# Annual Report 2009

VER

VALTION ELÄKERAHASTO
STATENS PENSIONSFOND
THE STATE PENSION FUND


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# A Professional in Pension Investment

## 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. The market value of VER's investment portfolio grew by EUR 2.0 billion in 2009, reaching EUR 12.3 billion at year end.

Employers and employees covered by the State Pension Scheme make pension contributions to the State Pension Fund. All state pensions are paid out from appropriations made for that purpose in the national budget. The State Treasury handles pension matters on the state's behalf.

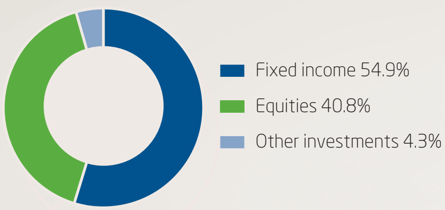
## Mission

The State Pension Fund 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.

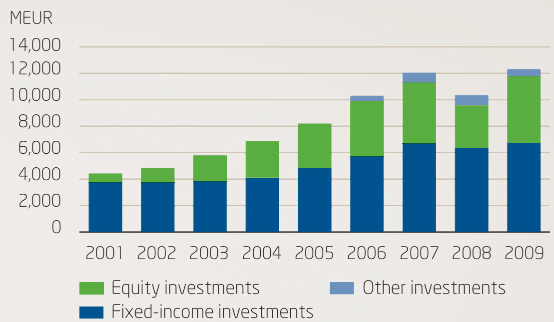
## Vision

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

VER's investment portfolio breakdown on 31 December 2009




VER's investment trend, 2001-2009



# Key indicators 2005-2009

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Total investments (MEUR) | 8,201 | 10,306 | 12,051 | 10,359 | 12,318 |
| Fixed-income investments (MEUR) | 4,848 | 5,722 | 6,707 | 6,400 | 6,765 |
| Fixed-income investments (%) | 59% | 56% | 56% | 62% | 55% |
| | | | | | |
| Equity investments (MEUR) | 3,353 | 4,163 | 4,584 | 3,183 | 5,024 |
| Equity investments (%) | 41% | 40% | 38% | 31% | 41% |
| | | | | | |
| Other investments (MEUR) | | 420 | 760 | 777 | 529 |
| Other investments (%) | | 4% | 6% | 7% | 4% |
| | | | | | |
| Income from investment operations (%) | | | | | |
| Return on investments | 14.9 | 7.0 | 1.8 | -15.8 | 16.4 |
| Fixed-income investments | 5.4 | 0.1 | 1.8 | 4.4 | 8.0 |
| Equity investments | 30.8 | 17.4 | 0.7 | -42.8 | 38.7 |
| Other investments | | 6.7 | 9.5 | -11.2 | -14.7 |
| | | | | | |
| Operating expenses (% of average capital) | 0.05 | 0.04 | 0.04 | 0.04 | 0.05 |
| | | | | | |
| Personnel | 15 | 14 | 16 | 18 | 19 |
| | | | | | |
| Income from pension premiums (MEUR) | 1,462 | 1,491 | 1,542 | 1,597 | 1,640 |
| | | | | | |
| Net premiums (MEUR) | 296 | 1,496 | 1,544 | 271 | 216 |
| Transfer to state budget (MEUR) | 1,175 | 0,1 | 3,5 | 1,331 | 1,427 |
| Balance sheet total (MEUR) | 7,337 | 9,185 | 11,165 | 11,503 | 12,049 |
| Pension provision (MEUR) | 57,600 | 79,300 | 82,700 | 85,600 | 88,400 |
| Funding rate percentage [1] | 14% | 13% | 15% | 12% | 14% |

[1] Investments / pension provisions

*“VER produced a return of 16.4 per cent, which is a record in its 20-year history.”*

# Benefiting Fully from the Market's Recovery

Last year was an excellent year for pension investing. The State Pension Fund (VER) produced a return on investment of 16.4 per cent, which is a record in VER's 20-year history. In addition to benefiting from the recovery of the investment market, VER took advantage of its position as a long-term investor by being a significant net buyer of shares and corporate bonds.

Recovery from the international financial crisis was quicker than expected. Markets were rallied by decisive action on behalf of national governments and central banks towards the end of 2008. The equity market experienced an upturn in March 2009; after this, it maintained growth for the rest of the year. Reduced uncertainty and low interest rates also facilitated a sharp rise in the credit market.

During the financial crisis, VER took advantage of its position as a long-term investor. The fund strongly increased its investments in corporate bonds and shares during the recession of late 2008 and early 2009, and it made net purchases of bonds and shares totalling nearly EUR 900 million in 2009. This proved to be a wise decision: a review of 2009 showed significant rise in both markets in the course of the year.

As a result of the financial crisis and recession, the focus of the world economy is shifting even more quickly toward the East and to Asia. Growing Asian economies have experienced swifter economic growth than Europe and the United States. VER currently has 13 per cent of its equity investments in developing markets and Asia. This proportion has grown over the years. If our trend predictions hold true, we will continue increasing the weighting of these geographical areas. According to our forecasts, the expected return on our assets will rise, although this will somewhat increase the volatility of the portfolio at the same time.

The Finnish Government made major decisions regarding the status of universities in Finland in 2009. Here, those who previously held public office became privately employed from the beginning of 2010. This means that some university employees were transferred from state pensions to the private pension system. Accordingly, VER's pension premium income will decrease significantly in the next few years.

Finnish universities employ 32,000 people, of whom those born in 1980 and later were transferred to the private sector pension scheme with effect from 2010. Initially this applies to only 3,700 employees, but after a few decades all staff of universities will come under private-sector pensions. The transfer will reduce VER's pension premium income by EUR 20 million in 2010. The greatest effects will be felt between 2043 and 2050. Positive effects in the form of reduced pension costs will only be experienced by the state in the very long term. At the end of 2009, there were 130,000 state employees.

In 2009, VER completed certain projects for developing functions related to securities. These concerned clearing and custody services and a reporting system. The changes further increased our capacity to fulfil our duty as managers of the state's pension funds.

