VER

VALTION ELÄKERAHASTO
STATENS PENSIONSFOND
THE STATE PENSION FUND

ANNUAL REPORT 2013

Good returns,
responsibly!

VER

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Contents

ANNUAL REPORT
2013

The State Pension Fund (VER)

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 was EUR 16.3 billion at the end of 2013.

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

In 2011, the task of granting and paying out state pensions was transferred from the State Treasury to Keva, which has also acted as the state pension provider since then. At the start of 2013, also the employer services related to state pensions were transferred to Keva.

Mission

VER is responsible for investing the Finnish state's pension assets in a professional manner, thus helping the state to collect funds for and balance out future pension-related costs.

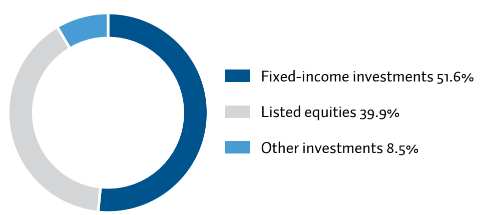
Vision

VER is a respected and successful pension investor. Our operations emphasise outstanding professional skills and ethical conduct.

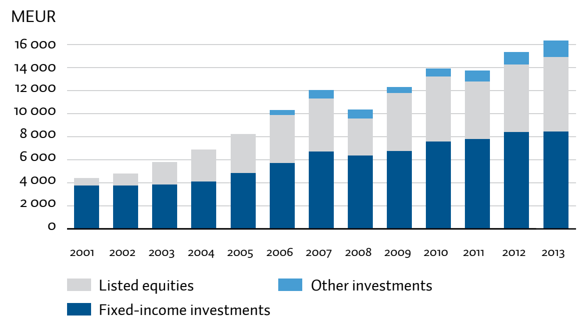
Values

Professionalism, ethics and openness

VER's portfolio allocation on 31 Dec 2013



Development of VER's investments 2001–2013



Key indicators, 2009–2013

	2009	2010	2011	2012	2013
Total investments (MEUR)	**12,318**	**13,937**	**13,736**	**15,359**	**16,335**
Fixed-income investments (MEUR)	6,765	7,574	7,781	8,380	8,431
Fixed-income investments (%)	55%	54%	57%	55%	52%
Listed equity investments (MEUR)	5,024	5,632	5,006	5,899	6,511
Listed equity investments (%)	41%	40%	36%	38%	40%
Other investments (MEUR)	529	731	948	1,080	1,392
Other investments (%)	4%	5%	7%	7%	9%
Income from investment operations (%)					
Return on investments	16.4	11.7	-2.3	11.3	6.4
Fixed-income investments	8.0	3.9	4.1	8.8	-1.6
Listed equity investments	38.7	23.6	-12.3	16.8	18.2
Other investments	-14.7	8.6	6.1	3.5	5.7
Cost of investment operations (% of average capital)	**0.05**	**0.05**	**0.05**	**0.05**	**0.04**
Number of personnel	19	19	20	21	22
Income from pension contributions (MEUR)	1,640	1,622	1,614	1,639	1,634
Net premiums (MEUR)	216	154	104	35	-45
Transfer to state budget (MEUR)	1,427	1,473	1,509	1,604	1,678
Balance sheet total (MEUR)	12,049	12,763	13,087	13,676	14,321
Pension liability (MEUR)	88,400	90,600	89,700**	92,600**	94,000**
Funding ratio (%)*	14%	15%	15%	17%	17%

* *Investments / pension liability*

** *A life expectancy coefficient was first taken into account in the pension liability calculations on 31 December 2012. The calculation is made using forecasts for the development of life expectancy from the Finnish Centre for Pensions. The like-for-like liability figure for 31 December 2011 has been recalculated to account for the life expectancy coefficient. The state pension liability confirmed for 31 December 2011 in the prior financial statements was approximately EUR 92.5 billion.*

Starting to Balance out Pension Expenditure

2013 was a fairly good year for pension investors. Even the economy showed signs of recovery. This created an environment in which VER was able to achieve a total return of 6.4 per cent.

There were many contrasts in the development of the economy. The United States enjoyed positive development, while a lot of bleak news came from Europe.

The same split was seen in the equity market, which grew sharply in the developed world but kept declining in developing countries. Considering this setting, the overall investment market and the results achieved were very favourable for institutional investors.

VER is now balancing pension expenditure

In 2013, VER's budgetary transfers to the state surpassed the amount of pension premiums it received for the first time. This meant that the net premium income was negative.

The net premium figure will remain close to zero in the next few years, after which it will turn even more negative. This indicates a change in VER's operations from collecting funds to balancing pension expenses.

The Finnish state's pension costs are estimated to reach their peak in 2030 or so. VER's duty is to balance out these costs, especially between 2020 and 2040.

The gradual downturn of net premium income will not affect VER's investment strategy in the next few years. Besides premium income, the strategy is affected by the realised returns. VER's assets will continue to grow despite the budget transfers, as long as the portfolio continues to yield enough.

New challenges from population ageing

The ageing of the population is increasing every year. Finland now has 390,000 inhabitants in the age group 60–64 years, while young people about to reach working age number 340,000, i.e. 50,000 fewer. This is a breaking point after which the number of pensioners will increase and the workforce will shrink.

It is well known that the growth of the workforce is directly linked to economic growth. The workforce is an engine and a facilitator of economic growth. This means that Finland is facing grave challenges, in terms not only of labour, but also of domestic consumption and tax revenue.

Finns consume the most at around the age of 50. At that age, they usually still have children at home and their homes are at their largest. After that, consumption tends to reduce in proportion to salary, and the same continues throughout retirement.

A significant proportion of the population is already living in this period of change between the ages of 50 and 70. The effects of this are starting to be visible in consumption and demand for housing. In other words, the effects of the ageing of the population fan out very widely in Finland. Additionally, they take place earlier here than in many other western European countries.

VER has made good strategic choices

The investment strategy of an institutional investor is continuously revised and adjusted. VER prepares an annual investment plan.

Public investors are expected to operate with transparency, and many public-sector pension investors operate as so-called buffer funds. This means that they don't constantly have to worry about maintaining solvency and hedging their portfolios against market decline, because that can have a detrimental effect on returns. If you happen to be away from the market on the best stock exchange days, you can lose a large part of your long-term returns.

In recent years, VER's development efforts have focused on improving the dynamic reaction ability of its investment portfolio. During the financial crisis we were able to increase equity and corporate bond investments at the right time. Simi-

Cost pressures on public finance are growing, so it is important to ensure there are enough financial assets to cover pension costs in the next decades.

larly, during the European sovereign debt crisis, VER carried out several changes to its portfolio seeking improved risk management and higher yields.

Recent development has been linked to VER's preparedness against interest rate rises and equity market fluctuations.

The last time interest rates rose steeply was in the 1990s. In the current decade, rates have been below long-term averages. This is due to many factors. Economic growth has been weak, central banks have worked on increasing their assets, and their purchases have pushed interest rates to record lows. There have been no significant inflationary pressures. If this setting should change, interest rates may also rise.

For investors, equity market fluctuations are commonplace and a part of the nature of the market economy. For long-term investors, fluctuations always bring opportunities for new acquisitions. When prices fall, many securities become cheaper and thereby profitable. Similarly, when prices rise, investors like to ride the wave and increase their profits.

It is usually impossible to predict changes accurately, but throughout its history VER has been able to make good use of equity market fluctuations. Crises and plummeting stocks have offered us great opportunities over the years.

All eyes on American economic growth

There is an optimistic outlook for 2014 thanks to the possibility of the U.S. economic growth spreading globally. The main challenges of the ongoing year will be the wind-down of central banks' stimulation activities and one-off issues in the emerging markets.

The signs of economic growth in the USA were mostly encouraging during 2013. In the second half of the year, the annual rate of growth had reached a good level. The housing market and unemployment were under control. The Federal Reserve is expected to reduce its purchases of market securities; if this happened with continued economic growth, it would raise interest rates.

During 2013 it became evident that rising interest rates in the USA have an extensive impact on the emerging markets. Many developing countries are still battling slow growth, national deficits and political instability. These factors may generate new problems if there is not enough global economic growth during 2014.

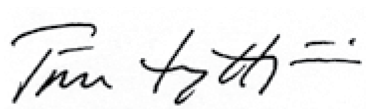
From the point of view of institutional investors, it would be best if all these challenges could be controlled and kept in balance; unexpected surprises are always a risk.

To conclude

VER carries out an important task in collecting funds for and balancing out the Finnish state's pension expenditure. The state, like many other entities, must prepare for the challenges caused by population ageing. There are growing cost pressures on public finance. Therefore it is important to ensure that there will be enough financial assets to cover pension costs in the next decades.

