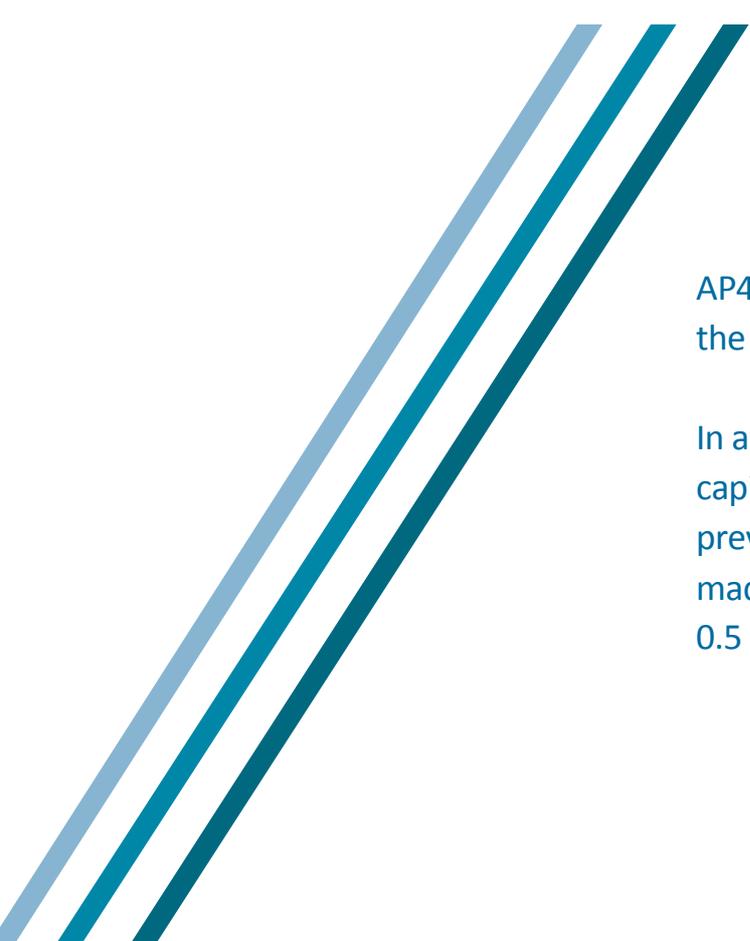


## ANNUAL REPORT 2011



AP4's brief is to manage the Fund's capital for the best possible return over time.

In a weak stock market, in which the fund capital decreased slightly compared to the previous year, the Fund's active management made a positive contribution of close to SEK 0.5 billion.

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## About this annual report

Welcome to the Fourth National Pension Insurance Fund's 2011 annual report, which sums up the past year with a focus on AP4's asset management.

The annual report is an intentionally brief summary of the past year. You can read the 2011 annual report online in its web version. You can also download a PDF version – either the entire document or just the parts you want.

Every entry in the tables in the annual report has been correctly rounded, though they may not always sum to the totals shown.

We wish all readers an informative reading experience.

For further information about the Fund, please visit the AP4 web site at [www.ap4.se](http://www.ap4.se).

For in-depth information about the pension system and automatic balancing of pensions, contact the Swedish Pensions Agency: [www.pensionsmyndigheten.se](http://www.pensionsmyndigheten.se) and [www.minpension.se](http://www.minpension.se).

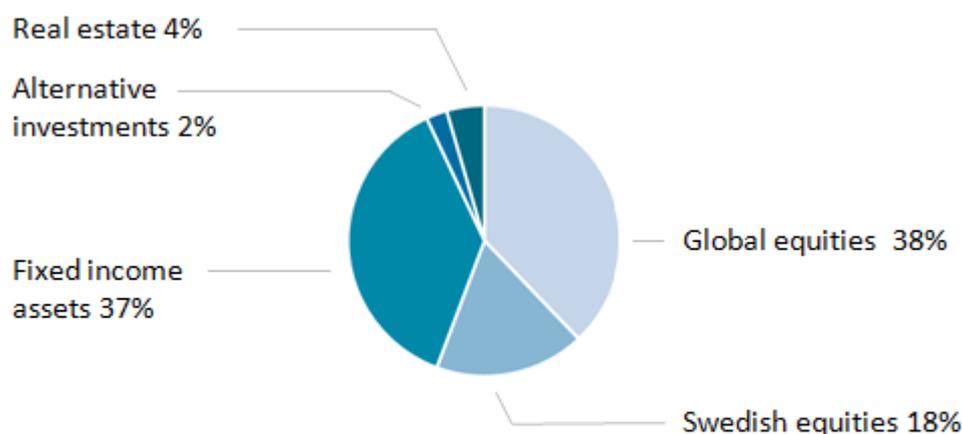
The Swedish Pensions Agency is the government agency for pension issues, and was formed on 1 January 2010, when the Premium Pension Authority (PPM) and the Swedish Social Insurance Agency's units for pensions were combined.

## Key points of 2011

- Fund capital amounted to SEK 210 billion**  
 Fund capital amounted to SEK 210.0 billion (212.8), a decrease of SEK 2.8 billion (+17.1).
- Total return was -0.7%**  
 Total return was -0.7% (11.0) before expenses Total return after expenses was -0.7% (10.9). The total negative return for the year is mainly due to the weak performance of global stock markets.
- Positive active return for the third consecutive year**  
 The active return outperformed the benchmark index by 0.2 percentage points (0.8) before expenses. This corresponds to earnings through active management of just over SEK 0.4 billion (1.4).
- Management expenses remain competitive**  
 The Fund's management expenses were SEK 179 million (176), which equates to an operating expense ratio of 0.084% (0.087). Including commission expenses, the corresponding figure is 0.095% (0.102).
- The Fund's foreign exchange exposure was 25.7% (19.8) at the close of the year**
- The Fund's net outcome for the year totalled SEK -1.6 billion (21.2)**
- The Fund paid out a net amount of SEK 1.2 billion (4.0) to the pension system in 2011**

It is the third consecutive year in which earnings through active management, following the Fund's reorganisation three years ago, have outperformed the benchmark index, thus making a positive contribution to earnings.

### The Fund's investment assets, 31 Dec 2011



AP4's investment assets predominantly consist of listed equities and fixed income corporate bonds. The allocation includes underlying values for various derivatives, which are used to continually maintain the desired asset allocation. The figures above are correctly rounded, and hence do not sum up to 100%.

## AP4 at a glance

AP4's brief is to contribute to the stability of the national pension system through managing Fund capital with the aim of generating the best possible return over time.

### Goals 2011

Based on its brief, AP4 has formulated two overall goals.

- Total return in real terms – that is, adjusted for inflation – shall average 4.5% per year over a 10-year period.  
In real terms 4.5% is, in the opinion of the Fund, the average return required over a 40-year period for the pension system's assets and liabilities to balance in the long run.
- The active return, that is the return in excess of the benchmark index, is to average 0.5 percentage points over a three-year period.

### Operations

The Fund is a governmental authority whose operations are regulated in the Swedish National Pension Funds Act (2000:192). The Government appoints all nine of the Fund's Board members. The Ministry of Finance continually supervises and evaluates the Fund's operations. The Fund shall independently formulate its targets and strategies, and by law the Fund's Board of Directors and operations are not to be controlled by Government directives or by national business or other

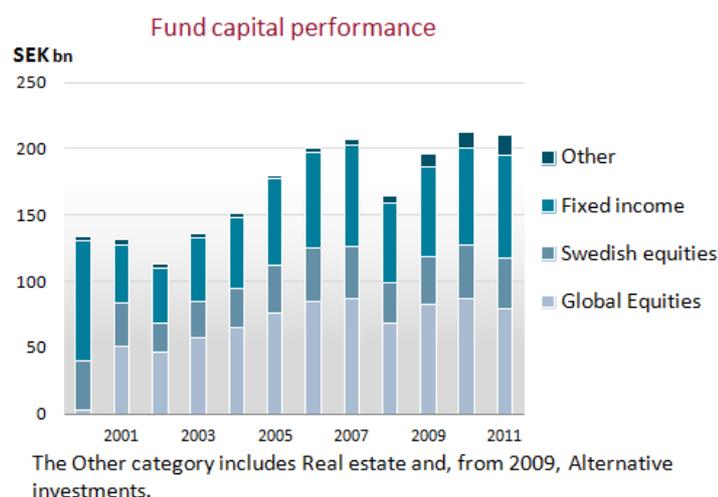
economic policy interests. Environmental and ethical issues must be taken into account without compromising the goal of best possible return

### Fund capital

At year-end 2011, Fund capital totalled SEK 210 billion.

The Board has decided that the Fund will best fulfil its long-term asset management brief by holding a large proportion of publicly quoted equities, Swedish and foreign.

At year-end, equities accounted for 56% of assets. Fixed income securities accounted for 37% of assets. The remaining 7% was invested in other assets such as real estate, private equity funds and other alternative investments.



## Investment policy

The investment rules according to the Swedish National Pension Funds Act include the following:

- The Funds may invest in all listed and transferable instruments except those that are commodity-based.
- At least 30% of the assets must be invested in fixed income securities with low credit and liquidity risk.
- A maximum of 40% of assets may be exposed to currency risk.
- A maximum of 10% of assets may be exposed to a single issuer or group of issuers that are interrelated.
- Holdings of equities issued by listed Swedish companies may not exceed 2% of total market capitalisation.
- A maximum of 10% of the votes may be owned in an individual listed company
- A maximum of 5% of the assets may be placed in unlisted securities. These investments must take place indirectly through venture capital firms or similar.
- Shares and investments in real estate companies may be directly owned.
- At least 10% of the assets must be managed by external asset managers.

# The year in brief

At the end of the year, Fund capital amounted to SEK 210 billion. Total return was negative, just below zero, mainly because of the weak performance of global stock markets.

However, the healthy earnings from active management of almost SEK 0.5 billion were gratifying. This marked the third consecutive year of the Fund posting positive active earnings. Overall, the Fund has made an active earnings contribution of SEK 3.7 billion in three years.

## Total return – just below zero

Total return was negative for the full year and amounted to -0.7% (11.0) before expenses.

The weak value performance of the Fund's assets was largely due to the weak performance of global stock markets during the year. The Fund, which has benefited in previous years from a high proportion of equities and its exposure to the Swedish stock market, was affected negatively by these exposures during the year.

## Uneasy financial markets

2011 was characterised by sharp share price fluctuations on uneasy financial markets. Events in focus were the global economic slowdown, highly indebted governments, ongoing bail-out actions from central banks, and also other events such as the severe earthquake in Japan, the world's third largest economy.

## Positive active earnings – for the third consecutive year

For the third consecutive year, the Fund's active management delivered positive earnings of almost SEK 0.5 billion.

With positive active return of 0.7 percentage points, measured as the average over the last three years, the Fund exceeded its target of 0.5 percentage points in rolling average return over a three-year period with a margin.

The positive active return for the year amounted to just over 0.2 percentage points (0.8). It was gratifying that three out of

five active management areas contributed to earnings. As a whole, active management contributed SEK 0.4 billion (1.4).

## Long-term goal for real return

AP4's real return during the period 2002–2011 averaged 2.5% annually. The Fund thus did not reach the long-term target of 4.5% on average over a 10-year period.

In real return, 4.5% is the average return required over a 40-year period, according to the Fund's analysis, for the pension system's assets and liabilities to balance in the long run.

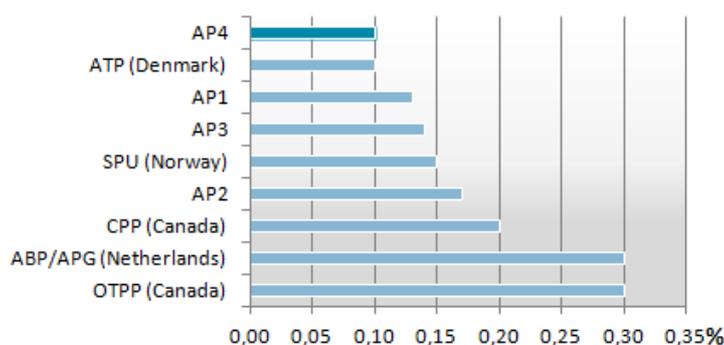
The main reason as to why the goal was not achieved for the past 10-year period is that the Fund suffered from the sharp slump in stock markets globally during the financial crises of 2000–2002 and 2007–2008.

## Competitive operating expenses

Cost-efficiency is very important to the Fund, and alternative ways of working and generating value added are assessed continually.

The management cost, measured as operating expenses divided by average fund capital, equalled 0.084% (0.087). Including commission expenses, such as fees paid to external managers and for custody accounts, the corresponding figure is 0.095% (0.102). The Fund's management cost, with and without commission expenses, is low and competitive in domestic as well as international comparisons.

## Cost comparison between pension fund managers



AP4 has low management expenses in both Swedish and international comparisons. Source: Government paper 2010/11:130, McKinsey. The comparison of expenses is based on information from the 2009/2010 annual reports.

# Letter from the CEO

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## Drama revisited

The aftershocks of the 2007–2008 financial crisis had just about subsided when the time came for fresh drama and new shake-ups on global stock markets.

The financial result for AP4 for the past year was an overall outcome of just below zero. Lurking behind that figure is a year of tremendous market fluctuations and dramatic events reminiscent of the turbulence a few years ago.

After a first half-year which, in the eyes of the stock market – at least with hindsight – could be referred to as "financially stable", the second half of 2011 saw the gradual onset of unease. The problems were not new in any way. The rapidly growing debt crisis in Europe, the US and Japan was primarily in focus. – How can these extraordinarily large debts be slimmed down without jamming the fragile global economy? – At what cost will these highly debt-burdened countries manage to finance themselves?

It has seemed that at times in Europe, the entire currency union has been at stake. In spite of many prolonged meetings at the highest political level, and despite the far-reaching efforts of central banks (including the IMF) and influential governments, a solution has still yet to be found to address the underlying and fundamental problems. This means also that the uncertainty and volatility that characterised financial markets in 2011 look set to persist.

## Promising real estate initiative

In the prevailing circumstances, I consider AP4's overall result for 2011 to be acceptable. In order to meet the stipulated return requirements in the long term, the AP Funds have a very large proportion of their capital allocated to listed equities, and not least Swedish equities. This is particularly the case for AP4. Last year, the world index (calculated in USD) fell by close to 8%, while the index for the Swedish stock market shrank by a hefty 17%.

It should also be noted that the Fund's outcome for 2011 is much better than for 2008, which was the toughest year of the financial crisis. The main reason for this is that stock markets, both globally and in Sweden, fared better last year. Another reason is that during recent years, we have taken measures internally at the Fund to create a more robust portfolio. At the same time, we continue to hone our ability to create value added in asset management. The overall earnings trend is a clear indication that the Fund is on the right track.

Another example of our efforts paying off is the healthy earnings of the real estate initiative. Since 2007, AP4 has increased exposure by SEK 15 billion in this class of asset. The latest addition is the 50%-owned company Rikshem, in which AP4 and AMF have equal ownership holdings. Rikshem is geared towards residential properties and what are known as public service properties (properties with long-term rental contracts where the tenant is often a municipality). The overall earnings of the Fund's real estate investments amounted to an impressive SEK 1,355 million last year.

In recent years the Fund has, to a greater extent, taken positions aimed at a time frame of three to five years, known as strategic positions. It is pleasing that, in the past four years, the strategic positions have generated returns of SEK 2.2 billion.



## Positive asset management outcome

Besides the strategy to increase investments in assets that generate returns that are somewhat safer but often slightly lower, the Fund is continuing its work to build a stable foundation for delivering positive active returns over time, i.e. returns that outperform the index. Our ability to perform better than what is known as a passive manager was strongly questioned by several observers in the middle of the last decade.

I have always held the opposite opinion; provided, of course, that active management is pursued by individuals with the right expertise and experience. Following thorough efforts, the Fund's structure and staffing have changed in recent years.

In light of this, it is particularly pleasing to ascertain that AP4 has, in the last three years, generated active earnings of close to SEK 3,750 million, SEK 440 million of which was earned in 2011. Our fixed income and foreign exchange management are once again convincing with their strong active return. Another piece of good news is that our global equity portfolio management has outperformed its benchmark index for the third year in a row.

One question often asked is whether active management really pays off, taking into account the additional costs that this strategy usually entails. In this annual report (p.13), we describe how large this additional cost is for AP4. A rough calculation shows that the surplus of close to SEK 3,750 million generated since 2009 can be seen in relation to an additional annual cost of around just SEK 100 million. A very profitable deal, in other words.

The 2010 annual report described how AP4 puts the individual in focus. That model has not changed. As I see it, individuals rather than models create high, sustainable returns in a management organisation over time. Of course, each unit within the Fund has its own accepted strategy for how value added is to be created.

## Important but sensitive commission

For a long-term pension fund manager like AP4, it is crucial that the game rules for running the operation over time are predictable. At the same time, it is naturally also important that we are given the best possible conditions to deliver competitive returns.

We therefore welcome the commission appointed by the Government regarding the buffer capital funds (AP1–4 and AP6). There is reason to review the framework considering that the rules were put in place over ten years ago, and that financial markets have undergone major changes during this

period. The commission regarding the AP Funds is a delicate task, particularly considering the very large amount of capital under management. However, at the same time it is important that the commission, and subsequently the Riksdag (Swedish Parliament), attend to these issues swiftly. Organisations that are heavily dependent on their staff do not usually thrive in drawn-out processes involving genuine uncertainty about the future of the individual.

## Equities – an important asset class

A year like 2011 with major fluctuations on financial markets evokes many questions. For example, how can the value of large, well-known listed companies fluctuate 10% (or more) in a single day without any new or significant information emerging?

Today, a great many stock market experts consider that this trend is linked to the advent of a new form of trading known as robot trading. These days, such trading often accounts for over half of trading volumes. – Is robot trading the reason for the increasingly sharper share price fluctuations, or is volatility high in spite of this new market feature?

**"A rough calculation shows that the surplus of close to SEK 3,750 million generated by the Fund's active management since 2009 can be seen in relation to an additional annual cost of around just SEK 100 million. A very profitable deal, in other words."**

Whatever the answer, there is reason to consider how confidence in the stock market is to be preserved and strengthened. Without public confidence, the stock market will not be the source of venture capital required by a functioning market economy. Neither will it be the source of healthy return that a long-term pension fund manager like AP4 needs to better live up to its commitments in the pension system.

One alternative to investing in liquid listed shares is unlisted assets, for example private equity funds. So far, however, AP4 has used that possibility sparingly, and there are several reasons for this.

For example, as a rule, investments in unlisted structures are associated with much higher costs and indebtedness. Also, such initiatives often lead to significant lock-in effects compared with listed shares.

Unlisted investments are perceived by many as less risky because the prices do not fluctuate as much as they do for listed shares. This is, however, largely fanciful and explained by the fact that the instruments are not quoted daily.

In addition, in the world of listed instruments, the corporate governance model is more transparent than for unlisted investments. In this respect, there is particular reason to call attention to the Swedish corporate governance model for listed companies. Somewhat surprisingly, this has been questioned in certain circles in recent years. However, criticism has only been

raised at home in Sweden. Where international managers are concerned, there are, on the contrary, many who express strong approval of the Swedish corporate governance model, and actually view it as a role model.

