The State Pension Fund

Annual Report 2004

Annual Report

2000 2001 2002 2003 **2004** 2005 2006 2007 2008

The State Pension Fund 15 years

Design and Production of Annual Report by Spokesman Oy
Photographs Manu Rantanen, Lehtikuva, Gettyimages & Com.pic.
Printing Libris Oy
Paper cover Novatech Single Matt 250g/m², pages Novatech 170g/m²

The State Pension Fund – SPF

Established in 1990, the State Pension Fund 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.

2004 IN BRIEF

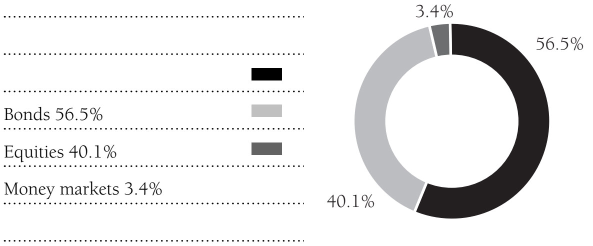
• The investment portfolio's value was around EUR 6.9 billion at the end of 2004, from EUR 5.8 billion at the end of 2003.

• The investment portfolio is divided into fixed-income investments and equities. Fixed-income investments accounted for 60 per cent of the portfolio, and equities for 40 per cent at the end of 2004. Fixed-income investments amounted to EUR 4.1 billion and equities to EUR 2.8 billion at the year-end. The corresponding figures for 2003 were EUR 3.8 billion and EUR 2.0 billion.

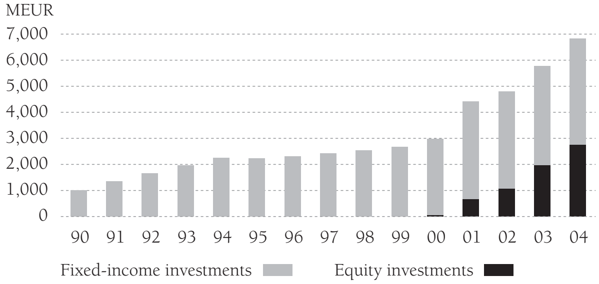
• The investments yielded a return of 9.6 per cent in 2004, against 9.4 per cent a year earlier. The return on fixed-income investments was 7.0 per cent (4.0 per cent) and the return on equity investments 14.4 per cent (20.7 per cent).

• Operating expenses amounted to 0.05 per cent of total assets.

The State Pension Fund's investment portfolio breakdown on 31 Dec. 2004



Trend in State Pension Fund's investments 1990–2004



Amount of assets under management, MEUR

	2004	2003
State Pension Fund's investments, total	6,867	5,795
- Fixed-income investments	4,113	3,821
- Equity investments	2,754	1,974

Return from investment operations, %

	2004	2003
Return on investments	9.6	9.4
- Fixed-income investments	7.0	4.0
- Equity investments	14.4	20.7

Timo Löyttyniemi

Managing Director's Review

2004 a good year for the State Pension Fund (SPF) in terms of investments.

The State Pension Fund continued to diversify its assets in 2004, achieving the targeted 40 per cent equity weighting. From now on, equity weighting may vary in accordance with market trends and outlooks. Falls in interest rates increased the value of the portfolio's long-term fixed-income instruments, which yielded a high return. In addition, the equity markets performed well in 2004. SPF's investment portfolio yielded a return of 9.6 per cent in 2004 (9.4 in 2003).

Higher Funding Objective

The State Pension Fund Act was amended at the end of 2004. The essential reform enacted, which became effective on 1 January 2005, raised the funding objective from 20 to 25 per cent. It is estimated that the Fund will reach this funding objective by 2020. The State uses SPF to provide for future pension liabilities, which are expected to grow until 2030. The aim is to expend the fund's assets in a controlled manner from 2020 to 2040, the period when the state's pension expenditure will be at its highest.

Funding pension assets has become more important each year. In the Finnish Employees' Pensions Act system, the funding ratio has continued to increase. It is thought to account for approximately 27 per cent of total pension liabilities. During 2004, the funding ratio of pension assets also increased in many other European countries.

