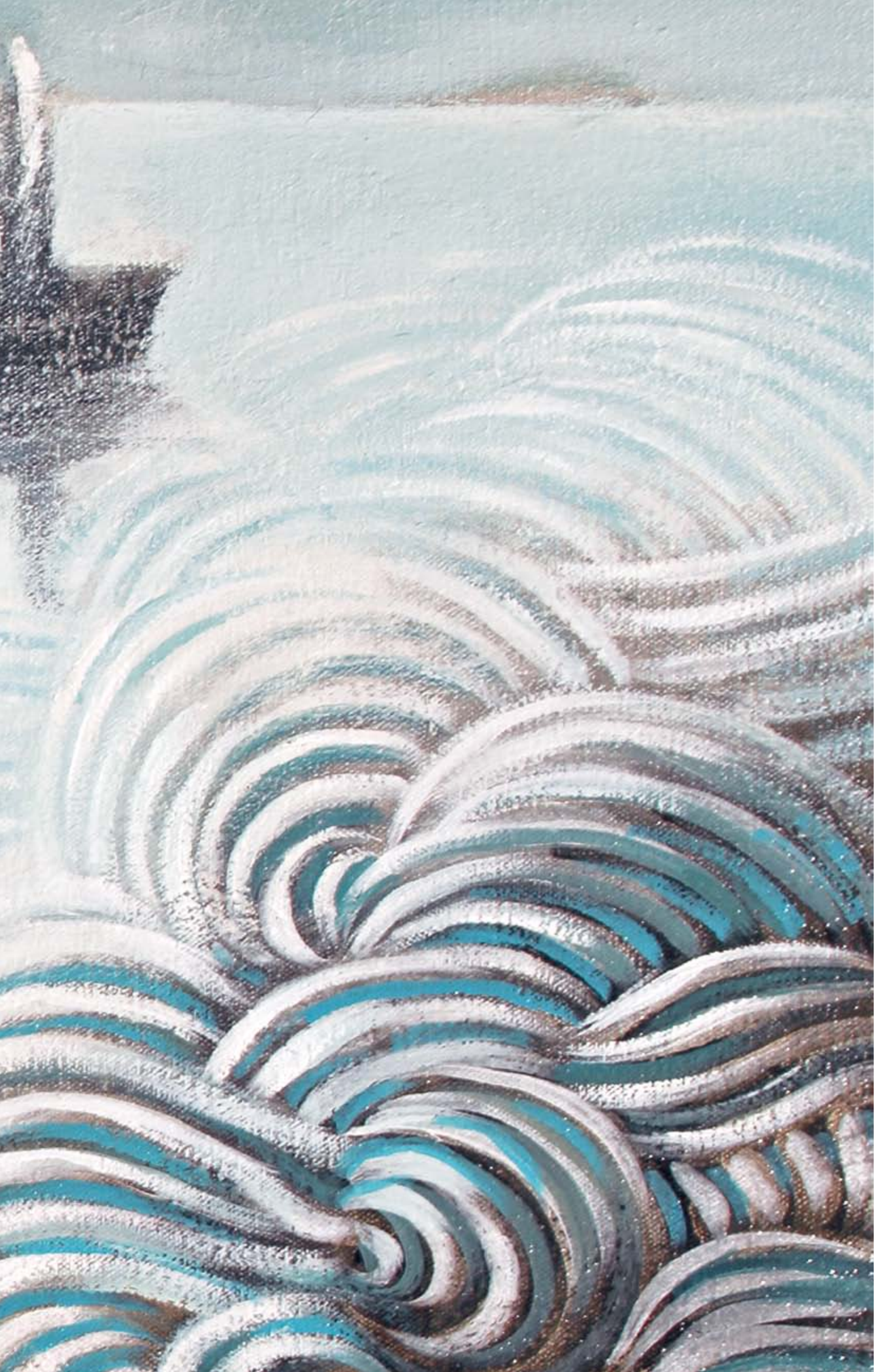
VER

VALTION ELÄKERAHASTO
STATENS PENSIONSFOND
THE STATE PENSION FUND

# ANNUAL REPORT 2011



# Contents

# Responsible Pension Investor

## The State Pension Fund

The State Pension Fund VER is a fund external to the State budget, established in 1990, whose proceeds the Finnish state uses to prepare for the financing of future pension liabilities and the balancing of pension costs. VER is an investment organisation with the task of managing and investing the assets allocated to it by the state. VER's investment portfolio's market value was EUR 13.7 billion at the end of 2011.

Employers and employees covered by the State Pension Scheme make pension contributions to VER. All state pensions are paid out from appropriations made for that purpose in the national budget.

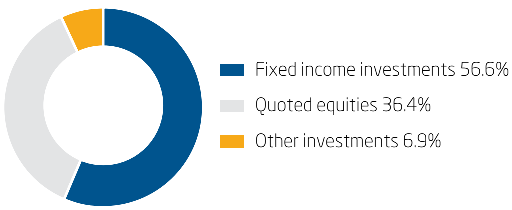
## Mission

VER manages the assets entrusted to it for the long term. VER ensures that its investments are secure, deliver a high return, can be converted into cash, and are appropriately diversified and spread.

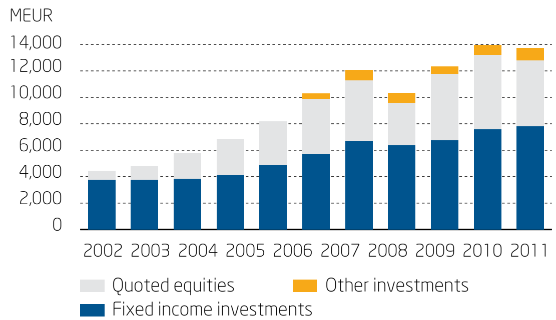
## Vision

VER is a respected and successful pension investor, emphasising outstanding professional skills and ethics in all aspects of its operations.

Distribution of VER's investment portfolio on 31 Dec 2011




Development of VER's investments 2002-2011



# VER 2007-2011

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Total investments (MEUR) | 12,051 | 10,359 | 12,318 | 13,937 | 13,736 |
| Fixed-income investments (MEUR) | 6,707 | 6,400 | 6,765 | 7,574 | 7,781 |
| Fixed-income investments (%) | 56% | 62% | 55% | 54% | 57% |
| | | | | | |
| Equity investments (MEUR) | 4,584 | 3,183 | 5,024 | 5,632 | 5,006 |
| Equity investments (%) | 38% | 31% | 41% | 40% | 36% |
| | | | | | |
| Other investments (MEUR) | 760 | 777 | 529 | 731 | 948 |
| Other investments (%) | 6% | 7% | 4% | 5% | 7% |
| | | | | | |
| Income from investment operations (%) | 1.8 | -15.8 | 16.4 | 11.7 | -2.3 |
| Fixed-income investments | 1.8 | 4.4 | 8.0 | 3.9 | 4.1 |
| Equity investments | 0.7 | -42.8 | 38.7 | 23.6 | -12.3 |
| Other investments | 9.5 | -11.2 | -14.7 | 8.6 | 6.1 |
| | | | | | |
| Operating expenses (% of average capital) | 0.04 | 0.04 | 0.05 | 0.05 | 0.05 |
| | | | | | |
| Personnel | 16 | 18 | 19 | 19 | 20 |
| | | | | | |
| Income from pension contributions (MEUR) | 1,542 | 1,597 | 1,640 | 1,622 | 1,614 |
| | | | | | |
| Net premiums (MEUR) | 1,544 | 271 | 216 | 154 | 104 |
| Transfer to state budget (MEUR) | 3,5 | 1,331 | 1,427 | 1,473 | 1,509 |
| Balance sheet total (MEUR) | 11,165 | 11,503 | 12,049 | 12,763 | 13,087 |
| Pension liability (MEUR) | 82,700 | 85,600 | 88,400 | 90,600 | 92,500 |
| Funding rate percentage* | 15% | 12% | 14% | 15% | 15% |

* Investments / pension liability

Managing Director's Review, 2011

# Year Coloured by the Euro Crisis

2011 was a challenging year for European countries. The market's confidence in their ability to fund their operations was shaken. There was turmoil on the market, with violent fluctuations. In these circumstances, investors sought safe havens for their investments in Europe, but also looked for new return opportunities in other continents.

The State Pension Fund (VER) managed its investment operations relatively well amid this turbulence. The return on its fixed-income portfolio was 4.1 per cent. In terms of its fixed-income investments, VER continued, as in 2010, to reduce the weighting of Southern European sovereign bonds. If faith and confidence in the finances, budgetary balance and debt management of those states is restored, VER may well return to increasing these investments at a later stage.

Europe has a lot of room for improvement in its crisis management mechanisms. The responsibility for this lies primarily with the national governments, but also with pan-European institutions. Certain flaws in the system did not become apparent until the crisis hit. Investors hope that confidence in the European system can be restored.

VER has 88 per cent of its fixed-income investments and 63 per cent of its equity investments in Europe, where the investment market is now awaiting new economic growth. Current economic forecasts are not encouraging, however.

## Interest in emerging markets

VER has gradually increased its investments in areas outside of Europe. By the end of 2011, the weighting of emerging markets had grown to 10 per cent within VER's fixed-income investments and 16 per cent within equity investments. As developing countries undergo social and economic reforms, their investment markets are experiencing constant flux and transformation. Investment targets fluctuate more sharply there than in more developed economies. Although greater growth is expected from the emerging markets, it is risky to allow their weighting to rise too high in the investment portfolio.

Short and long-term currency fluctuations also have an impact on the success of national economies and returns on investment. A weaker currency can improve

> *VER was able to take advantage of the 2008/2009 financial crisis by being a significant net buyer of shares and corporate bonds.*

a country's competitiveness, but predicting foreign exchange fluctuations is very challenging and always entails surprises.

VER has decided to hedge its investments against currency risks, at least partly. If an investment target, such as a real estate fund, is expected to produce relatively stable returns, it is mostly hedged against currency risk. This is to prevent currency risk from dominating returns from the underlying investment target as the invested amount grows.

