



 Sjunde AP-fonden

Annual Report 2005 PART 2



INVESTOR IN PEOPLE



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# Annual report 2005 • Premium Savings Fund

COMPANY REGISTRATION NUMBER: 504400-8182

## Report of the directors

### The Premium Savings Fund in the general pension system

Sweden's general pension system includes some of the pension premiums being earmarked for premium pensions. These are then managed in mutual funds according to the choice of the pension saver. For those refraining from selecting any other fund the pension capital is invested in the Premium Savings Fund, which functions just like a mutual fund. The Premium Savings Fund is managed by the Seventh Swedish National Pension Fund (AP Fund), which is a state authority that in this context functions as a fund management company. The Premium Savings Fund is intended solely for premium pension capital and is not open to other types of saving. The rules regulating the Seventh AP Fund and the Premium Savings Fund are laid down in the Act (2000:192) concerning the AP Funds.

### Reauthorisation of fund rules

The Act (2004:46) on Investment Funds came into effect on April 1, 2004. At the same time the Act (1990:1114) on Mutual Funds was rescinded. This meant that all fund rules that were approved in accordance with the previous act had to be reformulated and approved pursuant to the new act (reauthorisation). Such reauthorisation must be completed by February 13, 2007. Finansinspektionen approved new fund rules for the Premium Savings Fund on October 12, 2005.

### Investment and withdrawal of capital

In 2005 additional capital was channelled into the Premium Savings Fund in connection with the allocation to funds of premium pension capital for 2003. The Fund also received further capital in the form of re-investment by the Premium Pension Authority (PPM) of the discount on the management fee and invested inheritance profits, and when people who had previously selected another fund had their premium pension capital transferred to the Premium Savings Fund when their previous fund of preference left the PPM system. Over the year a total of around MSEK 8,000 (MSEK 7,600) was injected into the Fund. Of the first time selectors, 92% refrained from actively selecting another manager and consequently had their premium pension capital invested in the Premium Savings Fund.

In 2005 withdrawals of capital as a result of premium pension savers transferring to other funds or premium pension capital being required for its purpose were higher than in previous years, but the amount remained relatively small. Total withdrawals amounted to around MSEK 1,700 (MSEK 800), which corresponds to 3.3% (2.3%) of the average fund total during the year. Withdrawals were predominantly due to premium pension savers changing to other funds.

By the end of 2005, 2,312,736 people (2,270,175) had premium pension investments with a total market value of about MSEK 58,100 (40,100) invested in the Premium Savings Fund. This was equivalent to 30.2% (32.2%) of the total premium pension capital, making the Fund by far the largest in the premium pension system.

### Management goals

In the AP Funds Act, the Riksdag stipulated that the Seventh AP Fund's management of the Premium Savings Fund must be solely in the interest of pension investors. Given the selected risk level the Fund capital must be invested in such a way that in the long term a high return is achieved. The total risk level of the fund's investments must be low. According to the preparatory work for the Act, a low risk means that the Premium Savings Fund's risk level shall normally be lower than that of the average private manager of pension capital with the same investment horizon.

The board of the Seventh AP Fund has defined the long-term goal stipulated by the Riksdag as follows. During moving five-year periods the total return earned by the Premium Savings Fund must be equivalent to at least the average of all funds that can be actively selected in the premium pension system, but at a lower risk. The operational target for active management in 2004 was that the total return should exceed the Fund's benchmark index by at least 0.5 percentage units.

### Strategic distribution of assets

The Premium Savings Fund's capital is managed on the basis of a standard portfolio. This shows the long-term distribution of the Fund's various types of asset, expressed as a share of its total market value. In 2005 the standard portfolio had the following structure:

<b>Shares</b>	<b>82%</b>
of which Swedish	17%
of which foreign	65%
<b>Fixed income investments</b>	<b>10%</b>
of which Swedish inflation-linked bonds	10%
<b>Alternative investments</b>	<b>8%</b>
of which private equity funds	4%
of which hedge funds	4%

### Foreign shares

The foreign shares in the standard portfolio are distributed among four geographical regions (Europe, North and South America, Japan and Southeast Asia/Oceania) on the basis of the relative importance of each sub-market on the global stock market. In 2005 share investments

were made in the countries within the eurozone as well as in Sweden, Denmark, Norway, Poland, Switzerland, the UK, the Czech Republic, Hungary, Turkey, Brazil, Canada, Mexico, the USA, Japan, Australia, Hong Kong, Korea, New Zealand, Singapore and Taiwan.

### Alternative investments

The types of asset known as alternative investments include hedge funds and private equity funds. The Fund invests in these through fund-of-fund investments. This means that the Premium Savings Fund invests in units in funds which in turn invest in a number of other hedge funds and private equity funds. Investments are only made if they satisfy the liquidity requirements of Finansinspektionen for this type of investment. Hedge funds and private equity funds often take the form of limited partnerships. Since it is a requirement of the Seventh AP Fund that direct investments must not go via tax havens, most alternative investments are channelled through specially formed Swedish limited partnerships in which the Premium Savings Fund is a limited partner. This type of asset also includes shares in such listed companies as, in turn, invest mainly in shares in unlisted companies or private equity funds.

The term *hedge fund* is not a uniform concept, it is more of an umbrella name for funds that aim to earn a stable, positive return, regardless of the performance of the underlying market (e.g. stock or bond market). Various strategies and a wide range of financial instruments are used to achieve this. The return on hedge funds only co-varies slightly with the return on shares and fixed income securities. A holding of units in hedge funds can thus help to reduce fluctuations in the return, i.e. the risk, on a securities portfolio owning various types of asset.

The term *private equity fund* is an umbrella name for funds with investments in unlisted companies at various stages of their development. Such investments are often made on a 10-15-year investment horizon in companies at an early phase of their development. Skilled managers have been able to earn a very good return on long-term investments in unlisted companies. A holding of private equity funds can therefore help to increase the return on a securities portfolio with various types of asset. Admittedly, the return on private equity funds tends to co-vary more closely with the stock market than that on a hedge fund, but such a holding can to a certain extent still help to reduce fluctuations in the return on a securities portfolio owning a variety of different assets.

### Currency hedging

Fifty per cent of the market value of equity investments denominated in euro, sterling, US dollars and ¥en are hedged by means of 6-

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month moving currency futures. Fifty per cent of the value at which investments in private equity funds denominated in euro, sterling and US dollars are included in the NAV calculation are hedged by means of currency futures. Hedge fund investments in euro, sterling and US dollars are hedged by means of currency futures for 100% of the value at which they are taken up in the NAV calculation. Other investments in foreign currencies are not hedged. This currency hedging strategy meant that at the end of 2005 the amount hedged corresponded to 45% of the assets denominated in foreign currencies and 33% of the total capital of the Fund.

### Active management and tracking

By active management we mean that the investments deviate from the market average with the object of achieving a higher return. Tracking means that the investments follow the average on the market (index) as closely as possible, in which case the return will also match the market average. Active management has been chosen for markets where this type of management can be expected to generate a higher return than tracking, taking account of cost differentials between the two types of management. The following management structure was applied in 2005:

### Inflation-linked fixed income investments:

Tracking

### Equity investments:

percentage of equity investments on each market

Market	Active management	Tracking
Sweden (up to April 11)	75	25
Sweden (from April 12)	67	33
Europe	50	50
America	0	100
Japan	100	0
Southeast Asia/Oceania	100	0

In the autumn of 2005 a model was introduced to a limited extent, which involved active management of Swedish shares in the form of separated alpha and beta management. In traditional active share management the capital is invested in shares in such a way that the weighting of the shares in the portfolio deviates from the corresponding share's weighting in the index. The aim is to outperform the average on the market (index) by being overweight in shares that are expected to outperform the index and underweight in those that are expected to underperform in relation to the index. Separated alpha and beta management involve making a sharper division of the management into two parts, one aiming to generate an average return (beta) and the other aiming to earn a return in excess of the market average (alpha). The total risk of the separated alpha and beta management remains unchanged in relation to traditional active management.

In the separated alpha management the return is generated using the long/short management model. Long positions are taken in the tradi-

tional way by investing in shares whose prices are expected to rise. Short positions are taken in shares whose prices are expected to decline. This takes the form of selling short; which means that shares are borrowed and sold immediately. No capital, over and above a limited amount of working capital, needs to be earmarked for this separated alpha management. The long investments are financed using the proceeds received from the short selling of the borrowed shares.

The return on separated beta management is created by managing the total capital in the separated alpha and beta management in accordance with the tracking model.

### Internal and external management

By internal management we mean that investment decisions are made by portfolio managers employed by the Fund. By external management we mean that investment decisions are made by specially engaged external portfolio managers, often large specialist firms. The Seventh AP Fund manages all fixed income investments internally as well as currency hedging and the separated alpha management of Swedish shares. For global tracking management of equity investments and the separated beta management of Swedish shares, active equity management abroad is used, while external managers are engaged for a small proportion of the Swedish active equity management, and for investments in hedge funds and private equity funds.

The following external managers were engaged in 2005:

- State Street Global Advisors, London (all global equity tracking).
- Nomura Asset Management, London/Tokyo (all active equity management in Japan).
- Goldman Sachs Asset Management International, London (all active equity management in Europe).
- B. Carlsson Investment Management, Stockholm (20% of the active equity management in Sweden).
- Schroder Investment Management, Singapore (all the active equity management in Southeast Asia/Oceania).
- EIM, Nyon, Switzerland (hedge-fund investments).
- K2 Advisors, New York (hedge-fund investments).
- LGT Capital Partners, Pfaeffikon, Switzerland (private equity fund investments).
- HarbourVest Partners, Boston/London (private equity fund investments).
- Hamilton Lane Advisors, Cynwyd, USA (private equity fund investments).

