



**Third Swedish National
Pension Fund**
Annual Report 2003

Contents

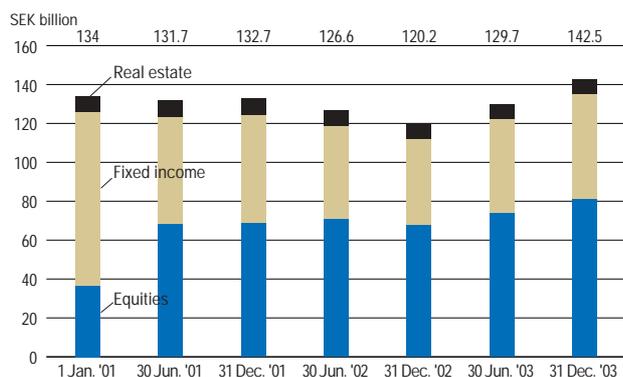
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- 3 The Year in Brief
 - 4 Statement by the CEO – Constructive debate on responsibility and trust
 - 6 Our Mandate – To manage Sweden’s national pension capital
 - 7 Investment Policy – Optimum returns at low levels of risk
 - 10 Corporate Governance Policy – We aim to be a clear and independent voice on governance issues
 - 11 Environmental and Socially Responsible Investment – We promote corporate codes of conduct
 - 12 Report of the Directors 2003
 - 15 Tables:
 - 15 Portfolio overview
 - 16 Performance and risk
 - 16 Private equity
 - 17 External management
 - 18 Income Statement and Balance Sheet
 - 19 Board of Directors
 - 20 Employees

The Year in Brief

Net profit of SEK 19.8 billion

Net profit in 2003 totalled SEK 19.8 billion, which equated to a total return of 16.2% after expenses and adjustments for net capital flows. The return on the market-listed portfolio was 17.2%, which was marginally lower than the return on the Fund's reference portfolio, which totalled 17.3%.

Figure 1
Historical value of AP's portfolio



Fund capital of SEK 142.5 billion

At year-end, the market value of AP3's fund capital stood at SEK 142.5 billion, compared to SEK 120.2 billion at the start of the year. During the year the Fund recorded a net capital inflow of SEK 2.6 billion, which was primarily attributable to pension contributions outweighing pension disbursements.

Table 1
Change in fund capital 2003

SEK million	
Pension capital on 1 Jan.	120,211
Pension contributions	41,481
Pension disbursements	-39,057
Administration fee to National Social Insurance Board	-281
Transfers from discontinuing funds	424
Profit for the year	19,758
Pension capital on 31 Dec.	142,536

Reference portfolio structure

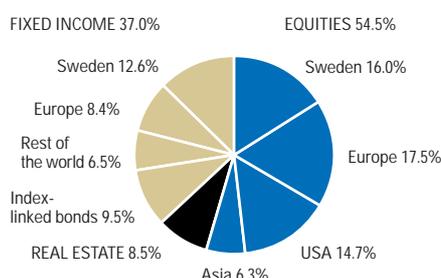
The favourable return on fund capital in 2003 was due to a strong rally on world equity markets. Equities account for 54.5% of AP3's reference portfolio, which represents the Fund's long-term asset allocation and whose structure conforms to what is considered to be in the long-term best interests of the national pension scheme. Foreign assets account for 55% of the reference portfolio.

New reference portfolio in 2004

An updated asset liability modelling analysis performed in 2003 resulted in a Board decision to adjust the

reference portfolio for 2004. It was decided to increase the weighting of Asian stocks in the equity portfolio and reduce the weighting of US equities. In the fixed income portfolio, index-linked bond holdings are to increase at the expense of nominal bonds. The Fund is also moving towards a reference portfolio based on "semi-fixed weightings", which means that the main asset classes are allowed to fluctuate within a band of ± 3 percentage points from their target weighting. The objective here is to reduce transaction costs associated with rebalancing the portfolio in response to market movements.

Figure 2
AP3's reference portfolio 2004



Improved risk diversification

AP3 makes continual efforts to improve risk diversification within its portfolios by investing in new markets. In 2003 the Fund made its first investments in US and European small-cap equities and in US high-yield bonds. In 2004 the Fund plans to diversify via investments in foreign index-linked bonds and also intends to examine possibilities for expanding its investments in emerging markets.

Currency risk at 9%

At year-end the Fund's currency risk amounted to 9% of the total portfolio, or SEK 12.8 billion. The Fund has decided to increase currency risk in the reference portfolio to 19.3%, though this will remain well below the 30% maximum permitted according to national pension fund legislation.

Lower internal asset management expenses

The Fund's asset management expenses totalled SEK 235 million in 2003. Excluding external asset management expenses, the figure was SEK 125 million, a decrease of SEK 6 million from 2002. However, external asset management expenses increased due to a higher proportion of active portfolio management and new investments in private equity.

Statement by the CEO

Constructive debate on responsibility and trust

In 2003, words like trust, responsibility and ethics took centre stage in public debate. While the events that precipitated the debate were regrettable, the discussion itself usefully highlighted the importance of the balance of power in the corporate arena. As Lord Acton once said towards the end of the 17th century: "Power tends to corrupt, and absolute power corrupts absolutely."

I came across that quotation many years ago and my belief today is that whenever the balance of power is disturbed it creates fertile conditions for corrupt behaviour. Many of the scandals we have witnessed in recent years have arisen due to a deficient balance of power between corporations and their owners. In many cases, we as shareholders have not lived up to our responsibilities. The Swedish Companies Act identifies three decision-making institutions: the annual general meeting, the board of directors and the chief executive. If shareholders shirk their responsibilities at annual general meetings it disrupts the balance of power. Capitalism cannot function without active owners.

The core theme of AP3's new, expanded corporate governance policy, approved by the Board in October 2003, is our desire to help create an improved balance of power between shareholders and corporate managements. Living up to this means being prepared to invest the resources required to exercise competent and independent governance.

Corporate managements and boards must know what we shareholders stand for. Equally, they are entitled to make demands of AP3 as a shareholder. We see our role as being a constructive and well informed discussion partner.

My job as CEO of AP3 carries particular responsibility. The people whose pension capital we manage have not had the opportunity to choose between different fund managers. We should therefore ask ourselves the following question: what would lead savers to choose us if we were required to compete for their confidence? The answer to this question is the foundation of the trust that AP3 inspires.

Complex task

Our overriding goal is to generate strong returns at a low level of risk, where risk is measured in terms of future pension disbursements. This goal applies throughout AP3's operations, but achieving

it is a complex task. Factors such as demographic trends, economic growth, the labour participation rate and asset returns are all subject to uncertainty. The strategic asset mix

that we select depends on numerous variables and scenarios. Also, we are expressly required by law to choose an asset mix that is generation-neutral. For example, we cannot invest the entire fund capital in short-term govern-

"Managements and boards are entitled to make demands of AP3 as a shareholder. We see our role as being a constructive and well informed discussion partner."



– Receptiveness to new ideas is one of AP3's core values, says Tomas Nicolin.

ment bonds (traditionally regarded as having the lowest risk level) since that would benefit current pensioners at the expense of future pensioners.

In considering all these aspects, we have not compiled a portfolio expected to generate the highest average return but one that provides greater security for the pension system across a range of risk scenarios. The thinking behind this is simple: we believe that for most people it is worse to receive 100 kronor less a month than expected than to receive 100 kronor more. This is especially so for those with the lowest pensions.

The Swedish people are entitled to demand that state pension assets are managed at least as effectively as private pension capital. The asset management industry is evolving fast as new approaches, products and methods

emerge. This progress has been particularly marked in the last few years in the wake of the stock market downturn. Receptiveness to new ideas is one of AP3's core values. Our ambition is to be per-

manently at the forefront of developments in our industry. Last year was an intensive one for AP3, and all departments were involved in one or more major development projects.

Development projects in 2003

New approach for an efficient portfolio structure. This project is an example of our long-term efforts to stimulate innovation. It involves examining possibilities for separating the portfolio management task into highly specialised mandates, some of which focus on exposure to overall market risk while others focus on exposure to security-specific risk. Opportunities exist in this context for reducing asset management costs and improving portfolio returns.

Improved strategy for external asset management.

About one quarter of AP3's portfolio is managed by external partners. This project aims to enhance the process for selecting the best portfolio managers in each asset category. The emphasis here is on using modern portfolio theory to identify the optimum mix of asset managers.