## Crises as an opportunity for investors

The 2008 financial crisis and the 2011 bond crisis were also an opportunity for long-term pension investors. VER was able to take advantage of the 2008/2009 financial crisis by being a significant net buyer of shares and corporate bonds. This proved to be a wise decision, as there was a significant rise in both markets for the next two years.

The 2011 eurobond crisis was of a different nature. VER was a net seller on the equity market in early 2011 and a net buyer in the latter half of the year. If the crisis deepens, it could weaken economic prospects and growth. A swift solution to the problematic countries' debt crisis is needed to prevent uncertainty from turning into a recession.

## Population developments weaken prerogatives for economic growth

The development of the population structure in Finland and the rest of Europe is unfavourable. The working-age population is shrinking, while the proportion of older members of society is rising. The dependency ratio is becoming disadvantageous, putting pressure on European states and their economic growth. Population growth is one of the drivers of economic growth.

In Finland, more people are leaving the job market than joining it. For pension companies, this means a reduction in premium incomes. At the same time, the components of economic growth in Finland are thus declining.

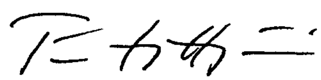
The diminishing base of premium payers puts pressure on pension companies' investment activities. Global diversification of the investment portfolio may be one way to obtain higher growth and returns. The prospects for economic growth are best in countries in which the working-age population is growing and which can make use of technological advances by increasing productivity.

## Future prospects

The decline in the number of state employees in Finland has caused a halt in the growth of VER's premium income. In the next few years, VER's net premiums, i.e. premium income minus transfers to the state budget, will turn negative. VER's target funding ratio of 25 per cent is not expected to be reached until close to the peak year for pension costs, 2030; the delay is due to the impact of changes in the state employment structure. At the start of 2010, some university employees in Finland were transferred from state pensions to the private pension system.

In terms of the investment market and its prospects, the key element is how the euro crisis is managed. The basic pillars of Europe must be in working order. The euro crisis currently poses one of the greatest investment risks worldwide. If it continues, investors will be forced to seek growth and returns elsewhere.

Overall, VER's return for 2011 was -2.3 per cent. Its fixed-income and other investments were clearly positive, but return on equity investments was negative. Despite this, as an organisation, we managed to make an excess return. It was the fourth consecutive year in which the excess return on investment, not including non-liquid investments, was positive. For this I would like to thank our highly professional personnel, who have worked persistently for the benefit of VER's investment operations.



Timo Löyttyniemi
Managing Director
State Pension Fund

# VER: Key Events in 2011

- Return on investments: The total return on the portfolio was -2.3 per cent (11.7 per cent in 2010), comprising fixed-income investments 4.1 (3.9) per cent, listed equity investments -12.3 (23.6) per cent and other investments 6.1 (8.6) per cent.
- The State's pension liability stood at EUR 92.5 (90.6) billion at the year-end. The pension liability will continue to grow in the next few years, but will begin falling in the early 2020s.

## The European Sovereign Bond Crisis

- The European government debt crisis worsened, causing a growing interest difference between Germany and the sovereign bonds issued by Belgium, Spain, Italy and even France.
- The debt crisis weakened global economic prospects.

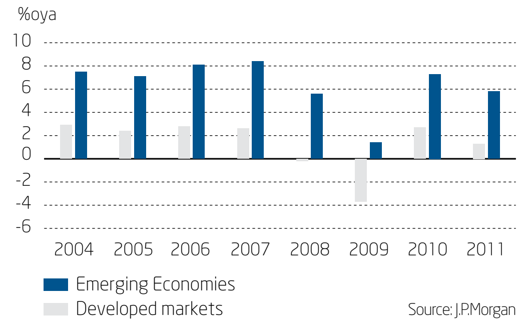
## Rise in Emerging Markets

- The importance of the emerging markets grew in the investment market.
- 10 per cent of VER's fixed-income investment and 16 per cent of its equity investments are in emerging markets.

## Responsible Investment

- In the summer, VER signed the United Nations' Principles for Responsible Investment (UNPRI). VER must therefore abide by the principles in its process for making investment decisions and ownership policy, and report on its progress annually to UNPRI.
- VER joined Finland's Sustainable Investment Forum (FINSIF). The purpose of FINSIF is to promote responsible investing, which takes into account matters related to environment, society and corporate governance in financial management and investment decisions.

Real GDP




Source: J.P.Morgan

# Early Optimism Cooled As 2011 Progressed

This was due to some countries' debt problems and related uncertainty concerning the state and development of the financial system, especially in the euro area.

## The global economic outlook weakened remarkably in the course of 2011

The international economic turmoil had its roots in the financial crisis of recent years, the preceding increase in consumer debt, and the subsequent strong increase in public debt. Geopolitical uncertainty grew during the spring with the popular uprisings in North Africa.

Economic growth in the euro area slowed down radically in 2011, turning negative in the last quarter. For the year as a whole, economic growth was only 1.5 per cent in Europe. The trend in the United States was the opposite, with growth significantly below the euro zone's level at the beginning of the year but showing clear acceleration later. Total US growth for the year came to 2.0 per cent. In China, the growth rate was maintained above nine per cent for most of the year, with a slight decline towards the end. Still, growth in China for 2011 reached 9.2 per cent.

The global market prices of raw materials declined moderately at the end of the year because of the levelling out of the rapid growth of emerging economies and to an increase in supply. The European Central Bank raised its key interest rates in the spring as inflation accelerated but was forced to lower them later, in line with weakening economic prospects. In addition, the ECB announced new liquidity operations towards the end of the year, offering banks unlimited three year loans against collateral. Meanwhile, in the United States, the Federal Reserve kept its key interest rates at the low levels to which they were reduced during the initial financial crisis.

The government debt crisis increased uncertainty in the market and significantly raised the interest rates – and thereby the debt servicing costs of some countries' sovereign bonds. If the uncertainty continues, it will reduce investments and slow down consumer demand. Continuing unemployment has increased consumer caution and delayed the recovery of private consumption. The high debt level of the private sector has encouraged savings and reduced consumption. The housing market has a major impact on consumer wealth and, consequently, on private consumption. In the United States, private consumption accounts for some 70 per cent of the entire gross domestic product, so any changes in it are critical for economic growth. Economic prospects for the near future are very uncertain, and visibility is low.

## VER's Investment Portfolio

At the end of 2011, VER's investment portfolio had a market value of EUR 13.7 (13.9) billion. At year-end, 56.6 per cent of investments were in fixed-income instruments, 36.4 per cent in equities, and 6.9 per cent in other instruments.

The total return of the investment portfolio for 2011 was -2.3 (11.7) per cent. The return is calculated in accordance with the recommendations of FIN-FSA and the Working Group for Return Calculations of the Finnish Pension Alliance (TELA), as money-weighted return, with the cost of investment operations totalling EUR 6.2 (6.4) million.

## VER's Shareholder Policy

According to the principles of its shareholder policy, VER operates as an independent portfolio investor. VER is a long-term investor and a major shareholder in a number of companies. The companies must ensure that the value of their shares increases in the long term.

VER can best promote the performance of these companies by being a responsible shareholder, who keeps track of their operations as well as their success. In 2011, VER attended the general meetings of 15 Finnish companies. By attending meetings and using its vote, VER can influence matters that are important for the companies and their shareholders.

VER personnel are not involved in the management of listed companies in which the fund has holdings.

## Responsible Investment Promotes Sustainable Development

Through its investment activities, VER strives to comply with the objectives of responsible investment promoted by the UN Principles for Responsible Investment (UNPRI).

When selecting potential investment targets, VER uses sustainable development indices as a basis for comparison. VER's investment decisions are primarily based on expected returns.

## Risk Management

The identification, assessment, limitation and control of risks are key factors in investment operations. It is the task of risk management to ensure that any risks realised do not cause substantial financial losses, endanger the continuity of operations, or weaken the confidence of stakeholders.

The comprehensive risk management plan applied by VER specifies the most important operational risks, risk management objectives and measures, the limits of risk exposure, as well as responsibilities, indicators, and control principles.

In setting the limits for risk exposure, VER's risk-taking and risk-bearing capacity are taken into account. The risk management plan also takes into consideration outsourced operations.

A risk survey was carried out jointly with PwC between 2004 and 2011.

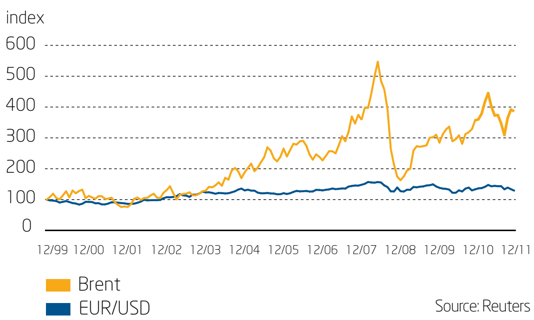
**VER sensitivity analysis, 31 December 2011**

| 31 December 2011 | Change in share price -20% | Change in interest rates +1 percentage pt |
|---|---|---|
| Capital (MEUR)* | 5,006 | 7,781 |
| Effect on capital (MEUR) | -1,001 | -328 |
| In proportion to subportfolio | - 20% | -4% |
| In proprtion to entire capital | -7% | -2% |

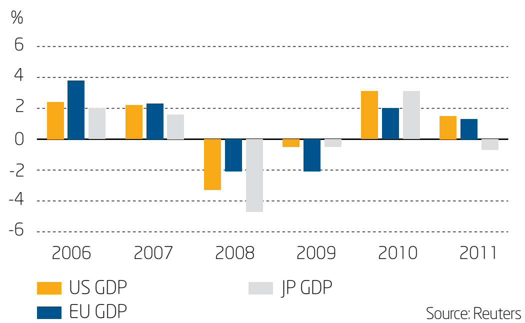
*Listed equity and fixed-income portfolio

*Continuing unemployment has increased consumer caution and delayed the recovery of private consumption. The high debt level of the private sector has encouraged savings and reduced consumption.*