The factor that differentiates Swedish corporate governance from its equivalent in the US and UK is that we have much clearer boundaries between owners (AGM), board and management. Added to this are nomination committees, which are dominated by the companies' owners and not by their managements and boards. Those in favour of strong and thriving Swedish industry therefore have every reason to safeguard and develop the Swedish model.

Never before has the phrase "the markets are harder to judge than ever" been better coined than at the beginning of 2012. It is easy to line up all the threats, and perhaps a bit harder to see the opportunities. At the same time, for a manager like AP4, the important factor is the trend over some time.

In recent years, AP4 has had difficulty in reaching the required return established by the Board. I have on several occasions indicated that ten years is too short a period to express what is a reasonable goal for an AP Fund in the long term. Not seldom, we have had periods of ten years or more in which shares and bonds have generated returns that deviate sharply from the historical picture. This applies not least to the past ten years, when measurements also started at the peak of a stock market frenzy. There is a risk that many will take the last ten-year period as a forecast for the coming period, and that the proportion of shares will thus be reduced in favour of unlisted assets or fixed income securities.

Although we will continue to work actively with allocation between the asset classes, I am still convinced that, in a long-term perspective (which is the only relevant time perspective for a pension fund manager), shares are an asset class that provides better return than nominal government bonds.



Mats Andersson, CEO

## Interview with Bengt Lindefeldt, Head of Fixed Income and Foreign Exchange Management

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The return of fixed income management for the full year was just over 9%, which is 0.7 percentage points better than the benchmark index. This means that the active management of fixed income assets generated an additional impact on earnings of just over SEK 500 million.

Since the new fixed income management organisation was built up in 2008, active earnings have overshoot their target more than threefold on average annually. Active earnings delivered are close to SEK 2,200 million for the last three years. In addition, foreign exchange management has had positive active earnings of just over SEK 500 million in the same period.

"The explanation lies in trading in rate fluctuations and taking positions between different markets," says Bengt Lindefeldt, Head of Fixed Income and Foreign Exchange Management.

"It's mainly because our team made correct assessments about how four specific events would play out, and taken positions accordingly. We saw the slowdown and subsequent rate cuts in the US early on. We held the view that Australia's exposure to Asian markets, and the weak domestic economy, which is not exposed to exports, would affect the rate trend with declining interest rates there. We correctly assessed developments in the Eurozone, with increasing differences in rates between Germany and the other EMU countries, and understood that the slowdown in the UK would bring down interest rates."



## Specialists with their own areas of responsibility and earnings accountability

Lindfeldt points out that the reasons for the successful active management include the working methods and work distribution in his team.

"We have a work model based on specialists with their own clearly defined areas of responsibility and earnings accountability, and our asset portfolio is divided up according to the expertise of each individual. It may seem obvious, but this is not always the case in the type of management we conduct."

"In our model, the decision about a position in a certain area is taken by a person specialised in that area," explains Lindfeldt.

"This gives us key advantages, such as clearer responsibility on the basis of expert knowledge. In my capacity as head of the business, it gives me and also ultimately the Fund the advantage of being able to capitalise on an extensive knowledge base from different subject fields to analyse what is happening with different asset classes in a specific geographic or economic area."

## Using the right financial instruments

"The different financial instruments in fixed income and foreign exchange trading that we use can often be complex for non-experts, and are also quite advanced in our own industry," says Lindfeldt. "In active foreign exchange management, we trade, for example, in exotic options in currencies, which is a skill that is not very common. In credit management, we mainly use credit derivatives to take positions more effectively compared with trading in bonds."

## Solid understanding and position-taking

"However, ultimately it's about understanding what drives rates in different economies, and predicting rate trends," continues Lindfeldt. "In other words, seeing when a rising or declining rate trend starts, and taking positions accordingly."

## Not following the herd

"One strength of the Fund's fixed income and foreign exchange management team is that we have a global focus. This gives us better knowledge about what is happening on markets abroad, and thus on the Swedish market too," says Lindfeldt. "We have a much broader knowledge base to stand on. This means that we don't need to follow the herd, even though we naturally keep track of where it is heading. We also have a strategy of following what analysts outside of the mainstream say, evaluating this and developing our own analytical models."

## Overshooting targets several years in a row

"It's then also possible to overshoot our own targets by a wide margin. Since the new fixed income management organisation was built up in 2008, active earnings have surpassed their target more than threefold on average annually. Also, foreign exchange management has had positive earnings approximating its target for the same period.

Our earnings for 2011 of just over SEK 500 million mean that we have more than doubled return over this target.

Considering how indiscernible the markets have been in 2011, we're very satisfied

indeed with the additional impact on earnings we have achieved," concludes Lindfeldt.

**"We also have a strategy to follow what analysts outside of the mainstream say, evaluate this and develop analytical models of our own."**

# Interview with Björn Kvarnskog, Head of Global Equities Management

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Although the market value of the global equity portfolio fell during the year to SEK 80 billion, mainly because of the massive slump on stock markets globally, the global equity portfolio management nevertheless outperformed its benchmark index by just over 0.2 percentage points. That corresponded to an active profit contribution of close to SEK 200 million.

## Internal index management with an active component

"The absolute majority of the Fund's global equity portfolio is index-managed using what is known as beta management. This does not mean, however, that management is completely passive," says Björn Kvarnskog, Head of Global Equities Management. At AP4, we conduct index management mainly internally and with an active component, which gives us important advantages.

Many pension funds and institutional investors opt to outsource their index management. AP4 has chosen to manage the majority of its index portfolio in-house. Besides lower transaction costs and more effective risk distribution, it gives AP4 better control over management and the possibility of being active, mainly in two different ways.

"In an index portfolio as large as ours, about a thousand corporate actions take place each year. These are various kinds of decisions regarding equities or other financial instruments in the companies we invest in," says Kvarnskog. "As an active index manager, we can make individual decisions about how to deal with them, instead of always choosing the alternative of receiving cash payment, for instance. In this way, we get a higher return.

"As there is a pronounced active element in index management, we can also act ahead of expected index revisions, in other words when companies are removed from or added to the index," continues Kvarnskog. "Thanks to our insight into how the index is composed, we can predict relatively successfully which companies are in line for index



revision. Then, we can adjust our index portfolio in advance and achieve outperformance by increasing or reducing the holding in the company being reweighted in the benchmark index.

Another difference compared to more common equities management models is that AP4's alpha portfolio, the active management, is conducted with external managers applying solely absolute return strategies and with tailored mandates."

## Transparency, control and intervention possibilities

The outperformance of the global equity portfolio was derived mainly from the alpha platform.

"We have entered a process of distributing the active management between about ten different managers in Europe and North America, who have a mixture of different management horizons, with short or long positions," says Kvarnskog. "The design of the external management portfolio is based on a combination of several factors, with a mixture of different investment horizons in term of time frame and investment style, and who base their information on different types of sources, so that not all the managers have their eye on the same ball. Naturally, it's also a case of finding the right people in terms of talent, work capacity and ability to deal with equities. To put it simply, we have chosen a number of managers who have the opportunity of showing what they are made of within the framework of a rule book that is clearly defined for each one of them."

In the rule books, the Fund has established set terms adapted to the manager's procedures, management style and risk profile. There are also clear rules for emergency brakes – Kvarnskog calls them "autopilots" – that are set in motion if earnings drop below a certain level, with the purpose of stopping losses in time.

"Our work with external managers is based on three principles: transparency, control and intervention possibilities," emphasises Kvarnskog. "In this way, we know how they work.

We have clear rules about how they are to act and ultimately, we also have the possibility of intervening in courses of events that we deem undesirable. But we have not needed to take the latter steps on a single occasion so far, mainly because the first two principles of transparency and control are effective instruments of control."

## High performer with repetitive behaviour

Managers with clear investment processes and a structured investment philosophy have a better chance of investing successfully. In external managers, the Fund seeks "high performers with repetitive behaviour," as Kvarnskog calls them. It is then a case of building a team of managers with different investment styles in order to obtain a good, risk-adjusted result.

Kvarnskog highlights that building up the external management was timely from a buyer's perspective. The turbulence prevailing on financial and stock markets enabled the Fund to find good managers on favourable terms for the Fund:

"But our long-term approach and predictability and the good reputation of the AP Funds were also important factors for the many skilled managers who were contracted."

**"We know how the managers work, we have clear rules for how they should act and we also have the possibility of intervening, and can close down units that do not live up to expectations swiftly and simply."**

## Advantages of system infrastructure

In recent years, the Fund has spent a lot of time on developing good system infrastructure, in which lessons learned in asset management can be recorded, and that offers an effective attribute system that enables different types of return factors to be clearly monitored, from currencies and company size to pure company-specific factors.

"We have an elaborate structure in place, both in terms of beta and alpha management. We have succeeded in building up a well-diversified portfolio of external managers that complement each other. Going forward, we want to scale up our working model with maintained high flexibility, enabling us to swiftly and simply close down units that do not live up to expectations. The expansion of the working model is to be complete in the opening months of 2012. I therefore have great confidence in our ability to deliver an even better returns contribution from active management," concludes Kvarnskog.

# Active management – a profitable business

The estimated additional cost for the Fund to conduct active management has been around SEK 100 million annually. This should be seen in relation to the additional contribution of close to SEK 3,750 million, or SEK 1,250 annually, delivered by the Fund.

A subject of almost eternal debate is the question of whether it is worth conducting active management, in other words trying to perform better than the index. Many have maintained that all information is available to everybody at the same time, and that the current pricing of the asset in question is therefore correct. It is claimed that nobody can be better than "the market" over time.

The Fund is a long-term manager that sees an opportunity to conduct active management in the short-term perspective while maintaining a long-term focus, because the Fund works with different investment horizons in the portfolio. Since the beginning, the Fund has advocated active management, and this strategy contributes positively over time.

The violent share price fluctuations and crises of recent years are perhaps arguments to suggest that the market is in fact not "perfect", and that for those with the resources and wisdom, being an active manager pays off.

The next question is, of course, "Is the additional expense incurred by active management justifiable?"

Active management costs more. On that point, the view is unanimous. It is not just a matter of costs for individuals. Active return also requires major investments in systems for following up risk/return, and general administration.

## Costs of passive management

An internal and very rough estimate shows that AP4 could conduct completely passive management, with all assets invested according to a chosen index. This would cost around SEK 100 million annually, of which employee expense amount to 50%. The

high level of the cost is attributable to the fact that even passive management requires staffing, administration and monitoring of risk/return.

Where is the additional expense in active management? The above-mentioned rough estimate indicates that it is mainly attributable to employee benefits expense and system support.

## Active earnings of SEK 3,750 million

The estimated additional cost incurred by AP4 in the last few years to conduct active management has been around SEK 100 million annually. This should be seen in relation to the additional contribution of close to SEK 3,750 million, or SEK 1,250 million annually, delivered over the last three-year period.

Looking at the additional risk taken by the fund, which is a prerequisite for active management, that too is acceptable. The active risk in the last three years corresponded to volatility of 0.4% expressed as an annual rate. Seen in relation to the active return, which has generated an annual rate of 0.7%, an information ratio of 1.7 for the period is achieved, which is an exceptionally high figure. For each SEK 1 that the Fund has taken in risk, SEK 1.7 has been created.

All in all, the choice of conducting active management, based on the last three years, is justifiable. At the same time, three years is a short period in which to draw more far-reaching conclusions. For this reason, the Fund continually evaluates performance.

One aspect of active management that receives very little attention is that it enhances possibilities to be a knowledgeable and shrewd owner. As one of the largest owners on the Nasdaq OMX Stockholm exchange, AP4 is often contacted by companies regarding various ownership issues. Performing one's own analysis and establishing a view of the company, which is a prerequisite for active management, increases the chances of responding to the companies' questions wisely and constructively.

Perhaps the conditions for conducting active management have never been better than they are today. As an increasing number choose the passive alternative at a time when return is often evaluated on a quarterly basis, there is an exciting alternative for a manager with AP4's mandate.

**"Perhaps the conditions for pursuing active management have never been better than they are today."**

# 2011 – an eventful year

Global economic growth weakened in 2011, despite several forecasts indicating the opposite at the beginning of the year. There was tremendous turbulence on financial markets. A severe earthquake in Japan, unrest in the Middle East and, in constant focus, public debt crises and the question of whether the euro collaboration would stand or fall. The performance of stock markets globally was weak overall.

## Uneasy stock markets

The year got off to a positive start, and many harboured hopes of the strong growth continuing. The positive stock market trend lasted until the middle of February, when it headed south. Then, investors started to worry again about the euro collaboration and the high debts of several European countries.

The beginning of March saw a further decline in stock markets, partly because of heightened unrest in the Middle East, and partly because Japan, the world's third largest economy, suffered a severe earthquake and major subsequent damage.

Stock markets recovered temporarily in mid-March before heading south again after a few months. The slump in stock markets was triggered by the severe debt problems in both the US and Europe.

At the end of the year, the Swedish stock market had shown a negative performance, falling by around 17%, which was largely in line with Continental Europe. The British and Swiss stock markets, which are defensive in their composition, fared relatively well, yet nevertheless shrank over 5% during the year. The best performers of the year included the US stock market, which ended the year largely unchanged. Emerging markets generally performed worse than developed markets.

## Fixed income markets also uneasy

Stock market unease contributed to record-low interest rate levels during the year. Investors sold shares in favour of safer fixed income investments.

At times, liquidity in the banking system was so low that the central banks were forced to coordinate actions to avoid

problems. Interest rates fell during the year on all major markets, including Sweden.

## Europe – woes over debts and currency collaboration

There was an intense debate in Europe during the year regarding the countries' budget problems, high indebtedness and whether or not the currency collaboration would stand or fall. Politicians from the entire EU held successions of crisis meetings. No less than three summits were held in 2011 at which it was said that a satisfactory and final solution to the debt problem had been found.

In practice, however, focus has largely been on finding short-term solutions in the hope of calming the unease on financial markets. Because of the lack of long-term measures to address the underlying problems, the turbulence continued. Towards the end of the year, politicians began discussing common fiscal and financial policy in the euro countries, which had a certain calming effect on financial markets.

The road to a common European fiscal and financial policy is both long and very difficult in political terms. It is therefore hardly plausible that we have heard the last of this.

## Record-high US debts in focus

In the latter part of July, focus shifted towards the US' high debt levels and major budget problems. Indebtedness had then risen to new record heights, and discord among US politicians regarding the measures that were needed led to stock markets falling rapidly across the globe.

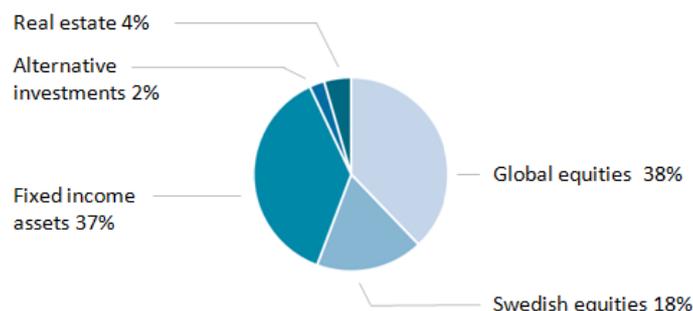
At the beginning of August, there was tremendous uncertainty on global stock markets, and dramatic share price plunges ensued. Under great pressure regarding payment suspension, American politicians agreed on a solution, and the US stock market recovered.

## Unrest in the Middle East, but oil price relatively stable

At the beginning of the year, it was feared that the unrest, which started in Tunisia and then spread across the Middle East, would give rise to sharply rising oil prices. This would lead to a deterioration in already weakened economic growth globally. The oil price trend was, however, relatively stable, probably because of the weak economic growth globally. This led to subdued demand for oil and kept the oil price down.

# Returns on investment assets

## The Fund's investment assets, 31 Dec 2011



AP4's investment assets predominantly consist of listed equities and fixed income corporate bonds. The allocation includes underlying values for various derivatives, which are used to continually maintain the desired asset allocation. The figures above are correctly rounded, and hence do not sum up to 100%.

## Calculation of risk-adjusted return

Risk-adjusted return in the form of the information ratio presented in the annual report is calculated with the help of active risk. Active risk expresses the portfolio's volatility in relation to the benchmark index, where higher active risk entails a larger variation in the return of the portfolio in relation to return for the benchmark index.

### Daily data

Risk can be calculated in many different ways. One method is the calculation of daily data, which means that price changes on a daily basis that affect return are captured in the form of daily volatility. Another method is to first aggregate daily return data into weekly data, and then calculate the volatility. The choice of time period has implications for the risk metric, and in turn for the

## Returns on investment assets

Asset class	Portfolio return %	Active return %	Sharpe ratio 4)	Informati on ratio 5)
			12 months	12 months
Global equities 1)	-6.1	0.22	neg.	1.0
Swedish equities	-14.2	-0.67	neg.	neg.
Fixed income	9.2	0.71	2.3	0.8
Tactical asset allocation 2)	-0.1	-0.06	-	neg.
Foreign exchange management 2)	0.1	0.06	-	0.5
<b>Total actively managed liquid assets</b>	<b>-2.2</b>	<b>0.23</b>	<b>neg.</b>	<b>0.5</b>
Alternative investments	15.2			
Real estate	17.6			
<b>Total actively managed assets</b>	<b>-1.1</b>			
Implementation of the strategic portfolio etc. 3)	0.3			
<b>Total investment assets</b>	<b>-0.7</b>			

1) Due to different source tax rates for portfolio and reference indexes, source tax (positive or negative) may be included in active return.

2) Portfolio return and active return based on total investment assets.

3) Strategic asset allocation and foreign exchange exposure, cash and strategic positions.

4) Sharpe ratio, a measure of risk-adjusted return. It is measured as portfolio return minus risk-free interest, divided by the standard deviation of the portfolio. A high Sharpe ratio indicates good trade-off between return and risk.

5) Information ratio, a measure of risk-adjusted return. It is measured as active return divided by the portfolio's active risk. The measure describes how much annual additional return that has been achieved in relation to the active risk taken. Values over 0.5 for individual years are usually considered to be a good result.

risk-adjusted return, because daily data compared with weekly data usually shows higher volatility and thus reduces the risk-adjusted return. The volatility increase is partly due to small price deviations in securities prices and exchange rates, between indexes and portfolio holdings, and pure errors in price information, dividend dates, etc., and partly due to actual price changes.

In choosing a calculation method, it is important to balance minimising the occurrence of volatility caused by erroneous price surges, and minimising the loss of correct price information. The figures presented by the Fund are calculated on a daily basis, which gives lower risk-adjusted return.

## Global equity

The return for the full year was -6.1% (9.8), outperforming the benchmark index by 0.2 percentage points (0.4). This corresponded to an active profit contribution of SEK 198 million (277).

At year-end, the market value of the global equity portfolio equalled SEK 80.5 billion (85.8), corresponding to 37.9% (41.0) of Fund assets.

### Healthy risk-adjusted active return

By setting the portfolio's active return of 0.2 percentage points against its active average risk of 0.2 percentage points, a risk-adjusted return expressed as an information ratio of 1.0 is obtained based on daily data.

Since the new organisation and staffing were put in place three years ago, global equity management has outperformed the index by an information ratio much higher than 1.

