359	5 926
Board of Directors, excluding Chair	479			150	629
Executive Management Group, excl. CEO					
Chief Investment Officer (CIO)	2 727	_	818	1 076	4 621
Head of IT, Business Control & Accounts	1 494	_	568	617	2 679
Chief Investment Strategist (CIS)	2 218	_	795	904	3 917
General Counsel	2 095	-	615	825	3 535
Head of Communication & HR	1 570	_	694	697	2 961
Head of Performance & Risk Management	1 553	-	520	614	2 687
Other employees	44 403	5 344	18 368	19 657	87 772
Total	59 865	5 344	23 734	25 936	114 879
Other personnel costs					3 012
Total personnel costs					117 891

				Social costs incl.	
	Salaries and	Variable		special employer's	
Personnel costs in SEK k, 2013	remuneration	remuneration	Pension costs	contribution	Total
Chair of the Board	104	_	_	34	138
CEO	3 083	_	1 233	1 288	5 604
Board of Directors, excluding Chair	609	-	-	191	800
Executive Management Group, excl. CEO					
Chief Investment Officer (CIO)	2 769	_	781	1 080	4 630
Head of IT, Business Control & Accounts	1 422	_	643	616	2 681
Chief Investment Strategist (CIS)	2 156	_	792	888	3 836
General Counsel	2 039	_	612	807	3 458
Head of Communication & HR	1 572	_	694	697	2 963
Head of Performance & Risk Management	1 516	-	480	593	2 589
Other employees	43 298	4 466	16 007	18 624	82 395
Total	58 568	4 466	21 242	24 818	109 094
Other personnel costs					3 283
Total personnel costs					112 377

Board of Directors

Fees and other remuneration 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. The Swedish Government has determined that remuneration totalling SEK 100 000 may be paid for committee work carried out by board members. No remuneration has been paid to board members for their work on the Remuneration Committee. Work on the Risk Committee is remunerated as follows: SEK 30 000 to the Chair and SEK 25 000 to the other directors. Work on the Audit Committee is remunerated as follows: SEK 20 000 to the Chair and SEK 15 000 to the other directors.

Other directorships held by Members of the Board

See page 74.

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 30 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 sixmonth period of notice, less income from an eventual new appointment.

Social

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 67 (66) k.

Executive Management Group

In addition to salaries, other remuneration and pension contributions, the Executive Management Group has received benefits as per the following disclosure: Chief Invest-ment Officer (CIO), SEK 66 (66) k; Head of IT, Business Control & Accounts, SEK 30 (44) k; Chief Investment Strategist (CIS), SEK 45 (58) k; General Counsel, SEK 55 (58) k; Head of Communication & HR, SEK 62 (61) k and Head of Performance & Risk Management, SEK 1 (1) 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 eighten months' severance pay for senior executives. Two 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 swar

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 Swedish Government guidelines. In 2014, the Second AP Fund's incentive programme comprised all staff apart from the CEO and other members of the Executive Management Group. 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 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 remuneration paid to the Board of Directors is determined by the Swedish Government. The Board determines the CEO's salary and the guidelines applied in remunerating the Fund's senior executives.

Government guidelines

For more than a decade, the Second AP Fund has participated in the 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 2014, 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, the Riksbank (Swedish Central Bank) and Kammarkollegiet (Swedish Legal, Financial and Administrative Services Agency). 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 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. Nevertheless, the combined costs incurred in connection with a dismissal are well within the limits defined in the Swedish Government guidelines. More information at www.ap2.se

Other

To comply with GRI (Global Reporting Initiative) regulations, companies shall report the degree to which trade unions are free to operate and whether there are any employees of less than 18 years of age. In compliance with Swedish legislation, trade unions are free to operate at the Second AP Fund. The Fund has no employees under the age of 18.

Other administrative expense

Amounts in SEK million	JanDec. 2014	JanDec. 2013
Rental expenses	5	5
Information and IT expenses	46	38
Purchased services	14	10
Other expenses	12	13
Total other administrative expenses	77	66
Fees to auditors		
Audit assignments		
EY	0.60	0.72
Accounting activities in addition to audit assignments		
EY	0.14	0.09
Total remuneration to EY	0.74	0.81

Equities and participations, listed

Amounts in SEK million	December 31 2014	December 31 2013
Swedish equities	30 992	31 236
Foreign equities	104 746	89 852
Participations in foreign funds*	11 302	8 247
Total listed equities and participations	147 040	129 335
* of which participations in mixed funds	1 409	1 259

Like others engaged in long-term asset management, the Second AP Fund is also active in securities lending. This lending concerns foreign equities and is to counterparties that have high credit ratings and that provide guarantees corresponding to about 105 percent of the market value of the pledged securities. Both the administration and management of the guarantees secured for the loans has been transferred from the Fund's custodial bank to an external party during 2013, as part of a strategy to transform the Fund's securities lending activities into a more active business area.

