



Annual Report 2005 PART I



INVESTOR IN PEOPLE



**Lennart Låftman,
Anna Hesselman,
Peter Norman.**

Welcome to AP7's annual report!

I never knew five years could fly by so quickly! In the summer of 2000, my colleagues and myself were struggling to get everything ready for the PPM inception in the autumn. The inception came and everything worked smoothly – except for the fact that we saw the biggest slump in the stock market in living memory.

Now, most PPM funds have worked their way up into the black, which is of course gratifying. Both for all would-be-pensioners, as well as for the legitimacy of the system as such.

In this annual report we will use the rear-view mirror, as well as the binoculars. AP7 has in many ways been an innovator in fund management, and we have no intentions of resting on our laurels.

Only one thing is sacred – our objective. “Those who will not or cannot choose, will have at least as good a pension as everyone else – that is our aim.”

Welcome!

Peter Norman

PETER NORMAN
EXECUTIVE PRESIDENT,
THE SEVENTH SWEDISH NATIONAL PENSION FUND



Former Vice-President of the United States, Al Gore.

Sustainable development

EXTRACTS FROM AL GORE'S SPEECH AT THE ANNIVERSARY

AP7 HAS PRESENTED TRULY IMPRESSIVE results and, to me, it holds special significance, because success today is far too often defined in terms of short-term results.

In the United States, as recently as thirty years ago, the average period for holding a share was seven years. Today, the average mutual fund turns over its entire portfolio in eleven months. The value of most companies is created over a period of several years, over a business cycle or even longer, and thus, if the investment lasts less than one year, you cannot, with any justification, call it an investment. Rather it should be termed speculation. But as

investment managers have started evaluating themselves on the basis of a short time-frame, every three months, or even every day or hour, the temptation to define success on the basis of those short time-frames become irresistible to many.

A result measured over a period of five years, that AP7 presents today, is of far greater value. Five years more or less correspond to a business cycle, and many investment experts have long argued that investments should be made with a long-term perspective in mind, to a far greater extent than is the case today.



grating environmental and ethical aspects into investment strategies, as a quality assurance. I am thinking, for example, of the well-known British mutual fund, Scottish Widows, who proudly declared: – We follow the AP7 philosophy concerning environment and ethics. You may not have heard or read much about that, but those of us who work in global finance have, in admiration, followed and studied AP7.

In the United States we recently lived through a tragedy in the wake of the hurricane Katrina. I wish to express my thanks, by the way, to those of you who expressed your sympathy and who supported the United States in those terrible times. Katrina was preceded by clear warning signals of a hurricane, classified as category one when approaching the coast of Florida and who would be crossing unusually warm waters in the Mexican gulf and subsequently would grow in force on its way to New Orleans.

There were specific warnings about the possibilities of the levees breaking apart, but for some reason, nothing was done in time. The consequences of that became clear in the tragic scenes we could all see on the television. I mention this tragedy because I want to use what took place in August as an analogy to other warnings we have all been made aware of at this moment in time.

“Sweden should be proud of the fact that investment managers in other parts of the world have adopted the AP7 way of integrating environmental and ethical aspects into investment strategies, as a quality assurance.”

Kyoto

The scientific community is just as clear about the consequences of global warming, as the meteorologists were clear in their warnings about what could happen in New Orleans. Those warnings, as I mentioned, were ignored. The warning signals concerning our planet that we hear today, are likewise ignored to a great extent; however, not by Sweden who has a very progressive policy on the environment and who has signed the Kyoto agreement.

My own country is extremely sensitive to the slightest increases in the risk of an act of terrorism, and that is only proper. Some of the complex security measures some of you have witnessed during visits to our country have been created on the basis of a strong intolerance to the risk of acts of terrorism, and that is also only proper. But why are we so tolerant to risks concerning the future of our planet?

Why should we have one level of concern for unforeseeable events that stem from terrorism, but instead ignore the terrible risks we subject ourselves to every day, by continue to tolerate the enormous pollution that leads to global warming and changes the earth's climate?

By the way, is it not a bit warm in Stockholm for this time of year? I spoke to friends in Moscow earlier and they told me it was even warmer in Moscow, which is very unusual for the season.

I am convinced that we who inhabit this planet must realise that this period in our history is unique, compared to any period preceding it. We must respond to these new circumstances with a new level of commitment, in order to go forward. I also believe we have access to everything we need to solve these problems. With the possible exception of political will. But political will is also a renewable resource.

AP7 shows its qualities in action, rather than words. What I perhaps appreciate even more, is that AP7 has achieved these results by, among other things, applying a set of principles often found under the heading of sustainable development: environmental policy, ethics and the principles that show that you care about your employees. Congratulations, by the way, to the distinction, Investor in People, that you have received as a confirmation of that.

Those principles have contributed in a meaningful way to the process through which AP7 has analysed what is a good investment and what is not. That is why it is also a confirmation of the market system, if it is pursued in an intelligent and devoted way, can play a far more active role in spreading the values we all believe are necessary and that should be brought out into the light.

