



# **Third Swedish National Pension Fund Annual Report 2002**

AP3  
**European Leader**  
Investment Strategy  
IPE-awards 2002

**AP3 named European market leader for 2002**  
Read more on page 4

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# The year in brief

## Asset management income SEK –17.5 billion

Asset management income for 2002 amounted to SEK –17.5 billion, which is equivalent to a total return of –12.6 per cent. This negative income is chiefly attributable to unrealised capital losses.

## Fund capital SEK 120.2 billion

The value of the fund capital on 31 December 2002 amounted to SEK 120.2 billion. Like the other three buffer funds during 2002, AP3 received a net capital inflow totalling SEK 5 billion. This was largely attributable to a positive net inflow of pension contributions relative to pension disbursements.

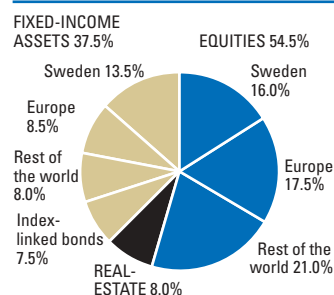
Figure 1  
Change in fund capital 2002

	SEK million
Fund capital 1 January	132,724
Pension contributions	40,186
Pension disbursements	37,939
Administration fee, National Social Insurance Board (RFV)	–263
Transferred from phase-out funds	3,017
Net income for the year	–17,514
<b>Total fund capital 31 December</b>	<b>120,211</b>

## Reference portfolio with 55 per cent equities

AP3's strategic asset allocation, the reference portfolio, is determined based on an analysis of what asset mix is judged to be best for the pension system in the long term. During 2002, the portfolio contained 54.5 per cent equities, which in the short term led to a shrinking fund capital.

Figure 2  
AP3's reference portfolio 2002



## Active return of SEK 700 million

For the liquid part of the portfolio, which excludes real estate, the return amounted to –12.9 per cent. This was 0.6 percentage points better than the return for the fund's reference portfolio, which totalled –13.5 per cent. This active return corresponds to approximately SEK 700 million.

## Outperformance in Swedish equity portfolio

The asset class that yielded the poorest return during 2002 was Swedish equities, which fell by 35.9 per cent. However, the fund succeeded in generating a positive active return, in relation to the SIXRX-index. The fund's Swedish equity portfolio showed a negative return of 33.9 per cent, which was 2.0 percentage points better than the market. The fund's Swedish equity portfolios also outperformed the market in 2001 – by 3.4 percentage points.

## Asset management expenses of 0.14 per cent

The fund's management expenses for 2002 amounted to a total of SEK 177 million, which is equivalent to 0.14 per cent of managed assets. Of this, approximately 40 per cent was staff expenses. At the close of 2002 the number of employees totalled 41.

## Small adjustments to the reference portfolio for 2003

During Autumn 2002 the fund updated and extended its ALM-study, which is an analysis of the pension system's long-term development and of which portfolio mix generates the greatest benefit relative to the fund's liabilities. The new ALM-study largely confirmed the results of previous studies. Consequently, no major changes to the composition of the reference portfolio were justified. However, based on the results of the study, the board decided on a few minor adjustments to the reference portfolio for 2003. The proportion of real estate is to be increased by 0.5 percentage points and Japanese bonds have been removed from the portfolio.

## Increased share of active portfolio management

During 2002 the fund has initiated and finalised several manager-searches, with the aim of increasing the share of the fund capital that is actively managed. At the start of the year, all AP3's external asset management mandates were passive, i.e. index mandates. By the close of the year, 50 per cent of the fund's externally managed assets were invested in active mandates.

## Currency risk 8.3 per cent

The fund's currency exposure totalled 8.3 per cent at year-end, corresponding to SEK 10 billion. A higher proportion of currency hedging than the reference portfolio contributed positively to the fund's active return when the Krona strengthened during 2002.

# Statement by the CEO: AP3 named European market leader for 2002



AP3 was named European market leader for 2002 by *Investment & Pensions Europe*, Europe's leading trade journal for pension managers.

Following the bottoming of the equity market on 9 October 2002, the value of AP3's fund capital increased towards the turn of the year by SEK 8.8 billion. The return for 2002 as a whole, however, still shows a substantial negative figure of -12.6 per cent (after expenses and adjusted for net flows) for the fund's entire portfolio. This is equivalent to SEK -17.5 billion.

It is obviously painful to have to report a dwindling fund capital, but given the long-term nature of the fund's liabilities, it is unfortunately inevitable that the fund will contract in value during periods when the equity market falls as sharply as it did in 2002. AP3's investment horizon extends 30-40 years ahead. Consequently, we must be prepared to take short-term risks in order to generate the long-term return required to meet the fund's commitments in the pension system.

Determining which long-term portfolio mix will generate the greatest benefit for the pension system is AP3's most important task. We have therefore devoted a great deal of time and labour to an in-depth ALM-study evaluating the consequences of different portfolio alternatives, based on alternative assumptions for asset price developments, GDP growth, demographic trends, etc. We have studied thousands of portfolios for several million possible scenarios.

Pension funds around the world are focusing to an ever greater degree on developing the analysis that should form the basis for the choice of long-term portfolio structure. We at AP3 are therefore proud of the fact that in 2002 we were named European market leader for investment strategy by *Investment & Pensions Europe*, Europe's leading trade journal for pension managers. We received this distinction in competition with national market leaders in thirteen European countries. The honour related to the analysis project carried out by AP3's team for strategic asset allocation (ALM analysis): Niklas Ekvall, Erik Valtonen, Claudia Stanghellini and Bengt Hansson.

## Equities only five per cent of pension assets

This distinction feels especially important in a year like this, when the AP funds, in the light of the sharp downturn on the equity market, have received a great deal of criticism for our choice of asset allocation. Some people have maintained that "we ought to have realised" that equity prices would continue to fall and should therefore have refrained from investing in equities. Others based their criticism on more profound doubts about the long-term ability of the equity market to deliver more than a marginally better return than bonds.

Let me begin with the initial argument. AP3 is a long-term investor and according to the Riksdag's mandate, our asset management must be implemented at a low risk in relation to our liabilities in the pension system. According to AP3's calculations, a pure bond portfolio would imply a significant risk over time of deficits occurring in the pension system, resulting in lower pension levels. This risk is considerably lower if the buffer

funds invest their assets in mixed portfolios of both equities and bonds. The low-risk requirement relative to future pension liabilities means that it is not appropriate to undertake large deviations from the long-term strategic portfolio. Consequently, it is not possible to make drastic changes to the portfolio's proportion of equities in individual years in the hope of delivering maximum absolute return for every individual year. This would be both risky and irresponsible.

It should also be remembered that the pension system's buffer funds are only equivalent to around 10 per cent of the total liabilities of the pension system. The remainder of the pension system's assets consist of the present value of all future pension contributions. This flow of income has major similarities to bond assets. The proportion of equities in the buffer funds currently amounts to around 59 per cent. This may sound a lot, but, viewed in relation to the entire pension system's asset side, the proportion of equities is only just over 5 per cent.

What would I say to those who have fundamental doubts about equities as investments – even from a long-term perspective?

*"A pure bond portfolio represents a significant risk over time of the brake mechanism being activated, which means that pensions will be reduced."*

The fact that the equity market can offer long-term investors a risk premium is one of the foundation stones on which economic prosperity rests. If investors cannot be compensated for the risk that equity investments represent, firms' access to risk capital will be thwarted. If the long-term pension capital cannot bear the risk of the equity market – then who can?

### **New corporate governance policy**

The past year's accounting scandals and questions involving excessive compensation to top management – primarily in the US – have damaged confidence in the equity market. But now powerful forces are in motion to restore the vital balance of power between shareholders and management. For AP3's part, we have indicated that we are prepared to assume our share of the responsibility and help to strengthen shareholder influence in Sweden.

The global political uncertainty has also led to a surge in investor risk aversion. This is nothing new. The risk premium tends to fluctuate substantially in the short term, in a kind of capital market ebb and flow. But in the long term equity market return is determined by the ability of businesses to generate profits. This ability is determined, in its turn, by the structural conditions for economic growth. Still, there are good reasons to believe in favourable environment for growth over the next few decades. The revolution in information technology is continuing, as well as the benefits of a deregulated capital market. All this indicates that equity market return in the long term should return to a level around the historical average of 6–7 per cent per year in real terms.