Established in 1990, VER modelled itself on funds operating in the private sector and in local government. The state's implementation was different, however: VER operates as the buffer fund for pension liabilities associated with state employees. By the beginning of 2010, VER had fulfilled and developed this role for 20 years. For the last decade, it has done so as an independent pension investor.

The 2009 financial year was an excellent year for VER. We enjoyed our highest return on investment ever and recovered quickly from the previous year's financial crisis. I wish to thank our staff for their successful investments and their active efforts in developing VER.

Timo Löyttyniemi
Managing Director
State Pension Fund

# Key Events in 2009

> *“Investment efforts during the financial crisis were profitable in 2009.”*

- VER’s investment operations yielded good returns: the portfolio as a whole had returns of 16.4 per cent, with fixed-income investments returning 8.0 per cent and equity investments 38.7 per cent. Other investments still felt the impact of the financial crisis and yielded -14.7 per cent.

- VER was a significant net buyer during the financial crisis. Despite the recession, VER acquired shares and corporate bonds with a total value of almost EUR 900 million in the course of the year 2009.

- As a consequence of changes in Finland’s Universities Act, some university staff were transferred from state employ to the private pension system on 1 January 2010. This will cause significant reductions in VER’s pension premium income in coming years.

- The state’s pension liability was EUR 88.4 billion. While the pension liability still continues to grow in real terms, it will begin to decline from the beginning of the 2020s.

- VER transferred its securities clearing and custody services from Nordea to J.P. Morgan.

- Minister Antti Tanskanen was appointed Chairman of the Board of Directors as of 1 March 2009.

# Financial Crisis Gives Way to Stabler Times

The worst of the global financial crisis appears to be over, and the fluidity of the international financial markets improved significantly during 2009. However, the year saw the global economy remain in the grips of a deep recession. In developed economies, production volumes shrank noticeably, and growth slowed down even in developing countries. Reductions in GDP accelerated at the beginning of 2009 in the eurozone, Japan, and the United States.

The international financial markets and economic growth recovered in the second half of the year, but the environment remained challenging. Thus far, growth has been based on massive streamlining of fiscal and monetary policy. The prospects for the near future are subdued, and the sustainability of economic growth without further support measures remains uncertain. The risk of deflation has abated, but there are as yet no signs of accelerating inflation.

Central banks in Europe and the United States continued and extended diverse measures for increasing market liquidity and improving the functioning of the financial markets. Some central banks adopted unusual measures such as buying sovereign and corporate bonds or quantitatively increasing central bank balance sheets. This improved the financial markets' functionality, while risk-seeking investors boosted share prices from the spring of 2009. In addition, various credit risk premiums were significantly reduced.

A major factor injecting uncertainty into the global economy is the ongoing unloading of debt, whose effects will be felt extensively in the financial, commercial, and household sectors of areas that were previously showing a deficit. The unloading of debt and strengthening of capital will weaken the financial sector's ability to finance economic growth. Conversely, reductions in national debt will imply cost-cutting measures and tax increases, which will cut private spending. Another uncertainty factor is related to when central banks will begin to reduce market liquidity and raise interest rates.

## VER's investment portfolio

At the end of 2009, VER's investment portfolio had a market value of EUR 12.3 billion (EUR 10.4 billion in 2008). At year end, 54.9 per cent of investments were in fixed-income instruments, 40.8 per cent in equities, and 4.3 per cent in other investments.

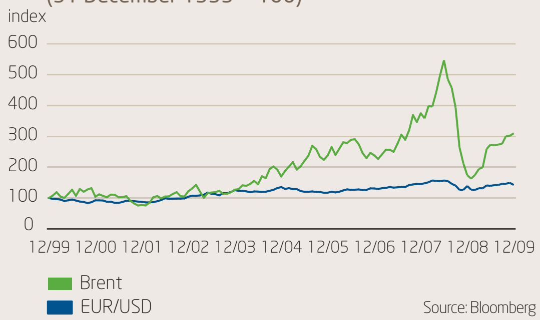
The total return of the investment portfolio for 2009 was 16.4 per cent (compared with -15.8 per cent in 2008). This return is calculated in accordance with the international GIPS standard, from which operating expenses of EUR 6.0 million (2008 comparative: EUR 4.7 million) have been deducted.

## VER's shareholder policy

According to the principles of its shareholder policy, VER operates as an independent portfolio investor. Since the fund is a long-term investor and major shareholder in a number of companies, it best promotes the successful performance of its portfolio companies by acting as a responsible shareholder. The companies must ensure the increasing value of their shares in the long term.

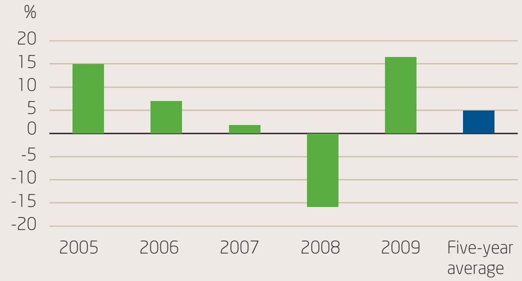
VER monitors the companies in its portfolio and their performance, in order to take a stand on their activities and on the major resolutions brought before general meetings. No VER personnel are involved in the management of listed companies in which the fund has holdings.