Global equities	3 years (on annual basis)	2011	2010
Information ratio	2.6	1.0	6.0
Active return, % points	0.4	0.2	0.4

### Alpha/beta separated management

Global equity management is alpha and beta separated and focuses on portfolio composition, choice of external manager and index management.

The alpha management (active management) is conducted by external specialists. These primarily manage tailored mandates based on absolute return. The alpha mandate divides the Fund into two segments – market-neutral mandates and mandates based on absolute return. Alpha management uses a cost-efficient external platform that was specially developed for the Fund.

Beta management (index management) is primarily conducted in-house.

### Active management with stable and solid earnings

The positive active return of global equity management is mainly derived from alpha management.

The earnings of alpha management performed very well indeed during the year and, since the start in the autumn of 2010, alpha management has delivered stable and positive earnings, as shown in a high information ratio.

The alpha management's market-neutral mandate in particular performed well. The mandate based on absolute returns was slightly disappointing; indirect dependency on the stock market had arisen. Thanks to limited risk and capital allocation to this segment, the Fund was able to limit its impact on aggregated earnings. This is a sign of the strength in the Fund's alpha management, where the Fund acts with the help of a cost-efficient platform with several slightly covariant active portfolios.

### Index portfolio managed mostly in-house

The index portfolio is managed with a good system infrastructure and low risk, and during the year it has – as it has done since the start in 2009 – delivered positive active return.

The Fund's internal index management has major advantages over external. Besides cost benefits, including transaction costs, there are efficiency gains in portfolio composition and a noticeable relative advantage in index rebalancing, for example.

## Swedish equity

The return for the full year ended at -14.2% (27.0), which was -0.7 percentage points (1.0) lower than the benchmark index. This corresponded to an active profit contribution of SEK -267 million (323).

At year-end, the market value of the Swedish equity portfolio excluding unlisted equities was SEK 37.4 billion (40.3), corresponding to 17.8% (18.9) of Fund assets.

Swedish equities	3 years (on annual basis)	2011	2010
Information ratio	0.7	neg.	1.6
Active return, % points	0.2	-0.7	1.0

## Fundamental research is the starting point

Swedish equities management is pursued based on fundamental research. At year-end, asset management was divided into three large-cap mandates and one mandate with small and mid-cap companies. All four mandates can invest a certain portion in Nordic equities. The proportion of holdings outside Sweden totalled 3.6% at year-end, somewhat lower than at the preceding year-end.

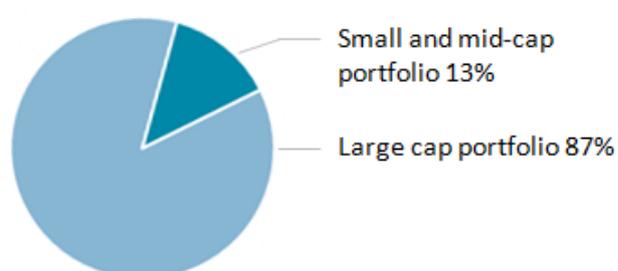
## Weak performance for the large-cap portfolio

Large-cap portfolio management contributed a return of -13.1% (25.9), which was -0.6 percentage points (0.7) lower than the benchmark index. The active return performed well during the first half of the year, but lost ground in the turbulent market conditions of the second half. Overweighting cyclical companies had a negative impact on the active return. Underweight positions in Lundin Petroleum and Millicom were the largest individual negative contributors, together with overweight positions in UPM Kymmene, Metro and Enquest.

## Small and mid-cap portfolio

The portfolio of small and mid-cap companies returned -20.4% (33.1), -1.0 percentage points (2.8) lower than its benchmark index. Underweighting in real estate companies had a negative impact on the active return in the amount of just over one percentage point. Overweight positions in Trancom, B&B Tools and New Wave, and underweight positions in Niscayah and Axis were other major negative contributors.

### Swedish equity portfolio, 31 Dec 2011



## Fixed income management

The return for the full year ended at 9.2% (4.3), which was 0.7 percentage points (0.8) better than the benchmark index. This corresponded to a positive active profit contribution of SEK 501 million (534).

At year-end, the market value of the fixed income portfolio equalled SEK 77.5 billion (71.3), corresponding to 37.3% (34.0) of Fund assets.

The high active return is primarily attributable to trading in interest rate fluctuations in the US and Australia on the one hand and a very low proportion of European government bonds outside of Germany, the UK and Sweden on the other.

The corporate bond holdings have been protected by credit derivatives. Losses ensuing from higher interest rate differences between government and corporate bonds have thus been avoided.

Fixed income	3 years (on annual basis)	2011	2010
Information ratio	1.4	0.8	1.0
Active return, % points	1.1	0.7	0.8

## Focus on expertise and earnings accountability

Fixed income management is divided into a number of mandates, each of which is managed by specialists with their own defined areas of responsibility and earnings accountability. The asset portfolio is divided according to the expertise of each individual.

## Powerful market fluctuations benefited performance

2011 was the year in which earlier powerful stimulus from central banks and governments in the western world and strong growth in countries beyond the west were to give a sustainable recovery. Also, problems relating to public finances in southern European countries looked to have eased following support from the EU and IMF.

Later in the spring, the problems resurged in Europe and spread to most countries in central and southern Europe. Also, growth across the globe turned out to be weaker than expected. These two events led to a sharp decline in interest rates in countries including the US, UK, Sweden and Germany, while at the same

time interest rates in other countries in Europe rose. The interest rate difference between government and corporate bonds also rose.

The political response from governments in the west was limited, because in most cases, they had already exhausted their normal possibilities to provide stimulus. Most also had abnormally high public debts. The central banks already had historically very low interest rates and instead used unconventional methods, for example bond purchasing.

In the Fund's management, positions for such a turn of events had already been taken in the spring, which gave a very healthy return in the summer and autumn.

### Positioning for a probable global slowdown

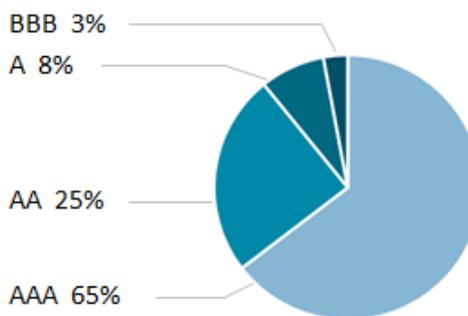
At the turn of the year 2011/12, the fixed income portfolio still had underweight positions in European government bonds outside of Germany and Sweden, underweight positions in corporate bonds and a position for lower rates in Australia.

The portfolio reflects the Fund's anticipation of ongoing problems in Europe, in its banking sector and for governments with high debts and growth that is much too low, combined with lower global growth than expected.

The big question facing us in 2012 is: What will happen to the world economy in a global slowdown? The entire world, particularly the west, has the highest debts in modern history. Most western countries already have problems in their banking sectors. They also have major budget deficits with slim possibilities for stimulus, and policy rates close to zero.

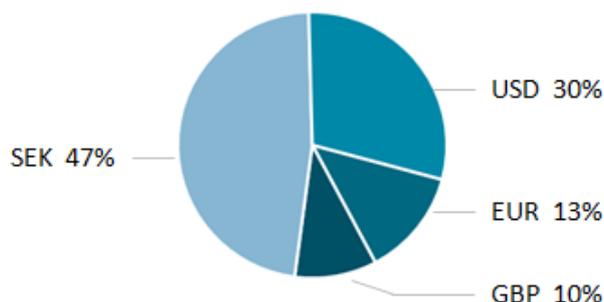
The Fund's bond holdings distributed by type of bond, currency breakdown and credit rating are shown in the diagram in this section

### Bond holdings by rating, 31 Dec 2011



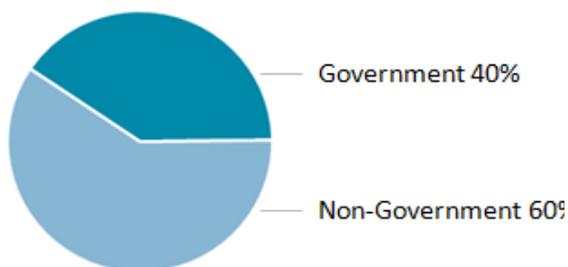
Investment-grade corporate bonds are predominant in the Fund's bond portfolio. The figures above are correctly rounded, and hence do not sum up to 100%.

### Bond holdings by currency, 31 Dec 2011



Bond holdings distributed by currency were in line with the benchmark index at year-end. This involved a high exposure in SEK and USD, and much lower exposures in EUR and GBP.

### Fixed income portfolio by issuer, 31 Dec 2011



Investment-grade bonds are pre-dominant in the Fund's bond portfolio

## Tactical asset allocation

The active return totalled -0.06 percentage points (0.04), corresponding to an active contribution to earnings of SEK -119 million (+85).

Tactical asset allocation	3 years (on annual basis)	2011	2010
Information ratio	0.1	neg.	1.0
Active return, % points	0.0	-0.1	0.0

## Mandates based on absolute return

In tactical asset allocation the Fund takes positions in different asset class indexes to achieve the highest possible return, given a carefully structured level of risk. The tactical allocation is managed as an independent management mandate with an absolute return target related to the Fund's total assets.

## Japanese earthquake brought down the result

The result was brought down mainly by long positions in the Japanese market, which were held by the Fund when the severe earthquake struck Japan. The weak performance of the global economy at the start of the year also had a negative impact on the positions.

## Foreign exchange

The active return totalled 0.06 percentage points (0.10), corresponding to a positive active contribution to earnings of SEK 128 million (199).

Currencies	3 years (on annual basis)	2011	2010
Information ratio	1.1	0.5	1.5
Active return, % points	0.1	0.1	0.1

## Currencies – absolute return mandates

Foreign exchange management is divided into two mandates: one foreign exchange mandate and one interest rate risk mandate.

The foreign exchange mandate has an absolute return target related to the Fund's total assets. The interest rate risk mandate actively manages interest rate risk in the portfolio for forward currency contracts and implements and rebalances currency exposure in a cost-effective manner.

## Positive active earnings – for the fifth consecutive year

The main reason for the outcome for the year is that the Fund had taken long positions in USD and SEK against short positions in EUR and AUD.

The active management of the Fund's portfolio for forward currency contracts also generated a positive result. This can mainly be explained by positioning in anticipation of the Riksbank bringing its policy rate hike trend to an end, in combination with increased global financing strains.

For the fifth consecutive year, foreign exchange management delivered a positive return, although the return target for 2011 was not quite reached.

## Real estate

The Fund's real estate holding returned 17.6% (22.1), which translates into an impact of SEK 1,355 million (1,478) on earnings.

At year-end, the book value of the real estate amounted to SEK 9.4 billion (8.2), corresponding to 4.5% (3.9) of the Fund's total assets.

## Expansion through direct ownership

In the last few years, the Fund has expanded within real estate – a strategic asset class. The Fund has chosen the strategy of directly owning property companies, because this is deemed to be the most cost-effective and transparent method, thus providing a better expected return.

AP4's investment in real estate mainly comprises the investments in Vasakronan (25% owned) and Rikshem (50% owned).

## Vasakronan

The Fund owns the property management company Vasakronan jointly with AP1, AP2, and AP3. Vasakronan, which manages commercial properties in Sweden to a value of just over SEK 80 billion, is Sweden's largest property owner.

## Rikshem

In the previous year, 2010, the Fund acquired Dombron, which was geared towards residential properties. In 2011, half of the company was sold to AMF. Dombron was renamed Rikshem during the year, and at the turn of the year the company owned properties with a market value just under SEK 13 billion. The holdings are geared towards residential properties and what are known as public service properties (properties with long-term rental contracts where the tenant is often a municipality).

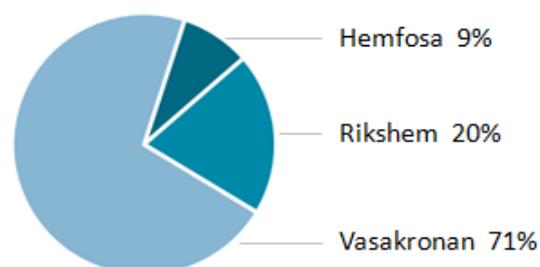
## Hemfosa

Besides Vasakronan and Rikshem, the Fund owns 15% of the property company Hemfosa. At the end of the year, the company's property holdings had a book value of close to SEK 15 billion.

## Expected market trend

On the whole, the property and rental market continue to perform in a positive direction, although at the end of 2011 there were signs of a slowdown within commercial properties.

## Real estate portfolio, 31 Dec 2011



AP4's real estate holdings returned 17.6%, giving an effect on earnings of SEK 1.4 billion. At year-end, the book value of the real estate was SEK 9.4 billion. In the last few years, the Fund has expanded within real estate – a strategic asset class.

## Alternative investments

Return amounted to 15.2% (13.0), corresponding to an earnings impact of SEK 695 million (449).

The market value of alternative investments was SEK 5.2 billion (4.3) at year-end, corresponding to 2.5% (2.0) of total Fund's total assets.

## Mainly unlisted assets

The alternative investments are mainly unlisted and are distributed over private equity funds and opportunistic investments.

Alternative investments are made using a longer investment and valuation horizon than the Fund's publicly quoted assets. The benchmark for each alternative investment is determined based on an individual assessment of relevant risk. For example, for private equity funds, MSCI World is used with an outperformance requirement of four percentage points, which reflects an investment in equities including compensation for lower liquidity and higher operational and financial risk.

## Private equity funds

The environment for private equity funds during the first half of 2011 remained favourable. The transaction activity level increased, there were favourable opportunities for loan financing, and several managers established new funds. The Fund's return was boosted by a number of successful sales in our buyout funds. Concerns about the economic trend and related market turbulence during the second half of the year dampened the activity level among private equity funds. There was an abrupt deterioration in the financing markets and general concerns about economic outlook led to several

planned sales being cancelled. Return for the private equity funds in 2011 was 15.7%.

## Opportunistic investments

The opportunistic portfolio, which has an orientation towards interest rate-related investments, was relatively unaffected by the market unease in the second half of the year. However, individual cases were noted of companies starting to experience problems in meeting their loan terms. This led to a few cases of loan renegotiation and capital injections among the borrowers. The opportunistic portfolio returned 11.8%.

## Integration of environmental aspects continues

Work on integrating ESG<sup>1</sup> in unlisted asset management has continued. With the help of a consultant, screening is performed of the holdings to discover any infringements on international conventions. At the end of the year, a significant number of the Fund's managers had their own internal ESG policies, and had endorsed the UN Principles for Responsible Investment (PRI). Implementation of operational goals, activities and follow-up is under way among the Fund's managers. The Fund welcomes these developments and contributes through its commitment.

## Investments and commitments during the year

During the year, new commitments were made to the private equity funds Accent 2012, EQT VI and Priveq IV. The Fund also bought holdings in Priveq III from another investor. Within the scope of the opportunistic portfolio, new commitments were made to Proventus Capital Partners II. The Fund was also an investor in Hemfosa Tetis AB.

## Environmental and ethical issues in asset management

The Fund believes that good regard for ethics and the environment, and sustainable value creation, are prerequisites for companies achieving sustainable healthy returns. It also believes that active responsible owners are needed to drive change for the better and induce companies to become more responsible. This applies to both Swedish and foreign companies.

The Fund pursues ESG integration in asset management, because this ensures risk awareness and capitalises on business opportunities in the area of ESG.

## Fund's ESG-related work pursued on several fronts

The Fund's work on environmental and ethical issues is conducted in the asset management in the different asset classes by the Fund's corporate governance unit, and through the Fund's involvement in the Ethical Council. Please read more about the Ethical Council on the Fund's web site, [www.ap4.se](http://www.ap4.se).

The Fund's corporate governance unit pursues and coordinates the Fund's work relating to ethics, the environment and corporate governance. This work includes holding dialogues with companies regarding ESG and exercising corporate governance by voting the Fund's shareholdings at shareholder meetings. The Fund's representatives on the Ethical Council work in the corporate governance unit.

## Integrating ESG into asset management

The Fund's different asset classes and management models provide different conditions for how work relating to sustainable value creation (ESG) can be pursued in the context of each management mandate.

Responsibility for integration work, with the goal of fully integrating ESG into management, lies with each management unit. The management unit reports on the integration work to the Chief Investment Officer and CEO. Integration work is pursued in close collaboration with the corporate governance unit, which is responsible, for instance, for conducting dialogues with companies regarding ESG.

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<sup>1</sup> ESG (Environment, Social and Governance) is often the term used for issues pertaining to the environment, ethics and corporate governance.

## Another step forward

The different management units have, in the past year, taken a further step in their work aimed at integrating environmental and ethical issues into asset management to an even higher degree. In the autumn of 2011, the work of the asset management in this area was presented in the Fund's Corporate Governance Report 2011. This report can be read and downloaded on the Fund's web site [www.ap4.se](http://www.ap4.se).

## Risks

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### Risk management keeps evolving

Financial risk-taking is part of the Fund's everyday operations and is necessary to conduct asset management. It should be possible to project risks before an investment is made and subsequently to control them. It is important to avoid risks that do not involve a possibility of returns, for example operational risks. The financial risks are monitored and controlled by an independent Performance and Risk Control unit that reports directly to the CEO and Board.

In 2011, risk management has evolved and comprises measuring risk on a daily basis and monitoring the Fund's liquid assets. This gives the Fund access to forecasts of the aggregate risks in the Fund's investments, both in absolute numbers and relative to their benchmarks.

Risk forecasts can be broken down by management area, instrument, risk factor, etc. and serve as input data for the Fund's ongoing efforts to optimise its risk-taking. The Fund plans and analyses its strategic risk-taking with the help of stress tests and different scenarios.

Because of the financial instability that has affected parts of the global economy, liquidity and credit risks have risen, particularly among heavily indebted European governments and in the European banking sector. This has meant that counterparty exposure and the credit ratings of counterparties have been monitored to a greater extent.

The Fund's exposure to governments with a rating below AAA in the euro area was low at the turn of the year. With the inclusion of France, which at that time still held an AAA rating, the Fund had a negative exposure of around SEK 500 million.

The Fund's counterpart exposure to the banking and financial sector is large, and the 15 biggest holdings collectively correspond to total counterpart exposure of around SEK 40 billion, of which SEK 30 billion is from exposure to the Swedish banking and financial sector.

### Risk in investment assets

#### Sharp market fluctuations

Volatility on stock markets and fixed income markets rose sharply in the second half of 2011, then fell back towards the end of the year. The volatility of liquid investment assets averaged 9.8% (7.8). The increase in volatility was particularly pronounced on stock markets, with increases to 26.8% (18.9) for Swedish equities and to 18.1% (14.3) for global equities.

The active risk for the Fund's liquid investment assets rose during the year to 0.5% (0.3), partly as a result of increased market volatility.

The beta portfolio of the global equities management was indexed with very low active risk. Together with the risk contribution from the global equity management's alpha mandate (active management), average active risk increased to 0.2% (0.1). The active risk in Swedish equities management averaged at an unchanged level of 0.6% (0.6). In fixed income management, it was unchanged at 0.8% (0.8).

The risks in the mandates based on absolute returns – active tactical asset allocation and active foreign exchange management – were low and made only minor contributions to the Fund's aggregate active risk.

Note 21 reports the financial and operational risks to which the fund is exposed, and their monitoring and control.

# AP4's long-term brief

AP4's long-term brief is to support the stability of the pension system through managing Fund capital with the goal of generating the best possible return over time.