In 2014, total income from pledged securities amounted to SEK 33 million. This income made a positive contribution to the Fund's relative return and is reported as interest income in the income statement. The guarantees secured for securities on loan are reported in Note 16.

The 20 largest Swedish and foreign shareholdings, by value, are listed on pages 67–69.

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

Equities and participations, non-listed

Amounts in SEK million	December 31 2014	December 31 2013
Equities in Swedish associated companies	14 791	13 682
Equities in foreign associated companies	8 565	4 872
Equities in other non-listed Swedish companies	9	10
Equities in other non-listed foreign companies	16 417	11 944
Total non-listed equities and participations	39 782	30 508

Cont. Note 8								
Amounts in SEK million	Corp. Reg.	Registered office	No. of equities	Participation right capital/votes, %	Dec 31 2014 Fair value	Dec 31 2013 Fair value	Equity	Result
Swedish equities and participations, associated and subsidiary companies								
Cityhold Property AB	556845-8631	Stockholm	4 105 066	50	2 130	1 406	2 789*	517*
NS Holding AB	556594-3999	Sundsvall	1 819 884	50	5 712	5 266	7 022*	-89*
Vasakronan Holding AB	556650-4196	Stockholm	1 000 000	25	6 949	7 010	23 094**	1 797**
Foreign equities and participa- tions, associated and subsidiary companies								
U.S. Office Holdings L.P.		New York, USA		41	3 910	2 785		
U.S. Core Office APTWO L.P. ***		New York, USA		99	697	-		
TIAA-CREF Global Agriculture LLC		New York, USA		23	3 530	2 087		
TIAA-CREF Global Agriculture II LLC		New York, USA		54	428	_		

^{*} Refers to figures published as per December 31, 2013.

** Refers to figures published as per December 31, 2014.

*** Holding companies with a 42-percent participation in US Core Office Holding L.P. and minority participations in other properties, in partnership with NPS and Tishman Speyer.

Amounts in SEK million	Registered office	Capital participation, %	Dec 31 2014 Acquisition value	Dec 31 2013 Acquisition value
Other non-listed Swedish equities and participations				
EQT Northern Europe KB	Stockholm	1	56	63
Swedstart Life Science KB	Stockholm	5	7	10
Swedstart Tech KB	Stockholm	3	7	8
Five largest holdings in other non-listed foreign equities and participations				
Pathway Private Equity Fund IXB	USA	99	1 031	1 158
Pathway Private Equity Fund IXC	USA	99	906	755
Teays River Investments LLC	USA	11	650	650
Pathway Private Equity Fund IX	USA	99	567	634
Nordic Capital VII	Jersey	1	380	376

See Note 3 regarding changed method in 2013 for calculating fair value for non-listed real-estate companies. A complete list of Swedish and foreign non-listed shareholdings is available on the Fund's website at www.ap2.se

	December 31 2014	December 31 2013
Amounts in SEK million	Fair value	Fair value
Swedish State	10 123	10 208
Swedish municipalities	96	40
Swedish mortgage institutions	18 039	19 251
Other Swedish issuers		
Financial companies	10 520	11 618
Non-financial companies	3 680	3 012
Foreign states	9 297	5 059
Other foreign issuers	57 694	40 673
Deposits	2	1 418
Total	109 451	91 279
Other bonds	80 654	68 620
Non-listed loans	3 681	3 000
Participations in foreign fixed-income funds	25 114	18 241
Deposits	2	1 418
Total	109 451	91 279

	De	cember 31 2014		De	cember 31 2013	
Amounts in SEK million	Nominal amount*	Fair value, positive	Fair value negative	Nominal amount*	Fair value, positive	Fair value negative
Equities-linked instruments						
Options, held	61	57	_	3	3	_
Options, pledged	60	_	85	3	_	13
Forward contracts	15	12	96	6	119	10
Other instruments	-	_	_	6 423	7 027	_
Total	136	69	181	6 435	7 149	23
of which cleared	136			12		
Fixed income-linked instruments						
Options, held	-	_	_	106	29	11
Options, pledged	-	_	-	213	16	27
FRA/futures	90 635	66	63	122 023	83	57
Swaps	1 000	1	17	1 000	76	-
Total	91 635	67	80	123 342	204	95
of which cleared	90 626			122 333		
Currency-linked instruments						
Options, held	6 330	57	_	6 590	9	_
Options, pledged	28 527	_	97	6 239	_	5
Futures	218 393	2 167	9 370	176 766	2 269	823
Total	253 250	2 224	9 467	189 595	2 278	828
of which cleared	-			-		
Total derivative instruments	345 021	2 360	9 728	319 372	9 631	946

^{*} Nominal amount 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.