New portfolio system. Top-class systems are needed to enable AP3 to capture future opportunities in the asset management field. In 2003 we commenced the procurement of a new portfolio system. We have high demands, and only a handful of service providers around the world today are capable of supplying a system that comes close to meeting them. Our aim is to identify a partner which can develop a flexible system able to handle the ever-expanding range of financial instruments.

New system for return analysis. AP3 strives to structure the investment process into well defined decision points in order to promote decentralised investment decisions and risk diversification. This structure makes it important that we are able to measure risk and return for every single decision point. In 2003 the Quantitative Analysis department purchased a new system for performance analysis that was specially adapted to AP3's needs.

New developments in ALM analysis. Performing analysis to determine which portfolio generates the highest return for the pension system (a process known as asset liability modelling) is an important part of our work. Each year we conduct an updated and expanded ALM analysis, with the aim of expanding our knowledge in this complex area. Last year's study resulted in a transition to a reference portfolio with "semi-fixed weightings". This means that the weightings of the main asset classes are allowed to deviate within a defined band. This approach addresses the fact that it is impossible to define precisely the optimal asset weightings. It will also enable us to reduce asset management transaction costs.

These projects are just a few examples of the wide-ranging development work performed by AP3 in 2003. It is this spirit of innovation, creativity and individual responsibility that makes the job of AP3 CEO so stimulating. I am also convinced that this approach is cru-

cial if we are to merit the trust placed in us by the Swedish people as managers of their pension capital.

Portfolio return of 16%

The return on AP3's portfolio amounted to 16% last year, which is significantly above what can be considered a sustainable level. At the time of writing we had recouped the full extent of the losses we suffered during the stock market slump. The Fund's performance should be measured in relative terms, however. During 2003 AP3 fell short of the Board's target of a 0.4 percentage point annual outperformance compared to the reference portfolio. The portfolio return (after expenses) was 0.2 percentage units lower than the return on the reference portfolio.

Although we cannot be satisfied with this outcome, I would nevertheless submit that we performed extremely well in some areas of our portfolio management. I refer primarily to our internal fixed income and currency

management operations, whose performance in 2003 put them comfortably among the leading quartile of asset managers in this field.

During the year Claes de Neergaard took over from Johan Björkman as AP3 Chairman. Johan led the Fund for 14 years and oversaw the transition from the former Fifth Fund to the new Fund's more demanding structure and role. His experience and support have been invaluable.

I myself recently accepted a new position, which means I will leave AP3 during 2004. My time as CEO of AP3 has been extremely stimulating and it has been a privilege to recruit and work with so many skilled colleagues. I know that AP3's staff will continue the work to develop the Fund as one of the international leaders in the pension fund industry.

Stockholm, 12 February 2004



Tomas Nicolin
Chief Executive Officer

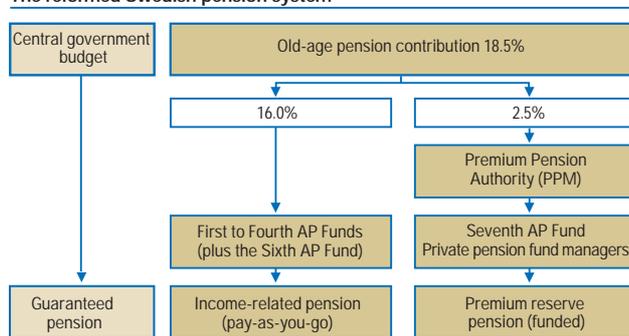
Our Mandate

To manage Sweden's national pension capital

AP3 is one of four so-called buffer funds of the Swedish national pension scheme that are mandated by the Riksdag to generate the best possible long-term return on pension capital at a low risk.

AP3 is thus part of the system set up to meet current and future pension needs. The Swedish pension system has two elements. The first is the pay-as-you-go system in which pension disbursements to current pensioners are financed by the contributions (amounting to 16% of nominal pay) of those currently in work. The second element is the premium reserve pension system, in which pension disbursements are financed by funds accumulated via premium reserve contributions (amounting to 2.5% of nominal pay). The premium reserve is managed by private pension fund managers and by the Seventh Swedish National Pension Fund.

Figure 3
The reformed Swedish pension system



What is a buffer fund?

The size of contributions to and disbursements from the national pension scheme varies from year to year due to demographic changes, labour participation rates and the rate of wage growth, etc. The task of the First, Second, Third and Fourth Swedish National Pension Funds is to serve as a buffer, smoothing out temporary fluctuations in contributions and disbursements while at the same time contributing to the pension system's long-term financing.

The new pension system includes a built-in automatic balancing system that prevents automatic increases in pensions in line with annual wage growth if long-term deficits arise in the system. The pension system's balance

figure, showing the size of pension assets in relation to liabilities, is calculated annually. Figure 4 shows the pension system's balance sheet at the end of 2002 and points out that the size of the buffer funds is small (about 10%) in comparison to future pension commitments.

The buffer funds' size may nevertheless have an effect on whether the automatic balancing mechanism is applied, and their role is thus to manage fund capital so as to minimise the risk of an automatic balancing occurring.

Figure 4 The pension system's balance sheet, 31 Dec. 2002

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

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

Investment rules

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

The funds must take account of environmental and social considerations in their asset management operations but this should not interfere with the overriding goal of a high return on capital. Moreover, the Riksdag has decided that fund investments should not be influenced by industrial or other economic policy concerns.

Fund governance and follow-up

AP3 is a state-owned body, which means we are subject to legislation on public procurement and the principle of free public access to official documents. There are, however, a number of important differences between AP3 and government agencies in general.

- The Fund has its own board of directors, appointed by the government and fully responsible for the operations of the Fund.
- The Fund has external auditors.

Further information on AP3's mandate and investment rules is available at www.ap3.se



"Managing the buffer for the national pension system is a complex task. We have made great efforts to analyse the Fund's commitments, including in-depth stress testing. We have paid particular attention to academic research in these areas and attached priority to finding new practical ways to implement the latest advances."

Bengt Hansson, Chief Economist

Investment Policy

Optimum returns at low levels of risk

Generating the best possible return for the national pension system is the basis of AP3's investment policy. Asset allocation should reflect the Fund's role and obligations as a buffer fund. The goal is to generate optimum returns on fund capital at a low level of risk

The investment policy describes the Fund's strategy for managing the asset management mandate conferred on it by the Riksdag. The policy consists of three strategic areas, in each of which the aim is to attain the highest possible returns at a low level of risk.

1. *Reference portfolio.* The choice of reference portfolio involves conducting an asset liability modelling analysis to identify the best long-term strategic asset mix for the national pension scheme. The reference portfolio is modelled as a weighted portfolio of regional indices for equities, bonds and real estate. It serves as a yardstick against which the Fund's asset management performance can be measured.

2. *Manager structure.* How can the theoretical reference portfolio be implemented through investments in various markets? And in which markets is it possible to outperform the market, i.e. will active asset management generate an active return? The manager structure decision also involves deciding how to allocate assets between internal and external management.

3. *Risk budgeting.* This involves setting risk limits for tracking error for every decision point in the investment process.

Choice of reference portfolio

Identifying the best long-term strategic asset mix is a key task for the Fund and is carried out via a process known as asset liability modelling (ALM). By exploring the relationship between Fund assets (the return on fund capital) and liabilities (the commitments of the buffer funds) we can study the consequences that portfolios with different asset allocations would have for the long-term development of the national pension system in a range of demographic and economic scenarios.

The Fund has performed an annual ALM analysis since 2000 and the latest exercise was thus the fourth. This annual review enables AP3 to benefit from any new information or data pertaining, for example, to demo-

Figure 5
AP3's reference portfolio 2003

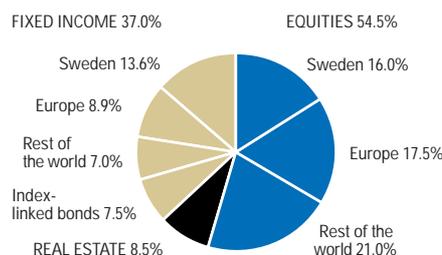
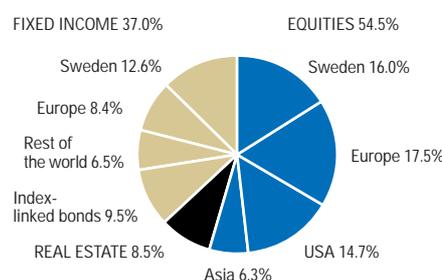


Figure 6
AP3's reference portfolio 2004



graphics or asset prices. It also facilitates continual improvement of our analytical tools.

As with all models, the outcome of an ALM analysis depends on the underlying assumptions. A key objective of the 2003 exercise was to develop the sensitivity analysis – the evaluation of the consequences of alternative assumptions. ALM analyses are based on two main sets of assumptions, relating to demographics and asset prices.

