VER

VALTION ELÄKERAHASTO
STATENS PENSIONSFOND
THE STATE PENSION FUND

2000 2001 2002 2003 2004 2005

2006 ANNUAL REPORT

Contents

The State Pension Fund

Established in 1990, the State Pension Fund (VER) is an off-budget fund by means of which the State prepares for financing pensions payable in the future and for evening out pension expenditure. The State Pension Fund is an investment organisation with the task of managing and investing the assets entrusted to it.

Employers and employees covered by the State Pension Scheme make pension contributions to the State Pension Fund. Pensions are not paid out of the Fund, but all pensions falling within the State Pension Scheme are paid out of appropriations from the state budget.

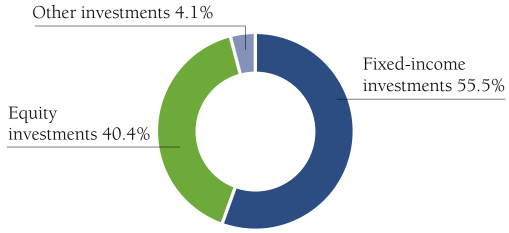
Mission

The State Pension Fund's mission is to manage the assets entrusted to it over the long term and to ensure that investments are secure, deliver a high return and can be converted into cash, while being appropriately diversified.

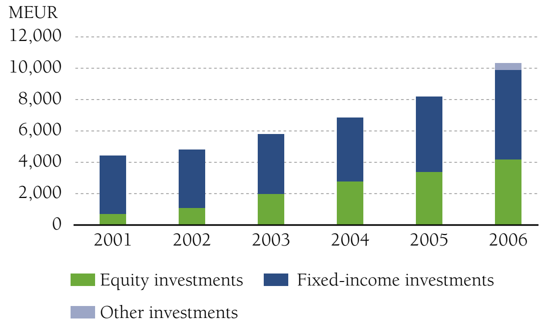
Vision

The State Pension Fund's goal is to be a respected and successful pension investor, emphasising excellent professional skills and ethics throughout its operations.

VER investment portfolio breakdown on 31 December 2006



Trend in VER's investments 2001–2006



2006 in brief

- VER's investment portfolio yielded a return of 7.0 per cent in 2006, against 14.9 per cent a year earlier.
- The return on fixed-income investments was 0.1 per cent, the return on equity investments was 17.4 per cent and the return on other investments was 6.7 per cent.
- Equity investments accounted for 40.4 per cent of the portfolio at the end of 2006, while the share of other investments increased to 4.1 per cent.
- The five-year average yield came to 8.1 per cent.
- The Investment & Pensions Europe (IPE) magazine ranked the State Pension Fund as the best pension investor in Finland for the second year in a row.
- The State Treasury estimated the State's pension liability to be EUR 79.3 billion.
- The funding ratio was 13 per cent of pension liabilities.
- The State's supplementary budgets reduced the amount of budget transfers by EUR 1,1 billion.
- Operating expenses stood at 0.04 per cent.

VER 2002–2006

	2002	2003	2004	2005	2006
Total investments, MEUR	4,841	5,795	6,867	8,201	10,306
Fixed-income investments, MEUR	3,777	3,821	4,113	4,848	5,722
Fixed-rate investments %	78%	66%	60%	59%	56%
Equity investments, MEUR	1,064	1,974	2,754	3,353	4,163
Equity investments %	22%	34%	40%	41%	40%
Other investments, MEUR					420
Other investments %					4%
Income from investment operations %					
Return on investments	-0.4	9.4	9.6	14.9	7.0
Fixed-income investments	7.2	4.0	7.0	5.4	0.1
Equity investments	-26.7	20.7	14.4	30.8	17.4
Other investments					6.7
Operating expenses (% of average capital)	0.04	0.05	0.05	0.05	0.04
Personnel	7	11	13	15	14
Income from pension premium, MEUR	1,285	1,324	1,380	1,462	1,491
Net premiums, MEUR	404	408	431	296	1,496
Transfer to state budget, MEUR	881	917	952	1,175	0.1
Balance sheet total, MEUR	5,198	5,898	6,620	7,337	9,185
Pension provision, MEUR	54,200	55,100	56,300	57,600	79,300
Funding rate % [1]	9%	11%	12%	14%	13%

1) Investments / pension provisions

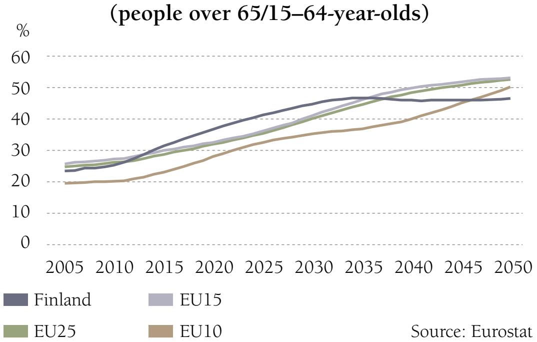
Events in 2006

Additional capital to cover the increased pension liability

The State decided to prepare for upcoming substantial increases in pension liability by reducing transfers of VER's assets to the State budget in 2006 and 2007. The decision resulted in approximately EUR 1,1 billion of additional capital for VER in 2006.

The increase in the State's pension liability is reflected by the Eurostat population forecast, according to which the proportion of people who have reached retirement age will increase from 16 per cent to 27 per cent of the population. The retiree dependency ratio (the number of people over 65 years in proportion to 15–64-year-olds) will increase from 24 per cent to 45 per cent.

Retiree dependency ratio, %
(people over 65/15–64-year-olds)



Source: Eurostat

The State Pension Fund was ranked the best pension fund in Finland

The State Pension Fund has been granted an award for operating the best pension investment scheme in Finland. VER was ranked number one in Finland by the Investment & Pensions Europe (IPE) magazine. VER received the award for the second time in a row. According to the jury, the development of VER's portfolio structure and investment operations during recent years proved decisive.

Many pension funds all over Europe participated in the competition arranged by the Investment and Pensions Europe (IPE) magazine, which was its sixth industry-wide competition.

Amendments to legislation and regulations

- The role of the Ministry of Finance as VER's supervisor was defined more precisely, and the Ministry was granted the right to issue general regulations concerning VER's administration, finances and investment policies.
- The duties of VER's Board of Directors were written in law.
- The duties of VER's auditors were added to law.