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, the Fund is always required to meet the commitments specified in the options contract, i.e. once the Fund has 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 special delivery requirements.

Use of derivative instruments

Derivative instruments are the primary means of hedging the Fund's portfolios. They also contribute to more efficient portfolio 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 2014, derivative instruments have principally been utilized in the following areas:

- Foreign exchange derivatives forward contracts and options for managing the Fund's FX exposure.
- Equity derivatives mainly standardized equity-index forward contracts for efficient rebalancing of the portfolio and when adopting positions in tactical asset allocation.

- Interest derivatives mostly standardized interest forwards and interest-rate swaps – for rebalancing, tactical asset allocation and managing the Fund's interest risk. Limited utilization of interest options to position the Fund in respect of interest risk.
- Structured derivatives not strictly exposed to a single asset class such as dividend forwards. These derivatives are utilized to generate relative return.
- The adopting of positions within the framework of the Fund's GTAA mandates, as well as alternative risk premiums 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 2014	Dec. 31 2013
Incoming payments, unsettled transactions	92	947
Other receivables	5	4
Total	97	951

Amounts in SEK million	Dec. 31 2014	Dec. 31 2013
Interest income accrued	1 338	1 496
Dividends accrued	121	77
Restitutions	63	56
Other prepaid expenses and accrued income	18	27
Total	1 540	1 656

Amounts in SEK million	Dec. 31 2014	Dec. 31 2013
Outgoing payments, unsettled transactions	1 361	5
Accounts payable	7	7
Other liabilities	10	8
Total	1 378	20

Amounts in SEK million	Dec. 31 2014	Dec. 31 2013
Accrued external management fees	14	19
Accrued interest expenses on currency forwards	34	20
Other accrued expenses	27	26
Total	75	65

Amounts in SEK million	Dec. 31 2014	Dec. 31 2013
Opening Fund capital	264 712	241 454
Net inflows to the national pension system		
Pension contributions received	58 880	56 839
Pension disbursements to the Swedish Pensions Agency	-63 775	-63 490
Transfer of pension entitlements to EC	-2	-2
Adjustment of pension entitlements re. previous years	1	3
Administration contribution to the Swedish Pensions Agency	-224	-230
Total payments to the national pension system, net	-5 120	-6 880
Net result for the year	34 315	30 138
Closing Fund capital	293 907	264 712

Amounts in SEK million	Dec. 31 2014	Dec. 31 2013
Other pledged assets and comparable collateral		
Securities on loan for which guarantees have been secured in the form of securities and cash*	9 724	4 747
Securities pledged in connection with exchange-cleared derivatives	828	328
Commitments		
Commitments regarding future payments, non-listed holdings	17 211	8 650
Subscription commitments, certificates	4 500	_
Underwriting commitment guarantee	14	_

^{*} Guarantees secured for securities on loan: SEK 10 413 (5 061) million.

Financial instruments, price and valuation hierarchy

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 exchange forwards 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 2014, 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.

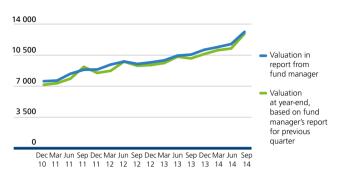
Valuation of Fund capital – Alternative investments

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 non-listed real-estate assets (about ten percent of the total portfolio), private equity funds (almost five percent of the total portfolio) and OTC derivatives.

Private equity funds are appraised in accordance with the IPEV (International Private Equity and Venture Capital Valuation) Guidelines or equivalent valuation principles and shall first and foremost be based on transactions with third parties, although other valuation methods may be used. In calculating fair market values, private equity funds rely mainly on discounted cash flows, the material value method and multiple valuation. Valuation of holdings is based on the most recent interim reports published by individual private equity funds. Interim

Cont. Note 17

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 report submitted by managers of private equity funds.

reports are normally available within 90 days of the last quarterly financial statement. This means that Fund holdings valued at year-end 2014 were based mainly on an appraisal of private equity funds made on September 30, 2014, 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 December 2010 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 2014 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 could be sold or a debt settled by means of an orderly transaction between market players on the valuation date. 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.

Fair value hierarchy, SEK m

	December 31 2014			
	Level 1	Level 2	Level 3	Total fair value
Equities and participations, listed	135 714	11 302	24	147 040
Equities and participations, non-listed	_	_	39 782	39 782
Bonds and other fixed-income assets	80 594	25 537	3 320	109 451
Derivative assets	218	2 142	-	2 360
Derivative liabilities	-332	-9 396	-	-9 728
Financial assets and liabili-	216 194	29 585	43 126	288 905*

	December 31 2013			
	Level 1	Level 2	Level 3	Total fair value
Equities and participations, listed	123 747	5 534	54	129 335
Equities and participations, non-listed	_	_	30 508	30 508
Bonds and other fixed-income assets	80 941	7 333	3 005	91 279
Derivative assets	202	9 429	_	9 631
Derivative liabilities	-59	-887	_	-946
Financial assets and liabilities, valued at fair value	204 831	21 409	33 567	259 807*

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

- **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 nonlisted real estate, where the appraisal is not based on observable market data.