The Fund makes no demographic projections of its own but uses those of the National Social Insurance Board, which in turn are based on forecasts produced by Statistics Sweden. The 2003 ALM analysis also included a number of risk scenarios specially developed for the National Pension Funds. The aim was to understand the impact of demographic factors, such as average life expectancy, the labour participation rate, birth rates, net immigration etc, on the buffer funds.

Assumptions relating to asset prices were developed using two methods. First, the Fund devised its own

“At AP3 we update our ALM study every year. This annual update enables us to benefit from new information, such as demographics and asset prices. We continuously strive to develop our analytical tools and to explore new topics.”

Niklas Ekvall, Deputy CEO and Chief Investment Officer



assumptions based on a review of current theoretical and empirical research in the field. Second, we hosted workshops attended by leading international asset managers, consultants and investment banks.

This broad-based approach is intended to create a good basis for the analysis of a range of alternative scenarios. The assumptions produced are alternative sets of forecasts of expected return and standard deviation for the main asset classes. The forecasts are both medium-term (defined as a business cycle or 5-6 years) and long-term. The different time horizons enable us to take account of temporary imbalances in financial prices that may result in the expected return on a particular asset class being higher or lower than normal in the medium term.

The ALM process has two steps

Step 1: Identification of the optimal long-term share of equities. Here, we look for a portfolio that generates a good average return for the pension system and also minimises the likelihood of any substantial effects arising from automatic balancing. Automatic balancing is a mechanism whereby pensions are not automatically indexed upward in line with annual wage growth when long-term deficits arise in the system. The portfolio should also be generation-neutral. In other words, no single generation of current or future pensioners should be advantaged or disadvantaged. The analysis covers a 40-year term.

Step 2: Identify optimal regional market weightings for equities and fixed income assets. This includes setting currency hedging ratios for equities and bonds based partly on projected medium-term foreign exchange rate trends.

“Semi-fixed weightings” in the reference portfolio for 2004

The latest ALM study confirmed the findings of previous years, namely that the optimum share of equities in the reference portfolio is 52–57%. These portfolios have favourable characteristics in relation to the Fund’s liabilities in the pension system. Hence, the share of equities in the reference portfolio was unchanged for 2004.

From 2004, the weightings of the main reference portfolio asset classes will no longer be fixed but will instead be allowed to fluctuate within a band of ± 3 percentage points. Semi-fixed weightings have the important benefit

of reducing transaction costs stemming from rebalancing of the portfolio in response to market movements.

For 2004, minor adjustments in reference portfolio weightings were also made based on revised forecasts of medium-term returns:

- The share of Asian equities is to increase by two percentage points at the expense of US equities.
- The weighting in index-linked bonds is to increase by two percentage points at the expense of nominal bonds. Portfolio diversification will improve since the Fund is to start investing in foreign index-linked bonds.
- The currency hedging ratio for foreign equities is to decrease from 75% for all currencies to 65% for the US dollar, 50% for European currencies and 30% for Asian currencies. As a result, the currency exposure of the reference portfolio will increase from 10.8% to 19.3%.¹ Nevertheless, exposure will still be well below the upper limit of 30% stipulated by Swedish national pension fund legislation.

Table 2
Currency hedging ratios for the reference portfolio in 2004
(2003 figures in brackets)

	Gross exposure as % of reference portfolio	Currency hedging ratio, %	Net exposure as % of reference portfolio
Foreign bonds	14.9 (15.9)	100 (100)	0
Foreign equities	38.5 (38.5)	52 (75)	18.3 (9.6)
Swedish equities with foreign domicile	1.0 (1.2)		1.0 (1.2)
Reference portfolio	54.4 (55.6)		19.3 (10.8)

Forthcoming ALM projects

AP3 makes continual efforts to refine the ALM process and in 2003 embarked on a number of projects that will continue in 2004. Three of these merit special mention:

Emerging markets. We will examine how a broader exposure to investments in emerging markets might contribute to risk diversification and portfolio returns.

Options strategies. We will study whether it is possible to deploy options or similar instruments on a long-term and strategic basis to improve portfolio characteristics. Preliminary indications are that this may be the case under certain conditions. However, a number of significant practical difficulties exist and our research will continue in this area.

¹ Note that shares in companies listed on the Stockholm stock exchange but which have a foreign domicile are considered as exposed to currency risk.



“The aim of ALM analysis is to identify a portfolio that generates a good return and creates a low risk of deficits in the pension system that would trigger the automatic balancing mechanism. This means that pensions are not increased in line with average wage growth. The time horizon in our calculations is 40 years.”

Claudia Stanghellini, Quantitative Analyst in Asset Liability Modelling

Dynamic allocation rules. Ought the composition of the reference portfolio to be formally tied to key measures of the financial balance of the national pension system? For instance, one might employ a decision rule by which an automatic shift in the share of equities versus bonds was triggered at certain levels of deficit or surplus in the pension system. We have examined a number of alternative decision rules, but have yet to identify any rule that appears significantly to improve the characteristics of the portfolio. Nevertheless, we will continue to study this area in 2004.

Risk budgeting

Risk budgeting is the process whereby risk limits and active return targets are defined for each decision point in the investment process. The purpose is to maximise active return subject to the risk mandate set by the Board. Risk budgeting takes place on an ongoing basis and often entails frequent revisions. This contrasts with decisions concerning asset management structure, which tend to be

more of a more overarching and long-term character. Revisions of the risk budget may be necessary for a variety of reasons:

Changes in market conditions, for instance a major shift in volatility on a certain market or if the correlation between different asset managers deviates from historical patterns.

Deviations from targets for active return and risk. Asset management performance is subject to continual monitoring and evaluation.

Excessive impact on total risk from a particular decision point in the investment process. This can require a reallocation of risk limits between different mandates.

AP3's Deputy CEO and Chief Investment Officer, Niklas Ekvall, is in charge of risk budgeting. The Fund's quantitative analysis team is responsible for performance reporting and the development of analytical tools. In 2003, AP3 initiated a project to develop the decision processes in the areas of manager structure and risk budgeting. The goal is to develop a consistent and repeatable methodology with clearly defined criteria and decision rules.

Figure 7
AP3's investment process

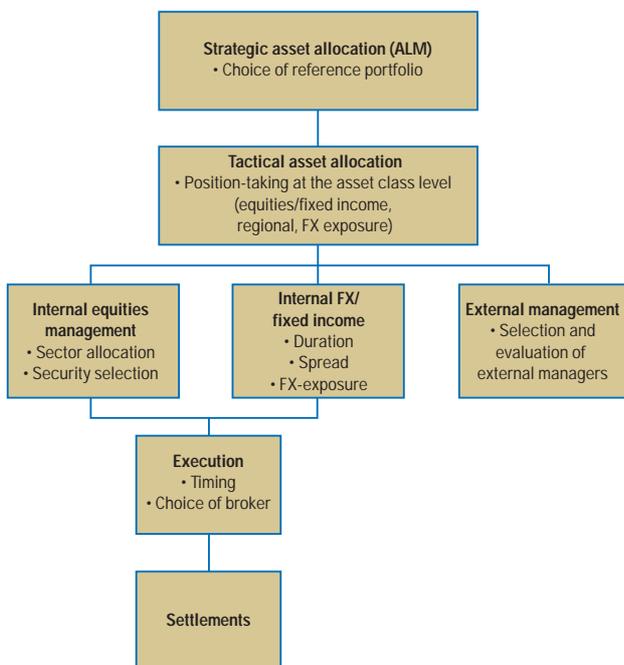


Table 3
Asset management structure

	Internal		External		Total	
	SEK bn	Share, %	SEK bn	Share, %	SEK bn	Share, %
Active management	97.4	68	17.4	12	114.8	80
Passive management	4.0	3	23.7	17	27.7	20
Total	101.4	71	41.1	29	142.5	100

Targets for return and risk

AP3's overriding asset management target is that the Fund's annual portfolio return should exceed that of the reference index by 0.4 percentage points over a rolling five-year period and after expenses. This is supplemented by a target for risk-adjusted return, which defined as the information ratio should exceed 0.2. These targets should be reached within a limit for active risk (or tracking error) of 4%. This limit represents a ceiling that may not be exceeded and does not denote the general risk level within the portfolio. Active risk should normally be between 1% and 2%. The above targets are currently under review and may be revised during 2004.