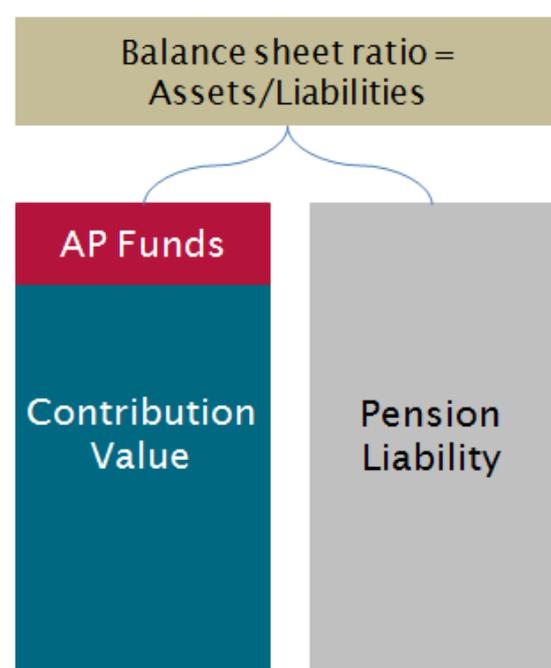
## The AP Funds – one tenth of the pension system

Combined, the AP Funds work partly as a buffer, with the purpose of covering future pension disbursements, and their returns partly contribute to the long-term financing of the pension system.

The AP Funds only constitute one tenth of the pension system's assets.

The pension system's largest asset, representing around 90%, is what is known as the contribution value. The contribution value is the expected value of future pension contributions from the gainfully employed.

The size of the pension system's contribution value is mainly affected by how long a person is gainfully employed (retirement age, for instance), wage increases and the number of people in employment.



## Pension system largely unfunded

The pension system is unfunded on the whole.

If a large number of people retire without the inflow of a fresh workforce, an imbalance arises in the system. This imbalance affects both the contribution value and the AP Funds – the buffer – negatively. Having fewer people in employment reduces paid-in pension contributions (the contribution value). Concurrently, negative net flows arise; the paid-in pension contributions for the year do not cover disbursed pensions. This affects the AP Funds, the buffer, because money is withdrawn from the AP Funds in the event of negative net flows.

## The AP Funds - an intergenerational buffer

As the large post-war generation of people born in the 1940s now retires, the amount of pensioners will increase compared with the number of people employed in the economy. When these "boomers" leave gainful employment, their pension contributions will cease and they will start to draw their pensions instead. Net flows have been negative since 2009. In other words, paid-in contributions are lower than disbursed pensions, and funds are withdrawn from the AP Funds to cope with the pension disbursements.

According to forecasts by the Swedish Pensions Agency, the net outflows will remain negative each year until the mid-2040s. The AP Funds, from which the funds will be drawn, thus act as an intergenerational buffer in the pension system.

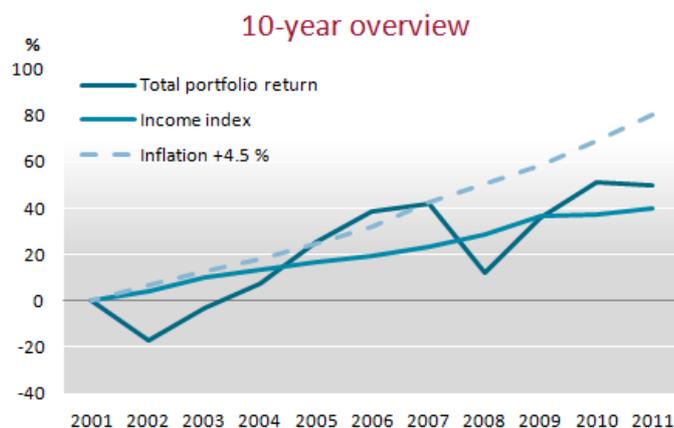
## Income index - minimum level for AP Funds' returns

The liability side of the pension system (accrued pension rights) is as a rule increased to the income index – the average income trend. To keep in pace, the asset side of the pension system – the AP funds and contribution value – must increase by at least as much as the income index, in order for the assets of the pension system to be as large as its liabilities.

During the period 2002–2011, the income index increased by 3.4% annually.

## Outperforming the income index

AP4's return for the same period, 2002–2011, was above 4.1%. The Fund has therefore made a positive contribution to the stability of the pension system.



The graph shows how the Fund's total return (dark blue line) exceeds the income index (blue line) but does not reach the real target (dotted line). In real terms 4.5% (inflation-adjusted) is, in the opinion of the Fund, the average return required over a 40-year period for the pension system's assets and liabilities to balance.

## Demographic imbalances require higher returns

To maintain long-term stability in the pension system, it does not suffice for the AP Funds to deliver returns on a par with the income index. Forecasts regarding the performance of the pension system show demographic imbalances in the future.

The imbalances are arising in connection with the retirement of the generation born in the 1940s. Because of these changes, the AP Funds must deliver a higher return than the income index.

## Requirements for the AP Funds to offset the imbalances

AP4's Board has established a long-term goal entailing that the Fund is to reach an average real (inflation-adjusted) total return of 4.5% annually. This, according to the Fund, is the average return required over a 40-year period for the pension system's assets and liabilities to balance.

The long-term return target has been calculated using analyses regarding how the assets and liabilities of the entire pension system are expected to perform in the long term, for periods of up to 40 years. The analyses are produced with the help of various assumptions, for instance expected trends in the number of gainfully employed people and pensioners, retirement age, the number of births, life span and immigration over the next 40 years.

The Fund's average real return over a ten-year period is evaluated in light of the long-term return target.

## High return target requires high proportion of equities

In order for the AP Funds to deliver high returns in line with the estimated requirement, the return target of 4.5% in real terms, the AP Funds invest a large proportion of capital in equities.

Equities are the class of asset that has historically given the best return over long periods, and that can still be expected to give higher returns than fixed income assets in the long term. Equities are also associated with higher risk and a risk of higher volatility, in other words short-term share price fluctuations.

## Proportion of equities in the pension system of 7%

Of the pension system's total assets, the proportion of equities is about 7%. These equities are in the AP Funds. Overall, in the context of the entire pension system, 7% is a relatively low proportion of shares in relation to the long period of time during which pension assets are managed.

Since the AP Funds collectively constitute just over a tenth of the pension system, this 7% of the total pension system means a relatively high proportion of equities in each Fund. One of the reasons for there being five buffer funds was to ensure risk diversification. AP4's proportion of equities at the end of 2011 was around 56%.

## Long-term outlook in the context of pensions: 30-40 years<sup>2</sup>

The real (inflation-adjusted) return of equities has varied greatly over the past 90 years or so. The average real return on Stockholm's stock exchange between 1918 and 2010 was 7% annually; just over 10% annually in nominal terms.

### Major differences in equity returns between different 10-year periods

Real returns on equities have, in various 10-year periods, varied sharply, from over 20% annually (1980s) to negative figures for other periods. Major differences between consecutive 10-year periods are common.

Historically, real returns on equities have been much more stable during 35-year periods. It is only in a 35-year perspective that the real value change for equities is reasonably comparable in terms of stability with the real wage trend in a 10-year perspective.

The real wage trend is what largely governs the value trend of income pensions. During the period 1918–2010, the real wage

<sup>2</sup> Source: Orange report 2010, Swedish Pension Agency.

trend was 2.4% annually. The difference between the real trend for equities and wages has been largest in the last two to three decades.

### 30–40 years possibly fairer time frame

When evaluating returns on equities, very long time periods should therefore be used. In terms of pensions, 30–40 years might be a fair time frame.

## AP Funds – higher returns possible in the long term

Equities are assets with expected high returns in the long term, but also high risk. The returns of the AP Funds can therefore be expected to vary relatively sharply between individual years.

This has also been the case for the present pension system since it was launched in 2001. With hindsight, 2001 can now be described as the peak of a stock market bubble. Taking that point as the start of the measurement period, shares have therefore generated returns far below expectations.

## Financial crashes make achieving goals difficult

During the 10-year period 2002–2010, the Fund's real return averaged 2.5% per year, which was less than the target of 4.5%. The return fell short of the Fund's target because that period included two financial crises: 2000–2002 and 2007–2008, which largely impacted equity markets.

The significant impact of these events on the Fund's real return is apparent from the fact that in 2012, even with a zero real return in the same year, the Fund could exceed the target of a 4.5% average real 10-year return. This is because the steep market downturn of 2001–2002 would no longer be included in the evaluation period.

# The role of AP4 in the pension system

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## The Fund's brief

AP4 constitutes part of the Swedish income pension system. The Fund's brief is to support the stability of the national pension system by managing Fund capital with the aim of generating the best possible return over time.

Together with AP1, AP2 and AP3, AP4 has two important roles in the national pension system. The four Funds work partly as a buffer, with the purpose of covering future pension disbursements, and their returns partly contribute to the long-term financing of the pension system. AP6 is also a buffer fund, but is not part of the regular flows of the pension system.

## The national pension system

The national pension system consists of the income pension and the premium pension. The income and premium pensions are completely independent of the national budget, and financing is linked to the contributions paid in by employers each month as part of the pension income of employees.

There is a safety net for people who are entitled to a pension but who do not have sufficient income – the guarantee pension. This

is financed through the national budget and is independent of the income and premium pension system.

In addition to this are occupational pensions or contractual pensions, arranged for employees by employers, often through a collective agreement, as well as voluntary pensions, which are pension schemes entered on a voluntary basis.

The income pension is a distribution system in which pension contributions paid in by the gainfully employed during the year are used to pay out pensions to pensioners the same year. The premium pension is the part of the national pension that individuals can themselves influence through investment choices. Each month, employers pay in 18.5% of the pensionable income of employees to income pension (16 percentage points) and to premium pension (2.5 percentage points). The size of the income pension depends on the income of the individual throughout their entire working life, in other words how many pension rights have been accumulated during gainful employment. The size of the premium pension depends on the performance of the securities funds containing the invested capital until the individual retires.

Because the income pension is constructed as a distribution system, this means that assets must be as large as liabilities. In other words, the funds that are to suffice for pensions to be disbursed must be as large as the pensions to which pensioners are entitled. This must be ensured in order for the income pension system to work in a stable manner over several generations.

## AP4's role in the income pension system

Assets in the income pension system consist of two parts. In simple terms, close to nine tenths consist of what is known as the contribution value, which is the value of future contributions to the income pension system; in other words, the funds that are to account for pension disbursements. The contribution value is affected mainly by salaries, the rate of employment in the economy and retirement age. The remaining portion of just over one tenth consists of the AP Funds' assets including AP6, and comprises the buffer that is to ensure that the income pension system is in balance across the generations. The total assets of an individual AP Fund of around SEK 200 million thus constitute around 2.5% of all assets in the pension system.

Income pension disbursements are increased annually, taking the average wage trend into consideration. For maximum indexing of the pensions, the income pension system must be in balance. In other words, the assets must be as large as, or larger than, the liabilities. The value contribution and the AP Funds' assets should therefore always correspond to the pension liability created. The income pension system therefore has a built-in mechanism to ensure the financial stability of the system. The mechanism is

called automatic balancing (or "the brake") and is to prevent disbursements in the system being higher than what it can cope with in the long term. This is achieved by slowing down indexing of the value of the pensions, with this process continuing until the system regains balance. This means that the income pension system is self-financing and that the Government therefore does not need to increase pension contributions or borrow money to disburse pensions.

## The AP Funds and "the brake"

Automatic balancing has come close to being triggered on two occasions in the 2000s, in 2004 and 2007. This was avoided because the AP Funds' capital has grown, thus balancing the system.

After 2008, automatic balancing was activated for the first time, which had the effect of pensions not being increased to the maximum during 2010. Also in the following year, 2009, the balance ratio was still below one, which meant that balancing was also activated in 2011.

## Buffer necessary

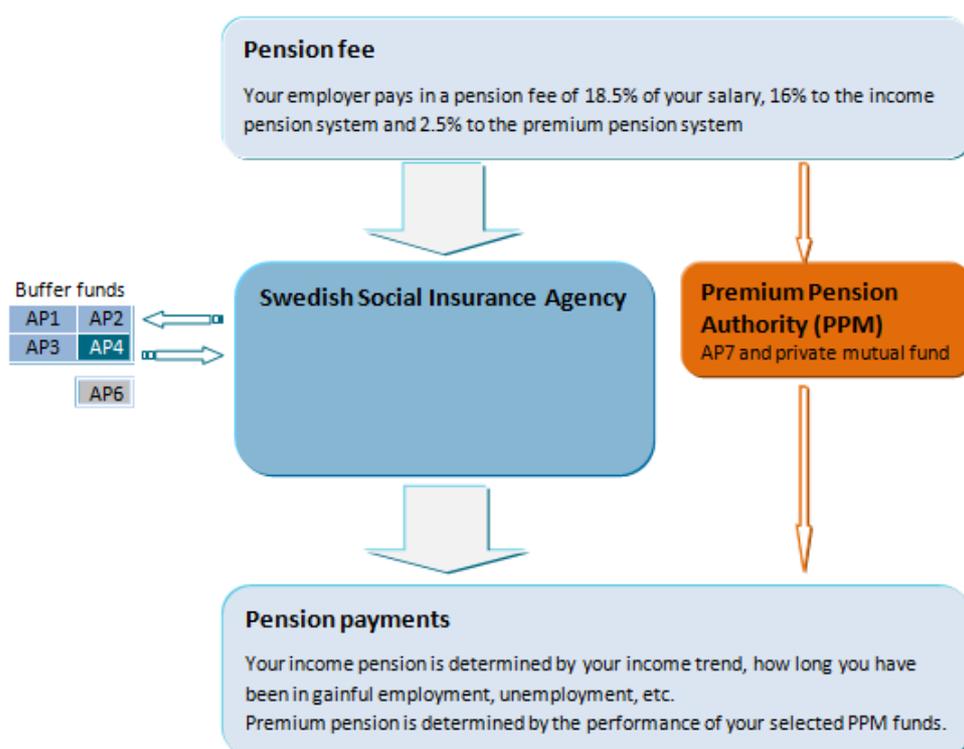
There is currently a net outflow from the AP Funds to pensioners. Since 2009, disbursements to current pensioners have been larger than contributions to the pension system from current wage earners.

According to forecasts by the Swedish Pensions Agency, disbursements to pensioners will be higher than contributions until the mid-2040s. One important reason for this is that the post-war generation born in the 1940s is now approaching

retirement age. When these "boomers" leave gainful employment, they will stop paying income pension contributions and start drawing their pensions instead.

## A stable pension system

The composition of the Swedish pension system was one of the first of its kind when it emerged at the end of the 1990s, and is, from a financial point of view, deemed stable. As the challenge of a growing ageing population is similar in all parts of the world, many countries have taken an interest in the Swedish income pension system and the brief of the AP Funds.



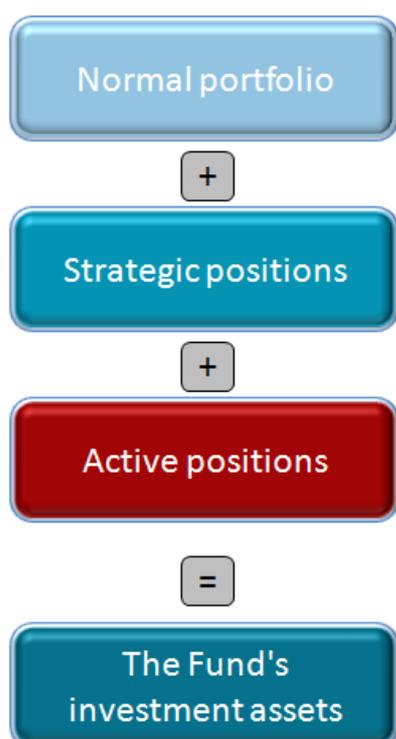
# Asset allocation – from 40 years to the short term

The Fund's asset allocation, in other words the proportion of equities in relation to fixed income assets and other asset classes such as real estate, is estimated to produce 80%–90% of total return in the long run.

The Fund invests significant resources in creating optimal asset allocation.

The investment horizon for pension capital is very long; the Fund makes analyses of up to 40 years.

To optimise asset allocation over different investment horizons, the analysis is broken down into a number of different ones. This annual report describes three investment horizons. Different investment horizons enable the Fund to better capitalise on the opportunities and manage the limitations inherent in long-term (40 years), medium-term (3–5 years) and short-term analyses. For each investment horizon, the Fund determines an optimal asset portfolio.



## The normal portfolio – best over 40 years

The normal portfolio indicates the asset allocation that will yield the best anticipated return in the long run, in a 40-year perspective, based on the Fund's analyses.

The normal portfolio consists of different classes of asset which, if purchased today and kept for 40 years, would be expected to generate the best return. Had the Fund been obliged to keep the portfolio composition constant until 2050, the normal portfolio would be the best choice.

## How the normal portfolio is determined

To establish the best asset allocation for the Fund in a 40-year horizon – the normal portfolio – the Fund performs analyses regarding expectations of the trend for the pension system's liabilities and assets during this period. These analyses are known as ALM (Asset Liability Management) analyses of all of the assets and liabilities of the income pension system.

The Fund's ALM analyses are made with the help of forecasts of the pension system's future contributions and disbursements. Factors governing forecasts of the future trend of the pension system include the number of pensioners and workers, unemployment, immigration, number of births, and the expected return and risk of different asset classes. The Fund performs these analyses each year.

AP4's Board adopts the normal portfolio with the aim of contributing the greatest benefit possible to the pension system.

ALM analysis shows that the AP Funds can best contribute to the pension system if they invest long-term in assets with good anticipated returns, though this may entail high risk in the short term.

## Assets expected to contribute best

According to the results of the ALM analysis, the normal portfolio should have a high proportion of equities, a large proportion of fixed income assets with investment grade corporate bonds, and fixed income instruments of long maturity.

The normal portfolio is a fictitious asset portfolio, a model portfolio, made up of different indexes for each asset class.

## Just over 50% equities in the AP Funds = 7% equities in the pension system

AP1, AP2, AP3 and AP4 have all invested over 50% of investment assets in equities in order to fulfil their brief. The equities in the AP Funds give a total proportion of equities of around 7% in the pension system.

Thus, the income pension system overall, in the opinion of the Fund, has a modest exposure to stock market risk.

A proportion of shares of around 60% means that the Fund's return is largely determined by global stock market performance. It is expected that this exposure can give higher return in the long term, but also that the Fund's return can vary from year to year.

## AP Funds make up one tenth of pension system

The collective assets of the AP Funds constitute around one tenth of the income pension system.

In simple terms, the majority of the pension system's assets (about 90%) consists of the value of future pension contributions, which have not yet been earned or paid in. Pension contributions are paid into the system in the same month as they are earned, and directly finance the running disbursements to current pensioners. In principle, the same money that is paid in during the month is paid out to pensioners in the form of pensions.

The liabilities of the pension system correspond to the value of paid-in pension contributions increased by the pension system's internal rate of return (IRR), normally the income index – the average income trend.

## The normal portfolio at year-end

At the end of December 2011, AP4's normal portfolio consisted of 61.1% equities, 34.4% fixed income assets, and 4.5% real estate. During 2011, the normal portfolio delivered a return of -0.9%.