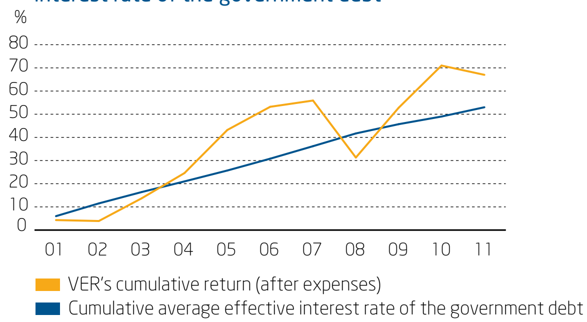
## Brent and euro/dollar exchange rate development (31 Dec 1999 = 100)



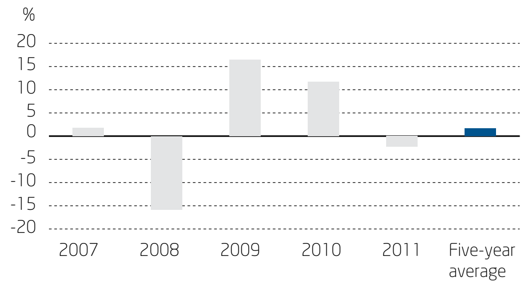

## GDP development in the United States, the eurozone and Japan



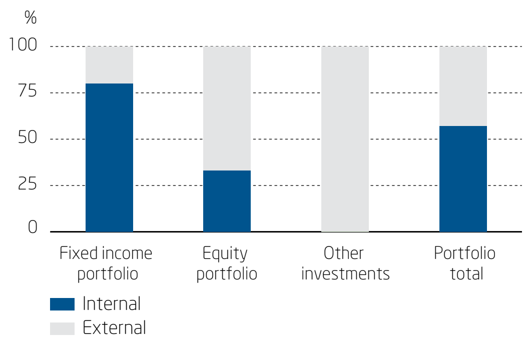

## VER returns on investment vs. average effective interest rate of the government debt



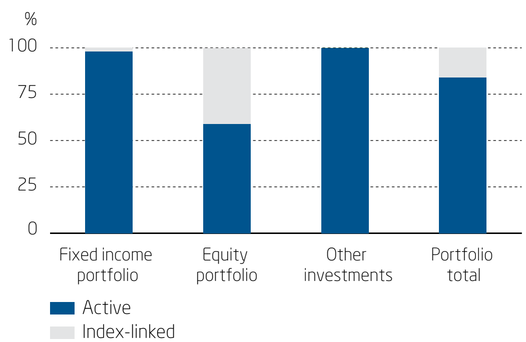

## Return on VER's investment portfolio




## External and internal portfolio management, 31 Dec 2011




## Active, index-linked portfolio management, 31 Dec 2011



# Good Returns from the Fixed-Income Market

Interest rates were up and down in the euro zone in the first few months, but within a small range. Rates began to fall in mid-April and continued doing so through to the end of the year.

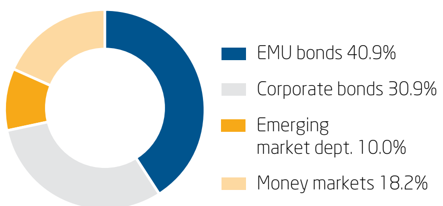
Development was favourable in the core markets until year-end. Interest on Germany's 10-year government loan peaked at 3.50 per cent in mid-April and bottomed out at 1.67 per cent in September. Yield curves were relatively steep at the beginning of the year but flattened out towards the end. The interest difference in relation to German government loans narrowed in the first half, especially for Spanish and Italian sovereign bonds. The favourable development was interrupted in July, however, and the latter countries' interest rates rose sharply for the rest of the year, despite the ECB buying bonds from both countries on the secondary market. Interbank lending was also disturbed by the growing interest difference between secured and unsecured loans and the rising cost of hedging against credit risk.

Principally, VER makes direct-income investments in sovereign bonds, investment-grade corporate bonds, and money-market instruments, while other investments are made through mutual funds. Direct investments accounted for approximately 80.0 per cent (comparative: 84.6 per cent) of the aggregate fixed-income portfolio at the end of the year. There were 269 (256) commitments to fixed-income investments and fund units in 25 (23) funds.

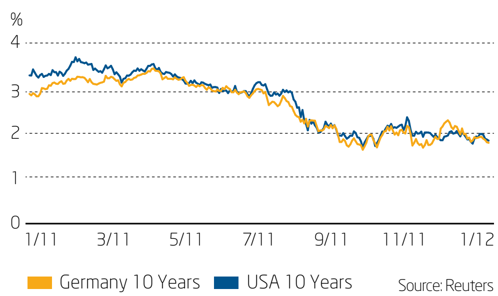
Fixed-income portfolio allocations were modified at the beginning of the year, over-weighting the share of the money markets and correspondingly under-weighting sovereign bonds. In June, the allocation was readjusted, taken in a more neutral direction. At the same time, the proportion of high-risk sovereign bonds was significantly reduced. The Emerging Fixed-Income Markets portfolio was somewhat under-weighted at the end of the year. The duration of the fixed-income portfolio was adjusted within a relatively small range, and at the end of the period it was close to neutral.

At year-end 2011, the interest on VER's fixed-income portfolio totalled EUR 7.8 billion. The fixed income portfolio had good returns, at 4.1 (3.9) per cent. Bonds were bought and sold for a total of EUR 7.64 billion, and money-market investments totalled EUR 3.67 billion.

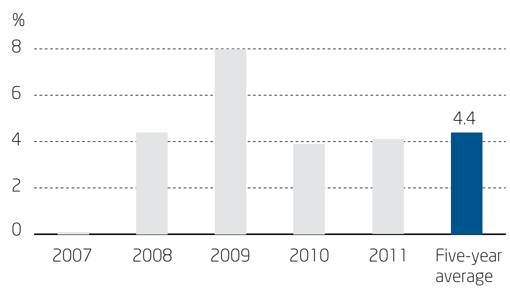
Fixed-income investments by sector 31 Dec 2011




Interest rates




Return on fixed-income investments



# Equity Market Buffeted by Debt Crisis

The still unsolved economic problems in Greece afflicted the financial market throughout the early part of the year, and in the summer the euro crisis began to expand to other indebted states, such as Spain and Italy.

Overall, 2011 was characterised by several exceptional events. Violent uprisings took place in North Africa and the Middle East from the beginning of the year, part of the Arab Spring. In mid March, Japan experienced a tsunami of uncommon magnitude, which caused great damage along the country's east coast. The financial market, on the other hand, was affected by the spiralling euro crisis as well as the lowering of the United States credit rating, which only increased unease. These were some of the reasons for which 2011 was a disappointment for equity investors after two very good years.

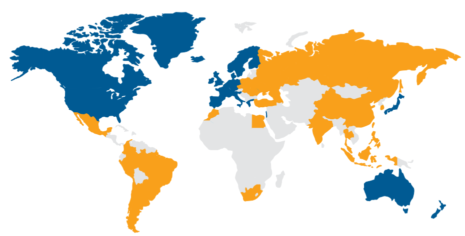
The still unsolved economic problems in Greece afflicted the financial market throughout the early part of the year, and in the summer the euro crisis began to expand to other indebted states, such as Spain and Italy. In combination with the confusion surrounding the raising of the US debt ceiling, this led to a powerful decline of the equity market in early August. With the exception of some brief rebounds, share prices continued to fall until the end of September. In October, the trend gradually broke, and some markets, such as North America, achieved a positive result by year-end.

Returns on the State Pension Fund's equity portfolio, comprising listed shares and fund units, were negative for 2011 at -12.3 (23.6) per cent. The performance of the Helsinki Stock Exchange, in particular, was weak, with returns of about -25 per cent. The only positive return came from the North America sub-portfolio. Small companies performed worse than large ones over the course of the year, especially in Europe.

VER's equity allocation was successful in 2011. Equity risk was reduced in the half of the year, after which the proportion of shares was again increased amid the decline of the equity market in August and September. VER's net purchases of shares in 2011 totalled some EUR 63 million. Equities accounted for 36.4 per cent of VER's overall portfolio at year-end.

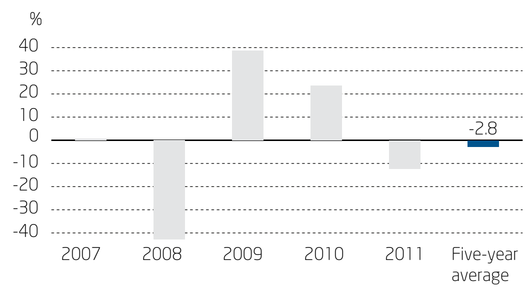
The equity portfolio was managed at a lower risk level than market risk, with a Beta of 0.89. At the end of the year, 67 per cent of VER's equity portfolio was invested through funds and 33 per cent was in direct investments. At that time, VER had direct equity investments in 149 companies and holdings in 60 funds.

Geographic distribution of the equity portfolio
31 Dec 2011

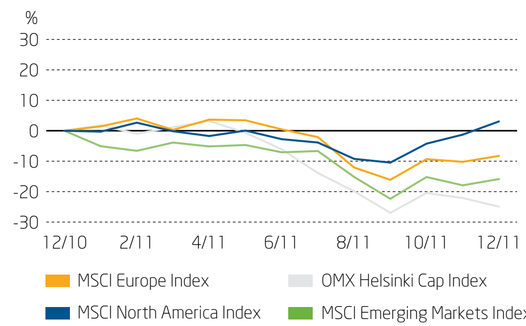



Source: www.MSCI.com

Return on equity investments




Equity market developments in 2011




Source: Bloomberg

# Trend of Positive Return Continued in Other Investments

Despite the instability of the financial market, VER's other investments produced very good returns in 2011. With the exception of absolute-return funds, other asset classes were clearly in the positive.