The legal amendment also clarifies SPF's organisational status and supervision. The Fund is controlled by the Ministry of Finance, and its Board of Directors consists of representatives of both the Ministry of Finance and employee organisations.

The SPF, which began operating in 1990, was founded after the Employees' Pensions Act system for the private sector and the corresponding system for the municipal sector.

The SPF's goal is to prepare for covering the state's future pension liabilities and balancing pension expenditure. Funding is a long-term process: currently, having operated for 15 years, the SPF has funded 12 per cent of the state's pension liabilities. The payment of employees' pension contributions into the fund began in 1993.

The SPF will maintain a lean organisation. In 2004, operating expenses amounted to an average of 0.05 per cent of total assets. We aim to operate efficiently.

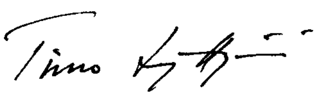
Diversification of Assets Continues

By the end of 2004, the SPF had achieved its allocation goal of 40 per cent of investment assets being invested in the equity market. The Fund began investing in the equity market at the end of 2000, and investment activities have continued to expand in 2004. We have examined several European real estate mutual fund investments, and aim to make the first investments there during 2005. We will also expand the benchmark portfolio for 2005 by adding inflation-linked fixed-income instruments. The yield and capital value of inflation-linked bonds is tied to the inflation rate, which means that they will maintain their real value in the long term.

During 2004, the SPF has analysed the significance for its investment portfolio of investments in Finland, assessing the volume of investments there in the years to come from the viewpoint of asset diversification and expected yields. When investing, the SPF evaluates the benefits of investment in Finland in relation to other markets while maintaining the sufficient and appropriate diversification of assets. More than 22 per cent of fixed-income investments and some 28 per cent of equity investments were targeted at Finland at the year-end. Both in Europe and elsewhere, the general trend is to invest a larger share of pension assets domestically than their global market index weighting would require.

We will continue to diversify our assets, maintaining the special status of investments in Finland. We will analyse good capital fund investment targets in Finland, since such investments not only give good returns but they have a positive effect through the public economy on economic growth and the employment rate.

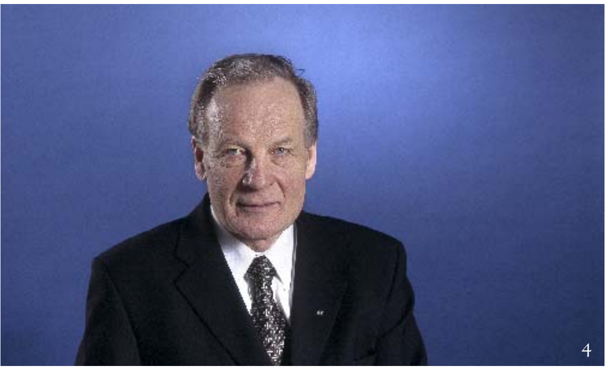
I would like to thank our staff and partners for their valuable contributions in 2004 towards the success of our fund. I would also like to express my gratitude to those who have developed the Fund with such wisdom and farsightedness over the last 15 years.



Timo Löyttyniemi Managing Director


1

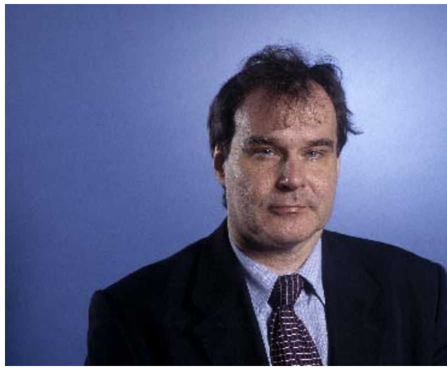

2


4


5


7


8



The State Pension Fund Organisation

SPF's organisation emphasises excellent professional skills and the representation of employers and employees alike.