During both 2001 and 2002, AP3 succeeded in generating a positive active return, relative to the Fund's reference portfolio. In 2002, this active return amounted to 0.6 per cent. This is equivalent to around SEK 700 million, which should be compared to the fund's total asset management expenses for 2002 of SEK 177 million. In addition, this outperformance has been generated at a low risk level, providing a risk-adjusted return that exceeds the board's targets by a healthy margin.

We have built AP3's asset management organisation on the basis of a strong conviction that the investment professional with the greatest knowledge of a particular market should also be responsible for the investment decisions made involving that market. So, it is particularly gratifying that our decentralised asset management model to date has functioned well.

So far, there is every reason for me to be satisfied with my organisation's ability to generate positive active return in relation to markets, although it would, of course, have been nicer if the reformed buffer funds had been able to launch their operations in a rising equity market.

Stockholm, 11 February 2003



Tomas Nicolin  
CEO



*“The Fund's active return amounted to 0.6 per cent in 2002, which is equivalent to around SEK 700 million.”*

# Our mandate: To manage the Swedish national pension capital

Figure 3  
The reformed Swedish pension system

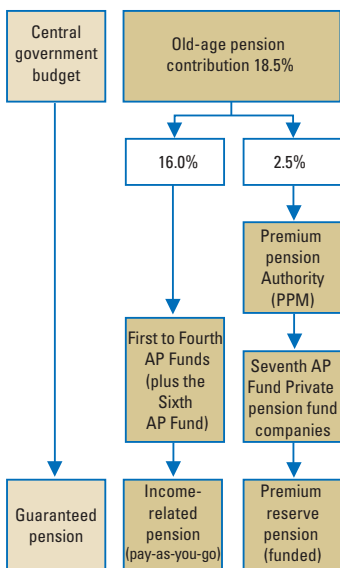


Figure 4  
The pension system's balance sheet, 30 June 2002

Assets	Liabilities
SEK 5,605 billion	SEK 5,435 billion
Funds SEK 520 billion	Pension liabilities SEK 5,435 billion
Contribution assets SEK 5,085 billion	

Source: National Social Insurance Board (RFV), preliminary estimate

**AP3 is one of four buffer funds in the Swedish pension system. The Riksdag has given each of the four funds the same unambiguous mandate: to generate the best possible long-term return on capital at a low risk.**

AP3 is part of the reformed Swedish pension system, which 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 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 Swedish National Pension Fund.

### What is a buffer fund?

The size of contributions to and disbursements from the pension system varies from year to year, due to demographic developments, workforce participation rates and the rate of wage growth, etc. The mandate of the First to Fourth National Pension Funds is to serve as a buffer, smoothing out any temporary variations in contributions and disbursements, and to contribute to the long-term financing of the pension system.

The new pension system includes a built-in automatic balancing mechanism. This 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 so called balance figure is calculated, showing the size of the system's assets in relation to its liabilities. Figure 4 shows an estimate of the pension system's balance sheet on 30 June 2002.

These figures show that the size of the buffer funds is relatively small in relation to future pension liabilities, being about 10 per cent. But the size of the buffer funds may nonetheless have an effect on whether or not the automatic balancing mechanism is applied. The mandate of the buffer funds is thus to manage the fund capital so as to minimise the risk of the automatic balancing mechanism being activated.

### Investment rules

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

The funds are to take environmental and ethical considerations into account in their asset management operations, 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.

To find out more about AP3's mandate, visit [www.ap3.se](http://www.ap3.se)



"We must remember that the buffer funds are relatively small in relation to future pension liabilities; they correspond to approximately 10 per cent of the pension liabilities. The remainder of the pensions system's assets consist of the *contribution capital*, which is the value of all future pension fees."

Erik Valtonen, Head of Quantitative Analysis

# Investment Policy: Best possible return at a low risk

**Generating the greatest possible benefit for the pension system is the basis for AP3's investment policy. The asset allocation should reflect the Fund's liabilities in the pension system. The goal is to generate the best possible return on the fund capital at a given low risk level.**

According to the Riksdag's mandate, the Fund's Investment Policy should be based on an analysis of our commitments as a buffer fund in the Swedish pension system. This analysis forms the basis of the Fund's long-term strategic asset allocation, what we call the 'reference portfolio'. The reference portfolio is modelled as a weighted benchmark portfolio consisting of regional indices for equities, bonds and real estate (see figure 5). In the short and medium term, the Fund will pursue active management, with a view to generating a positive active return relative to the market, where we believe this is possible.

One key task for the Fund is to identify the best long-term strategic asset mix by means of ALM analysis (Asset/Liability Modelling). 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 for the long-term development of the pension system, given different demographic and economic scenarios.

Since 2000, AP3 has carried out an annual ALM study. We have updated demographic assumptions using new projections from Statistics Sweden (SCB) and also continually extended and refined the analyses. The Board of Directors' decision on the strategic asset allocation of the Fund (the reference portfolio) are based on these studies.

## Small adjustments to the reference portfolio

The results of this year's ALM study were largely in line with the result of previous studies. Consequently, no major changes to the composition of the reference portfolio were required. However, based on the result of the study, the Board decided on the following minor adjustments to the reference portfolio:

- The share of real estate is increased by 0.5 percentage point and Swedish fixed-income assets are reduced correspondingly. The argument for this was that real estate has good diversification effects and provides a favourable return in relation to the risk.
- The share of Japanese bonds is reduced from 1.4 per cent of the total portfolio to zero. The reason for this is that the return on these assets is expected to be low over the next five-year period. The share of other nominal fixed-income assets is increased correspondingly.
- The currency hedge ratio for foreign equities is reduced from 80 to 75 per cent.

As in previous ALM studies, the simulation result showed that the choice of portfolio mix only has a minor impact on the pension level if the demographic developments are in line with Statistics Sweden's (SCB's) main scenario. However, in the pessimistic demographic scenarios, portfolios with around 50–60 per cent in equities minimise the expected effect of the automatic balancing mechanism<sup>1</sup> on the pension level. This represents one of the strongest arguments for the share of equities that AP3 has chosen for its reference portfolio.

Figure 5  
AP3's reference portfolio 2002

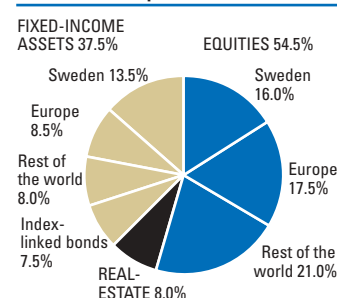
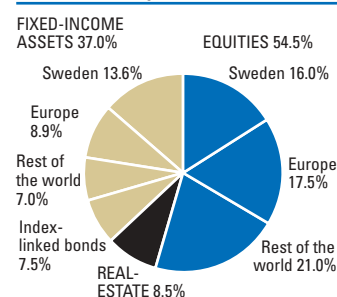


Figure 6  
AP3's reference portfolio 2003



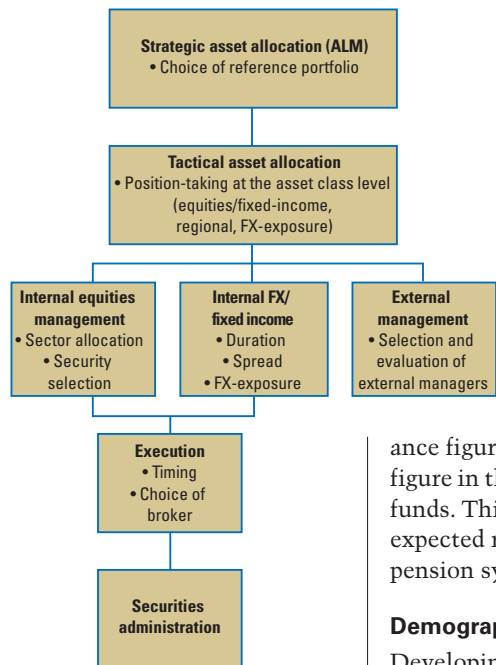
<sup>1</sup>The automatic balancing mechanism refers to the rules that imply that pensions and pension rights are reduced if long-term deficits appear in the pension system.