Tough salary decisions were made in Finland in late 2013. These were preceded by a flood of poor economic figures combined with even bleaker future prospects and predictions. What Finland needs now is new thinking, seeds for new growth, and a healthy confidence in the future.

I would like to thank our competent and committed personnel, our partners, and our many important stakeholders for the past year's success.



Timo Löyttyniemi
Managing Director
The State Pension Fund

VER: Key Events in 2013

VER was named Finland's Best Pension Investor for the third time in a competition run by Investment & Pensions Europe (IPE) magazine. The reasons behind the award included VER's excellent long-term strategy combined with dynamic short-term changes in the investment portfolio.

Good return on investment

- VER's ten-year nominal return (2004–2013) averaged 5.7 per cent per annum. The average five-year return (2009–2013) was 8.5 per cent per annum.
- Income from investment operations: the whole portfolio yielded 6.4 per cent after investment expenses, with fixed-income investments yielding -1.6, listed equity investments 18.2 and other investment 5.7 per cent.

VER balancing out pension expenditure

- The total sum of pension funds held in VER by the year-end 2013 was EUR 16.3 billion.
- The transfer from VER to the state budget totalled EUR 1.7 billion, corresponding to 40 per cent of the state's annual pension costs. The pension premium income of EUR 1.6 billion was not enough to cover the whole transfer, and the difference was taken from VER's fund assets. This is the start of VER's duties in balancing out pension expenditure.
- The annual transfer to the state budget has been a major factor regulating fund growth and the achievement of the funding target. As the state's pension costs grow, more of VER's assets will be needed to cover the transfer.
- The state's pension liability was EUR 94.0 billion at the year-end. The pension liability will continue to grow in the next few years, but will begin falling in the early 2020s.
- The employer services related to the state pension scheme were transferred to Keva from the start of 2013. Keva collects the pension contributions from employees in the state pension scheme and transfers them to VER.
- The State Pension Fund Act was amended, transferring to it the clauses concerning the funding ratio and pension premiums from the State Pension Act.

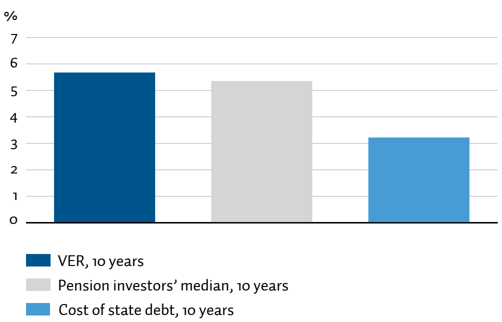
Challenges of ageing

- Finland is ageing and the proportion of the population aged over 68 is continuously growing. People are also retired for longer.
- The state pension system prepares for the growing pension costs and lengthening life expectancy by funding its assets.

Duality in the world economy

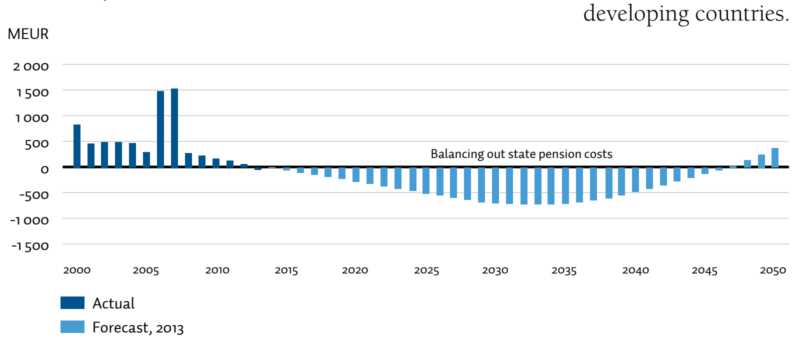
- Economic growth continued in the United States, but in Europe structural problems restricted growth.
- Equity markets grew sharply in the West but fell in developing countries.

Good returns for VER



Pension investors' median = median of nominal 10-year returns on investments by largest Finnish pension investors
Sources: VER and Finnish Pension Alliance investment statistics

VER's net premium income



Increasing Dependency Ratio is a National Challenge

The ageing of the Finnish population will accelerate in coming years and decades. Even though our population is growing, the size of the working-aged population, which is crucial to the dependency ratio, will continue to decrease.

According to the most recent forecasts, the proportion of the working-aged population will decrease from its current 65 per cent to 58 per cent by 2030. This means 120,000 fewer Finns of working age then than now.

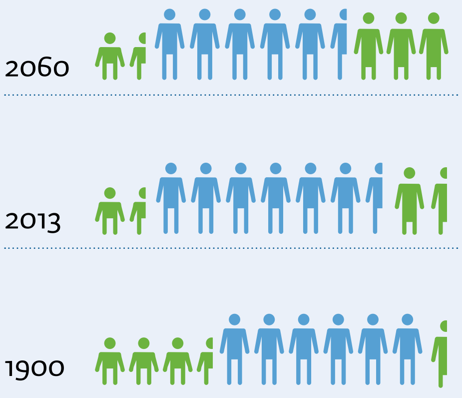
At the same time, the proportion of people aged over 68 will grow. Forecasts place them at over one fifth (22 per cent) of the whole population at the end of the next decade.

This is a great challenge for the country's dependency ratio, which will increase at an accelerating rate already in the next five years. This is illustrated by the fact that the demographic dependency ratio based on population age, which was 53 at the end of 2011, is predicted to be around 63 in 2020 and as high as over 70 by the end of that decade.

The dependency ratio indicates the number of people of non-working age in Finland per one hundred people of working age.

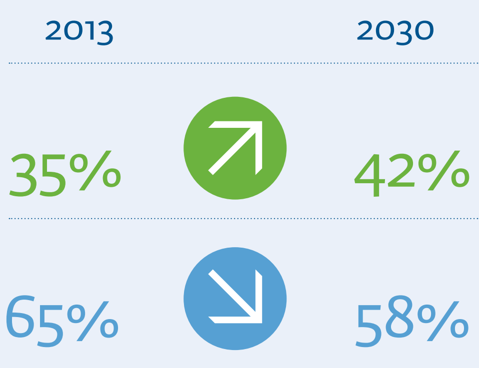
If the trends continue according to forecasts in the next 10–15 years, many Finnish regions will have populations with a majority of children and pensioners. The worst prospects appear in Etelä-Savo, North Karelia, Kainuu and Lapland.

Population, by age group, 1900–2060*



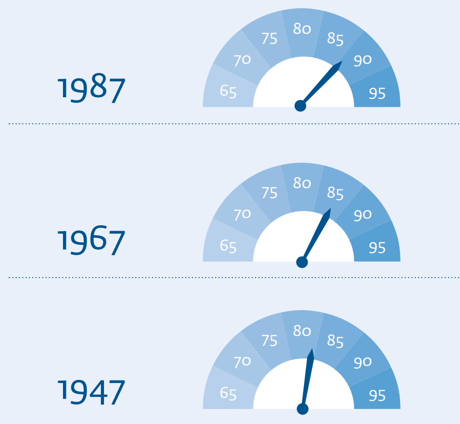
- Children (under 15s) and pensioners (over 65s)
- Working-aged population

Proportion of the population, 2013–2030*



- Children (under 15s) and pensioners (over 65s)
- Working-aged population

Life expectancy by year of birth



*Sources: Statistics Finland, Finnish Centre for Pensions, Association of Finnish Local and Regional Authorities (*forecast)*

In spite of internal migration and immigration, the worsening dependency ratio will be evident even in urban growth areas.

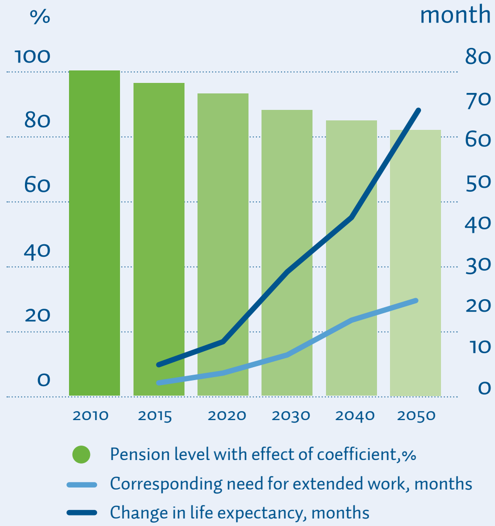
This is a great challenge for the Finnish pension system, even though preparations have been ongoing for several decades for the retirement and growing pension costs of the baby boomers, using diverse buffer funds. The whole system is based on a so-called generation agreement, by which the current working generation pays the pensions of those who have retired.