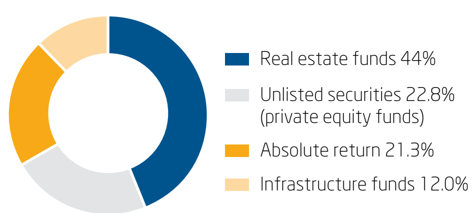
In private equity this was thanks to good exits and the maintenance of relatively high values of companies. Returns in real estate based on positive rental income and rises in property value, grew especially toward the end of the year. The weakening of the euro had a positive impact on real-estate, infrastructure, and absolute-return investments.

Overall, 2011 was an active year for European private-equity funds. New funds were rised, and there were clearly more transactions than in the previous year. In the property market, value increases were seen mainly for good-quality real estate. The market's instability had no effect on cash flow from real estate. As in the previous year, investor interest in absolute-return funds grew, which resulted in a growth in capital for these funds.

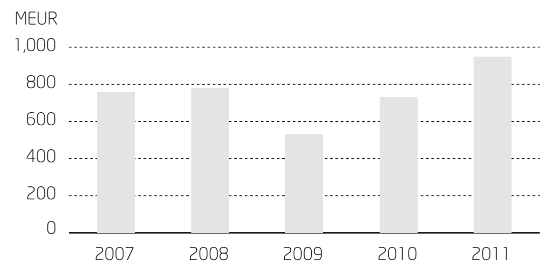
VER's 'other investments' consist of investments in real estate, private-equity and infrastructure funds, and absolute-return funds. At the end of 2011, these other investments made up 6.9 per cent of VER's overall portfolio (up from the previous year's 5.2 per cent), the neutral allocation being seven per cent. The market value of the portfolio was EUR 948.3 (731.4) million. The amount of open investment commitments was EUR 339.7 (315.9) million. Of total invested assets, indirect real-estate investments accounted for 44.0 (39.3) per cent, of which listed real-estate investments made up 1.2 (1.8) percentage points. Private-equity fund investments accounted for 22.8 (26.9) per cent, infrastructure funds for 12.0 (12.0) per cent, and absolute-return funds for 21.3 (21.9) per cent of invested assets.

VER's other investments yielded a total return of 6.1 (8.6) per cent. Private-equity investments had a return of 11.7 (17.8) per cent, infrastructure 8.8 (9.4), real estate 5.8 (6.2), and absolute-return funds -0.6 (6.1) per cent.

Distribution of other investments 31 Dec 2011




Market value of other investments, 2007-2011



# General Investment Principles

## Funding Target

According to the State Pension Act, VER's funding target is 25 per cent of the state's pension liability. VER is to accumulate assets until this target is met. At the end of 2011, the fund's market value was EUR 13.7 billion (comparative: EUR 13.9 billion), making the funding ratio 15 (15) per cent. Reaching of the funding target is affected by investment income, pension contribution income, and transfers to the state budget.

## Principles Governing Investments

VER must ensure that its investments are secure, deliver a high return, can be converted into cash, and are appropriately diversified. Investments have been diversified in a manner similar to that applied in other employment pension schemes.

In its investment operations, VER also complies with international and Finnish principles and recommendations for responsible investment. In the summer of 2011, VER signed the United Nations Principles for Responsible Investment (UNPRI), which emphasise observance of environmental and social responsibility and responsible corporate governance in the making of investments. In addition to these, VER strives to abide by the responsible investment principles of the Finnish Pension Alliance (TELA) and Finland's Sustainable Investment Forum (FINSIF).

| Fixed-income portfolio benchmark indices: | |
|---|---|
| Euro Government Composite Index | 35.0% |
| BarCap Euro Government Inflation-Linked Bond Index | 10.0% |
| BarCap Euro Aggregate Ex Treasury Index | 30.0% |
| JP Morgan EMBI Global Diversified Eur Hedged | 5.0% |
| JP Morgan GMI-EM Diversified Eur Unhedged | 5.0% |
| JP Morgan Cash Index 3 Month Index | 15.0% |
| | 100.0% |

| Quoted equity portfolio benchmark indices: | |
|---|---|
| OMX Helsinki Cap Index | 21.0% |
| OMX Stockholm Benchmark Cap Index | 9.0% |
| MSCI Europe Index | 26.0% |
| MSCI Europe Value Index | 6.5% |
| MSCI North America Index | 15.0% |
| MSCI Japan Index | 7.5% |
| MSCI Emerging Markets Index | 10.0% |
| MSCI AC Far East Ex Japan Index | 5.0% |
| | 100.0% |

| Other investments' benchmark indices: | |
|---|---|
| INREV Index | 46.5% |
| EVCA Index | 26.5% |
| Dow Jones Credit Suisse AllHedge Index | 27.0% |
| | 100.0% |

## VER As a Buffer Fund

State pensions in Finland are paid out from appropriations reserved in the national budget. Instead of paying out pensions, VER transfers an amount equivalent to 40 per cent of the state's annual pension costs to the state budget. The remaining assets are left in the fund. As a so-called buffer fund, VER – unlike TyEL (EPA) pension companies – does not have any pension liabilities to cover individually. Therefore, VER is not subject to regulations governing solvency.

As a long-term investor, VER makes investment decisions on the basis of its required return and the yield potential of prospective investments, taking risk levels into account. Risks are diversified through investment in various categories, markets, industries, instruments, and companies, as well as in bonds issued by different governments and of different maturities. The fund may buy or sell interest-rate and equity instruments. The real-estate, private-equity, infrastructure, and absolute return funds classed as 'other investments' are of a longer-term nature.

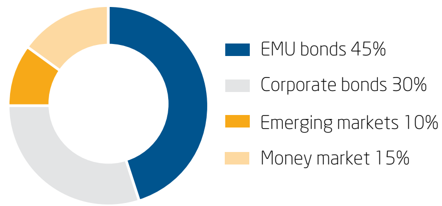
The fund operates as an independent portfolio investor. It does not intervene or otherwise participate in the administration of the companies in which it has holdings, but it does maintain dialogue with their management. In connection with this, VER may appoint fund representatives to General Meetings. In 2011, VER attended the AGMs of 15 Finnish companies. In decisions requiring voting, VER may be able to influence matters that significantly affect the companies and their shareholders. The best way for VER to promote the success of companies in which it has holdings is to be a responsible shareholder.

## The return and profit targets set for the fund in the operation guidelines issued by the Ministry of Finance are as follows:

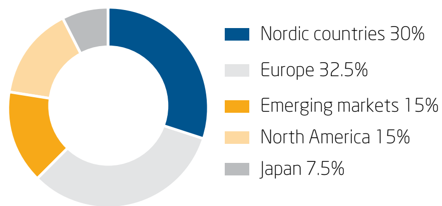
**1. Long-term target return**

In the long term, VER's investment activities must produce a higher return than an investment alternative that would be risk-free from the state's point of view. 'Risk-free alternative' refers to the cost of the state's net debt, including the cost of derivative contracts made as part of debt management. Here, 'net debt' refers to the difference between the state's budgeted debt and cash reserves.

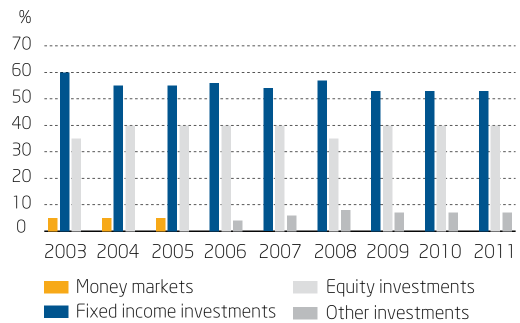
### Neutral allocation of fixed income investments at the end of 2011




### Neutral allocation of equity investments at the end of 2011




### Neutral basic allocation of the investment portfolio



**2. Operational target return**

The return on VER's investment activities, when adjusted for risk, must exceed the return of the benchmark index specified in the fund's investment plan.

**Risk Limits and Neutral Basic Allocation**

The risk limits set by the operation guidelines issued on 13 November 2007 by the Ministry of Finance are as follows:

- fixed-income investments must account for at least 45 per cent of the investment portfolio
- equity investments may not exceed 45 per cent
- other investments may not exceed 12 per cent

The VER annual investment plan defines a neutral basic allocation for the investment portfolio. The goal is to create a portfolio that yields the best possible return in the long run, at the risk level set by the Board. The neutral basic allocation is continuously monitored, and it can be adjusted in accordance with market changes by Board decision, within the given risk limits. Changes to the neutral allocation require adjustments to the fund's investment strategy.

An expected return is calculated for the portfolio annually, based on the prevailing interest rates and the risk premiums for different asset categories. A general risk premium of 4.0 per cent was used for the equity market in the calculations for 2011, making the portfolio's long-term expected return, according to the neutral allocation, 6.3 per cent. The portfolio's expected risk level is also revised each year on the basis of the various asset categories' volatility and correlations.

## Co-operation

The goal of VER is to be a respected and successful pension investor, emphasising outstanding professional skills and ethics throughout its operations. To this end, VER not only conducts successful investment activities but also co-operates with various stakeholder groups. For these purposes, VER actively networks with the management of companies in which it invests, public authorities, Finnish and foreign providers of investor and brokerage services, and other European pension investors.

## Overall Assessment of Operations

The success of investment activities is analysed on a long-term basis, chiefly via consideration of the portfolio from a broad perspective. The performance of fixed-income and equity portfolios, as well as other investment portfolios, is monitored separately. Relative returns are assessed through comparison of returns with benchmark indices listed in the investment plan. If necessary, VER may liquidate losses from its investments, should the prospects for a certain investment suddenly change.

The international GIPS set of standards are applied in the calculation of the fund's returns. This harmonises the various methods of return and risk calculation and renders the figures comparable. Clarity and transparency are emphasised throughout the fund's operations. The responsibilities and roles of personnel responsible for investment activities are clearly defined, improving the controllability of investment activities.