The fact is that AP7, quietly has raised the bar. Sweden should be proud of the fact that investment managers in other parts of the world have adopted the AP7 way of inte-

PETER NORMAN, EXECUTIVE PRESIDENT:

Anniversary

ON THE 12TH OF OCTOBER WE CELEBRATED our fifth anniversary with a seminar. All of five years had passed. I climbed the rostrum and reminisced. Many employees, including myself, were employed on the first of April 2000. There was no time to lose. We knew that the money would start coming in on the 26th of September. Everything had to be done in only a few months.

- Firstly, people needed to be hired.
 - Secondly, an IT solution needed to be purchased and implemented.
 - Thirdly, a portfolio had to be created.
 - Fourthly, portfolio managers had to be acquired.
- Everything came to fruition and on Friday, September 22, we concluded the public contracts.

The following Tuesday, we received the first money. The PPM system had been launched!

We really stuck our necks out in the beginning of the PPM launch and said that you would not end up worse off, if you did not actively choose. Now, five years later, it is time to put our money where our mouth was..

Those who did not choose, but ended up in Premiesparfonden have had a return that is approximately eight points higher than the return in the average fund. In addition, the risk level in Premiesparfonden has been, and is, significantly lower than in the average fund.

Posted targets achieved

Of course, there are mutual funds with far better returns than that of Premiesparfonden. We have never claimed we will be the best, and neither has that been our ambition! That would entail too great a risk.

Our ambition is, and has been

from the word go, to give people who save with us, a return that is better than the average for the mutual funds that can be selected.

So we can – not without pride – say that we have achieved the posted objective.

AP7 has, during five years of managing pension money, been an innovator in a variety of fields.

To start with, we were one of the first to introduce the

concept of external asset management. Today this feels like old hat, but five years ago it was a revolution.

We have created an automated reporting process. In brief, this means that our external managers must report electronically every transaction they make, no matter where they are located, within fifteen minutes.

When we introduced index linked bonds, it was an unknown asset type to many people. Another innovation was currency-hedged share holding.

We brought hedge funds and private equity funds into our portfolio about three years ago. Those two types of assets fit well into a simultaneous introduction; private equity funds increase both expected risk and expected return, while the hedge funds reduce the expected risk.

Throughout our work, transparency has been our guiding light. The financial sector has a history of mystery-mongering. I believe that the industry, as well as individual businesses, does itself a disservice by not keeping the public better informed about what they do.

According to a decision by parliament, all AP funds must institute an environment and ethics policy. We chose to break new ground in this field as well. We blacklist all companies who violate the UN and ILO conventions Sweden has ratified.

Are we satisfied? Will we sit back and relax? No, of course not!

We recently launched a project where we try to separate market return from “skill return”. Our expectations are that this will enable us to get away from the “index hugging” that today, characterises many aspects of asset management.

Presently, we are discussing including active currency management in the portfolio.

We are also looking at the asset type: “tactical asset allocation (TAA)”. TAA entails changing the weighting regarding e.g. interest and shares or the weighting between different regions.

We are also looking into exposure in developing countries, so called “emerging markets”.

Unfortunately I do not see the same power of innovation among the 700 eligible mutual funds in the PPM system. In spite of the large number of funds, there is a very limited measure of innovation.

Legislative change

The premium pension inquiry which was presented in October suggests a number of changes to the premium pension system. Several of these changes have previously been suggested by us, and we welcome the inquiry. Among other things, it is suggested that Premiesparfonden should create so-called life style funds. They mean that the risk in the portfolio is reduced over the course of a person's life. Furthermore, it is proposed that AP7 should be given the possibility to vote

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Peter Norman.

on their Swedish holdings, something that presently is not allowed. According to the inquiry, it should also be possible to come back to Premiesparfonden if you have once chosen a different alternative. Today, there is an abstruse catch, stopping anyone who has once made an active choice.

I have tried to outline our plans for the future. We foresee great changes in the next few years. But one thing remains firm: our objective.

“Those who will not or cannot choose will have at least as good a pension as everyone else – that is our aim.”



RICHARD GRÖTTHEIM, EXECUTIVE VICE PRESIDENT:

Good gets better

TODAY WE LOOK BACK AT FIVE years of asset management in the fund. What lessons have we learned so far? What has been good? What can we do better?

Let me start by telling you what we were thinking when we chose to structure the management the way we did.

We started by asking ourselves two main questions. One dealt with what we should manage in-house and what should

we hand over to external managers. The other question dealt with what we should manage passively, i.e. as closely as possible follow a benchmark index, and what we should manage actively, i.e. try to beat the benchmark index.

The answer to the first question was, that anything where we felt we could not compete with the best in the field, we should let external managers handle. The second question

We decided to place the entire interest portfolio passively with AP7 in-house. In addition, a little over half the Swedish shares should be managed actively by the in-house team.

The remainder should be handled by external managers. We started by placing all portfolio management with an index manager, in order later to gradually procure active managers for Japan, the rest of Asia, Europe as well as for some of the Swedish shares.