## The strategic portfolio – best over 3–5 years

The Fund's strategic portfolio is an important tool for achieving an even better return than the normal portfolio in the medium term (3–5 years).

The asset allocation of the strategic portfolio is adapted to anticipated economic trends, capital market volatility and medium-term return forecasts for different asset classes.

## A model portfolio consisting of different indexes

In the same way as the normal portfolio, the strategic portfolio is a fictitious asset portfolio, a model portfolio, comprising different indexes for each asset class. It constitutes the benchmark index for the Fund's asset allocation.

## Strategic positions

The Fund's strategic positions, for instance allocation and foreign exchange positions, are determined differences between the normal portfolio and the strategic portfolio. The positions are determined by the CEO and are reported to the Board subsequently.

## Strategic positions for the year

The strategic positions contributed a total of -0.2 percentage points (0.3) to return.

During the second half of the year, the Fund was strategically underweight in equities and correspondingly overweight in fixed income securities equalling around 3.5%. On the whole, the Fund's strategic underweight position in equities and corresponding overweight position in fixed income securities have generated a return contribution of -0.1 percentage points.

The Fund has also held strategic positions in fixed income assets, which returned -0.2 percentage points. Strategic foreign exchange positions during the year contributed 0.1 percentage points.

Because strategic positions are taken in the medium term, the outcome of individual years should be interpreted with caution. The Fund has chosen to evaluate these over a rolling four-year period, 2008–2011. During this period, the Fund's strategic positions generated a return of SEK 2.2 billion, equalling 0.2 percentage points on an annual basis.

## The Fund's investment assets

### Annual objective evaluation

Each year, all asset management at the Fund undergoes an objective assessment of its possibilities for generating an active return. Important choices that are made include whether management should be conducted internally or externally, actively or passively.

At year-end, 64% (61) of the Fund's investment assets was managed actively, while 36% (39) was managed passively. 18% (23) of assets was managed externally.

### The cost of asset allocation and foreign exchange exposure

The Fund's asset allocation and foreign exchange exposure reflect the strategic portfolio. In order to maintain the desired asset allocation, re-weightings are implemented when the value changes of different asset classes have varied from each other.

Costs to maintain the desired asset allocation, excluding the strategic positions, were negligible.

### Foreign exchange exposure

The Fund hedges parts of its foreign assets in accordance with the foreign exchange exposure set by the CEO/Executive Management Committee.

At year-end 2011/12, the Fund's foreign currency exposure, that is, the proportion of assets in foreign currencies not neutralised by hedges, equalled 25.7% (19.8) of total assets.

### Exposure, 31 Dec 2011

Asset class	Market value, SEK bn	Proportion of exposure, %
Global equities	80.5	37.9
Swedish equities	37.4	17.8
Fixed income	77.5	37.3
Tactical asset allocation 2)	0.0	0.0
Currencies	0.0	0.0
Total actively managed liquid assets	195.3	93.0
Alternative investments	5.2	2.5
Real estate	9.4	4.5
Total actively managed assets	209.9	100.0
Implementation of the strategic portfolio, etc. 1)	0.2	0.0
<b>Total investment assets</b>	<b>210.1</b>	<b>100.0</b>

1) Strategic asset allocation and foreign currency exposure, cash and strategic positions.

2) In the share of exposure for tactical allocation, underlying capital subjected to value changes due to market fluctuations has been distributed over each asset type.

## Facts in brief – asset allocation

	Normal portfolio	Strategic portfolio	The Fund's investment assets
<b>Investment horizon</b>	40 years	3–5 years	<1 year
<b>Purpose</b>	The normal portfolio indicates the asset allocation and currency mix yielding the best anticipated return in the long run (40 years).	The return should exceed the normal portfolio's return in the medium term.	In active management, a manager strives to achieve a better return by deviating from the index and taking positions, such as when pricing disparities appear in the market.
<b>Asset allocation:</b>	Determined based on analyses of all assets and liabilities in the pension system. The normal portfolio's asset allocation is estimated to determine 80%–90% of the Fund's return.	Based on the normal portfolio's asset allocation, which is adjusted for prevailing economic conditions and medium-term forecasts of returns.	Reflects the strategic portfolio's asset allocation and currency mix.
<b>Contains:</b>	Model portfolio containing different indexes.	Model portfolio containing different indexes.	The Fund's investment assets
<b>Benchmark index:</b>		Uses the normal portfolio as its benchmark.	Uses the strategic portfolio as its benchmark.
<b>Positions:</b>		Strategic positions, that is, deviations from the normal portfolio, such as in asset allocation, foreign exchange exposure, and choice of index.	Active positions are taken in managing the sub-portfolios.
<b>Deciding authority:</b>	Adopted by the Board of Directors once a year.	The strategic positions are decided by the CEO and reported to the Board subsequently.	The unit heads are responsible for asset management within the framework of the mandates assigned by the Board.
<b>2011 return:</b>	-0.9%	-1.1%	-0.7%

# Corporate governance

By law, AP4's work on active corporate governance shall promote the Fund's overall goal of generating the best possible return over time. AP4 has the responsibility of safeguarding and growing the capital invested. This is fundamental to AP4's active ownership.

AP4 shall exercise the rights and obligations of its ownership role in a responsible and sustainable manner. It shall also promote the development of good practices in the securities market for the benefit of those insured by the retirement pension system.

By law, work in corporate governance is not to be controlled by Government directives or by national business or other economic policy interests. Environmental and ethical issues must be taken into account without compromising the goal of best possible return.

## Fund's ownership policy an important tool

Each year, AP4's Board of Directors approves the Fund's ownership policy, which contains guidelines for how the Fund shall apply its voting rights and take policy positions in individual companies, Swedish as well as foreign. The ownership policy shall safeguard the best interests of shareholders and individual companies. It shall take into account the unique circumstances and needs of each company and strive to contribute in the long run to maximising AP4's long-term return.

## Remuneration to be reasonable, defensible and definable

Remuneration matters have always been a matter of priority in the Fund's corporate governance work, and have gained importance both as a matter of corporate governance in general, and in light of the public debate in recent years about remuneration at listed companies.

In the ownership policy for the Fund adopted by the Board of the Fund in 2009, the Board clarified and tightened up the requirements taking into consideration the Government's *Guidelines for Terms of Employment for Senior Executives in state-owned Companies* regarding remuneration programmes featuring incentive-based pay. As a national pension fund, it is

crucial that the Fund's actions in these matters instil confidence.

## Fund's demands lead to improvement

Therefore, the Fund's evaluation of proposed remuneration programmes has consequently been systematised and tightened up further. Each remuneration programme on which the Fund votes is evaluated in detail with reference to the requirements of the Fund's ownership policy. The dialogues of the Fund and other institutions with companies regarding remuneration matters have led to an improvement in submitted proposals.

The Fund's view is that incentive-based pay programmes aimed at senior executives are to be in harmony with the long-term interests of shareholders. They are to reward positive, long-term achievements, but also work in the opposite direction. If the desired level of achievement has not been reached, total remuneration shall be lower. Incentive-based remuneration shall therefore require clear-cut and measurable achievement. The remuneration shall also have a ceiling.

The Fund therefore puts stringent demands on the structure, evaluation, and transparency of the programmes. They should be "definable and defensible". In the ownership policy, the Board of the Fund decides in detail what should be paid special attention for the Fund to be able to vote in favour of proposals at an AGM.

The Fund's work on environmental and ethical issues is conducted in the asset management in the different asset classes by the Fund's corporate governance unit. Please read more on page 21, under the heading Environmental and ethical issues in asset management.

In the field of the environment and ethics, the Fund has chosen to work on many issues through the Ethical Council, a collaboration between AP1, AP2, AP3, and AP4.

For further information about the Fund's work on corporate governance in 2011, please read Corporate Governance Report 2011 and AP4's Ownership Policy available on the Fund's web site [www.ap4.se](http://www.ap4.se).

## Corporate governance in Sweden

In Sweden, particular emphasis is placed on companies in which AP4 has a significant shareholding or is one of the largest shareholders. In addition, the Fund strives to play an active role in significant issues of principle.

- The annual general meeting (AGM) is the shareholders' principal forum, and voting rights are one of the most important means a shareholder has to influence a company. AP4 strives primarily to attend and exercise its voting rights at AGMs of companies in which the Fund has a significant shareholding or AGMs deemed important for some matter of principle.
- The primary task of a nominating committee is to propose candidates for the board of directors to the AGM. One of the Fund's most important tasks as an owner is to ensure that each company has the best possible board. Thus AP4 will participate in nominating committees in companies as justified by the Fund's holding.
- AP4 will also participate in processes preparatory to AGMs of companies in which the Fund has a significant shareholding even if the Fund is not among the shareholders with the most votes. In these tasks, the Fund will take the initiative for dialogue with other shareholders on issues of common interest.
- The Fund will also actively attempt to drive the development of quality and practices in corporate governance and to promote a smoothly functioning Swedish securities market. Direct contact with companies on ownership issues will normally be taken via the company's chairman of the board, paying heed to the general regulations that apply to disclosure by stock market companies.

## Corporate governance outside Sweden

Outside Sweden AP4 also uses several means to exercise corporate governance. Important tools include exercising the Fund's voting rights at AGMs and cooperating with other institutional investors to put more weight behind the pursuit of key questions of principle.

The Fund's opportunities for exercising its ownership role abroad in the way it does in Sweden are limited. The Fund is one of Sweden's largest institutional investors. Internationally, the picture is completely different, because the Fund's ownership is more widely spread and holdings are relatively smaller. Thus the Fund may have limited opportunities for pursuing ownership issues on its own or for participating in nominating committees.

The rules and regulations for pursuing ownership issues differ significantly among markets. What may appear self-evident in Sweden, in terms of opportunities for exercising an ownership role, can be completely different in another market. Thus local codes and regulations, industry standards, listing agreements, and market-specific circumstances can lead to divergence from principles appropriate to particular markets.

AP4's guidelines for corporate governance in foreign companies are based on internationally accepted principles for good corporate governance, chiefly the UN Global Compact and the OECD Principles for Corporate Governance and Multinational Corporations. The principles cover proposals from boards as well as shareholders.

# Report of the Directors

At year-end, Fund capital totalled SEK 210 billion. Total return was slightly negative, mainly because of the weak performance of stock markets globally.

It was gratifying, however, that active liquid management once again contributed positively in 2011, as it did in 2009 and 2010. The contribution for the year amounted to SEK 0.5 billion

## Fund capital of SEK 210 billion

Fund capital decreased by SEK 2.8 billion to SEK 210.0 billion (212.8). The change in fund capital consists of profit/loss for the year, in other words the return for the year less management expenses, as well as the net payment to the pension system.

### Weak stock markets affected performance

The poor performance of global equity markets had a negative impact on Fund capital. The Fund's proportion of shares of around 56% and exposure to the Swedish stock market therefore weighed down earnings.

### Active management continued to deliver

For the third year in a row, active management continued to contribute positively to earnings, bolstering Fund capital. This year, the contribution was close to SEK 0.5 billion.

### Payments to the pension system

Net payments to the pension system were SEK 1.2 billion (4.0), which reduced Fund capital by the same amount.

## Change in Fund capital

SEK bn	2011	2010
Fund capital, opening balance	212.8	195.7
Net payments to the pension system	-1.2	-4.0
Profit/Loss for the period	-1.6	21.2
<b>Fund capital, closing balance</b>	<b>210.0</b>	<b>212.8</b>

## Total return

Total return for 2011 was negative, at -0.7% (11.0) before expenses and -0.7% (10.9) after expenses. This return corresponded to a management return of SEK -1.6 billion (21.2).

## Portfolio return and contribution to profit/loss for the year

Asset class	Portfolio return, %	Contribution to total Return, %	Contribution to profit/loss for the year, SEK bn
Global equities	-6.1	-2.4	-5.0
Swedish equities	-14.2	-2.6	-5.6
Fixed income	9.2	3.1	6.6
Tactical allocation 1)	-0.1	-0.1	-0.1
Currencies 1)	0.1	0.1	0.1
<b>Total actively managed liquid assets</b>	<b>-2.2</b>	<b>-1.9</b>	<b>-4.0</b>
Alternative investments	15.2	0.3	0.7
Real estate	17.6	0.6	1.4
<b>Total actively managed assets</b>	<b>-1.1</b>	<b>-0.9</b>	<b>-1.9</b>
Implementation of the strategic portfolio, etc. 2)	0.3	0.3	0.5
<b>Total investment assets</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-1.4 3)</b>

1) Portfolio return based on total investment assets.

2) Strategic asset allocation, strategic foreign exchange exposure, cash and strategic positions.

3) Profit/Loss before expenses. The loss after expenses was SEK -1.6 billion.

## Equity holding brought total return down

The performance of global stock markets brought down total return and profit/loss for the year, because the Fund has a large proportion of equities. Total return for the global equity portfolio was negative, with a return of -6.1% (9.8), and the Swedish equity portfolio returned -14.2% (27). In total, equities contributed negatively in the amount of -5.0 percentage points (8.5) to the Fund's total return.

## Positive contribution from fixed income

The fixed income portfolio returned 9.2% (4.3). This gave a positive contribution of 3.1 percentage points (11.0) to the Fund's total return. Once again, real estate produced a healthy return of 17.6% (22.1), as did alternative investments, returning 15.2% (13.0).

## Active earnings in positive territory for third consecutive year

Active management made a positive contribution to earnings of SEK 0.4 billion (1.4). Over a three-year period, active management has made a positive contribution to earnings of just over SEK 3.7 billion.

Active return for the year was 0.2 percentage points (0.8), falling short of the Fund's target of 0.5 percentage points. For the evaluation period, which is three years, the target was exceeded by 0.3 percentage points.

## Positive contribution from three out of five sub-portfolios

Three out of the five sub-portfolios made a positive contribution to active return.

Fixed income management once again delivered extremely robust active earnings. Active return was 0.7 percentage points (0.8).

The global equity portfolio delivered a positive active return of 0.2 percentage points (0.4). Both the alpha and beta management contributed to the positive earnings. The alpha management (the active management) which was started in the autumn of 2010, continued to generate strong earnings in 2011.

Foreign exchange management also achieved a positive active return of 0.1 percentage points (0.1), delivering a positive return for the fifth consecutive year.

Swedish equity management and tactical allocation contributed negatively to total active return in 2011.

### Active return

Asset class	Active return, %	Contribution to active return, %
Global equities	0.22	0.10
Swedish equities	-0.67	-0.13
Fixed income	0.71	0.26
Tactical asset allocation 1)	-0.06	-0.06
Currencies 1)	0.06	0.07
<b>Total actively managed liquid assets</b>	<b>0.23</b>	<b>0.23</b>

1) Portfolio return and active return based on total investment assets

## Good risk-adjusted return

The information ratios of the management units are high overall, as shown in the table below. This means that the Fund's risk-adjusted return is and has been good since the new management organisation was set up.

### Information ratios

Asset class	3 years, (on annual basis)	2011	2010
Global equities	2.6	1.0	6.0
Swedish equities	0.2	neg.	1.6
Fixed income	1.4	0.8	1.0
Tactical asset allocation	0.1	neg.	1.0
Foreign exchange management	1.1	0.5	1.5
<b>Total actively managed liquid assets</b>	<b>1.8</b>	<b>0.5</b>	<b>2.5</b>

The information ratio is used to measure risk-adjusted return. The measure describes how much additional annual return has been achieved in relation to the active risk taken. Values over 0.5 for individual years are usually considered to be a good result. Daily data has been used in calculating the Fund's risk-adjusted return, which gives a lower information ratio. Read more about daily data on page 15, heading Returns on investment assets.

## Low operating and employee benefits expenses

Cost-efficiency is very important to the Fund, and alternative ways of working and generating value added are assessed continually.

The management cost, measured as operating expenses divided by average fund capital, equalled 0.08% (0.09). Including commission expenses, such as fees paid to external managers and for custody accounts, the management cost was 0.10% (0.10).

The Fund's management cost, with and without commission expenses, is low and competitive in domestic as well as international comparisons with other pension fund managers.

### Management costs

	2011	2010
Operating expenses, SEK mn	179	176
Commission expenses, SEK mn	24	30
Operating expense ratio, % 1)	0.08	0.09
Operating expense ratio, % 2)	0.10	0.10

1) Operating expenses as a percentage of the average Fund capital.

2) Operating expenses including commission expenses as a percentage of the average Fund capital

## Changes in staffing

Following a period of high staff turnover, in the last two years including 2011, the level has been low. At year-end, the Fund had 52 (51) employees.

## SEK 3.7 billion in three years – good organisation in place

The healthy active earnings of 2011, 2010 and 2009 are a positive sign that the asset management, which was reorganised during 2007–2008, remains on the right track. During this three-year period since the organisation was established, positive active earnings of just over SEK 3.7 billion have been delivered.

The Fund's organisation is set apart by broadly accepted procedures, clear targets, an explicit division of responsibilities, and – not least – modified management strategies and improved measurement of risk and return.

## Remuneration must be reasonable and definable

For a pension manager of public funds, it is obvious that employee remuneration levels must be reasonable, defensible and definable. AP4 endeavours to ensure that remuneration is at market rates and enables the Fund to attract and keep skilled staff. The Fund shall not be a wage leader.

The Board bears ultimate responsibility for remuneration matters being dealt with responsibly, wisely and transparently. It annually determines principles regarding remuneration and other employment terms. The Board also ensures that the Government's guidelines regarding terms of employment for senior executives at the AP Funds are followed.

With the help of external consultants, the Board of the Fund follows up to ensure that the remuneration principles are adhered to. For the past two years, the Board has had a remuneration committee consisting of three Board members. The committee has the task of advising the Board and preparing matters regarding remuneration made to the CEO and other senior executives. The remuneration committee also prepares matters relating to the Fund's principles regarding remuneration and other employment terms for all employees.

Total remuneration for an employee of AP4 consists of fixed salary, incentive-based salary, pension and other benefits.

Incentive-based remuneration is not payable to the CEO or senior executives.

Incentive-based salary may amount to a maximum of two months' salary, and, as mentioned above, does not apply to the CEO or senior executives. It is payable when clear and measurable goals have been achieved. Such salaries are based on group-oriented quantitative goals and the quantitative contribution of the individual employee measured over a rolling three-year period. Incentive-based remuneration is only payable if AP4 posts a positive total result for the financial year.

Other benefits constitute a very limited value. Examples of such are healthcare coverage, group insurance and wellness contribution. AP4 also has four parking spaces that employees can use, which are taxable as a fringe benefit.

Read more on AP4's web site, [www.ap4.se](http://www.ap4.se). There, you will find more information about the Fund's remuneration principles and follow-up.

## Collaboration between the AP Funds

One of the basic ideas behind managing assets in an income pension system was that several buffer funds would diversify risk and performance would benefit from creative competition among the Funds. At the same time, it was feared that, because of its size, an extremely large fund might have a negative impact on the way the Swedish capital markets work.

Ever since the pension system was reorganised in 2001, AP1, AP2, AP3, and AP4 have worked closely together in different areas that did not affect competition between the Funds. The most extensive example of this cooperation is the Funds' work since 2007 on environmental and ethical issues through their Ethical Council.

