



**Third Swedish National Pension Fund
Annual Report 2001**

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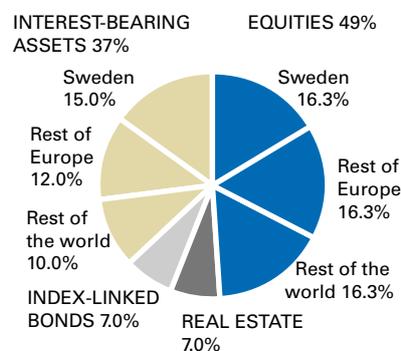
The semi-annual report for the first six months
will be published on 23 August 2002

The year in brief

• Global, well-diversified portfolio

On 1 January 2001, AP3 received a portfolio with an asset structure dominated by Swedish treasury bonds. The Fund immediately began the task of adjusting the asset mix of the portfolio in order to better fit its long-term commitments in the Swedish pension system. By the end of the first half of 2001, we had achieved this goal: a global, well-diversified portfolio with a considerably higher proportion of equities than previously. The composition of the reference portfolio can be seen in the figure below.

Figure 1
AP3's reference portfolio, 2001



• Fund capital of SEK 132.7 billion

The value of AP3's fund capital on 31 December 2001 was SEK 132.7 billion. Like the other three buffer funds in the Swedish pension system, during 2001 AP3 received a net capital inflow totalling SEK 4.5 billion. This was largely attributable to a positive net inflow of pension contributions relative to pension disbursements.

• Total return of -4.2 percent

Due to the sharp downturn in the stock market during 2001, the Fund reported a loss of value of SEK 5.8 billion (including unrealised capital gains/losses). This was equivalent to a total return of -4.2 per cent (after expenses and adjusted for net inflows). For the liquid part of the portfolio, which excludes real estate, the return amounted to -4.4 per cent. This was slightly better than the Fund's benchmark index, which declined by 4.6 per cent.

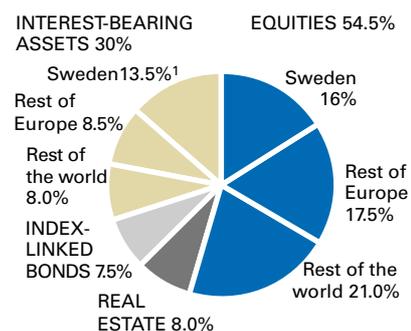
• Internal management outperformed the market

More than three fourths of AP3's assets are managed actively by the Fund's own portfolio managers. Non-European equities as well as US and UK corporate bonds are managed externally, currently through index management. In the internally managed portion of AP3's assets, both the equities portfolio and the fixed income portfolio outperformed their benchmark indices during 2001. The Swedish equities portfolio showed the best performance, beating its index by 3.4 percentage points.

• New reference portfolio for 2002

During the autumn of 2001, the Fund updated and extended its Asset/Liability Modelling study. This is an analysis of the long-term development of the Swedish national pension system indicating what portfolio mix will create the greatest benefit in relation to the Fund's commitments. The new analysis was based on the latest demographic forecast from Statistics Sweden, which points towards a population trend more favourable to the development of the pension system than earlier projections. As a result of this study, the Fund's Board of Directors decided on adjustments in the reference portfolio for 2002. The proportion of equities in the reference portfolio was increased by 5.5 percentage points, while the proportion of foreign interest-bearing assets was reduced.

Figure 2
AP3's reference portfolio, 2002



¹ Including AP3's share of the First Swedish National Pension Fund's phase-out portfolio.

• Management expenses of 0.08 per cent

The Fund's expenses amounted to SEK 110 M, which was equivalent to 0.08 per cent of managed assets. Nearly half of these expenses consisted of staff salaries. During the year, the number of employees rose from 29 to 38.

Statement of the CEO: First year of new mandate

One year has passed since my colleagues and I were entrusted with managing one of the four buffer funds in the reformed Swedish pension system. Our new mandate is clear and unambiguous: To generate the greatest possible benefit for the pension system. This implies two main duties: The first is to identify what strategic asset mix will best fulfil our long-term commitment as a buffer in the pension system. The second is to continuously manage this portfolio in the best way possible.

“We aimed at identifying a portfolio yielding a good expected return on capital, while reducing the risks of imbalances in the pension system in risk scenarios.”

The task of performing the first duty began during 2000, when the Fund carried out an initial Asset/Liability Modelling study of the long-term effects that portfolios with different asset mixes would have on the pension system. We aimed at identifying a portfolio yielding a good expected return on capital, while reducing the risks of imbalances in the pension system in risk scenarios. In a statistical simulation exercise, we studied the characteristics of portfolios with different asset mixes in a great number of scenarios with varying assumptions, for example about GDP growth, demography, inflation and asset prices. At AP3, our ambition

is to be in the forefront of the development of Asset/Liability Modelling in the pension management industry. It was thus not without pride that in November 2001 in Brussels, I accepted the International Pensions Europe Award as the Swedish market leader in the Investment

Strategy category on behalf of AP3. This prize was awarded to AP3's ALM study.

During 2001, the Fund carried out an updated and extended ALM study. This study indicated that a portfolio containing 55 per cent equities, 37 per cent interest-bearing assets and 8 per cent real estate has the best potential to benefit the Swedish pension system. The most balanced outcome is achieved when nearly half of assets (45 per cent) are invested in Sweden and the rest abroad.

Our calculations show that the opportunity to invest abroad is of particularly great importance in situations where the pension system is subjected to strains and the so-called automatic balancing mechanism risks being applied. This means that pensions will not be increased at the promised rate if long-term deficits appear in the system.

Deep downturn in world economy

During 2001, financial markets were marked by a deep downturn in the world economy and political uncertainty in the aftermath of the September 11 terrorist attacks. Global equity markets fell by around 14 per cent, measured in local currencies. As a result, return on AP3's fund capital in 2001 was negative, amounting to -4.2 per cent after expenses.

After last year's extensive portfolio transition, AP3 has entered a new phase. Now we focus on managing the strategic asset mix in order to generate the best possible return in different sub-markets, at a given low risk level. During 2001, return on AP3's total portfolio outperformed the reference portfolio

by 0.2 percentage points (0.1 after expenses). This means that we did not quite achieve our target of outperforming the reference portfolio by 0.3 percentage points. But – given a demanding portfolio adjustment process, a turbulent market situation and a larger share of passive management than we are aiming for in the long term – I am nevertheless satisfied with this positive active return. It is especially gratifying that our internal management of Swedish equities beat its index by 3.4 percentage points.

The Fund's new asset management mandate placed major demands on the new AP3 organisation. In three years, we grew from 5 to 38 employees. An important part of the task of creating the new AP3 has been to establish a strong organisational culture and to define a clear common set of values. I feel that our strong focus on cultural issues has had a clear impact on AP3's way of working. Among my colleagues, I encounter a mutual respect for the unique skills of each employee and an individual willingness to assume responsibility which, I believe, sets us apart from other asset management organisations.