### Environmental and ethical considerations

In its investment activities, the Seventh AP Fund shall take the environment and ethics into consideration, without compromising on the overall goal of earning a high return. This involves only investing in companies which, in the view of the

Fund, comply acceptably with the requirements of international conventions to which Sweden is a signatory. Companies in Sweden are also subject to the further requirement that they comply with Swedish law. The main conventions referred to here are:

- Human Rights Conventions
- The UN Convention on the Rights of the Child
- ILO conventions
- International environmental conventions
- Conventions against bribery and corruption

The Seventh AP Fund is therefore free to invest in shares in the approx. 1,500 companies worldwide that are included in the managed funds' benchmark index. In addition, the managing director can decide that investments may be made in shares not in the index. Furthermore, the Fund may also invest in inflation-linked, corporate bonds with the highest rating. All these companies are scrutinised on the basis of the principles stated. The Fund is not permitted to invest in companies that are not approved after such a scrutiny. Exclusion of a company from investment by the Seventh AP Fund applies for five years after:

- a court decision, or
- publication of documents by the official supervisor of an international convention that refer to the company, or
- the company's management has acknowledged the offence.

If a company can verify that measures have been taken to rectify the criticised conditions, the Fund's Board, after obtaining a recommendation from the consultants engaged to perform the scrutiny, and after special review, can decide that the company can be taken off the exclusion list before the five years are up.

In connection with alternative investments in hedge funds and private equity funds, the managers shall make every effort to assure themselves that the underlying investments comply as closely as possible with the Seventh AP Fund's policy on environmental and ethical investments.

Changes to the list of prohibited investments are decided upon twice a year. In 2005 the following companies were excluded from investment by the Premium Savings Fund:

- Amerada Hess as from February 1, 2005
- BASF
- Bayer as from February 1, 2005
- BHP Billiton
- Caci International as from February 1, 2005
- Cathay Pacific as from February 1, 2005
- Chevron Texaco
- Coca Cola
- Dupont
- Encana

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- Exxon Mobil as from February 1, 2005
- Hyundai Motor and Kia Motors
- Jaya Tiasa Holdings up to and including January 31, 2005
- Marathon Oil as from February 1, 2005
- Marriott International
- Occidental Petroleum
- Pepsi as from February 1, 2005
- Petrobras up to and including January 31, 2005
- Repsol
- Sanyo Electric
- SAS
- Singapore Technologies
- Titan as from February 1, 2005
- Total as from February 1, 2005
- Unilever
- Unocal as from February 1, 2005
- Wal-Mart
- Wyeth from February 1, 2005 up to and including July 31, 2005

### Derivatives and borrowing and lending of shares

The Premium Savings Fund's investments are based on spot markets. However, derivatives can be used in situations where they will help to further improve the management of the Fund or can protect it against unwanted risk exposure.

Equities may be lent if this helps to improve the return. The Fund rules contain specific restrictions and collateral requirements for the use of derivatives and the lending of shares. In 2005 derivatives were only used to a limited extent. The lending of shares covered most of the Swedish share portfolio. There was a limited amount of borrowing of shares for the purposes of selling short.

### Management fee

The Premium Savings Fund pays the Seventh AP Fund a management fee that corresponds to 0.5% per year of the Fund's value. The Fund is debited 1/365th part of the estimated annual fee daily. The fee covers the cost of management, administration, accounting, safekeeping of securities, information, supervision etc.

According to an agreement with the Premium Pension Authority (PPM), the Seventh AP Fund grants PPM a discount on the management fee. For this discount PPM buys new units in the Fund on behalf of premium pension savers. The size of the discount depends on the amount of the fee and also on how much capital the Fund has under management. As the capital managed by the Premium Savings Fund is large, the discount will be considerable. As far as pension savers are concerned, this means that in 2005 the net fee after the discount was 0.15%.

Transaction costs such as brokerage commissions and fees payable to deposit banks for securities transactions are charged direct against the Fund and not included in the management fee.

### Benchmark index

The benchmark index consists of a weighted index of the various benchmarks for the sub-portfolios based on the weighting of each sub-portfolio in the standard portfolio, account also being taken of any currency hedging. The following benchmark indices are used:

<b>Swedish equities</b>	SBX Stockholmsbörsen's benchmark index (SIX-RAX up to and including 31 July 2002)
<b>Foreign equities</b>	
Europe	FTSE All World Index Europe (excl. Russia and Turkey up to and including 1 May 2005)
America	FTSE World Index Americas
Japan	FTSE World Index Japan
Southeast Asia/Oceania	FTSE World Index Asia Pacific excl. Japan
<b>Private equity</b>	FTSE All World Index
<b>Hedge funds</b>	Index based on STIBOR overnight lending rate
<b>Inflation-linked bonds</b>	OMRX-REAL

### Fund's ten largest holdings as % of fund capital at year-end 2005

(excluding investments in unlisted hedge funds and private equity funds)

Ericsson	2.9
Kingdom of Sweden inflation-linked bond 3105	2.2
Kingdom of Sweden inflation-linked bond 3104	1.7
3I Group	1.4
Nordea	1.4
Kingdom of Sweden inflation-linked bond 3102	1.3
Hennes & Mauritz	1.0
General Electric	1.0
AstraZeneca	1.0
Svenska Handelsbanken	0.8
<b>Total ten largest holdings</b>	<b>14.7</b>

### Return

The Premium Savings Fund's return and risk are measured on the basis of daily valuations of the Fund's assets, which are performed using two different models:

- The first calculation model is used to determine the Fund's NAV (Net Asset Value), which is used for purchases and redemptions of units in the fund. The management fee that the Premium Savings Fund pays to the Seventh AP Fund is deducted from this value. The NAV is determined on the basis of the prices of the Fund's investments at 4.00 pm Swedish time. The calculation made on the basis of changes in the NAV reflects the change in value from the pension savers' perspective. The discount that is received by PPM and returned to the savers is, however, not reflected in the value calculated using this model. In 2005 the discount for the Premium Savings Fund was equivalent to an excess return of 0.35%.

### Geographical distribution of investments as % of fund capital at year-end 2005:

America	37
Sweden	27
Rest of Europe	25
Japan	7
Southeast Asia and Oceania	4
<b>Total</b>	<b>100</b>

- The second model is used for following up the Fund's performance in relation to its benchmark index. The valuation is therefore made in accordance with the same principles as those used for determining the value of the benchmark index. The management fee paid by the Premium Savings Fund to the Seventh AP Fund is not deducted. This model uses the prices of the Fund's assets that are listed at the close of each market where the Fund's assets are listed.

The return earned by the Premium Savings Fund in 2005 was 25.1%, measured according to the NAV model. The risk, expressed as the standard deviation, was 7.8%. By type of asset, the return was 36.4% on Swedish equities, 26.4% on global equities (including currency hedging), 7.5% on inflation-linked bonds, 5.1% on hedge funds and 31.9% on private equity funds.

The target for the Premium Savings Fund is that the return during each moving five-year

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period should correspond at a minimum to the average of all the funds included in the premium pension system, but at a lower risk. The comparison with other funds in the pension system is based on the return measured using the NAV model. The Seventh AP Fund's PPM Index is calculated for this purpose. This index measures the capital-weighted average of all funds that are open for active selection in the premium pension system. The weightings in the index correspond to the proportion of the premium pension capital invested in each fund. The risk is measured in terms of the standard deviation in the Premium Savings Fund's return and is compared with the standard deviation in the Seventh AP fund's PPM Index.

The Premium Pension System was launched in the autumn of 2000. An assessment can now be made for the first time of how well the target has been achieved for a whole five-year period. During the period 2001-2005 the Premium Savings Fund earned a return of 6.9% and its risk was 14.8%. In the same period the return on the Seventh AP Fund's PPM Index was 0.2% and the risk was 15.4%. The Premium Savings Fund's excess return in relation to the PPM average during the past five-year period was therefore 6.7 percentage points. The target for the Premium Savings Fund was therefore exceeded by a wide margin.

One important reason why the Premium Savings Fund has outperformed against the PPM average was that over the last five years around 50% of the foreign securities portfolio has been hedged against currency losses. The fall in the value of the dollar during the five-year period has therefore not had a particularly large effect on the return on foreign equities. The decision to invest in inflation-linked bonds instead of nominal ones and the structure of the equities portfolio were other factors behind this performance.

The operative target for active management in 2005 was to outperform the Fund's benchmark index by at least 0.5 percentage points. This comparison is made using the return measured according to the closing-price model. Measured in this way, the Premium Savings Fund's return in 2005 was 25.5% while that of the benchmark index was 24.8%. The target for active management was thus exceeded in 2005 by 0.2 percentage points.

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Key ratios	2005	2004	2003	2002	2001
Fund capital (SEK)	58,114,166,991	40,130,238,621	29,857,197,025	18,652,106,412	19,049,366,918
Number of units in issue	587,602,051,4883	507,478,606,1886	415,689,109,6900	308,322,102,5321	229,974,474,9307
Price of units (SEK)	98.86	79.05	71.80	60.48	82.81
Management fee (SEK '000)	260,304	191,231	132,987	104,816	89,386
<b>Calculated return and risk, NAV model</b>					
Total return, Premium Savings Fund (%)	25.1	10.1	18.7	-27.0	-10.5
Total return, Seventh AP Fund's PPM Index (%)	32.3	8.8	16.2	-33.1	-10.6
Total risk, Premium Savings Fund (standard deviation, %)	7.8	9.3	14.3	19.8	19.1
Total risk, Seventh AP Fund's PPM Index (standard deviation, %)	8.0	10.1	14.5	20.4	19.8
<b>Return and risk, closing price model</b>					
Total return, Premium Savings Fund (%)	25.5	10.8	19.8	-27.1	-9.3
Total return Benchmark index (%)	24.8	11.2	19.5	-26.5	-9.1
Total risk, Premium Savings Fund (standard deviation, %)	7.1	8.7	13.5	18.8	16.1
Total risk, Benchmark index (standard deviation, %)	7.2	8.7	13.6	18.8	16.5
<b>Sharpe ratio</b>					
Active risk (%)	0.4	0.5	0.8	1.2	2.4
Information ratio	1.4	-0.9	0.3	-0.5	-0.1
Turnover rate (%)	23.3	30.2	34.2	28.8	28.4
<b>Costs</b>					
Management fee before PPM discount (%)	0.50	0.50	0.50	0.50	0.50
Management fee after PPM discount (%)	0.15	0.15	0.16	0.16	0.17
Total cost ratio (TCR) before PPM discount (%)	0.56	0.57	0.61	0.67	0.73
Total cost ratio (TCR) after PPM discount (%)	0.20	0.22	0.27	0.33	0.40
Total cost ratio (TCR) before PPM discount including alternative investments (%)	0.63	0.64	-	-	-
Total expense ratio (TER) before PPM discount (%)	0.50	0.50	0.50	0.50	0.50
Transaction costs (SEK '000)	28,780	27,840	29,732	19,969	26,677
Transaction costs, proportion of turnover (%)	0.10	0.08	0.11	0.11	0.12

### Definitions

**Return and risk calculations:** the Premium Savings Fund's return and risk are calculated in two ways. The first method reflects the growth in value seen from the pension savers' perspective and is based on the Fund's NAV (Net Asset Value), which is used for when units are bought and redeemed. With this method, the return is stated after deduction of the management fee that the Premium Savings Fund pays to the Seventh AP Fund, but without taking into account the reinvestment of the discount made by PPM on behalf of savers. A comparison is made with the Seventh AP Fund's PPM Index. When determining the NAV, the prices of the Fund's assets at 4.00 pm Swedish time are used. With the other method, which is used in comparisons with the Fund's benchmark index, the return is shown before deduction of the management fee that the Premium Savings Fund pays to the Seventh AP Fund. The valuation based on this model uses the prices of the Fund's assets that are listed at close of each of the markets where the Fund's assets are listed.