In the future, however, there will be fewer workers to carry the growing pension burden. It is also significant that people are enjoying their pensions for longer and longer, often for over 30 years.

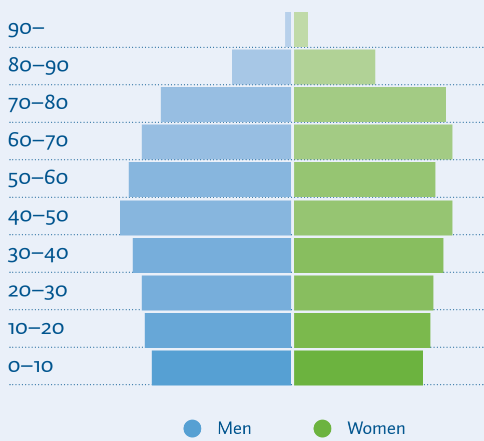
Long-term corrections require many structural changes. Some of the changes that have been discussed so far have been raising the retirement age, actions to reduce structural unemployment and unemployment as a whole, and more efficient integration and adaptation of immigrants to the labour market. Finding the right solutions and implementing them is undoubtedly difficult – especially in a situation in which economic growth is forecast to be slow for a long time – but it is critical for the future.

Sources: Statistics Finland, Finnish Centre for Pensions, Association of Finnish Local and Regional Authorities

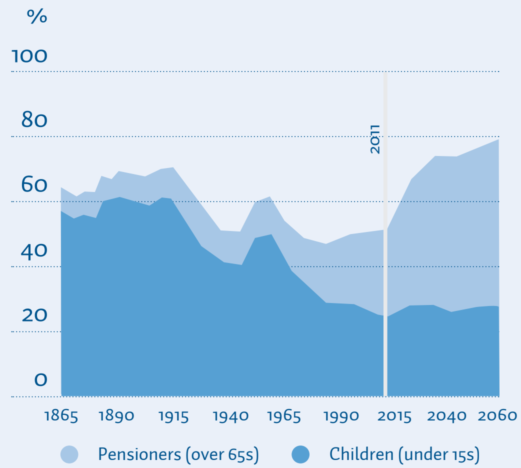
Life expectancy coefficient, life expectancy projection and need for extended work



Population structure by age and gender, 2030*



Population dependency ratio, 1865–2060



*Sources: Statistics Finland, Finnish Centre for Pensions, Association of Finnish Local and Regional Authorities (*forecast)*

Brightening Prospects for the World Economy

Global economic growth picked up after a difficult start.

The global economy was relatively weak in the early part of 2013. Heavy taxation policies on both sides of the Atlantic kept consumer confidence low. Monetary policy remained easy and further relief was provided by the European Central Bank towards the end of the year.

The euro debt crisis gradually loosened its grip and signs of recovery were seen in the peripheral countries. The Cypriot debt crisis, which peaked in the spring, only shook the market momentarily.

Confidence indicators started strengthening midway through the year, and a positive trend was seen almost throughout 2013. The change was significant especially in the euro zone, although the starting levels of the indicators were low.

It is interesting to note that the euro zone GDP reached positive figures for the first time since late 2011 in the latter half of the year.

In the United States, growth was initially hampered by tax raises and uncertainty related to debt ceiling negotiations. In China, after a slight disappointment early on in the year, growth returned to near average levels.

In terms of monetary policy, the Federal Reserve indicated possible cuts to its bond-purchasing programme for the first time in the spring. This scared the market and pushed rates upwards. The equity market also suffered temporarily from this announcement.

The buying cuts were delayed by a few months and ultimately caused no great stirs in the market. The ECB kept its monetary policy easy and even cut its main referencing rate to a record low of 0.25 per cent towards the end of the year.

VER's Investment Portfolio

At the end of 2013, VER's investment portfolio had a market value of EUR 16.3 (15.4) billion.

At the year-end, 51.6 per cent of investments were in fixed-income instruments, 39.9 per cent in equities, and 8.5 per cent in other instruments.

The total return of the investment portfolio for 2013 was 6.4 (11.3) per cent. The return is calculated in accordance with the recommendations of FIN-FSA and the Working Group for Return Calculations of the Finnish Pension Alliance (TELA) as money-weighted return. The cost of investment operations, totalling EUR 7.0 (7.1) million, is deducted from it.

Risk Management

The identification, assessment, limitation, and control of risks are key factors in investment operations. The purpose of risk management is to ensure that any realised risks 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 covers all functions of the State Pension Fund. It specifies the most important risks, the risk management objectives and measures, the limits of risk exposure, as well as responsibilities, indicators, and control principles. In setting the limits for risk exposure, VER's risk-taking and risk-bearing capacity are taken into account. The risk management plan also takes into consideration outsourced operations.

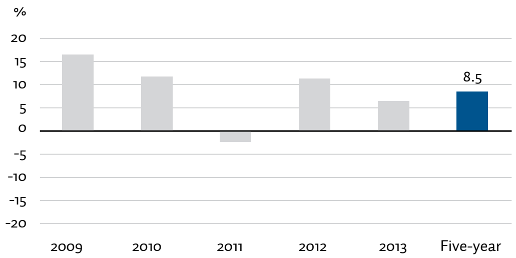
Risk surveys have been carried out jointly with PwC Finland.

31/12/2013	Share prices, MSCI World, -20%
Impact on VER's portfolio returns	-9%
Impact on equity portfolio	-18%

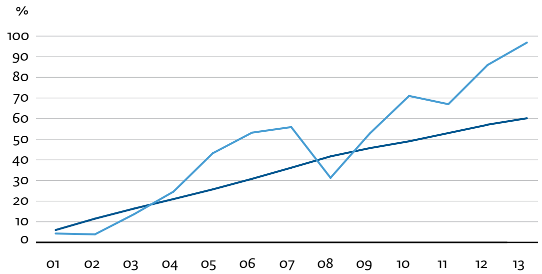
31/12/2013	Change in interest rates +1% pt
Impact on VER's portfolio returns	7%
Impact on fixed-income portfolio	-2%

Assuming 3-year historic correlations. Source: Pohjola Asset Management. MSCI RiskMetrics.

Return on VER's investment portfolio

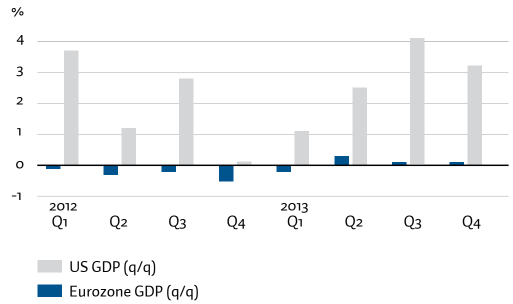


VER returns on investment vs. average effective interest rate of the government debt



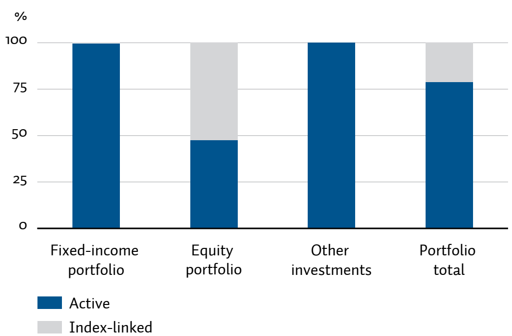
Sources: VER, Keva

GDP development in the United States and the eurozone 2012–2013

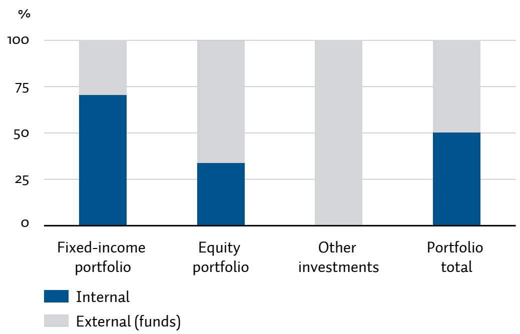


Source: Bloomberg

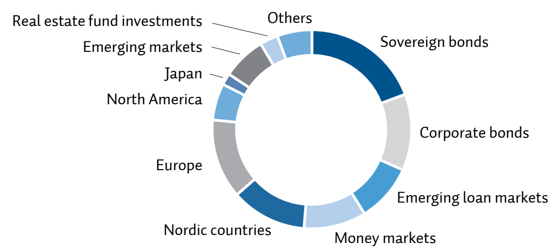
Active and index-linked portfolio management, 31 Dec 2013



Internal and external portfolio management, 31 Dec 2013



Allocation by sub-portfolio



VER in the Fixed-Income Market

Talk of reductions in the U.S. Federal Reserve's bond-buying programme caused a rise in interest rates.