### VER'S INVESTMENT BELIEFS

VER's investing activities are based on certain underlying conceptions about the investment market, the investment process, and the organisation of investing. Because investment beliefs can – and will – change over time, they are reviewed from time to time. Shared beliefs clarify the investment decision process and guide our operations toward successful value-adding investments.

Investment beliefs in the autumn of 2011:

1. Utilising risk premiums enables strategic success.
2. Diversification reduces portfolio fluctuation.
3. Markets are for the most part effective.
4. Long-term investment offers clear benefits.
5. Excess returns come from multiple sources.
6. Organising investments is based on cost-efficiency and utilising our own strengths.
7. Professional personnel and successful selection of outside managers enable success.
8. Operations and investment beliefs are under constant review.

## VER Is Committed to Responsible Investment Operations

VER strives to take into account the principles of responsible investing in its investment operations. For VER, responsibility means considering the environmental and social impact and corporate governance of the investment targets when making investment decisions and managing existing ones.

VER must ensure that its investments are secure, deliver returns, can be converted into cash, and are appropriately diversified. These objectives also apply to non-financial factors; in other words, VER may not invest in targets that deliver poor performance or security within the scope of corporate responsibility.

In spring 2011, VER joined Finland's Sustainable Investment Forum (FINSIF) This is the Finnish contact organisation for the Principles for Responsible Investment (PRI), and its mission is to promote awareness of responsibility within financial management and investment-related decision-making.

In the summer of 2011, VER signed the United Nations PRI, committing to abiding by them in its investment operations. In relation to new investments, compliance with the UNPRI comes in when one is preparing an investment decision. For existing investments, compliance entails monitoring events at the companies and, if necessary, intervening or giving up the investment. The UNPRI require annual reporting from members concerning compliance. The reporting model is extensive and covers six basic principles of responsible investment in great detail.

In addition, VER complies with the recommendations for investment operations of the Finnish Pension Alliance (TELA), whose principles for responsible investment are based on sustainable development, the United Nations Global Compact, and the UNPRI.

### UNPRI

The United Nations Principles for Responsible Investment address ESG matters – i.e., environmental responsibility, social responsibility, and corporate governance – as a part of responsible investment operations. Organisations that commit themselves to the principles are encouraged to:

1. include ESG matters as a part of investment analyses and decision-making,
2. be active shareholders and account for ESG in their ownership policies and practices,
3. promote proper ESG reporting among their investment targets,
4. promote the acceptance and adoption of responsible investment principles in the financial sector,
5. work with others to further the effective application of responsible investment principles, and
6. report on their operations and their progress in complying with the principles for responsible investment.

# The State Pension Security

In 2011, the Finnish State Pension Act covered roughly 160,000 people, of whom 85,000 were state employees.

From the beginning of 2011, execution of the state pension scheme was transferred from the State Treasury to Keva (formerly the Local Government Pensions Institution). The pension expenditure was EUR 3.8 billion and there were more than 350,000 pensioners. Each system will continue to fund its own pension expenditure.

## VER Balances the Financing of Pension Expenditure

The state uses the State Pension Fund to prepare for the financing of future pensions and particularly to balance the upcoming pension expenditure of the baby boom generation.

## The State Pension Scheme as Part of the Finnish Employment Pension Scheme

Thanks to revisions made in 2005, the state pension cover, originally slightly better than the basic cover under the Employees Pensions Act, is on a par with the local government and private sectors. The pension reform also introduced a career model for state pensions, where a pension is calculated on the basis of annual earnings and a growth percentage. A pension is accumulated for work done between the ages of 18 and 68, and an increased growth percentage, known as super-accumulation, encourages 63-year-olds to continue working. Integration of pensions was abolished, which means that the maximum pension accumulation limit of 60–66 per cent no longer exists. The pension reform also means that the life expectancy factor, which is used to prepare for longer life expectancy, will affect the amount of pensions.

## The State and the State Pension Fund

Through the State Pension Fund, the state prepares for financing pensions payable in the future, and to even out pension expenditure on a year-to-year basis. Pension expenditure will increase in the next few years with the ageing of the baby boom generation. The state is responsible for being able to pay the accumulated pensions in the future. With VER's activity, the state is aiming at a 25 per cent funding ratio in proportion to pension liability.

VER is supervised by the Financial Markets Department of the Finnish Ministry of Finance. VER's investment activities are directed by the Board of Directors, appointed by the Ministry of Finance, which includes representatives from both the employers and the employees. VER manages the assets entrusted to it and makes all investment decisions in accordance with the investment plan adopted by the Board of Directors, and with its investment authorisations and set limits.

Some of VER's assets are transferred to the state budget each year. The transfer has been justified by the fact that all state pensions are paid out from budget appropriations, and therefore some of the pension fund's assets can be used for the payment of pensions. The transfer of funds to the state budget has been a crucial factor in regulating VER's growth. The State Pension Act specifies the transferable amount, which is 40 per cent of annual state pension expenditure. By the end of 2011, a total of over EUR 20 billion in VER assets had been transferred to the state budget. In accordance with parliamentary decisions, the transfers of VER assets to the state budget were substantially reduced in 2006 and 2007 in order to allow a greater expansion of the State Pension Fund than in previous years.

## Pension Costs in Relation to Payroll

The proportion of the state's pension expenditure in relation to state payroll will continue to have a sharp growth until the beginning of the 2030s. In 2011, the proportion of pension expenditure of payroll was approximately 57 per cent; it is expected to peak in 2031 at over 85 per cent. After this peak, the proportion will slowly fall up until the end of the 2040s. After the mid-2070s, pension expenditure is expected to stabilise at around 34 per cent of payroll.

Calculated in euros (at the 2011 value), pension expenditure will peak in 2032 (at approximately EUR 5.1 billion). The number of employees covered by the state pension scheme (VaEL) is expected to fall sharply by the mid-2040s, which will also reduce pension expenditure.

In recent years, the new Universities Act has had a particular impact on the number of VaEL employees, as only staff born before 1980 remain within the scope of the state pension scheme. With the reform, in 2010 the number of university employees under the State Pension Act was reduced by 8,700, and it will continue to decrease until Finnish universities no longer employ anyone covered by the state pension scheme. The impact of the Universities Act will not become significantly visible as a saving in state pension expenditure until the mid-2040s. However, as the state payroll decreased, VER's pension contribution income was reduced already in 2010. The pension contribution income of VER is reduced by a reduction in VaEL payroll in universities, local governments and state-subsidised institutes, and by lower growth in the state pay arising from the government productivity programme. According to an estimate by the State Treasury, the growth of VER's pension contribution income will continue to slow down until the late 2040s, after which it will achieve steady growth according to the earnings index.

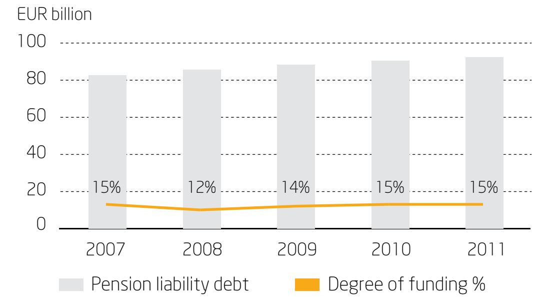
## State's Pension Liability

Pension liability refers to the sum of money and its future return on investment that, calculated at a certain point in time, would cover the future pensions earned by the time of calculation. The liability includes all paid-up pensions (pensions deriving from finished state employment relationships), also for former state employees who have become employees of local governments or private companies or have left state employment due to incorporation of state institutions. Therefore, pension liability always involves an assumption regarding the return on investments. The state's pension liability indicates the cost of the pensions promised by the state to its current and previous employees, at the time of calculation.

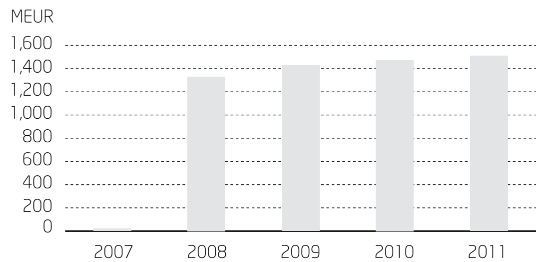
In addition to expected returns, the pension liability calculation includes other assumptions related, for instance, to changes in life expectancy and retirement age, and to how many people are expected to take disability pensions in the future. To calculate pension liability, it is essential to know the accurate sum of pensions accrued until the time of calculation. Because the employed population accumulates a pension each year, new people retire, and people entitled to receive pensions die, the pension liability sum is not constant but is recalculated annually.

The pension liability figure consists of a provision for earned premiums and a provision for unearned premiums. The former refers to the amounts to be paid to people who have already retired – i.e., the capital value of old-age, family, disability, unemployment, and part-time pensions that have already started being paid out. The latter refers to the capital value of pensions accrued by the time of calculation that have not yet begun to be paid out.

### Pension liability debt and degree of funding




### Asset transfer from VER to the state budget



## Calculation of Pension Liability

For the purposes of the financial statements of the state and of the State Pension Fund, pension liability is calculated according to the full funding principle following (where applicable) the calculation instructions provided to pension funds by the Financial Supervisory Authority and the calculation principles concerning registered supplementary pension benefits set forth in the Employees Pensions Act, as well as and the provisions of the State Pension Act. The basis lies in mathematical models and calculation principles generally accepted in the insurance field.

Pension liability is calculated individually for every person who has, at some point in his or her employment history, accrued a Finnish state pension, whether retired, employed under the State Pension Act, or no longer employed but not yet retired. The calculation is done according to the so-called prospective method, in which the capital value of each person's pension accrued to date under the State Pension Act is calculated by discounting pensions to be paid in the future to their current value. The mortality and new disability assumptions used in the Employees Pensions Act are applied in the calculation.

The discount rate used is 2.7 per cent, which is considered to be a real rate of interest that will exceed future income level changes and index increases in pensions.