Managing Director's Review

VER exceeded EUR 10 billion

Investments achieved expectations in 2006. Equities were generally estimated to be undervalued in relation to the corporate earnings level and prevailing interest rates. It was also estimated that returns on equities would fall short of the previous year, and that the level of interest rates would increase. All of these expectations came true during 2006.

Our estimate is that the State Pension Fund (VER) would achieve long-term returns of approximately 5 to 6 per cent with the current structure of its investment portfolio. This level was exceeded in 2006 as investments yielded a return of 7.0 per cent. Share prices increased strongly in the beginning of the year. In the spring, there was a substantial downswing in the market for the third year in a row. However, strong growth resumed in the equity market during the autumn. The sovereign bond market fell short of the previous years' favourable development. However, fixed-income investments yielded a positive return.

The Investment and Pensions Europe (IPE) magazine ranked the State Pension Fund as the best pension investor in Finland for the second year in a row. We received recognition for successful portfolio construction and the best return on investment among large pension investors during the last few years. Everyone at VER is pleased with the recognition that proves the correct focus of our efforts.

Parliament passed a legislative amendment concerning the State Pension Fund in June 2006. According to the new Act, the Ministry of Finance is entitled to issue general regulations concerning administration of the Fund, its finances and investment policies. The general regulations address issues such as the long-term return target, the risk limits for investment operations and a number of other factors associated with investments, finances and administration. VER's Board of Directors is the ultimate decision-making body responsible for the Fund and approves an annual investment plan. With regard to investment decisions, VER operates as an independent investor.

The State uses the State Pension Fund to prepare for increases in pensions and other benefits during upcoming decades. It is estimated that the costs of ageing will reach their peak in Finland around the year 2030. The State is preparing for this cost burden by accumulating reserves in the State Pension Fund. This also balances the pressures arising from these costs.

Through two supplementary budgets in 2006, Parliament decided to increase the State Pension Fund by a total of EUR 1,1 billion. This made VER's investment portfolio exceed EUR 10 billion. The State's pension liabilities are quite high. During past years, approximately 800,000 people have been in State employ for a shorter or longer period and earned the right to pension. The State also has pension liabilities remaining from the incorporation of State enterprises. The State's annual pension expenses currently amount to EUR 3 billion, exceeding those of any other pension institution in Finland. The expenses are estimated to increase during the next few years.

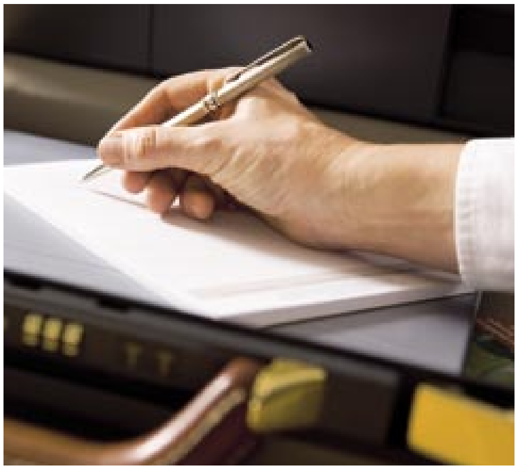
The diversification of VER's investment portfolio will continue in upcoming years. The objective is to further increase the weight of other investments within the investment portfolio. At the end of 2006, these investments accounted for 4 per cent of the portfolio. They are focused on real estate funds, venture capital funds, infrastructure funds and absolute return funds. Despite the costs of the construction

phase, we aim to achieve a satisfactory level of return within a couple of years. Most of the return expectations concern a longer time span.

I would like to thank our staff and interest groups for a successful year. Success is the aggregate of several factors and requires continuous effort. Our investment operations are always exposed to the markets but competent staff can manage these risks. This is a good starting point.

Timo Löyttyniemi
Managing Director

Investment Activities



Economic environment

The global economy has grown with an extraordinary intensity for the last three years. Similar growth rates have not been seen since the early 1970s. Even though growth has been strong, core inflation has been relatively moderate.

During recent years, the global economy has grown rapidly under circumstances in which major central banks have practiced a loose monetary policy for a prolonged period. This has brought increases in the prices of various asset categories due to low real interest rates and abundant liquidity. The increase of consumer prices accelerated in the first half of the year as the price of crude oil reached a record-breaking high of almost USD 78 but a rapid reversion to the USD 60 level resulted in a corresponding decrease in inflation. Even though the prices of oil and other raw materials were higher at the end of the year, this increase has not yet been reflected in other prices to any significant extent. The development of wages and salaries has also been moderate.

The first signs of a slowdown in the growth rate were visible in the United States in the spring of 2006. This was particularly evident in the housing market as a declining price trend and an increased volume of unsold housing. The weakness of the housing market and increased interest rates have cut down consumer demand particularly towards the end of the year. The rate of growth in new jobs also slowed down during the year. This resulted in a slowdown in GDP growth from 5.6 per cent in the first quarter to slightly less than 3.0 per cent in the latter half of the year. Due to this development, the US Federal Reserve has at least for the time being retained its Federal Funds rate at 5.25 per cent after 17 subsequent increases.

Economic growth in the euro zone has exceeded expectations. The GDP growth rate in the second quarter was the fastest in five years. Annual economic growth outperformed the long-term average of two per cent in the first half of the year. The European Central Bank (ECB) increased its central bank rate to 3.5 per cent in December and is anticipating additional increases should there be pressure towards accelerated inflation due to economic growth. However, the economic cycles in the euro zone have been quite short in recent decades.

Favourable economic development in Japan continued for almost the entire year. GDP growth in the second quarter was a disappointment but after all, outperformed the trend. It seems that Japan would break loose of its deflationary spiral as the trend in consumer prices has been positive recently. As a consequence, the Japanese central bank increased its key rate by 0.25 percentage points for the first time. The growth of the Japanese economy no longer depends on exports alone, as the demand in household consumption has also picked up speed during last year. Economic growth in India and China has been very strong, and similar development is expected to continue. The rate of growth in India has been 7–8 per cent in recent years, and rapidly increasing demand has boosted inflation. The Chinese economy has maintained a growth rate of 10 per cent for the last few years. However, inflation has not accelerated even though the growth rate has been record-breaking.

The State Pension Fund's Investment Portfolio and its development

VER's investment portfolio grew significantly in 2006, reaching a year-end market value of EUR 10,306 million (EUR 8,201 million at the end of 2005). The portfolio's time and capital-weighted returns, calculated according to the GIPS standard, were

7.0 per cent. This figure includes all investment activity expenses. During the same period, the portfolio's benchmark index yielded 7.1 per cent. In 2005 the investment portfolio yielded 14.9 per cent.