Extensive transition of assets

One of the year's major projects was the extensive transition of assets that our new mandate required. The fact that this large volume of transactions was handled in such a smooth and professional way is clear evidence of the ethic of responsibility that characterises AP3. I am very pleased that in a short time, we have succeeded in building up a well functioning asset management organisation, focused on the task of benefiting the Swedish pension system.

Stockholm, 12 February 2002



Tomas Nicolin
CEO



“But – given a demanding portfolio adjustment process, a turbulent market situation and a larger share of passive management than we are aiming for in the long term – I am nevertheless satisfied with this positive active return”

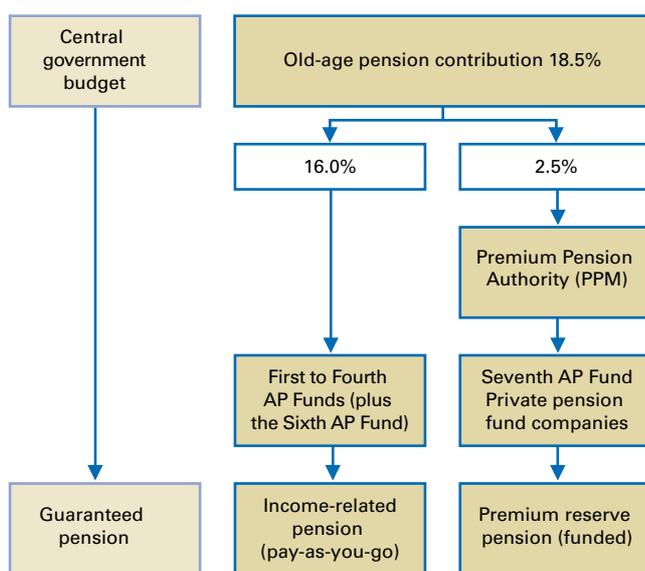
Our mandate: To benefit the pension system

AP3 is one of four¹ buffer funds in the Swedish pension system. The Riksdag (Swedish Parliament) gave each of the four funds the same unambiguous mandate: generate the best possible long-term return on capital, in relation to our liabilities in the pension system.

Early in 2000, the Riksdag approved a new organisational structure and new investment rules for the Swedish National Pension Funds (AP Funds). What was then the Fifth Fund Board was assigned a mandate, as one of four restructured

AP Funds, to manage the buffer capital in the reformed income-related pension system. The new investment rules went into effect on 1 January 2001.

Figure 3
The reformed Swedish pension system



Assuring long-term stability

AP3 is a part of the reformed Swedish pension system that is designed to assure long-term stability. The system is divided into two parts. In one part (the pay-as-you-go system), the basic principle is that disbursements of pensions to today's pensioners are financed by contributions (16 per cent of nominal pay) from today's employees. The size of contributions to and disbursements from the system will vary from year to year, due to demographic changes and rate of wage growth. The task of the First to Fourth (plus Sixth) AP Funds is to serve as a buffer, smoothing out temporary variations in contributions and disbursements.

The second part is the premium reserve pension system, in which pension disbursements are financed by funds built up from the premium reserve contribution (2.5 per cent of nominal pay). The premium reserve is managed by private pension fund managers but also

by the Seventh AP Fund.

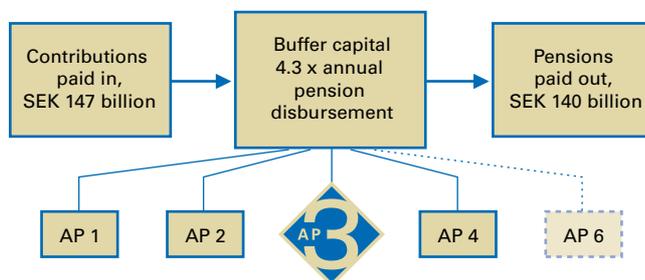
What is the role of the buffer funds for future pensions?

The new Swedish pension system is contribution-defined, hence pensions are determined by the amount of contributions paid into the system. This implies that the return on the buffer funds will only influence the pension level in certain situations.

The new pension system contains a built-in automatic balancing mechanism, which means that the indexing of pensions – which is regularly tied to the rate of growth in average income – will be reduced if long-term deficits appear in the system. Every year, the pension system's "balance figure" is calculated. This figure shows how large the system's assets are in relation to its liabilities. Figure 5 shows a preliminary estimate of the pension system's balance sheet at the

Figure 4
The role of the buffer funds in the pension system

Amounts are for 2000



beginning of 2001.

These figures show that the size of the buffer funds is relatively small in relation to future pension liabilities, about 11 per cent. But the size of the buffer funds may nonetheless have an effect on whether the balancing mechanism is applied or not. The mandate of the buffer funds is thus to manage their assets so that the risk that the balancing mechanism will be activated is minimised.

The Riksdag has also decided that there should be an "accelerator"

¹The Sixth AP Fund is also part of the buffer in the pension system, but it has a different mandate, which involves investing only in unlisted securities.

mechanism. This means that pensions will be increased if long-term surpluses appear in the system. Exactly how these rules should be formulated is currently being investigated.

According to the Riksdag, the AP Funds are to determine their long-term investment policy on the basis of Asset/Liability Modelling analysis. This is an analytic method for establishing the best possible asset allocation in relation to the liabilities of the funds.

New investment rules

The AP Funds are completely independent of each other and are each entrusted with establishing their own investment policies and strategies. The new investment rules allow great flexibility. The most important restriction is that at least 30 per cent of a fund's assets must be invested in low-risk interest-bearing securities.

The rules limited exposure to foreign exchange (FX) risk to 15 per cent of the portfolio in 2001. After that the ceiling on FX risk is being raised by 5 percentage points per year, ending at 40 per cent in 2006. Given the availability of low-cost currency hedging, these rules do not restrict the ability of the Fund to invest in foreign assets. The investment rules approved by the Riksdag are listed in the box to the right.

The funds are to take environmental and ethical considerations into account in their asset management task, but without relinquishing the overall goal of high return on capital. The Riksdag has also decided that industrial or other economic policy concerns must not influence the funds' investments.

Organisation, governance and monitoring

By creating four independent buffer funds with identical tasks, the Government and Riksdag intended to generate competition in achieving the best results and make evaluation easier.

AP3 is a central government agency. This means, for example, that we are subject to the laws governing publicity and the Swedish Public Procurement Act. However, there are a number of important differences between AP3 and Swedish government agencies in general:

- The Fund has its own Board of Directors, which is appointed by the Government. The Board has full responsibility for operations. This includes deciding on the Fund's investment policy, corporate governance policy and risk management plan. The Board has, in turn, chosen to delegate responsibility for day-to-day operations to a Chief Executive Officer, in the same way as in a limited company.
- The Fund has a more independent position than other Swedish central government agencies. Its operations are regulated only by law. The Government cannot issue directives that regulate its operations.
- Every year, AP3 is evaluated by the Government. This examination is carried out by officials at the Ministry of Finance. Their evaluation is presented in a written report to the Riksdag.
- The Fund has its own external auditors.