An intense public procurement process was started and we ended up hiring six international managers around the globe to help manage AP7's assets in as professional a way as possible.

During 2002, the board made the decision to invest in hedge funds and private equity, i.e. unlisted companies. In this, we also felt it was suitable both to hire external hedge fund and private equity fund managers, as well as letting so called fund-in-fund managers select which hedge funds and private equity funds to invest in.

Regular evaluations

As of today, AP7 has eleven external managers. We have replaced one during our time in operation, due to poor results. The staff of the fund follow up those managers on the basis of a clear framework, where return, risk and how well the administration works is thoroughly evaluated every six months.

So how has this way of managing worked so far? On the whole very well, is the general impression. With the exception of the manager we replaced about a year ago, most managers have had returns in line with posted objectives. The markets we identified as suitable for active management seem to have been just that, particularly the Japanese, but also the other Asian markets. In Sweden, the excess return has generally been lower, but it is difficult to draw any conclusions about whether this is due to Sweden being less suitable for active management.

That which, so far, has given us some reason to reconsider this, is how clarity could be achieved about how to achieve index return and excess return, respectively. In financial markets these are called alpha and beta returns. The thoughts we have entertained at the fund has given rise to a developing of the internal Swedish equity management, aiming to separate alpha from beta. Beta return can be effectively created by passive management. Alpha return can be achieved by focusing on buying good quality shares and selling an equal amount of bad shares, so called short selling. This is known as market neutral management, which means that a return greater than zero is achieved, irrespective of the market going up or down.

If this set-up turns out to be successful for the internal team, we will consider developing the concept for the entire portfolio.

So far, we have been satisfied with the model we have chosen to manage the fund's assets. We also look with confidence and new ideas to the next five-year period.

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Richard Gröttheim.

we passed on to investment consultants Mercer of London to investigate. Based on various criteria, the consultants produced a platform defining in which markets active management might pay off. Only in those markets were we to invest in the more expensive active management.

Balancing passive – active management

During the summer of 2000, we produced and decided on an asset distribution in Premiesparfonden, where 65 percent were foreign shares, 20 percent Swedish shares and 15 percent index linked bonds.

On the basis of this, we were now to choose fund managers.

MARIANNE BJÖRK,
VICE PRESIDENT ADMINISTRATION:

Building foundations

ASSET MANAGEMENT STARTED IN the autumn of 2000. Before that, extensive administrative preparations had been ongoing since 1998. In the autumn of 1999 a new board started working, and the task at hand was the recruiting of the fund's management and the office staff. An extensive checklist was being reviewed during the preparatory work, e.g. defining fund guidelines, getting a corporate identity number from the Tax authority, purchasing computer systems for capital management,

registering, building business and salary systems, etc. All those were both necessary and extensive tasks. But it was also about the venue, the post box, the copier, the faxes and, not least, the coffee machine. Preparing to set up a new business is both time-consuming and trying. But eventually, everything was in place for the operations to begin.

The start

The management, in the form of an MD and his deputy, were recruited at the turn of the

year, 1999/2000. Only at this point did the work on creating a body of experts and work processes really begin. The first fund selection in the autumn of 2000 was the time of external information. Around the country, we were informing people of our operations. The amount of interest was impressive. We were seen as serious and skilled in our contact with the media, consumer advisers and the public. Maybe it worked to our advantage not having AP7 taking part in the advertising campaigns that many other players revelled in.

Outsourcing as a concept

During the first few years, it was all about getting the administration working perfectly. In collaboration with the Legal, Financial and Administrative Services Agency, we developed relevant processes for financial and salary management. The strategy to keep the administrative function small and instead invest in outsourcing, was successful. Purchasing external services as well as following up and quality assuring them, were the main tasks. The same applied to law, office services and information. Throughout, our focus has been on keeping administrative costs low, in order

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not to burden the fund with high service fees. The fact that we succeeded in that can be seen in both our low service fees and the evaluation of the AP fund's administrative costs, that was made by the government last year.

Investor in People

HR policy is also a primary task for the administrative management. A number of HR policies have been developed and implemented. Strategic skill development has been a top priority. A measure that led to our being approved as an “Investor in People” in the autumn of 2005. Investors in People (IIP) is an international standard aiming to improve companies and their results by purposefully and systematically developing their employees. One of the cornerstones of IIP is that operating plans and skill plans should work in parallel. The standard is British in origin and has spread throughout



**Marianne Björk
and Al Gore.**

the world, both as a development tool and as a standard according to which you can be approved and certified after examination. You then become an Investor in People.

Board work

In my capacity as the board's secretary since 1998, I have had the privilege of working for a very experienced chairman and board. For that reason, developing processes for the board work and evaluations etc, went smoothly and quickly.

In the binoculars' viewfinder

The future offers many challenges. Now, it is about continuously evaluating the various administrative functions and quality-assuring them. The internal controls are of particular importance.