The yield on the German 10-year government bond fluctuated in 2013, as in the previous year, dipping to 1.16 per cent at its lowest and reaching 2.04 at its highest.

The yield on the corresponding 10-year US bond rose more sharply, and the spread to Germany widened to over 1.0 per cent, approaching the widest spreads reached in 2005.

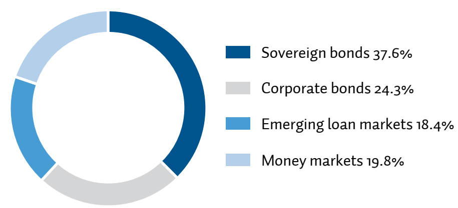
A relatively large rise was seen towards the end of the year in interest rates shorter than 12 months, caused by the drying up of interbank liquidity over the new year. Money market rates were still low, with the three-month EURIBOR at 0.29 per cent at the year-end.

The spread between Germany and the eurozone's peripheral countries narrowed throughout the year. At the end of the year, the Spanish 10-year rate was 2.2 per cent higher than that of Germany, compared to a difference of nearly 4 per cent at the start of the year.

The return on the fixed-income portfolio was negative for the year. Of the sub-portfolios, fairly positive returns were achieved by the corporate bond portfolio, with particularly good performance from the high yield funds.

The strategic allocation of the fixed-income portfolio was modified in the autumn, reducing the proportion of corporate bonds and increasing that of money markets. The tactical allocation of the portfolio was also altered with moderation during the year.

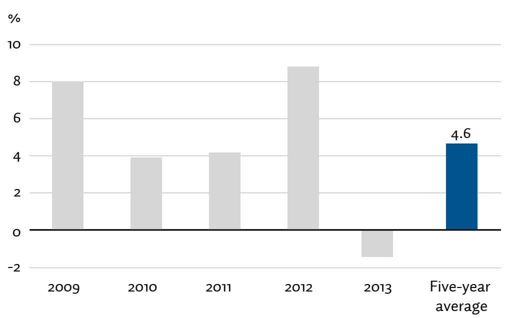
Fixed-income investments, 31 Dec 2013



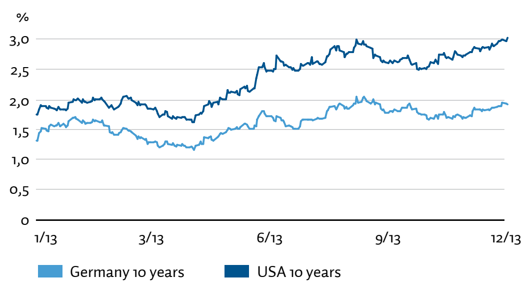
The money market and sovereign bond portfolios remained over-weighted during the period under review, while the emerging bond market and corporate bond portfolios were kept under-weighted. The interest rate risk of the fixed-income portfolio was actively adapted to correspond to market conditions. At the end of the year, the portfolio was under-weighted compared to its benchmark index.

At the year-end 2013, the size of VER's fixed-income portfolio was EUR 8.4 billion. During the year, the return on the fixed-income portfolio was –1.6 per cent, compared to –1.8 per cent for the benchmark index. Bonds were bought and sold for a total of EUR 14.45 billion during the year, while money market investments during the period totalled EUR 1.78 billion.

Return on fixed-income investments

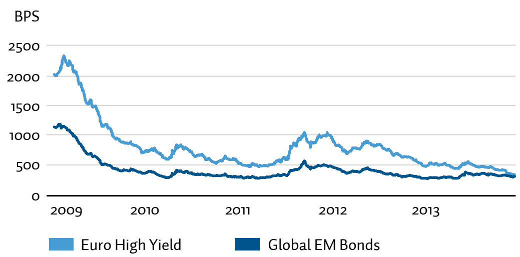


Interest rates



Source: Bloomberg

Interest rate spread between corporate and emerging loan markets



Source: Bank of America / Evli

From left: **Jukka Järvinen,** Head of Fixed Income; **Ilkka Rinne,** Portfolio Manager; **Antti Huotari,** Deputy Director; **Simo Matilainen,** Portfolio Manager; and **Sami Lahtinen,** Senior Portfolio Manager.

From left: **Kai Ylikangas,** Portfolio Manager; **Jan Lundberg,** Head of Equities; **Niklas Rosenqvist,** Portfolio Manager and **Esa Artimo,** Senior Portfolio Manager.

Good Year for Equities

2013 turned out to be a good year for equity investing, even though large-scale fluctuations were experienced in the market.

The year began very strongly, but in mid-May a shock was caused by comments from the Federal Reserve indicating a gradual reduction in stimulatory actions. There was a significant drop in global equity markets, with continuous decline almost until the last week of June.

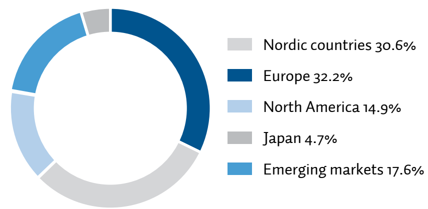
In July the market recovered with renewed strong growth, when the Fed stressed that any reductions would take place slowly and in many stages. The European Central Bank also announced that it would have no need to tighten its monetary policy for a long time yet.

A lot of other economic data was released in July that exceeded expectations and gave a boost to equity markets. The final quarter of the year saw good performance from the equity markets, even though domestic problems in the United States caused a degree of uncertainty in October.

The return on VER's equity portfolio, comprising listed shares and fund units, was 18.2 (16.8) per cent in 2013.

The highest returns came from equity investments in developed countries, with particularly good performance among Finnish stocks, of over 30 per cent. The performance of the emerging markets was weak, with primarily negative returns on equity investments.

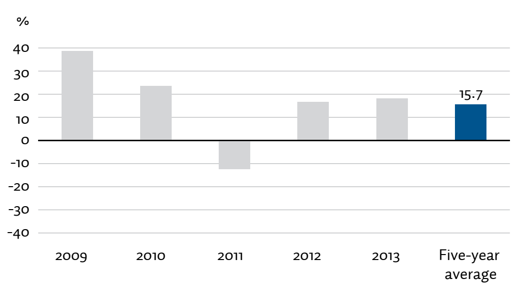
Equity investments, 31 Dec 2013



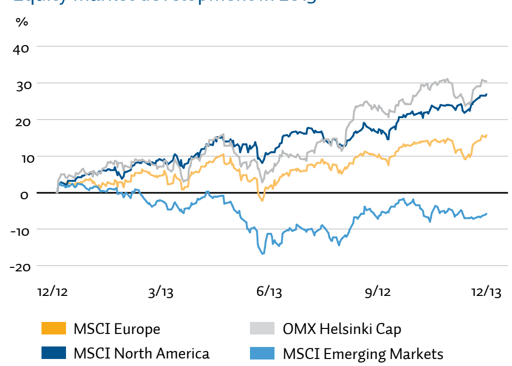
VER was a net seller on the equity market during the year, with net sales amounting to EUR 434 million. There was lots of sales activity especially in the fourth quarter, as the equity markets had risen significantly from the start of the year. Equities accounted for 39.9 per cent of VER's overall portfolio at the year-end.

The portfolio's risk level corresponded to that of the market in 2013, with a beta value of 1.0. At the end of the year, 66 per cent of VER's equity portfolio was invested through funds and 34 per cent was in direct investments. At that time, VER had direct equity investments in 160 companies and holdings in 61 funds.

Return on equity investments

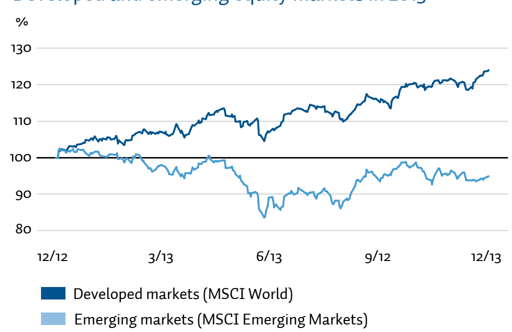


Equity market development in 2013



Source: Bloomberg

Developed and emerging equity markets in 2013



Source: Bloomberg

Successful Year in Other Investments

2013 was a particularly successful year for VER's other investments, with returns reaching good levels in all asset classes. Real estate and private credit investments in particular experienced a significant boost in the last few months of the year.