Change during 2014 in Level 3, SEK million

	Equities and participations, listed	Equities and participations, non-listed	Bonds and other fixed-income assets	Total
Value brought forward, January 2014	54	30 508	3 005	33 567
Purchases	_	1 799	310	2 109
Divestments	_	-	-	-
Changes in value	–31	7 476	5	7 450
Reclassifications	_	_	_	_
Total	23	39 783	3 320	43 126

100 percent of the changes in value are unrealized as per year-end.

Change during 2013 in Level 3, SEK million

	Equities and participations, listed	Equities and participations, non-listed	Bonds and other fixed-income assets	Total
Value brought forward, January 2013	46	25 412	3 781	29 239
Purchases	10	2 119	5	2 134
Divestments	-4	-2	-781	-787
Changes in value	2	2 979	_	2 981
Reclassifications	_	_	_	_
Total	54	30 508	3 005	33 567

100 percent of the changes in value are unrealized as per year-end.

Sensitivity analysis, non-listed assets

Farmland and timberland investments

Growth in the value of farmland and timberland investments is largely determined by the demand for forest-and-agricultural raw materials. The value of forestand-agricultural land can nevertheless vary considerably within the same region, as can the correlation with raw material prices. The operational focus of the agricultural asset, the quality of the land, the size of the property's forest assets, the long-term felling plan, the infrastructure, topography and various macroeconomic factors are all parameters that have a significant impact on the

In the long run, the value of forest-and-agricultural land is mainly determined by the anticipated income it can generate, combined with the effect of interest levels. The value of forest-and-agricultural land tends to rise when interest rates are low and raw material prices are high. Conversely, the value of land tends to fall as interest rates rise, a consequence of the discounting of anticipated future income from cultivation of the land. Higher interest rates lead to a decline in the price of forest and agricultural products, which means reduced revenues for operators and, eventually, a reduction in the value of the land. This said, however, the grain price needs to fall fairly dramatically over an extended period to have any really significant effect on land values.

Private equity funds

The valuations of the individual companies in the portfolio of a private equity fund are determined largely by the following factors:

- profit growth in the company, improved sales and EBITDA
- multiple expansion, improved margins
- reduced debt
- increased market shares, development of products and services (geographic expansion, technical advances, unique/new range of products/services).

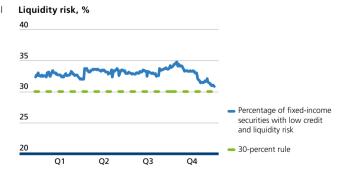
The guidelines pertaining to the valuation of fair value for this type of investment feature valuation models which in many cases are linked to market-listed companies in relevant benchmark groups. Consequently, the valuation of these portfolio companies is affected by the publicly-traded market, but not to the same extent, and always with a three-month shift in time. In the Second AP Fund's experience, most fund managers generally adopt a conservative approach in their valuations, something that is especially apparent in markets that feature rapid and sharp rises in share prices.

Conventional real estate

Although many different factors can affect the performance and financial status of real estate companies, the growth in the value of the companies' real-estate portfolios constitutes the greatest risk and has the greatest impact on their net result. The market value of real estate is affected by changed assumptions in rental and vacancy levels, as well as operating costs and dividend yield requirements. The assumptions made when making these valuations are based on the economic health of the markets where these properties are located. Economic growth is assumed to generate increased demand for commercial premises, thereby causing a decline in vacant leases and creating opportunities to increase market rents. The single most important factor is the dividend yield requirement. Concerning the Second AP Fund's holdings in conventional real-estate companies, the combined effect on the Fund's share in profits of a planned change in the direct yield requirement of +/- 0.25 percent on companies' reported pre-tax results is estimated at SEK -1.3 billion and SEK +1.3 billion respectively.

The liquidity risk is limited, among other things, by the 30-percent rule (external investment regulations for the First to Fourth AP funds, which specify that a minimum 30 percent of the funds' total capital shall be invested in securities with a low credit and liquidity risk) and that no more than five percent of the Fund's total assets may be invested in private equity funds. During 2014, the Fund's share of securities with a low credit and liquidity risk was around 31–35 percent. The liquidity risk on the liability side is very limited, consisting of derivative liabilities.

For further risk data, see 'Stable risk in a changeable world', page 39.