Figure 5
The pension system's balance sheet, 1 January 2001

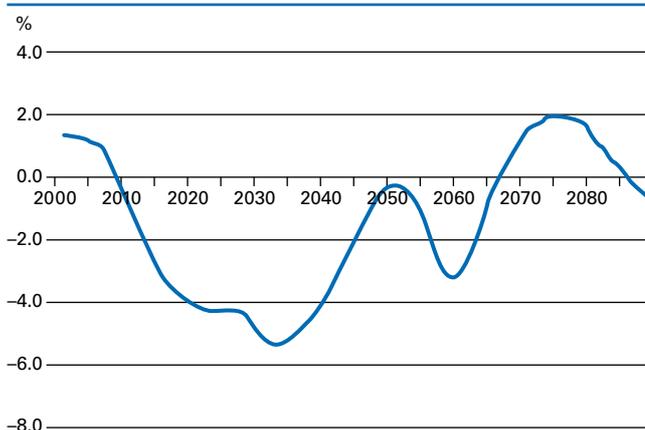
Assets: SEK 5,220 bn		Liabilities SEK 5,200 bn	
Funds SEK 580 bn			Pension liabilities SEK 5,200 bn
Contribution assets SEK 4,640 bn			

Source: National Social Insurance Board, preliminary estimate

Investment rules

- Investments may be made in all instruments occurring in the capital market that are quoted and marketable.
- At least 30 per cent of Fund assets are to be invested in low-risk interest-bearing securities.
- Following a gradual increase, a maximum of 40 per cent of assets may be exposed to currency risk. During 2001 the ceiling was 15 per cent of the market value of the Fund's assets, which was raised to 20 per cent in 2002.
- Each fund may own a maximum of 10 per cent of the voting power in a single listed company.
- A maximum of 5 per cent of fund assets may be invested in unlisted securities. These investments must be made indirectly via securities funds or the like.
- At least 10 per cent of fund assets are to be managed by external asset managers.

Figure 6
Net flow of pension contributions and pension disbursements as a percentage of the contribution base



Source: National Social Insurance Board (Assumptions: Statistics Sweden's demographic main scenario and 2 per cent annual GDP growth)

Investment policy: Best possible return at a low risk

Generating the greatest possible benefit for the pension system is the foundation of AP3's investment policy. The allocation of assets should reflect its liabilities as a buffer fund. The goal is to generate the best possible return at a given low risk level.

Figure 7
AP3's reference portfolio, 2001

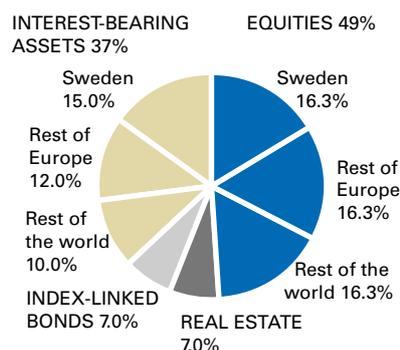
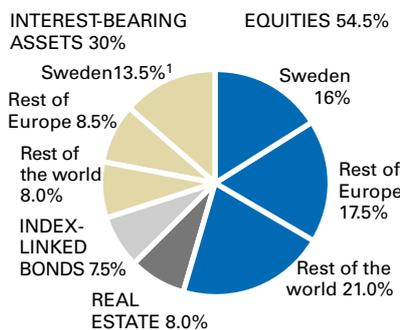


Figure 8
AP3's reference portfolio, 2002



¹ Including AP3's share of the First Swedish National Pension Fund's phase-out portfolio.

According to the Riksdag's mandate, AP3's investment policy should be based on an Asset/Liability Modelling (ALM) study, where the liability side represents the Fund's commitment as a buffer in the Swedish pension system. This analysis provides the basis for the Fund's long-term strategic asset allocation, i.e. its reference portfolio. In the short and medium term, the Fund pursues active asset management with the aim of generating a higher return than the reference portfolio in those sub-markets where this is possible.

One key task for the Fund is to identify the best long-term asset mix by means of ALM analysis. By exploring the relationship between the Fund's asset side (return on fund capital) and liability side (the commitments of the buffer funds), we can study what consequences portfolios with different asset allocations would have on the long-term development of the pension system, given different demographic and economic scenarios.

In preparation for the beginning of 2001, when the new asset management mandate came into effect, the Fund carried out its first ALM study. This provided the basis for the Board's decision on a reference portfolio for 2001. To make it possible to achieve the new reference portfolio in a short period, at this stage the Fund took into account the composition of its initial portfolio, dominated by Swedish government bonds.

New reference portfolio for 2002

During the autumn of 2001, the Fund carried out a new ALM study which entailed both an update and a more extensive analysis compared to the first ALM study. The model was updated with new forecasts of demographics and asset prices, as well as final figures for 2000. For example, the study used the latest base scenario for demographic developments from Statistics Sweden. Compared to the earlier forecast, the demographics were more favourable from the standpoint of the pension system, mainly as a consequence of higher net immigration.

The study also included a more in-depth analysis of the risk that the pension system will be subjected to demographic strains, and of what consequences the composition of the portfolio would have in these situations. The analysis showed that in such cases, the asset allocation of the AP Funds will be especially important in determining actual pension disbursements. Both the new demographic assumptions and the analysis of what portfolios are best suited to prevent imbalances in the pension system indicated that it was suitable to make certain adjustments in the Fund's reference portfolio for 2002. The composition of this portfolio can be seen in Figure 8. In the new reference portfolio, the proportion of equities will increase by 5.5 percentage points, and there are also some adjustments in the weights assigned to real estate and index-linked bonds. The proportion of foreign assets is unchanged.

AP3 will continue to devote substantial resources to ALM analysis. Our ambition is to carry out a yearly ALM study whose conclusions may lead to adjustments in the composition of the reference portfolio. Aside from updating our analysis by using new incoming data, our ambition is to gradually build up greater knowledge of the characteristics of the pension system and the effects of the buffer funds.

Currency risk in the reference portfolio

The latest ALM study also analysed what share of foreign currency risk exposure is appropriate, considering the Fund's liabilities in the pension system. The study indicated that it is suitable to employ a 100 per cent hedge ratio for foreign interest-bearing instruments and 55–80 per cent hedging of foreign equities. Considering the prevailing situation in the foreign exchange market, with a weak krona, the Fund decided to retain a high degree of currency hedging. As in 2001, the hedging ratios in the reference portfolio for 2002 will remain at 100 per cent for foreign interest-bearing instruments and 80 per cent for foreign equities. However, total currency exposure in the 2002 reference portfolio will be higher than in 2001, since the proportion of foreign equities will increase.

The hedge ratios in the 2002 reference portfolio imply a currency risk of 9.6 per cent of the total portfolio, compared to the equivalent figure for 2001 of 8.5 per cent (see Figure 9). Note that companies quoted on Stockholmsbörsen (the Stockholm Stock Exchange) with foreign legal domicile are counted as being exposed to currency risk, as defined by law¹.

Also note that in its day-to-day asset management, the Fund may choose to deviate – both upward and downward – from the hedge ratios in the reference portfolio. However, total exposure may obviously not exceed the maximum (20 per cent in 2002) stipulated by law.