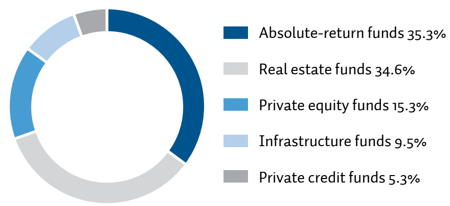
The asset class with the highest returns in 2013 was private credit funds. The strong equity market supported the positive performance of private equity investments, as in the previous year. In real estate investments, the change in the market mood was reflected in positive performance, especially in the final months of the year.

Returns in the absolute return portfolio varied significantly, depending on the strategy. Equity strategies produced excellent results across the board, but the year was worse for CTA funds, which track market trends using quantitative methods. In infrastructure investments, macroeconomic issues had an impact on some of the funds in the portfolio.

VER's other investments comprise real estate, private equity, infrastructure, private credit (new investment class as of 1 January 2013) and absolute return funds.

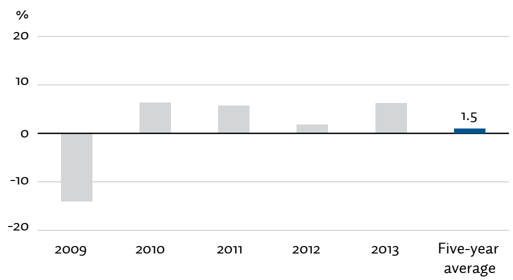
At the year-end, the market value of other investments was EUR 1.39 billion, and their weigh in VER's overall portfolio was 8.5 per cent. The amount of open investment commitments was EUR 516.5 million.

Other investments, 31 Dec 2013

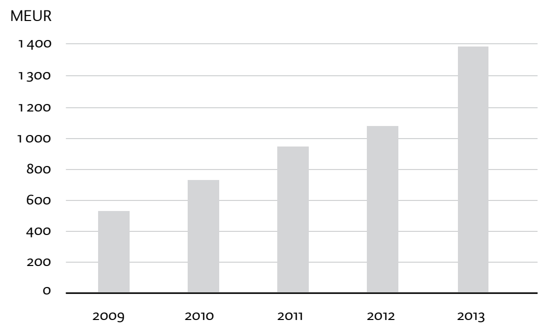


The total return on other investments was 5.7 per cent. Private credit yielded 8.1 per cent, private equity 7.3 per cent and absolute return funds 6.3 per cent. Meanwhile, returns on real estate fund investments totalled 5.3 per cent and on infrastructure, 3.7 per cent.

Return on other investments



Market value of other investments, 2009–2013



From left: **Jussi Häkkinen,** Analyst; **Maarit Säynevirta,** Head of Investments; **Antti Vartiainen,** Portfolio Manager and **Johannes Edgren,** Portfolio Manager.

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 2013, the fund's market value was EUR 16.3 (15.4) billion, making the funding ratio 17(17) per cent. Reaching of the funding target is affected by investment income, pension contribution income, and transfers to the state budget.

Principles governing investments

In its investment activities, 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 to other employment pension schemes.

VER as a buffer fund

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

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

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

Fixed-income portfolio benchmark indices	
Government Composite Index	30.0%
BarCap Euro Government Inflation-Linked Bond Index	5.0%
BarCap Euro Aggregate Ex Treasury Index	25.0%
JP Morgan EMBI Global Diversified Eur Hedged	5.0%
JP Morgan Global Diversified IG-Index Eur Hedged	5.0%
JP Morgan GBI-EM Diversified EUR Unhedged	10.0%
JP Morgan Cash Index 3 Month	20.0%
	100.0%

Listed equity portfolio benchmark indices	
OMX Helsinki Cap Index	21.0%
OMX Stockholm Benchmark Cap Index	9.0%
MSCI Europe Index	26.0%
MSCI Europe Value Index	6.5%
MSCI North America Index	15.0%
MSCI Japan Index	5.0%
MSCI Emerging Markets Index	12.5%
MSCI AC Far East Ex Japan Index	5.0%
	100.0%

Other investments' benchmark indices	
INREV Index (LOC)	40.50%
TELA (pl. VER) median	21.50%
75% INREV Index (LOC), 25% TELA (pl. VER) median	10.00%
HFRI FoF Composite Index + 0,5%	28.00%
	100.0%

Total as of 31 Dec 2013

1. Long-term target return

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

2. Operational target return

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

Risk limit and strategic allocation

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

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

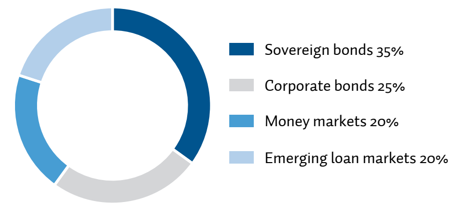
VER's annual investment plan defines a strategic allocation for the investment portfolio. The goal is to direct investments so that they yield the best possible return in the long run, at the risk level set by the Board. The strategic allocation is continuously monitored and can be adjusted in accordance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

Annual expected returns and risk levels are set for the various asset classes and the portfolio as a whole using scenario analysis. They take into account the prevailing interest rate level and the changes in risk premiums and correlations over time in each asset class. The portfolio's long-term expected return in accordance with the strategic allocation is 5.2 per cent.

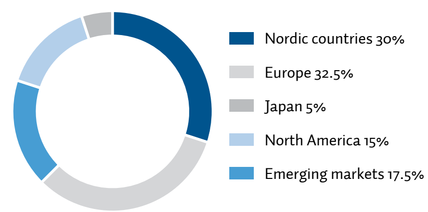
Active cooperation

The goal of VER is to be a respected and successful pension investor, emphasising outstanding professional skills and ethics throughout its operations. One of the requirements for good overall returns is a comprehensive network of partners. This means that VER actively networks with the management of companies in which it invests, as well as with public authorities, Finnish and foreign providers of investor and brokerage services, and other European pension investors.

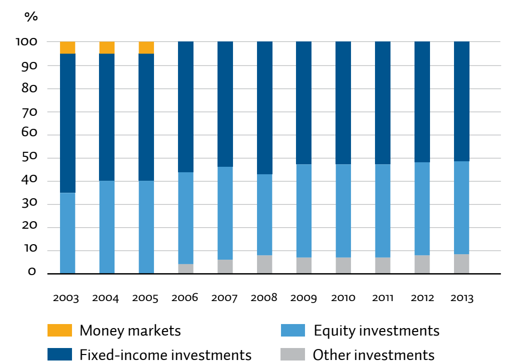
Strategic allocation of fixed-income investments, 31 Dec 2013



Strategic allocation of equity investments, 31 Dec 2013



Strategic allocation of VER's portfolio



VER's investment beliefs

VER's investment operations have always been based on certain beliefs concerning the investment market, the investment process and the organisation of investment activities. Investment beliefs may and do change over time, so they are periodically revised. Having these common beliefs makes it simpler to make investment decisions and directs VER's operations towards profitable investments that produce added value.

Investment beliefs in 2013:

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

Overall assessment of operations

The success of investment activities is analysed on a long-term basis, chiefly via consideration of the portfolio from a broad perspective. The performance of fixed-income and equity portfolios, as well as other investment portfolios, is monitored separately. Relative returns are assessed through comparison of returns with benchmark indices set 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 standards are applied in the calculation of VER's returns. This harmonises the various methods of return and risk calculation and renders the figures comparable. Clarity and transparency are emphasised throughout VER's operations. The responsibilities and roles of personnel responsible for investment activities are clearly defined, improving the controllability of investment activities.

Responsible investment

VER is committed to responsible investment operations.

VER does its best to observe the aims of responsible investing in its operations. This means considering the environmental and social impact and corporate governance of the investment targets when making new investment decisions and managing existing investments.

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

VER is a member of Finland's Sustainable Investment Forum (FINSIF). This is the Finnish contact organisation for the Principles for Responsible Investment (PRI), and it promotes awareness of responsibility within financial management and investment-related decision-making.

VER has signed the United Nations PRI, committing to abiding by them in its investment operations. In the case of new investments, compliance with the principles is ensured already at the time of preparing for the investment decision. For existing investments, it takes place by monitoring investments and corporate events and, if necessary, influencing investment targets or, ultimately, giving up the investment. The UNPRI require annual reporting from members concerning implementation and compliance.

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

VER's shareholder policy

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

VER promotes the successful performance of its portfolio companies by being a responsible shareholder that follows up on its investees. In 2013, VER attended the AGMs of 21 Finnish companies. By attending AGMs and exercising its voting rights, VER can influence decisions that are significant in terms of the companies and their shareholders.