The State Treasury calculates the state's pension liability. At the end of 2011, the state pension scheme's pension liability was EUR 92.5 billion (EUR 90.6 billion at year-end 2010). While the pension liability will continue to grow in real terms in coming years, it will begin to decline in the early 2020s and continue to do so until the mid-2050s. This decline will be due to the decreasing proportion of accumulated pensions thanks to increases in payroll, and to the fact that, as the baby boom generation retires, the current pension liability will begin to be defused in the form of paid-out pensions.

The state pension liability calculated according to IFRS was EUR 120 (102) billion at the year-end. Pension liability according to IFRS is influenced by the applied discount rate and its fluctuations. The applied discount rate is the nominal interest on 15-year corporate loans with AA credit rating, being 3.684 per cent on 31 December 2011 (4.528 per cent on comparable 20-year loans in 2010).

### State Pension Liability on 31 December 2010 (MEUR)

| | Current liability | Future liability | | | Total |
|---|---|---|---|---|---|
| | | Old-age | Disability | Survivors' | (MEUR) |
| Active | 0 | 24,074 | 1,355 | 2,332 | 27,760 |
| Vested pension | 0 | 9,654 | 802 | 1,223 | 11,677 |
| Pensioners | | | | | |
| Old-age pensions | 37,976 | 0 | 0 | 3,922 | 41,898 |
| Disability pensions | 986 | 2,989 | 0 | 318 | 4,293 |
| Unemployment pensions | 25 | 460 | 0 | 44 | 529 |
| Part-time pensions | 133 | 752 | 0 | 101 | 986 |
| Survivors' pensions | 3,458 | 0 | 0 | 0 | 3,458 |
| Total | 42,578 | 4,201 | 0 | 4,385 | 51,164 |
| Total | 42,578 | 37,927 | 2,156 | 7,940 | 90,600 |

## PENSION LIABILITY

### What is pension liability?

Pension liability refers to the sum of money and its future return on investment that, calculated at a certain point in time, would cover the future pensions earned at the time of calculation. Therefore, pension liability always involves an assumption regarding the return on investments. The state's pension liability indicates the cost of the pensions promised by the state to its current and previous employees, at the time of calculation.

In addition to expected returns, the pension liability calculation includes other selected assumptions related, for instance, to changes in life expectancy and retirement age, and to how many people are expected to take disability pensions in the future.

To calculate pension liability, it is essential to know the accurate sum of pensions accrued until the time of calculation. Because the employed population accrue pensions each year, new people retire, and people entitled to receive pensions die, the pension liability sum is not constant but is recalculated annually.

### What makes the state's pension liability sum so large?

According to the the estimated value of accumulated employee pension was EUR 623.4 billion with 2.5% real interest rate on 31 December 2010 (5/2011 report by the Finnish Centre for Pensions Statutory pensions. Long-term projections 2011 Ismo Risku, Kalle Elo, Tapio Klaavo, Sergei Lahti, Hannu Sivonen ja Risto Vaittinen).

### What is the role of VER?

External to the State budget, the State Pension Fund is responsible for investing the state's pension assets. The State Pension Fund was founded as a buffer fund to balance the effects of state pension expenditure to the national economy. In particular, the purpose of funding was to prepare for the retirement of the baby boomers and the increasing pension expenditure.

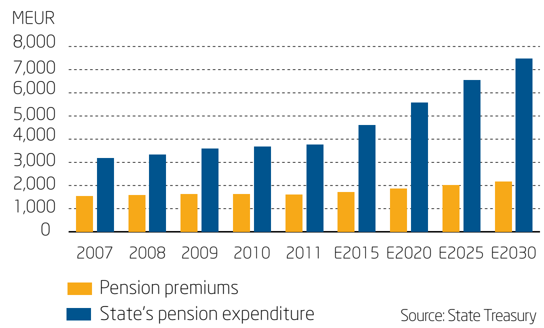
### What is the degree of funding in pension liability?

= VER's assets on 31 December 2011 / MEUR 92,500. The degree of funding is 15 per cent.

### In the end, who is responsible for pensions?

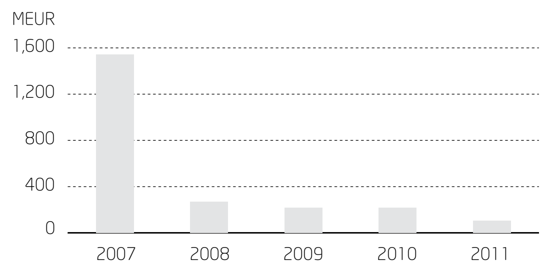
The State's pension expenditure belongs to statutory expenses and therefore defrayed by the State. Employment pension institutions are (jointly) responsible for the employee pensions (TyEL).

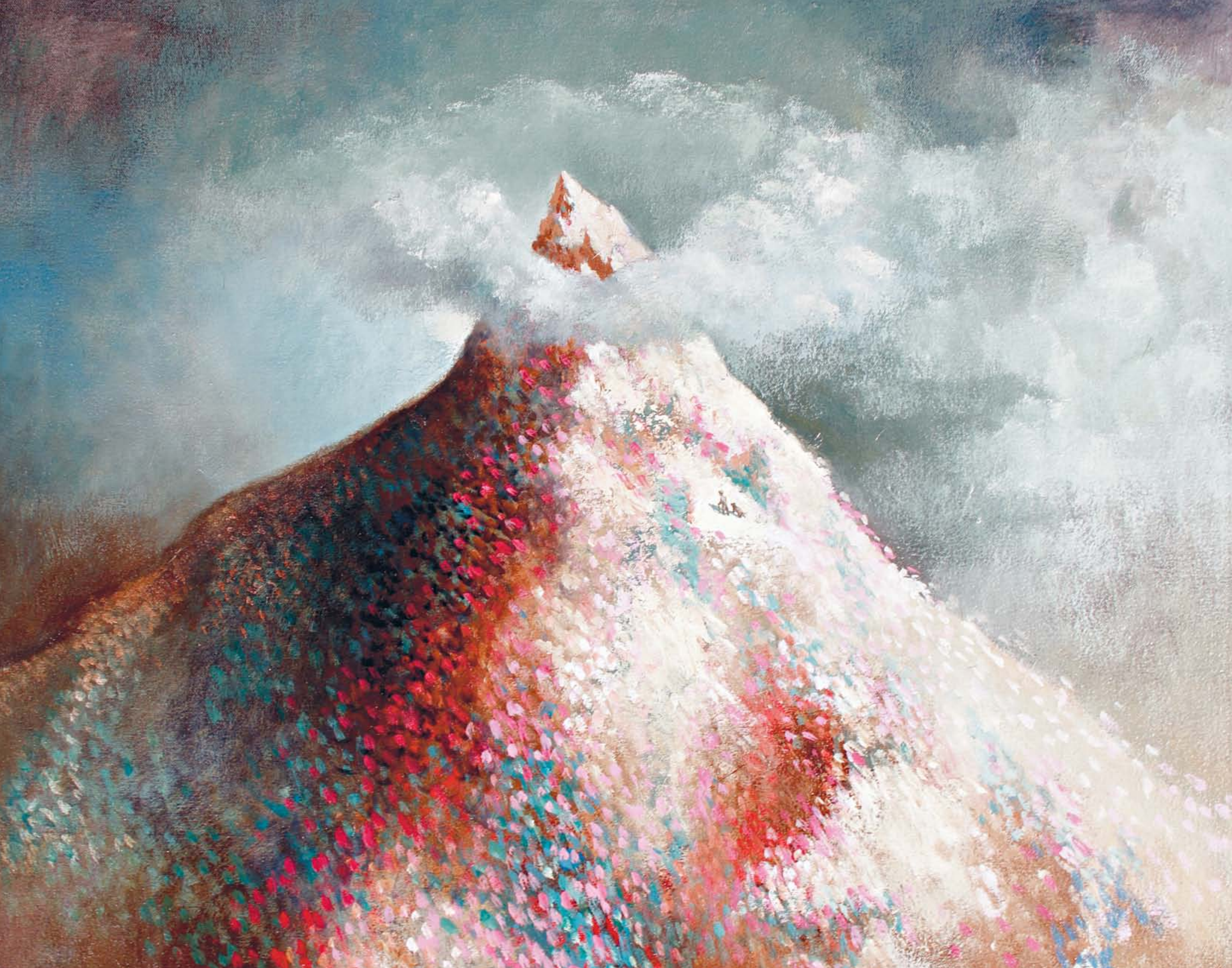
VER's pension premiums and the state's pension expenditure




Source: State Treasury

VER's net premiums, five years





## 1989

- The State Pension Fund is established within the State Treasury.
- The funding target is set for the year 2010.

## 1991

- Pension contributions from state offices, institutions, and enterprises are directed to VER.

## 1993

- Pension contributions from state employees are directed to VER.
- Investment activities are expanded.
- The transfer of funds to the budget is restricted (to three quarters of pension expenditure).
- The VER Board of Directors is appointed, to bear responsibility for the fund's investment activities.

## 1999

- Municipalities start to pay in pension contributions for teachers to the State Pension Fund.

## 2000

- The budget transfer is reduced to a third of annual pension expenditure until the end of 2006 (subsequent to this, one half).
- The funding target is set at 1.5 times the total of state wages and salaries, a minimum of 20 per cent of the state pension liability, in 2010.
- Dedicated staff are hired for the fund.
- Investment activities are extended to include equity investments.

## 2003

- The fund's first full-time managing director, Timo Löyttyniemi, is appointed.

## 2005

- The funding target is set at 25 per cent of the state's pension liability.
- The annual transfer from VER to the state budget is prescribed as equalling 40 per cent of annual pension expenditure until the target funding ratio is met. Subsequently, the amount of the transfer is to be specified annually in the state budget.

## 2006

- The role of the Ministry of Finance as supervisor of VER is defined more precisely, and the ministry is granted the right to issue general regulations concerning VER's administration, finances, and investment policies.
- The tasks of the VER Board of Directors are laid down in the law.
- The duties of VER's auditors are set by law.
- The transfer of assets from VER to the state budget is reduced for 2006 and 2007.
- The Ministry of Finance issues its first operation guidelines to VER, in November.