**Seventh AP Fund's PPM Index:** Indicates the capital-weighted average for all funds within the PPM system

that are open for active choice. The weightings correspond to the proportion of the premium pension capital invested in each fund.

**Standard deviation:** Indicates the magnitude of the fluctuations in the return and the index around the mean.

**Sharpe ratio:** A measure of the risk-adjusted return that indicates the return per unit of risk (risk = standard deviation). The Sharpe ratio is calculated as the portfolio return less the risk-free return divided by the standard deviation. For example: If the annual return is 10%, the risk-free return 4% and the standard deviation 15%, the Sharpe ratio will be  $((10-4)/15) = 0.4$ . This means that we earn a return of 0.4% per unit of risk.

**Active risk:** A measure of how much a portfolio deviates from its benchmark index. The day-to-day return on a portfolio is compared with the day-to-day return for the corresponding index. The standard deviation for this difference is a measure of the active risk. The lower the standard deviation the lower the active risk. A low active risk means that the weighting of each

individual security in the portfolio is roughly the same as the weighting of the security in the index. The return on a portfolio with a low active risk will most probably be the same as the return on the index. A high active risk means that the weighting of each individual security in the portfolio deviates from its weighting in the index. The return on a portfolio with a high active risk can be considerably higher or lower than the return on the index.

**Information ratio:** A measure of whether the risk exposure that is shown by the active risk has made a positive contribution to the portfolio's return. A positive information ratio indicates that the portfolio has earned a higher return than the index. The bigger the positive figure, the greater the excess return (portfolio's return less index return) per unit of risk. If the information ratio is negative, the return on the portfolio has been lower than the index. The information ratio is calculated by dividing the portfolio's relative return by its active risk. By the portfolio's relative return is meant the return earned on the portfolio during the period in question less the return on the index during the same period.



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**Turnover rate:** Measures how many times securities have been bought or sold in relation to the value of the Fund. It is calculated by dividing the lowest value of the sum of bought and total securities during the period by the average value of the Fund, stated as a percentage.

**Total cost ratio (TCR):** The sum of the Fund's costs including transaction costs on the purchase and sales of securities. TCR is expressed as a percentage of the average value of the Fund. Both TCR before and TCR after the PPM discount are stated. The PPM discount is described in greater detail in the report of the directors.

**Total cost ratio (TCR) including alternative investments:** Calculated in the same way as TCR before the PPM discount (see above), but it also includes the costs of the limited partnerships through which the bulk of the alternative investments are channelled.

**Total expense ratio (TER):** Calculated as TCR (see above) but exclusive of transaction costs associated with the purchase and sale of securities.

**Transaction costs:** Commission paid to the broker and transaction fees paid to the deposit bank.

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### Balance sheet

<i>All amounts in SEK '000</i>	31 Dec 2005		31 Dec 2004	
<b>Assets</b>				
Financial instruments with positive market value (Note 1)	58,312,754	100.4%	40,161,090	100.1%
Cash at bank and other liquid funds	180,402	0.3%	109,160	0.2%
Other current receivables	242,457	0.4%	75,017	0.2%
<b>Total assets</b>	<b>58,735,613</b>	<b>101.1%</b>	<b>40,345,267</b>	<b>100.5%</b>
<b>Liabilities</b>				
Financial instruments with negative market value (Note 2)	387,275	0.7%	168,732	0.4%
Other current liabilities	234,171	0.4%	46,296	0.1%
<b>Total liabilities</b>	<b>621,446</b>	<b>1.1%</b>	<b>215,028</b>	<b>0.5%</b>
<b>Value of Fund (Note 3)</b>	<b>58,114,167</b>	<b>100.0%</b>	<b>40,130,239</b>	<b>100.0%</b>
<b>Memorandum items (Note 12)</b>	<b>5,219,956</b>	<b>9.0%</b>	<b>4,040,205</b>	<b>10.1%</b>

### Income statement

<i>All amounts in SEK '000</i>	2005	2004
<b>Income and change in value</b>		
Change in value of equity-related instruments (Note 4)	13,000,559	1,570,692
Change in value of fixed income related instruments (Note 5)	204,264	272,161
Interest income (Note 6)	-23,359	240,814
Dividends (Note 7)	1,014,898	710,776
Currency gains and losses, net (Note 8)	-2,194,392	801,008
Other income (Note 9)	6,693	9,566
<b>Total income and change in value</b>	<b>12,008,663</b>	<b>3,605,017</b>
<b>Costs</b>		
Management costs (Note 10)	-260,304	-191,231
Other costs (Note 11)	-4,743	-3,749
<b>Total costs</b>	<b>-265,047</b>	<b>-194,980</b>
<b>Net profit/loss for the year</b>	<b>11,743,616</b>	<b>3,410,037</b>

### Accounting principles

The Fund's annual report is made up in accordance with the Investment Funds Act and Finansinspektionen's ordinances and general recommendations.

Financial instruments are valued at their actual value. Instruments listed on an authorised market are valued at 4.00 pm at their latest transaction price. In the case of unlisted holdings a cautious valuation is made of their actual value. The average method is used for calculating capital gains and losses. Lent securities are still stated in the balance sheet and included within the line. Borrowed securities are not stated in the balance sheet but are included within the line. Premiums received or accrued are stated as interest income. Paid and accrued premiums (interest paid) for borrowed securities are stated under other costs.

### Tax

The Premium Savings Fund is not liable for taxation in Sweden. In the case of investments abroad, there may in some instances be a liability to pay tax in the form of "definitive tax at source" on dividends.

The notes on the income statement and balance sheet are omitted from this printed annual report. An appendix with notes may be obtained from the Seventh AP Fund. It is also available at [www.ap7.se](http://www.ap7.se)

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### Audit report

#### Seventh AP Fund's Premium Savings Fund

Co. Reg. No. 504400-8182

In our capacity as auditors of the Seventh AP Fund we have examined the annual report for the Premium Savings Fund for 2005. Our audit was performed in accordance with generally accepted auditing standards in Sweden.


The annual report is made up in accordance with the Act Concerning the AP Funds and the rules in the Investment Funds Act as specifically referred to in the AP Funds Act. The annual report thus provides a true and fair picture of the Fund's financial result and position in accordance with generally accepted accounting standards in Sweden.

Our audit has found no grounds for qualifying this annual report, the accounting records or the management in general.

STOCKHOLM, 8 FEBRUARY 2006



ANDERS BÄCKSTRÖM  
Authorised public accountant  
Appointed by the Government



ANNA HESSELMAN  
Authorised public accountant  
Appointed by the Government



JAN PALMQVIST  
Authorised public accountant  
Appointed by the Swedish Financial Supervisory Authority

# Annual report 2005 • Premium Choice Fund

COMPANY REGISTRATION NUMBER: 504400-8240

## Report of the directors

### What is the Premium Choice Fund?

Sweden's general pension system includes the earmarking of some of the pension premiums for premium pensions. These are then managed in mutual funds according to the choice of the pension savers. The Premium Choice Fund functions just like a mutual fund and can be selected in the same way as other funds within the premium pension system. The Premium Choice Fund is managed by the Seventh Swedish National Pension Fund (AP Fund), which is a state authority that, in this context, functions as a fund management company. The Premium Choice Fund is intended solely for the premium pension capital and is not open to other types of saving. The rules regulating the Seventh AP Fund and the Premium Choice Fund are laid down in the Act (2000:192) concerning the AP Funds.

### Reauthorisation of fund rules

The Act (2004:46) on Investment Funds came into effect on 1 April 2004. At the same time the Act (1990:1114) on Mutual Funds was rescinded. This means that all fund rules that were approved in accordance with the previous act have to be reformulated and approved in accordance with the new act (reauthorisation). Such reauthorisation must be completed by 13 February 2007. Finansinspektionen approved new fund rules for the Premium Choice Fund on 12 October 2005.

### Investment and withdrawal of capital

In 2005 additional capital was channelled into the Premium Choice Fund in connection with the allocation to funds of premium pension capital for 2003. The Fund also received further capital when pension savers transferred from other funds to the Premium Choice Fund and when the Premium Pension Authority (PPM) reinvested the discount on the management fee and invested inheritance profits. During the year a total of around MSEK 202 (MSEK 200) was injected into the Fund. In 2005, the withdrawal of capital as a result of premium pension savers transferring to other funds, or premium pension capital being required for its purpose, was greater than in previous years but was still relatively small. Total withdrawals amounted to around MSEK 70 (MSEK 32), which corresponded to 4.7% (3.0%) of the average fund capital during the year. The outflow was mainly attributable to the fact that premium pension savers transferred to other funds.

By the end of 2005, 108,114 people (113,699) had premium pension investments with a total market value of some MSEK 1,700 (MSEK 1,200) invested in the Premium Choice Fund. This was equivalent to 0.9% (1.0%) of the total premium pension capital, making the

fund the seventeenth largest (fifteenth largest) among the approx. 700 funds eligible for active choice in the premium pension system.