Index structure

The Fund's risk and return are measured against a weighted index consisting of sub-indices for different asset classes. An overview of the index structure is provided in Figure 10. For equities, the Fund uses the FTSE (developed by the Financial Times and the London Stock Exchange). For Swedish equities, we use the SIXRX (SIX Return Index) and for fixed-interest assets, we have chosen to work mainly with the Merrill Lynch index family.

Return and risk targets

During 2001, the target of AP3's asset management operations was to outperform the return on the benchmark portfolio by 0.3 percentage points. In 2002, the Fund is shifting to a long-term target of outperforming the benchmark portfolio by 0.4 percentage points annually. Here "long-term" is defined as a five-year moving average. This target for active management is supplemented by another target: that risk-adjusted return, measured as the information ratio, shall exceed 0.2. According to its mandate, the Fund's assets are to be managed at a low risk level. AP3's return targets are to be achieved within an active risk limit (tracking error) of 5 per cent.

The 5 per cent active risk limit is an upper limit that is not to be exceeded – not a benchmark for the risk level in the total portfolio. The risk level for the Fund should normally lie within the 1.5–3.5 per cent range, measured as active risk.²

Figure 9
Foreign currency hedge ratios in the reference portfolio, 2002 (2001 in brackets)

%	Gross exposure as % of reference portfolio	Hedge ratio	Net exposure as % of reference portfolio
Foreign bonds	16.5 (22.0)	100	0
Foreign equities	38.5 (32.6)	80	7.7 (6.5)
Swedish equities with foreign legal domicile	1.9 (2.0)		1.9 (2.0)
Reference portfolio	56.9 (56.6)		9.6 (8.5)

Figure 10
Index structure

Main asset class	Benchmark index
Equities	
Sweden	SIXRX (SIX Return Index)
Europe excl. Sweden	FTSE W Europe
Rest of the world	Mixture of FTSE AW North America and FTSE AW Developed Asia Pacific
Interest-bearing	
Sweden	Mixture of Merrill Lynch Swedish Government and Handelsbanken mortgage bond index
Europe excl. Sweden	Merrill Lynch Index Family
Rest of the world	Merrill Lynch Index Family
Index-linked bonds	Merrill Lynch Swedish Index Linked
Real estate	SfiX (Swedish real estate index)

¹The most important of these companies are ABB, AstraZeneca, Autoliv, Pharmacia, Stora Enso, Syngenta, TietoEnator and Nokia.

²Simply dividing the target for active risk by the maximum tracking error leads to the wrong result. The information ratio of 0.2 is to be judged on the basis of the actual risk level.

Report of the Directors

Figure 1
Change in fund capital, 2001

	SEK M
Fund capital, 1 January	133,975
Pension contributions	39,202
Pension disbursements	-35,891
Administration fee, National Social Insurance Board	-249
Transferred from phase-out funds	1,461
Net income for the year	-5,774
Total fund capital, 31 December	132,724

Figure 2
Major expense items during 2001 (SEK M)

Staff	50.9
Premises	4.8
Travel and entertainment	1.5
Of which, entertainment	0.07
External asset managers	5.2
Suppliers of market information (e.g. Reuters, BARRA)	10.7
Global custodian	18.9

Figure 3
Revenues from securities lending, 2001 (SEK M)

Bonds	2.7
Equities	9.9
Total	12.6

The Board of Directors of the Third Swedish National Pension Fund (AP3) and the Chief Executive Officer hereby submit their report on 2001 operations.

The market value of AP3's fund capital at the close of 2001 was SEK 132.7 billion. Asset management income in 2001 was SEK -5.8 billion. This was equivalent to a total return of SEK -4.2 per cent. Management expenses amounted to SEK 110 M, of which nearly half consisted of staff expenses.

The factors behind the year's change in fund capital are described in Figure 1. The change in capital under management is explained by return on fund capital as well as external capital flows. These external capital flows consisted primarily of the net inflow of pension contributions and disbursements, which resulted in an inflow totalling SEK 3.1 billion for 2001 as a whole. In addition, AP3 received an inflow of funds totalling SEK 1.5 billion from the phase-out of asset management under the auspices of the First and Fourth AP Funds.

The balance sheet of AP3 is valued according to current market valuation. Net income for the year thus included unrealised changes in value and amounted to SEK -5.8 billion.

The Fund's asset management expenses totalled SEK 110 M, which was equivalent to 0.08 per cent of managed assets. Of this, nearly half was staff expenses (SEK 50.9 M), of which SEK 8.9 M consisted of a provision for disbursement of bonuses to AP3 employees related to 2001.

During 2001, the number of employees rose from 29 to 38 and the process of staffing the new AP3 organisation is thereby completed. This means that internal asset management expenses during late 2001 reached a level that we expect to continue in the long term.

Some of the largest expense items during 2001 can be seen in Figure 2. The largest single item was fees to the Fund's global custodian, Northern Trust Company. Another large item was payments to suppliers of market information and risk analysis (for example Reuters, Bloomberg and BARRA).

Increased expenses for external asset managers ahead

Expenses for external asset managers amounted to SEK 5.2 M. During the next few years, expenses for external management will increase as AP3 makes the transition from passive (index-based) management to active management.

Like other long-term asset managers, AP3 engages in securities lending. The lending programme for 2001 has been of a limited size. These operations consist of short-term lending of equities and bonds to counterparties that both have high creditworthiness and provide full collateral. Total revenues for securities lending amounted to SEK 12.6 M in 2001. At year-end, securities totalling SEK 9.2 billion were loaned out, of which 44 per cent were equities and 56 per cent bonds.

Financial markets and fund return, 2001: Low risk exposure in a volatile market

During 2001, financial markets were marked by the deep downturn in the world economy and political uncertainty in the aftermath of the September 11 terrorist attacks. Due to sharp declines in equity markets, both in Sweden and abroad, the value of the AP3 portfolio (after expenses and adjusted for net inflows) declined by 4.2 per cent during the year. The liquid and market-listed portfolio (excluding real estate) declined by 4.4 per cent before expenses. This was slightly better than for the benchmark portfolio, which fell by 4.6 per cent.

During 2001, the Fund's investment strategy was generally characterised by a cautious approach in an environment of volatile financial markets. Only about one fourth of the risk budget (that is, the 4 per cent tracking error limit approved by the Board of Directors for the total portfolio) was utilised. This low risk exposure is also explained by the Fund's focus on its extensive transition of assets and the fact that investment operations were still in a start-up phase, which implied a higher share of passively managed assets.

In some sub-portfolios, however, the Fund chose to activate risk. This was the case in the internally managed equities portfolios, where risk was activated at both the sector and the stock-picking level. The Swedish equities portfolio provided the single largest positive contribution to active return, outperforming its comparative index by 3.4 percentage points (-11.4 per cent compared to -14.8 per cent for the index). The internally managed European equities portfolio, however, yielded a negative contribution to active return.