Cont. Not 18

Financial assets and liabilities net accounted in balance sheet or subject to right of set-off

Amount not net-accounted Net-accounted Set-off of financial Total in balance amount in Net amount in instruments per Guarantees Net amount post offset Dec. 31, 2014 Gross amount balance sheet balance sheet agreement received Other* sheet **ASSETS** Derivatives 2 225 2 2 2 5 -777 1 448 135 2 360 Total 2 225 2 225 -777 1 448 135 2 360 LIABILITIES Derivatives 9 484 9 484 -777 8 707 244 9 728 Total 9 484 9 484 -777 8 707 244 9 728

Amount not net-accounted in balance sheet Net-accounted Set-off of financial Net amount in instruments per Guarantees Net amount Total in balance amount in Dec. 31, 2013 Gross amount balance sheet balance sheet agreement post offset Other* received sheet **ASSETS** Derivatives 2 354 2 354 -806 1 548 7 277 9 631 Total 2 354 2 354 -806 1 548 7 277 9 631 LIABILITIES Derivatives 828 828 -806 22 118 946 Total 828 828 -806 22 118 946

The administration report, income statement, balance sheet and notes for 2014 have been approved by the Board of Directors.

Gothenburg, February 17, 2015

Marie S. Arwidson
Chair

Sven Björkman
Vice Chair

Ola Alfredsson

Jeanette Hauff

Ole Settergren

Johnny Capor

Lenita Granlund

Ulrika Boëthius

Christer Käck

Our audit report was submitted on February 17, 2015

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

^{*} Other instruments in the balance sheet that are not subject to right of set-off.

Auditors' report

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 2014. The annual accounts of the company are included in the printed version of this document on pages 29-65.

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 the 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 Fund Act and present fairly, in all material respects, the financial position of the Second Swedish National Pension Fund as of

December 31, 2014 and of its financial performance for the year then ended in accordance with the Swedish National Pension Fund Act. The administration report is consistent with the other parts of the annual accounts.

We therefore recommend the income statement and balance sheet to be

Report on other legal and regulatory requirements

In addition to our audit of the annual accounts, we have examined the inventory of assets managed by the Second Swedish National Pension Fund. We have also reviewed whether there is any qualification otherwise regarding the Board of Directors' and the Managing Director's administration of the Second Swedish National Pension Fund for the year 2014.

Responsibilities of the Board of Directors and the Managing Director

The Board of Directors and the Managing Director are responsible for the accounting documents and administration of the Second Swedish National Pension Fund's assets in accordance with the Swedish National Pension Funds Act.

Auditor's responsibility

Our responsibility is to express an opinion with reasonable assurance on the results of the audit of the assets that are managed by the Second Swedish National Pension Fund, and on the administration on the basis of our audit. We conducted the audit in accordance with generally accepted auditing standards in Sweden.

As a basis for our opinion concerning the inventory of assets we examined the fund's inventory and a selection of supporting evidence.

As a basis for our opinion concerning the administration in general, in addition to our audit of the annual accounts, we have 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 has acted in contravention of the Swedish National Pension Fund Act.

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

The audit has given us no reason to qualify our opinion on the inventory of the assets or any other aspects of administration.