Fixed-income investments' market value totalled EUR 5,722 million at year-end, corresponding to a weight of 55.5 per cent, while the fixed-income portfolio yielded a return of 0.1 per cent (benchmark index -0.2 per cent). Return on equity investments totalled 17.4 per cent last year (benchmark index 18.3 per cent). At the end of 2006, the market value of equity investments was EUR 4,163 million.

The entire investment portfolio's tracking error, calculated over a period of 12 months, came to 0.65 per cent, i.e. the portfolio's return was almost equal to that of the benchmark index. However, Jensen's alpha for the portfolio was positive, and the portfolio's risk-adjusted yield was better than that of the benchmark index. The Sharpe indicator was 0.99, while the portfolio's beta was 0.94, indicating that its risk level was below that of the benchmark index, and that it was less volatile than the benchmark index. The information ratio for the entire portfolio was -0.1. The risk indicators for the investment portfolio are calculated over a 12-month period based on monthly figures.

Ownership Policy

VER prepared its ownership policy principles in 2004, stating that VER operates as an independent portfolio investor. Because the Fund is a long-term investor and major shareholder in a number of companies, it can best promote the successful performance of its portfolio companies by acting as a responsible owner. One of the principal tasks of a company is to ensure the increasing value of its shares over the long term.

VER monitors its portfolio companies and their success so as to be able to take a position on their activities and the principal resolutions brought before General Meetings. VER can, to the extent it deems appropriate, get in touch with other institutional investors in matters concerning resolutions at individual companies' General Meetings or other matters of general importance. VER employees do not participate in the administration of listed companies in which the Fund holds shares.

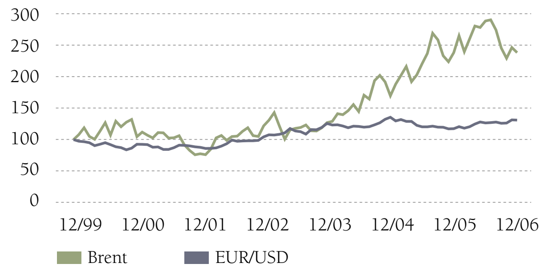
Social Responsibility

VER's investment activities adhere to an investment policy in favour of sustainable development, because companies adhering to such an ideology have often proved successful within their operating environments.

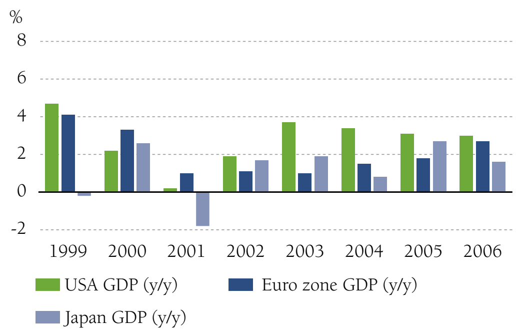
When selecting potential investment targets, VER uses sustainable development indices as a basis for comparison. VER invests primarily on the basis of the expected return from the investment target, but between any two companies equal in this respect, the selected candidate will be the one represented in any sustainable development index.

The investment policy also provides for negative evaluation so as to avoid making direct investments in companies deriving a substantial share of their turnover from the alcohol, tobacco, firearms, pornography or gambling industries. The same pertains to countries and enterprises which do not respect human rights and the fundamental rights which the International Labour Organisation (ILO) has confirmed on a trilateral basis.

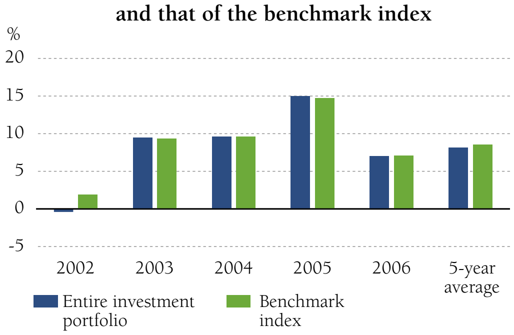
Trend in the Brent and euro/dollar exchange rate (31 December 1999=100)



GDP trend in the United States, euro zone and Japan



VER's investment portfolio return and that of the benchmark index



Fixed-Income Investments

Fixed-Income Market in 2006

The interest rate trend during the first half of 2006 was upwards on both sides of the Atlantic. This was affected by accelerated inflation during the spring and interest rate increases carried out by central banks in order to calm down inflation. The short-term end of the interest rate curve showed the strongest increase. Long-term interest rates assumed a downward trend halfway through the year as weakened economic indicators were published in the United States. Another factor supporting a decline in interest rates was that rate hikes by the US Federal Reserve ended at 5.25 per cent in June 2006, at least for the time being. Interest rate curves became substantially less steep on both sides of the Atlantic. The US interest rate curve actually turned downwards, which has usually indicated the possibility of a recession.

Also in the euro zone, the European Central Bank (ECB) increased its central bank rate to 3.50 per cent as economic growth was rapid and inflation exceeded the Bank's target of two per cent. Inflation actually fell slightly below two per cent towards the end of the year but this is assumed to be temporary, and accelerated inflation is expected in early 2007 due to the increased VAT rate in Germany.

Increased demand and short supply jointly with a low rate of credit default and strengthened corporate balance sheets supported the corporate bond market in 2006. Individual companies are facing risks through increased merger activity and private equity funds targeting new acquisitions. High Yield bonds offered good returns at a volatility lower than that of sovereign bonds. The emerging bond market and convertible bonds yielded good returns but the volatility was strong at times. The emerging bond market was strengthened by the improved debt positions and current account surpluses of governments, which resulted in improved credit ratings. The convertible bond market has succeeded with support from the equity markets.

The State Pension Fund's Fixed-Income Investments in 2006

The State Pension Fund's fixed-income investment portfolio yielded 0.1 per cent, while the benchmark index yielded -0.2 per cent. The Fund outperformed its benchmark index due to successful allocation in the High Yield market and the bonds of emerging countries, as well as correct positioning with regard to interest rate risk. At the end of the year, VER's fixed-income investments had a weight of 55.5 per cent in proportion to the overall allocation of the investment portfolio. The fixed-income portfolio was maintained at a slight under-duration for the first half of the year, and the duration was raised to slight overweight for the rest of the year. Sovereign bonds were clearly overweight while corporate bonds were underweight for almost the entire year. The corporate bond portfolio mainly consisted of bonds with a high credit rating. The share of inflation-linked bonds in the EMU portfolio was further increased, and their share of the entire fixed-income portfolio totalled more than 15 per cent at the end of the year.