"Risk budgeting is a high priority for us at AP3. It involves setting targets for risk and return for each of the Fund's asset management mandates – both for internally managed portfolios and for our external managers. The ultimate aim is to maximise active return subject to the limits for total active risk set by the Board."

Gunnar Dahlfors, Quantitative Analyst



Corporate Governance Policy

We aim to be a clear and independent voice on governance issues

Since acquiring its new asset management mandates in 2001, AP3 has focused a growing share of its time and resources on corporate governance issues. The primary focus has been on remuneration issues and nominations to corporate boards. In 2003 AP3's Board adopted a new, extended corporate governance policy which aims to strengthen further the Fund's efforts in this field.

The Fund's mandate from the Riksdag states that "shareholder governance shall be exercised unambiguously for the purpose of securing a high return on assets under management". This clear statement forms the basis for the formulation and implementation of AP3's corporate governance policy.

A central theme in this context is the Fund's objective of preserving the balance of power between shareholders and corporate managements through clear and independent shareholder engagement. However, corporate governance is not just about imposing demands. Managements and boards are entitled to make demands of AP3 as a shareholder. We see our role as being a constructive and well informed discussion partner.

AP3's corporate governance activities are co-ordinated by a steering committee headed by the CEO and including the Head of Equities Management, Magnus Eriksson, the Communications Manager, Pernilla Klein, and Portfolio Manager Mats Andersson. In 2003 this group produced the draft for the new, extended corporate governance policy that was approved by the Board in October.

AP3's shareholder engagement in 2003

In conjunction with its first-half results, the Fund published a report on its shareholder engagement activities allied to annual general meetings held in 2003. AP3 aims to participate in the AGMs of all Swedish companies in which it owns shares. In 2003 the Fund was represented at 62 AGMs and one extraordinary general meeting.

AP3 actively promotes the creation of nomination committees and therefore considers it important to join such committees when asked. Last year AP3 was represented on 11 nomination committees. In our board nomination work we strive to ensure a broad recruitment base and have also proposed that board remuneration should contain a variable component linked to company performance. During 2003 AP3 helped establish this remuneration model for the boards of SKF and Nobia.

Key elements of AP3's extended corporate governance policy

- AP3 promotes the introduction of systematic procedures to review board performance. These are necessary so that nomination committees can perform their tasks effectively.
- Attitudes toward the role of board members need to change. Directorships are not honorary positions to be held for life. Turnover of directors should increase and changes in board composition be seen as less dramatic.
- Nomination committees should be made more independent of corporate boards and should therefore be chaired by a shareholders' representative rather than the chairman of the board, as is often the case today.
- Audits are a governance issue. The nomination committee must oversee the board and ensure it allocates sufficient time to audit-related issues such as the selection of auditors.
- We take a positive view of performance-based pay but there must be a clear link between performance and ultimate levels of remuneration.

The Fund aims to voice its opinions at AGMs, even in cases where these opinions are unlikely to receive majority support. Last year AP3 expressed its view that chief executive officers should not be appointed to boards as directors and that equity-related incentive schemes should be stated as an expense on the income statement.

Nomination processes prior to the 2004 annual general meeting season

With regards to the 2004 annual general meeting season, AP3 is represented on the nomination committees of Alfa-Laval, Cardo, Getinge, Haldex, Höganäs, Munters, Nobia, ORC, SKF and Switchcore. During the course of the year the Fund will intensify its calls for nomination committee work to be based on an assessment of board performance.

Further information on AP3's corporate governance policy is available at www.ap3.se



"Every company is unique. Constructive governance is characterised by flexible application of the corporate governance policy, taking into account each company's different circumstances."

Magnus Eriksson, Head of Equities Management

Environmental and Socially Responsible Investment

We promote corporate codes of conduct

The legislation governing Sweden's National Pension Funds states that "environmental and social considerations shall be taken into account in investment activities without impinging on the overall goal of a high return on capital". AP3 has chosen to pursue these considerations via a strategy of active engagement. Instead of employing a screening method to exclude individual companies or sectors from our portfolios, we believe we can make more of a difference by pursuing dialogue with the companies in which we hold shares.

We firmly believe that observance of good environmental and social practices is essential if companies are to be run in the best interests of shareholders over the long term. Thus, these issues are an important component of AP3's corporate governance activities. We set out to ensure that the executive managements of companies in which we hold shares identify and manage social and environmental risks in a way that maximises value to investors.

Systematic process

In recognition of the importance of environmental and social issues, AP3 has developed a systematic process to incorporate these issues in the management of the Fund. This process includes two key steps:

- *Company analysis* – whereby we understand company exposure to environmental and social risks and how well companies manage these risks.
- *Engagement* – defined as an active dialogue between the company and its shareholders on key issues of concern.

This process is designed to ensure that AP3 has good knowledge of the environmental and social risks in companies in which it holds a significant ownership stake. It is primarily Swedish corporations that are relevant in this regard. Where there are particular areas of concern relating to individual companies, AP3 enters into a proactive dialogue with the company. The engagement strategy seeks to encourage companies to adopt best practice when managing the social and environmental impacts of their business.

Where deficiencies appear, AP3 initiates dialogue with the company in question and in collaboration with the UK consultancy Core Ratings.

AP3 takes a positive view of companies signing up for the principles of the UN Global Compact.

What is a corporate code of conduct?

AP3's shareholder engagement programme focuses on promoting companies' adoption of codes of conduct. This mainly applies to businesses whose production processes

AP3's Socially Responsible Investment Policy

AP3 assumes that the companies in which it owns shares follow international conventions and agreements ratified by Sweden. The Fund also assumes that companies with operations in Sweden abide by Swedish law. AP3 attaches particular importance to the following international agreements:

- The OECD's guidelines for multinational corporations.
- The ILO's core conventions (relating to forced labour, child labour, working conditions, equal treatment, and freedom of association).
- The UN Declaration on Human Rights.

involve considerable environmental impact or that have production and/or procurement in countries where the national government either does not want or lacks the ability to enforce basic international agreements on human rights, workers' rights, corruption and the environment.

By a code of conduct we mean a company-wide policy and management system for corporate social responsibility issues. A code of conduct should meet the following standards:

- *Transparency.* The basic principles of the code should be disclosed to shareholders and other stakeholders. AP3 will, however, respect the fact that it is not always appropriate to communicate all detailed internal guidelines externally. It is also important that the code is communicated clearly to all employees.
- *Follow-up and control mechanisms.* In order for the code of conduct to be efficient and credible, a monitoring system and quality check procedure for adherence is required.
- *Reporting.* In order to make it possible for shareholders and other stakeholders to evaluate the code of conduct, companies should report on its contents, monitoring procedures and relevant performance data. A good benchmark for this reporting is provided by the UN initiative to produce international standards for sustainability reporting, the Global Reporting Initiative (GRI). AP3 encourages companies to report according to the GRI.

"Many Swedish corporations still lack corporate codes of conduct, even though they have substantial operations in countries where breaches of international agreements on human rights and environmental issues occur regularly. However, we currently see a growing awareness of these issues in Swedish business. This is a trend that AP3 as an investor wishes to encourage."

Pernilla Klein, Communications Manager



Report of the Directors 2003

Report of the Third Swedish National Pension Fund's (AP3) Board of Directors and Chief Executive Officer for the financial year 1 January–31 December 2003.

Asset management profit for 2003 totalled SEK 19.8 billion, representing a total return of 16.2% (after expenses and adjustments for net capital flows). At year-end, the market value of AP3's fund capital stood at SEK 142.5 billion, compared to SEK 120.2 billion at the start of the year. During the year the Fund recorded a net capital inflow of SEK 2.6 billion.

Table 1
Changes in fund capital 2003

SEK million	
Pension capital at 1 Jan. 2003	120,211
Pension contributions	41,481
Pension disbursements	-39,057
Administration fee to National Social Insurance Board	-281
Transfers from discontinuing funds	424
Profit for the year	19,758
Total fund capital at 31 Dec. 2003	142,536

The favourable return on fund capital in 2003 reflected a strong rally on world equity markets. Equities account for 54.5% of AP3's reference portfolio. However, the 16.2% return on the total portfolio was substantially higher than the Fund can sustain over the long term. On the basis of our long-term asset return forecasts, the Fund expects to generate an average annual return of about 8%. However, returns can vary widely from year to year and the estimated standard deviation is 11%. This means that the Fund can be expected to post a negative overall return every fourth year.

The stock market recovery in 2003 meant the Fund has now recouped almost the full extent of the losses it sustained during the slump in 2001–2002. See Table 2.