**“In those markets where our internal management organisation does not have the sufficient skills, we hire external managers. Approximately one quarter of AP3's assets is currently managed externally.”**

*Lena Djurberg, Portfolio Manager, responsible for procurement and evaluation of external asset managers*



Figure 7  
AP3's investment process



<sup>2</sup>The balance figure is a measure of the solvency of the pension system, defined as the assets of the pension system in relation to its liabilities.

In addition, in the 2002 ALM study, we did an analysis of possible development paths of fund strength up to 2040, for alternative asset allocations. Fund strength is defined as the number of years that it would take for the buffer funds to be depleted if no new pension fees were paid in. With a pure bond portfolio, fund strength is expected to fall from the current level of around 4 years to about 1.5 years in 2040. In the most favourable scenarios, fund strength is maintained at the current level. With 50 per cent equities, fund strength is expected to increase slightly over the next 40 years. In the most favourable scenarios, fund strength increases to over 20 years. Figure 8, on page 9, illustrates the probability distribution of the trend in fund strength for a portfolio with 50 per cent equities.

In this year's ALM study we also chose to study the properties of the strategic asset allocations of the other buffer funds in the Swedish pension system. This analysis showed that the Fourth Swedish National Pension Fund and the Second Swedish National Pension Fund's portfolios had a higher expected return, measured as the expected outcome of the balance figure<sup>2</sup> for 2030. In the risk dimension (measured as the outcome of the balance figure in the fifth percentile), AP3's portfolio displayed the lowest risk of all the buffer funds. This means that AP3's Board of Directors has decided to accept a slightly lower expected return to secure a better result in situations where imbalances occur in the pension system.

#### Demographic stress-tests planned for 2003

Developing and extending the ALM analysis will continue to be a priority for AP3. At present we are working on the following development areas:

- In 2003, Statistics Sweden (SCB), is expected to publish more detailed forecast material with a greater number of different demographic scenarios, in conjunction with the National Social Insurance Board (RFV). We plan to use these scenarios to carry out more extensive stress-tests.
- We are striving to improve the integration of the medium-term return forecasts into the ALM analysis. For example, we plan to develop the model so that the optimal asset allocation is allowed to vary over time.

#### Clearly defined investment process

AP3's investment process is based on a clear structure for responsibility and evaluation, with well-defined decision points. One fundamental principle is that investment decisions are made by the AP3 investment professional who is the expert in the specific field. In this respect, we differ from asset management organisations where analysts have a purely advisory function and decisions are made by investment committees. Instead, AP3's investment process is based on a decision structure that clearly defines which portfolio manager is responsible for each decision point. This allows us to do a detailed performance attribution analysis, evaluating the performance of every individual portfolio manager. The decision-making structure of AP3's investment process is illustrated in figure 7 above.



"AP3's portfolio can be expected to show a slightly lower return compared with the other buffer funds in the Swedish pension system. On the other hand, we can be expected to have a more favourable outcome in risk-scenarios where the pension system is subject to demographic strains."

*Niklas Ekvall, Deputy CEO and Chief Investment Officer*



## Risk budgeting

AP3's investment operations are based on a structured process of risk-budgeting. In this context, risk is defined as deviations from the reference portfolio, overweighting and underweighting of asset classes and individual securities for the purpose of generating a better return than the benchmark.

AP3 emphasises a highly focused activation of risks, where we first attempt to identify market segments where it is possible to generate out-performance. This determines which assets should be managed actively or passively. We then decide whether internal or external managers are best equipped to handle the respective mandates.

## Targets for return and risk

The target of AP3's asset management operations is to outperform the return on the benchmark portfolio in the long term by 0.4 percentage point per year, after expenses. Long-term is defined as a rolling five-year period. This target for active return is supplemented by another target: that risk-adjusted return, measured as the information ratio, shall exceed 0.2. AP3's return targets are to be achieved within a risk limit for tracking error of 5 per cent.

The 5 per cent risk limit for tracking error, is an upper limit that is not to be exceeded – it is not a target for the risk level in the portfolio. The risk level for the Fund should normally be in the range of 1.5–3.5 per cent, measured as tracking error.

Figure 8  
Probability distribution for the development of fund strength  
Portfolio with 50% stocks

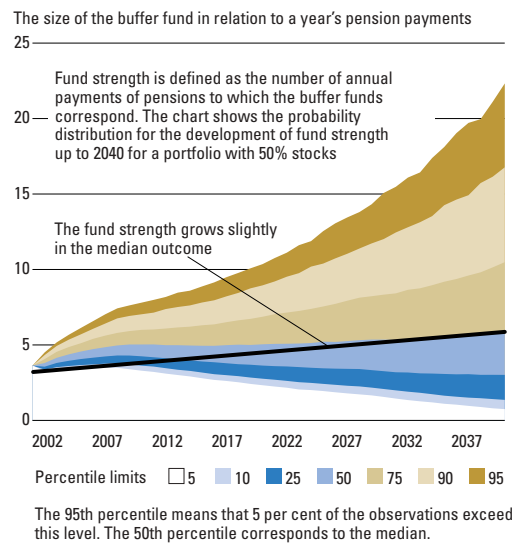


Figure 9  
Index structure

Main asset class	Benchmark index
<b>Equities</b>	
Sweden	SIXRX (SIX Return Index)
Europe	FTSE AW Developed Europe
Rest of the world	Mix of FTSE AW North America and FTSE AW Developed Asia Pacific
<b>Fixed-income</b>	
Sweden	Mix of Merrill Lynch Index for Swedish Government Bonds and Handelsbanken's index for mortgage bonds
Europe	Mix of Merrill Lynch's EMU Direct Government Index, Jumbo Pfandbriefe Index, UK Gilts Index and Sterling Corporate Index
Rest of the world	Mix of Merrill Lynch's US Treasury Master, US Agencies Bullet Structures, US Corporate Large Cap and Japanese Government's
Index-linked bonds	Merrill Lynch Index for Swedish Inflation-Linked Government Bonds
<b>Real estate</b>	SfiX (Swedish real estate index)

“The basic idea behind AP3's investment process is that investment decisions are made by the investment professional who is the expert in a specific field. This may seem obvious. But in fact, today this is a common flaw in many asset management organisations. Investment decisions are made though compromising in committees. At AP3 we have tried to avoid this”

*Magnus Eriksson, Head of Equities Management*



# Corporate Governance Policy: The objective is a high return on investment

## Key elements of AP3's Corporate Governance Policy:

- We promote the establishment of nominating committees in those companies in which the fund is a shareholder.
- The structure of the board should be characterised by diversity in terms of age, gender, occupational background and nationality.
- Every board should include some members who are not in a position of dependence in relation to either the major shareholder or the company.
- It is generally inappropriate for a former CEO of a company to become chairman of the board.
- The CEO should not be on the board.
- Board members should be shareholders in the company.
- Equity-related compensation systems must be characterised by a clear link between performance and benefits.
- Option schemes must be expensed in the profit and loss statement.
- Differentiated voting rights may be justified in some cases.

**According to the Fund's mandate from the Riksdag, "shareholder influence shall be exercised unambiguously for the purpose of improving the return on managed assets". This clear mandate is the basis for the formulation and execution of AP3's Corporate Governance Policy.**

In order for AP3's shareholder influence to be handled effectively and successfully, we must focus on issues and areas where the Fund can be expected to achieve results. Consequently, AP3's Corporate Governance activities will initially focus on companies in which the Fund has a significant voting share, which, in practice, implies that these activities are limited to Swedish companies.

In August 2002, the Fund's Board of Directors adopted a revised Corporate Governance Policy. The complete policy document can be downloaded from [www.ap3.se](http://www.ap3.se).

### Raised level of activity

In addition to formulating a new Corporate Governance Policy in 2002, the Fund also worked to raise the level of activity within the corporate governance sphere. The continuous monitoring of corporate governance issues is handled by the portfolio managers in the Fund's equities management team. In 2002, a steering committee was formed that is responsible for handling the corporate governance issues identified by the portfolio managers. The committee is headed by CEO Tomas Nicolin and also includes the Head of Equities Management, Magnus Eriksson, the Communications Manager, Pernilla Klein and the Portfolio Manager, Mats Andersson.

AP3's ambition is to participate in all general shareholders' meetings in Swedish companies in which the Fund holds shares. Of the 73 Swedish companies included in AP3's internally-managed Swedish equities portfolio, the Fund was represented at 69 ordinary general shareholders' meetings and all of the seven extraordinary general shareholders' meetings called by these companies in 2002.