The money market was kept slightly overweight in the first half of the year and at a neutral weight towards the end of the period. The position on the interest rate curve for the longest maturities was neutralised towards the end of the year as the interest rate curves flattened out.

The fixed-income portfolio's volatility was 2.88 per cent, while the corresponding figure for the benchmark index was 2.91 per cent. The portfolio's beta was 0.90, and the information ratio was 1.22. Risk indicators for the fixed-income portfolio are calculated on monthly returns over a period of twelve months. Calculated at market values, VER's fixed-income portfolio grew from EUR 4,113 million at the beginning of the year to EUR 5,722 million. During the year, bonds were acquired for EUR 3,063 million while money market investments totalled EUR 740 million in the corresponding period.

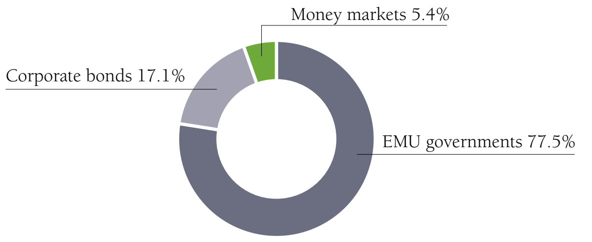
Principally, the State Pension Fund makes its own direct income investments in sovereign bonds, Investment Grade corporate bonds and money market instruments, while other investments are made through mutual funds. Direct investments accounted for approximately 92 per cent of the aggregate fixed-income portfolio at the year-end.

The State Pension Fund's fixed-income portfolio is entirely hedged from currency risks because the instruments are either euro-denominated or hedged by the mutual funds we use.

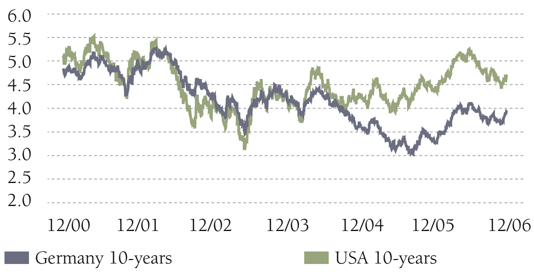
Major fixed-income investments on 31 December 2006

	EUR	Percentage of fixed-income portfolio
Government of France 25.4.2014 4.0%	170,035,280	3.3
Government of Germany 13.6.2008 3.25%	151,358,445	2.9
Government of Germany 4.7.2016 4.0%	139,944,912	2.7
Government of Greece 18.4.2008 3.5%	122,301,567	2.3
Government of Italy 1.2.2009 3.0%	119,370,339	2.3
Government of Italy 1.8.2014 4.25%	117,423,401	2.3
Government of Ireland 18.4.2016 4.6%	108,182,000	2.1
Government of the Netherlands 15.7.2011 5.0%	106,737,767	2.0
Government of the Netherlands 15.7.2008 5.25%	104,400,205	2.0
Government of Spain 30.7.2017 5.5%	103,576,154	2.0

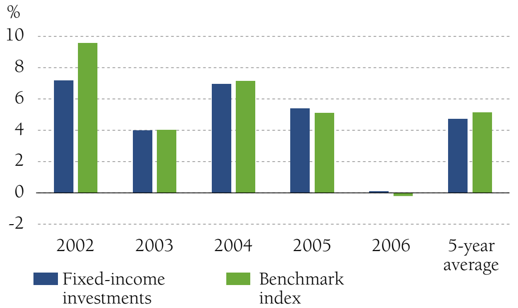
Fixed-income instruments by sector on 31 December 2006



Interest rate trends



Return of fixed-income investments compared with the benchmark index



Equity Investments

The Market and The Equity Investments in the Year 2006

Equity markets yielded good returns in 2006 for the fourth year in a row. VER's equity portfolio yielded a return of 17.4 per cent during the year (30.8 per cent in 2005), while the benchmark index yielded 18.3 per cent. Falling short of the benchmark index was mainly due to a difficult year in the Japanese equity markets where the performance of small-cap companies in particular was poor.

VER's equity portfolio increased from EUR 3.4 billion to EUR 4.2 billion during the year. The growth was backed by good returns from equities as well as cash flows coming into the Fund. 40 per cent of these cash flows were invested in equities in accordance with the neutral allocation. The proportionate share of equities within the entire investment portfolio remained close to the neutral weight of 40 per cent for the entire year, ending up at 40.4 per cent at year-end.

The beta coefficient representing the portfolio's sensitivity to the markets was 0.92 in 2006. As the portfolio fell short of its benchmark index, the information ratio was negative at -0.72 per cent. However, Jensen's alpha was positive (0.41 per cent), which meant that the portfolio yielded risk-adjusted added value in comparison with the benchmark index. The equity portfolio's tracking error was 1.44 per cent – in other words, the portfolio closely tracked its benchmark index. Risk indicators for the equity portfolio are calculated over a 12-month period based on monthly figures.

Returns from the equity markets stood at a good level at year-end even though major fluctuations were seen during the year. The equity markets developed very favourably in the first quarter as liquidity was flowing into equities. This was the case despite the fact that the price of oil continued to increase to new record levels. A clear increase in the interest rate level did not strike fear in equity investors either. In addition to a sustained favourable earnings development, the equity markets were supported by high dividend payouts and the abundance of equity buyback schemes that reinforced the confidence of equity investors. New capital flowed into emerging equity markets in particular, which was reflected in very strong growth within these markets.

The atmosphere on the equity markets changed during the second quarter. The equity markets saw a very substantial downswing in May as investor sentiment was shaken by fears in relation to the US economic outlook, manifested by signs of accelerated inflation. The emerging equity markets that had boomed in the first quarter turned into a steep decline as hedge funds were reducing the weight of investments in these markets. The decline continued until mid-June when the situation calmed down as the US Federal Reserve raised its key interest rate as expected and no new risk factors were seen in the markets. From mid-June to the last days of November, the development of the equity markets was fairly steady, and several markets regained the entire May-June decline.

The Nordic equity markets showed their strength once again during 2006, and the Nordic portfolio was the best performer among VER's sub-portfolios. In particular, metal and engineering companies continued their strong upward trend but other sectors such as telecom operators and banks also developed favourably. Returns on forest companies remained modest, and a clear decline in the dollar against the euro towards the end of the year means that the future will bring even greater challenges to this sector. The Nordic portfolio yielded a return of 29.9 per cent (33.4 per cent in 2005), while the benchmark index yielded 30.6 per cent.