Brent and euro/dollar exchange rate
(31 December 1999 = 100)

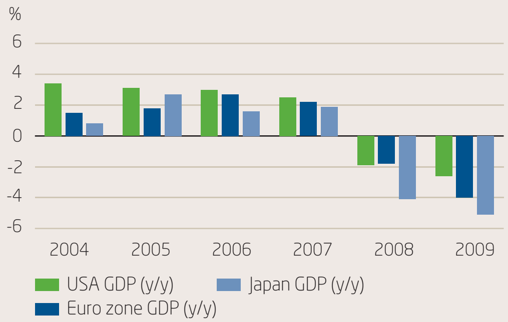



Source: Bloomberg

Return on VER's investment portfolio

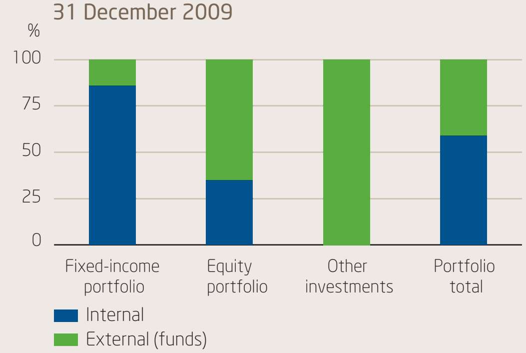



GDP of the United States, eurozone, and Japan

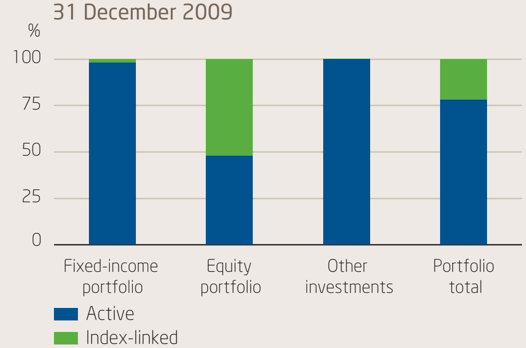



Source: Bloomberg

External and internal portfolio management,
31 December 2009




Active, index-linked portfolio management,
31 December 2009



## Responsible investment promotes sustainable development

In its investment activities, VER strives to comply with the principles of responsible investment approved by the Finnish Pension Alliance TELA.

When selecting potential investment targets, VER uses sustainable development indices as a basis for comparison. The primary factor in VER's investments is the investment targets' expected returns, but between any two companies equal in this respect, the one represented in any sustainable development index will be the one selected for the portfolio.

In its investments, VER applies principles of social responsibility, avoiding investments in companies that derive a substantial proportion of their turnover from the alcohol, tobacco, firearms, pornography, or gambling industry. The same applies to countries and enterprises that do not respect human rights or the fundamental rights confirmed by the International Labour Organization (ILO).

## 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, responsibilities, indicators, and control principles.

In setting of 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 PricewaterhouseCoopers between 2004 and 2008.


“More than one million
Finns are covered by
the State Pension Scheme.”

# The Highest fixed Income Return of the Decade

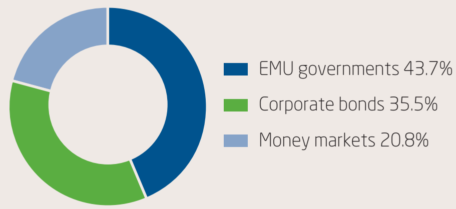
Interest rates in the eurozone fluctuated in the early part of the year but within a relatively small range. The decrease in interest rates that began in mid-June continued until early December. In that period, yield curves became significantly steeper. Interest rate spreads between EMU countries had narrowed substantially by the early autumn. After that, they began to widen again, which continued until year end.

Markets with higher credit risk did well on account of falling risk premiums and produced significant returns in the period. The highest returns were produced by high-yield bonds and emerging market bonds.

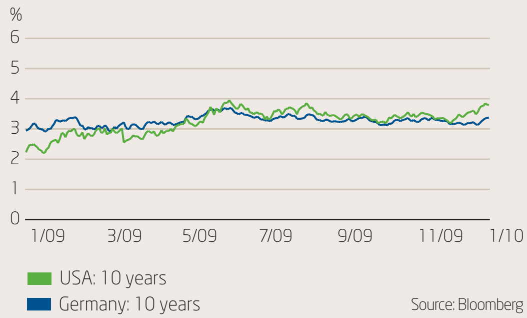
For the State Pension Fund, 2009 was the most profitable year of the decade. VER's fixed-income portfolio yielded 8.0 per cent (as compared with 4.4 per cent in 2008). The allocations of the portfolio were adjusted in moderation. The corporate and money markets were over-weighted in the allocation, while sovereign bonds were under-weighted in relation to neutral. The duration of the fixed-income portfolio varied within a relatively small range, and at year end it was slightly under-weighted. The allocation of corporate bonds continued to increase as the year progressed. Calculated according to market value, the fixed-income portfolio grew from EUR 6.4 billion at the beginning of the year to EUR 6.8 billion at the end.

Principally, VER makes its own 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 86 per cent of the aggregate fixed-income portfolio at year end, with direct fixed-income investments comprising 231 commitments, and fund units being held in 20 funds.

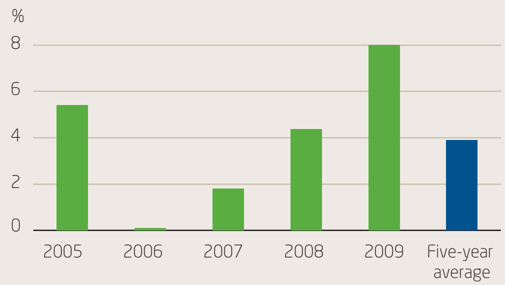
Fixed-income investments by sector, 31 December 2009




Interest rates




Return on fixed-income investments



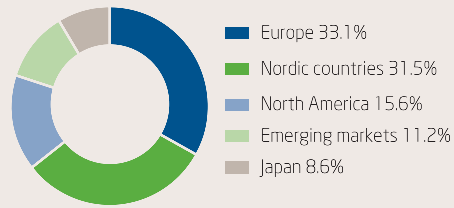
# An Exceptionally Split Year for Equities

In many ways, 2009 was a unique year for equity investments. The first two months still witnessed a strong decline across the board in the equity market. The financial markets only began to level off in mid-March, when the worst-case scenarios predicted for the global economy failed to materialise. The liquidity-increasing measures taken by national governments and central banks began to take effect, and trust in the financial system gradually returned. From the middle of March, the primary direction of the equity market was an upward one, with the exception of a couple of small glitches.