Responsible investing

As a long-term investor, VER can adopt an investment policy that allows the return on investments to vary considerably. Investment decisions are based on the expected returns of investment targets, taking into account risk levels. Risks are diversified through investment in various categories, markets, industries, instruments, and companies, as well as in bonds issued by different governments. Diversification is also done in terms of the maturity of investments.

For VER, responsible investment implies effective and consistent observance of the investor's responsibility. It encompasses monitoring the responsibility and sustainable development of target companies, as well as conducting responsibility-related dialogue with these and with external asset managers.

VER has signed the United Nations Principles for Responsible Investment (UNPRI). In its operations, VER abides by the responsible investment principles of the Finnish Pension Alliance (TELA), and is a member of Finland's Sustainable Investment Forum (FINSIF).

The principles of responsible investment apply to all fixed-income, equity and other investments made by VER. Their implementation may vary by the type of investment, however, as their applicability differs in the various categories.

In its responsible investment operations, VER observes the following principles of ethical and sustainable development:

- Ethical investment refers to avoiding certain industries (companies with significant portions of revenue coming from arms, alcohol, tobacco, gambling or adult entertainment).
- Sustainable investment refers to considering ESG (environmental, social and governance) factors in the investment process.

Criteria and their application

The ethical principles are applied in all direct investments.

The sustainable development principles are applied by using ESG criteria in evaluating investment targets.

The ethical and ESG factors are included in the investment decisions. VER is aware of the fact that these principles may be difficult to abide by in the case of certain complex investment instruments.

The fulfilment of responsibility principles is evaluated regularly and action is taken where necessary. External asset managers are also expected to observe the ESG factors, and the extent to which they do is periodically assessed.

Application of principles

- Evaluation of ethicalness and sustainability
- Assessment of external asset managers
- Dialogue with target companies and external asset managers
- Influencing methods
- Annual reporting

VER's Board of Directors receives reports on the fulfilment of responsible investment principles in VER's operations.

The State Pension Scheme

In 2013, the Finnish State Pension Act covered more than 150,000 people, of whom some 81,000 were state employees. The state's pension expenditure was EUR 4.2 billion, i.e. over 18 per cent of all employment pensions. There were around 360,000 pensioners, corresponding to just over 25 per cent of all employment pension recipients.

The State Pension Scheme as part of the Finnish employment pension system

After a pension reform in 2005, state pension cover has been on a par with the local government and private sectors. The reform also introduced a career model for state pensions, where pensions are calculated on the basis of annual earnings and a growth percentage.

A pension is accumulated for work done between the ages of 18 and 68. An increased growth percentage, known as super-accumulation, encourages 63-year-olds to continue working. The aforementioned reform also removed a 60–66 per cent maximum pension accumulation limit, and included the life expectancy coefficient in calculations of pension amounts.

State pension security

Since the beginning of 2011, the execution of the state pension scheme has been the task of Keva. In 2013, Keva was also put in charge of duties related to employers and actuarial services.

State pensions are paid out from appropriations reserved for that purpose in the state budget. The state is responsible for ensuring that accrued pensions can be paid in the future.

In the state pension system, the employers and employees pay the sum equivalent to the amount accrued in pensions each year as pension insurance premiums to VER. The state aims at a 25 per cent funding ratio in proportion to pension liability.

Balancing the financing of pension costs

Through VER, the state is preparing to finance pensions payable in the future, and especially to even out the coming pension costs of the baby boom generation.

Each year, VER transfers some of its assets into the state budget because all state pensions are paid out from budget appropriations. Therefore some of VER's assets are used for paying pensions.

These transfers have been a crucial factor in regulating VER's growth. The Act on the State Pension Fund specifies the transferable amount, which is 40 per cent of the annual state pension expenditure. By the end of 2013, a total of EUR 23 billion in VER assets had been transferred to the state budget. By parliamentary decision, the budgetary transfers from VER were substantially reduced in 2006 and 2007, while state pension funding was increased.

In 2012, VER's pension premium income still exceeded the budget transfer, but in 2013 the situation reversed. This realised VER's original purpose of balancing out pension expenditure.

With the present funding mechanism, the state pension scheme's pension contribution cost (i.e. the net cash flow tied to the state pension scheme each year) will remain lower than the actual pension expenditure well into the future.

Supervision by the Ministry of Finance

VER's operations are supervised by the Financial Markets Department of the Finnish Ministry of Finance. VER's investment activities are directed by a Board of Directors that is appointed by the Ministry of Finance and includes representatives from both the employer and the employee sides.

VER manages the assets entrusted to it and makes all investment decisions in accordance with the investment plans adopted by the Board of Directors and within its investment authorisations and set limits.

Growing pension costs in coming years

The proportion of the state's pension expenditure in relation to state payroll will continue growing sharply until the beginning of the 2030s.

In 2013 the proportion of pension expenditure in the payroll was around 64 per cent. It is expected to peak in 2031 at around 90 per cent. After this, it will slowly fall until the end of the 2040s, stabilising after the mid-2070s at around 36 per cent of payroll.

Calculated in euros (at the 2012 value), pension expenditure will peak in 2032 at approximately EUR 5.0 billion. The number of employees covered by the state pension scheme (VaEL) is expected to fall sharply by the mid-2040s. This will also reduce pension expenditure between 2030 and 2070.

The reduction in personnel covered by the scheme is a consequence of privatisations and legislative changes. An example of the latter is the gradual removal of primary, secondary and tertiary education teachers from the scheme into private pension schemes.

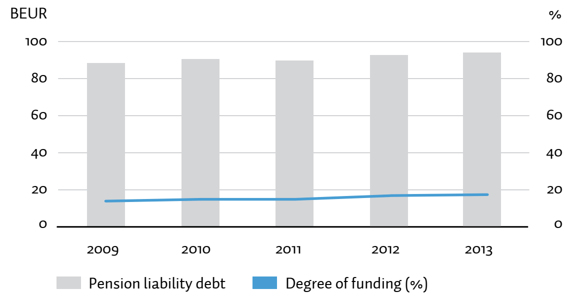
Extensive pension liability of the state

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

In addition to expected returns, the 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. In calculating pension liability, it is essential to know the accurate sum of pensions accrued by the time of calculation. Because the employed population accumulates a pension each year, new people retire, and people entitled to receive pensions die, the pension liability sum is not constant but is recalculated annually.

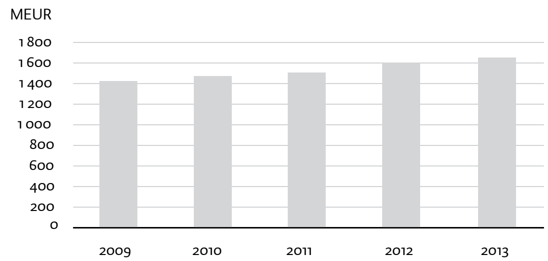
The pension liability figure consists of provisions for earned and unearned premiums. Earned premiums refers to the amounts to be paid to people who have already retired – i.e., the capital value of old-age, family, disability, unemployment, and part-time pensions that have already started being paid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

Pension liability debt and degree of funding



Source: Keva

Asset transfer from VER to the state budget



Source: Keva

Degree of funding of pension assets

Value of accrued pensions and pension assets in 2012, real discount rate of 3.5%. Figures in BEUR. Calculations according to figures from the Finnish Centre for Pensions.

	TyEL	VaEL	KuEL	Private	Public	Total
Pension assets, 31 Dec 2012	96.4	15.4	34.4	97.4	52.3	149.7
Degree of funding, 31 Dec 2012	28.9	18.1	31.6	25.9	26.1	25.8
Accrued pensions / earned income	19.2	24.8	21.8	19.6	22.6	20.9

Source: Finnish Centre for Pensions 04/2013: Statutory pensions: long-term projections 2013.

Individual calculation of pension liability

For the purposes of the financial statements of the state and of the State Pension Fund, Keva calculates the pension liability according to the full funding principle, following (where applicable) the calculation instructions provided for pension funds by the Financial Supervisory Authority, the principles concerning registered supplementary pension benefits set forth in the Employees Pensions Act, 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 they are retired, employed, or no longer employed under the State Pension Act 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 calculation uses the mortality and disability pension statistics of the TyEL basic employee pension scheme. Since 2012 the calculation has also taken into account a life expectancy coefficient and the estimates regarding its development provided by the Finnish Centre for Pensions.