Collaboration has also intensified in the last three years between the administrative staff at all the AP Funds, including AP6 and AP7. The areas that collaborate with each other are accounting, legal, IT, HR, risk management, and business and office administration. Through the collaboration, experience and knowledge are exchanged in common matters. In certain cases, the decision is made to collaborate further at a deeper level. This cooperation aims at achieving transparency and cost-efficiency for the AP Funds.

It is vital that AP4's operations continue to be run in a cost-effective manner, which embraces opportunities for efficiency gains through administrative collaboration with the other AP funds. However, such collaboration must be devised so that it does not limit the possibility of competition among the Funds.

Aided by external consultants, AP1, AP2, AP3, and AP4 have jointly carried out a thorough analysis to obtain solid background data for deciding on whether to expand administrative cooperation. The Funds share the external consultants' conviction that some savings can be achieved through more coordination, but that such coordination demands relatively large investments and entails significant risk in setting up. Questions concerning the governance and priorities of coordinated administration could cause problems in the future, because the Funds' operations are increasingly diverging.

## Significant events after the end of the financial year

The Fund's work is progressing according to plan, and there are no significant events to report that have occurred since year-end.

# Financial information

## Five-year summary

Five-year summary	2011	2010	2009	2008	2007
<b>Fund capital, flows and net profit/loss, SEK bn</b>					
Fund capital	210.0	212.8	195.7	164.7	207.3
Net inflows from the pension system and special asset management funds	-1.2	-4.0	-3.9	0.9	2.0
Profit/Loss for the period	-1.6	21.2	34.9	-43.5	4.8
<b>Return, %</b>					
Return on total portfolio before expenses	-0.7	11.0	21.6	-20.8	2.5
Return on total portfolio after expenses	-0.8	10.9	21.5	-21.0	2.4
Active return, total portfolio before expenses	0.5	1.0	0.9	-1.1	-1.0
Active return, liquid assets before expenses 1)	0.2	0.8	1.4	-0.5	-1.2
Inflation	2.0	2.3	0.9	0.9	3.5
Real return after expenses	-2.7	8.6	20.6	-21.9	-1.0
<b>Management costs as a % of assets under management (annually)</b>					
Operating expenses	0.08	0.09	0.10	0.08	0.07
Operating expenses and commission expenses	0.10	0.10	0.11	0.11	0.10
<b>Risk in total portfolio, %</b>					
Portfolio ex post 2)	9.8	7.8	11.6	17.1	8.6
Active risk, ex-post	0.5	0.3	0.4	0.7	0.7
Sharpe ratio 2)	neg.	1.3	1.8	neg.	neg.
Foreign exchange exposure, %	25.7	19.8	14.6	14.5	14.2
Proportion under active management, including enhanced, %	63.6	61.2	57.7	59.7	93.5
Proportion under external management, including investments in venture capital firms, %	18.4	22.6	21.1	41.9	17.8
Number of employees at end of accounting period	52	51	53	50	45
<b>Allocation of investment assets, % 3)</b>					
Global equity portfolio	37.9	41.0	42.4	41.7	42.0
Internally managed	26.6	24.3	25.8	0.0	24.2
Externally managed	11.3	16.7	16.6	41.7	17.8
Swedish equity portfolio	17.8	18.9	18.0	18.0	18.8
Fixed income portfolio	37.3	34.0	34.9	36.8	36.9
Real estate	4.5	3.9	3.2	4.1	2.4
Alternative investments 4)	2.5	2.0	1.3		
Foreign exchange/Tactical asset allocation/Cash	0.0	0.2	0.3	-0.6	-0.2
<b>Total investment assets</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

1) Refers to actively managed liquid assets starting in 2008, and total listed assets prior to 2008.

2) Refers to liquid assets (investment assets excluding alternative investments and real estate); prior to 2009 refers to all investment assets.

3) Refers to exposure; underlying values for derivatives have been distributed by asset class.

4) Alternative investments are included in global and Swedish equities before 2009.

## Income statement

SEK mn	Note	2011	2010
<b>OPERATING INCOME</b>			
Net interest income	2	3,189	2,955
Dividends received		3,200	2,759
Net income, listed shares and investments	3	-12,739	14,406
Net income, unlisted shares and investments	4	1,554	1,721
Net income, fixed income assets		3,848	238
Net income, derivatives		-3,030	2,061
Net income, changes in exchange rates		2,584	-2,775
Net commission expenses	5	-24	-30
<b>Total operating income</b>		<b>-1,418</b>	<b>21,335</b>
<b>OPERATING EXPENSES</b>			
Employee benefits expense	6	-101	-101
Other administrative expenses	7	-78	-75
<b>Total operating expenses</b>		<b>-179</b>	<b>-176</b>
<b>PROFIT/LOSS FOR THE YEAR</b>		<b>-1,597</b>	<b>21,159</b>

## Balance sheet

SEK mn	Note	31 Dec 2011	31 Dec 2010
<b>ASSETS</b>			
Shares and investments, listed	8	108,872	118,278
Shares and investments, unlisted	9	8,100	6,722
Bonds and other fixed income securities	10	81,555	75,169
Derivatives	11	11,581	12,150
Cash and bank balances		1,226	685
Other assets	12	105	731
Prepaid expenses and accrued income	13	2,307	1,840
<b>Total assets</b>		<b>213,746</b>	<b>215,575</b>
<b>LIABILITIES AND FUND CAPITAL</b>			
<b>Liabilities</b>			
Derivatives	11	3,393	1,720
Other liabilities	14	83	877
Deferred income and accrued expenses	15	271	142
<b>Total liabilities</b>		<b>3,747</b>	<b>2,739</b>
<b>Fund capital</b>			
Fund capital, opening balance	16	212,836	195,718
Net payments to the pension system		-1,240	-4,041
Profit for the year		-1,597	21,159
<b>Total fund capital</b>		<b>209,999</b>	<b>212,836</b>
<b>TOTAL LIABILITIES AND FUND CAPITAL</b>		<b>213,746</b>	<b>215,575</b>
Pledged assets, contingent liabilities, and commitments	17		

## Notes to the income statement and balance sheet

AP4, corporate identity number 802005-1952, is one of the buffer funds in the Swedish pension system and is headquartered in Stockholm. The annual report for the 2011 financial year was approved by the Board on 16 February 2012. The income statement and balance sheet shall be adopted by the Government.

### Note 1. Accounting and valuation policies

According to the Swedish National Pension Funds Act (2000:192), the annual report shall be prepared according to generally accepted accounting principles, such that the assets in which AP4's funds are invested shall be recognised at fair value. Based on this premise, AP1–AP4 have developed and put into practice a set of common accounting and valuation policies as summarised below. The accounting and valuation policies have not changed since the preceding year.

The Fund's accounting and valuation policies are being successively adapted to comply with International Financial Reporting Standards (IFRS). The IFRS are undergoing extensive revision, so in 2011 compliance focused on disclosure requirements under IFRS 7. Complete compliance with IFRS would not materially affect reported earnings or capital. The following major discrepancies with current IFRS have been identified.

- The Funds do not measure financial instruments using purchase or sale prices but using the market prices applied in each designated index (often average prices).
- Transaction costs, such as brokers' commissions, are recognised as part of the purchase cost of financial instruments recognised at fair value through the profit/loss.
- Consolidated financial statements and cash flow statements are not prepared.

### Transaction date accounting

Purchases and sales of securities and derivative instruments in the money, bond, equity, and foreign exchange markets are recognised in the balance sheet at the transaction date; that is, at the point when material rights, and therefore risks, are transferred between the parties. Receivables and liabilities posted between transaction and settlement dates are recognised in other assets and other liabilities, respectively. Other transactions, primarily transactions in private equity, are recognised in the balance sheet at the settlement date, conforming to market practices.

### Net accounting

Net accounting is applied for fund settlements, repurchase agreements, and derivatives when the right to offset assets and liabilities is established and the intent is to wind them up simultaneously.

### Translation of foreign currencies

Transactions in foreign currencies are translated to SEK at the exchange rate applicable on the transaction date. At year-end, assets and liabilities in foreign currencies are translated to SEK at the exchange rates on the balance sheet date. Changes in the values of foreign-currency-denominated assets are divided into changes attributable to changes in the value of the asset or liability in local currency and changes stemming from fluctuations in exchange rates. The exchange gain/loss arising from exchange rate changes is recognised in the income statement on the line Net income, changes in exchange rates.

### Shares in subsidiaries and associated companies

According to the Swedish National Pension Funds Act, shares in subsidiaries and associated companies are recognised at fair value. Fair value is determined according to the same methods applied for unlisted shares and investments. There is no requirement to prepare consolidated financial statements.

### Valuation of financial instruments

All of the Fund's investments are stated at fair value such that realised and unrealised changes in value are recognised over the income statement. The lines Net profit/loss per asset class thus include realised and unrealised gains. Where the following refers to designated index providers, please see the glossary on pages 53–54 in the annual report for information about each index. The following describes how fair value is determined for the Fund's different investments.

#### Listed shares and investments

For shares and investments traded on a regulated market or trading platform, fair value is determined based on official public quotation at year-end according to the Fund's designated index, usually an average rate. Holdings not included in an index are recognised at quoted prices observable in an active market. Commission fees paid are recognised as expenses in net income, listed shares.

#### Unlisted shares and investments

For shares and investments not traded on a regulated market or trading platform, fair value is determined based on a valuation obtained from the counterparty or other external party. The value recognised is updated upon receipt of a new valuation and is adjusted for any cash flows up to the end of the accounting period. If the Fund has good reason to judge the valuation to be incorrect, the valuation received is adjusted. Stated values comply with International Private Equity and Venture Capital (IPEVC) Valuation Guidelines or equivalent principles and are based primarily on transactions with third parties, though other valuation methods may be used such as discounted cash flow, net worth or multiples based valuation.

#### Bonds and other fixed income securities

For bonds and other fixed income securities, fair value is calculated based on the official public quotation (usually the bid rate) at year-end according to the Fund's designated index provider. Holdings not included in an index are recognised at quoted prices observable in an active market. If an instrument is not traded in an active market and reliable market prices are not available, the instrument is measured using generally accepted valuation models, which discount cash flows using a yield curve appropriate for the instrument.

In terms of interest income, interest recognised is calculated according to the effective interest rate method based on amortised cost. The amortised cost is the discounted present value of future payments,

where the discount rate corresponds to the effective interest rate at time of purchase. Thus, premiums or discounts on acquisition are accrued to maturity or until the coupon changes and are included in recognised interest income.

### Derivatives

For derivatives, fair value is calculated based on year-end market rates. If an instrument is not traded in an active market and if reliable market prices are not available, the instrument is measured using generally accepted valuation models, in which observable market data is used as the input data.

Derivative positions with a positive fair value on the balance date are recognised as assets, while positions with a negative fair value are recognised as liabilities. The difference between forward and spot rates is accrued evenly over the term of the forward contract and reported as interest.

### Buybacks

In a true repurchase transaction (buyback), the asset remains on the balance sheet, and cash received is recognised as a liability. The divested security is recognised as a pledged asset on the balance sheet. The cash value difference between the spot and forward legs is accrued to maturity and recognised as interest.

### Securities on loan

Securities on loan are recognised in the balance sheet at fair value, while payment received for the loan is recognised as interest income in the income statement. Collateral received for securities on loan can consist of securities and cash. If AP4 is entitled to exercise control over cash received as collateral, the collateral is recognised on the balance sheet as an asset, and an offsetting liability. In other cases the received collateral is not recognised on the balance sheet, but is specified separately under the heading "Pledged assets, contingent liabilities and commitments". Under this heading the value of the securities on loan and collateral received for them are also recognised.

### Items recognised directly in Fund capital

Transfers to and from the national pension system are recognised directly in fund capital.

### Net commission expenses

Commission expenses are recognised in the income statement as a deduction from operating income. They consist of direct transaction costs such as custody account fees and fixed fees paid to external managers as well as fixed fees for exchange-traded funds. Performance-based fees, paid when a manager produces returns above the agreed level where profit sharing applies, are recognised in the income statement as a deductible item in net income for the asset class in question.

Fees for the management of unlisted shares and investments, for which repayment is granted prior to profit sharing and for which repayment is deemed probable, are recognised as a procurement cost and are thus included in unrealised earnings. Otherwise, such fees are recognised as commission expenses.

### Operating expenses

All management expenses except brokers' commissions, fees to external managers, and custody account fees are recognised as

operating expenses. Investments in equipment and in software, whether developed in-house or purchased, are customarily expensed as they are incurred.

### Taxes

AP4 is exempt from all income tax on investments in Sweden. Tax on dividends and interest withheld in certain countries is recognised net in the income statement under each type of income.

Amounts in SEK mn, unless otherwise specified.

### Note 2. Net interest income

	2011	2010
<b>Interest income</b>		
Bonds and other fixed income securities	2,784	2,739
Derivatives	2,194	730
Other interest income	62	80
<b>Total interest income</b>	<b>5,040</b>	<b>3,549</b>
<b>Interest expense</b>		
Derivatives	-1,843	-584
Other interest expense	-8	-10
<b>Total interest expense</b>	<b>-1,851</b>	<b>-594</b>
<b>Net interest income</b>	<b>3,189</b>	<b>2,955</b>

### Note 3. Net income, listed shares and investments

	2011	2010
Net income, listed shares and investments	-12,709	14,448
Less brokers' commissions	-30	-34
Less performance-based fees	0	-8
<b>Net income, listed shares and investments</b>	<b>-12,739</b>	<b>14,406</b>

### Note 4. Net income, unlisted shares and investments

	2011	2010
Realised gains	498	221
Unrealised changes in value	1,056	1,500
<b>Net income, unlisted shares and investments</b>	<b>1,554</b>	<b>1,721</b>

### Note 5. Net commission expenses

	2011	2010
External management fees, listed assets	-15	-20
External management fees, unlisted assets	0	-2
Other commission expenses, including custody account fees	-9	-8
<b>Net commission expenses</b>	<b>-24</b>	<b>-30</b>

Performance-based fees are not included in commission expenses. Such fees totalled SEK 0 million (8) for the year, and reduce net income for each asset class. External management fees for unlisted assets are recognised as commission expenses to the extent agreements do not permit repayment prior to profit sharing in connection with future profitable divestment. During the year, SEK 62 million (85) in management fees related to unlisted assets were paid. Of this total, SEK 62 million (83) referred to agreements that permit repayment of fees paid prior to profit-sharing upon divestment. These are recognized as part of the purchase cost of the asset.

**Note 6. Personnel**

	2011		2010	
	Total	Women	Total	Women
Average number of employees	52	16	51	16
Number of employees at 31 December	52	15	51	16
Number of executive management committee members at 31 December	4	1	9	3

Employee benefits expense, SEK '000, 2011	Salaries and remuneration	Incentive-based pay	Pension expenses	Social security expenses	Total
Chairman of the Board Monica Caneman	117	-	-	37	154
Other Members of the Board 1)	458	-	-	128	586
Chief Executive Officer Mats Andersson 2)	3,384	-	1,096	1,329	5,809
<b>Other executive management committee members</b>					
Chief Investment Officer Magnus Eriksson 3)	2,798	-	1,137	1,155	5,090
Director of Administration Agneta Wilhelmson Kåremer 4)	1,677	-	950	757	3,384
Head of Performance and Risk Control Nicklas Wikström 5)	1,145	-	486	478	2,109
Other employees 6, 7)	46,687	-	14,955	17,917	79,559
<b>Total</b>	<b>56,266</b>	<b>-</b>	<b>18,624</b>	<b>21,801</b>	<b>96,691</b>
Other employee benefits expense					3,881
<b>Total employee benefits expense</b>					<b>100,572</b>

1) Remuneration to individual board members is set forth in the administration report

2) Substitution of pension for salary	59
3) Substitution of pension for salary	247
4) Substitution of pension for salary	224
5) Substitution of pension for salary	64
6) Substitution of pension for salary, other employees	1,505
7) Costs of employee cutbacks, other employees	1,578

Employee benefits expense, SEK '000, 2010	Salaries and remuneration	Incentive-based pay	Pension expenses	Social security expenses	Total
Chairman of the Board Monica Caneman	117	-	-	37	154
Other Members of the Board	433	-	-	115	548
Chief Executive Officer Mats Andersson 1)	3,382	-	968	1,298	5,648
<b>Other executive management committee members 8)</b>					
Chief Investment Officer Magnus Eriksson 7)	-	-	-	-	-
Director of Administration Agneta Wilhelmson Kåremer 2)	1,657	-	836	723	3,216
Head of Performance and Risk Control Nicklas Wikström 3, 6)	323	-	113	129	565
Other employees 4, 5)	47,234	4,982	15,295	19,814	87,325
<b>Total</b>	<b>53,146</b>	<b>4,982</b>	<b>17,212</b>	<b>22,116</b>	<b>97,456</b>
Other employee benefits expense					3,369
<b>Total employee benefits expense</b>					<b>100,825</b>

1) Substitution of pension for salary

2) Substitution of pension for salary

3) Substitution of pension for salary

4) Substitution of pension for salary, other employees

5) Costs of employee cutbacks, other employees

6) Appointed 1 Oct. 2010

7) Did not hold the position of Chief Investment Officer in 2010.

8) Payroll expense for individuals included in the executive management committee in 2010 and who are no longer included has been transferred to other personnel.

AP4 adheres to the Government's guidelines on remuneration for senior executives and employees of the AP Funds.

**Costs of employee cutbacks**

For 2011, the cost was SEK 1,578,000 and related to compensation for pension expenses and salary in connection with employee cutbacks in investment operations. The Fund had no costs of employee cutbacks in 2010.

## Salaries and remuneration

Remuneration for the Board of Directors, set by the Government, is unchanged. The Board sets the terms of employment for the CEO based on recommendations from the remuneration committee. Remuneration to the CEO and senior executives consists of basic salary.

## Incentive-based pay

The CEO and senior executives receive no incentive-based pay. The incentive-based pay policy is determined by the Board. The policy covers all employees, except for the CEO and senior executives, employed more than six months.

The basic principle is that employees earn incentive-based pay when the Fund outperforms the benchmark and reference indexes, provided that the Fund posts an absolute profit for the financial year. The maximum incentive-based entitlement for a full-year employee is two months' salary. No incentive-based salary shall be paid for 2011.

## Pensions and similar benefits

The CEO's pension benefits and severance package are specified in his employment contract. The provisions of the contract include pension entitlement at age 65, with a pension provision of 30% (30) of salary. A mutual period of notice of termination of six months applies for the CEO. If the Fund gives notice, the CEO is also entitled to a severance package equal to 18 months' salary.

Any other income is deducted from the severance pay, which is paid monthly.

Other executive management committee members and other employees have individual employment contracts that specify severance notice based on the current collective agreement between the Employers' Organisation of the Swedish Banking Institutions (BAO) and the Swedish Confederation of Professional Associations (SACO). Pension entitlements are based on either defined benefits, according to the current collective agreement between BAO and SACO, or defined contributions, according to the Fund's pension policy specifying a pension contribution of 30% on remuneration exceeding 7.5 basic amounts.

All employees are entitled to substitute pension contributions for gross salary. In such cases, the pension contribution is increased by 5.8%, corresponding to the difference between the Fund's costs for payroll tax and social security contributions. The procedure is neutral in terms of costs for the Fund.