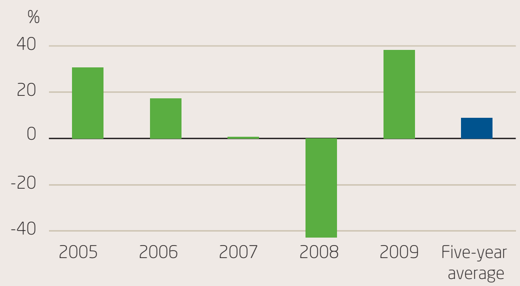
2009 was a good year for the State Pension Fund's equity investments. The stock portfolio, consisting of listed stocks and funds, yielded 38.7 per cent in 2009 (–42.8 per cent in 2008). VER was a major net buyer in the equity market already in the last quarter of 2008, and this continued during the year under review. The fund took advantage of the situation, in which investors in Finland and abroad significantly reduced their stockholdings, despite the low prices. Between the beginning of the severest financial crisis (September 2008) and the end of 2009, VER acquired shares and fund units worth a net total of approximately one billion euros. More than half of these purchases were made in the depths of the recession – i.e., the last quarter of 2008 and the first quarter of 2009. Stocks accounted for 41 per cent of VER's overall portfolio at year end.

VER strove to keep the equity portfolio's risk lower than the market risk throughout the year, achieving a beta value of 0.92 for the portfolio in 2009. At the end of the year, 65 per cent of VER's equity portfolio was invested through funds and 35 per cent was managed as direct investments. At that time, VER had direct equity investments in 150 companies and holdings in 64 funds.

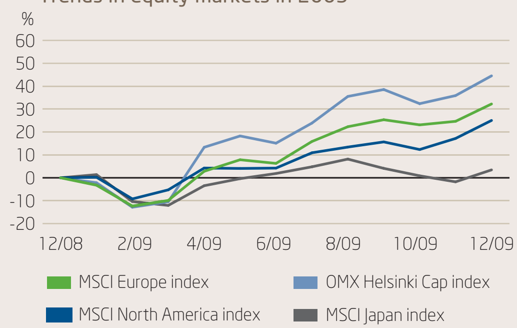
Equity portfolio breakdown by region, 31 December 2009




Return on equity investments




Trends in equity markets in 2009




“VER manages the assets entrusted to it with a long-term view, assuring the value of its investments.”

# A Challenging Year for Other Investments

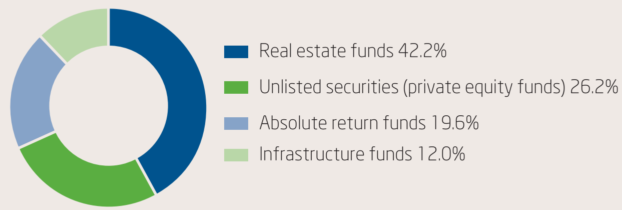
Investments classed by VER as 'other investments' comprise real estate, private equity, and infrastructure funds, as well as absolute return funds. With the exception of absolute return funds, 2009 was a very challenging year for these investments. The financial crisis led to an unwillingness on behalf of banks to fund real estate and private equity transactions, which caused the number of property and corporate acquisitions to slump to a historic low. At the same time, the global recession caused a crash in real estate and company values. The sharp equity market growth, beginning in March, had a positive effect on private equity fund valuations in the second half of the year. Among absolute return funds, 2009 saw a return to positive yields. These funds benefited from the normalisation of the operating environment, as well as from the strong interest rate and equity markets.

The year was characterised by increased investor caution in making new fund investments. As a consequence, significantly fewer new funds were brought to the market in all 'other investments' classes than in previous years. Although VER continued actively seeking new investment opportunities, only a few materialised. The strong rise in the equity market and large withdrawals from absolute return funds contributed to lowering the proportion of other investments in VER's overall portfolio from 7.5 per cent at the end of the previous year to 4.3 per cent at the end of 2009.

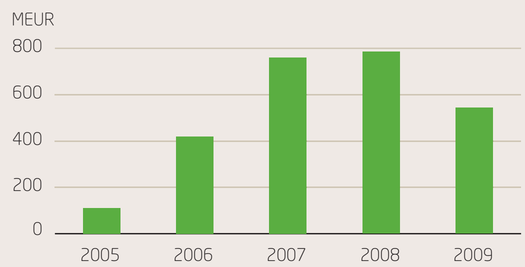
The market value of the portfolio at the end of the year was EUR 529 million (2008 comparative: EUR 777 million), while the amount of open investment commitments was EUR 285 million. Of total invested assets, indirect real estate investments accounted for 40.3 per cent and listed real estate investments for 1.9 per cent. Private equity investments accounted for 26.2 per cent, infrastructure funds for 12.0 per cent, and absolute return funds for 19.6 per cent of invested assets.

Other investments yielded a total return of –14.7 per cent (–11.2 per cent in 2008). Absolute return funds had a yield of 8.0 per cent. Real estate funds were negative at –28.5 per cent, private equity funds at –17.0 per cent, and infrastructure funds at –12.5 per cent.

Breakdown of other investments, 31 December 2009




Market value of other investments, 2005–2009



# 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 2009, the fund's market value was EUR 12.3 billion, making the funding ratio 14 per cent (12 per cent in 2008). 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.

## Buffer Fund Operating Model

All state pensions in Finland are paid out from appropriations reserved in the national budget. VER does not pay out pensions but transfers 40 per cent of the state's annual pension costs to the state budget. The remaining assets are left in the fund. VER is a so-called buffer fund, which means that, unlike TEL (EPA) pension companies, it 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 investment 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.

Fixed-income portfolio benchmark indices:

| | Weighting |
|---|---|
| EFFAS Euro Government Index | 35.0% |
| BarCap Euro Government Inflation-Linked Bond Index | 15.0% |
| BarCap Euro Aggregate Ex Treasury Index | 30.0% |
| JP Morgan Cash Index 3 Month Index | 20.0% |

Equity portfolio benchmark indices:

| | Weighting |
|---|---|
| OMX Helsinki Cap Index | 21.0% |
| OMX Stockholm Benchmark Cap Index | 9.0% |
| MSCI Europe Index | 24.5% |
| MSCI Europe Value Index | 10.5% |
| MSCI North America Index | 15.0% |
| MSCI Japan Index | 10.0% |
| MSCI Emerging Markets Index | 5.0% |
| MSCI AC Far East Ex Japan Index | 5.0% |

Other investments' benchmark indices:

| | Weighting |
|---|---|
| INREV Index | 49.5% |
| EVCA Index | 28.5% |
| Credit Suisse/Tremont AllHedge Index | 22.0% |

VER 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. VER representatives may attend companies' general meetings in order to protect shareholder interests. The best way for VER to promote the success of companies in which it has holdings is to be a responsible shareholder. VER strives to comply with the principles of responsible investment approved by the Finnish Pension Alliance TELA, which are based on principles of sustainable development and responsible shareholding and on the United Nations Global Compact. In its direct investments, VER uses negative screening in addition to financial principles. Also VER invests in companies belonging to significant sustainable development indices.