Economic growth in Europe was stronger than expected. The confidence indicators of the euro zone reached new record-setting levels during the year, which resulted in increased investor confidence towards Europe. The development of the German economy in particular was strong after a number of difficult years. VER's European portfolio yielded 21.2 per cent, while the benchmark index yielded 20.6

per cent. Small-cap companies continued to perform better than blue chips. VER's investments in the Russian equity markets also yielded good returns.

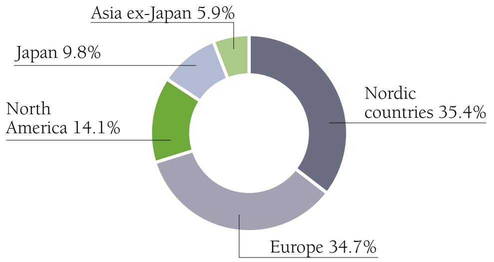
The development of North American stock exchanges was good during the year but from the viewpoint of an euro-based investor, the great decline in the dollar against the euro in the latter half of the year clearly hampered the returns. VER maintained its North American portfolio underweighted for the entire year as economic indicators suggested a likely decline in the dollar. VER's North American portfolio yielded 3.1 per cent, while the benchmark index yielded 2.9 per cent.

The Japanese equity markets were very challenging in 2006. Small-cap companies, which were overweighted in the first half of the year, performed particularly poorly. VER's Japanese portfolio as a whole was overweighted as well in the beginning of 2006, which further weakened the sub-portfolio's contribution to the overall returns of the equity portfolio. VER's Japanese portfolio yielded -11.4 per cent during the year, while the benchmark index yielded -4.8 per cent.

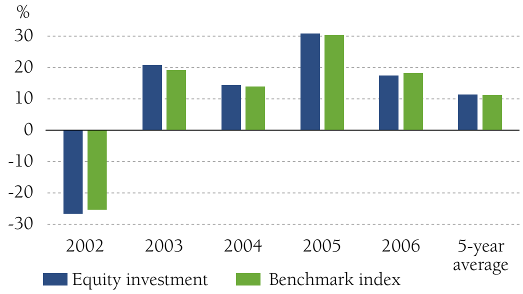
The Asian equity markets (excluding Japan) performed well in 2006 even though strong fluctuations were seen during the year. The Asian sub-portfolio suffered the most from the great equity market decline in May-June but developed favourably after June. The equity markets of China and India developed particularly well. VER's Asian portfolio yielded 19.4 per cent by the end of the year, while the benchmark index yielded 18.0 per cent. The Asian portfolio was kept clearly overweighted for the entire year.

At the end of the year, approximately 59 per cent of VER's equity portfolio was invested through mutual funds, while 41 per cent was managed as direct investments. The Fund had direct equity investments in 138 companies and mutual fund units in 52 different funds. During 2006, the Fund purchased shares for some EUR 941 million and sold shares for some EUR 494 million.

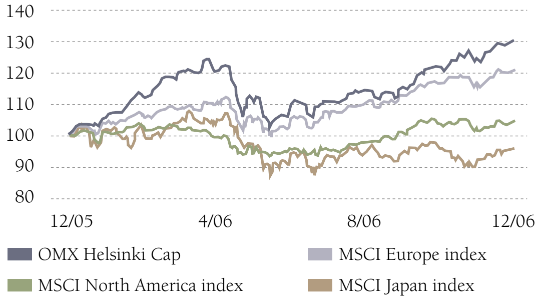
Equity portfolio breakdown by country on 31 December 2006



Return on equity investments compared with the benchmark index



Trends in equity markets in 2006



Major direct equity investments on 31 December 2006

	EUR	Percentage of the equity portfolio
Nokia Corporation	103,716,000	2.5
Fortum Corporation	95,942,000	2.3
Sampo plc	81,120,000	1.9
Nordea AB (SEK)	77,020,928	1.8
TeliaSonera AB (SEK)	68,442,768	1.6
UPM-Kymmene Coporation	60,228,000	1.4
Stora Enso Oyj R	57,600,000	1.4
Neste Oil Corporation	43,757,000	1.1
Ericsson AB LM B (SEK)	38,231,162	0.9
Kone Coporation B	37,787,200	0.9

Major direct mutual fund investments on 31 December 2006

	EUR
BGI Europe ex UK Index sub Fund	182,642,245
Vanguard European Stock Index Fund	126,595,793
Mandatum European Enhanced Index	119,089,544
Dow Jones Euro Stoxx Index Fund	110,425,500
BGI US Index sub Fund	107,033,271
BGI Japan Index sub Fund	106,062,124
Vanguard US Futures Fund	89,062,448
Sampo Japani	87,998,315
BGI UK Index sub Fund	76,950,190
Mandatum North America Enhanced Index	76,917,636

Other Investments

Investment Markets 2006

The year 2006 was characterised by extremely strong development of the real estate markets, fueled by demand, and the increased popularity of indirect real estate investments. Increased investor interest in international diversification also contributed to the activity seen during the year. The continued compression of yields and the lively rental market boosted real estate values despite increased interest rates. Vacancy rates continued to decrease in many cities, and transaction activity increased in the German real estate market as local funds divested their real estate mainly to foreign investors. The year was record-breaking in Finland, with the value of real estate transactions exceeding EUR 5 billion. According to the European EPRA index, the market value of listed real estate companies increased by almost 46 per cent during 2006.

New private equity funds raised the greatest amounts of new capital in all time, and several buyout transactions of record-breaking amounts were carried out during the year. The exit market continued to be lively. The active investment markets increased the popularity of mezzanine financing as well. Several new funds specialising in infrastructure were launched during the year. VER started to invest in European infrastructure funds in 2005 and expanded these activities through two new funds in 2006.

The year was good for absolute return funds. Even though the favourable beginning was followed by the lack of any clear trend for many hedge funds in the summer months, the final quarter turned out to be excellent. At the end of the year, 95 per cent of VER's investments in absolute return funds were in funds-of-funds.