Gothenburg February 17, 2015

Jan Birgerson Authorized Public Accountant Appointed by the Swedish Government

Peter Strandh Authorized Public Accountant Appointed by the Swedish 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
Alfa Laval	0.84	3 519 179	522	0.84	Industrials
Assa Abloy B	0.55	2 036 673	845	0.37	Industrials
Atlas Copco A	0.34	4 211 040	920	0.48	Industrials
Atlas Copco B	0.19	2 288 208	460	0.03	Industrials
Ericsson (LM) B	0.35	11 656 244	1 100	0.21	IT
Getinge B	1.04	2 479 821	441	0.65	Healthcare
Hennes & Mauritz B	0.42	6 931 609	2 257	0.20	Consumer discretionary
Hexagon B	1.11	3 970 705	961	0.80	IT
Investor A	0.01	41 787	12	0.01	Financials
Investor B	0.67	5 150 662	1 466	0.14	Financials
Nordea Bank	0.57	23 247 245	2 113	0.57	Financials
Sandvik	0.45	5 702 734	436	0.45	Industrials
SCA SV Cellulosa A	0.03	230 663	39	0.16	Consumer discretionary
SCA SV Cellulosa B	0.60	4 219 515	713	0.29	Consumer discretionary
SEB A	0.78	17 134 058	1 706	0.79	Financials
SKF B	0.93	4 233 260	698	0.53	Industrials
Swedbank A	0.76	8 624 172	1 686	0.76	Financials
Swedish Match	1.94	3 897 481	954	1.94	Consumer discretionary
Svenska Handelsbanken A	0.22	1 416 247	519	0.23	Financials
TELE2 B	1.99	8 950 528	850	1.42	Telecoms
TeliaSonera	0.39	17 008 045	857	0.39	Telecoms
Unibet	5.46	1 545 473	761	5.46	Consumer discretionary
Volvo A	0.05	1 039 901	89	0.15	Industrials
Volvo B	0.58	12 268 675	1 039	0.18	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
Investec Emerging Markets Investment Grade Debt	39 732 790	5 421
Ashmore SICAV Emerg Mark Investm Grade Local Curr	7 002 052	4 290
Genesis Emerging Markets Class A	5 475 561	2 369
Babson Capital	2 742 428	2 152
Generation Im Global Equity Fund Class I 20071201	1 001 932	2 113
Ares Strategic Investment Partners IV	250 000 000	2 095
Wellington Emerging Local Debt	25 439 858	1 966
Generation Im Global Equity A Shares LTA20 090401	889 517	1 847
GAM FCM Cat Bond Inst Initial Series	1 480 389	1 595
AQR Merger Arbitrage fund	1 952 820	1 577
BNY Mellon Emerg Mark Local Curr Invest Grade Debt	204 765 250	1 384
Bridgewater GTAA Fond	75 115	1 345
Stone Harb Invest Grade Emerg Mark Local Curr Debt	2 015 621	1 330
GAM FCM Cat Bond 2014 series 12	1 300 000	1 018
CVC Credit Partners	1 000 000	989
AQR Emerging Equities Fund L.P.	1 070 000	897
GAM FCM Cat Bond 2014 series 6	1 000 000	807
Generation Im Global Equity Fund Class I 20090401	288 519	614
GSO Global Dynamic Credit Feeder Fund Ireland A	751 088	590
AQR Opportunistic Convertible Arbitrage Offshore Fund	726 485	561
Generation Im Asia Fund	483 698	475
Elementum Zephyrus Total Return Cat Bond	50 000	392
M&G Lion Credt Opp Fund XIV – Series 1 Share Class	39 000	363
GAM FCM Cat Bond 2014 series 11	200 000	157
Bridgewater GTAA Fond Major Market 1100-031	5 655	64
State Street Short Liquidity Fund	383 470	2
GAM FCM Cat Bond 2014 series 10	1 984	2
GAM FCM Cat Bond 2014 series 7	733	1
GAM FCM Cat Bond Inc. Institutional 2014 series 1	715	1

The Second AP Fund's 20 largest foreign shareholdings*

Company name	No. of equities	Market value SEK m	Sector
Samsung Electronics Co Ltd	103 415	977	IT
Taiwan Semiconductor Manufacturing Co Ltd	22 718 000	793	IT
AstraZeneca	1 412 732	775	Healthcare
ABB Ltd	3 848 113	638	Industrials
China Mobile	6 070 000	555	Telecoms
Nestlé	949 807	551	Consumer discretionary
Johnson & Johnson	624 165	511	Healthcare
Tencent Holdings Ltd	4 496 800	511	IT
Proctor & Gamble	639 288	456	Consumer discretionary
China Construction Bank	69 387 000	446	Financials
Industrial and Commercial Bank of China	72 781 000	416	Financials
Exxon Mobil Corp	571 400	414	Energy
McDonald's Corp	540 897	397	Consumer discretionary
Duke Energy Holding	588 900	385	Commodities
Pepsico	495 500	367	Consumer discretionary
Naspers Ltd	348 014	357	Consumer discretionary
Merck & Co	802 100	357	Healthcare
Bank of China Ltd	80 774 000	356	Financials
Verizon Communications	965 100	353	Telecoms
Novartis	473 958	347	Healthcare

^{*} 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

c 1: 1			c. 1	
Swedish	nominal	bonds,	five larges	t holdings

Bond	Fair value, SEK m		
Nordea Hypotek AB	3 400		
Swedish Government 1047	3 363		
Stadshypotek AB	2 505		
Skandinaviska Enskilda Banken SEB	2 367		
Swedish Government 1054	2 211		