### Management goals

In the AP Funds Act the Riksdag has stipulated that the Seventh AP Fund's management of the Premium Choice Fund must be solely in the interest of pension investors. Given the selected risk level, the Fund capital must be invested in such a way that in the long term a high return is achieved.

The board of the Seventh AP Fund has defined the long-term goal stipulated by the Riksdag as follows. The target for the end of 2003 was for the total return during moving five-year periods to be high enough for the Premium Choice Fund to be in the top 25% of all funds in the premium pension system. As of 2004, the target for the Premium Choice Fund is for the total return during moving five-year periods to be equivalent at least to the average of all funds that can be actively selected in the premium pension system plus 0.35 percentage points per year. The reason for the change is as follows.

When the target was established conditions were different from those that now apply. At the time of the decision – at the end of 1999 – the first premium pension selection had not taken place. Forecasts indicated that about 75% of the total premium pension capital would be invested in equities. Once the selection had taken place it turned out that more than 90% of the active selectors' total assets was invested in equities. This meant that the likelihood of the Premium Choice Fund earning a higher return by having more shares than average was far less than could have been expected when the target was decided upon. Nor was it foreseen at the time the decision was made that such a high proportion of the PPM funds would be niche funds with limited diversification and high risk. With this in mind, if the target for the Premium Choice Fund was to be retained, it would be necessary to significantly raise the Fund's risk level if there was to be any reasonable chance of achieving the target. The Seventh AP Fund has not found it appropriate to make such a change in the risk level. Instead the target has been altered, to make it realistic to achieve the target with an unchanged investment policy and risk level.

The operating target for active management in 2005 was for the total return earned by the Premium Choice Fund to outperform its benchmark index by at least 0.5 percentage units.

### Strategic distribution of assets

The Premium Choice Fund's capital is managed on the basis of a standard portfolio. This

shows the long-term distribution of the Fund's various types of asset, expressed as a share of its total market value. Up until the end of 2005 the standard portfolio had the following structure:

<b>Shares</b>	<b>88%</b>
Of which Swedish	20%
Of which global	68%
<b>Fixed income investments</b>	<b>4%</b>
Of which Swedish inflation-linked bonds	4%
<b>Alternative investments</b>	<b>8%</b>
Of which private equity funds	8%

### Global shares

The global shares in the standard portfolio are divided into four geographic areas (Europe, North and South America, Japan and Southeast Asia/Oceania), based on the relative weighting of each sub-market on the global stock market. In 2005, share investments were made in countries in the Eurozone as well as in Sweden, Denmark, Norway, Poland, Switzerland, Great Britain, the Czech Republic, Hungary Turkey, Brazil, Canada, Mexico, the USA, Japan, Australia, Hong Kong, Korea, New Zealand, Singapore and Taiwan.

### Alternative investments

The type of asset known as alternative investments consists of private equity funds. The Fund invests in these through fund-of-fund investments. This means that the Premium Choice Fund invests in units in funds, which in turn invest in a number of private equity funds. Investments are only made if they satisfy Finansinspektionen's liquidity requirements for this type of investment. Private equity funds often take the form of limited partnerships. Since it is a requirement of the Seventh AP Fund that the direct investments must not go via tax havens, most alternative investments are channelled through specially formed Swedish limited partnerships in which the Premium Choice Fund is a limited partner. This type of asset also includes shares in such listed companies as in turn mainly invest in shares in unlisted companies or in private equity funds.

The term *private equity fund* is an umbrella name for funds that invest in unlisted companies at various stages of their development. Such investments are often made on a 10- to 15-year horizon in companies at an early phase of their development. Skilled managers have been able to earn a very high return on long-term investments in unlisted companies. A holding of private equity funds can therefore help to increase the return on a securities portfolio with various types of asset. Admittedly, the return on private equity funds tends to co-vary with the

## Annual report 2005 • Premium Choice Fund

stock market, but such a holding can to a certain extent still help to reduce fluctuations in the return on a securities portfolio owning a variety of different types of asset.

### Currency hedging

Fifty per cent of the market value of equity investments denominated in euro, Sterling, US dollars and Yen are hedged by means of moving six-month currency futures. Fifty per cent of the value at which investments in private equity funds denominated in euro, Sterling, US dollars are included in the NAV calculation are hedged by means of currency futures. Other investments in foreign currencies are not hedged. This hedging strategy means that at the end of 2005 the amount hedged was equivalent to 42% of the assets denominated in foreign currencies and 31% of the total capital of the Fund.

### Active management and tracking

By active management we mean that the investments deviate from the market average with the object of achieving a higher return. Tracking means that the investments follow the average on the market (index) as closely as possible, in which case the return will also match the market average. Active management has been chosen for markets where this type of management can be expected to generate a higher return than tracking, taking account of cost differentials between the two types of management. The following management structure was applied in 2005:

### Inflation-linked fixed income investments:

Tracking

### Equity investments:

Percentage of equity investments on each market

Market	Active management	Tracking
Sweden (up to and including April 11)	75	25
Sweden (as from April 12)	67	33
Europe	50	50
America	0	100
Japan	100	0
Southeast Asia/Oceania	100	0

In the autumn of 2005 a model involving active management of Swedish equities in the form of separated alpha and beta management was introduced to a limited extent. In a traditional active equities management the capital is invested in equities in such a way that the weighting of the shares in the portfolio deviates from the corresponding weighting of the corresponding shares in the index. A profit in excess of the agreed level in relation to the average on the market (index) is aimed at by overweighting those shares that are expected to outperform the index and underweighting those that are expected to underperform the index. Separate alpha and beta management means there is a clear division of the management into two areas, one where the aim is to generate the market's average return

(beta) and one where the aim is to generate a return over and above that of the market (alpha). The total level of risk in the separated alpha and beta management is unchanged in relation to traditional active management.

In separated alpha management the return is generated using the long/short management model. Long positions are taken in the form of traditional investments in equities whose share prices are expected to increase. Short positions are taken in equities with expected negative price performance. This takes the form of short selling, which means that equities are borrowed and then sold immediately. Apart from a limited amount of working capital, no other capital needs to be earmarked for separated alpha management. The long investments are financed using the capital generated by the short selling.

The return on the separated beta management is generated by managing the total capital in the separated alpha and beta management in accordance with the tracking model.

### Internal and external management

By internal management we mean that investment decisions are made by portfolio managers employed by the Fund. By external management we mean that investments are made by specially engaged external portfolio managers – often large specialist firms. The Seventh AP Fund manages all fixed-income investments and currency hedging internally as well as the separated alpha management of Swedish equities. External managers are engaged for global tracking of equity investments and the separated beta management of Swedish equities, active equity management abroad and a small proportion of the Swedish active equity management, as well as for private equity fund investments.

The following external managers have been engaged:

- State Street Global Advisors, London (all global equity tracking).
- Nomura Asset Management, London/Tokyo (all active equity management in Japan).
- Goldman Sachs Asset Management International, London (all active equity management in Europe).
- B. Carlsson Investment Management, Stockholm (20% of the active equity management in Sweden).
- Schroder Investment Management, Singapore (all the active equity management in South-east Asia/Oceania).
- LGT Capital Partners, Pfaeffikon, Switzerland (private equity fund management).
- HarbourVest Partners, Boston/London (private equity fund management).
- Hamilton Lane Advisors, Cynwyd, USA (private equity fund management).

### Environmental and ethical considerations

In its investment activities, the Seventh AP Fund shall take the environment and ethics into con-

sideration without compromising on the overall goal of earning a high return. This involves investing only in companies which, in the view of the Fund, acceptably comply with the requirements of the international conventions to which Sweden is a signatory. Companies in Sweden are also subject to the further requirement that they comply with Swedish law. The main conventions referred to here are:

- Human Rights conventions
- The UN Convention on the Rights of the Child
- ILO conventions
- International environmental conventions
- Conventions against bribery and corruption.

The Seventh AP Fund is therefore free to invest in shares in the approx. 1,500 companies worldwide that are included in the managed funds' benchmark index. In addition, the managing director can decide that investments may be made in shares that are not in the index. Furthermore, the Fund may also invest in inflation-linked corporate bonds with the highest rating. All these companies are scrutinised on the basis of the principles stated. The Fund is not permitted to invest in companies that are not approved after such a scrutiny. Exclusion of a company from investment by the Seventh AP Fund applies for five years after

- a court decision, or
- documents that have been published by the official supervisor of an international convention that refer to the company, or
- the company's management has acknowledged the offence.

If a company can verify that measures have been taken to rectify the criticised conditions, the Fund's Board, after obtaining a recommendation from the consultants engaged to perform the scrutiny and after a special review, can decide that the company can be taken off the exclusion list before the five years are up.

In connection with alternative investments in hedge funds and private equity funds, the managers shall make every effort to assure themselves that the underlying investments comply as closely as possible with the Seven AP Fund's policy on environmental and ethical investments.

Changes to the list of prohibited investment are decided upon twice a year. In 2005 the following companies were excluded from investment by the Premium Choice Fund:

- Amerada Hess as from 1 February 2005
- BASF
- Bayer as from 1 February 2005
- BHP Billiton
- Caci International as from 1 February 2005
- Cathay Pacific as from 1 February 2005
- Chevron Texaco

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- Coca Cola
- Dupont
- Encana
- Exxon Mobil as from 1 February 2005
- Hyundai Motor and Kia Motors
- Jaya Tiasa Holdings up to and including 31 January 2005
- Marathon Oil as from 1 February 2005
- Marriott International
- Occidental Petroleum
- Pepsi as from 1 February 2005
- Petrobas up to and including 31 January 2005
- Repsol
- Sanyo Electric
- SAS
- Singapore Technologies
- Titan as from 1 February 2005
- Total as from 1 February 2005
- Unilever
- Unocal as from 1 February 2005
- Wal-Mart
- Wyeth as from 1 February 2005 up to and including 31 July 2005.