All employees also have healthcare coverage. The CEO and persons employed before 1 January 2007 have, in addition to remuneration as per the collective agreement, sickness insurance covering terms of illness longer than three months, which pays compensation of 90% of income less than 20 basic amounts and 80% of income greater than 20 basic amounts. The maximum amount is 40 basic amounts. The amount disbursed is reduced by any other amounts disbursed from the Swedish Social Insurance Agency, SPP insurance, and any other insurance policies.

## Other benefits

All employees can purchase group life insurance taxed as a fringe benefit. The Fund also has four parking spaces that employees can use, which are also taxable as a fringe benefit.

## Note 7. Other administrative expenses

	2011	2010
Costs of premises	11	11
Information and IT expenses	37	37
Services purchased	22	19
Other administrative expenses	8	8
<b>Total other administrative expenses</b>	<b>78</b>	<b>75</b>

Services purchased includes fees to accounting firms as follows:

Audit services, Ernst & Young	0.9	1.1
Other audit services, Ernst & Young	0.3	0.5
<b>Total fees to accounting firms</b>	<b>1.2</b>	<b>1.6</b>

## Note 8. Shares and investments, listed

	31 Dec 2011	31 Dec 2010
	Fair value	Fair value
Swedish equities	37,444	39,720
Foreign equities	65,697	71,518
Investments in foreign mutual funds	5,731	7,040
<b>Total shares and investments, listed</b>	<b>108,872</b>	<b>118,278</b>

A detailed list of holdings is published on the AP4 web site, [www.ap4.se](http://www.ap4.se).

**Note 9. Shares and investments, unlisted**

	31 Dec 2011			31 Dec 2010		
	Quantity	Share of equity, %	Purchase cost	Quantity	Share of equity, %	Purchase cost
<i>Unlisted shares, Swedish</i>						
Rikshem Intressenter AB (formerly Dombron Intressenter AB), 556806-2466	250	50	660	500	100	539
Hemfosa Fastigheter AB, 556780-5816	1,500,000	15	26	1,500,000	15	26
Hemfosa Tetis AB, 556847-5825	2,160,000	18	14	-	-	-
Innoventus AB, 556602-2728	2,334	17	2	2,334	17	2
Innoventus Project AB, 556616-8356	31,032	9	13	31,032	9	13
Vasakronan Holding AB, 556650-4196	1,000,000	25	1,221	1,000,000	25	1,221
<b>Total unlisted shares, Swedish</b>			<b>1,936</b>			<b>1,801</b>
<i>Investments in venture capital firms and mutual funds, Swedish</i>						
Accent Equity 2003 KB, 969694-7739		19	68		19	68
BrainHeart Capital KB, 969674-4102		21	103		21	110
HealthCap 1999 KB, 969656-1647		8	33		8	33
HealthCap Annex Fund I-II KB, 969690-2049		20	77		20	76
HealthCap CoInvest KB, 969625-6255		-	-		24	-
HealthCap III Sidefund KB, 969699-4830		20	43		20	43
HealthCap IV KB, 969683-6650		41	36		41	35
HealthCap KB, 969614-4162		-	-		16	-
Industrial Development & Inv. Equity KB, 969640-9631		15	-		15	-
Innoventus Life Science I KB, 969677-8530		16	23		16	25
Northern Europe Private Equity KB (EQT III), 969670-3405		10	36		10	33
Priveq Investment Fund III KB, 969704-1524		31	154		19	103
Priveq Investment II KB, 969654-5046		60	68		60	67
<b>Total investments in venture capital firms and mutual funds, Swedish</b>			<b>641</b>			<b>593</b>
<b>Total purchase cost unlisted shares and investments, Swedish</b>			<b>2,577</b>			<b>2,394</b>
<b>Total fair value unlisted shares and investments, Swedish</b>			<b>5,239</b>			<b>4,128</b>
	31 Dec 2011		31 Dec 2010			
	Share of equity, %	Purchase cost	Share of equity, %	Purchase cost		
<i>Investments in venture capital firms and mutual funds, foreign:</i>						
Accent Equity 2008 LP	6	123	6	95		
Accent Equity 2012 LP	6	-	-	-		
CapMan Public Market Fund FCP-SIF	18	193	18	152		
EQT IV LP	4	629	4	683		
EQT V LP	2	452	2	469		
EQT VI LP	0.4	6	-	-		
EQT Opportunity LP	12	115	12	124		
EQT Infrastructure LP	3	165	3	84		
European Strategic Partners II	4	207	4	213		
Goldman Sachs Multi-Strategy Fund Offshore LP	95	387	95	416		
Goldman Sachs Vintage Fund IV Offshore LP	1	120	1	134		
Goldman Sachs Distressed Opportunities Fund III Offshore LP	5	158	5	151		
Goldman Sachs Private Equity U.S.Focused II Offshore LP	21	110	21	89		
Goldman Sachs Vintage Fund V Offshore LP	2	161	2	113		
HealthCap V LP	12	115	12	105		
Keyhaven Capital Partners III LP	8	34	8	30		
Priveq Investment Fund IV LP	8	3	-	-		
Scope Growth II LP	10	80	10	71		
<b>Total purchase cost unlisted shares and investments, foreign</b>		<b>3,058</b>		<b>2,929</b>		
<b>Total fair value unlisted shares and investments, foreign</b>		<b>2,861</b>		<b>2,594</b>		
<b>Total purchase cost unlisted shares and investments, total</b>		<b>5,635</b>		<b>5,323</b>		
<b>Total fair value, unlisted shares and investments, total</b>		<b>8,100</b>		<b>6,722</b>		

**Note 10. Bonds and other fixed income securities**

	31 Dec 2011	31 Dec 2010
	Fair value	Fair value
<b>Issuer category</b>		
Kingdom of Sweden	10,178	9,252
Swedish municipalities	541	-
Swedish housing institutions	19,271	17,664
Other Swedish financial services companies	4,366	3,839
Swedish non-financial companies	9,090	7,611
Foreign governments	17,872	18,522
Other foreign issuers	20,237	18,281
<b>Total fixed income assets</b>	<b>81,555</b>	<b>75,169</b>
<b>Type of instrument</b>		
Bonds	75,190	69,208
Treasury bills	-	131
Subordinated debentures	821	809
Unlisted promissory note loans	3,625	3,625
Unlisted shareholder loans	1,919	1,396
<b>Total fixed income assets</b>	<b>81,555</b>	<b>75,169</b>

**Note 11. Derivatives**

	31 Dec 2011			31 Dec 2010		
	Nominal amount	Fair value Positive	Fair value Negative	Nominal amount	Fair value Positive	Fair value Negative
Equity-based instruments:						
Stock options	8,778	8,778	-	8,392	8,372	20
Stock futures	7,000	-	-	6,906	-	-
<b>Total equity-based instruments</b>	<b>15,778</b>	<b>8,778</b>	<b>-</b>	<b>15,298</b>	<b>8,372</b>	<b>20</b>
of that total, cleared	7,000	-	-	6,906	-	-
Interest-based instruments:						
FRAs / Forward contracts	25,175	-	-	38,240	-	-
Swaps	16,377	479	255	8,474	141	46
<b>Total interest-based instruments</b>	<b>41,552</b>	<b>479</b>	<b>255</b>	<b>46,714</b>	<b>141</b>	<b>46</b>
of that total, cleared	25,175	-	-	38,240	-	-
Instruments based on foreign exchange:						
Stock options	29,328	360	218	15,013	29	35
Stock futures	185,782	1,964	2,920	156,983	3,608	1,619
<b>Total instruments based on foreign exchange</b>	<b>215,110</b>	<b>2,324</b>	<b>3,138</b>	<b>171,996</b>	<b>3,637</b>	<b>1,654</b>
<b>Total derivative instruments</b>	<b>272,440</b>	<b>11,581</b>	<b>3,393</b>	<b>234,008</b>	<b>12,150</b>	<b>1,720</b>
of that total, cleared	32,175	-	-	45,146	-	-

Per 31 Dec 2011, the Fund had no put options written.

**Maturity analysis**

The majority of the Fund's derivatives have a maturity of less than a year. Only a handful of foreign exchange options have a longer maturity, and out of these only three contracts have a negative market value. These are listed below.

## Written foreign exchange options

Currency pair	Time until maturity (year)	Market value SEK mn
USD/JPY	2.9	-6
USD/JPY	2.9	-9
USD/JPY	2.9	-9
<b>Total</b>		<b>-24</b>

**Note 12. Other assets**

	31 Dec 2011	31 Dec 2010
Receivables on unsettled transactions	103	45
Received securities	-	685
Other assets	2	1
<b>Total other assets</b>	<b>105</b>	<b>731</b>

**Note 13. Prepaid expenses and accrued income**

	31 Dec 2011	31 Dec 2010
Accrued interest income	2,177	1,729
Accrued dividends and repayments	123	104
Other prepaid expenses and accrued income	7	7
<b>Total prepaid expenses and accrued income</b>	<b>2,307</b>	<b>1,840</b>

**Note 14. Other liabilities**

	31 Dec 2011	31 Dec 2010
Trade payables	8	6
Payables for unsettled transactions	71	148
Payables for collateral received	-	685
Other liabilities	4	38
<b>Total other liabilities</b>	<b>83</b>	<b>877</b>

All liabilities have a maturity of less than a year.

**Note 15. Deferred income and accrued expenses**

	31 Dec 2011	31 Dec 2010
Accrued interest expense	233	98
Accrued employee benefits expense	7	12
Accrued external management expenses	26	27
Other accrued expenses	5	5
<b>Total deferred income and accrued expenses</b>	<b>271</b>	<b>142</b>

All deferred income and accrued expenses have a maturity of less than one year.

**Note 16. Fund capital**

	31 Dec 2011	31 Dec 2010
Fund capital, opening balance	212,836	195,718
<b>Net payments to/from the pension system:</b>		
Paid-in pension contributions	53,895	51,267
Pension funds disbursed to the Swedish Pensions Agency	-54,919	-55,050
Transfer of pension entitlements to the EU	-2	-1
Settlement of pension entitlements	-1	-
Administration fee paid to the Swedish Pensions Agency	-213	-257
<b>Total net payments to the pension system</b>	<b>-1,240</b>	<b>-4,041</b>
<b>Profit for the year</b>	<b>-1,597</b>	<b>21,159</b>
<b>Fund capital, closing balance</b>	<b>209,999</b>	<b>212,836</b>

**Note 17. Pledged assets, contingent liabilities, and commitments**

	31 Dec 2011	31 Dec 2010
<b>Collateral pledged for AP4's liabilities and equivalent collateral:</b>		
Securities on loan for cash received 1)	-	647
<b>Other pledged assets and equivalent collateral:</b>		
Securities on loan for securities received 2)	20,640	15,208
Collateral pledged for exchange-traded derivative contracts	1,423	876
Collateral pledged for OTC derivative contracts 3)	578	10
<b>Commitments</b>		
Investment commitments for alternative investments	2,354	1,988

1) Collateral received for securities on loan totalled SEK 0 million (685). These are recognised as part of other assets.

2) Collateral received for securities on loan totalled SEK 21,696 million (16,399).

3) Collateral received for OTC derivatives totalled SEK 10,205 million (9,515).

**Note 18. Related parties**

AP4 rents its office premises from Vasakronan AB at market rates.

**Note 19. Income and expense external management, unlisted shares and investments**

	31 Dec 2011	31 Dec 2010
Gross income (interest income, dividends, realised and unrealised gains/losses)	1,651	1,817
Management fees paid and posted on the balance sheet	-62	-83
Management fees paid and recognised as commission expenses	-	-2
<b>Net contribution</b>	<b>1,589</b>	<b>1,732</b>
Capital under management, fair value	8,100	6,722
Invested capital	5,635	5,323
Commitments for future investments	1,493	1,528

**Note 20. Financial instruments, price and valuation hierarchy**

Fair value, SEK mn	31 Dec 2011			Total
	Level 1	Level 2	Level 3	
<b>Financial assets</b>				
Shares and investments	108,872	-	8,100	116,972
Bonds and other fixed income securities	74,651	1,360	5,544	81,555
Derivatives	9,122	2,459	-	11,581
<b>Total financial assets</b>	<b>192,645</b>	<b>3,819</b>	<b>13,644</b>	<b>210,108</b>
<b>Financial liabilities</b>				
Derivatives	- 110	- 3,283	-	- 3,393
<b>Total financial liabilities</b>	<b>- 110</b>	<b>- 3,283</b>	<b>-</b>	<b>- 3,393</b>
<b>Net financial assets and liabilities</b>	<b>192,535</b>	<b>536</b>	<b>13,644</b>	<b>206,715</b>

Fair value, SEK mn	31 Dec 2010			Total
	Level 1	Level 2	Level 3	
<b>Financial assets</b>				
Shares and investments	118,278	-	6,722	125,000
Bonds and other fixed income securities	69,208	940	5,021	75,169
Derivatives	8,397	3,753	-	12,150
<b>Total financial assets</b>	<b>195,883</b>	<b>4,693</b>	<b>11,743</b>	<b>212,319</b>
<b>Financial liabilities</b>				
Derivatives	-26	-1,694	-	-1,720
<b>Total financial liabilities</b>	<b>-26</b>	<b>-1,694</b>	<b>-</b>	<b>-1,720</b>
<b>Net financial assets and liabilities</b>	<b>195,857</b>	<b>2,999</b>	<b>11,743</b>	<b>210,599</b>

**Changes in level 3**

Shares and investments	
Opening balance 1 Jan 2011	6,722
Realised and unrealised gains (+) or losses (-) in the income statement	1,052
Purchase and sale	326
<b>Closing balance 31 Dec 2011</b>	<b>8,100</b>

Bonds and other fixed income securities	
Opening balance 1 Jan 2011	5,021
Realised and unrealised gains (+) or losses (-) in the income statement	-
Purchase and sale	523
<b>Closing balance 31 Dec 2011</b>	<b>5,544</b>

**Level 3** pertains mainly to investments in alternative investments and real estate. According to IFRS, a sensitivity analysis shall be presented with the help of an alternative valuation of these assets. In terms of valuation methodology, an alternative valuation of these assets is associated with tremendous difficulties. A standard premium valuation of 10% on these assets affects the total value of the portfolio by just over SEK 1.2 billion.

**Level 1. Instruments with publicly quoted prices**

Financial instruments traded in an active market. A market is deemed active if quoted prices are regularly updated and if the prices are used unaltered to settle trades in the market.

**Level 2. Valuation methods based on observable market data**

Financial instruments traded in a market that is not active and does not periodically update quoted prices; values are determined using valuation methods. If the valuation uses input data that is observable, the instrument is classified as level 2.

**Level 3. Valuation methods based on non-observable market data**

Financial instruments that lack an active market and for which the input data for valuation is not observable are classified as level 3.

## Note 21. Risks

Each year, the Board of Directors adopts an investment policy, a credit policy and a risk management plan for the Fund's operations. The investment policy describes, for instance, the Fund's management orientation and goals in terms of return and risk. The credit policy stipulates rules and limitations regarding management of credit risk and credit risk exposure. The risk management plan clarifies the allocation of responsibility and authority for the investment operations. The risk management plan also describes the principal operational risks and how these risks shall be controlled and monitored. The principal risks are of a financial and operational nature.

## Risk management

### Financial risks

Financial risks, which mainly include market, credit and liquidity risks, are followed up and controlled in an independent Performance and Risk Control unit, which reports directly to the CEO.

The task of this unit is to ensure that the Fund's operations comply with legislated investment rules, the investment and credit policies and the risk management plan. This includes careful measurement and analysis as well as daily reporting of return and risk, in absolute terms and in relation to benchmarks. The unit is divided into a compliance function and a risk analysis function. The compliance function is responsible for complying to rules with monitoring and control of, for instance, credit risk and liquidity risk. The risk analysis function is responsible for analysis, control and reporting of chiefly market risks.

There is also a legal unit that is responsible for following up on legal aspects relating to risk in agreements and such. This includes follow-up and monitoring of employees' securities transactions.

### Operational risks

To manage operational risks, the head of each AP4 unit takes responsibility for identifying, limiting, and controlling their units' operational risks in accordance with the risk management plan. The compliance function is responsible for monitoring the operational risks in the investment operations, and ensuring compliance with regulations relating to these risks. Operational risks are specifically evaluated in connection with the implementation of new products, and system and organisational changes.

In accordance with the risk management plan, and with the purpose of minimising operational risks and ensuring quality internal control, there is a clear allocation of responsibility and authority documented in written instructions. Procedures and routines are regularly reviewed to assess whether the documentation is up to date and to identify weak points in transaction chains or other procedures. What is known as the duality principle is consistently applied.

## Financial risks

### Market risks

Market risk is the risk of the value of an instrument changing due to variations in share prices, foreign exchange rates or market rates.

The asset management's market risks are defined partly as risk in relation to the benchmark (active risk in the short and medium term), and partly in absolute terms as a contribution to total actual portfolio risk. The risks are broken down into different investment horizons and analysed with the help of risk contribution based on the investment procedure of each mandate. Stress tests and scenario analyses are also used. Foreign exchange, fixed income, and equity risks in active management are managed by means including limitation of active risk, duration, and permissible deviations from index weights.

### Risk in investment assets

The Value at Risk (VaR) metric is used to calculate financial risks. Value at Risk is defined as the maximum loss that can occur with a given probability and a given time horizon. The table below applies an analytical factor model for a time horizon of 10 days and a confidence level of 95%.

#### Risk in investment assets 1)

Asset class	VaR, ex-ante	Volatility	
		% 12- month portfolio	Active risk % 12 months
Global equities	4,908	18.1	0.2
Swedish equities	2,957	26.8	0.6
Fixed income	771	3.2	0.8
Active tactical asset allocation 2)	39	0.1	0.1
Active foreign exchange management 2)	0	0.1	0.1
<b>Total actively managed liquid assets</b>	<b>7,223</b>	<b>11.2</b>	<b>0.5</b>
Alternative investments 3)	267		
Real estate 3)	685		
<b>Total actively managed assets</b>	<b>8,034</b>		
Diversification effect 4)	-1,650		
<b>Total investment assets</b>	<b>7,978</b>		

1) All assets are appraised 100% currency-hedged except for active foreign exchange management. Thus the majority of the Fund's currency risk is found on the "Total investment assets" line in the table above.

2) Based on total investment assets.

3) The Fund's illiquid assets, real estate and alternative investments, lack public prices quoted periodically. Thus the Fund has therefore chosen to use listed shares in Swedish real estate companies as an approximation of the risk in its property holdings. For approximations of the risk in alternative investments, the Fund uses an index for European companies combined with a European high-yield fixed-income index.

4) The risks reported for asset types refer to individual types of asset. Risks cannot be added up, because diversification effects result from the imperfect correlation between asset types.

As a comparison, AP4 has also estimated VaR for the total portfolio based on a one-day holding period, 95% confidence level and a data term of one year, in which the observations are equally weighted. A simulation method with historical return allocation has been used in the calculation. This estimation generates a result equalling just over SEK 2,400 million.

## Foreign exchange exposure

The Fund hedges all of its holdings of foreign fixed income assets and parts of its foreign shareholdings using foreign exchange derivatives. At year-end, the Fund's foreign currency exposure was 25.7% (19.8). The following table shows the Fund's foreign exchange exposure.