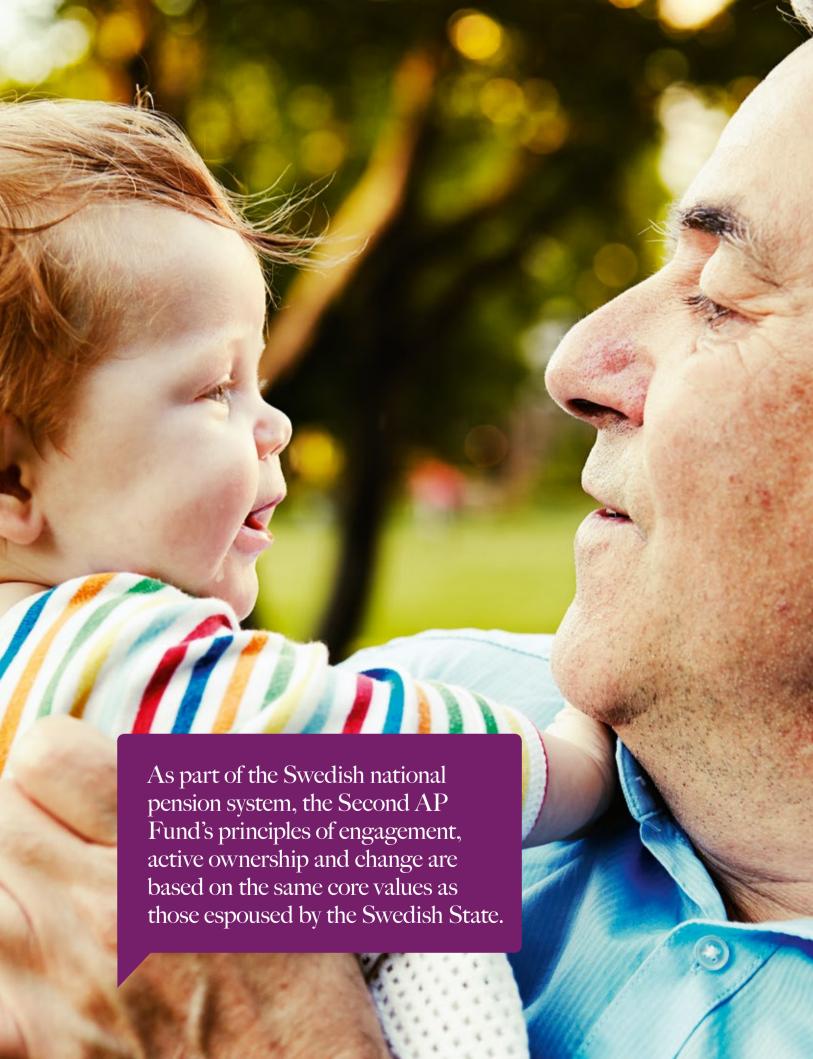
Global credits, five largest holdings

Bond	Fair value, SEK m		
BTPS	298		
European Invt BK EIB 1	251		
European Invt BK EIB 1	250		
European Invt BK EIB 2	243		
European BK Recon & Development	238		

Global credits, five largest holdings

Bond	Fair value, SEK m
Bank of America Corp	182
Verizon Comm Inc	175
BNP Paribas	125
Bank Nova Scotia	119
Rabobank	119

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 sets 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 January 2014, the Swedish Government appointed Christer Käck a new Member of the Board, which had had a vacancy dating from June 2013, when Niklas Johansson left the Board. In May 2014, the Swedish Government decided on a new Board, involving the following changes: Helén Källholm left the Board of Directors and Johnny Capor was appointed a new Member. 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 2014 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. The Swedish Government has determined that payments amounting to SEK 100 000 in total may be made for committee work. No fees have been paid for work conducted by Board Members on the Remuneration Committee. For work on the Risk Committee, remuneration has been paid to the Chairman in an amount of SEK 30 000 and to individual Members in amounts of SEK 25 000. For work on the Audit Committee, remuneration has been paid in an amount of SEK 20 000 to the Chair and in amounts of SEK 15 000 to individual Members.

Board Member	Remuneration Committee	Risk Committee	Audit Committee	Attendance/ total meetings	Comments
Marie S. Arwidson	Х		X	5/6	
Sven Björkman	Х	X		6/6	
Jeanette Hauff		X		6/6	
Ola Alfredsson				4/6	
Ole Settergren				6/6	
Lenita Granlund				4/6	
Ulrika Boëthius				5/6	
Christer Käck				5/6	From January
Johnny Capor			Χ	4/4	From June
Helén Källholm			Χ	1/2	Until May

The work of the Board

The most important tasks assigned to the Board of the Second AP Fund involve the establishment of operational targets, the recruitment and evaluation of the CEO and the taking of decisions concerning broad strategic issues, such as the composition of the Fund's strategic portfolio. To ensure that the Board's decisions are implemented, that intrinsic risks are managed and that the Fund's operations are in all other respects conducted in an appropriate manner, effective control and follow-up are essential. During the year, the Board held six ordinary meetings, one being of greater duration, at which broad strategic issues were addressed, with special emphasis on investment strategy, the Fund's long-term business plan and first and foremost its sustainability programme. 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 4.5 percent over the long term.

Strategic portfolio

A new strategic portfolio has been approved for 2015.

Discussion about performance, governance issues and costs
The Fund's management performance is reviewed at every Board
meeting. The Board regularly discusses fundamental sustainability and
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 committees

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. Swedish government guidelines on terms of employment for AP Fund employees are monitored and checked against the Fund's own guidelines and to ensure their correct implementation. Decisions reached by the Remuneration Committee are submitted for consideration by the Board at its next meeting.

The Board has established 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 comprises two Members of the Board. The items placed before the Committee for consideration are presented by the Fund's CEO and the Head of Performance and Risk 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 limited 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 2014, among other activities, the Risk Committee has reviewed developments concerning the Fund's financial and operative risks, as well as reviewing its alternative investments. The Fund's latest risk status was also presented and discussed at each of these meetings.