## Investment in the long term

Since no insolvency requirement is imposed for the fund, the characteristics of its investment operations are determined by the expected return and the choice of risk level. The crucial factor affecting long-term returns is achievement of an overall allocation that optimises the yield-to-risk ratio.

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

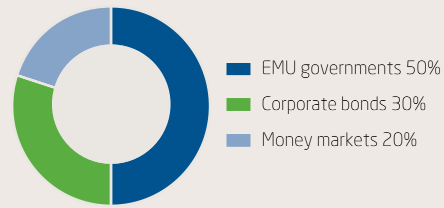
1. Long-term target return

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. A 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. Net debt refers to the difference between the state's budgeted debt and cash reserves.

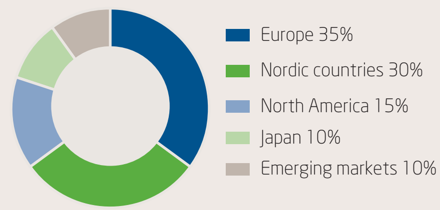
2. Operational target return

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

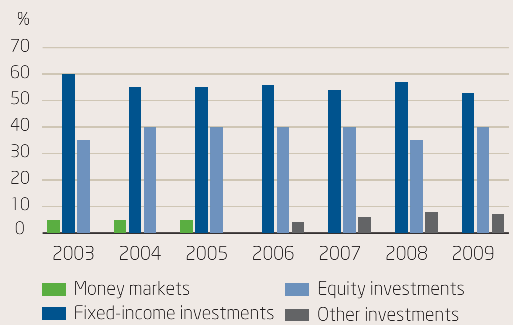
Neutral allocation of fixed-income investments at year-end 2009




Year-end 2009 neutral allocation of equity investments




Basic neutral allocation of VER's portfolio



## 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
- equity investments may not exceed 45 per cent
- other investments may not exceed 12 per cent of the investment portfolio

VER's Board of Directors defines the neutral basic allocation in an annual investment plan. 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 according to 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 3.5 per cent was used for the equity market in the calculations for 2009, making the portfolio's long-term expected return, according to the neutral allocation, 6.4 per cent. The portfolio's expected risk level is also revised each year on the basis of the 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. VER works toward this objective not only by conducting successful investment activities but also by co-operating with various stakeholder groups. To this end, VER actively builds a co-operation network involving 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 by considering the portfolio from an overall perspective. The performance of fixed-income and equity portfolios, as well as other investment portfolios, is monitored separately. Relative returns are assessed by comparing 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 standard is applied for the calculation of the fund's returns. It unifies the different 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 as the State's Buffer for Pensions

In 2009, the Finnish State Pension Act covered roughly 180,000 people, of whom 130,000 were state employees. Pension payments of EUR 3.6 billion were made, to 280,000 eligible persons. Decisions on the management of state pensions are made by the State Treasury.

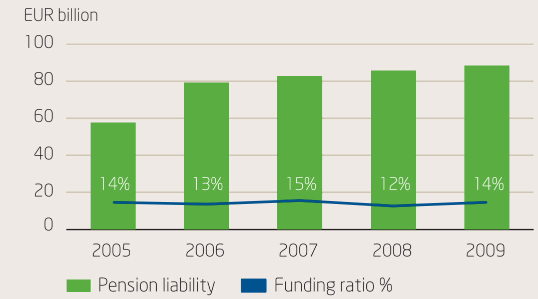
## VER, balancing the financing of pension costs

The state uses the State Pension Fund to prepare for the financing of future pensions, particularly for balancing the upcoming pension costs of the baby boom generation.

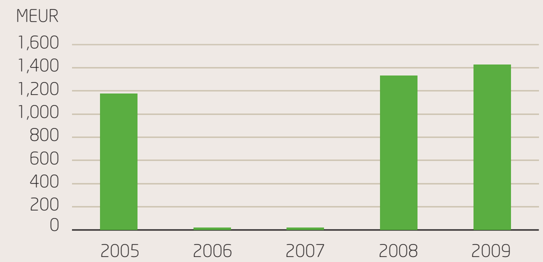
## The State Pension Scheme as part of the Finnish employment pension scheme

Following the pension reform that took effect at the beginning of 2005, the scheme has in most respects been similar to other employment pension schemes in Finland. Thanks to the revisions, state pension cover, originally slightly better than the cover under the Employees Pensions Act, is on a par with that seen in the municipal and private sectors. The pension reform also introduced a career model for state pensions, according to which pensions are calculated on the basis of employment income and a percentage of accumulation for each year. Pension is accumulated for work performed between the ages of 18 and 68, and an increased rate of accumulation, 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 increased life expectancy, will affect the amount of pension.

Pension liability and funding ratio




Asset transfer from VER to the state budget



## The state and the State Pension Fund

Through the State Pension Fund, the state prepares for financing pensions payable in the future, and for the year-to-year evening out of pension expenditure, which will increase in the next few years with the ageing of the baby boom generation. The state will be responsible for paying the accrued pension amounts in the future. With VER's activity, the state is aiming at a 25 per cent funding rate in proportion to pension liability.

The VER investment activities are directed by the Board of Directors, appointed by the Ministry of Finance, which includes representatives from the employer and employee side both. VER manages the assets entrusted to it and makes all investment decisions in accordance with the investment plan, authorisations, and limits confirmed by the Board of Directors.

VER's assets can be transferred to the state budget, and the state has exercised this option every year. The transfer has been justified by the fact that, because all state pensions are paid out from budget appropriations, some of the pension fund's assets can be used for the payment of pensions.