For 2001 as a whole, nominal interest-bearing assets showed an absolute return for the Fund's benchmark index of 4.6 per cent. The Fund's active management of fixed-income assets also outperformed its benchmark. The largest contribution came from the Swedish fixed-income portfolio, which returned 3.7 per cent, compared to 3.3 per cent for the benchmark. During 2001, tactical asset allocation (which we define as weighting of main asset classes and regions) provided a negative contribution to the Fund's active return. Although risk exposure was limited, sharp price movements in the markets meant that even small positions made a noticeable contribution to the active return of the total portfolio.

Major contribution to active return from stock-picking

The strong relative performance of the Swedish equities portfolio can largely be attributed to stock-picking. Sector allocation also resulted in a positive contribution to active return. The largest positive contribution can be attributed to stock-picking in the general industrials sector. Among the year's most negative contributions to relative performance was the over-weighting of Ericsson and the under-weighting of Stora Enso. In all actively managed sectors of the Swedish equities portfolio, stock-picking yielded positive contributions to relative performance during 2001, with the exception of cyclical consumer goods. In the European equities portfolio, in contrast, negative active return was attributable to stock-picking, while sector allocation yielded a positive contribution to active return.

Currency risk: High degree of hedging

During 2001, AP3 chose a high degree of currency hedging for its foreign securities holdings. As established in the benchmark portfolio, foreign bonds and equities were hedged at 100 and 80 per cent, respectively (read more about the Fund's currency risk policy on page 9). Figure 5 shows the

Figure 4

Active return by main asset classes

%	Absolute return	Benchmark return	Active return
Equities	-13.3	-14.3	1.0
Sweden	-11.4	-14.8	3.4
Rest of Europe	-18.1	-16.7	-1.4
Rest of the world	-14.7	-14.7	0.0
Interest-bearing	4.6	4.3	0.3
Index-linked bonds	5.6	5.5	0.1
Total	-4.4	-4.6	0.2

trend of the Fund's total exposure to currency risk, expressed as a percentage of the portfolio in the course of 2001. On 31 December 2001, actual currency exposure amounted to 8.1 per cent of the portfolio, compared to a risk of 8.5 per cent in the benchmark portfolio. A more detailed overview of the AP3 portfolio's currency risk on 31 December 2001 can be found in Table 4 on page 16.

Information ratio in line with 2001 target

The target of the Fund's investment operations during 2001 was to outperform the return on the benchmark portfolio by 0.3 percentage points, and to achieve an information ratio (a measure of risk-adjusted return) of 0.2. The outcome for 2001 as a whole was an active return of 0.2 percentage points and an information ratio of 0.21. Active return thus did not fully achieve its target. Starting in 2002, new targets apply as described on page 7.

During 2001, tracking error for the Fund's total portfolio amounted to 1.0 per cent. This relatively low risk exposure is explained partly, by the special situation that the Fund was in during the first year of its new asset management mandate. Over the next few years, the Fund will activate more risk in its asset management, in a controlled and appropriate way. In external asset management, the proportion of index management will gradually decrease as active asset management mandates expand. As the Fund continues to refine its risk and performance analysis, investment

processes and risk budgeting, risk exposure in its internal asset management will increase.

Corporate governance policy during 2001

In February 2001 the Fund's Board of Directors adopted a corporate governance policy. The exercise of our corporate governance policy focuses on Swedish companies in which the Fund has a significant ownership stake.

The Fund's new asset management mandate and the new rules on environmental and ethical considerations have placed new demands on the Fund's corporate governance policy. During 2001, AP3 focused on strengthening its expertise in this field. During 2002, the Fund intends to take further steps towards developing and implementing its corporate governance policy.

During 2001 the Fund was represented on the nominating committees of two of its Swedish equity holdings, Cardo and Kungsleden. In Europolitan, we informed the Board of Directors of our views on the company's compensation system. In another of the fund's equity holdings, Adcore, we participated in a targeted new share issue as part of the restructuring of the company. In two companies, we submitted proposals on a voluntary reclassification of high-voting-power Series A shares to Series B shares. We also con-

tacted a few portfolio companies to suggest that they establish nominating committees. With a few exceptions, the Fund has been represented at the general shareholders' meetings of those companies that are part of our Swedish equities portfolio.

Figure 5

Percentage of currency exposure in the total portfolio

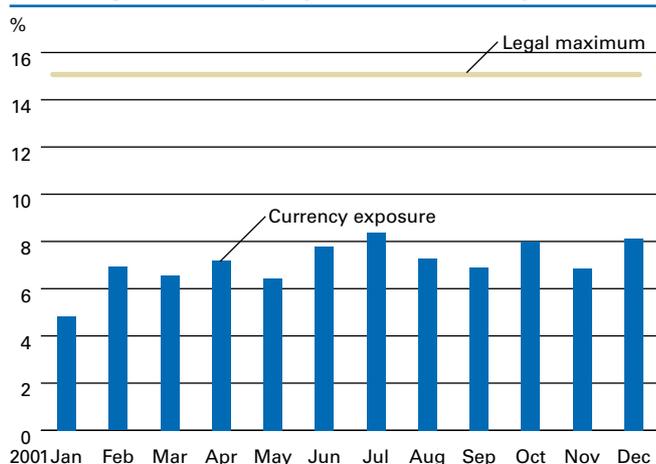


Figure 6

Risk and return for the total portfolio (excl real estate)

	Portfolio	Index	Active
Return (time-weighted daily)	-4.4%	-4.6%	0.2%
Risk (standard deviation, annual basis)	11.2%	10.9%	1.0%
Risk-adjusted return on capital			
Information ratio	0.2		
Sharpe ratio	Neg	Neg	

Internal asset management: Continued development of the investment process

At the close of 2001, 77 per cent of AP3's fund capital was being managed internally, that is, by its own portfolio managers. After having implemented the Fund's sizeable transition of assets during the first half of 2001, the internal asset management organisation focused on developing its investment processes and analytical models in order to generate higher returns through active position-taking. Active asset management was phased in to include an increasing number of sub-markets and types of instruments. This process will continue during 2002.

Administration

AP3 has a relatively small and focused administrative and back office team. Portions of its operations are outsourced, for example computer support. Securities settlement and portfolio reporting are managed by the Fund's global custodian.

In IT business systems, after a period of major investments the Fund has entered a phase where the focus is on ensuring the best possible use of the existing systems. Our overriding ambition is to develop connections between the different systems for the purpose of attaining straight-through processing.

Fixed-income and FX Management

The fixed-income/FX team is a new unit that was built up as a result of the new asset management mandate that came into force in the beginning of 2001. Of the Fund's total investments in interest-bearing instruments (SEK 60 billion at year-end), 94 per cent was handled by the internal asset management team.

During 2000, the team laid the groundwork for professional management of a global fixed-income portfolio and of the Fund's foreign exchange risk, with a focus on building up support systems and administrative routines. During 2001, it devoted extensive work to formulating an effective investment process and developing analytical tools.