## 2007

- In March and November, the Ministry of Finance further specifies the operation guidelines issued in 2006.

## 2008

- The global financial crisis begins.

## 2009

- Antti Tanskanen is appointed as chairman of the Board of Directors.
- Reform of the Universities Act is implemented, as a consequence of which university employees are gradually transferred to private pension schemes.

## 2010

- VER celebrates its 20th anniversary.

## 2011

- The European debt crisis begins.
- VER signs the United Nations Principles for Responsible Investment (UNPRI).
- VER joins Finland's Sustainable Investment Forum (FINSIF).

# VER's Organisation

## Board of Directors, 1 March 2009 – 28 February 2012


Antti Tanskanen


Teuvo Metsäpelto


Helena Tarkka


Tiina Astola


Risto Kangas


Antti Palola


Pirjo Mäkinen

*Chairman*
**Antti Tanskanen**
born 1946
Education:
Doctor of Economics

*Vice-Chairman*
**Teuvo Metsäpelto**, Director General
Office for the Government As Employer
born 1949
Education:
Licentiate of Laws

*Members:*
**Helena Tarkka**, Senior Adviser for the Budget
Ministry of Finance, Budget Department
born 1955
Education:
Master of Political Science, Associate of Laws

**Tiina Astola**, Permanent Secretary
Ministry of Justice
born 1953
Education:
Licentiate of Laws

**Risto Kangas**, Director of Negotiations
Negotiation Organisation for Public Sector Professionals (JUKO)
born 1954
Education:
Comprehensive-school teacher

**Antti Palola**, Chairman
Confederation of Salaried Employees (Pardia)
born 1959
Education:
Sea captain

**Pirjo Mäkinen**, Chief Executive Officer
Trade Union for the Public and Welfare Sectors (JHL)
born 1955
Education:
Master of Science

*Deputy members:*
**Veikko Liuksia**, Senior Government Adviser
Office for the Government As Employer
born 1947
Education:
Bachelor of Laws
- serving until 19 May 2011

**Asko Lindqvist**, Senior Adviser for Finance
Ministry of Finance/Personnel and Governance Policy Department
born 1952
Education:
Master of Science (Economics and Business Administration)
- serving from 19 May 2011

**Raine Vairimaa**, Senior Adviser for the Budget
Ministry of Finance, Budget Department
born 1948
Education:
Licentiate of Laws

**Marja-Leena Rinkineva**, Economic Development Director
City of Helsinki
born 1964
Education:
Licentiate of Laws

**Seppo Väänänen**, Director of Negotiations
Confederation of Salaried Employees (Pardia)
born 1948
Education:
Master of Arts (Education)

**Markku Nieminen**, Chief of Negotiations
Negotiation Organisation for Public Sector Professionals (JUKO)
born 1953
Education:
Bachelor of Laws

**Mika Hämäläinen**, Department Manager
Trade Union for the Public and Welfare Sectors (JHL)
born 1959
Education:
Bachelor of Laws

## The Management Team

Timo Löyttyniemi

Seija Kettunen

Tiina Tarma

Jukka Järvinen

Jan Lundberg

Maarit Säynevirta

The State Pension Fund is administered by the Board of Directors and the managing director, assisted by a management team. The Ministry of Finance appoints the Board of Directors, which manages the fund's investments, decides on investment policies, and approves the annual investment plan. The Board's term of office is three years. The Board consists of a chairman, a vice-chairman, and up to five other members. A personal deputy is appointed for each member.

The current Board began its term on 1 March 2009, and is chaired by Antti Tanskanen, PhD (Econ.). The Board of Directors convened 12 times in 2011. In addition to investment operations, the meetings concerned matters related to responsible investing; derivatives; changes to the premium criteria of the state pension system; and the condition of the global and, particularly, European economy.

The Board of Directors appoints a consultative committee with seven members, who are external investment and finance professionals. The Consultative Committee assesses the fund's investment plan, monitors its realisation, and reports to the Board of Directors. The Consultative Committee convened twice in 2011.

The VER management team, consisting of the managing director and five other members, convenes regularly.

## Investment Consultative Committee, 31 December 2011

*Chairman*
**Eva Liljeblom**, Rector of Hanken School of Economics

*Vice-Chairman*
**Vesa Puttonen**, Professor, Aalto University

**Topi Piela**, Managing Director of Umo Capital Oy

**Timo Hukka**, Investment Director,
Suomi Mutual Life Assurance Company

**Liisa Jauri**, Director, Nordea

**Erik Valtonen**, PhD

**Hanna Kaleva**, Managing Director,
Institute for Real Estate Economics

# VER profit and loss statement

| | 1 Jan–31 Dec 2011 | | 1 Jan–31 Dec 2010 | |
|---|---|---|---|---|
| OPERATING INCOME | | | | |
| Other operating income | | | | |
| Sales gains on equities and shares | 108,348,895.55 | | 255,033,766.82 | |
| Pension contributions from State offices and institutions | 738,505,999.85 | | 743,763,047.09 | |
| Other pension contribution income | 531,723,300.54 | | 554,666,342.32 | |
| Employees' pension contributions | 338,858,855.86 | | 323,125,636.23 | |
| Disability insurance contribution income | 4,721,618.00 | 1,722,158,669.80 | 5,371,566.00 | 1,881,960,358.46 |
| | | | | |
| OPERATING EXPENSES | | | | |
| Materials, supplies and goods | | | | |
| Purchases during the period | 55,539.99 | | 80,586.36 | |
| Personnel expenses | 2,392,764.93 | | 2,302,982.81 | |
| Rents | 260,477.16 | | 257,974.42 | |
| Outsourced services | 3,158,566.12 | | 3,376,750.03 | |
| Other expenses | | | | |
| Other expenses | 315,857.69 | | 289,990.54 | |
| Sales losses on equities and shares | 64,033,266.84 | | 38,250,744.78 | |
| Depreciation | 60,753.52 | -70,277,226.25 | 64,355.60 | -44,623,384.54 |
| | | | | |
| SURPLUS I | | 1,651,881,443.55 | | 1,837,336,973.92 |
| | | | | |
| FINANCIAL INCOME AND EXPENSES | | | | |
| Financial income | 313,146,908.28 | | 346,111,895.25 | |
| Financial expenses | -160,147,691.97 | 152,999,216.31 | -13,025,652.92 | 333,086,242.33 |
| | | | | |
| SURPLUS II | | 1,804,880,659.86 | | 2,170,423,216.25 |
| | | | | |
| INCOME AND EXPENSES FROM TRANSFERS | | | | |
| Income | | | | |
| Transfer fees | | 25,706,289.02 | | 25,073,470.83 |
| | | | | |
| SURPLUS III | | 1,830,586,948.88 | | 2,195,496,687.08 |
| | | | | |
| SURPLUS/DEFICIT FOR THE PERIOD | | 1,830,586,948.88 | | 2,195,496,687.08 |

# Balance sheet

| ASSETS | 31 Dec 2011 | | 31 Dec 2010 | |
|---|---|---|---|---|
| FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | | | |
| | | | | |
| INTANGIBLE ASSETS | | | | |
| Other long-term expenditure | | 58,458.32 | | 86,518.34 |
| | | | | |
| TANGIBLE ASSETS | | | | |
| Machinery and equipment | 0.00 | | 8,740.36 | |
| Furniture and fittings | 44,001.63 | 44,001.63 | 67,954.77 | 76,695.13 |
| | | | | |
| SECURITIES HELD AS FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | | | |
| Purchases of bonds denominated in euros | 4,757,545,468.61 | | 4,802,599,112.04 | |
| Other long-term investments denominated in euros | 4,784,081,111.44 | | 4,467,057,567.56 | |
| Other long-term investments denominated in foreign currency | 2,118,497,110.61 | 11,660,123,690.66 | 1,990,259,349.43 | 11,259,916,029.03 |
| | | | | |
| TOTAL FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | 11,660,226,150.61 | | 11,260,079,242.50 |
| | | | | |
| LONG-TERM RECEIVABLES | | | | |
| Long-term receivables | | 208,577.75 | | 236,213.31 |
| | | | | |
| CURRENT RECEIVABLES | | | | |
| Accrued credits and deferred charges | 219,445,711.84 | | 215,446,459.96 | |
| Other current receivables | 14,448,579.47 | | 7,830,846.83 | |
| Advance payments | 0.00 | 233,894,291.31 | 23.74 | 223,277,330.53 |
| | | | | |
| FINANCIAL SECURITIES AND OTHER SHORT-TERM INVESTMENTS | | | | |
| Purchases of bonds denominated in euros | | 940,620,089.24 | | 1,152,858,822.31 |
| | | | | |
| CASH, BANK DEPOSITS AND OTHER FINANCIAL ASSETS | | | | |
| Joint account receivable from the State | 0.00 | | 4,379,540.29 | |
| Other bank accounts | 251,824,778.40 | 251,824,778.40 | 122,630,068.28 | 127,009,608.57 |
| | | | | |
| TOTAL INVENTORIES AND FINANCIAL ASSETS | | 1,426,547,736.70 | | 1,503,381,974.72 |
| | | | | |
| TOTAL ASSETS | | 13,086,773,887.31 | | 12,763,461,217.22 |

| EQUITY AND LIABILITIES | 31 Dec 2011 | | 31 Dec 2010 | |
|---|---|---|---|---|
| EQUITY | | | | |
| Fund capital | -17,897,522,909.37 | | -16,424,831,950.49 | |
| Accrued changes in capital | 30,659,292,118.29 | | 28,463,795,431.21 | |
| Budget transfers | -1,509,380,155.00 | | -1,472,690,958.88 | |
| Surplus/deficit for the period | 1,830,586,948.88 | 13,082,976,002.80 | 2,195,496,687.08 | 12,761,769,208.92 |
| LIABILITIES | | | | |
| CURRENT | | | | |
| Accounts payable | 554,531.47 | | 355,605.51 | |
| Items to be rendered forward | 39,376.37 | | 36,550.31 | |
| Accrued charges and deferred credits | 3,141,263.69 | | 1,246,134.01 | |
| Other current liabilities | 62,712.98 | 3,797,884.51 | 53,718.47 | 1,692,008.30 |
| TOTAL LIABILITIES | | 3,797,884.51 | | 1,692,008.30 |
| TOTAL EQUITY AND LIABILITIES | | 13,086,773,887.31 | | 12,763,461,217.22 |