In accordance with IIP, strategic skill training forms an integral part of achieving AP7's overarching objectives. The

skill training of each individual employee is important in order to achieve excellence on the whole.

As for the legal field, the re-authorisation in accordance with the Investment Funds Act, is finished on behalf of the fund. In the next stage, further changes to the fund guidelines will become relevant, as new forms of asset management develop.

The information to the pension savers and the public about our results, is essential in order to build on an already extensive trust. AP7 is an important brand that should guarantee security, wisdom and moderation. A brand that has been built, not through advertising campaigns, but through our actions and our way of being. In total, we have more than two million people saving with us, and they need to know what we are doing for them. The premium pension inquiry and its conclusions will lead to further information to people who are about to start saving, as well as to those who are already part of the system.



SVANTE LINDER, VICE PRESIDENT FUND ADMINISTRATION:

5 people and SEK 55 billion

THE FUND ADMINISTRATION IS at the heart of AP7. It is us who deal with the daily handling of the fund's assets, it is us who calculate how the fund is doing on a daily basis (the so called NAV rate) and it is us who make sure the rules and objectives posted by the board and the fund's management are obeyed. The fund requires complex systems and operational reliability must be high. This also falls under the responsibilities of the fund administration.

All this must not only be done flawlessly every day. In addition, we constantly review expenses in order to be as

cost-effective as possible. Cost-effectiveness is of the utmost importance, because if we can keep costs down it will mean better pensions for the people who save with us.

Operational reliability

Few fund managers have as reliable and cost-effective a system to administrate their funds as we do. The AP7 system is unique. The high return and low costs of the fund can be partially explained by two factors that have entailed great challenges to us at the fund administration.



Svante Linder.

The first factor is that the lion share of our assets are managed externally. We believe the people who save with us will get better returns by our choosing specialists in the markets where we invest. There are fund managers all over the world, which is a challenge to us in the administration. We must always calculate the correct NAV rate, even if the transaction is being made on the other side of the globe. Communicating and straightening out issues with an external manager in a completely different time zone places far different demands on us than dealing solely with internal managers, who often sit in the next room.

The second factor is that the fund invested in hedge funds and private equity funds at an early stage. Those assets increase the risk adjusted return. That also presented the administration with a challenge. The investments in private equity means buying into a number of unlisted companies with the objective of owning them for an extended period of time. One of the challenges with those assets is that they are difficult to evaluate as they are unlisted. However, we must make a daily evaluation in order to present the correct NAV rate to our savers.

Few people

In spite of those challenges, the fund administration today consists of only five employees. That is one important reason why AP7 has significantly lower fees than other pension funds.

Lower fees make for higher pensions. The fact that the fund has succeeded so well in controlling cost, while the returns have been so high, depends very much on the thorough analyses being made at the time of the inception in 2000. That was when the groundwork was laid for the effective administration today. Perhaps the most important consequence was that we simplified the business flow, among other things by our developing a unique technical solution for automatic communication between ourselves and our external managers. Several private managers have since chosen to adopt that same solution. The system has also enabled us to place greater demands on our external managers. For example, we demand of our managers, wherever they are located, that they must report all transactions they make on behalf of the fund within fifteen minutes of their completion. That leads not only to good control, but also to more correct NAV calculations.

“Few fund managers have as reliable and cost-effective a system to administrate their funds as we do. The AP7 system is unique.”

11,000 transactions

The fund administration is not only significantly smaller at AP7 than at other funds. We have also managed to keep the number of employees at the same level since the inception in 2000. And that is in spite of the fact that we, in 2005, managed assets totaling SEK 55 billion, carried out more than 11,000 transactions and had more than 4,000 different kinds of securities!

In order to keep costs down in the future, this year we carried out a public procurement procedure for a depot bank. The depot bank is the most important partner of the fund administration, and keeps all our documents of value. The procurement was very successful and over the coming years it will lead to our getting significantly better service at a significantly lower price. Of course, we are not satisfied with that and will continuously work on streamlining our procedures. This is particularly important in the light of the fund growing steadily for the foreseeable future.

CHRISTIAN RAGNARTZ, VICE PRESIDENT CHIEF ANALYST:

Sustainable return

AP 7 CONTROLS THE RISKS and, consequently, the expected return in Premiesparfonden and Premievalsfonden, by defining a strategic model portfolio. The model portfolio defines the long-term allocation between a fund's various asset types, e.g. shares and interest-bearing assets. In the case of AP7, the model portfolio represents more than 95 percent of the fund's return. Assuming you find active portfolio managers who create added value, the remaining part comes from active management.

In order to create a model portfolio we chose an approach based on Asset Liability Management (ALM). In order to carry out a high-quality ALM study with the limited resources and very little time available, the fund chose to collaborate with Watson Wyatt Investment Consulting. The unique aspect of AP7's ALM study was that not only did we need to consider a liability side that, before the first selection was made, to a great extent had to be assumed; in addition, we had legislation to consider. Premiesparfonden should not only be managed to achieve a long-term high return. Risk also had to be low and,

moreover, even lower than for the average private pension fund. Considering the large number of funds that would be part of the premium pension system, this may sound like an impossibility in terms of financial theory. Particularly as the fund chose a low-cost strategy which has led to the fund's savers having paid about one third as much as the savers who chose a private alternative.