### The Fund's activities in 2002

Last year AP3 focused its corporate governance activities on equity-related compensation systems. The Fund held discussions regarding proposals for such systems in Skandia, Karo Bio, Nordea, Munters, OM and Holmen. In the case of Skandia, AP3's action was instrumental in forcing the Board to withdraw the proposal.

In SKF and Tele2, AP3 put forward a proposal regarding the right to convert A-shares to B-shares. At the SKF general meeting our proposal was approved. This resulted in the previous discount on A-shares being eliminated and the liquidity of the shares improving.

In connection with Ericsson's new share issue, AP3, together with three other Swedish institutions, decided to underwrite a portion of the issue volume equivalent to the Fund's equity interest at that time. In addition, we participated in the banks' guarantee consortium.

At Telia's extra general shareholders' meeting in November 2002, AP3 voted against the proposal to abolish the nominating committee of shareholder representatives.

To read more about AP3's Corporate Governance Policy, visit [www.ap3.se](http://www.ap3.se)



**"In 2003, AP3 will maintain its high level of ambition in the field of engagement in corporate governance issues. Within the framework provided by our mandate from the Riksdag, we will strive to be an independent owner, with distinct views."**

*Tomas Nicolin, CEO*

# SRI Strategy: Focus on engagement

**AP3 has chosen to apply the Fund's Environmental and Social Investment Policy through engagement with companies in matters of Corporate Social Responsibility. Instead of choosing a screening method that excludes individual companies or sectors from the portfolio, we hope to be able to make a difference by pursuing a dialogue with the companies that the Fund holds shares in.**

The law governing the Swedish National Pension Funds' mandates states that "Environmental and social considerations shall be taken into account in investment activities without relinquishing the overall goal of a high return on capital".

In the period 2000–2002, AP3 has invested considerable resources in investigating how environmental and social considerations can best be integrated into the Fund's investment operations. Our work on the strategy has been based on three fundamental premises.

- *The ethical basis for AP3 should be the fundamental values expressed by the Swedish state. It is therefore natural to base the policy on international agreements and conventions that Sweden has ratified. The conventions to which AP3 attaches particular importance are specified in the summary above.*

One implication of this perspective is that the Fund has chosen not to exclude investments in certain sectors, such as tobacco and defence.

- *How the Ethical Policy is implemented is determined by in what way the Fund can accomplish the most visible results in the form of concrete improvements in the companies in which the Fund invests.*

It is our view that AP3 can achieve the best results, as an active shareholder, by promoting good ethics in the companies in which we invest. By selling off holdings in companies that are mismanaged, we lose the potential to have influence. Choosing to focus on engagement also allows the Fund to take ethical issues into account without any negative impact on the portfolio's return and risk diversification.

- *Expenses for the work on ethical issues must be in reasonable proportion to the Fund's total asset management expenses.*

Consequently, it is necessary for the engagement program to focus on a number of well-defined issues where the Fund can realistically exercise an appreciable influence. This means that in the initial phase we have chosen to focus our engagement efforts on Swedish companies, as the Fund has considerably greater ownership stake there than in our foreign equity portfolios.

## Procurement of ethical consultancy services

To facilitate a professional evaluation of the companies in which AP3 invests, the Fund invited a tender for an ethical research consultant in 2002. The UK company CoreRatings was chosen. CoreRatings will also support AP3's engagement strategy. This could involve contacting companies in which AP3 owns shares, to clarify specific issues or in order to effect changes to policies, management systems and reporting.

## Summary

Important international agreements on which AP3's Ethical Policy is based:

- OECD's guidelines for multinational enterprises.
- ILO's core conventions (relating to forced labour, child labour, working conditions, equality, and freedom of association and protection of the right to organise).
- UN's Declaration on Human Rights.
- UN conventions on climate change/the Kyoto Protocol.

"As shareholders, we wish to promote the adoption of corporate codes of conduct for environmental issues and human rights by the companies in which we invest. It is also important to ensure that the companies' reporting on these issues is transparent, making it possible to assess the company's ability to live up to ethical requirements."

*Pernilla Klein, responsible for SRI*



# Report of the Directors 2002

The Board of Directors of The Third Swedish National Pension Fund (AP3) and the Chief Executive Officer hereby submit the Report of the Directors for 2002.

**Asset management income for 2002 amounted to SEK –17.5 billion, equivalent to a total return of –12.6 per cent (after expenses and adjusted for net flows). This negative income is chiefly attributable to unrealised losses in market value.**

Figure 1  
Change in fund capital 2002

	SEK million
Fund capital 1 January	132,724
Pension contributions	40,186
Pension disbursements	–37,939
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<b>Total fund capital 31 December</b>	<b>120,211</b>

At end-2002 the market value of AP3's fund capital totalled SEK 120.2 billion, compared with SEK 132.7 billion at the start of the year. During the year the Fund also received a net inflow of capital totalling SEK 5 billion.

The negative return on fund capital in 2002 can be explained by the continued sharp downturn in the stock market. Equity assets amounted to a total of approximately 55 per cent of the Fund's reference portfolio in 2002. The reference portfolio represents the Fund's long-term strategic asset allocation. This is determined, according to the mandate from the Riksdag, on the basis of an analysis of the Fund's commitments in the Swedish pension system over the coming 30–40 years.

Every year, AP3 carries out an in-depth ALM-study, with a view to determining which asset allocation has the potential to create the greatest long-term benefit for the pension system. Such an analysis was also carried out prior to the Board's decision regarding the reference portfolio for 2002. This analysis indicated that it would be appropriate to increase the equity share in the reference portfolio by 5.5 percentage points. In addition, some minor upward adjustments were made in the weights for real estate and index-linked bonds. The share of currency risk in the reference increased from 8.5 per cent to 9.6 per cent.

The portfolio transactions required to achieve the new reference portfolio were implemented in January and February 2002. The Fund undertook net purchases of foreign equities for a total of SEK 9.5 billion, which were financed by sales of Swedish and foreign bonds. At the same time, the Fund undertook net sales of Swedish kronor to a value of SEK 2 billion.

In 2002, the ALM-study was updated, which led the Board to decide on some minor adjustments in the reference portfolio for 2003. The changes in the reference portfolio for 2003 are described on page 7.

## Active return 2002

The liquid and market-listed portfolio (excluding real estate) declined by 12.9 per cent in 2002. This was slightly better than the benchmark portfolio, which fell by 13.5 per cent. The active return (before expenses) thus amounted to 0.6 percentage point.

Management expenses totalled SEK 177 million, which means that the active return after expenses amounted to 0.4 percentage point. This should be compared to the Board's long-term goal of the actual portfolio outperforming the benchmark portfolio by an average of 0.4 percentage point per year (after expenses), over a rolling five-year period.

This target is complemented by a target for the risk-adjusted return (measured as the information ratio, after expenses) of 0.2. The information ratio (after expenses) amounted to 0.5. This favourable turnout for the information ratio is a result of outperformance being achieved at a low level of active risk.

Since the introduction of the Fund's new mandate on 1 January 2001, the accumulated active return amounts to 0.7 percentage point (0.6 after expenses). The information ratio for this period is 0.6.

The Board can confirm that the Fund's asset management operations to date seem to be well on the way to fulfilling the set targets. However, it should be emphasised that two years is too short an operating period to provide a meaningful assessment of portfolio performance.

## Expenses and staff

The Fund's management expenses for 2002 amounted to a total of SEK 177 million, equivalent to 0.14 per cent of managed assets. Of this, approximately 40 per cent was staff expenses (SEK 71 million), of which SEK 15 million consisted of a provision for disbursement of employee bonuses (performance-related pay) for 2002.

Figure 2  
Major expense items in 2002 (SEK million)

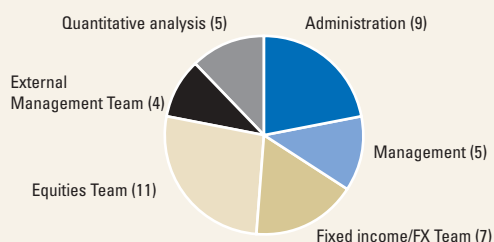
	SEK million	Percentage of total
<b>Total expenses</b>	<b>177</b>	
Of which	71	40
External asset managers	46	26
Global custodian	19	11
Suppliers of		
market information	12	7
IT	7	4
Premises	5	3

Compared with 2001, the Fund's management expenses for 2002 increased by around 60 per cent. This rise was expected and is primarily attributable to the increased share of active management among the Fund's external asset management mandates. Over the next few years, the share of passive mandates in the Fund's external asset management will continue to decline, which means that the management expenses are expected to edge up further.