## Portfolio Structure and Performance, 2001-2011

| | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Structure of portfolio (year-end)** | | | | | | | | | | | |
| AUM (MEUR)* | 13,736.1 | 13,937.1 | 12,318.0 | 10,359.4 | 12,050.9 | 10,305.6 | 8,200.6 | 6,867.1 | 5,795.0 | 4,840.6 | 4,426.9 |
| Allocation, % | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Fixed-income investments | 56.6% | 54.3% | 54.9% | 61.8% | 55.7% | 55.5% | 59.1% | 59.9% | 65.9% | 78.0% | 84.8% |
| Quoted equity investments | 36.4% | 40.4% | 40.8% | 30.7% | 38.0% | 40.4% | 39.6% | 40.1% | 34.1% | 22.0% | 15.2% |
| Other investments | 6.9% | 5.2% | 4.3% | 7.5% | 6.3% | 4.1% | 1.3% | 0.0% | 0.0% | 0.0% | 0.0% |
| **Performance and costs, %** | | | | | | | | | | | |
| Return before investment expenses | -2.3% | 11.7% | 16.5% | -15.7% | 1.8% | 7.0% | 15.0% | 9.6% | 9.5% | -0.4% | 4.3% |
| Fixed-income investments | 4.1% | 3.9% | 8.0% | 4.4% | 1.8% | 0.1% | 5.4% | 7.0% | 4.0% | 7.2% | 5.2% |
| Quoted equity investments | -12.3% | 23.6% | 38.7% | -42.8% | 0.7% | 17.4% | 31.5% | 14.4% | 20.7% | -23.7% | -11.5% |
| Other investments | 6.1% | 8.6% | -14.7% | -11.2% | 9.5% | 6.7% | 2.2% | - | - | - | - |
| Excess return before costs** | n/a | 1.1% | -0.2% | 0.0% | 0.0% | -0.1% | 0.2% | 0.0% | 0.1% | -2.4% | -0.1% |
| Excess return before costs (excl. other investments) | 0.4% | 1.4% | 0.6% | 1.1% | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Costs (% of average invested capital) | 0.05% | 0.05% | 0.05% | 0.04% | 0.04% | 0.05% | 0.05% | 0.05% | 0.05% | 0.04% | 0.02% |
| **Return after costs** | **-2.3%** | **11.7%** | **16.4%** | **-15.8%** | **1.8%** | **7.0%** | **14.9%** | **9.6%** | **9.4%** | **-0.4%** | **4.3%** |
| **Risk indicators** | | | | | | | | | | | |
| Volatility*** | 6.3% | 5.0% | 8.3% | 10.2% | 3.5% | 4.1% | 4.5% | 3.3% | 3.6% | 3.7% | 2.7% |
| Volatility (benchmark)*** | 6.5% | 5.0% | 9.2% | 11.7% | 3.6% | 4.0% | 4.5% | 3.4% | 3.7% | 3.3% | 3.3% |
| Jensen's alpha*** | -0.2% | 1.8% | 3.2% | -0.1% | -0.2% | 0.2% | 1.5% | 0.7% | 1.1% | -2.3% | -0.2% |
| Tracking error*** | 0.6% | 0.3% | 1.3% | 0.8% | 0.3% | 0.7% | 0.5% | 0.4% | 0.6% | 0.9% | 1.0% |
| Beta*** | 0.9 | 1.0 | 0.8 | 0.8 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 1.0 | 0.7 |
| Sharpe ratio*** | neg | 2.2 | 1.9 | neg | neg | 1.0 | 2.9 | 2.2 | 1.9 | neg | neg |
| Sharpe ratio (benchmark)*** | neg | 1.9 | 1.6 | neg | neg | 1.0 | 2.8 | 2.2 | 1.8 | neg | neg |
| Information ratio*** | 0.6 | 4.5 | 0.5 | 1.3 | -0.4 | -0.1 | 0.5 | 0.0 | 0.3 | -2.7 | -0.1 |
| **Effective average interest rate on Finnish government debt****, %** | **2.5%** | **2.5%** | **2.8%** | **4.1%** | **4.1%** | **4.1%** | **3.9%** | **3.9%** | **4.4%** | **5.2%** | **6.0%** |

*) AUM corresponds to the market value of investments, plus accured interest, cash balances and open trades. Exchange rate: ECB fixing.
**) Excess return for the whole portfolio for the financial year under review will be available in spring 2012 once the benchmark indices are ready.
***) Excluding other investments whenever a figure is available for other investments; otherwise applies to whole portfolio.
****) The effective average interest rate on Finnish government debt and the return on investment operations are calculated using different principles, so they are not directly comparable.

| | |
|---|---|
| Cumulative return over 10 years (2002-2011) | 59.8% |
| Average annual return over 10 years (2002-2011) | 4.8% |
| Real return over 10 years (2002-2011) | 3.1% |
| Average annual return over 5 years (2007-2011) | 1.7% |

# Glossary

### Absolute-return fund
A fund that applies active and unrestricted investment strategies to benefit from diverse alternative risk premia on the fixed-income, equity, foreign exchange, commodity, and credit markets. These funds have a low correlation with the equity and fixed-income markets.

### Benchmark index
The index to which the returns and risks of an investment are compared.

### Beta
Measurement factor for the sensitivity of an investment to fluctuations in the value of the benchmark index. If an investment's beta is less than 1, the investment is not expected to fall at the same rate as the index.

### Bond
An instrument through which companies, national and local governments, and other organisations (issuers) can take out a loan from the public by issuing debenture bonds, more commonly known as bonds.

### Certificate of deposit
A marketable promissory note issued by a bank.

### Commercial paper
A short-term marketable promissory note issued by a company.

### Correlation
Dependence between variables – for example, the relationship between different financial instruments or types of assets.

### Derivative
A financial instrument whose value is based on another, underlying security, index, currency, commodity, or option.

### Effective yield
The return on a security in relation to its market value.

### Excess return
The difference between the returns of the portfolio and the benchmark index.

### Forward contract
A contract involving the obligation to buy or sell an underlying security, such as a share, for a specified price in the future.

### Funding ratio
The ratio between funded assets and pension liability.

### High-yield investment fund
A registered fund that invests in bonds promising to pay higher yields on account of the low credit rating of the issuing company.

### Inflation-linked bond
Primarily sovereign bonds, with interest rate and principal are adjusted in proportion to changes in the consumer price index for reaching the agreed real return between the issue date and the maturity date.

### Information ratio
The ratio between a portfolio's active return and tracking error.

### Investment commitment
A commitment given by a private-equity fund investor to the fund, which is fulfilled when the fund makes capital calls to raise cash for its investments.

### Investment-grade fund
A corporate bond fund that invests in bonds issued by companies with high credit ratings, offering higher interest than sovereign bonds do.

### Liquidity
The convertibility of an investment into cash. A liquid investment can quickly be converted into cash.

### Market risk
The effect of general market movements on the price of a share, a systematic risk.

### Modified duration
Sensitivity of a fixed-income investment to fluctuations in interest rates. The longer the duration, the higher the interest-rate risk.

### Option
A contract involving the right to buy or sell an underlying security, such as a share, for a specified price in the future.

### Pension liability
The nominal value of pensions earned by a certain point in time.

### Sharpe ratio
The return on an investment, adjusted for risk, comparing the return that exceeds the risk-free return to the volatility of the return. The higher the Sharpe ratio, the better the risk-adjusted return. The risk-free return is usually estimated as the calculated return on a short-term money market investment.

### Tracking error
Standard deviation of the excess return, measuring how closely the yield on an investment follows the yield of the benchmark index. A high tracking error means that the yield on the investment has fluctuated a lot in comparison to the benchmark index. The tracking error (active risk) of a passive portfolio is close to 0.

### Volatility
The standard deviation of the return – the most common risk indicator. It measures the fluctuations in the return on an investment; the higher the risk, the greater the volatility. For example, a volatility figure of 20 means that if the expected return is 10 per cent, in two years out of three the return on the investment will be between -10 and +30 per cent.

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*Samuli Heimonen* was born in Saarijärvi in 1975.

He graduated in 2002 as a Master of Arts from what was then the University of Art and Design Helsinki, having also studied art education there and art at the  Orivesi College of Arts.

Heimonen was the Young Artist of the Year in 2008 and also received a medal from the Tapper Art Society in 2003.

He lives and works in Kangasniemi.

As a painter, I often work with themes and feelings that are difficult to define. In fact it is exactly this indefinability that endows the themes with power and fascination. I almost always approach the content of my art through metaphors. The world of my paintings is mythical and animals often play an important role.

The three paintings in my Vuori (Mountain) series, ***Lähellä*** (Close), ***Tahto*** (Will) and ***Huippu*** (Summit) each offer a different take on the same basic theme. The idea of the mountain is considered slightly differently in each picture: in one, an attempt is made to manage the magnitude of the mountain by lassoing its summit. Another gets as close as possible to the mountain, whereas in the third, a small figure and a dog hike up the steep mountainside.

The mountain is something larger than man, whose nature is at the same time threatening, beautiful and tempting. It is also something we try to manage or understand. It is human nature to tackle challenges and scale our own mountains.

The works Virta and Jano describe encounters between man and nature. ***Jano*** (Thirst) illustrates a surprising gesture of compassion, as a human offers water to a wild animal in the desert. ***Virta*** (Flow), on the other hand, describes a situation in which high winds blow and man must do his best to sail through the tempest. Sometimes the captain can steer the boat, while at others we must let the sea steer us.

Design: Spokesman Oy Photography: Manu Rantanen Illustration: Samuli Heimonen Paper: Munken Polar Printing: DMP Oy

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