Table 2
Changes in pension capital 2001–2003

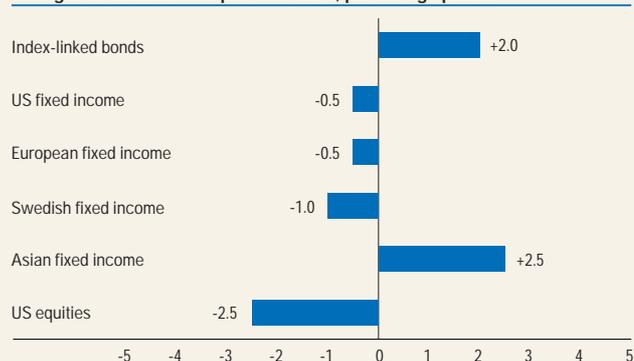
SEK million	
Pension capital at 1 Jan. 2001	133,975
Net capital inflow 2001	4,523
Net loss for 2001	-5,774
Net capital inflow 2002	5,001
Net loss for 2002	-17,514
Net capital inflow 2003	2,567
Net profit for 2003	19,758
Pension capital at 31 Dec. 2003	142,536
Pension capital at 1 Jan. 2001	133,975
Net capital inflow 2001–2003	12,091
Total	146,066

AP3 carries out annual asset liability modelling (ALM) studies to determine the optimal allocation of assets for the long-term benefit of the national pension system. An ALM study was conducted to serve as a basis for the Board's decision on the composition of the reference portfolio for 2003.¹ The analysis indicated that it would be appropriate to remove Japanese bonds from the Fund's fixed income portfolio. Japanese bonds accounted for 1.4% of the reference portfolio in 2002. The hedge ratio for equities was also reduced from 80% to 75%. These

changes in the reference portfolio were implemented in January 2003. The Board also decided to increase the real estate weighting in the reference portfolio by 0.5 percentage points at the expense of Swedish fixed income assets. This change has yet to be implemented, however, pending a review of the Fund's real estate investment strategy.

An updated ALM analysis was performed in 2003 and resulted in a Board decision to adjust the reference portfolio for 2004, as shown in Fig. 1.

Figure 1
Changes in the reference portfolio 2004, percentage points



Active return in 2003

The Fund's portfolio of market-listed assets (which excludes real estate and private equity) posted a return of 17.2% in 2003. This was a slight underperformance against the reference portfolio, which returned 17.3%. Active return (before expenses) totalled -0.1 percentage points.

AP3's asset management expenses (excluding management fees for private equity holdings) corresponded to 0.1% of assets under management. Including expenses for the market-listed part of the portfolio, active return was -0.2 percentage points.

Three years have now passed since AP3 assumed its new asset management mandates. In that time the Fund has generated an accumulated active return of 0.7 percentage points (before expenses), or 0.3 percentage points on an annualised basis. After expenses, the annual active return is 0.1 percentage points.

The Board has set a long-term target that return should exceed the reference portfolio by an average of 0.4 percentage points per annum (after expenses) over a rolling five-year period. It has also stipulated a target of 0.2 for risk-adjusted return (measured as an information ratio and after expenses).² The information ratio (after expenses) was 0.2 for the three-year period 2001–2003.

It should be stressed that three years is far too short a time to allow a full evaluation of asset management performance. Nevertheless, the Board notes that the Fund's asset management activities thus far appear to be well on the way to reaching the risk-adjusted return target.

¹ See pages 7–9 in AP3's Annual Report 2002 for an overview of the 2002 asset liability modelling analysis.

² Excluding fees to private equity funds.

Figure 2
Active return

Accumulated return on AP3's liquid portfolio (equities and fixed income) compared to the reference index since inception in 2001.



* The active return for January-June 2003 was adjusted downward by 0.2 percentage points from the figure stated in the interim report for the first six months of 2003.

Asset management expenses

The Fund's asset management expenses totalled SEK 235 million, an increase of SEK 58 million from 2002. This increase was expected and reflected the increased share of actively managed external mandates and the continued growth of private equity investments. The largest cost increase was SEK 37 million and related to external management of traditional assets.

Table 3
Manager structure

	Internal		External		Total	
	SEK bn	Share, %	SEK bn	Share, %	SEK bn	Share, %
Active management	97.4	68	17.4	12	114.8	80
Passive management	4.0	3	23.7	17	27.7	20
Total	101.4	71	41.1	29	142.5	100

External asset management expenses

At the end of 2003, 29% of fund capital was managed externally. Some 59% of these funds were under passive management and 41% under active management. AP3's long-term strategy is gradually to reduce the proportion of funds managed passively in favour of active mandates in markets where this can be expected to contribute to active return.

Fees paid to external managers of active mandates have both a fixed and variable component, with the latter linked to the active return generated by each mandate. In 2003, fixed asset management fees totalled SEK 32 million (excluding passive management), while variable fees amounted to SEK 24 million.

Management fees for private equity funds rose to SEK 54 million (from SEK 27 million 2002) and at year-end AP3's private equity holdings totalled SEK 4.4 billion. Private equity investments require a long-term investment approach and yield a negative return for the first few years. AP3 expects its private equity portfolio to generate a positive return within 4-5 years.

Personnel and other internal expenses

The Fund seeks to ensure cost-efficiency and optimal resource utilisation throughout its operations. Internal asset management costs (excluding fees to external asset managers and private equity funds) decreased from SEK 131 million in 2002 to SEK 125 million in 2003. This was due chiefly to lower bonus provisions as well as to ongoing efficiency efforts and cost controls. Since 2001 the Fund has operated a bonus system that aims to enhance the prospects for good asset management performance by establishing a direct link between Fund goals and remuneration of employees.

Table 4
Major expenses

	2003		2002	
	SEK million	% of total	SEK million	% of total
Total expenses	235		177	
of which Staff	63	27	71	40
External asset managers	56	24	19	11
Private equity fund fees	54	23	27	15
Global custodian	20	9	19	11
Market data	10	4	12	7
IT	7	3	7	4
Premises	6	3	5	3

The Swedish government in 2003 published new guidelines covering incentive schemes in state-owned companies, and these apply to the National Pension Funds. One of the key changes was the stipulation that no performance-based remuneration may be paid if the Fund reports a net loss in any financial year. As a result, the Board decided to amend the previous salary model, which consisted of a fixed component and a variable, performance-based component. The new model will result in higher fixed remuneration rates in 2004.

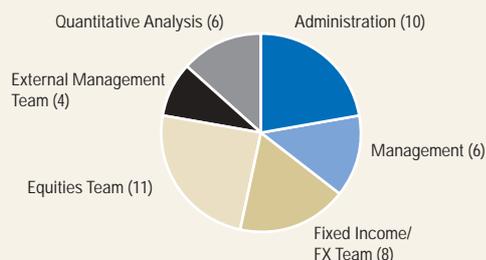
Focused administration

At year-end 2003 the Fund had 45 employees, four of whom joined the company during the year – including a new recruit to the compliance unit. There were no departures from the Fund during the year. The rate of sickness absence was 1.2% and no staff members were absent for more than 60 consecutive days because of illness.

AP3 has a relatively small and focused administrative staff. Some operations, such as IT support and computer maintenance, are outsourced, while settlements and portfolio reporting are handled by AP3's global custodian. One important project that began during the year was the procurement of a new portfolio system. The objective was to identify a system that met the Fund's high demands on flexibility and reliability and also capable of handling the ever-growing range of new financial instruments. All AP3's business units were involved in the process of performance specification, testing and evaluation. The purchase is expected to be finalised at the start of 2004 and implementation work will begin immediately thereafter.

The purchase of a new performance analysis system

Figure 3
Number of employees for the Fund's operating functions at Dec. 2003



was also finalised during the year, with the choice falling on PEARL, a system produced by the Dutch software consultants Ortec. PEARL is specially designed for pension funds and is used by some of the largest Dutch funds. It will expand the level of detail and improve the security and reliability of the Fund's portfolio performance analysis.

The Fund strives to implement a decentralised investment process with well defined decision points. This structure creates a strong need for detailed performance attribution analysis, which allows exact measurement of risk and return for every decision point. The adoption of the PEARL system, which is expected to be fully operational in the first quarter of 2004, is a core element of this strategy.

Like most fund managers, AP3 engages in securities lending whereby it conducts short-term lending of equities and bonds to counterparties with high creditworthiness and that provide full collateral. Total revenue from securities lending in 2003 amounted to SEK 35.1 million (27.2). This revenue is reported as interest income in the income statement.