Equities Management

AP3's equities management is based on the organisation that handled the Fund's previous mandate, which was to manage a mainly Swedish equities portfolio. The team thus already has a well-established investment process. For European equities, however, a new and expanded mandate has applied from 2001 onward. Today the equities management team is responsible for a Swedish equities portfolio of SEK 24 billion as well as for managing 70 per cent of the European (ex Sweden) equities portfolio of SEK 22 billion.

The equities team's investment organisation is based on a sector perspective. The team consists of a head, a sector strategist and ten sector managers. The equities strategist is responsible for allocation between sectors, and the sector managers have total responsibility for financial analysis and stock selection within their respective sectors.

Evaluation of brokers

AP3 attaches great importance to allocating securities transactions among brokers according to clear principles. Since 2001, both the equities team and the fixed-income/FX team have applied a ranking system, in which brokers are evaluated according to a number of specified criteria, including the quality of the research provided by the company. This ranking is then used as the basis for allocating transactions among brokers. Figure 7 lists in alphabetical order the five brokers to which the AP3 equities team paid the largest total commissions during 2001.

Figure 7

Five brokers to which the Fund's equities management paid the most commissions during 2001 (alphabetically)

ABN Amro including Alfred Berg
Carnegie
Deutsche Bank
Enskilda Securities
UBS Warburg

The above brokers received more than 50 per cent of total brokerage commissions.

Total commissions¹ during 2001, SEK M: 48.6

Total number of brokers for equities management during 2001: 25

¹ Refers to the Fund's internal management of Swedish and other European equities.

External asset management: From passive to active mandates

In areas where we do not have our own expertise, AP3 hires external asset managers. During 2001, all external asset management mandates involved passive management (index management). In markets where active management is expected to create value-added, these passive management mandates will gradually be replaced by active mandates.

Approximately 23 per cent of AP3's fund capital is currently being handled by external managers. A special external management team is responsible for selecting and evaluating these managers. The team is also responsible for the Fund's investments in unlisted shares, hedge funds and real estate.

Traditional asset classes

According to the investment rules for the AP Funds, at least 10 per cent of fund capital must be managed externally. By hiring external asset managers, AP3 can invest in regions and market segments where it is not efficient to invest directly or where the Fund, for other reasons, lacks high-level expertise. How large a proportion of asset management will be outsourced to external parties will be reassessed continuously, with the performance of AP3's internal asset management teams being evaluated in relation to potential external managers.

At present, the Fund employs external management for North American, Japanese and Asian equities.¹ In addition, 30 per cent of the European equities portfolio is managed externally. In the fixed-income portfolio, there are two external mandates related to corporate bonds listed in US dollars and UK sterling, respectively. All the above mandates are in the form of index management. During 2002, the team will be focused on active management of these assets, as appropriate.

Unlisted equities

According to AP Fund investment rules, a maximum of 5 per cent of AP3's assets may be invested in unlisted equities. These investments must be made indirectly, via mutual funds or limited partnerships. Our target is to reach investment commitments equivalent to about 5 per cent of AP3's fund capital within a 3–5 year period. We intend to build up a diversified portfolio containing a balanced mix of investments in different regions, industries and stages (buy-outs, venture capital etc). These investments will be made both directly through funds and indirectly through funds of funds. During 2001, AP3 made investment commitments totalling SEK 729 M. Of this commitment, SEK 19.8 M had been invested by year-end.

Hedge funds

Can investments in hedge funds add value to an AP Fund portfolio? This issue was explored in the ALM study that the Fund carried out during the autumn of 2001. The study demonstrated that certain types of hedge funds have attractive characteristics that enable them, as elements of an otherwise diversified portfolio, to help improve the return on the portfolio without significantly increasing risk. It also indicated that in the long term, at least 5 per cent of AP3's portfolio should be invested in hedge funds.

However, due to the complex nature of this field, continued study of the hedge fund market is necessary before any investments can be considered. A strategy for the Fund's investments in hedge funds will be drafted during 2002.

¹ Asia Pacific, which refers to Japan, Singapore, Hong Kong, Australia and New Zealand.

² The two equities mandates are for Japan and Asia Pacific excluding Japan.

Portfolio overview, 31 December 2001

Table 1

Market value by main asset classes, 31 Dec 2001

	SEK bn
Equities	
Sweden	23.8
Rest of Europe	22.5
Rest of the world	22.1
Total equities	68.4
Interest-bearing	
Sweden	23.2
Rest of Europe	15.0
Rest of the world	12.8
Total interest-bearing	51.0
Index-linked bonds (Sweden)	9.5
Real estate	3.8
Cash¹	0.0
Total	132.7

¹ In practice, cash was not zero since there is a small amount of cash in the individual sub-portfolios. In terms of tactical asset allocation, however, cash allocation was zero.

Table 2

Reference portfolio and actual portfolio, 31 Dec 2001

%	Benchmark weight	Portfolio weight	Active weight
Equities			
Sweden	16 1/3	17.8	1.4
Rest of Europe	16 1/3	16.8	0.5
Rest of the world	16 1/3	16.6	0.2
Total equities	49.0	51.2	2.2
Interest-bearing			
Sweden	15.0	13.8	-1.2
Rest of Europe	12.0	11.2	-0.8
Rest of the world	10.0	9.6	-0.4
Total interest-bearing	37.0	34.6	-2.4
Index-linked bonds (Sweden)	7.0	7.1	0.1
Real estate	7.0	7.1	0.1
Cash	0.0	0.0	0.0
Total	100	100	0

Table 3

External asset managers

Managers	Reference index	Market value, 31 Dec 2001 (SEK M)	Starting date of mandate
Equity mandates			
Merrill Lynch Investment Managers	FTSE All-World USA	17,544	2 Jan 2001
State Street Global Advisors	FTSE All-World Developed Europe	6,021	3 Jan 2001
State Street Global Advisors	FTSE All-World Developed Asia Pacific	3,567	4 Jan 2001
Fixed-income mandates			
State Street Global Advisors	Merrill Lynch Corporate Large Cap – USD	2,533	8 Jun 2001
State Street Global Advisors	Merrill Lynch Sterling Corporate	1,096	1 Aug 2001

All above external mandates are passive.