The transfer of funds to the state budget is a crucial factor regulating VER's growth. The State Pension Act specifies an amount for this transfer, which is 40 per cent of annual state pension expenditure. By the end of 2009, a total of almost EUR 17 billion in VER assets had been transferred to cover the amounts in the state budget. In accordance with parliamentary decisions, the transfers of VER assets to the state budget were substantially reduced for 2006 and 2007, raising the funding of pensions above previous levels.

## Pension costs in relation to salaries

The proportion of the State's pension costs under the State Pension Act in relation to salaries will continue growing sharply until the beginning of the 2030s. In 2008, the share of pension costs in the salary total was approximately 53 per cent; it is expected to reach its highest in 2031, at over 77 per cent. After this peak, the proportion will slowly fall until the end of the 2040s. After the mid-2070s, pension expenditure is expected to stabilise at around 32 per cent of total salaries.

Calculated in euros (at the 2008 value), pension costs will peak in 2032 (at approximately EUR 4.7 billion). The number of employees falling under the State Pension Act is expected to fall sharply until the mid-2040s, which will also reduce pension costs.

The greatest impact on the number of employees came from the new Universities Act, as only those employees born before 1980 were left within the scope of the state pension scheme. In 2010, the number of university employees under the State Pension Act will fall by some 3,700, and the decrease will continue until Finnish universities no longer employ people under the State Pension Act. Major savings in pension costs due to the university reform will not be seen until the mid-2040s, but, as the salary total is cut, VER's pension premium income will be negatively affected already in 2010. VER's pension premium income is influenced by reductions in salaries subject to state pension payments from universities, local governments, and state-aided institutions, and by the slowing down of state pay rises due to the National Productivity Programme. According to an estimate by the State Treasury, the growth of VER's pension premium income will continue slowing until the late 2040s, after which it will achieve steady growth according to the earnings index.

## The concept of pension liability

Pension liability refers to the sum of money that is calculated at one time to be enough, in consideration of its future growth through investment, to cover the future cost of paying out state pensions earned until the time of the 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 return, 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 sum of pensions accrued until the time of calculation as accurately as possible. 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.

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 value of old-age, family, disability, unemployment, and part-time pensions that have already started being paid out. The latter refers to the value of pensions accrued by the time of calculation that have not yet begun to be paid out.

## Calculation of pension liability

The State Treasury is responsible for implementing the State Pension Scheme and calculating the amount of pension liability. At the end of 2009, the state's pension liability stood at EUR 88.4 billion (2008 comparative: EUR 85.6 billion). 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 total salaries, 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.

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 by the Financial Supervisory Authority to pension funds that are covered by the Pension Foundation Act, as well as the calculation principles set forth in the Employees Pensions Act concerning registered supplementary benefits, 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 pensions 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 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.

State pension liability, 2006–2009


* The pension liability for 2009 was derived retrospectively via the individual method from that calculated for 2008.

Below are further details of the year-end 2008 pension liability.

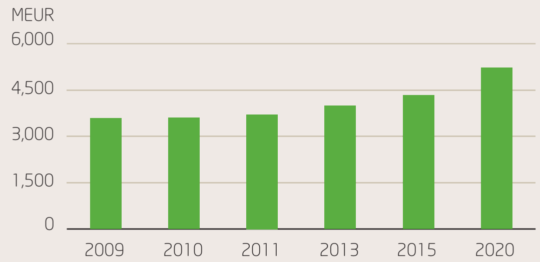
Source: State Treasury

State pension liability on 31 December 2008 (MEUR)

| | Current liability | Future liability Retirement | Disability | Survivor | Total |
|---|---|---|---|---|---|
| Active | 0 | 22,942 | 1,471 | 2,313 | 26,726 |
| Paid-up | 0 | 8,093 | 782 | 1,060 | 9,935 |
| Pensioners | | | | | |
| Retirement pensions | 34,381 | 0 | 0 | 3,592 | 37,974 |
| Disability pensions | 1,128 | 3,359 | 0 | 356 | 4,843 |
| Unemployment pensions | 45 | 1,030 | 0 | 102 | 1,178 |
| Part-time pensions | 91 | 1,175 | 0 | 105 | 1,371 |
| Survivor's pensions | 3,573 | 0 | 0 | 0 | 3,573 |
| Total | 39,218 | 36,600 | 2,253 | 7,528 | 85,600 |

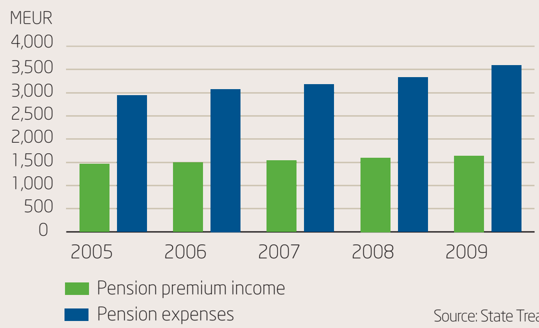
Source: State Treasury

Trend in state pension expenses and projection to 2020



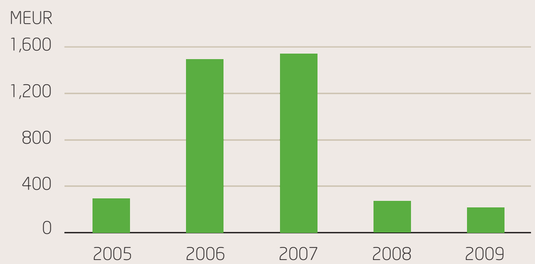

Source: State Treasury

VER's pension premium income and the state's pension expenses




Source: State Treasury

VER's net premiums, five years



# 20 Years of the State Pension Fund

## 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 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.
- Designated staff are hired for the fund.
- Investment activities are extended to include equity investments.

## 2003
- Timo Löyttyniemi DSc (Econ), is appointed as the Fund's first full-time Managing Director.

## 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 set funding ratio is achieved. Subsequently, the amount of the transfer is to be specified annually in the state budget.