When the strategic portfolios were determined, a large number of market scenarios were studied, producing a variety of future pension results. Various asset allocations were analysed with those scenarios. Portfolios with attractive return and risk properties were identified.

Simulations showed that it was actually possible to find a strategic portfolio for Premiesparfonden that was expected to give a somewhat higher expected return, with lower expected risk, than what the average active pension saver's portfolio was expected to give. Premievalsfonden was given a more return-oriented profile than Premiesparfonden.

The possibilities of such a strategic allocation for Premiesparfonden were due to the fact that the average active premium pension saver does not sufficiently spread the risks between different markets. The most common approach is to invest too much in Swedish shares, to omit CPI linked bonds, and to take excessive currency risks. Both Premiespar-

fonden and Premievalsfonden have, among other things, about half the exposure to the Swedish stock market of the average PPM saver and approximately 60 percent of the foreign assets are currency-hedged.

Seen from a five-year perspective, the fund has exceeded the predetermined objectives. The fund's savers have received approximately eight points higher return compared to those who chose a private alternative. It is even more enjoyable discussing the result in light of the fact that the fund, as opposed to private alternatives, also must make environmental and ethical considerations. Those are demands that many associate with higher risk, lower return and uncertain effects. In this field as well, AP7 have shown that, quite the contrary, it is very possible to achieve both good risk-adjusted return as well as actual effects!

Another example is that AP7, as one of the top managers in Europe, divided management into passive management (beta management) and active management (alpha management). This time, it was about using different managers' skills and creating the best possible conditions for good return, in a market where previous studies had shown that it was possible to create additional return. By allocating management responsibility to different specialists, we expect not only a higher return, but also lower costs due to the specialisation – a trend that has been on-going and proven profitable in the industry.

New assets

So far, so good, but in order to maintain and possibly even increase our lead, we continue working on the strategic analysis. During next year, a number of new assets will be analysed in order to see if we can find an even better and more efficient portfolio. As long as there is not complete co-variation between a portfolio's assets, there are reasons to consider them. Basic financial theory states that you should invest in the so-called market portfolio, which, in principle, consists of all the assets in the world. Thus, there are reasons, even from a theoretical perspective, to consider additional assets.

It will be equally important to analyse existing assets and whether we should continue investing in all of them. Maybe the weight of each respective asset should be changed? For example, are there reasons to deviate from the theoretical framework for the so called BRIC countries, i.e. Brazil, Russia, India and China? Here, you should also consider whether the stock markets in those countries correctly reflect their actual economic importance. The fund's currency strategy has been one of the strategic decisions that contributed the most to the positive result. Have the conditions for that strategy changed?

All this will be analysed with a continued strong focus on the costs. Consequently, the AP7 will continue to work to provide better return at lower risk than the private alternatives, and all this for a significantly lower cost!

"The fund's savers have received approximately eight points better return compared to those who chose the private alternatives. It is even more enjoyable discussing the result in light of the fact that the fund, as opposed to private alternatives, also must make environmental and ethical considerations."



Christian Ragnartz
and Jonas B. Lind.

BENGT RYDÉN, CHAIRMAN OF THE BOARD:

About board work – in AP7 and elsewhere

AP7 HAS BEEN IN OPERATIONS for five years now, and the present board has served for six years. That is a sufficiently long period for a meaningful attempt at evaluating its work, as well as for a comparison with boards of other organisations.

The conclusions may serve as a starting point for reflexions and ambitions around future board work in Sweden in general, and in AP7 in particular. What important observations concerning the inner workings, and what probable changes to the world around us, may have a bearing on board work during the years to come?

The opinions expressed below are, naturally, based on my experience from AP7 and some other boards in which I have worked. The opinions are my own and not necessarily shared by my fellow directors.

Radical changes

The first evident observation is that board work has changed radically in a very short space of time. The demands on skill, time, commitment and responsibility have grown ever more strict. Those increasing demands probably have affected board work in general and, in particular, the role of the chairperson.

When the board of AP7 took up their duties in November 1999, it had one month to make some very tough and difficult decisions for the future of the fund, concerning management strategy and the recruiting of a Managing Director, among other things. In hindsight, it is satisfying to be able to say that those decisions turned out to be wise ones and that they, so far, have not needed reconsidering. My own impression is also that the board, at this important initial stage, proved that they had the skills, the commitment and the other properties I have mentioned, in tackling issues of great complexity. Add to that, both drive and courage. The standard thus established has been a guiding principle in all the subsequent work of the board.

My experience of AP7 has brought home to me the importance of having diversity on the board concerning skill, experience, age, sex, personality, etc. but also agreement on the need for commitment, openness, integrity, tolerance and, not least, the basic objective of the organisation. All of this forms the culture that is essential to efficiency and satisfaction on a board. I feel that the board of AP7 is a good example of how a good composition and culture can lead to success, but I have also seen how the opposite may lead to severe problems.