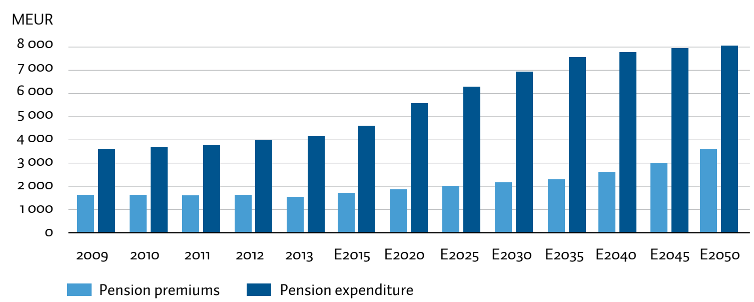
The discount rate is 2.7 per cent, which is considered to be a real rate of interest that will exceed future income level changes and index increases in pensions.

The liability for the end of each financial year is derived retrospectively from the previous year's liability by adding the new liability generated during the year (pension premium income) and deducting the realised liability (pension cost), while accounting for interest.

At the end of 2013, the state pension scheme's pension liability totalled EUR 94.0 (92.6) billion. The pension liability is expected to remain at its current level in real terms until 2020. After that it will start a decline that is expected to continue until the 2040s. 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.

Calculated according to IFRS, the state's pension liability at the year-end was EUR 146 (151) billion. In the IFRS calculation, pension liability is affected by the chosen discount rate and its fluctuation. The discount rate used was the nominal interest rate for 20-year AA-rated corporate bonds, which was 3.136 (2.824) per cent on 31 December 2013.

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



Board of Directors

Vice-Chairman
Professor
Hannu Kahra (*born 1950*)
Education: Doctor of Philosophy

Deputy member:
Senior Adviser for Finance
Asko Lindqvist (*born 1952*)
Ministry of Finance
Education: Master of Science (Economics and Business Administration)

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

Professor
Minna Martikainen (*born 1969*)
Education: Doctor of Economics

Deputy member:
Ministry of Finance
Mika Kuismanen (*born 1967*)
Education: Doctor of Philosophy

Ministerial Advisor
Raili Mäkitalo (*born 1949*)
Ministry of Finance, Economics Department
Education: Master of Administrative Sciences, Bachelor of Social Services
from 11 April 2013

Deputy member until 12 September 2013:
Senior Adviser for Finance
Pauli Kariniemi (*born 1970*)
Ministry of Finance
Education: Master of Science (Economics and Business Administration)

Deputy member from 12 September 2013:
Ministerial Advisor
Sari Sontag (*born 1964*)
Ministry of Finance
Education: Master of Science (Political Science)

Head of Administration
Pirjo Mäkinen (*born 1955*)
Trade Union for the Public and Welfare Sectors (JHL)
Education: Master of Science

Deputy member:
Head of Legal Affairs
Mika Hämäläinen (*born 1959*)
Trade Union for the Public and Welfare Sectors (JHL)
Education: Bachelor of Laws

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

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

Chairman
Niko Simola (*born 1974*)
Federation of Salaried Employees Pardia
Education: Master of Laws
from 2 January 2014

Deputy member:
Administrative Manager
Anne Puolakka (*born 1955*)
Federation of Salaried Employees Pardia
Education: Vocational Qualification in Business and Administration

Outgoing Board members (not pictured):

Director of Administrative Governance and Development
Helena Tarkka (*born 1955*)
Ministry of Finance
until 11 April 2013

Chairman
Antti Palola (*born 1959*)
Federation of Salaries Employees Pardia
until 2 January 2014

Investment Consultative Committee, Dec 31 2013

Chairman
Eva Liljeblom, Rector of Hanken School of Economics

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

Topi Piela, Managing Director of Umo Capital Oy

Timo Hukka, Investment Director, Suomi Mutual Life Assurance Company

Liisa Jauri, Director, Nordea

Erik Valtonen, Doctor of Philosophy

Hanna Kaleva, Managing Director, Institute for Real Estate 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 up to five other members. A personal deputy is appointed for each member.

The current Board began its term on 1 March 2012, and is chaired by Antti Tanskanen, PhD (Econ.). The Board of Directors convened 12 times in 2013. In addition to investment operations, the meetings concerned matters related to VER's funding target, responsible investing and the development of risk management.

The Board of Directors appoints a Consultative Committee with seven members, who are external investment and finance professionals. The Consultative Committee assesses the fund's investment plan, monitors its realisation, and reports to the Board of Directors. The Consultative Committee convened twice in 2013.

The VER management team, consisting of the Managing Director and five other members, convenes regularly.

The Management Team

Jukka Järvinen
Head of Fixed Income

Tiina Tarma
General Counsel

Timo Löyttyniemi
Managing Director

Maarit Säynevirta
Head of Other Investments

Seija Kettunen
Head of Administration

Jan Lundberg
Head of Equities

The State Pension Fund: Preparing and Balancing

History

1989

The State Pension Fund is established within the State Treasury for the purpose of preparing for future pension costs and for balancing out pension expenditure.

The funding target, 1.5 times the state payroll as in private pension schemes, is set for 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.

1994

The funding target is revised and now encompasses the whole state pension scheme instead of the former state payroll figure.

Director General Teuvo Metsäpelto starts as the first Chairman of the Board of Directors.

1999

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

2000

The budget transfer is reduced to one third of annual pension expenditure until the end of 2006 (subsequent to this, one half).

The funding target is revised to be 1.5 times the total state payroll in 2010 and is tied to the state's pension liability (being at least 20 per cent in 2010). The transfer of VER assets to the state budget is reduced to a maximum of one third of pension expenditure for 2001–2006.

Dedicated staff are hired for the fund.

Investment activities are extended to include equity investments.

2003

The fund's first full-time managing director, Timo Löyttyniemi, is appointed. Eino Keinänen is appointed Chairman of the Board of Directors.

2005

The funding target is set at 25 per cent of the state's pension liability, and this is expected to be achieved by 2020.

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

2006

The role of the Ministry of Finance as supervisor of VER is defined more precisely and the Ministry is granted the right to issue general regulations concerning VER's administration, finances and investment policies.

The tasks of the VER Board of Directors are laid down in law.

The duties of VER's auditors are laid down in law.

The transfer of assets from VER to the state budget is reduced for 2006 and 2007 to expand the fund.

The Ministry of Finance issues its first operating guidelines to VER in November.

2007

The Act on the State Pension Fund of 1989, with all its amendments, is revoked and a new Act is passed.

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

2008

The global financial crisis begins.

2009

Antti Tanskanen is appointed as Chairman of the Board of Directors.

A reform of the Universities Act is implemented, which leads to the gradual transfer of university employees to private pension schemes.

2010

VER celebrates its 20th anniversary.

The European debt crisis begins.

2011

European sovereign debt crisis.

VER signs the United Nations Principles for Responsible Investment (UNPRI).

VER joins Finland's Sustainable Investment Forum (FINSIF).

The execution of state pension security is transferred from the State Treasury to Keva.

2012

The sum of VER's investment assets exceeds EUR 15 billion.

The decision is made to transfer the employer services related to the state pension scheme to Keva from 2013 onwards.

2013

The budget transfers from VER's assets exceed premium income for the first time. This means that VER begins to fulfil its second original task of balancing out state pension expenditure.

The Act on the State Pension Fund is amended, transferring to it clauses concerning the funding ratio and pension premiums from the State Pension Act.

VER is named Finland's Best Pension Investor for the third time in a competition run by Investment & Pensions Europe (IPE) magazine. The reasons behind the award include VER's excellent long-term strategy combined with dynamic short-term changes in the investment portfolio.