### Foreign exchange exposure

31 Dec 2011	USD	EUR	GBP	JPY	Other	Total
Shares and investments	47,748	13,924	6,875	6,321	8,623	83,491
Bonds and other fixed income securities	22,813	10,073	7,615	0	0	40,501
Derivatives, excluding foreign exchange derivatives	-22	244	0	0	0	222
Other receivables and liabilities, net	352	363	187	112	242	1,255
Foreign exchange derivatives	-28,566	-21,493	-7,434	-7,898	-6,109	-71,500
<b>Foreign exchange exposure, net</b>	<b>42,324</b>	<b>3,110</b>	<b>7,243</b>	<b>-1,465</b>	<b>2,756</b>	<b>53,968</b>

31 Dec 2010	USD	EUR	GBP	JPY	Other	Total
Shares and investments	51,133	14,595	7,056	7,365	9,432	89,580
Bonds and other fixed income securities	21,209	9,919	7,223	0	0	38,350
Derivatives, excluding foreign exchange derivatives	1	72	0	9	0	83
Other receivables and liabilities, net	259	100	47	73	109	587
Foreign exchange derivatives	-42,190	-19,073	-7,963	-7,458	-9,732	-86,416
<b>Foreign exchange exposure, net</b>	<b>30,411</b>	<b>5,614</b>	<b>6,362</b>	<b>-11</b>	<b>-191</b>	<b>42,185</b>

## Credit risks

Credit risk consists of the risk of individual counterparties being unable to fulfil their commitments to the Fund.

AP4 has established individual counterparty limits to manage credit risks. The limits are continually monitored. Credit risk is also limited by a rule that permits investment only in securities with a rating of BBB or better. The following table summarises the Fund's credit exposure broken down by credit rating.

### Credit risks

31 Dec 2011	Bonds exposure 2)	Non-standard derivatives Fair value 2)	Collateral/security	Residual risk
Ratings				
AAA	49,798			
AA	18,980	-253	89	-164
A	6,066	8,789	-9,719	-929
BBB	2,265			
Lacks rating 1)	5,761			
<b>Total credit risk exposure</b>	<b>82,871</b>	<b>8,537</b>	<b>-9,630</b>	<b>-1,093</b>

31 Dec 2010	Bonds exposure 2)	Non-standard derivatives Fair value 2)	Collateral/security	Residual risk
Ratings				
AAA	57,138			
AA	6,718	483	-111	372
A	5,045	10,078	-8,712	1,366
BBB	2,236			
Lacks rating 1)	5,235			
<b>Total credit risk exposure</b>	<b>76,372</b>	<b>10,561</b>	<b>-8,823</b>	<b>1,738</b>

1) Relates to subordinated debentures, bonds and shareholder loans in alternative investments and real estate.

2) Fair value, including accrued interest.

## Liquidity risks

Liquidity risk consists of the risk that a financial instrument cannot be sold or can only be sold at a significantly lower price than the publicly quoted price.

The risk is limited by special rules for investment in fixed income assets and by careful monitoring of cash balances. The Fund invests a large proportion of the portfolio in listed equities and government bonds with good liquidity.

### Liquidity risk

Maturity structure 31 Dec 2011						
Maturity	< 1 year	1 < 3 years	3 < 5 years	5 < 10 years	> 10 years	Total
Nominal government	-	1,848	8,718	13,567	6,988	31,121
Nominal corporate	2,151	24,161	16,951	7,368	1,118	51,749
<b>Total</b>	<b>2,151</b>	<b>26,009</b>	<b>25,669</b>	<b>20,935</b>	<b>8,106</b>	<b>82,871</b>

Maturity structure 31 Dec 2010						
Maturity	< 1 year	1 < 3 years	3 < 5 years	5 < 10 years	> 10 years	Total
Nominal government	132	4,792	8,933	12,987	3,719	30,562
Nominal corporate	2,092	13,871	19,331	9,141	1,374	45,810
<b>Total</b>	<b>2,224</b>	<b>18,663</b>	<b>28,264</b>	<b>22,128</b>	<b>5,093</b>	<b>76,372</b>

Bonds and fixed income instruments recognised at fair value, including accrued interest

All liabilities have a maturity below a year except a handful of foreign exchange options; see note 11.

## Managing derivatives

The Fund uses derivatives in most of its management mandates. Derivatives have several areas of usage and purposes, the most important being:

- Hedging the Fund's foreign investments, for which derivatives are the only alternative.
- Making index management more efficient, where derivatives are used to minimise transaction costs and simplify administration.
- Making active management more efficient, where derivatives are used not only to minimise transaction costs and simplify administration but also to enable positions to be taken that cannot be generated using other instruments (short positions, volatility positions, and more).
- Regulating the strategic portfolio's risk with the help of strategic derivative positions.

The use of derivatives is limited in terms of the nominal underlying values as well as market risk. All derivative positions and associated risks are subject to daily position and risk monitoring.

# Board of Directors' signatures

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Stockholm, 16 February 2012

**Monica Caneman**  
CHAIRMAN OF THE BOARD

**Jakob Grinbaum**  
DEPUTY CHAIRMAN

**Håkan Arnelid**

**Ing-Marie Gren**

**Kajsa Lindståhl**

**Stefan Lundbergh**

**Lena Micko**

**Roger Mörtvik**

**Charlotte Strömberg**

**Mats Andersson**  
CHIEF EXECUTIVE OFFICER

Our auditors' report was submitted on 17 February 2012

**Anna Peyron**  
AUTHORISED PUBLIC ACCOUNTANT  
Appointed by the Government

**Peter Strandh**  
AUTHORISED PUBLIC ACCOUNTANT  
Appointed by the Government

# Auditors' report

## For the Fourth Swedish National Pension Fund

Corporate identity number 802005-1952

## Report on the annual accounts

We have examined the annual accounts of the Fourth Swedish National Pension Fund for the financial year 2011. The Fund's annual accounts are included in this document and found under the headings Report of the Directors and Financial Statements, pages 32-50.

### The responsibility of the Board and CEO for the annual accounts

The Board of Directors and CEO bear responsibility for preparing annual accounts that provide a true and fair view according to the Swedish National Pension Funds Act, and for such internal controls that the Board and CEO deem necessary to prepare annual accounts that are free from material misstatement, whether due to fraud or error.

### The responsibility of the auditors

Our responsibility is to express our opinion on the annual accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing and generally accepted auditing standards in Sweden. These standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that 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 Fund's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board and CEO, 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 opinions.

### Opinions

In our opinion, the annual accounts have been prepared in accordance with the Swedish National Pension Funds Act (2000:192) for the AP

Funds, and present fairly, in all material respects, the financial position of AP4 as of 31 December 2011 and of its financial performance for the year then ended according to the Swedish National Pension Funds Act. The Report of the Directors is compatible with the other sections of the annual accounts.

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

## Report on other legal and regulatory requirements

In addition to our audit of the annual accounts, we have also examined the inventory of assets managed by AP4, along with the general administration of the Board and CEO.

### The responsibility of the Board and CEO

The Board and CEO bear responsibility for these accounting documents and the administration of the Fund's assets in accordance with the Swedish National Pension Funds Act.

### The responsibility of the auditors

Our responsibility is to express, with reasonable assurance, our opinion on the results of our examination and inventory of the assets managed by the Fund, and on the administration in general on the basis of our audit. We conducted our audit in accordance with generally accepted auditing standards in Sweden.

As a basis for our opinion regarding the inventory of assets, we have examined the Fund's inventory and, on a test basis, supporting evidence thereof.

As a basis for our opinion regarding the administration in general we have, in addition to our audit of the annual accounts, examined material decisions, measures and circumstances in the Fund in order to assess whether a Board member or the CEO has acted in violation of the Swedish National Pension Funds Act.

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

### Opinions

The audit has given us no reason for qualification with regard to the inventory of assets or of the administration in general.

Stockholm, 17 February 2012

**Anna Peyron**

AUTHORISED PUBLIC ACCOUNTANT

Appointed by the Government

**Peter Strandh**

AUTHORISED PUBLIC ACCOUNTANT

Appointed by the Government

# Board of Directors

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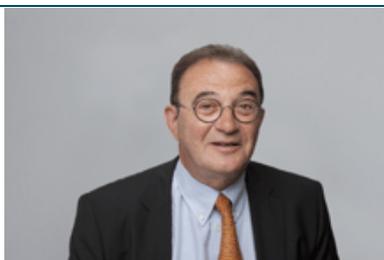
## Monica Caneman

Chair since 2008. Born 1954.

Other board assignments:

Board Chair: Allenex AB, Arion Bank hf, Big Bag AB and Frösunda LSS AB.

Member of the Board: Investment AB Öresund, Poolia AB, My Safety AB, SAS AB, Storebrand ASA, Intermail AS and Schibsted ASA.



## Jakob Grinbaum

Deputy Chair since 2011.

Member of the Board since 2010. Born 1949.

Senior Advisor.

Other board assignments:

Member of the Board: SBAB, IK Sirius and Foundation of Östgötagården Uppsala.



## Håkan Arnelid

Member of the Board since 2009. Born 1949.

Former CFO Swedish Industrial and Metal Workers Union.



## Ing-Marie Gren

Member of the Board since 2011. Born 1951.

Professor.



## Kajsa Lindståhl

Member of the Board since 2004. Born 1943.

Director.

Other board assignments:

Board Chair: Södersjukhuset AB, Vectura Consulting AB and Foundation of Stiftelsen Tumba Bruk.

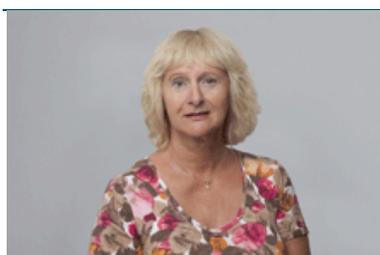
Member of the Board: PRI Pensionsgaranti, Thule-Foundation and SIFR (Swedish Institute for Financial Research).



## Stefan Lundbergh

Member of the Board since 2011. Born 1968.

PhD



## Lena Micko

Member of the Board since 2011. Born 1955.

City Commissioner

Other board assignments:

Board Chair: The Swedish Air Transport Society.

Deputy Chair: Municipal executive board in Linköping and Stadshus AB.

Member of the Board: The Swedish Association of Local Authorities and Regions (SALAR), SKL Företag AB, KPA Pensionservice AB and Norrköpings Hamn och Stuveri AB.



## Roger Mörtvik

Member of the Board since 2009. Born 1960.

Head of the Swedish Confederation of Professional Employees' social policy department.

Other board assignments:

Member of the Board: KPA Pensionsförsäkring AB.



## Charlotte Strömberg

Member of the Board since 2007. Born 1959.

Senior Advisor.

Other board assignments:

Member of the Board: Skanska AB and Intrum Justitia AB.

# Executive Management Committee

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## Mats Andersson

Chief Executive Officer Born 1954.  
Employed by AP4 since 2006. B.Sc. Economics.  
Previously employed by Deutsche Bank, AP3,  
Skandia Liv, and other companies.  
Other board assignments:  
Member of the Board: Rikshem AB, Svolder AB and the  
Association  
for Generally Accepted Principles in the Securities  
Market.



## Magnus Eriksson

Chief Investment Officer. Born 1959.  
Employed by AP4 since 2008. CEFA.  
Previously employed by Catella, AP3, MGA  
and other companies.  
Other board assignments:  
Member of the Board: Rikshem AB  
and Hemfosa fastigheter AB.



## Nicklas Wikström

Head of Performance and Risk Control. Born 1968.  
Employed by AP4 since 2008. Masters, Accounting and  
Financing, CEFA, AFA.  
Previously employed by AFA  
Försäkring and other companies



## Agneta Wilhelmson Kåremar

Director of Administration. Born 1952.  
Employed by AP4 since 2001. Bachelor of  
Laws and DIHM Diploma in Business  
Finance. Previously employed by Nordnet,  
Swedbank Markets, and Handelsbanken.

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# Glossary

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## Absolute return target

A targeted return intended to produce over time a positive return regardless of market trends. Contrast with a relative return target, for which the target is to outperform a specific index.

## Active return

Difference between the return on a portfolio and the return on its benchmark index. The active return is disclosed in the Fund's annual and interim reports for the actively managed portfolios with liquid assets. The term is used synonymously with return versus index, relative return, and outperformance.

## Active management

Asset management using a portfolio with a composition that differs from the index in an effort to achieve a higher return.

## Active risk

Risk that results from active management. Defined as the standard deviation of the difference between actual performance and index performance (that is, the standard deviation of the active return). Also known as tracking error.

## Return contribution

Shows how large a part of the return is attributable to a particular portfolio or decision. Return contributions are usually measured in percentage points. The sum of all return contributions equals the total percentage return for asset management overall or for a specific area.

## The brake

Automatic rebalancing, also called "the brake", is triggered when liabilities exceed assets in the pension system. This reduces the indexing of pensions until the pension system is once again in balance.

## Derivatives

Collective term for many different instruments. The value of a derivative is linked to the value of an underlying instrument. A government bond future is an example of a derivative that has a government bond as its underlying instrument.

## Diversification

Diversification means the spreading of risks. In other words, assets having varying correlation with each other, thereby reducing the total risk in the portfolio.

## Duration

Measure of interest rate risk. Measures the average time to maturity of all future cash flows (coupons and final redemption) for a bond or bond portfolio. Also known as Macaulay duration. See also Modified duration.

## Global equity portfolio

Consists of equities and equity-based instruments listed on stock exchanges included in the MSCI All Country Index. (Note that an equity listed on a Swedish stock exchange can be included in the global as well as the Swedish equity portfolio. At the time of purchase, the holding is assigned to the intended portfolio.) Foreign exchange derivatives are also managed in this portfolio. The benchmark indexes were MSCI North America, MSCI Europe, MSCI Japan, MSCI Pacific ex Japan and MSCI Emerging Markets. Gross Return for USA, Net Return for other countries, currency-hedged to SEK. The index has been adjusted through exclusion of companies in accordance with the recommendations of the Ethical Council.

## Index management

Also referred to as passive management. Management of a portfolio so that the holdings mirror the composition of a designated index so the portfolio achieves the same returns as the index.

## Information ratio

A measure of risk-adjusted return. Measured as a portfolio's active return in relation to its active risk.

## Benchmark index

Index against which a portfolio's return and risk are compared. Also called reference index.

## Short position

Negative exposure to a market or type of asset. For example, negative exposure to a foreign currency using derivatives.

## Corporate bond

Bond that carries a higher credit risk than a government bond.

## Credit risk

Risk that a counterpart cannot meet all or part of their obligations as a result of financial incapacity.

## Liquidity risk

Risk that a financial instrument cannot be divested within a reasonable time without significantly affecting its price.

## Long position

Positive exposure to a market or type of asset. For example, a positive exposure to a foreign currency using derivatives.

## Market risk

Risk of a change in the value of a financial instrument as a result of variations in equity prices, exchange rates, or interest rates.

## Operational risks

Collective term for risk of loss resulting from disruptions in business operations, for reasons such as human error, deficient systems, or shortcomings in instructions or procedures.

### Passive management

Management of a portfolio so that the holdings mirror the composition of a designated index so the portfolio achieves the same returns as the index. Also known as indexing.

### Investment assets

Used in this annual report to denote the Fund's total capital under management. In the balance sheet, however, investment assets are defined in accordance with generally accepted accounting principles. The principles require that buybacks, cash and equivalents, and derivatives with negative market value are recognised on the balance sheet but not as investment assets.

### Real return

Return minus inflation.

### Rebalancing

Restoring the composition of assets in a portfolio or a benchmark index to a desired allocation, such as 50% equities and 50% fixed income.

### Reference index

Index against which a portfolio's return and risk are compared. Also called benchmark index.

### Portfolio risk, ex post

The standard deviation of the return on the portfolio during the period. Indicates the extent of fluctuations in the value of the portfolio and reflects the portfolio's risk level. See also Volatility.

### Fixed income portfolio

Comprises fixed income assets including interest rate derivatives. The foreign portion of the fixed income portfolio's reference index is hedged in Swedish kronor. The benchmarks were Svenska Handelsbanken's government and housing bond index as well as Merrill Lynch's government and corporate bond index hedged in Swedish kronor.

### Semi-active management

Portfolio management carrying somewhat higher active risk than passive management; that is, indexed management with limited active intervention. Also known as enhanced indexing.

### Sharpe ratio

A measure of risk-adjusted return. Calculated as the portfolio's return minus risk-free interest, divided by the standard deviation of the portfolio. A high Sharpe ratio indicates a good trade-off between risk and return.

### Strategic allocation

Medium-term deviations from the normal portfolio's asset allocation, foreign exchange exposure, duration, and so forth aimed at enhancing the returns on and risk characteristics of the strategic portfolio. Strategic allocations are decided by the Board of Directors based on the normal portfolio and medium-term forecasts of risk and return.

### Swedish equity portfolio

Consists of equities and equity-based instruments listed on a stock exchange in Sweden or another Nordic country. The benchmark was SIX 60 for the large cap portfolio and OMX smallcap for the portfolio with small and mid-cap companies.

### Tactical asset allocation

Active position-taking between different asset categories or regions, for example, to outperform an index.

### Time-weighted return

Time-weighted return, calculated on a daily basis and based on the assumption that all transactions occur at the end of the day. This concept is always used in reporting the financial performance of a portfolio or sub-portfolio and refers to the performance before expenses unless stated otherwise.

### Value at Risk (VaR)

A measure of risk that indicates the maximum loss a portfolio risks during a specific period given a certain statistical confidence level.

### Foreign exchange exposure

Denotes the proportion of the portfolio denominated in a currency other than the Swedish krona and for which foreign exchange risk has not been neutralised by hedging.

### Hedging

Neutralisation of foreign exchange risk by changing the foreign currency exposure to Swedish krona, using foreign exchange derivatives such as foreign exchange forward contracts.

### Volatility

Measure of risk equal to the standard deviation of the return on an asset. It shows how much the return varies

### Outperformance

Achieved when a portfolio produces a higher return than its benchmark or reference index. Equal to an active return greater than zero

# Administration report

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The Fourth Swedish National Pension Fund (AP4) annually submits an Administration Report containing those parts of the Swedish Code of Corporate Governance appropriate for the Fund.

AP4's Board of Directors, comprising nine regular members, is appointed by the Government and is responsible for the organisation and the management of AP4's funds. At the end of May, the Ministry of Finance announced that Jakob Grinbaum had been appointed Deputy Chairman of the Fund's Board of Directors. Jakob Grinbaum replaces Lars Frithiof, who had declined re-election. Ing-Marie Gren, Stefan Lundbergh and Lena Micko were appointed new members of the Fund's Board, as Elisabeth Nilsson has declined re-election and Illmar Reepalu has left his position because he had been a member of the Fund's board for 11 years.

[>Board member presentations.](#)

The Board has delegated responsibility for day-to-day management to AP4's CEO, who has an executive management committee of three employees to support him in the decision-making process.

[>Executive management committee presentation.](#)

AP4's auditors are appointed by the Government. The current audit mandate for 2011 is valid until the income statement and balance sheet for 2011 are adopted. The auditors report to the Fund's Board and to the Ministry of Finance. The Administration Report has not been examined by the Fund's auditors.

The 2011 Administration Report can be downloaded here [>Administration report.](#)

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## Contact

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If you have questions regarding AP4, please contact Annika Andersson, Head of Corporate Governance and Information.

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