Over the last few years, regular board evaluations have become a mainstay of the industry. The demands of the corporate governance code will surely lead to this also becoming standard practice in other organisations, outside of the major listed corporations. I am convinced that a thorough evaluation, the results of which are discussed openly, can contribute to developing and strengthening a good corporate culture. It is also important to keep developing the evaluation process, lest it becomes routine and loses its importance. The chairman is of vital importance in that process.



**Bengt Rydén,
Chairman of the Board.**



Karin Moberg.



Reinhold Geijer.



Lars Linder-Aronson.



Christina Striby.



Mari-Ann Krantz.



Hans Mertzig.



Per-Olof Edin, Deputy Chairman of the Board.



Lena Hagman.

Caution when renewing

Besides the soft issues, things like order, time-keeping, working technology and other practical considerations are more important than many people perhaps appreciate. I have noted more than once the irritation and frustration that shortcomings in those areas can create, to the detriment of the board's work – however, not on the board of AP7!

A board, like any other group, will benefit from renewal, by having new people contribute new perspectives and additional experience. That is the task of the owners. But that renewal must be done with care, as it takes time to build a winning team. AP7 has been able to “spontaneously” renew itself at a reasonable pace as a few directors have resigned after receiving new assignments.

The interaction between the board and the MD is a particularly important issue. The board's most important job is to hire and evaluate the MD as well as, if necessary, remove him or her from office. But the role of the entire board, and not just the chairman, as a support and a sounding board for the MD is also essential. I have experienced board meetings that have been as painful to the MD as any student's final exams, due to tetchiness and lack of empathy from one or several of the directors. An MD is often more affected by psychological incentives than by financial ones! And for the owners, psychology comes a lot cheaper.

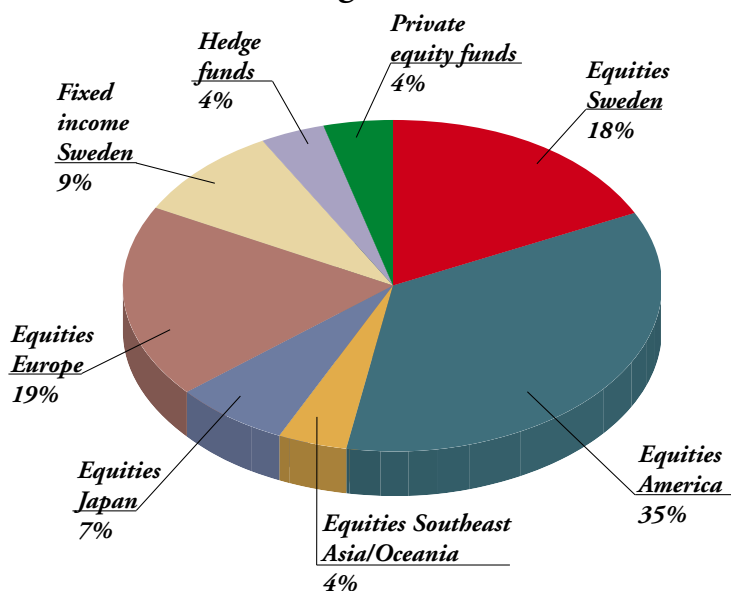
Increased remunerations

So what do the cards hold for the future of board work? Greater responsibility, more transparency, bigger involvement and time commitment are already demanded. This places increasing demands on the chairman. It is no coincidence that the corporate governance code requires the chairman to be elected by the general shareholders' meeting, and not, as has been the case so far, by the board. Those increasing demands should lead to gradually increasing remunerations to directors, which is fast becoming a profession in its own right. It is difficult to motivate – and accept – that the state as owner should not participate in that development. The same should apply to the AP fund boards whose remunerations, far below those of state-owned companies and private funds, have no bearing on the importance and responsibilities of the work involved.

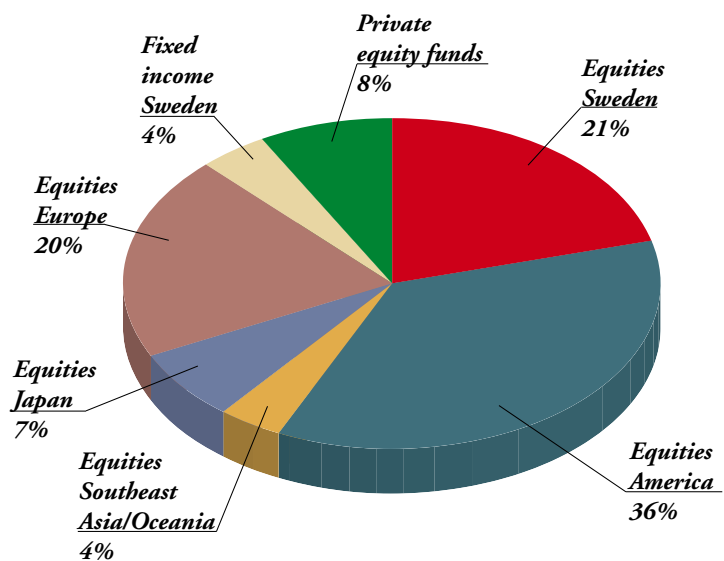
The greatest challenge for the boards over the next few years, I believe is to avoid having matters of form taking over from the important task of the board to define and develop the strategy of the organisation. The role of the board as a control body is, of course, important but there is a risk of it going to excess under the influence of the corporate scandals that have occurred in Sweden and elsewhere. We need to find a format for the board's work that will merge the controlling and strategic functions. I believe that the criticism against growing regulation – e.g. the corporate governance code in Sweden, IFRS in Europe, Sarbanes-Oxley in the US – that we see, will eventually lead to renewed deregulation.