VER's Other Investments

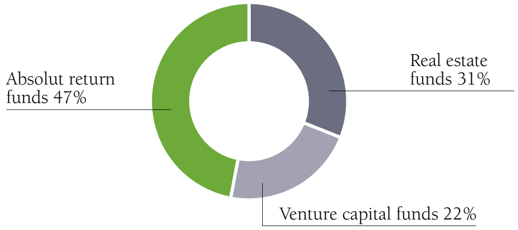
VER's Other Investments became an independent asset class as of the beginning of 2006. The Other Investments category comprises investments in real estate and private equity funds, as well as absolute return funds. The target allocation for the Other Investments category is 10 per cent, and the proportion of these investments increased from 1.3 per cent to 4.1 per cent during the year. The market value of the investments stood at EUR 419.9 million at the end of the year, while the amount of open investment commitments was EUR 345.2 million. Investment commitments will generally become invested within 3 to 4 years of the launch of a fund. In accordance with its strategy, VER has utilised funds-of-funds particularly with regard to hedge fund investments and private equity investments.

Within the amount of invested assets, indirect real estate investments accounted for 31 per cent, venture capital funds for approximately 22 per cent and absolute return funds for approximately 47 per cent of the total. Including open investment commitments, indirect real estate investments accounted for 39 per cent, private equity funds for approximately 35 per cent and absolute return funds for approximately 26 per cent of the total.

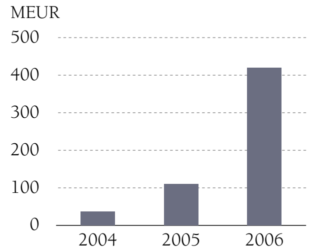
The focus of indirect real estate investments is in non-listed funds making investments in European office, retail and logistics properties. At the end of the year, approximately 13 per cent of the real estate investments involved funds investing in listed real estate equities and real estate investment trusts (REITs). VER has been a member of INREV, the European Association for Investors in Non-listed Real Estate Vehicles, since 2005. The targets for private equity fund investments are funds and funds-of-funds making investments in Europe. During the last two years, VER has made investment commitments in four European infrastructure funds. Investments in absolute return funds are focused on funds of hedge funds.

VER's Other Investments category yielded a return of 6.7 per cent, while absolute return funds yielded 5.2 per cent. In the initial phase, returns on investments in non-listed real estate funds and particularly in private equity and venture capital funds are hampered by the effect of management fees and formation expenses.

Breakdown of other investments on 31 December 2006



Market value of other investments 2004–2006



General Investment Activity Principles

1.1 Background of the State Pension Fund (VER)

The State Pension Fund is an off-budget State fund whose mandate is set out in the State Pension Fund Act. VER exists to provide for the State's future pension liabilities and even out pension-related expenditure. Its purpose is to build up reserves that can be applied to evening out the heavy costs of baby-boomers' pensions in the peak pension expenditure years through partial dissolution of the Fund in a controlled manner.

VER has a Board of Directors appointed by the Ministry of Finance that decides on the Fund's investment principles and is responsible for the Fund. VER employed 14 people in 2006.

Pensions are not paid out of the Fund, but all pensions falling within the State Pension Scheme are paid out of appropriations from the state budget. Because pensions are paid out of the budget, VER can make annual transfers of assets to the State reserves to cover pension expenditure. The statutory amount to be transferred from the Fund to the State budget each year is 40 per cent of annual expenditure arising from pensions based on years of service covered by the State Pension Scheme. Assets not transferred to the State reserves will remain in the Fund. VER is a so-called buffer fund, i.e. the Fund does not incur pension liabilities that must be covered individually as for pension companies under the Employees' Pensions Act. Therefore, VER is not subject to regulations governing its solvency.

At the end of 2006, the Fund's capital at market value stood at EUR 10.3 billion. The Fund will be accumulated until the funded amount corresponds to 25 per cent of the pension liabilities arising from pensions based on years of service covered by the State Pension Scheme. More detailed provisions on the use of the Fund's assets will be enacted once the funding objective has been achieved.

1.2 Investment Objectives

1.2.1 High Return, Security, Diversity and Liquidity

When making investments, VER must ensure that the 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 of other employment pension schemes.

The Fund's goal is to be a respected and successful pension investor, emphasising excellent professional skills and ethics throughout its operations. Another goal of the Fund is to clarify and develop its corporate image as an independent portfolio investor.

1.2.2 Expected Long-Term Return and Risk Level

The Ministry of Finance has specified that the long-term target for the Fund's investment activities is to exceed the costs arising from the State's net liabilities.

The expected return and risk of VER's investment portfolio is estimated annually on the basis of expert calculations. Returns from the Fund should make it possible to achieve the 25 per cent funding ratio referred to in the appropriate Act and its preamble by around 2020. Achievement of the funding objective will be affected by investment income, pension contribution income and transfers to the State budget.

1.2.3 VER's Basic Allocation

The State Pension Fund prepares an investment plan annually, defining the neutral basic allocation of the investment portfolio, i.e. how investments are to be allocated in various investment categories. The goal is to create an optimal investment portfolio that yields the best possible return over the long term at the risk level defined by the Board of Directors.

At the end of 2006, the neutral basic allocation of VER's investment portfolio comprised 56 per cent of fixed-income investments (allowable variation 45–70 per cent), 40 per cent of equity investments (allowable variation 30–45 per cent) and 4 per cent of other investments. Issues related to the distribution of investments are discussed at VER's internal allocation meetings.

Furthermore, the Fund's Board of Directors makes annual decisions concerning limits to be set for different categories of assets, taking into account the diversification requirements imposed by risk management.

1.3 Investment Activities

1.3.1 The Pension Fund as a Portfolio Investor

The State Pension Fund is a long-term investor, a so-called buffer fund, which can adopt an investment policy allowing the return on investments to vary considerably over the short term. Investment decisions are taken on the basis of the Fund's required return and the yield potential of prospective investments, taking risk levels into account. Investment risks are spread by spreading investments between different investment grades, various markets and sectors, various instruments, companies and a range of sovereign bonds with varying maturities.

VER operates as an independent portfolio investor. VER's employees do not participate in the administration of companies in which the Fund holds shares. However, direct discussion contacts with corporate management increases VER's credibility as an investor and improves the Fund's expertise. VER may appoint representatives to General Meetings. VER prepared its own ownership policy in the spring of 2004.

Fixed-income and equity instruments belonging to the investment portfolio can be purchased and sold, but the liquidity of venture capital fund investments within the Other Investments category is partly restricted. The Fund makes independent investment decisions without any parties external to its investment operations. Third-party advisors can be used as part of the investment process if necessary. The Fund's investments are always made in accordance with the best available information, understanding and assessments.

1.3.2 Monitoring of Investment Activities

The success of investment activities is analysed on a long-term basis, chiefly considering the portfolio from an overall perspective. The fixed-income and equity portfolios' performances are monitored separately, applying geographical criteria with the help of benchmark indices.