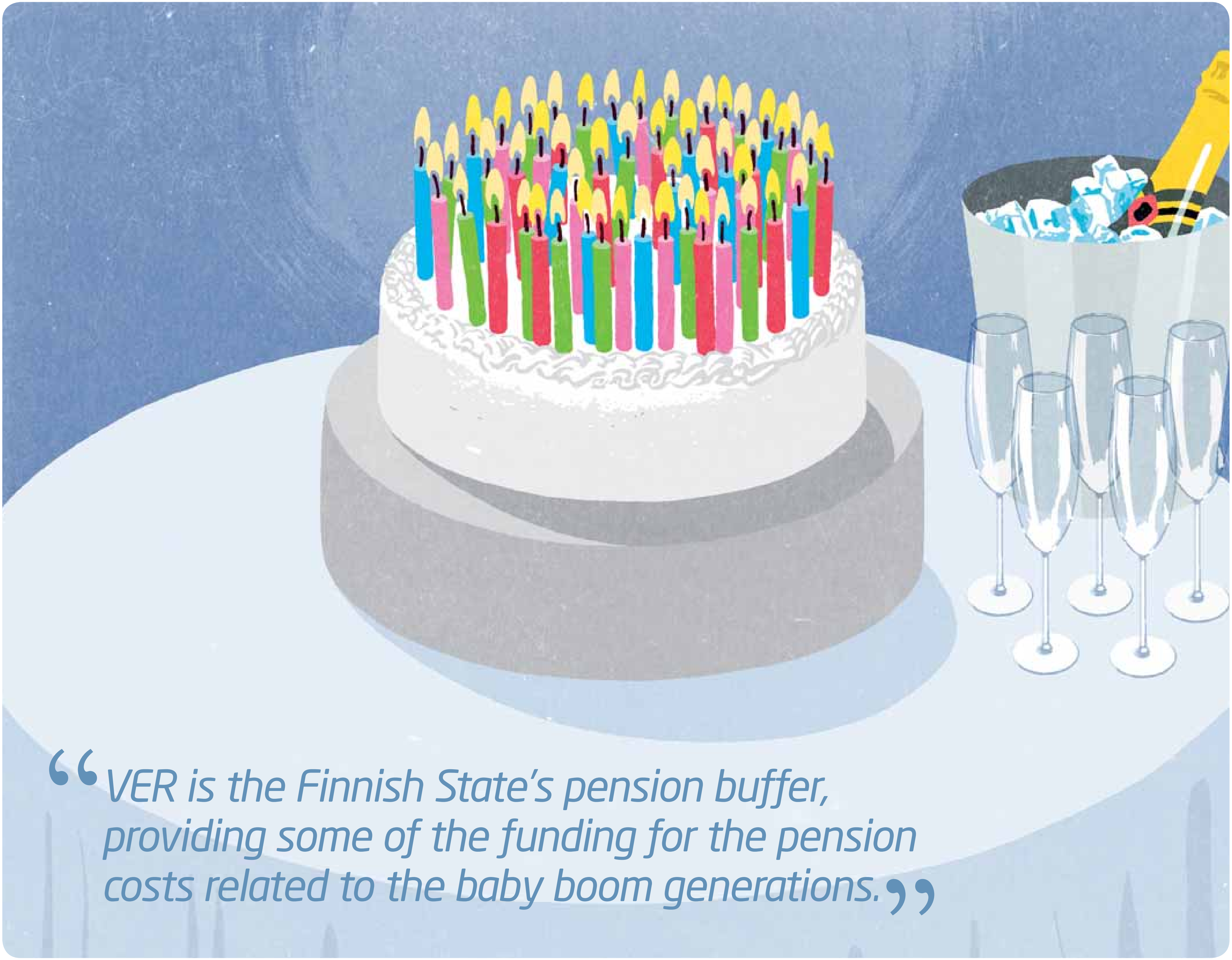
## 2006
- The role of the Ministry of Finance as supervisor of VER is defined more precisely, and the ministry is granted the right to issue general regulations concerning VER's administration, finances, and investment policies.
- The tasks of the VER Board of Directors are laid down in the law.
- The duties of VER's auditors are set by law.
- The transfer of VER assets 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 guideline issued in 2006.

## 2008
- Global financial crisis begins.

## 2009
- Minister 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.

VER | 1990 - 2010



"VER is the Finnish State's pension buffer, providing some of the funding for the pension costs related to the baby boom generations."

# VER's Organisation

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

Chairman
Antti Tanskanen
Minister
born 1946
Education: Doctor of Economics

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 a maximum of five other members. A personal deputy is appointed for each member.

The Ministry of Finance appointed Antti Tanskanen, PhD (Econ.), as Chairman of the Board, to serve from 1 March 2009. The Board of Directors convened 10 times in 2009.

Vice Chairman
Teuvo Metsäpelto
Ministry of Finance/Office for the Government as Employer
born 1949
Education: Licentiate of Laws

Deputy Member: Veikko Liuksia
Senior Adviser for Legal Affairs, Ministry of Finance/Office for the Government as Employer

Helena Tarkka
Ministerial Counsellor for the Ministry of Finance, Budget Department
born 1955
Education: Master of Political Science, Associate of Laws

Deputy Member: Raine Vairimaa
Senior Adviser, Ministry of Finance

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

Deputy Member: Marja-Leena Rinkineva
Senior Adviser, Ministry of Employment and the Economy

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

Deputy Member: Seppo Väänänen
Director of Negotiations, Pardia

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

Deputy Member: Markku Nieminen
Chief of Negotiations, JUKO

Pirjo Mäkinen
Human Resources Manager, Trade Union for the Public and Welfare Sectors (JHL)
born 1955
Education: Master of Science

Deputy Member: Mika Hämäläinen
Department Manager, JHL

The Board of Directors appoints a consultative committee with seven members for the fund. The members 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 three times in 2009.