Currency positions, 31 December 2001

Table 4
Currency positions, 31 Dec 2001

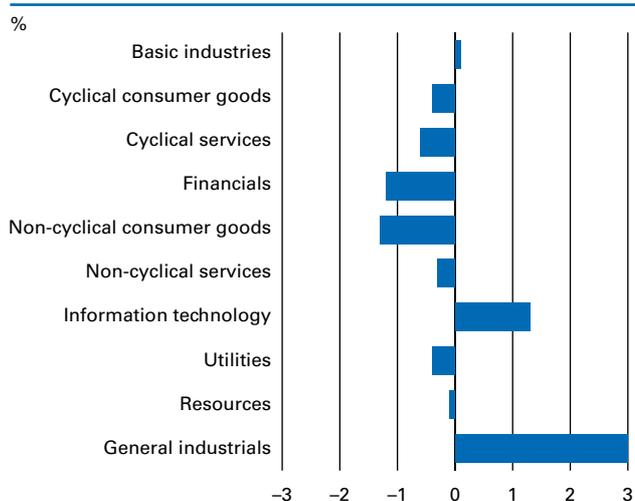
SEK M	CHF	EUR	GBP	JPY	USD	Others	Total
Exposure	2,265	24,358	9,867	7,158	25,347	1,864	70,859
Hedging	-1,762	-22,476	-8,169	-6,592	-21,753	-1,238	-61,990
Net exposure	503	1,882	1,698	566	3,594	626	8,869
Exposure through SEK-listed companies with a foreign legal domicile		261	1,443		195		1,899
Total currency exposure	503	2,143	3,141	566	3,789	626	10,768

Internally managed equities portfolio, 31 December 2001

Table 5
Five largest shareholdings, 31 Dec 2001

SEK M	
Swedish equities portfolio	
Ericsson	3,735.3
Hennes&Mauritz	1,596.3
AstraZeneca	1,443.0
Svenska Handelsbanken	1,280.0
Telia	1,100.8
European (ex Sweden) internally managed equities portfolio	
Vodafone Airtouch	607.1
Nokia	535.2
BP	527.2
GlaxoSmithKline	448.4
Royal Dutch Petroleum	391.9

Table 6
Active sector weights in Swedish equities portfolio, 31 Dec 2001



Fixed-income portfolio

Table 7

Allocation by rating category (S&P) in the bond portfolio, 31 Dec 2001

	SEK M	% of portfolio
Sweden		
AAA	22,777	69.8
AA	7,321	22.4
A	2,557	7.8
BBB	0	0.0
Total	32,655	100.0
Euro		
AAA	11,337	85.7
AA	1,746	13.2
A	146	1.1
BBB	0	0.0
Total	13,229	100.0
UK		
AAA	860	49.3
AA	319	18.3
A	351	20.1
BBB	215	12.3
Total	1,745	100.0
USA		
AAA	6,447	82.5
AA	250	3.2
A	602	7.7
BBB	516	6.6
Total	7,814	100.0
Japan		
AAA	0	0.0
AA	5,016	100.0
A	0	0.0
BBB	0	0.0
Total	5,016	100.0

Table 8

Average maturity (modified duration) of AP3's internally managed fixed-income portfolio, 31 Dec 2001

	Portfolio	Index	Relative
Sweden			
Treasury bonds	4.60	4.24	0.35
Mortgage bonds	2.32	2.28	0.05
Total	3.60	3.38	0.22
Euro zone			
Treasury bonds	6.34	5.03	1.30
Mortgage bonds	2.11	3.96	-1.85
Total	4.97	4.65	0.32
United Kingdom			
Treasury bonds	7.50	7.23	0.27
USA			
Treasury bonds	4.62	5.78	-1.17
Mortgage bonds	7.44	4.51	2.93
Total	5.47	5.37	0.10
Japan			
Treasury bonds	5.85	6.15	-0.30
Index-linked bonds (Sweden)	9.09	8.75	0.35

Income statement and balance sheet

INCOME STATEMENT¹

SEK K	2001
Operating revenues	
Operating revenues	
Dividends receive	1,104,019
Net interest items	3,218,915
Net capital gains	-2,262,957
Net exchange rate gains	827,336
Net unrealized changes in value	-8,551,401
Total operating revenues	-5,664,088
Operating expenses	
External management expenses	-5,205
Staff expenses	-50,868
Other administrative expenses	-54,259
Total operating expenses	-110,332
NET INCOME	-5,774,420

¹ At the beginning of 2001, the assets from the First – Fourth AP Funds were redistributed in such a way that each fund received assets of equally large value. AP3 has therefore chosen not to present any comparative figures for the income statement and is presenting opening balances as a comparison in the balance sheet.

BALANCE SHEET¹

SEK K	31 Dec 2001	Adjusted opening balance, 1 Jan 2001
ASSETS		
Investment assets		
Shares and participations:		
Listed	65,943,299	36,483,056
Unlisted	3,808,739	3,660,000
Bonds and other interest-bearing assets	57,151,099	88,863,483
Derivatives	1,372,055	–
Total investment assets	128,275,192	129,006,539
Receivables and other assets		
Cash and bank balances	3,190,218	2,776,275
Other assets	13,770	34,652
Prepaid expenses and accrued revenues	1,292,407	2,195,445
Total receivables and other assets	4,496,395	5,006,372
TOTAL ASSETS	132,771,587	134,012,911

SEK K	31 Dec 2001	Adjusted opening balance, 1 Jan 2001
FUND CAPITAL LIABILITIES		
Fund capital		
Opening fund capital	133,975,182	133,975,182
Net payment from pension system	3,062,449	–
Transferred from phase-out funds	1,461,156	–
Income for the year	-5,774,420	–
Total fund capital	132,724,367	133,975,182
Liabilities		
Derivatives	10,669	19,419
Other liabilities	17,061	6,128
Accrued expenses and prepaid revenues	19,490	12,182
Total liabilities	47,220	37,729
TOTAL FUND CAPITAL AND LIABILITIES	132,771,587	134,012,911

MEMORANDUM ITEMS, SEK M

Assets and comparable collateral pledged for own debts	1,229
Other assets pledged and comparable collateral	837
Commitments	729

Board of Directors



Standing, from the left:

Christina Liffner
MBA

Karin Kronstam
Business Executive

Christine Jönsson
Chair of the Municipal Executive Board, Lund

Seated, from the left:

Harriet Piscator
Executive Vice President, Finance, ABB AB

Rolf Andersson, Deputy Chairman
Head of Research, Swedish Municipal Workers' Association

Christer Romilson
President, Swedish Teachers Union

Dag Sehlin
MBA

Dan Andersson
Chief Economist, Swedish Trade Union Confederation (LO)

Johan Björkman, Chairman
Licentiate in Economics

Auditors

Pål Wingren, Authorized Public Accountant
Per-Olof Akteus, Authorized Public Accountant

Employees

Here is a presentation of all 38 Fund employees. The organisation is flat, with short and efficient reporting lines. We emphasise teamwork in combination with extensive personal responsibility for the individual employee.