It is in such fluctuations our politicised societies must act. And that environment will always affect the work of organisations and their boards.

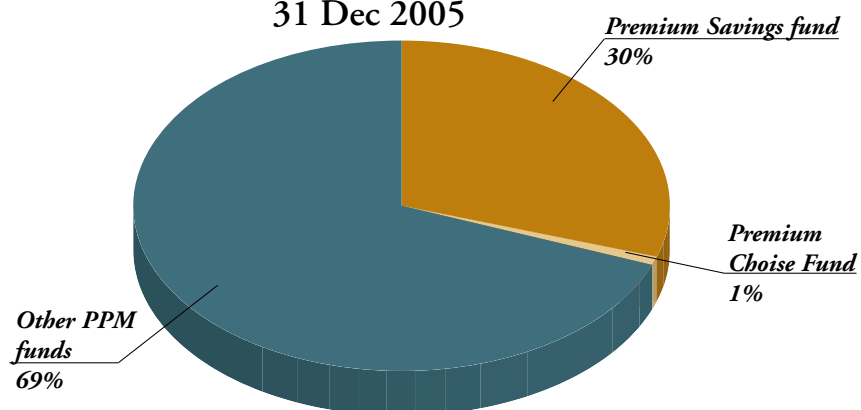
**Premium Savings Fund
Holdings 31 Dec 2005**