At end-2002 the number of employees totalled 41. During the year the Fund appointed six new staff. In the same

period, three employees left the Fund, one of which was due to retirement. An additional employee has been engaged for employment in 2003. We are also currently recruiting for a new post as internal controller, within the Fund's Compliance function.

Figure 3  
Number of employees for the fund's operating functions December 2002



AP3 has a relatively small and focused administrative and back office team. Parts of its operations are outsourced, e.g. IT support and computer operations. Settlements and portfolio reporting are handled by the Fund's global custodian. Important projects during the year included internal training to improve efficiency in the utilisation of the portfolio system and the order management system. In 2002, the Fund relocated all its computer servers. This is part of the ongoing work to minimise the risk of operational disruptions. In addition, the communications network has been strengthened to enable teleworking.

Work has started on the procurement of systems for measuring risk and performance. This is expected to be finalised in the first quarter of 2003 and the system is expected to be in full operation in the second half of 2003.

In 2002, an executive group was formed, consisting of the CEO, the Deputy CEO, the Chief Administrative Officer, the Head of Equities Management, the Head of Fixed Income Management, the Head of Quantitative Analysis, the Head of External Asset Management and the Communications Manager.

### Increased share of active management

At end 2002, 74 per cent of assets were managed internally, i.e. by AP3's own portfolio managers. The remainder was managed externally. In 2002, the share of externally managed assets that was managed passively was reduced in favour of active mandates, where this was deemed to be profitable.

At the beginning of 2002, all the Fund's external asset management mandates were passive. Over the course of the year, around half of the externally managed assets were transferred to active asset management. As active asset management is more costly, this has entailed an increase in external management fees for traditional assets from SEK 5 million in 2001 to SEK 19 million in 2002. In addition, management fees totalling SEK 27 million for the Fund's private equity investments are recorded in the income statement as expenses for external asset management. At end-2002, the Fund's investments in unlisted shares totalled SEK 631 million.

### Securities lending

Like other long-term asset managers, AP3 engages in securities lending. These operations consist of short-term lending of equities and bonds to counterparties that have high creditworthiness and provide full collateral. Total revenues amounted to SEK 27.2 million in 2002, compared with SEK 12.6 million in 2001. This is recorded as interest income in the income statement.

Figure 4  
Revenues from securities lending 2002

	SEK million
Bonds	1.1
Equities	26.1
<b>Total</b>	<b>27.2</b>

### Corporate governance issues

During the year AP3 has increased the time and resources allocated to corporate governance issues. There is a review of the issues in which AP3 has been active on page 11. For the purpose of clarifying the Fund's viewpoints in the Corporate Governance arena, the Board of Directors adopted a revised and improved Corporate Governance Policy in August 2002.

At end-2002, an additional portfolio manager was employed by the Fund's equities management team, who, among other things, will work on improving AP3's monitoring of corporate governance issues.

Before the introduction of AP3's new asset management mandate in 2001, the Board adopted a policy on Socially Responsible Investments (SRI) as part of the Fund's first Corporate Governance Policy. During 2002, AP3 ran an internal development project with the aim of finding methods for the practical implementation of this policy. This project resulted in AP3's executive group approving an action plan in May 2002. This action plan entails the development of the Fund's shareholder influence to include environmental and ethical issues. During the autumn, a tender was put out for an environmental and ethical consultant. This resulted in the UK ethical research firm Core Ratings being contracted to supply analysis support for the Fund's engagement activities in the field of Corporate Social Responsibility.

AP3's SRI strategy will be developed further over the next few years.

To find out more about AP3's Corporate Governance Policy, visit [www.ap3.se](http://www.ap3.se)

### Internal ethical guidelines

The mandate of managing the Swedish national pension capital is associated with special responsibility. In 2002, the Board of Directors adopted new, tougher internal ethical guidelines for AP3's employees. These guidelines include regulations for employees' securities transactions based on the recommendations of Svenska Fondhandlareföreningen (The Swedish Securities Dealers Association), but are in certain sections more far-reaching.

### Choice of brokers within security trading

AP3 attaches great importance to distributing securities transactions among brokerage houses according to clear principles. Both the equities team and the fixed income/FX team apply a ranking system, in which brokers are evaluated according to a number of specified criteria. These include the quality of the research provided by the broker. The ranking is then used as the basis for distributing transactions among brokers. The five brokers to which AP3's equities team paid the largest commissions in 2002 are listed below in alphabetical order.

Figure 5  
**Five brokerage houses to which the Fund's equities management paid the largest commissions in 2002 (in alphabetical order)**

ABN Amro including Alfred Berg
Deutsche Bank
JP Morgan
Salomon Brothers Intl Ltd
UBS Warburg

The above brokers received more than 55 per cent of total brokerage commissions.

Total commissions in 2002, SEK million:	41.8
Total number of brokers for equities transactions in 2002:	26

In situations where brokers have handled the business partnership in a way that is not in line with AP3's interest, the Fund applies a trading embargo to that particular broker for a given period. In 2002, three brokers were subject to trading embargos over several months that covered equity, fixed income and FX transactions. These cases related to incidents in equity trading that were judged to be so serious that fixed income and FX dealing was also included in the trading ban. In addition, two brokers were subject to a trading embargo for equity transactions for a shorter period. In FX trading, the Fund applied a limited-time trading embargo on five brokers.

### Performance-related pay

Like the majority of asset managers in Sweden and internationally, AP3 has system for performance-related compensation (bonus) for rewarding employees when we are successful in our asset management operations. The purpose of the system is to improve the conditions for outperformance by creating a direct link between the Fund's performance targets and employee compensation. A competitive bonus system is also essential in order to attract and retain competent employees.

From 2002, a new and revised system applies. The new system includes a target to encourage teamwork as well as rewarding individual performance. The bonus targets are defined for both short-term and long-term time horizons. The purpose is that good relative performance should lead to tangible rewards relatively quickly, as well as maintaining a strong link to the Fund's long-term asset management income. The bonus targets include goals for active return and goals for risk-adjusted return (measured as information ratio).

The Fund's current guidelines for performance-related pay are presented in full (in Swedish) on the Fund's website, [www.ap3.se](http://www.ap3.se). The bonus system applies for one year at a time, which means that, prior to the start of each year, the Board of Directors has to make a decision regarding the guidelines for the system for the coming year. For 2003, the Board decided to extend the rules for the 2002 bonus system.

### Government evaluation

The AP Funds' operations are evaluated annually by the Government in the form of an official letter to the Riksdag. In May 2002, the evaluation for 2001 was presented. This focused on an assessment of the Funds' targets, and in particular on the analysis underlying the choice of reference portfolio (ALM). The documentation for the evaluation was produced by a consortium comprising of the Swedish investment consultancy firm Wassum and the UK-based consultancy firm Bacon&Woodrow.

With regard to AP3's ALM analysis, the Government issued the following comments: "The Third Swedish National Pension Fund has developed the most sophisticated ALM process". The Government judged the Fund's choice of reference portfolio to be well founded.

### The work of the Board of Directors

During the year, the Board has held seven meetings, one of which was a telephone conference. In addition to the usual issues incumbent on the Board of Directors, such as adopting an operations plan and an annual report, a couple of areas have been of particular importance to the Board in 2002. These include the approval of a new Corporate Governance Policy and a number of other significant individual corporate governance issues that have been the subject of discussion. The Fund's ALM analysis and continual follow-up of fund performance were other important topics.

In 2002, the Board decided to form two internal committees: the compensation committee and the audit committee. The compensation committee comprises Johan Björkman (chairman), Dan Andersson and Harriet Piscator. The committee's brief is primarily to prepare questions regarding compensation for the Fund's CEO and to deal with any questions that fall to the committee in accordance with the bonus system. The compensation committee held three meetings during 2002.