Equities Team Head: Magnus Eriksson	Fixed-income/FX Team Head: Lennart Nordkvist	External Management Team
Administration Head: Sven Askenberger	CEO: Tomas Nicolin	Compliance Officer Mikael Sedolin
	Deputy CEO: Niklas Ekvall	
Communications Manager Pernilla Klein	Quantitative Analysis	Chief Economist Bengt Hansson

AP3 Management



Tomas Nicolin
Chief Executive Officer
23 years in the financial field
AP3 since October 1998
Previously: Handelsbanken Asset Management, CEO of Öhman Fondkommission

Administration, Accounting



Sven Askenberger
Chief Administrative Officer
21 years in the financial field
AP3 since September 2000
Previously: Swedish Industrial Development Fund, head of securities settlement at Gota Bank



Mikael Gustafsson
IT Manager
15 years in the IT field
AP3 since February 2001
Previously: Electrolux, Alcro-Beckers



Lotta Karlsson
Securities administration
25 years in the financial field
AP3 since June 1999
Previously: Öhman Fondkommission, Jacobson & Ponsbach



Sebastian Mossfeldt
Securities administration
8 years in the financial field
Previously: SEB Fonder



Kersti Waldenhagen-Taxén
Receptionist
26 years in office administration and accounting
AP3 since August 2001
Previously: Företagarhuset/Kontorshotellet, Täby



Ann-Mari Werin
Senior Accountant
26 years in the financial field
AP3 since August 1989
Previously: Chief Administrative Officer of AP Fund Fifth Fund Board, Trefond Invest



Lennart Nordkvist
Head of Fixed-income/FX Management
18 years in the financial field
AP3 since April 2000
Previously: Head of securities trading at Stora Financial Services, head of fixed-income management at Wasa



Anette Hellström
Portfolio Manager
Execution, FX
16 years in the financial field
AP3 since April 2001
Previously: SKF Treasury Centre, SEB Trading & Capital Markets

Equities Management



Lars Orest
Portfolio Manager
Swedish and foreign fixed-income securities
18 years in the financial field
AP3 since July 2000
Previously: Head of FX reserve management at Sveriges Riksbank, Sparbankernas Bank



Magnus Eriksson, AFA, CEFA
Head of Equities Management
Execution, equities, sector manager, real estate and construction
20 years in the financial field
AP3 since August 1999
Previously: Catella Kapitalförvaltning, Head of equities/Deputy CEO at Aragon Fondkommission



Axel Brändström, CFA
Portfolio Manager
Sector manager, IT hardware
7 years in the financial field
AP3 since January 1999
Previously: Handelsbanken Asset Management



Per Colleen
Portfolio Manager
Sector manager, general industrials, automobiles and forest products
6 years in the financial field
AP3 since May 1999
Previously: Aros Fondkommission, H. Lundén Fondkommission

Staff positions



Niklas Ekvall
Deputy CEO
Chief Investment Officer
Ph D in Finance and Adjunct
Professor of financial economics
11 years in the financial field
AP3 since April 1999
Previously: Handelsbanken



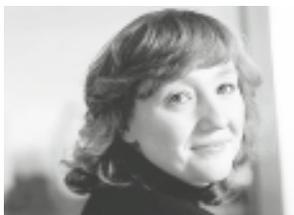
Mikael Sedolin
Internal legal monitoring and
Compliance Officer
Associate Judge of Appeal
8 years in the financial field
AP3 since December 2000
Previously: Ministry of Finance,
Swedish National Debt Office



Bengt Hansson
Chief Economist
Macro analysis, ALM
Ph D in Economics
11 years in the financial field
AP3 since August 2000
Previously: Head of Macro Fore-
casting at SEB, Handelsbanken
Markets Research



Pernilla Klein
Communications Manager
8 years in the financial field
AP3 since August 2000
Previously: Handelsbanken
Markets Research, Ministry of
Finance



Maria Prinsström
Securities administration
16 years in the financial field
AP3 since August 2000
Previously: Robur Kapitalförvalt-
ning, ABB



Patricia Rydén
Accountant
14 years in office administration
and accounting
AP3 since January 2001
Previously: WM-Data, Center for
Business and Policy Studies (SNS)



Michael Sandberg
Analyst
Risk and performance
4 years in the financial field
AP3 since July 2001
Previously: UBS Warburg, Nordea



Yvonne Thomson
Accounting Manager
20 years in the financial field
AP3 since October 2000
Previously: OM VPA, Gota Bank



Jannis Asdrás
Portfolio Manager
Credit bonds
5 years in the financial field
AP3 since March 2001
Previously: ABN Amro Transferator,
Handelsbanken Global Trading



Matthias Buhr-Berg
Portfolio Manager
Execution, FX
15 years in the financial field
AP3 since August 2000
Previously: Head of Emerging
Markets at Handelsbanken Markets,
head of Asian Operations and
Brussels Operations at Stora
Financial Services



Hans Ericsson
Portfolio Manager
Execution, fixed-income
17 years in the financial field
AP3 since October 2000
Previously: Handelsbanken Asset
Management, head of fixed-income
trading at Handelsbanken Markets



Jonas Ljungström
Portfolio Manager
Quantitative analysis
14 years in the financial field
AP3 since December 2000
Previously: SEB Trading & Capital
Markets, Banque Indosuez



Sofie Emilsson Nilvall
Portfolio Manager
Sector manager, pharmaceuticals
and medical technology
5 years in the financial field
AP3 since September 2001
Previously: Alfred Berg Fondkom-
mission, Danske Securities



Urban Eriksson
Portfolio Manager
Execution, equities, sector manager,
investment companies
16 years in the financial field
AP3 since August 1999
Previously: Head of equities
trading at Robur Kapitalförvaltning,
Sparbankernas Bank



Anne-Charlotte Hornsgård
Portfolio Manager
Sector manager, retail, services,
consumer goods
13 years in the financial field
AP3 since April 1993
Previously: Bohusbanken FK,
Folksam finance division



Erik Kovacs
Portfolio Manager
Sector Manager, banking and
financials
11 years in the financial field
Previously: Enskilda Securities,
Government Bank Investment
Fund in Norway

Equities Management / Continued



Björn Kvamskog
Portfolio Manager
Sector strategist
15 years in the financial field
AP3 since September 1999
Previously: Alfred Berg Asset Management, head of equities management at Handelsbanken Liv



Ulrika Slåne Sens, AFA, CEFA
Portfolio Manager
Sector manager, pharmaceuticals and medical technology
13 years in the financial field
AP3 since February 1999
Previously: Head of research at Aros Fondkommission, Enskilda Securities, Carnegie



Eskil Svensson
Portfolio Manager
Sector manager, telecommunications and media
13 years in the financial field
AP3 since May 2000
Previously: Alfred Berg Asset Management, Alfred Berg Fondkommission

External Management



Lena Djurberg
Portfolio Manager
14 years in the financial field
AP3 since September 2000
Previously: Deputy CEO of Sweden Post's Pension Fund, deputy manager of Sweden Post's Group staff unit Finance



Bengt Hellström
Portfolio Manager
17 years in the financial field
AP3 since October 2000
Previously: EQT Partners, Investor



Klas Åkerbäck
Portfolio Manager
3 years in the financial field
AP3 since September 2000
Previously: Alfred Berg Asset Management

Quantitative Analysis



Stig Jonsson
Analyst
Tactical asset allocation
13 years in the financial field
AP3 since July 1999
Previously: Handelsbanken Markets, Öhman Fondkommission



David Stillberger
Analyst
Risk and performance
1 year in the financial field
AP3 since July 2001



Erik Valtonen
Analyst
ALM, risk
Ph D in mathematics
12 years in the financial field
AP3 since May 2000
Previously: Head of financial research at Handelsbanken Markets



Lukas
Scottish Terrier
7 years in the financial field

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Address: Box 1176 · SE-111 91 Stockholm · Visiting address: Vasagatan 11 · Stockholm
Phone +46 8 555 17 100 · Fax +46 8 555 17 120 · www.ap3.se