**Premium Choice Fund
Holdings 31 Dec 2005**

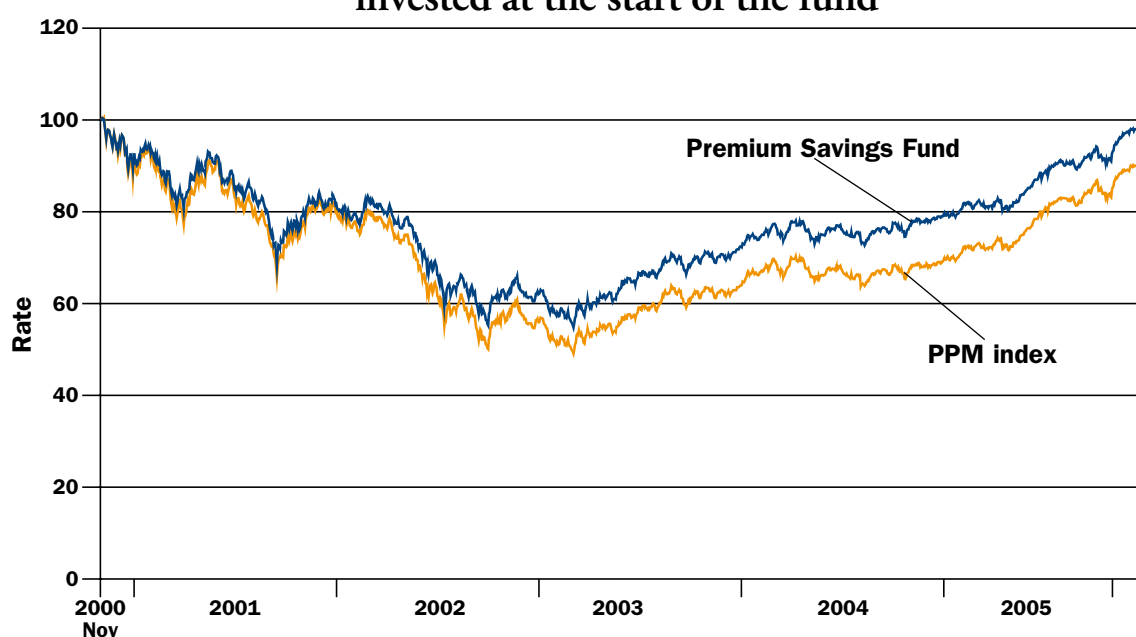


**Total PPM capital
31 Dec 2005**

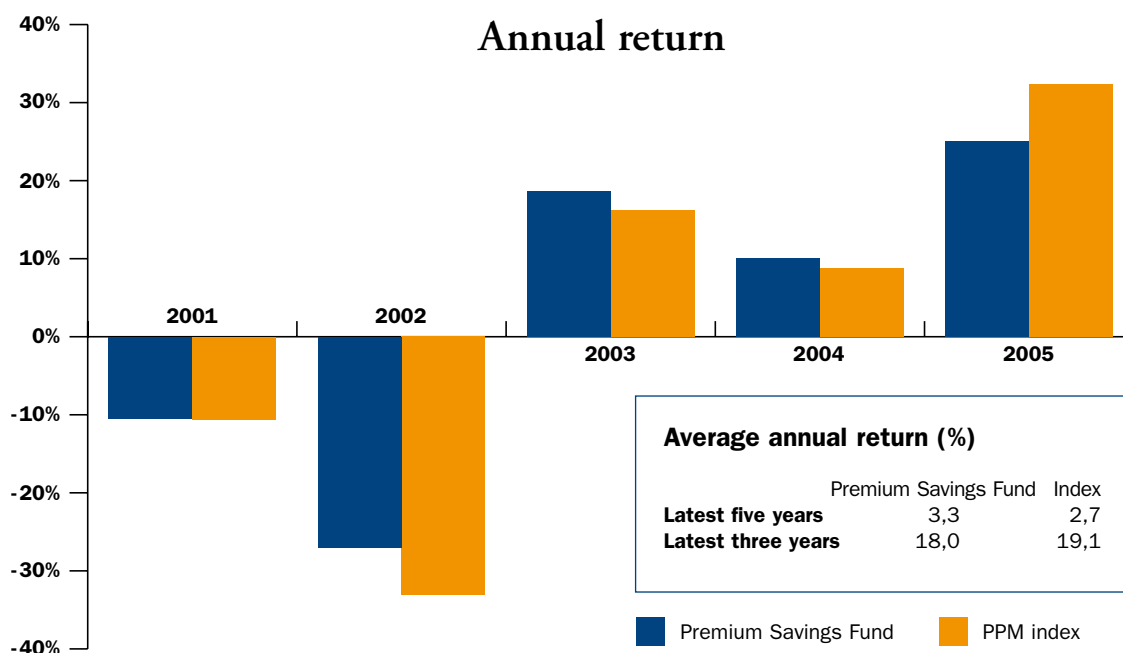


“Those who will not or cannot choose should receive at least as good a pension as everyone else – that is our aim”

The growth of SEK 100
invested at the start of the fund



Annual return



AP7's PPM index shows the average, weighted for capital, for all funds that can be actively chosen in the PPM system.

The shares of the following companies were, at the turn of the year 2005–2006, excluded from AP7 holdings

*AP7 only invest in companies that comply with the demands
of the international conventions ratified by Sweden.*

AMERADA HESS

Reported cases of corruption in Equatorial Guinea.

BASF

Reported violations against UN environmental regulations in the United States.

BAYER

Continued sales of toxic substances injurious to the environment in developing countries, in breach of FAO recommendations.

BHP BILLITON

Reported cases of anti-union action in Australia.

CACI INTERNATIONAL

Reported human rights violations during operations in Iraq.

CATHAY PACIFIC

Reported cases of labour rights violations.

CHEVRON TEXACO

Reported cases of human rights violations at Chevron Nigeria Ltd in Nigeria as well as environmental crimes in the Amazon.

COCA COLA

Reported labour legislation violations as well as reported cases of discrimination at Coca-Cola in the United States, Central and Latin America.

DUPONT

Reported damages to people and crops caused by one of the company's products (environmental toxin).

ENCANA

Reported cases of environmental crimes by the jointly owned company OCP in Ecuador.

EXXON MOBIL

Reported cases of corruption in Equatorial Guinea.

HYUNDAI MOTOR AND KIA MOTORS

Reported cases of anti-union action as well as substandard working conditions in South Korea.

MARATHON OIL

Reported cases of corruption in Equatorial Guinea.

MARRIOTT

Reported cases of sexual exploitation of children on company premises in Costa Rica.

OCCIDENTAL PETROLEUM

Reported cases of human rights violations in Colombia.

PEPSI

Reported labour legislation violations at operations in Guatemala.

REPSOL

Reported cases of environmental crimes by the jointly owned company OCP in Ecuador.

SANYO ELECTRIC

Reported cases of discrimination against women at their plant in Mexico.

SAS

Illegal restrictive agreements and practices.

SINGAPORE TECHNOLOGIES

A subsidiary manufactures landmines in breach of the convention banning landmines.

TITAN

Reported human rights violations during operations in Iraq.

TOTAL

Reported human rights violations by using forced labour when operating in Myanmar (Burma).

UNILEVER AND HINDUSTAN LEVER

Reported cases of dumping toxic waste with serious consequences by the subsidiary Hindustan Lever in India.

UNOCAL

Reported human rights violations by using forced labour when operating in Myanmar (Burma).

WAL MART STORES

Reported cases of discrimination against women in Guatemala as well as reported cases of anti-union action and labour legislation violations, as well as child labour at Wal Mart in the United States.

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