The audit committee consists of Rolf Andersson (chairman), Christina Liffner and Dag Sehlin. The committee operates within the areas of regulatory responsibility, internal audits and risk management. The committee also has regular contact with the auditors, participate in the planning of auditing work and follow up on how the auditors' recommendations are being implemented in the organisation. The audit committee held five meetings during 2002.

# Tables

## PORTFOLIO OVERVIEW

Table 1

### Market value per main asset class

SEK billion	31 Dec 2002	30 Jun 2002	31 Dec 2001	30 Jun 2001	1 Jan 2001
<b>Equities</b>					
Sweden	19.4	20.4	23.8	22.1	33.1
Europe	21.5	23.1	22.5	21.6	1.7
Rest of the world	26.7	27	22.1	24.3	1.7
<b>Total equities</b>	<b>67.6</b>	<b>70.5</b>	<b>68.4</b>	<b>68.0</b>	<b>36.5</b>
<b>Fixed-income</b>					
Sweden, nominal	15.1	18.8	18.5	19.9	45.9
Sweden, index-linked	9.8	10.4	9.5	9.5	9
Europe	10.7	6.9	15	14.4	0
Rest of the world	8.8	11.7	12.8	11.3	0
<b>Total fixed-income</b>	<b>44.4</b>	<b>47.8</b>	<b>55.8</b>	<b>55.1</b>	<b>54.9</b>
<b>Real estate<sup>1</sup></b>	<b>8.2</b>	<b>8.3</b>	<b>8.5</b>	<b>8.6</b>	<b>8.3</b>
<b>Cash<sup>2</sup></b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>34.3</b>
<b>Total</b>	<b>120.2</b>	<b>126.6</b>	<b>132.7</b>	<b>131.7</b>	<b>134.0</b>

<sup>1</sup> Note that AP3's real estate holdings (via shares in the real estate company AP fastigheter) are reported in this table in gross terms. This means that the fund assesses the holding based on the value of the properties which the company owns and considers financing separately. Financing is included in fixed-income Sweden, nominal.

<sup>2</sup> The cash corresponding to the futures positions have been distributed in this table by asset class.

<sup>3</sup> Notes 1) and 2) mean that the tables are not fully comparable with the balance sheet.

Table 3

### Index structure

Main asset class	Benchmark index
<b>Equities</b>	
Sweden	SIXRX (SIX Return Index)
Europe	FTSE AW Developed Europe
Rest of the world	Mix of FTSE AW North America and FTSE AW Developed Asia Pacific
<b>Fixed-income</b>	
Sweden	Mix of Merrill Lynch Index for Swedish Government Bonds and Handelsbanken's index for mortgage bonds
Europe	Mix of Merrill Lynch's EMU Direct Government Index, Jumbo Pfandbriefe Index, UK Gilts Index and Sterling Corporate Index
Rest of the world	Mix of Merrill Lynch's US Treasury Master, US Agencies Bullet Structures, US Corporate Large Cap and Japanese Government's
Index-linked bonds	Merrill Lynch Index for Swedish Inflation-Linked Government Bonds
<b>Real estate</b>	SfiX (Swedish real estate index)

## PERFORMANCE AND RISK

Table 5

### Active return per main asset class Jan-Dec 2002, %

	Portfolio	Index	Active
<b>Equities</b>	<b>-27.7</b>	<b>-28.8</b>	<b>1.1<sup>1</sup></b>
Sweden	-33.9	-35.9	2.0
Europe	-32.6	-31.4	-1.2
Rest of the world	-32.9	-33.6	0.7
<b>Fixed-income</b>	<b>5.2</b>	<b>6.0</b>	<b>-0.8</b>
Sweden, nominal	7.6	8.5	-0.9
Sweden, index-linked	14.7	14.6	0.1
Rest of the world (incl. Europe)	-1.2	-0.1	-1.1
<b>Total (excluding real estate)</b>	<b>-12.9</b>	<b>-13.5</b>	<b>0.6</b>
<b>Total</b>	<b>-12.4</b>		

<sup>1</sup> Also includes the effects of changes in market value for FX futures which are not seen in the asset classes below.

Table 2

### Reference portfolio and current portfolio 31 Dec 2002<sup>3</sup>

%	Benchmark weight	Portfolio weight	Active weight
<b>Equities</b>			
Sweden	16.2	16.2	0.0
Europe	17.7	17.9	0.2
Rest of the world	21.3	22.2	0.9
<b>Total equities</b>	<b>55.2</b>	<b>56.3</b>	<b>1.1</b>
<b>Fixed-income</b>			
Sweden, nominal	13.7	12.6	-1.1
Sweden, index-linked	7.6	8.1	0.5
Europe	8.6	8.9	0.3
Rest of the world	8.1	7.3	-0.8
<b>Total fixed-income</b>	<b>38.0</b>	<b>36.9</b>	<b>-1.1</b>
<b>Real estate<sup>1</sup></b>	<b>6.8</b>	<b>6.8</b>	<b>0.0</b>
<b>Cash<sup>2</sup></b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Total</b>	<b>100</b>	<b>100</b>	<b>0</b>

<sup>1</sup> Note that AP3's real estate holdings (via shares in the real estate company AP fastigheter) are reported in this table in gross terms. This means that the fund assesses the holding based on the value of the properties which the company owns and considers financing separately.

<sup>2</sup> The cash corresponding to the futures positions have been distributed in this table by asset class.

<sup>3</sup> Notes 1) and 2) mean that the tables are not fully comparable with the balance sheet.

Table 4

### Permitted deviations from the reference portfolio per main asset class 2002

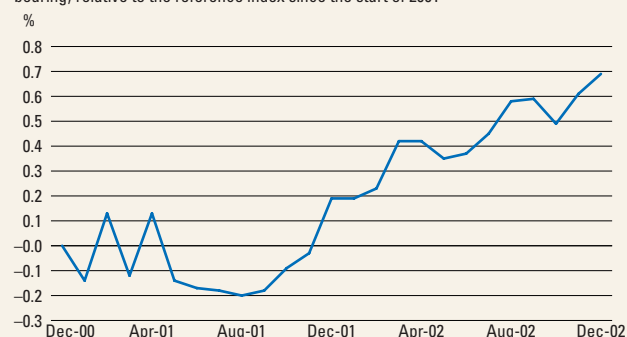
Asset class	Share of the reference portfolio	Permitted deviation in per cent
<b>Equities</b>		
Sweden	16.2	+/-5
Europe	17.7	+/-5
Rest of the world	21.3	+/-5
<b>Equities, total</b>	<b>55.2</b>	<b>+/-7</b>
<b>Fixed-income</b>		
Sweden, nominal	13.7	+/-5
Europe	8.6	+/-5
Rest of the world	8.1	+/-5
<b>Fixed-income, total</b>	<b>30.4</b>	<b>+/-7</b>
<b>Index-linked bonds</b>	<b>7.6</b>	<b>+/-4</b>
<b>Real estate</b>	<b>6.8</b>	<b>+/-4</b>
<b>Cash</b>	<b>0.0</b>	<b>+4</b>
<b>Foreign currency exposure</b>		<b>+/-20<sup>1</sup></b>

<sup>1</sup> Refers to the reference portfolio's currency hedge ratio for equities.

Table 6

### Active return

The AP3 portfolio's accumulated return for the liquid portfolio (equities and interesting bearing) relative to the reference index since the start of 2001



## PERFORMANCE AND RISK / CONT.

Table 7  
Return on the total portfolio Jan-Dec 2002

Allocation level	Description	Benchmark index	Managed assets 31 Dec (SEK billion)	Actual return (%)	Benchmark return (%)	Active return (%)
<b>Tactical asset allocation, total</b>				<b>-13.8</b>	<b>-13.5</b>	<b>-0.3</b>
of which	Allocation equities vs. bonds	AP3's reference portfolio		-13.8	-13.5	-0.3
<b>Equities, total</b>			<b>67.6</b>	<b>-27.7</b>	<b>-28.8</b>	<b>1.1</b>
of which	Sweden	SIXRX	19.4	-33.9	-35.9	2.0
	Europe	FTSE All-World Developed Europe	21.5	-32.6	-31.4	-1.2
	The rest of the world (USA, Japan, Asia)	A mix of the following indexes: FTSE All-World North America FTSE All-World Developed Asia Pacific	26.7	-32.9	-33.6	0.7
<b>Fixed-income, total</b>			<b>44.4</b>	<b>5.2</b>	<b>6.0</b>	<b>-0.8</b>
of which	Sweden, nominal	A mix of SHB's and Merrill Lynch's index Merrill Lynch Index for Swedish Government Bonds Handelsbanken Swedish Mortgage Bond Index	15.1	7.6	8.5	-0.9
	Sweden, index-linked	Merrill Lynch Index for Swedish Inflation-Linked Government Bonds	9.8	14.7	14.6	0.1
	The rest of the world (Europe, USA, Japan)	A mix of Merrill Lynch's indices	19.5	-1.2	-0.1	-1.1
<b>Total (excl. real estate)</b>			<b>112.0</b>	<b>-12.9</b>	<b>-13.5</b>	<b>0.6</b>
<b>Real estate<sup>2</sup></b>		25% of AP fastigheter	8.2	-1.0		
<b>Total (incl. real estate)</b>			<b>120.2</b>	<b>-12.4</b>		

<sup>1</sup> Also includes the effects of changes in market value for futures positions which are not seen in the asset classes below.