Profit and Loss Statement

	1 Jan–31 Dec 2013		1 Jan–31 Dec 2012	
OPERATING INCOME				
Other operating income				
Sales gains on equities and shares	269,766,460.97		135,423,651.64	
Pension contributions from State offices and institutions	747,873,952.44		741,326,330.20	
Other pension contribution income	507,234,838.61		518,998,141.01	
Employees' pension contributions	372,855,187.67		372,713,777.80	
Disability insurance contribution income	5,802,560.00	1,903,532,999.69	5,761,280.00	1,774,223,180.65
OPERATING EXPENSES				
Materials, supplies and goods				
Purchases during the period	94,986.85		83,145.29	
Personnel expenses	2,653,927.47		2,880,727.57	
Rents	295,782.04		267,989.64	
Outsourced services	3,568,076.04		3,440,633.56	
Other expenses				
Other expenses	289,967.76		332,255.87	
Sales losses on equities and shares	44,750,825.76		21,784,820.80	
Depreciation	49,907.40	-51,703,473.32	53,211.17	-28,842,783.90
SURPLUS I		1,851,829,526.37		1,745,380,396.75
FINANCIAL INCOME AND EXPENSES				
Financial income	455,715,743.64		456,811,808.10	
Financial expenses	-52,005,560.40	403,710,183.24	-75,769,853.61	381,041,954.49
SURPLUS II		2,255,539,709.61		2,126,422,351.24
INCOME AND EXPENSES FROM TRANSFERS				
Income				
Transfer fees		25,595,748.13		29,889,257.26
SURPLUS III		2,281,135,457.74		2,156,311,608.50
SURPLUS/DEFICIT FOR THE PERIOD		2,281,135,457.74		2,156,311,608.50

Balance Sheet

ASSETS	31 Dec 2013		31 Dec 2012	
FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS				
INTANGIBLE ASSETS				
Other long-term expenditure		4,416.85		30,398.30
TANGIBLE ASSETS				
Furniture and fittings		24,423.07		31,670.90
SECURITIES HELD AS FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS				
Purchases of bonds denominated in euros	3,806,393,788.38		4,283,992,357.61	
Other long-term investments denominated in euros	5,842,325,550.57		5,401,893,875.24	
Purchases of bonds denominated in foreign currency	1,040,665,085.42		257,431,778.81	
Other long-term investments denominated in foreign currency	2,302,174,794.43	12,991,559,218.80	2,213,811,960.63	12,157,129,972.29
TOTAL FIXED ASSETS AND OTHER LONG-TERM INVESTMENTS		12,991,588,058.72		12,157,192,041.49
LONG-TERM RECEIVABLES				
Long-term receivables		337,347.33		27,767.68
CURRENT RECEIVABLES				
Accrued credits and deferred charges	193,427,797.67		213,618,490.60	
Other current receivables	36,934,770.58	230,362,568.25	21,043,717.88	234,662,208.48
FINANCIAL SECURITIES AND OTHER SHORT-TERM INVESTMENTS				
Purchases of bonds denominated in euros		822,782,761.60		959,419,668.77
CASH, BANK DEPOSITS AND OTHER FINANCIAL ASSETS				
Other bank accounts		275,548,271.00		324,255,176.85
TOTAL INVENTORIES AND FINANCIAL ASSETS		1,329,030,948.18		1,518,364,821.78
TOTAL ASSETS		14,320,619,006.90		13,675,556,863.27

EQUITY AND LIABILITIES	31 Dec 2013		31 Dec 2012	
EQUITY				
Fund capital	-21,010,572,211.33		-19,406,903,064.37	
Accrued changes in capital	34,646,190,675.67		32,489,879,067.17	
Budget transfers	-1,678,298,078.13		-1,603,669,146.96	
Surplus/deficit for the period	2,281,135,457.74	14,238,455,843.95	2,156,311,608.50	13,635,618,464.34
LIABILITIES				
CURRENT				
Accounts payable	467,214.67		537,051.88	
Items to be rendered forward	108,626.30		108,706.89	
Accrued charges and deferred credits	821,929.07		3,483,310.88	
Other current liabilities	80,765,392.91	82,163,162.95	35,809,329.28	39,938,398.93
TOTAL LIABILITIES		82,163,162.95		39,938,398.93
TOTAL EQUITY AND LIABILITIES		14,320,619,006.90		13,675,556,863.27

Portfolio Structure and Returns, 2001–2013

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Structure of portfolio (at year-end)													
AUM (MEUR)*	16,334.9	15,359.0	13,736.1	13,937.1	12,318.0	10,359.4	12,050.9	10,305.6	8,200.6	6,867.1	5,795.0	4,840.6	4,426.9
Allocation (%)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Fixed-income investments	51.6%	54.6%	56.6%	54.3%	54.9%	61.8%	55.7%	55.5%	59.1%	59.9%	65.9%	78.0%	84.8%
Listed equities	39.9%	38.4%	36.4%	40.4%	40.8%	30.7%	38.0%	40.4%	39.6%	40.1%	34.1%	22.0%	15.2%
Other investments	8.5%	7.0%	6.9%	5.2%	4.3%	7.5%	6.3%	4.1%	1.3%	0.0%	0.0%	0.0%	0.0%
Performance and costs (%)													
Return before investment costs	6.4%	11.4%	-2.3%	11.7%	16.5%	-15.7%	1.8%	7.0%	15.0%	9.6%	9.5%	-0.4%	4.3%
Fixed-income investments	-1.6%	8.8%	4.1%	3.9%	8.0%	4.4%	1.8%	0.1%	5.4%	7.0%	4.0%	7.2%	5.2%
Listed equities	18.2%	16.8%	-12.3%	23.6%	38.7%	-42.8%	0.7%	17.4%	31.5%	14.4%	20.7%	-23.7%	-11.5%
Other investments	5.7%	3.5%	6.1%	8.6%	-14.7%	-11.2%	9.5%	6.7%	2.2%	-	-	-	-
Excess return before costs**	n/a	0.2%	0.6%	1.1%	-0.2%	0.0%	0.0%	-0.1%	0.2%	0.0%	0.1%	-2.4%	-0.1%
Excess return before costs (excl. other investments)	-0.3%	0.1%	0.4%	1.4%	0.6%	1.1%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Costs (% of average invested capital)	0.04%	0.05%	0.05%	0.05%	0.05%	0.04%	0.04%	0.05%	0.05%	0.05%	0.05%	0.04%	0.02%
Return after investment costs	**6.4%**	**11.3%**	**-2.3%**	**11.7%**	**16.4%**	**-15.8%**	**1.8%**	**7.0%**	**14.9%**	**9.6%**	**9.4%**	**-0.4%**	**4.3%**
Risk indicators													
Volatility***	5.3%	5.0%	6.3%	5.0%	8.3%	10.2%	3.5%	4.1%	4.5%	3.3%	3.6%	3.7%	2.7%
Volatility (benchmark)***	5.4%	5.1%	6.5%	5.0%	9.2%	11.7%	3.6%	4.0%	4.5%	3.4%	3.7%	3.3%	3.3%
Jensen's alpha***	-0.1%	0.4%	-0.2%	1.8%	3.2%	-0.1%	-0.2%	0.2%	1.5%	0.7%	1.1%	-2.3%	-0.2%
Tracking error***	0.4%	0.4%	0.6%	0.3%	1.3%	0.8%	0.3%	0.7%	0.5%	0.4%	0.6%	0.9%	1.0%
Beta***	1.0	1.0	0.9	1.0	0.8	0.8	0.9	0.9	0.9	0.9	0.9	1.0	0.7
Sharpe ratio***	1.2	2.3	neg	2.2	1.9	neg	neg	1.0	2.9	2.2	1.9	neg	neg
Sharpe ratio (benchmark)***	1.2	2.2	neg	1.9	1.6	neg	neg	1.0	2.8	2.2	1.8	neg	neg
Information ratio***	-0.7	0.4	0.6	4.5	0.5	1.3	-0.4	-0.1	0.5	0.0	0.3	-2.7	-0.1
Effective average interest rate on government debt** (%)**	**2.0%**	**2.3%**	**2.5%**	**2.5%**	**2.8%**	**4.1%**	**4.1%**	**4.1%**	**3.9%**	**3.9%**	**4.4%**	**5.2%**	**6.0%**

*) AUM corresponds to the market value of investments, plus accrued interest, investment bank account values, market values of forward contracts, warranties received and open deals. Exchange rate: ECB fixing.
**) Excess return for the whole portfolio for the financial year under review will be available in spring 2014 once the benchmark indices are ready.
***) Excluding other investments whenever a figure is available for other investments; otherwise applies to whole portfolio.
****) The effective average interest rate on government debt and the return on investment operations are calculated using different principles, so they are not directly comparable.

Cumulative return over 10 years (2004–2013)	73.7%
Average annual return over 10 years (2004–2013)	5.7%
Real return over 10 years (2004–2013)	3.7%
Average annual return over 5 years (2009–2013)	8.5%

Glossary

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

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

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

Bond
An instrument through which companies, national and local governments and other organisations (issuers) can take out a loan from the public.

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

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

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

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

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

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

Forward contract
A contract involving the obligation to buy or sell an underlying security, such as a share, for a specified price on a specific date.

Funding ratio
The ratio between funded assets and pension liability.

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

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

Information ratio

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

Investment commitment

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

Investment-grade fund

A corporate bond fund that invests in bonds issued by companies with high credit ratings, offering higher interest rates than sovereign bonds.

Liquidity

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

Market risk

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

Modified duration

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

Option

A contract involving the right to buy or sell an underlying security, such as a share, for a specified price on a specific date.

Pension liability

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

Sharpe ratio

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

Tracking error

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

Volatility

The standard deviation of the return; the most common risk indicator. It measures the fluctuations in the return on an investment: the higher the risk, the greater the volatility.

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