The international GIPS standard is applied to the calculation of the Fund's returns. GIPS is a standard aimed at employing uniform methods to yield and risk calculations, thereby arriving at comparable yield and risk figures.

Neutral allocations of fixed-income investments at the end of 2006:

	Basic allocation weight %
EMU governments	75
Corporate bonds	20
Money markets	5

Neutral allocations of equity investments at the end of 2006:

	Basic allocation weight %
Nordic countries	35
Europe	35
North America	15
Japan	10
Asia ex-Japan	5

The State Pension Scheme

In 2006, the State Pension Act covered roughly 180,000 people, of whom 130,000 were State employees. Benefits were paid to almost 310,000 people, and the State Treasury made around 20,500 pension decisions in 2006, paying out pensions of EUR 3.1 billion.

Top: Antti Karppinen, the Grand Old Man of Russian relationships, is often seen at the Ministry of Foreign Affairs despite his high age of 80. Photo: Raino Heinonen.

Bottom: New diplomats Riina-Riikka Kuparinen and Päivi Nevala examining their certificates from the Ministry for Foreign Affairs course in February 2004. They are most probably facing forty years of public service at the Ministry in Helsinki and at diplomatic missions all over the world. Photo: Raino Heinonen.

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

After the pension reform effective as of the beginning of 2005, the State Pension Scheme is mostly similar to the Finnish employment pension scheme in general. After the revisions, state pension coverage, originally slightly better than that pertaining to the basic principles of the Employees' Pension Act, now equals the municipal and private sector. The pension reform introduced the career model also to State pensions, according to which pension is calculated on the basis of employment income and an accumulation percentage for each year. Pension is accumulated for work performed between the ages of 18 and 68, and an increased rate of accumulation, also known as "super accumulation", encourages 63-year-olds to continue working. The 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.

The State and the State Pension Fund

Through the State Pension Fund, the State prepares for financing pensions payable in the future and for evening out pension expenditure in the years to come, particularly that of the baby-boomer generations. The State itself is responsible for paying accrued pensions in the future.

Pension liability refers to the capital required to pay the pensions accumulated through employment within the scope of the State Pension Scheme by a certain time, including interest. The State pension liability includes all paid-up pensions (pensions calculated on terminated employment), including paid-up pensions for people who have transferred from State employ to municipal or private employers or whose employment with the State has ended due to the incorporation of State entities.

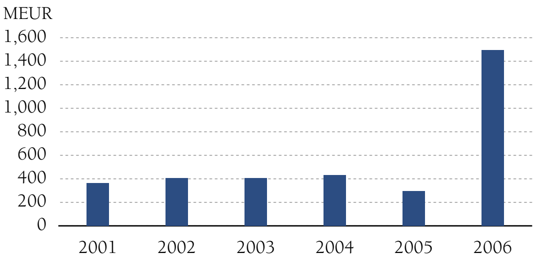
The State is aiming at a 25 per cent funding rate in proportion to the pension liability. The State Treasury is responsible for implementing the State Pension Scheme and calculating the amount of the State pension liability. The State Treasury's calculations of the pension liability were more precise in 2006 compared to previous years, and the amount of liability turned out to be clearly higher than in the previous calculations. The State Treasury's calculations at the end of 2005 indicated a pension liability of EUR 57.6 billion. According to the new calculations, the pension liability under the State Pension Scheme was EUR 79.3 billion at the end of 2006.

VER's investment activities are directed by the Board of Directors appointed by the Ministry of Finance, including both employer and employee representatives. 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.

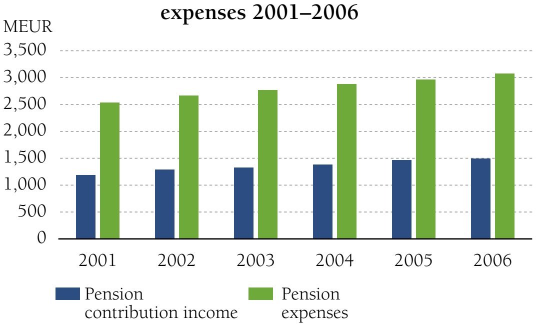
The State has had the option of borrowing assets from VER but this has not taken place since 1994. VER's assets can also be transferred to the State budget, and the State has exercised this option every year. The transfer has been justified by the fact that because all State pensions are paid from budget appropriations, a part of the Pension Fund's assets can be used for the payment of pensions.

The transfers of funds to the State budget have been a crucial factor regulating VER's growth. The State Pension Fund Act stipulates a specified amount for this transfer, which is 40 per cent of annual state pension expenditure. By the end of 2006, a total of approximately EUR 14.5 billion in VER assets had been transferred to cover the State budget. In accordance with a Parliament decision, the transfers of VER's assets to the State budget were substantially reduced for 2006 and 2007, increasing the funding of State pensions. The transfer in 2006 was minor in comparison to previous years, meaning that most of the pension contribution income remained within VER.

Net contribution income 2001–2006



VER's pension contribution income and State pension expenses 2001–2006



History of the State Pension Fund

1989 The State Pension Fund is established within the State Treasury. The funding target is set to the year 2010.

1990 Pensions shall not be paid out of the Fund but the State may borrow the Fund's assets or transfer them to the State budget.

1991 Pension contributions from State offices, institutions and enterprises are directed to VER.

1993 Pension contributions from State employees are directed to VER. A Board of Directors is appointed to bear responsibility for the Fund's investment activities.

1995 Start of investment activities on market terms.

1999 Municipalities start to pay pension contributions for teachers to VER.

2000 The budget transfer is reduced to one-third of annual pension expenditure until the end of 2006 (one-half subsequent to this). The funding target was 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 is hired for the Fund. Investment activities are expanded to equity investments.

2003 A full-time Managing Director is appointed.

2005 The funding target is set at 25 per cent of the State pension liability. The intention is to use the Fund's assets to cover public expenditure in a controlled manner in State budgets between 2020 and 2040. The annual transfer from VER to the State budget is prescribed to equal 40 per cent of annual pension expenditure until the funding ratio is achieved. The amount of transfer would subsequently be specified annually in the State budget.

2006 The role of the Ministry of Finance as VER's supervisor is defined more precisely. The Ministry is granted the right to issue general regulations concerning VER's administration, finances and investment policies. The tasks of VER's Board of Directors are written in law. The duties of VER's auditors are added to law. The transfer of VER's assets to the State budget is reduced for 2006 and 2007.