Table 5
Revenue from securities lending in 2003

SEK million	2003	2002
Bonds	1.6	1.1
Equities	33.5	26.1
Total	35.1	27.2

Corporate governance

AP3 made a conscious decision to invest more time and resources in corporate governance issues in 2003. At the end of 2002 the Fund recruited an equity portfolio manager whose remit included strengthening AP3's corporate governance activities. Moreover, a special team was formed that meets once a week to co-ordinate corporate governance positions and strategies, and the Fund also

hired a newly started consultancy firm, Nordic Investor Services, to assist in preparing materials and information in advance of annual general meetings.

AP3 also took further steps to promote transparency in its corporate governance activities. Together with its first-half results, the Fund published a report on corporate governance initiatives it had undertaken in connection with the annual general meeting season during the first half of the year. The intention is to publish similar reports in future years.

In October, the Board approved a new and revised corporate governance policy that included an extension of the section on environmentally and socially responsible investment. AP3 has chosen to enforce legal requirements pertaining to environmental and ethical standards via a policy of active shareholder engagement. As part of our efforts we enlisted support from Core Ratings, a UK ethical research firm.

See page 8 for more information on AP3's corporate governance activities.

Broker selection in securities transactions

AP3 attaches great weight to ensuring that clear principles are observed when allocating securities trades between brokerage houses. For its equity, fixed income and currency management the Fund assesses and ranks brokerages according to various criteria, for instance the quality of their investment analysis. The rankings are used as the basis for allocating trading volumes. The brokers that received the largest commissions from AP3's internal equity management operations and highest fixed income and currency volumes are listed below.

Table 6
Brokerage houses that received the largest commissions from AP3's equity management and rebalancing activities in 2003 (in alphabetical order)

Citigroup
Enskilda Securities
Goldman Sachs
NeoNet
UBS

The above brokers received approximately 52% of total brokerage commissions. Total commissions in 2003: SEK 31.7 million
Total no. of brokers for equities trading in 2003: 26

Table 7
Brokerage houses that handled the largest volumes from AP3's fixed income and currency management operations in 2003 (in alphabetical order)

Deutsche Bank
Goldman Sachs
JP Morgan
SEB
UBS

Tables

PORTFOLIO OVERVIEW

Table 1

Market value per main asset class³

SEK billion	31 Dec 2003	30 Jun 2003	31 Dec 2002	30 Jun 2002	31 Dec 2001	30 Jun 2001	01 Jan 2001
Equities							
Sweden	23.8	21.8	19.4	20.4	23.8	22.1	33.1
Europe	25.8	23.3	21.5	23.1	22.5	21.6	1.7
Rest of the world	31.2	28.5	26.7	27.0	22.1	24.3	1.7
Total equities	80.8	73.6	67.6	70.5	68.4	68.0	36.5
Fixed income							
Sweden, nominal	21.5	18.3	15.1	18.8	18.5	19.9	45.9
of which AP Fastigheter's debt financing	-4.1	-4.3	-4.6	-4.7	-4.7	-4.8	-4.9
Sweden, index-linked	10.2	9.6	9.8	10.4	9.5	9.5	9
Europe	15.7	13.3	10.7	6.9	15	14.4	0
Rest of the world	7.0	7.3	8.8	11.7	12.8	11.3	0
Total fixed income	54.4	48.5	44.4	47.8	55.8	55.1	54.9
Real estate¹	7.3	7.6	8.2	8.3	8.5	8.6	8.3
of which shares in AP Fastigheter	3.2	3.3	3.6	3.6	3.8	3.8	3.4
of which AP Fastigheter's debt financing	4.1	4.3	4.6	4.7	4.7	4.8	4.9
Cash²	0	0	0	0	0	0	34.3
Total	142.5	129.7	120.2	126.6	132.7	131.7	134.0

¹ 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.

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

³ Notes 1 and 2 mean that the tables are not fully comparable with the balance sheet.

Table 2

Index structure

Main asset class	Benchmark index
Equities	
Sweden	SIXRX (SIX Return Index)
Europe	FTSE AW Developed Europe HSBC European Smaller Companies Index, ex Sweden
Rest of the world	FTSE AW North America FTSE AW Developed Asia Pacific Russell 2500, ex REITs
Fixed income	
Sweden	Merrill Lynch Swedish Government Bonds Handelsbanken's index for mortgage bonds
Europe	Merrill Lynch EMU Direct Government Index Merrill Lynch Jumbo Pfandbriefe Index Merrill Lynch UK Gilts Index Merrill Lynch GBP Corporates Large Cap Index
Rest of the world	Merrill Lynch US Treasury Master Merrill Lynch US Agencies Bullet Structures Merrill Lynch US Corporate Large Cap
Index-linked bonds	Merrill Lynch Swedish Inflation-Linked Government Bonds

Table 3

Manager structure

	Internal SEK bn	Share, %	External SEK bn	Share, %	Total SEK bn	Share, %
Active management	97.4	68	17.4	12	114.8	80
Passive management	4.0	3	23.7	17	27.7	20
Total	101.4	71	41.1	29	142.5	100

Table 4

Reference and current portfolios³

%	Portfolio weighting	Reference portfolio weighting	Active weighting
Equities			
Sweden	16.7	16.1	0.6
Europe	18.1	17.7	0.4
Rest of the world	21.9	21.2	0.7
Total equities	56.7	55.0	1.7
Fixed income			
Sweden, nominal	15.1	16.2	-1.1
Sweden, index-linked	7.2	7.6	-0.4
Euro zone	9.2	7.5	1.7
UK	1.8	1.5	0.3
USA	4.9	7.1	-2.2
Total fixed income	38.2	39.9	-1.7
Real estate¹	5.1	5.1	0.0
Cash²	-	-	-
Total	100.0	100.0	0.0

¹ 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.

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

³ Notes 1 and 2 mean that the tables are not fully comparable with the balance sheet.

Table 5

Permitted deviations from the reference portfolio

	Reference portfolio weighting, %	Permitted deviation in % points
Equities		
Sweden	16.1	± 5
Europe	1.7	± 5
Rest of the world	21.2	± 5
Total equities	55.0	± 7
Fixed income		
Sweden, nominal	16.2	± 5
Europe	9.0	± 5
USA	7.1	± 5
Total fixed income	32.3	± 7
Index-linked bonds	7.6	± 4
Real estate	5.1	± 4
Cash	0.0	± 4
Foreign currency exposure¹		± 20

¹ Refers to the reference portfolio's currency hedge ratios for equities.

Figure 1

Return on fund capital since inception



PERFORMANCE AND RISK

Table 6
Return and risk for total portfolio (before expenses and excl. real estate)

%		2003	2002	2001	Since start	
					Annualised	2001 Accumulated
Return	Portfolio	17.2	-12.9	-4.4	-0.8	-2.5
	Index	17.3	-13.5	-4.6	-1.1	-3.2
	Active	-0.1	0.6	0.2	0.3	0.7
Risk (standard deviation)	Portfolio	8.6	12.5	11.2	10.9	
	Index	8.5	12.6	10.9	10.8	
	Active	0.9	0.8	1.0	0.9	
Information ratio		neg	0.7	0.2	0.3	
Sharpe ratio		1.6	neg	neg	neg	

Table 7
Active return per main asset class. Internally and externally managed assets (in SEK, excluding hedging)

%	Portfolio	Index	Active
Equities	17.0	18.7	-1.7
Sweden	31.9	34.2	-2.3
Europe	13.8	15.5	-1.7
Rest of the world	8.8	9.7	-0.9
Fixed income	1.6	1.1	0.5
Nominal	0.5	-0.2	0.7
Index-linked	6.2	6.4	-0.2
Total liquid assets (excl. real estate and private equity)*	17.2	17.3	-0.1
Real estate	-4.6		
Unlisted shares	-4.3		
Total*	16.4		

* Including currency hedging

Figure 2
Active return

Accumulated return on AP3's liquid portfolio (equities and fixed income) compared to the reference index since inception in 2001.



* The active return for January-June 2003 was adjusted downward by 0.2 percentage points from the figure stated in the interim report for the first six months of 2003.

Table 8
Performance attribution for the market listed portfolio

Portfolio	17.2
Reference portfolio	17.3
Active return, before expenses	-0.1
of which	
contribution to active return	
Tactical asset allocation	0.2
Swedish and foreign fixed income	0.2
Foreign exchange	0.1
External mandates	0.0
European equities (internally managed)	-0.2
Swedish equities	-0.3
Other	-0.1
Expenses	-0.1
Total active return after expenses	-0.2

PRIVATE EQUITY

Table 9
Investments in unlisted shares

AP3's investment commitments and investments in private equity via venture capital companies and funds were as follows on 31 December 2003. All amounts are stated in millions and in local currencies.