<sup>2</sup> Note that AP3's real estate holdings (via shares in the real estate company AP fastigheter) are reported in this table in gross terms. This means that the fund assesses the holding based on the value of the properties which the company owns and considers financing separately. Financing reduces the fixed-income Sweden, nominal asset class.

Table 8  
Return and risk for the total portfolio (before costs, excluding real estate)

	Since start 1 Jan 2001			2002		
	Portfolio	Benchmark	Active <sup>1</sup>	Portfolio	Benchmark	Active <sup>1</sup>
Return, %	-16.8	-17.5	0.7	-12.9	-13.5	0.6
Risk (standard deviation)	11.9	11.7	0.9	12.5	12.6	0.8
<b>Risk-adjusted return</b>						
Information ratio	0.8			0.7		
Sharpe ratio	neg			neg		

<sup>1</sup> Tracking error.

## CURRENCY EXPOSURE

Table 9  
Currency exposure per asset class, 31 Dec 2002

Currency exposed assets per currency, SEK million	EUR	GBP	JPY	USD	Others	Total
Equities and shares	9,269	7,358	2,227	18,049	4,210	41,113
Exposure through SEK-listed companies with a foreign legal domicile	157	1,171	0	91	0	1,418
Bonds and other interest-bearing securities	7,841	10	3,552	6,495	0	17,899
Derivatives	-7	32	-16	-170	-12	-172
Other investment assets	1,910	2,339	961	1,521	208	6,940
<b>Currency exposure, net</b>	<b>19,170</b>	<b>10,910</b>	<b>6,726</b>	<b>25,986</b>	<b>4,406</b>	<b>67,198</b>
Hedging	-17,807	-7,899	-6,060	-21,671	-3,764	-57,201
<b>Total currency exposure</b>	<b>1,363</b>	<b>3,012</b>	<b>666</b>	<b>4,314</b>	<b>643</b>	<b>9,997</b>

Currency exposure per asset class, 31 Dec 2001

Currency exposed assets per currency, SEK million	EUR	GBP	JPY	USD	Others	Total
Equities and shares	11,240	8,019	2,598	16,922	4,107	42,886
Exposure through SEK-listed companies with a foreign legal domicile	261	1,443	0	195	0	1,899
Bonds and other interest-bearing securities	12,007	1,701	3,834	7,498	0	25,040
Derivatives	-60	0	-1	20	0	-41
Other investment assets	1,171	147	727	907	22	2,974
<b>Currency exposure, net</b>	<b>24,619</b>	<b>11,310</b>	<b>7,158</b>	<b>25,542</b>	<b>4,129</b>	<b>72,758</b>
Hedging	-22,476	-8,169	-6,592	-21,753	-3,000	-61,990
<b>Total currency exposure</b>	<b>2,143</b>	<b>3,141</b>	<b>566</b>	<b>3,789</b>	<b>1,129</b>	<b>10,768</b>



## EXTERNAL MANAGEMENT

Table 15

### Management structure 31 Dec 2002

	Internal/ external	Managed amount, SEK billion	Share of total portfolio, %
<b>Active management</b>		<b>89.6</b>	<b>80.0</b>
of which	Internal	80.2	71.6
	External	9.4	8.4
<b>Passive management</b>		<b>17.0</b>	<b>15.2</b>
of which	Intern	0.0	0.0
	External	17.0	15.2
<b>Semi-passive management</b>		<b>5.4</b>	<b>4.8</b>
of which	Internal	0.0	0.0
	External	5.4	4.8
<b>Total*</b>		<b>112.0</b>	<b>100</b>

\* Excluding the value of AP3's real estate holdings.

Table 16

### Return on externally managed assets 2002

Asset class	Type of management	Region	Benchmark index	Fund manager	Managed amount, SEK billion, 31 Dec	Portfolio return, %	Benchmark return, %	Active return, %	Comments
<b>Equities</b>									
	Passive								
		North America	FTSE All-World North America	Merrill Lynch	12.4	-35.2	-35.2	0.0	
		Europe	FTSE All-World Developed Europe	State Street	4.6	-31.7	-31.4	-0.3	
		Asia-Pacific	FTSE All-World Developed Asia Pacific	State Street	0 0 (0.6 31 July)				Closed 31 July 2002
	Semi-passive								
		North America	FTSE North America	Merrill Lynch	5.4	-10.4	-10.3	-0.1	
	Active								
		Japan	FTSE Japan	Capital	1.1	-16.9	-17.5	0.6	Start 1 Aug 2002
		Japan	FTSE Japan	Schroders	1.1	-15.7	-17.6	1.8	Start 31 July 2002
		Asia-Pacific	FTSE Asia Pacific	JP Morgan	0.9	-9.2	-10.7	1.5	Start 31 July 2002
<b>Fixed-income</b>									
	Passive								
		GBP	Merrill Lynch Sterling Corporate	State Street	0 (1.7 30 April)				Closed 1 May 2002
		USD	Merrill Lynch USD Corporate Large Cap	State Street	0 (6.4 31 May)				Closed 31 May 2002
	Active								
		USD	Merrill Lynch USD Corporate Large Cap	Prudential	6.3	-2.4	-3.2	0.8	Start 31 May 2002

Table 17

### Investments in unlisted shares<sup>1</sup>

As of 31 Dec 2002, AP3 had made the following investments or investment commitments in unlisted shares via venture capital companies and funds.

Fund/venture capital company	Currency	Invested amount, million	Total commitment, million
Swedestart Tech	SEK	20	80
Swedestart Life Science	SEK	11	50
GS Vintage II	USD	3	25
HIPEP IV – European Venture Fund	EUR	1	20
Litorina Kaptial II	SEK	16	150
EQT Scandinavia I	SEK	155	180
Legal General Venture 2	GBP	4	7
Candover 2001 Fund	EUR	4	25
Vision Capital III	USD	1	10
PETP III (Adveq)	USD	3	20
Warburg Pincus VIII	USD	8	35
Bure – InnKap 1	SEK	52	60
Bure – InnKap 2	SEK	57	75
Carnegie BiotechBridge Fund	EUR	5	5
Legal General Venture 3	GBP	0	5
CapMan Equity VII	EUR	4	20
IT Provider IV	SEK	0	200

<sup>1</sup>Amount invested de facto by AP3 with the exception of investment commitments acquired on the secondary market. In these cases, the total sum invested refers to the whole term of the investment commitment, i.e. sums invested by both AP3 and the previous owner.