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

## Investment Consultative Committee 31 December 2009

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

Vice Chairman
**Vesa Puttonen**, Professor, Aalto University School of Economics

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

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

**Liisa Jauri**, Director, Nordea

**Erik Valtonen**, CIO, AP3

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

## Management Team

**Maarit Säynevirta**, Head of Other Investments

**Jan Lundberg,** Head of Equities

**Tiina Tarma,** Legal Counsel

**Timo Löyttyniemi,** Managing Director

**Seija Kettunen,** Head of Administration

**Jukka Järvinen,** Head of Fixed Incomer

# Financial Statements

| PROFIT AND LOSS STATEMENT | 1 Jan–31 Dec 2009 | | 1 Jan–31 Dec 2008 | |
|---|---|---|---|---|
| OPERATING INCOME | | | | |
| Other operating income | | | | |
| Sales gains on equities and shares | 37,184,851.89 | | 69,239,672.07 | |
| Pension contributions from State offices and institutions | 941,076,474.15 | | 922,883,053.11 | |
| Other pension contribution income | 384,018,435.84 | | 383,029,131.88 | |
| Employees' pension contributions | 314,772,917.26 | | 291,176,283.24 | |
| Disability insurance contribution income | 2,701,070.00 | 1,679,753,749.14 | 4,763,717.00 | 1,671,091,857.30 |
| | | | | |
| OPERATING EXPENSES | | | | |
| Materials, supplies and goods | | | | |
| Purchases during the period | 84,542.01 | | 84,511.52 | |
| Personnel expenses | 2,076,368.24 | | 1,646,892.90 | |
| Rents | 237,785.33 | | 231,321.92 | |
| Outsourced services | 3,231,395.38 | | 2,526,700.69 | |
| Other expenses | | | | |
| Other expenses | 267,765.64 | | 137,436.64 | |
| Sales losses on equities and shares | 82,044,147.84 | | 100,831,996.49 | |
| Depreciation | 62,943.50 | -88,004,947.94 | 28,973.90 | -105,487,834.06 |
| | | | | |
| SURPLUS I | | 1,591,748 801.20 | | 1,565,604,023.24 |
| | | | | |
| FINANCIAL INCOME AND EXPENSES | | | | |
| Financial income | 392,337,945.49 | | 325,410,870.23 | |
| Financial expenses* | -34,343,989.40 | 357,993,956.09 | -196,151,802.87 | 129,259,067.36 |
| | | | | |
| SURPLUS II | | 1,949,742,757.29 | | 1,694,863,090.60 |
| | | | | |
| INCOME AND EXPENSES FROM TRANSFERS | | | | |
| Income | | | | |
| From trade and industry | | | | |
| Transfer fees | | 13,824,937.01 | | 11,203,008.00 |
| | | | | |
| SURPLUS III | | 1,963,567,694.30 | | 1,706,066,098.60 |
| | | | | |
| SURPLUS/DEFICIT FOR THE PERIOD | | 1,963,567,694.30 | | 1,706,066,098.60 |

* Financial expenses include impairment on stocks and fund units.

# Balance Sheet



| ASSETS | 31 Dec 2009 | | 31 Dec 2008 | |
|---|---|---|---|---|
| FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | | | |
| INTANGIBLE ASSETS | | | | |
| Other long-term expenditure | | 114,578.36 | | 93,533.34 |
| TANGIBLE ASSETS | | | | |
| Machinery and equipment | 21,082.82 | | 34,351.60 | |
| Furniture and fittings | 91,907.89 | 112,990.71 | 115,860.97 | 150,212.57 |
| SECURITIES HELD AS FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | | | |
| Purchases of bonds denominated in euros | 4,469,566,076.24 | | 4,584,283,674.27 | |
| Other long-term investments denominated in euros | 4,298,401,870.37 | | 4,212,590,233.25 | |
| Other long-term investments denominated in foreign currency | 1,899,887,188.35 | 10,667,855,134.96 | 1,645,603,083.71 | 10,442,476,991.23 |
| TOTAL FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS | | 10,668,082,704.03 | | 10,442,720,737.14 |
| LONG-TERM RECEIVABLES | | | | |
| Long-term receivables | | 1,092,101.00 | | 599,261.06 |
| CURRENT RECEIVABLES | | | | |
| Accrued credits and deferred charges | 224,753,327.60 | | 218,032,896.10 | |
| Other current receivables | 1,434,615.52 | | 7,950,693.49 | |
| Advance payments | 12,839.69 | 226,200,782.81 | 16,226.53 | 225,999,816.12 |
| FINANCIAL SECURITIES AND OTHER SHORT-TERM INVESTMENTS | | | | |
| Purchases of bonds denominated in euros | | 983,627,857.81 | | 756,796,455.31 |
| CASH, BANK DEPOSITS AND OTHER FINANCIAL ASSETS | | | | |
| Joint account receivable from the State | 4,007,162.72 | | 4,221,918.71 | |
| Other bank accounts | 165,890,538.81 | 169,897,701.53 | 72,328,257.26 | 76,550,175.97 |
| TOTAL INVENTORIES AND FINANCIAL ASSETS | | 1,380,818,443.15 | | 1,059,945,708.46 |
| TOTAL ASSETS | | 12,048,901,147.18 | | 11,502,666,445.60 |

| EQUITY AND LIABILITIES | 31 Dec 2009 | | 31 Dec 2008 | |
|---|---|---|---|---|
| EQUITY | | | | |
| Fund capital | -14,998,271,461.16 | | -13,667,323,855.12 | |
| Accrued changes in capital | 26,500,227,736.91 | | 24,794,161,638.31 | |
| Budget transfers | -1,426,560,489.33 | | -1,330,947,606.04 | |
| Surplus/deficit for the period | 1,963,567,694.30 | 12,038,963,480.72 | 1,706,066,098.60 | 11,501,956,275.75 |
| LIABILITIES | | | | |
| CURRENT | | | | |
| Accounts payable | 289,028.79 | | 310,662.02 | |
| Items to be rendered forward | 32,298.57 | | 30,256.77 | |
| Accrued charges and deferred credits | 9,566,781.25 | | 319,557.58 | |
| Other current liabilities | 49,557.85 | 9,937,666.46 | 49,693.48 | 710,169.85 |
| TOTAL LIABILITIES | | 9,937,666.46 | | 710,169.85 |
| TOTAL EQUITY AND LIABILITIES | | 12,048,901,147.18 | | 11,502,666,445.60 |

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