The State Pension Fund Organisation

Board of Directors

Eino Keinänen
Chairman

Teuvo Metsäpelto
Vice Chairman
State Labour Market Director
Ministry of Finance

Tiina Astola
Legislative Director
Ministry of Justice

Pekka Hemmilä
Director of Public Sector Negotiating Commission
AKAVA - Confederation of Unions for Academic Professionals

Elina Selinheimo
Budget Counsellor
Ministry of Finance

Pirjo Mäkinen
Human Resources Manager
Trade Union for the Public and Welfare Sectors JHL

Antti Palola
Chairman
Confederation of Salaried Employees Pardia

Experts

Pertti Saarela
Director, Administration
Employers' Association for Transport and Special Services (VR Group)

Veikko Liuksia
Senior Adviser, Legal Affairs
Ministry of Finance

Deputy members of the Board

Veikko Liuksia
Senior Adviser, Legal Affairs
Ministry of Finance

Jarmo Pätäri
Legal Counsel
AKAVA - Confederation of Unions for Academic Professionals

Seppo Väänänen
Chief of Negotiations
Confederation of Salaried Employees Pardia

Ilkka Alava
Department Manager
Trade Union for the Public and Welfare Sectors JHL

Raine Vairimaa
Senior Adviser
Ministry of Finance

Marja-Leena Rinkineva
Senior Adviser
Ministry of Trade and Industry

Investment Consultative Committee

Chairman
Eva Liljeblom
Professor
The Swedish School of Economics and Business Administration

Vice Chairman
Paavo Prepula

Liisa Jauri
Head of Business Infrastructure
Nordea

Topi Piela
Managing Director
Umo Capital Oyj

Vesa Puttonen
Professor
Helsinki School of Economics

Hanna Kaleva
Director
Institute for Real Estate Economics

Jari Sokka
Executive Director
The Local Government Pensions Institution

The State Pension Fund

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Secretary
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Portfolio Analyst
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Tiina Tarma

Administration

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Equity Investments

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Jan Lundberg

Portfolio Manager
Esa Artimo

Portfolio Manager
Hans Parhiala

Other Investments

Portfolio Manager
Ilkka Tomperi

Financial Statements

PROFIT AND LOSS STATEMENT	1.1.–31.12.2006		1.1.–31.12.2005	
OPERATING INCOME				
Other operating income				
Sales gains on equities and shares	159,528,251.73		196,827,217.33	
Pension contributions from State offices and institutions	822,544,491.87		780,561,528.47	
Other pension contribution income	380,392,864.12		380,576,010.53	
Employees' pension contributions	287,910,535.48		301,250,252.20	
Disability insurance contribution income	5,036,973.00		8,933,271.00	
Write-downs on receivables from other operations	0.00	1,655,413,116.20	0.00	1,668,148,279.53
OPERATING EXPENSES				
Materials, supplies and goods				
Purchases during the period	39,981.79		38,879.20	
Personnel expenses	1,432,192.26		1,496,932.53	
Rents	133,625.83		137,226.23	
Outsourced services	1,871,956.75		1,619,874.93	
Other expenses				
Other expenses	132,449.65		130,260.66	
Sales losses on equities and shares	6,449,757.98		26,942,842.28	
Depreciation	112,061.27	-10,172,025.53	40,954.89	-30,406,970.72
SURPLUS I		1,645,241,090.67		1,637,741,308.81
FINANCIAL INCOME AND EXPENSES				
Financial income		202,579,182.18		253,182,007.79
SURPLUS II		1,847,820,272.85		1,890,923,316.60
INCOME AND EXPENSES FROM TRANSFERS				
Income				
From trade and industry				
Transfer fees	-172,686.81		1,398,675.37	
From financial and insurance institutions				
Returns of pension entitlement	0.00	-172,686.81	0.00	1,398,675.37
SURPLUS III		1,847,647,586.04		1,892,321,991.97
SURPLUS/DEFICIT FOR THE PERIOD		1,847,647,586.04		1,892,321,991.97

Balance sheet

ASSETS	31.12.2006		31.12.2005	
FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS				
INTANGIBLE ASSETS				
Intangible assets	1,170.19		2,460.38	
Other long-term expenditure	0.00	1,170.19	888.16	3,348.54
TANGIBLE ASSETS				
Machinery and equipment	13,822.07		20,474.93	
Furniture and fittings	21.88	13,843.95	66,600.11	87,075.04
SECURITIES HELD AS FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS				
Purchases of bonds denominated in euros	4,961,251,965.43		4,053,121,218.33	
Other long-term investments denominated in euros	2,506,864,988.85		1,956,527,670.34	
Other long-term investments denominated in foreign currency	1,226,656,712.15	8,694,773,666.43	895,273,507.77	6,904,922,396.44
TOTAL FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS		8,694,788,680.57		6,905,012,820.02
CURRENT RECEIVABLES				
Accrued credits and deferred charges	213,141,633.53		187,338,979.70	
Other current receivables	14,027.29		13,127,466.00	
Advance payments	4,804.74	213,160,465.56	0.00	200,466,445.70
FINANCIAL SECURITIES AND OTHER SHORT-TERM INVESTMENTS				
Purchases of bonds denominated in euros		209,406,385.88		210,595,672.56
CASH, BANK DEPOSITS AND OTHER FINANCIAL ASSETS				
Joint account receivable from the State	2,234,973.63		1,437,775.63	
Other bank accounts	65,180,156.30	67,415,129.93	19,770,847.27	21,208,622.90
TOTAL INVENTORIES AND FINANCIAL ASSETS		489,981,981.37		432,270,741.16
TOTAL ASSETS		9,184,770,661.94		7,337,283,561.18

EQUITY AND LIABILITIES	31.12.2006		31.12.2005	
EQUITY				
Fund capital	-13,663,679,855.12		-12,488,805,221.12	
Accrued changes in capital	21,000,207,673.55		19,107,885,681.58	
Budget transfers	-104,000.00		-1,174,874,634.00	
Surplus/deficit for the period	1,847,647,586.04	9,184,071,404.47	1,892,321,991.97	7,336,527,818.43
LIABILITIES				
CURRENT				
Items to be rendered forward	20,772.37		22,581.76	
Accrued charges and deferred credits	642,953.49		694,798.48	
Other current liabilities	35,531.61	699,257.47	38,362.51	755,742.75
TOTAL LIABILITIES		699,257.47		755,742.75
TOTAL EQUITY AND LIABILITIES		9,184,770,661.94		7,337,283,561.18

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