### Derivatives and borrowing and lending of shares

The Premium Choice Fund's investments are based on spot markets. However, derivatives can be used in situations where they will help to further improve the management of the Fund or can protect it against unwanted risk exposure. Equities may be lent if this helps to improve the return. The Fund rules contain specific restrictions and collateral requirements for the use of derivatives and the lending of shares. In 2005 derivatives were only used to a limited extent. There was no lending of shares.

### Management fee

The Premium Choice Fund pays the Seventh AP Fund a management fee that corresponds to 0.5% per year of the Fund's value. The Fund is debited 1/365th part of the estimated annual fee daily. The fee covers the cost of management, administration, accounting, safekeeping of securities, information, supervision etc.

According to an agreement with the Premium Pensions Authority (PPM), the Seventh AP Fund grants PPM a discount on the management fee. For this discount PPM buys new units in the Fund on behalf of premium pension savers. The size of the discount depends on the amount of the fee and also on how much capital the Fund has under management. As far as pension savers whose capital is managed by the Premium Choice Fund are concerned, this meant that in 2005 the net fee after the discount was 0.30%.

The Premium Choice Fund is debited direct for transaction costs such as broker's commissions and fees to deposit banks for security transactions. These costs are not included in the management fee.

### Return

The Premium Choice Fund's return and risk are measured on the basis of daily valuations of the Fund's assets, which are performed using two different models:

- The first valuation model is used to determine the Fund's NAV (Net Asset Value), which is used for purchases and redemptions of units in the fund. The management fee that the Premium Choice Fund pays to the Seventh AP Fund is deducted from this value. The NAV is determined on the basis of the prices of the Fund's investments at 4.00 pm Swedish time. The calculation made on the basis of changes in the NAV reflects the change in value from the pension savers' perspective. The discount that is obtained by PPM and returned to the savers is, however, not reflected in the value calculated using this model. In 2005 the discount for the Premium Choice Fund was equivalent to an additional return of 0.20%.
- The second model is used for following up the Fund's performance in relation to its benchmark index. The valuation is therefore made in accordance with the same principles as those used for determining the value of the

benchmark index. The management fee paid by the Premium Choice Fund to the Seventh AP Fund is not deducted. This model uses the prices of the Fund's assets that are listed at the close of each market where the Fund's assets are listed.

The return earned by the Premium Choice Fund in 2005 was 27.7%, measured according to the NAV model. Classified by type of asset, the return was 36.2% on Swedish equities, 26.4% on global equities (including currency hedging), 7.5% on inflation-linked bonds and 35.1% on private equity funds.

Since the end of 2003 the target for the Premium Choice Fund has been that the return for each moving five-year period should correspond at a minimum to the average of all the funds that are eligible for active selection in the premium pension system plus 0.35 percentage points per year. The comparison with other funds in the pension system is based on the return arrived at using the NAV model. The Seventh AP Fund's PPM Index is calculated for this purpose. This index measures the capital-weighted average of all funds that are open for active selection in the premium pension system. The weightings in the index correspond to the proportion of the

### Benchmark index

The benchmark index consists of a weighted index of the various benchmarks for the sub-portfolios based on the weighting of each sub-portfolio in the standard portfolio, account also being taken of any currency hedging. The following benchmark indices are used:

<b>Swedish equities</b>	SBX Stockholmsbörsen's benchmark index (SIX-RAX up to and including 31 July 2002)
<b>Foreign equities</b>	
Europe	FTSE All World Index Europe (excl. Russia and Turkey up to and including 1 May 2005)
America	FTSE World Index Americas
Japan	FTSE World Index Japan
Southeast Asia/Oceania	FTSE World Index Asia Pacific excl. Japan
<b>Private equity</b>	FTSE All World Index
<b>Inflation-linked bonds</b>	OMRX-REAL

### Fund's ten largest holdings as % of fund capital at year-end 2005 (excluding investments in unlisted private equity funds)

Ericsson	3.4
3I Group	2.5
Nordea	1.6
Hennes & Mauritz	1.2
AstraZeneca	1.2
General Electric	1.0
Svenska Handelsbanken	0.9
Förenings-sparbanken	0.9
Castle Private Equity Bearer	0.8
Pantheon Int. Participations Loan Notes	0.8
<b>Total ten largest holdings</b>	<b>14.3</b>

### Geographical distribution of investments as % of fund capital at year-end 2005:

America	36
Sweden	26
Rest of Europe	27
Japan	7
Southeast Asia and Oceania	4
<b>Total</b>	<b>100</b>

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premium pension capital invested in each fund.

The Premium Pension System was launched in the autumn of 2000. Until the end of 2003 the target was for the return earned by the Premium Choice Fund to be high enough to put the Fund in the top 25% of the funds in the PPM system. This target was not achieved. The reasons for this and for changing the target formulation are described in the section entitled Management goals. The new target of outperforming the average for the actively selected PPM funds by at least 0.35 percentage points per year over moving five-year periods has only been applied for two years, 2004 and 2005. The target was not achieved during this two-year period. During the five-year period 2001-2005 the return earned by the Premium Choice Fund was 1.6% and in the Seventh AP Fund's PPM Index the return was 0.2%. The Premium Choice Fund's return exceeded the PPM Index during the five-year period, but not by so much that the new target was achieved.

The operative target for active management in 2005 was to outperform the Fund's benchmark index by at least 0.5 percentage points. This comparison is made for returns measured according to the closing-price model. Measured in this way, the Premium Choice Fund's return in 2005 was 28.2% while that of the benchmark index was 27.2%. The target for active management was thus exceeded in 2005 by 0.5 percentage points.

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Key ratios	2005	2004	2003	2002	2001
Fund capital (SEK)	1,694,603,059	1,190,334,274	924,328,401	596,979,825	668,064,664
Number of units in issue	18,783,954,4286	16,844,514,4239	14,338,038,0435	11,076,428,2620	8,587,591,0666
Price of units (SEK)	90.17	70.64	64.44	53.88	77.67
Management fee (SEK '000)	7,550	5,734	4,113	3,478	3,181
<b>Calculated return and risk, NAV model</b>					
Total return, Premium Choice Fund (%)	27.7	9.6	19.6	-30.6	-12.5
Total return, Seventh AP Fund's PPM Index (%)	32.3	8.8	16.2	-33.1	-10.6
Total risk, Premium Choice Fund (standard deviation, %)	8.5	10.5	16.0	22.6	21.1
Total risk, Seventh AP Fund's PPM Index (standard deviation, %)	8.0	10.1	14.5	20.4	19.8
<b>Return and risk, closing price model</b>					
Total return, Premium Choice Fund (%)	28.2	10.5	21.2	-30.8	-11.2
Total return Benchmark index (%)	27.2	11.7	21.4	-30.0	-10.5
Total risk, Premium Choice Fund (standard deviation, %)	7.7	9.7	15.1	21.2	17.6
Total risk, Benchmark index (standard deviation, %)	8.0	9.8	15.4	21.4	17.9
Sharpe ratio	3.5	0.8	1.2	-1.6	-0.9
Active risk (%)	0.7	0.7	1.2	1.4	2.6
Information ratio	1.3	-1.8	-0.2	-0.6	-0.3
Turnover rate (%)	25.6	43.1	24.5	18.9	31.0
<b>Costs</b>					
Management fee before PPM discount (%)	0.50	0.50	0.50	0.50	0.50
Management fee after PPM discount (%) <sup>1)</sup>	0.30	0.32	0.25	0.25	-
Total cost ratio (TCR) before PPM discount (%)	0.69	0.79	0.82	0.91	0.93
Total cost ratio (TCR) after PPM discount (%) <sup>1)</sup>	0.50	0.61	0.57	0.66	-
Total cost ratio (TCR) before PPM discount including alternative investments (%)	0.72	0.81	-	-	-
Total expense ratio (TER) before PPM discount (%)	0.51	0.50	0.50	0.50	0.50
Transaction costs (SEK '000)	2,872	3,270	2,591	1,971	2,086
Transaction costs, proportion of turnover (%)	0.33	0.26	0.44	0.42	0.26

<sup>1)</sup> PPM has changed its method of re-entering discounts as from 2004. The PPM discount has been calculated on an approximate basis for the period 2001–2003.

### Definitions

**Return and risk calculations:** The Premium Savings Fund's return and risk are calculated in two ways. The first method reflects the growth in value seen from the pension savers' perspective and is based on the Fund's NAV (Net Asset Value), which is used for when units are bought and redeemed. With this method, the return is stated after deduction of the management fee that the Premium Savings Fund pays to the Seventh AP Fund, but without taking into account the reinvestment of the discount made by PPM on behalf of savers. A comparison is made with the Seventh AP Fund's PPM Index. When determining the NAV, the prices of the Fund's assets at 4.00 pm Swedish time are used. With the other method, which is used in comparisons with the Fund's benchmark index, the return is shown before deduction of the management fee that the Premium Savings Fund pays to the Seventh AP Fund. The valuation based on this model uses the prices of the Fund's assets that are listed at close of each of the markets where the Fund's assets are listed.

**Seventh AP Fund's PPM Index:** Indicates the capital-weighted average of all funds within the PPM system

that are open for active choice. The weightings correspond to the proportion of the premium pension capital invested in each fund.

**Standard deviation:** Indicates the magnitude of the fluctuations in the return and the index around the mean.

**Sharpe ratio:** A measure of the risk-adjusted return that indicates the return per unit of risk (risk = standard deviation). The Sharpe ratio is calculated as the portfolio return less the risk-free return divided by the standard deviation. For example: If the annual return is 10%, the risk-free return 4% and the standard deviation 15%, the Sharpe ratio will be  $((10-4)/15) = 0.4$ . This means that we earn a return of 0.4% per unit of risk.

**Active risk:** A measure of how much a portfolio deviates from its benchmark index. The day-to-day return on a portfolio is compared with the day-to-day return for the corresponding index. The standard deviation for this difference is a measure of the active risk. The lower the standard deviation the lower the active risk. A low active risk means that the weighting of each

individual security in the portfolio is roughly the same as the weighting of the security in the index. The return on a portfolio with a low active risk will most probably be the same as the return on the index. A high active risk means that the weighting of each individual security in the portfolio deviates from its weighting in the index. The return on a portfolio with a high active risk can be considerably higher or lower than the return on the index.