Fund/venture capital company	Currency	Total commitment, million	Invested amount million ¹	Distributions
Swedestart Tech	SEK	80	29	0
Swedestart Life Science	SEK	50	18	0
GS Vintage Fund II	USD	25	8	0
HIPPEP IV – European Venture Partnership	EUR	20	2	0
Litorina Kapital 2001	SEK	150	33	0
EQT Scandinavia I ²	SEK	180	155	108
Legal General Venture 2	GBP	7	5	0
Candover 2001 Fund	EUR	25	13	0
Vision Capital III	USD	10	3	0
PETP III (Adveq)	USD	20	4	0
Warburg Pincus Private Equity VIII	USD	35	13	2
InnKap 1 – Bure ²	SEK	60	57	0
InnKap 2 ²	SEK	95	68	0
Carnegie BiotechBridge Fund	EUR	5	5	0
Legal General Venture 3	GBP	5	1	0
CapMan Equity VII B	EUR	20	9	0
IT Provider Fund IV	SEK	200	13	0
InnKap 3 ²	EUR	14	4	0
Paul Capital Partners Top Tier Inv. II	USD	30	5	0
European Secondary Development Fund III	EUR	15	2	0
Altor 2003 Fund	EUR	25	5	0
Polder – Greenpark Co-Investment	EUR	10	5	4
Electra European Fund ²	EUR	20	9	0
Crown Private Equity				
European Buyout	EUR	26	3	0
Auda Secondary Fund	USD	15	3	0
Rhône Offshore Partners II	USD	20	4	0
Four Seasons Venture IV	NOK	100	73	0
GS US Middle Market Buyout Fund	USD	80	1	0

¹ Relates to the de facto amounts invested or received by AP3, excluding investment commitments acquired on the secondary market. Amounts stated correspond to the total investment sum during the life of the particular commitment, i.e. amounts invested by AP3 and previous shareholders.

² Holdings acquired on the secondary market.

EXTERNAL MANAGEMENT

Table 10

External mandates 31 Dec. 2003

Equity mandates

Managers	Reference index	Market value 31 Dec 2003 (SEK m)	Starting date of mandate	Active/ Passive
Merrill Lynch Investment Managers	FTSE All-World North America	17,332	02 Jan. '01	Passive
Merrill Lynch Investment Managers	FTSE All-World North America	3,835	02 Sep. '02	Semi-passive
State Street Global Advisors	FTSE All-World Developed Europe	6,363	03 Jan. '01	Passive
Capital International Ltd	FTSE All-World Japan	2,395	02 Aug. '02	Active
Schroders Investment Management	FTSE All-World Japan	1,477	01 Aug. '02	Active
JP Morgan Fleming Asset Management	FTSE All-World Developed Asia Pacific (ex. Japan)	932	02 Aug. '02	Active
Axa Rosenberg Investment Management Ltd	Russell 2500 (ex. REITs)	1,744	01 Jun. '03	Active
Batterymarch Financial Management Inc	Russell 2500 (ex. REITs)	1,844	01 Jun. '03	Active
Kempen Capital Management	HSBC European Smaller Companies Index (ex. Sweden)	578	01 Sep. '03	Active
Axa Rosenberg Investment Management Ltd	HSBC European Smaller Companies Index (ex. Sweden)	1,041	01 Sep. '03	Active
JP Morgan Fleming Asset Management	HSBC European Smaller Companies Index (ex. Sweden)	602	01 Sep. '03	Active
Pictet	HSBC European Smaller Companies Index (ex. Sweden)	615	01 Sep. '03	Active

Fixed income mandates

Managers	Reference index	Market value 31 Dec 2003 (SEK m)	Starting date of mandate	Active/ Passive
Prudential Investment Management	Merrill Lynch USD Corporate Large Cap	720	03 Jun. '02	Active
Prudential Investment Management	Merrill Lynch US High Yield BB-B Rated Constrained Index	575	15 Apr. '03	Active

Managers that have signed contracts with AP3. These managers may be assigned future management mandates.

Equities

Japan

Deutsche Asset Management
Fidelity Pensions Management
JP Morgan Fleming Asset Management
Morgan Stanley Investment Management
Nomura Asset Management

Asia Pacific

APS Asset Management
Baring Asset Management
Credit Agricole Asset Management
Fidelity Pensions Management
Schroder Investment Management

Europe small/midcap

BNP Paribas Asset Management
Morgan Stanley Investment Management
Scottish Widows Investment Partnership

USA small/midcap

Dimensional Fund Advisors
Harris Investment Management
Mazama Capital Management
New Amsterdam Partners
Times Square Capital Management

Global index management

Barclays Global Investors

Fixed income

US corporate bonds

BlackRock International
Western Asset Management

Table 11

Return on externally managed assets¹

Asset class	Type of management	Region	Fund manager	Assets under management, SEK bn., 31 Dec 2003	Portfolio return, %	Benchmark return, %	Active return, %	Comments
Equities								
Passive								
		North America	Merrill Lynch	17.3	29.3	29.4	-0.1	
		Europe	State Street	6.4	16.0	16.3	-0.3	
Semi-passive								
		North America	Merrill Lynch	3.9	28.4	29.4	-1.0	
Active								
		Europe	Pictet	0.6	11.5	7.4	4.1	Start 1 Sept. 2003
		Europe	Axa Rosenberg	1.0	5.2	7.4	-2.2	Start 1 Sept. 2003
		Europe	Kempen	0.6	4.4	7.4	-3.0	Start 1 Sept. 2003
		Europe	JP Morgan	0.6	9.3	7.4	1.9	Start 1 Sept. 2003
		North America	Axa Rosenberg	1.7	27.2	27.0	0.2	Start 1 June 2003
		North America	Batterymarch	1.8	28.7	27.0	1.7	Start 1 June 2003
		Japan	Capital	2.4	26.5	23.5	3.0	
		Japan	Schroders	1.5	13.9	23.5	-9.6	
		Asia Pacific	JP Morgan	0.9	55.7	46.1	9.6	
Fixed income								
Active								
		USD	Prudential	0.7	11.7	8.7	3.0	
		USD	Prudential	0.6	11.5	10.1	1.4	Start 15 Apr. 2003
Return all active external mandates²				12.5	12.6	12.5	0.1	

¹ In local currency.

² Return in SEK, excluding currency hedging.

Income Statement and Balance Sheet

Income Statement

SEK million	2003	2002
Operating revenues		
Dividends received	1,918	1,547
Net interest items	2,661	3,169
Net capital gains	-2,958	-6,899
Net exchange rate gains	-764	-1,322
Net unrealized changes in value	19,136	-13,832
Total operating revenues	19,993	-17,337
Operating expenses		
External management expenses	-110	-46
Staff expenses	-63	-71
Other administrative expenses	-62	-60
Total operating expenses	-235	-177
NET INCOME	19,758	-17,514

Balance Sheet

SEK million	31/12/2003	31/12/2002
ASSETS		
Investment assets		
Shares and participations:		
Listed	78,584	59,922
Unlisted	4,303	4,157
Bonds and other interest-bearing assets	54,476	50,714
Derivatives	2,855	1,605
Total investment assets	140,218	116,398
Receivables and other assets		
Cash and bank balances	1,492	3,233
Other assets	35	43
Prepaid expenses and accrued revenues	1,172	868
Total receivables and other assets	2,699	4,144
TOTAL ASSETS	142,917	120,542
FUND CAPITAL LIABILITIES		
Fund capital		
Opening fund capital	120,211	132,724
Net payment from pension system	2,143	1,984
Transferred from phase-out funds	424	3,017
Income for the year	19,758	-17,514
Total fund capital	142,536	120,211
Liabilities		
Derivatives	274	194
Other liabilities	44	92
Accrued expenses and prepaid revenues	63	45
Total liabilities	381	331
TOTAL FUND CAPITAL AND LIABILITIES	142,917	120,542

Board of Directors



From left to right:

Karin Kronstam

Director of GF Konsult, Lernia, Proliva, Svolder and TurnIT. Chairman of the investment committees of the Foundation for Technology Transfer in Göteborg and of Corporate Governance i Sverige AB. Former CEO of Samhall Gotia.

Christer Romilsson

Chairman of the Public Employees' Negotiation Council and Deputy Chairman of Folksam SAK. Member of the Board of Nationalmuseum. Former President of the Swedish Teachers' Union and Deputy Chairman of the Swedish Confederation of Professional Employees.