The Board has established an Audit Committee. The Audit Committee has been established as an advisory, supervisory and preparatory body for the Board in the areas of financial reporting, auditing, internal control and external auditing. The Audit Committee comprises two

Members of the Board. The items placed before the Committee for consideration are presented by the Fund's CEO, the Head of IT, Business Control and Accounts, and the Chief Financial Officer (CFO), as well as the Fund's auditors.

The Audit 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 limited by the establishment of the Audit Committee or its duties.

The Audit Committee has met three times during 2014, one meeting being held jointly with the Board's Risk Committee for the annual review of the Fund's progress on operative risk. Board Member Johnny Capor took over chairmanship of the Committee in the autumn of 2014. During the year, the work of the Committee has concentrated mainly on reporting from and conducting discussions with the Fund's auditors concerning the focus of the year's audit, the Fund's diversification strategy and the continued increase of investment in non-listed assets, as well as the ongoing work on operative risks.

Audit

The Second AP Fund's auditors are appointed by the Government. The current mandate, which came into effect on May 22 2014, is shared by Jan Birgerson and Peter Strandh from EY. EY 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. This mandate applies until adoption of the Fund's income statement and balance sheet for 2014.

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 and management administration as well as 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 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 at meetings of the Risk Committee and the Board

Board of Directors



Marie S. Arwidson
Chairman since 2010 M.Sc. (Econ).
Formerly Managing Director of the Swedish Forest Industries Federation. Directorship on the board of the Royal Swedish Academy of Engineering Sciences. Born 1951.



Sven Björkman
Vice Chairman since 2009.
Former head of SEB Region Väst. Chairman of
Shepherd of Sweden AB. Born 1949.



Ola Alfredsson

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



Jeanette Hauff
Member of the Board since 2010. L.Econ. Active
at Gothenburg University's School of Business,
Economics and Law, and Skandia. Directorship
on the board of QQM Fund Management AB.
Born 1965.



Ole Settergren

Member of the Board since 2013.

Head of Pensionsmyndighetens utvecklingsavdelning (The Swedish Pensions Agency Development Unit). Born 1964.



Johnny Capor

Member of the Board since 2014. Former Deputy

Managing Director and CFO of KF/Coop. Directorship on the board of Folksam Liv. Born 1966.



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.



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.



Christer Käck

Member of the Board since 2014. Self-employed.

Member of the Investment Advisory Board for the Stockholm County Council Foundations.

Born 1953.

Executive management



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



Ola Eriksson

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



Tomas Franzén

Chief Investment Strategist (CIS). Employed since 2001. Other directorships: Chalmers University of Technology Trust, Finance Committee. Chairman of International Advisory Board, EDHEC Risk Institute. .



Martin Jonasson

General Counsel. Secretary to the Board. Employed since 2001. Other directorships: ETC Battery and FuelCells Sweden AB. Born 1964.



This leadership strategy is regularly assessed are in regularly assessed, providing the basis for the drafting of an individual development plan for each manager.



Hans Fahlin

Chief Investment Officer (CIO). Employed since 2010. Other directorships: AFS Interkulturell Utbildning Sverige; Centre for Finance (CFF) at the School of Business, Economics and Law, Gothenburg University; Polar Music Prize Administrative board and Chairman of the Institute of Quantitative Research Europe (INQUIRE). Born 1957.



Henrik Westergård

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



Ulrika Danielson

Head of Communication & HR. Employed since 2009 Born 1965

Auditors

Jan Birgerson, **Authorized Public** Accountant, EY.

Peter Strandh, **Authorized Public**

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 generate an active return.

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

ALM study

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

Benchmark index

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

Carbon footprint

'Carbon footprint' is the term used to describe a company's/portfolio's combined carbon dioxide emissions.

Credit risk/counterparty risk

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

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

Credit spread

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

Discretionary mandate

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

Duration

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

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 non-listed 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.

Information ratio

A gauge of risk-adjusted relative return. Measured as relative return, divided by 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.

QFII licence

Investors who have been granted a licence to invest in Chinese domestic equities by the Chinese Financial Supervisory Board.

Quantitative management

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

Relative return

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

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.

S&P/Standard & Poor's

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

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

 $\label{thm:continuous} \mbox{Tactical Asset Allocation. An active portfolio management strategy focused on overperformance through in diverse asset classes.}$

Tracking erro

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

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.

Volatility

Volatility refers to the amount the price of a financial asset varies over time. This is normally expressed as a percentage, in terms of the standard deviation.



During the year, we have consistently pursued our long-term strategy for managing a greater part of Fund capital in-house, including parts of the bond portfolio in emerging economies.

Eva Halvarsson, CEO, Second AP Fund.