**Information ratio:** A measure of whether the risk exposure that is shown by the active risk has made a positive contribution to the portfolio's return. A positive information ratio indicates that the portfolio has earned a higher return than the index. The higher the positive figure, the greater the excess return (portfolio's return less index return) per unit of risk. If the information ratio is negative, the return on the portfolio has been lower than the index. The information ratio is calculated by dividing the portfolio's relative return by its active risk. By the portfolio's relative return is meant the return earned on the portfolio during the period in question less the return on the index during the same period.



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**Turnover rate:** Measures how many times securities have been bought or sold in relation to the value of the Fund. It is calculated by dividing the lowest value of the sum of bought and total securities during the period by the average value of the Fund, stated as a percentage.

**Total cost ratio (TCR):** The sum of the Fund's costs including transaction costs on the purchase and sales of securities. TCR is expressed as a percentage of the average value of the Fund. Both TCR before and TCR after the PPM discount are stated. The PPM discount is described in greater detail in the report of the directors.

**Total cost ratio (TCR) including alternative investments:** Calculated in the same way as TCR before the PPM discount (see above), but it also includes the costs of the limited partnerships through which the bulk of the alternative investments are channelled.

**Total expense ratio (TER):** Calculated as TCR (see above) but exclusive of transaction costs associated with the purchase and sale of securities.

**Transaction costs:** Commissions paid to the broker and transaction fees paid to the deposit bank.

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### Balance sheet

<i>All amounts in SEK '000</i>	31 Dec 2005		31 Dec 2004	
<b>Assets</b>				
Financial instruments with positive market value (Note 1)	1,679,068	99.1%	1,185,089	99.6%
Cash at bank and other liquid funds	25,401	1.5%	8,505	0.7%
Other current receivables	6,250	0.4%	2,360	0.2%
<b>Total assets</b>	<b>1,710,719</b>	<b>101.0%</b>	<b>1,195,954</b>	<b>100.5%</b>
<b>Liabilities</b>				
Financial instruments with negative market value (Note 2)	9,905	0.6%	3,957	0.3%
Other current liabilities	6,211	0.4%	1,662	0.2%
<b>Total liabilities</b>	<b>16,116</b>	<b>1.0%</b>	<b>5,619</b>	<b>0.5%</b>
<b>Value of Fund (Note 3)</b>	<b>1,694,603</b>	<b>100.0%</b>	<b>1,190,335</b>	<b>100.0%</b>
<b>Memorandum items (Note 12)</b>	<b>53,325</b>	<b>3.1%</b>	<b>47,771</b>	<b>4.0%</b>

### Income statement

<i>All amounts in SEK '000</i>	2005	2004
<b>Income and change in value</b>		
Change in value of equity-related instruments (Note 4)	407,667	52,715
Change in value of fixed income related instruments (Note 5)	2,179	2,885
Interest income (Note 6)	-3,190	4,472
Dividends (Note 7)	32,750	23,088
Currency gains and losses, net (Note 8)	-57,930	22,271
Other income (Note 9)	150	185
<b>Total income and change in value</b>	<b>381,626</b>	<b>105,616</b>
<b>Costs</b>		
Management costs (Note 10)	-7,550	-5,734
Other costs (Note 11)	-2,065	-2,036
<b>Total costs</b>	<b>-9,615</b>	<b>-7,770</b>
<b>Net profit/loss for the year</b>	<b>372,011</b>	<b>97,846</b>

#### Accounting principles

The Fund's annual report is made up in accordance with the Investment Funds Act and Finansinspektionen's ordinances and general recommendations.

Financial instruments are valued at their actual value. Instruments listed on an authorised stock market are valued at 4.00 pm at their latest transaction price. In the case of unlisted holdings a cautious valuation is made of their actual value. The average method is used for calculating capital gains and losses. Lent securities are still stated in the balance sheet and included as pledged assets within the line. Premiums received or accrued are stated as interest income. Paid and accrued premiums (interest paid) for borrowed securities are stated under other costs.

#### Tax

The Premium Savings Fund is not liable for taxation in Sweden. In the case of investments abroad, there may in some instances be a liability to pay tax in the form of "definitive tax at source" on dividends.

The notes on the income statement and balance sheet are omitted from this printed annual report. An appendix with notes may be obtained from the Seventh AP Fund. It is also available at [www.ap7.se](http://www.ap7.se)

## Annual report 2005 • Premium Choice Fund

### Audit report

#### Seventh AP Fund's Premium Choice Fund

Co. Reg. No. 504400-8240

In our capacity as auditors of the Seventh AP Fund we have examined the annual report for the Premium Choice Fund for 2005. Our audit was performed in accordance with generally accepted auditing standards in Sweden.

The annual report is made up in accordance with the Act Concerning the AP Funds and the rules in the Investment Funds Act as specifically referred to in the AP Funds Act. The annual report thus provides a true and fair picture of the Fund's financial result and position in accordance with generally accepted accounting standards in Sweden.

Our audit has found no grounds for qualifying this annual report, the accounting records or the management in general.

STOCKHOLM, 8 FEBRUARY 2006



ANDERS BÄCKSTRÖM  
Authorised public accountant  
Appointed by the Government



ANNA HESSELMAN  
Authorised public accountant  
Appointed by the Government



JAN PALMQVIST  
Authorised public accountant  
Appointed by the Swedish Financial Supervisory Authority

# Annual report 2005 • The Seventh Swedish National Pension Fund (AP Fund)

COMPANY REGISTRATION NUMBER: 802406-2302

## Report of the directors

### The role of the Seventh AP Fund in the general pension system

The general pension system involves a proportion of the pension premiums being allocated to premium pensions and managed in mutual funds on the basis of each saver's individual choice. The Premium Pension System is administered by the Premium Pension Authority (PPM), which functions just like a unit-link insurance company. The Seventh AP Fund, which is also a government authority, functions within this system as a fund company that manages mutual funds. For those individuals who refrain from choosing another fund in the premium pension system, the fund capital is invested by the PPM in a special fund known as the Premium Savings Fund and managed by the Seventh AP Fund. The Seventh AP Fund also manages a second fund, the Premium Choice Fund, which can be chosen in the same way as other funds within the premium pension system. The Premium Savings Fund and the Premium Choice Fund are only intended for premium-pension capital and are not open for any other type of saving.

The Seventh AP Fund's asset management activities began in connection with the first choice of funds within the premium pension system in the autumn of 2000. Since then, capital has been allocated each year to the Premium Savings Fund and the Premium Choice Fund, when the PPM has allocated each year's new premium pension capital to the funds. The two funds have also received additional capital mainly in the form of re-investments by the PPM of the discount it receives on the management fee. In total the assets under management increased by some MSEK 8,200 (MSEK 7,200) as a result of purchases of units in the two funds in 2005. Withdrawals of capital as a result of units being redeemed when premium pension savers switched to other funds amounted to some MSEK 1,800 (800) during the year. By the end of 2005 the Seventh AP Fund had management responsibility for total assets of MSEK 59,800 (41,300), of which approx. MSEK 58,100 (40,100), or 97.2% (97.1%) was in the Premium Savings Fund and approx. MSEK 1,700 (1,200), or 2.8% (2.9%), in the Premium Choice Fund.

### Separate annual reports for Premium Savings Fund and Premium Choice Fund

The asset management activities of the Premium Savings Fund and the Premium Choice Fund are described in separate annual reports published by these funds. This Report of the Direc-

tors relates to the activities of the fund manager, the Seventh AP Fund.

### Reauthorisation of fund rules

The Act (2004:46) on Investment Funds came into effect on April 1, 2004. At the same time the Act (1990:1114) on Mutual Funds was rescinded. This means that all fund rules that were approved in accordance with the previous act must be reformulated and approved in accordance with the new act (reauthorisation). Such reauthorisation must be completed by February 13, 2007. Finansinspektionen approved new fund rules for the Premium Savings Fund and Premium Choice Fund on October 12, 2005.

### External services

The Seventh AP Fund has a relatively small but highly qualified permanent organisation. External resources are also engaged in those areas where it is appropriate to ensure a high level of competence, low costs and low exposure. This model means that it is important for the permanent organisation to act as a qualified customer and maintain effective day-to-day control over the quality and costs of the outsourced functions.

In 2005 there was a new round of public procurement of deposit bank services. After extensive assessment, a new agreement was reached with Nordea, which for the purposes of this contract will be co-operating with the Bank of New York. The new agreement will mean both quality improvements and cost reductions. In addition four public procurements of various types of consultancy service were conducted. A public procurement of active management of European shares was launched during the year.

### Detailed evaluation of external portfolio managers

The scope and policies for the external portfolio management contracts is explained in the annual reports of the Premium Savings Fund and the Premium Choice Fund. Since a high proportion of the capital is managed by external managers, the Seventh AP Fund devotes a great deal of attention to systematically monitoring their performance. All the portfolio managers are visited twice a year, when their management results and administrative procedures are evaluated. After three years an in-depth evaluation is made of each manager. In 2005 this type of in-depth evaluation was made of the external portfolio managers of hedge funds and private equity funds.

### New management model for internal equities management

In the autumn of 2005 a model was introduced that involved active management of Swedish shares in the form of separated alpha and beta management. In traditional active share management the capital is invested in shares in such a way that the weighting of the shares in the portfolio deviates from the corresponding share's weighting in the index. The aim is to outperform the average on the market (index) by being overweight in shares that are expected to outperform the index and underweight in those that are expected to underperform in relation to the index. Separated alpha and beta management involves making a sharper division of the management into two parts, one aiming to generate an average return (beta) and the other aiming to earn a return in excess of the market average (alpha). The total risk of the separated alpha and beta management remains unchanged in relation to traditional active management.

In the separated alpha management the return is generated using the long/short management model. Long positions are taken in the traditional way by investing in shares whose prices are expected to rise. Short positions are taken in shares whose prices are expected to decline. This takes the form of selling short; which means that shares are borrowed and sold immediately. No capital, over and above a limited amount of working capital, needs to be earmarked for this separated alpha management. The long investments are financed using the proceeds received from the short selling of the borrowed shares.

The return on separated beta management is created by managing the total capital in the separated alpha and beta management in accordance with the tracking model.