# Income Statement and Balance Sheet

## Income statement

SEK million	2002	2001
<b>Operating revenues</b>		
Dividends received	1,547	1,104
Net interest items	3,169	3,219
Net capital gains	-6,899	-2,263
Net exchange rate gains	-1,322	827
Net unrealized changes in value	-13,832	-8,551
<b>Total operating revenues</b>	<b>-17,337</b>	<b>-5,664</b>
<b>Operating expenses</b>		
External management expenses	-46	-5
Staff expenses	-71	-51
Other administrative expenses	-60	-54
<b>Total operating expenses</b>	<b>-177</b>	<b>-110</b>
<b>NET INCOME</b>	<b>-17,514</b>	<b>-5,774</b>

## Balance sheet

SEK million	31 Dec 2002	31 Dec 2001
<b>ASSETS</b>		
<b>Investment assets</b>		
Shares and participations:		
Listed	60,159	65,947
Unlisted	4,157	3,809
Bonds and other interest-bearing assets	50,744	57,075
Derivatives	1,602	1,372
<b>Total investment assets</b>	<b>116,662</b>	<b>128,203</b>
<b>Receivables and other assets</b>		
Cash and bank balances	2,969	3,190
Other assets	58	14
Prepaid expenses and accrued revenues	853	1,365
<b>Total receivables and other assets</b>	<b>3,880</b>	<b>4,569</b>
<b>TOTAL ASSETS</b>	<b>120,542</b>	<b>132,772</b>
<b>FUND CAPITAL LIABILITIES</b>		
<b>Fund capital</b>		
Opening fund capital	132,724	133,975
Net payment from pension system	1,984	3,062
Transferred from phase-out funds	3,017	1,461
Income for the year	-17,514	-5,774
<b>Total fund capital</b>	<b>120,211</b>	<b>132,724</b>
<b>Liabilities</b>		
Derivatives	194	11
Other liabilities	92	17
Accrued expenses and prepaid revenues	45	20
<b>Total liabilities</b>	<b>331</b>	<b>48</b>
<b>TOTAL FUND CAPITAL AND LIABILITIES</b>	<b>120,542</b>	<b>132,772</b>

# Board of Directors



*Standing, from left:*

**Christina Liffner**

Member of the boards of Sveaskog, SJR and Vin & Sprit. Chairman of the board of Svensk Adressändring and Deputy Chairman of the board of Svenska Friidrottsförbundet (Swedish Athletic Association). Former Deputy CEO and CFO of AssiDomän.

**Karin Kronstam**

Member of the boards of GF Konsult, Lernia, Proliva, Svolder, and TurnIT. Former CEO of Samhall Gotia.

**Christine Jönsson**

Chairman of the municipal executive board, Lunds kommun.

*Sitting, from left:*

**Harriet Piscator**

Chief Financial Officer, ABB Sverige. Former Head of Administration, ABB Treasury Center Sweden.

**Rolf Andersson, Deputy Chairman**

Research Director, Svenska Kommunalarbetarförbundet (Swedish Municipal Workers' Union). Member of the board of Fackföreningsrörelsens institut för ekonomisk forskning (FIEF) (Trade Union Institute for Economic Research).

**Christer Romilson**

Chairman of Offentliganställdas förhandlingsråd (OFR) (Public Employees' Negotiation Council). Deputy Chairman of Folksam SAK. Member of the board of the Nationalmuseum. Former General Secretary of Lärarförbundet (Swedish Teachers' Union) and Deputy Chairman of TCO (The Swedish Confederation of Professional Employees).

**Dag Sehlin**

Member of the boards of D. Carnegie AB, Frontec, Mogul, Proact IT Group and VPC. Chairman of the boards of OM Broker Services and PBK Outsourcing. Former Deputy CEO, CFO and Acting Group President of Postkoncernen, and Deputy CEO of OM-Gruppen.

**Dan Andersson**

Chief Economist at LO (Swedish Trade Union Confederation), member of the boards of AMF-Pension, Nordea and Pensionsgaranti. Former under-secretary of state in the Ministry of Industry, Employment and Communications.

**Johan Björkman, Chairman**

Licentiate in Economics. Chairman of the boards of Invik, LjungbergGruppen, Nordstjernen and Skanditek.

*Auditors*

**Anders Bäckström, Authorised Public Accountant**  
KPMG Bohlins AB.

**Anna Hesselman, Authorised Public Accountant**  
Öhrlings PricewaterhouseCoopers AB.

# Employees

Here is a presentation of all 41 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.

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

## AP3 Management



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

## Administration, Accounting



**Sven Askenberger**  
Chief Operating Officer  
22 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  
16 years in the IT field  
AP3 since February 2001  
*Previously:* Electrolux, Alcro-Beckers



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



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

## Administration, Accounting / Cont.



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



**Lennart Nordkvist**  
Head of Fixed-income/FX Management  
19 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



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



**Matthias Buhr-Berg**  
Portfolio Manager  
Execution, FX  
16 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

## Equities Management



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



**Mats Andersson**  
Portfolio Manager  
Swedish equities, Corporate Governance  
20 years in the financial field  
AP3 since December 2002  
*Previously:* Head of the Stockholm office at Deutsche Bank, SG Warburg



**Axel Brändström, CFA**  
Portfolio Manager  
Sector Manager, IT hardware  
8 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  
7 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  
Professor of Finance  
12 years in the financial field  
AP3 since April 1999  
*Previously:* Handelsbanken



**Mikael Sedolin**  
Internal legal monitoring and  
Compliance Officer  
Associate Judge of Appeal  
9 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  
12 years in the financial field  
AP3 since August 2000  
*Previously:* Head of Macro Fore-  
casting at SEB, Handelsbanken  
Markets Research



**Pernilla Klein**  
Communications Manager  
Communications and Corporate  
Governance  
9 years in the financial field  
AP3 since August 2000  
*Previously:* Handelsbanken  
Markets Research, Ministry of  
Finance



**Maria Prinsström**  
Securities administration  
17 years in the financial field  
AP3 since August 2000  
*Previously:* Robur Kapital-  
förvaltning, ABB



**Patricia Rydén**  
Accountant  
15 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  
5 years in the financial field  
AP3 since July 2001  
*Previously:* UBS Warburg, Nordea



**Yvonne Thomson**  
Chief Financial Officer  
21 years in the financial field  
AP3 since October 2000  
*Previously:* OM VPA, Gota Bank



**Hans Ericsson**  
Portfolio Manager  
Execution, fixed-income  
18 years in the financial field  
AP3 since October 2000  
*Previously:* Handelsbanken Asset  
Management, Head of Fixed-income  
Trading at Handelsbanken Markets



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



**Lars Orest**  
Portfolio Manager  
Swedish and foreign fixed-income  
securities, governments bonds  
19 years in the financial field  
AP3 since July 2000  
*Previously:* Head of FX Reserve  
Management at Sveriges Riksbank,  
Sparbankernas Bank



**Mats Wirdefeldt**  
Portfolio Manager  
Swedish and foreign fixed-income  
securities, short rates  
5 years in the financial field  
AP3 since January 2002  
*Previously:* SEB Asset Manage-  
ment, SEB Trading



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



**Urban Eriksson**  
Portfolio Manager  
Execution, equities, Sector Manager,  
investment companies  
17 years in the financial field  
AP3 since August 1999  
*Previously:* Head of Equities  
Trading at Robur Kapitalförvaltning,  
Sparbankernas Bank



**Anne-Charlotte Homgard**  
Portfolio Manager  
Sector Manager, retail, services,  
consumer goods  
14 years in the financial field  
AP3 since April 1993  
*Previously:* Bohusbanken FK,  
Folksam Finance Division



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

Equities Management / Continued



**Björn Kvarnskog**  
Portfolio Manager  
Sector Strategist  
16 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  
14 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  
14 years in the financial field  
AP3 since May 2000  
*Previously:* Alfred Berg Asset Management, Alfred Berg Fondkommission

External Management



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



**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



**Cecilia Sved**  
Portfolio Manager  
12 years in the financial field  
AP3 since December 2002  
*Previously:* Länsförsäkringar Kapitalförvaltning, Wasa Kapitalförvaltning



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

Quantitative Analysis



**Erik Valtonen**  
Head of Quantitative Analysis  
ALM and risk  
Ph D in mathematics  
13 years in the financial field  
AP3 since May 2000  
*Previously:* Head of Financial Research at Handelsbanken Markets



**Mattias Bylund**  
Analyst  
Risk and performance  
1 year in the financial field  
AP3 since August 2002



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



**David Stillberger**  
Analyst  
Risk and performance  
2 years in the financial field  
AP3 since July 2001

Quantitative Analysis / Continued



**Claudia Stanghellini**  
Analyst  
ALM and risk  
5 years in the financial field  
AP3 since May 2002  
*Previously:* Sun Life Financial

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Produced by AP3 in cooperation with:

*Project management and graphic production:* Edita Communication AB.

*Graphic design:* Tommy Säflund Design AB. *Photo:* Elisabeth Ohlson.

*Translation:* T-company (The Translation Company)

*Printing:* Edita Västra Aros, Sweden 2003.



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](http://www.ap3.se)