Dag Sehlin

Director of Carnegie Investment Bank AB, Exact Funds AB, Proact IT Group, Utfors and VPC. Chairman of BTS Group. Former Deputy CEO, CFO and Acting Group President of Postkoncernen and Deputy CEO of OM Gruppen.

Dan Andersson

Chief Economist of the Swedish Trade Union Confederation and director of AMF Pension. Chairman of the Trade Union Institute for Economic Research. Former Undersecretary of State at the Ministry of Industry, Employment and Communications.

Christina Liffner

Director of Sveaskog, Swedish Exportkredit, SJR and Vin & Sprit. Chairman of Svensk Adressändring and Deputy Chairman of the Swedish Athletics Association. Former Deputy CEO and CFO of AssiDomän.

Claes de Neergaard, *Chairman*

Chairman of the Nordic Investment Bank and GuarantCo Ltd. First Deputy Chairman of the Swedish Export Credits Guarantee Board. Director of Access Capital Partners SA, the Emerging Africa Infrastructure Fund, Kaupthing Bank Sverige AB and the Swedish Export Credit Corporation. Former Deputy CEO of the European Investment Bank and Executive Director of the European Bank for Reconstruction and Development.

Harriet Piscator

Head of Group Function Finance at ABB Sweden. Former Director of Administration at ABB Treasury Centre Sweden.

Rolf Andersson, *Deputy Chairman*

Director of Research at the Swedish Municipal Workers' Union. Member of the Board of the Trade Union Institute for Economic Research.

Employees

Here is a presentation of all 45 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 Head: Bengt Hellström
Administration Head: Sven Askenberger	CEO: Tomas Nicolin	Compliance Officer Mikael Sedolin Joakim Strid
Communications Manager Pernilla Klein	Deputy CEO: Niklas Ekvall	Chief Economist Bengt Hansson
	Quantitative Analysis Head: Erik Valtonen	

AP3 Management



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

Staff positions / ctd.



Pernilla Klein
Communications Manager
Communications and corporate governance
10 years in the financial field
Joined AP3 in August 2000
Previously: Handelsbanken Markets Research, Ministry of Finance

Administration, Accounting



Sven Askenberger
Chief Operating Officer
23 years in the financial field
Joined AP3 in September 2000
Previously: Swedish Industrial Development Fund, Head of Securities Settlement at Gota Bank



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



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

Administration, Accounting / ctd.



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



Kersti Waldenhagen-Taxén
Receptionist
28 years in office administration
Joined AP3 in August 2001
Previously: Företagarhuset/Kontorshotellet, Täby



Erika Westlund
Receptionist and Information
2 years in office administration
Joined AP3 in February 2003

Fixed income and Foreign Exchange Management



Lennart Nordkvist
Head of Fixed Income/FX Management
20 years in the financial field
Joined AP3 in April 2000
Previously: Head of Securities Trading at Stora Financial Services, Head of Fixed Income Management at Wasa

Fixed income and Foreign Exchange Management / ctd.



Jerk Matero
Portfolio Manager
analyst
PhD in mathematics
7 years in the financial field
Joined AP3 in February 2002
Previously: Öhman Fondkommission



Lars Orest
Portfolio Manager
Swedish and foreign fixed income
20 years in the financial field
Joined AP3 in July 2000
Previously: Head of FX Reserve Management at Sveriges Riksbank, Sparbankernas Bank



Mats Wirdefeldt
Portfolio Manager
Short rates
6 years in the financial field
Joined AP3 in January 2002
Previously: SEB Asset Management, SEB Trading

Equities Management



Magnus Eriksson, AFA, CEFA
Head of Equities Management
Equities, corporate governance
22 years in the financial field
Joined AP3 in August 1999
Previously: Catella Kapitalförvaltning, Head of Equities/Deputy CEO at Aragon Fondkommission

Staff positions



Niklas Ekvall
Deputy CEO
Chief Investment Officer
PhD in Finance
Professor of Finance
13 years in the financial field
Joined AP3 in April 1999
Previously: Handelsbanken



Mikael Sedolin
Internal Legal Monitoring and
Compliance Officer
Associate Judge of Appeal
10 years in the financial field
Joined AP3 in December 2000
Previously: Ministry of Finance,
Swedish National Debt Office



Joakim Strid
Compliance Officer
8 years in the financial field
Joined AP3 in May 2003
Previously: Head of Middle Office
and Compliance Officer at Nordea
Securities



Bengt Hansson
Chief Economist
Macro analysis, ALM
PhD in Economics
13 years in the financial field
Joined AP3 in August 2000
Previously: Head of Macro Forecasting
at SEB, Handelsbanken Markets
Research



Sebastian Mossfeldt
Securities administration
10 years in the financial field
Joined AP3 in September 2001
Previously: SEB Fonder



Maria Prinsström
Securities administration
18 years in the financial field
Joined AP3 in August 2000
Previously: Robur Kapitalförvaltning,
ABB



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



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



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



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



Hans Ericsson
Portfolio Manager
Execution fixed income, portfolio
rebalancing
19 years in the financial field
Joined AP3 in October 2000
Previously: Handelsbanken Asset
Management, Head of Fixed Income
Trading at Handelsbanken Markets



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



Mats Andersson
Portfolio Manager Sweden
Banking and financial, Corporate
Governance
21 years in the financial field
Joined AP3 in December 2002
Previously: Head of the Stockholm
office at Deutsche Bank, SG Warburg



Axel Brändström, CFA
Portfolio Manager Sweden and
Europe
Sector Manager, IT hardware
9 years in the financial field
Joined AP3 in January 1999
Previously: Handelsbanken Asset
Management



Per Colleen
Portfolio Manager Sweden
Sector Manager, general industrials,
automotive and basic industry,
medical technology
8 years in the financial field
Joined AP3 in May 1999
Previously: Aros Fondkommission,
H. Lundén Fondkommission



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

Equities Management / *ctd.*



Urban Eriksson
Portfolio Manager
Execution, equities, derivatives,
portfolio rebalancing
18 years in the financial field
Joined AP3 in August 1999
Previously: Head of Equities
Trading at Robur Kapitalförvaltning,
Sparbankernas Bank



Anne-Charlotte Horngard
Portfolio Manager Europe
Sector Manager, retail, equities,
consumer goods
15 years in the financial field
Joined AP3 in April 1993
Previously: Bohusbanken FK, Folksam
Finance Division



Erik Kovacs
Portfolio Manager Europe
Sector Manager, banking and
financials
13 years in the financial field
Joined AP3 in June 2001
Previously: Enskilda Securities,
Government Bank Investment Fund
in Norway



Björn Kvamskog
Portfolio Manager Sweden and
Europe
Sector Strategist
17 years in the financial field
Joined AP3 in September 1999
Previously: Alfred Berg Asset
Management, Head of Equities
management at Handelsbanken Liv

Equities Management / *ctd.*



Ulrika Slåne Sens, AFA, CEFA
Portfolio Manager Europe
Sector Manager, pharmaceuticals and
medical technology
15 years in the financial field
Joined AP3 in February 1999
Previously: Head of Research at Aros
Fondkommission, Enskilda Securities,
Carnegie



Eskil Svensson
Portfolio Manager Sweden and
Europe
Sector Manager, telecommunications
and media
15 years in the financial field
Joined AP3 in May 2000
Previously: Alfred Berg Asset
Management, Alfred Berg
Fondkommission

External Management



Bengt Hellström
Head of External Management
Portfolio Manager
19 years in the financial field
Joined AP3 in October 2000
Previously: EQT Partners, Investor



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

External Management / *ctd.*



Cecilia Sved
Portfolio Manager
13 years in the financial field
Joined AP3 in December 2002
Previously: Länsförsäkringar
Kapitalförvaltning, Wasa Kapitalför-
valtning



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

Quantitative Analysis



Erik Valtonen
Head of Quantitative Analysis
ALM and risk
PhD in mathematics
14 years in the financial field
Joined AP3 in May 2000
Previously: Head of Financial
Research at Handelsbanken Markets



Mattias Bylund
Analyst
Risk and performance
2 years in the financial field
Joined AP3 in August 2002

Quantitative Analysis / *ctd.*



Gunnar Dahlfors
Analyst
Risk budgeting
PhD in finance
10 years in the financial field
Joined AP3 in February 2003
Previously: Head of risk management,
DnB kapitalförvaltning/Skandia kapital-
förvaltning, Handelsbanken Markets
Financial Research



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



David Stillberger
Analyst
Risk and performance
3 years in the financial field
Joined AP3 in July 2001



Claudia Stanghellini
Analyst
ALM and risk
7 years in the financial field
Joined AP3 in May 2002
Previously: Sun Life Financial



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