The internal management organisation has responsibility for the separated alpha management. The separated beta management, in common with all other tracking management, is handled by external managers.

### Shareholder policy

An ownership policy for the Seventh AP Fund is adopted every year as part of the business plan. This policy lays down guidelines as to how the Seventh AP Fund shall exercise the ownership function that is incumbent by virtue of the shares owned by the Premium Savings Fund and the Premium Choice Fund, one constraint being that, according to the AP Funds Act, the Seventh AP Fund may only exercise its voting rights for Swedish shares in certain exceptional cases.

In 2005, a great deal of attention was focused

## Annual report 2005 • The Seventh Swedish National Pension Fund

on the public bid submitted by Old Mutual for Skandia. The Seventh AP Fund considered the offer to be financially disadvantageous and therefore did not accept the bid.

### Board procedures

In 2005 the Board held six meetings. In connection with one of the meetings a board seminar was arranged on the theme of separated alpha and beta management, and on other occasions visits were arranged to one of the external managers of private equity funds, HarbourVest Partners LLC, and a manager of an underlying private equity fund, Berkshire Partners.

The Board has set up an executive committee consisting of the chairman, deputy chairman and managing director. The executive committee prepares business for meetings of the Board and makes decisions on business delegated by the Board to the executive committee. An Investment Council has been set up to provide support and advice for the managing director regarding various business decisions and as an advisory organ for the internal portfolio managers. At the end of 2005 the Investment Council consisted of four Board members and two external members. Over and above this, the Board has not appointed any committees or working groups from among its members.

In 2005 the auditors attended two of the board meetings. On one occasion they presented their audit plan, and after completion of their audit they commented on the results.

At the beginning of 2005 the Seventh AP Fund engaged Nordic Investor Services, a firm of consultants, to evaluate the Board's operating procedures. The evaluation took the form of a questionnaire sent to the Board members, who answered questions on the board as a whole, the work of the chairman, the work of the managing director on the Board and their own input. The firm's survey was complemented by one-to-one discussions between the chairman and each member of the board. The evaluation indicated that the Board was functioning well.

### Management functions

For overall issues not relating to capital management the Seventh AP Fund has a management group, consisting in 2005 of three people (two men and one woman): the managing director, the deputy managing director and the administrative manager.

For capital management there is an investment committee, which in 2005 consisted of three members (all men): the managing director, the deputy managing director in his capacity as head of the management group, and the fund administration manager.

### Personnel

In 2005 the number of established employees remained at thirteen (six women and seven men). Owing to leave of absence etc. an addi-

tional person (one woman for part of the year and one man for another part of the year) was employed on a temporary basis. Otherwise, there were no departures during the year.

Total sick leave during the year was 0.7% (0% for men and 1.4% for women) of the employees' aggregate working hours. There was no long-term sick leave (60 days or more).

### Investor in People

In autumn 2005 the Seventh AP Fund was approved as an Investor in People (IIP). IIP is an international standard, which aims to improve the results of organisations by continuously investing in their personnel. The Seventh AP Fund is the first asset management organisation in Sweden to be certificated in accordance with the IIP standard. The certification is evidence that the Seventh AP Fund also manages its human capital by developing and utilising the competence of its employees, and their capacity and engagement.

### Premium pension commission

In autumn 2005 the Premium pension commission of equity presented its report (SOU 2005:87) "Tricky to navigate? Premium pension saving on the right track. The conclusions are currently being circulated for comment. Several changes are proposed to the premium pension system, which will affect the activities of the Seventh AP Fund. The proposals mean, for example, that the Seventh AP Fund shall handle the management of a basic investment fund that would replace the Premium Savings Fund and Premium Choice Fund, that the basic fund should be open for active choice, that the basic fund should consist of generation funds and that the Seventh AP Fund should be allowed to exercise its voting right for Swedish shares.

### Five-year anniversary

In autumn 2005 the Seventh AP Fund celebrated five years since it began to manage capital within the premium pension system. The event was celebrated by inviting business contacts and industry colleagues to an afternoon of speeches and a panel discussion. Speakers included the USA's former vice president Al Gore, whose speech was entitled Earth in the balance sheet – creating wealth for Sweden. The panel discussion took up the theme of short-term – long-term ownership and was led by Pernilla Ström. The opening speaker was Per Strömberg, an assistant professor at the Institute for Financial Research. Other participants included Agnetha Ahrling and Anneli Nilsson, Hemtrivsel in Umeå, Carl-Johan Bonnier of the Bonnier Group, Christer Gardell, Cevian Capital, Tomas Nicolin, Alecta, and Mats Qviberg, Investment AB Öresund.

### Result

The result in the form of the returns earned by the Premium Savings Fund and the Premium

Choice Fund is presented in the annual reports of these funds.

In 2005 the Seventh AP Fund's gross operating income amounted to SEK 267,968,000 (197,069,000). The discounts granted to the PPM amounted to SEK 185,416,000 (135,766,000), giving net income of SEK 82,552,000 (61,303,000). Costs, including net interest, amounted to SEK 77,782,000 (78,933,000). The Seventh AP Fund's result for 2005 was consequently a profit of SEK 4,770,000 (loss 17,630,000). The accumulated loss at the end of the year thus amounted to SEK 150,229,000 (loss 154,999,000).

The significant improvement in the result in 2005 is due to a change in the assessment of Seventh AP Fund's obligation to pay VAT on external management services. Since its formation, the Seventh AP Fund has been registered for VAT and has paid Swedish VAT for the acquisition of services from abroad on the remuneration paid to the foreign managers. After an advance decision from the Council for Advance Tax Rulings, which was considering a similar case, the Swedish National Tax Board decided in 2005 that the Seventh AP Fund is not obliged to pay VAT on the purchase of these management services. The VAT that had already been paid for the 2001–2004 period will therefore be refunded, which means a one-off effect of MSEK 12.2 on the result for 2005.

### Result and financing forecast

The costs of the Seventh AP Fund's activities is to be covered by management fees charged on the assets under management in the Premium Savings Fund and the Premium Choice Fund. The cost of building up the business is to be periodised over several years in order not to charge a disproportionate amount against any individual annual cohort of premium pension savers. This means that the Seventh AP Fund authority will incur losses for a number of years after inception. In order to finance the accumulated losses, the Seventh AP Fund has access to credits from the Swedish National Debt Office. In accordance with a government decision, the Seventh AP Fund has at its disposal in 2006 an interest-bearing account on which credits of up to MSEK 200 could be drawn, along with loans of up to MSEK 10 to finance fixed assets.

As more than 97% of the assets under management are in the Premium Savings Fund, the fees paid by this fund play a decisive role in determining the Seventh AP Fund's financial result. The management fee, which is 0.5% per year of the assets under management, is reduced by the discount system applied by the Premium Pension Authority (PPM). This discount accrues to pension savers as the PPM buys new fund units for the amount of the discount. In the case of the Premium Savings Fund the discount system means that the net management fee is currently 0.15%.

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Of the net fee of 0.15% per year, 0.07 percentage points are applied to covering the variable (i.e. capital-based) costs of the external fund managers and the fiduciary custodian. The removal of VAT from external management services and new deposit bank agreement means that the proportion of capital-based costs has fallen by 0.02 percentage points in relation to the previous year. The remaining 0.08 percentage units shall cover all other costs (personnel, premises, computer systems etc.). In the short term these costs are fixed. An estimate made on the basis of various assumptions about inflow and outflow of capital, return, cost trends etc. shows that the Seventh AP Fund's annual result will improve successively. The Fund is expected to break even in 2006. As a result of the annual surpluses thereafter, it is expected that the accumulated deficit will steadily decline, and eventually be entirely eliminated by 2012. For the years thereafter estimates show that unchanged management fees can result in a sharply growing retained surplus, which could permit a reduction in the management fees.

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## Income statement

All amounts in SEK '000		2005	2004
<b>Operating income</b>			
Management fees	267,854	196,965	
Less discount to PPM	<u>-185,416</u>	<u>-135,766</u>	61,199
Other operating income	114		104
<b>Operating costs</b>			
Personnel costs (Note 1)	-23,698		-20,119
Other operating costs (Note 2)	-52,085		-56,406
<b>Operating profit/loss</b>		<b>6,769</b>	<b>-15,222</b>
<b>Financial income and costs</b>			
Interest income	422		342
Interest costs	-2,421		-2,750
<b>Profit/loss after financial income and costs</b>		<b>4,770</b>	<b>-17,630</b>
<b>Net profit/loss for the year (Note 3)</b>		<b>4,770</b>	<b>-17 630</b>

## Balance sheet

All amounts in SEK '000		31 Dec 2005	31 Dec 2004
<b>Assets</b>			
<i>Fixed assets</i>			
Equipment (Note 4)	1,668	2,089	
Total fixed assets	1,668	2,089	
<i>Current assets</i>			
Other current receivables (Note 5)	16,181	421	
Prepaid costs and accrued income (Note 6)	26,635	18,991	
Cash and bank	942	3,988	
Total current assets	43,758	23,400	
<b>Total assets</b>		<b>45,426</b>	<b>25,489</b>
<b>Equity and liabilities</b>			
<i>Equity</i>			
Accumulated losses	-154,999	-137,369	
Net profit/loss for the year	4,770	-17,630	
Total equity	-150,229	-154,999	
<i>Liabilities</i>			
Credits from Swedish National Debt Office (Note 7)	130,389	127,297	
Liabilities to suppliers	828	1,545	
Other liabilities	875	1,904	
Accrued costs and deferred income (Note 8)	63,563	49,742	
Total liabilities	195,655	180,488	
<b>Total equity and liabilities</b>		<b>45,426</b>	<b>25,489</b>
<b>Pledged assets</b>		None	None
<b>Contingent liabilities</b>		None	None

### Accounting principles

The Seventh AP Fund complies with the rules in the AP Funds Act (2000:192).

The PPM discount is stated as a negative item under income since it represents a significant part of gross income and is beyond the Seventh AP Fund's control.

Equipment is capitalised and depreciated according to plan over three years in the case of computer equipment and five years for other equipment. Receivables are stated at the value that is expected to be received.

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## Note 1 – Personnel costs

All amounts in SEK' 000	2005	2004
<b>Number of employees</b>		
Average number of employees	13	13
Employees 31 December	14	14
of whom employed for fixed periods	1	1
Number of people in management group/investment committee	4	5
<b>Salaries and fees</b>		
Chairman	125	100
Managing director	2,856	2,802
The board excl. chairman	483	441
Management group/investment committee excl. managing director	3,761	4,692
Other employees	6,297	5,600
<b>Total</b>	<b>13,522</b>	<b>13,635</b>
<b>Provision for variable remuneration in 2003 re-entered in 2004</b>		
Managing director	-	-373
Management group/investment committee excl. managing director	-	-560
Other employees	-	-1,831
<b>Total</b>	<b>-</b>	<b>-2,764</b>
<b>Pension costs</b>		
Managing director	880	737
Management group/investment committee excl. managing director	1,379	1,562
Other employees	1,550	1,185
<b>Total</b>	<b>3,809</b>	<b>3,484</b>
<b>Social insurance costs</b>		
Chairman	30	24
Managing director	928	853
Board excl. chairman	157	144
Management group/investment committee excl. managing director	1,247	1,502
Other employees	2,928	1,889
<b>Total</b>	<b>5,290</b>	<b>4,412</b>
<b>Other personnel costs</b>	<b>1,077</b>	<b>1,352</b>
<b>Total personnel costs</b>	<b>23,698</b>	<b>20,119</b>

The Seventh AP Fund applies the collective agreement between the Banking Employers' Organisation (BAO) and the Swedish Federation of Lawyers, Sociologists and Economists (JUSEK)/Swedish Association of Business Administration Graduates (CR)/Swedish Association of Graduate Engineers (CF) (Swedish Confederation of Professional Associations (SACO)).

The following conditions apply to the managing director and the deputy managing director: the retirement age is 65; they are exempted from the pension plan that applies under the collective agreement, and instead receive individual pension insurances at a cost equivalent to 30% of their fixed salary. The period of notice is 6 months. If notice is given by the employer, severance pay equivalent to the fixed monthly salary is provided for 18 months after the period of notice. Severance pay is netted against is against any other salary or income from business.

The Board fee is determined by the government. Over and above the fee determined by the government, a total of SEK 90,625 has been paid to board members who are also members of the executive committee or the Investment Council.

## Note 2 – Other operating costs

All amounts in SEK' 000	2005	2004
Auditing	1,295	1,416
External managers and fiduciary custodian	27,954	33,773
External services	15,652	14,721
Other costs	6,063	5,498
Depreciation according to plan	1,121	998
<b>Total other costs</b>	<b>52,085</b>	<b>56,406</b>
<b>Fees to audit companies</b>		
<b>Auditing</b>		
Öhrlings PricewaterhouseCoopers	875	843
KPMG	326	160
Deloitte	94	413
<b>Total auditing</b>	<b>1,295</b>	<b>1,416</b>
<b>Other contracts</b>		
Öhrlings PricewaterhouseCoopers	108	126
KPMG	0	0
Deloitte	0	1,368
<b>Total other contracts</b>	<b>108</b>	<b>1,494</b>

## Note 3 – Breakdown of the Seventh AP Fund's costs and income between Premium Savings Fund and Premium Choice Fund

According to the AP Funds Act (2000:192) the Seventh AP Fund is entitled to draw funds from both the Premium Savings Fund and the Premium Choice Fund to cover the management costs incurred on behalf of each fund. If the costs relate to both the Premium Savings Fund and the Premium Choice Fund, they shall be allocated in a reasonable manner. The following table shows how the Seventh AP Fund's income and costs have been allocated to the respective fund. The allocation of common costs is based on the average value of each fund's assets. In 2005 97% (97%) were attributable to the Premium Savings Fund and 3% (3%) to the Premium Choice Fund.

All amounts in SEK' 000	Premium Savings Fund	Premium Choice Fund	Total
<b>Income</b>			
Management fees	260,304	7,550	267,854
Less discount to PPM	<u>-182,524</u>	77,780	4,658
Other specific income	0	0	0
Allocated common income	520	16	536
<b>Total income</b>	<b>78,300</b>	<b>4,674</b>	<b>82,974</b>
<b>Costs</b>			
Specific costs	-37,632	-2,517	-40,149
Recomputation of VAT	11,810	385	12,195
Allocated common costs	<u>-48,743</u>	<u>-1,507</u>	<u>-50,250</u>
<b>Total costs</b>	<b>-74,565</b>	<b>-3,639</b>	<b>-78,204</b>
<b>Profit for the year</b>	<b>3,735</b>	<b>1,035</b>	<b>4,770</b>
<b>Opening accumulated losses</b>	<b>-154,054</b>	<b>-945</b>	<b>-154,999</b>
<b>Closing accumulated losses</b>	<b>-150,319</b>	<b>90</b>	<b>-150,229</b>



# Annual report 2005 • The Seventh Swedish National Pension Fund

## Note 4 – Equipment

All amounts in SEK '000	31 Dec 2005	31 Dec 2004
Opening acquisition value	18,602	17,078
Purchases	700	1,524
Closing accumulated acquisition value	19,302	18,602
Opening depreciation	-16,513	-15,516
Depreciation during the year	-1,121	-997
Closing accumulated depreciation	-17,634	-16,513
Closing book value	1,668	2,089

## Note 5 – Other receivables

The figure for 2005 includes a receivable of MSEK 12.2 relating to the refund of VAT for the years 2001 through 2004.

## Note 6 – Prepaid costs and accrued income

All amounts in SEK '000	31 Dec 2005	31 Dec 2004
Accrued fund fees, gross	25,312	17,436
Other	1,323	1,555
Total prepaid costs and accrued income	26,635	18,991

## Note 7 – Credits from the Swedish National Debt Office

All amounts in SEK '000	31 Dec 2005		31 Dec 2004	
	Total limit	Drawn	Total limit	Drawn
Check account credit	200,000	127,906	200,000	126,300
Loan for financing of fixed assets	10,000	2,483	10,000	997
Total credits from the Swedish National Debt Office	210,000	130,389	210,000	127,297

Loans for financing fixed assets have the same duration as the depreciation period for the assets being financed. The rates of interest on the check account credit and the loans for financing fixed assets are variable and based on the repo rate. At the end of 2005 the interest rate was 1.77%. In 2006 the Seventh AP Fund will have at its disposal an interest-bearing account with credit limit of MSEK 200 and a loan limit of MSEK 10 for financing fixed assets.

## Note 8 – Accrued costs and deferred income

All amounts in SEK '000	31 Dec 2005	31 Dec 2004
Accrued vacation pay and social insurance charges	3,256	3,145
Accrued discount for PPM	49,486	35,234
Other	10,821	11,363
Total accrued costs and deferred income	63,563	49,742

STOCKHOLM, 8 FEBRUARY 2006



BENGT RYDÉN  
Chairman of the Board



PER-OLOF EDIN  
Deputy Chairman of the Board



REINHOLD GEIJER



LENA HAGMAN



MARI-ANN KRANTZ



LARS LINDER-ARONSON




HANS MERTZIG



KARIN MOBERG




CHRISTINA STRIBY

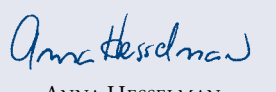


PETER NORMAN  
Executive President

Our audit report was submitted on 8 February 2006



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Appointed by the Government



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## Annual report 2005 • The Seventh Swedish National Pension Fund

# Report of the auditors

## Seventh AP Fund

Co. Reg. No. 802406-2302

We have examined the annual report and the accounting records, as well as the administration by the board of the Seventh AP Fund for 2005. The board has responsibility for the accounting records and the administration and for the application of the AP Funds Act when making up the annual report. Our responsibility is to express our opinion on the annual report and the administration on the basis of our audit.

We have carried out our audit in accordance with generally accepted auditing standards in Sweden, which require us to plan and perform the audit so as to obtain reasonable assurance but not certainty that the annual report is free from material misstatement. An audit includes examining a selection of the records supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, their application by the Board, and the presentation of the information in the annual report. We believe that our audit provides a reasonable basis for our opinion as set out below.

The annual report is made up in accordance with the Act concerning the AP Funds, and thus provides a true and fair picture of the Seventh AP Fund's financial result and position in accordance with generally accepted accounting practice in Sweden. The report of the directors is in agreement with the other sections in the annual report.

In our audit no grounds have emerged for qualifying this annual report, the income statement and balance sheet therein, the bookkeeping, the inventory of assets or the administration in general.

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

STOCKHOLM, 8 FEBRUARY 2006



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PER-OLOF EDIN, deputy chairman  
Professor. Chairman of the Labour Market Board and Baltic Sea Foundation. Board member of National Tax Agency, Svenskt Rekonstruktionskapital AB, Bergvik Skog AB, and Karolinska Development AB

REINHOLD GEJER  
CEO, Head of Nordic Region Royal Bank of Scotland. Board member of Nefab AB.

LENA HAGMAN  
Senior economist, TCO. Member of the National Accounts Board at Statistics Sweden.

MARI-ANN KRANTZ  
Chair of the Swedish Union of Clerical and Technical Employers in Industry. Chair of the Negotiation Cartel for Salaried Employees in the Private Business Sector. Deputy chair of Alecta's central board and TCO's board. Board member of the International Metal Federation.

LARS LINDER-ARONSON  
Chairman of Ventshare AB and Tanglin Investment Management AB. Board member of SBAB.

HANS MERTZIG  
Portfolio manager, Knowledge Foundation [KK-stiftelsen].  
Chair of Royal Swedish Academy of Engineering Sciences' investment committee, finance delegation of Gamla Livförsäkringsaktiebolaget

SEB Trygg Liv and TryggStiftelsen. Board member of Hufvudstaden AB.

KARIN MOBERG  
Marketing director, TeliaSonera Sverige AB.

CHRISTINA STRIBY  
Former Senior Legal Affairs Officer. Board member of Rikstrafiken.

## Auditors

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KPMG Bohlins AB.

ANNA HESSELMAN, authorised public accountant  
Öhrlings PricewaterhouseCoopers AB.

JAN PALMQVIST, authorised public accountant  
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