Board of Directors

The State Pension Fund's Board of Directors, appointed by the Ministry of Finance, is responsible for directing investment activities. The Board decides on investment principles and confirms the investment plan. The Chairman of the State Pension Fund's Board of Directors is Eino Keinänen, M.Sc.(Pol.Sc.), and the Vice Chairman is Teuvo Metsäpelto, State Labour Market Director. Members of the Board included Jukka Wuolijoki, Director General of the State Treasury; Elina Selinheimo, Budget Counsellor of the Ministry of Finance; Pekka Hemmilä, Director of AKAVA's Public Sector Negotiating Commission - JUKO; Matti Krats, Chairman of the Confederation of Salaried Employees Pardia; and Raimo Rannisto, Chairman of the Joint Organisation of State Employees VTY.

Permanent experts on the Board included Veikko Liuksia, Senior Adviser, Legal Affairs, State Employers' Office (Ministry of Finance) and Pertti Saarela, Director, Administration, Employers' Association for Transport and Special Service. Seija Kettunen, SPF's Head of Administration, was Secretary to the Board of Directors. In 2004, the Board convened nine times.

Personnel

The State Pension Fund's Managing Director is Timo Löyttyniemi, D.Sc.(Econ.) In 2004, the SPF had a payroll of thirteen full-time employees: Jukka Järvinen, M.Sc.(Econ), Head of Fixed Income; Seija Kettunen, MA (Pol.Sc.), Head of Administration; Mika Pesonen, M.Sc.(Econ), Head of Equities; Esa Artimo, M.Sc.(Econ),


3

6

9

Board of Directors

Chairman
1 **Eino Keinänen**

Vice Chairman
2 **Teuvo Metsäpelto**
State Labour Market Director
Ministry of Finance

3 **Pekka Hemmilä**
Director of AKAVA's
Public Sector Negotiating
Commission - JUKO

4 **Matti Krats**
Chairman
Confederation of Salaried
Employees Pardia

5 **Raimo Rannisto**
Joint Organization of State
Employees - VTY

6 **Elina Selinheimo**
Budget Counsellor
Ministry of Finance

7 **Jukka Wuolijoki**
Director General
State Treasury

Experts

8 **Veikko Liuksia**
Senior Adviser, Legal Affairs
Ministry of Finance

9 **Pertti Saarela**
Employers' Association
for Transport and
Special Service

Deputy Member

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
Secretary of Economic and Social Policy
Joint Organization of State
Employees - VTY

Pekka Saarinen
Budget Counsellor
Ministry of Finance

Timo Laitinen
Head of Division, Insurance
State Treasury

Investment Consultative Committee

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

Vice Chairman
Paavo Prepula

Liisa Jauri
Managing Director
Finnish Central Securities Depository

Topi Piela
Managing Director
Umo Capital Oyj

Vesa Puttonen
Professor
Helsinki School of Economics

Tuire Santamäki-Vuori
Chairman
Trade Union for the Municipal
Sector - KTV

Jari Sokka
Executive Director
The Local Government
Pensions Institution

State Pensions Fund

Managing Director
Timo Löyttyniemi

Secretary
Mira Forsell

Director, Administration
Seija Kettunen

Legal Counsel
Tiina Tarma

Portfolio Analyst
Oona Lievonen

Fixed-Income Investments

Head of Fixed-Income
Jukka Järvinen

Portfolio Manager
Antti Huotari

Portfolio Manager
Sami Lahtinen

Equity Investments

Head of Equities
Mika Pesonen

Portfolio Manager
Esa Artimo

Portfolio Manager
Jan Lundberg

Portfolio Manager
Hans Parhiala

Investment Assistant
Musse Habbaba

Portfolio Manager; Musse Habbaba, Commercial College Graduate, Portfolio Assistant; Antti Huotari, M.Sc.(Econ), Portfolio Manager; Hans Parhiala, M.Sc.(Econ), Portfolio Manager; Jan Lundberg, M.Sc.(Econ), Portfolio Manager; Mira Forsell, MA, Secretary; Sami Lahtinen, M.Sc.(Econ), Portfolio Manager; Tiina Tarma, LLM, Legal Counsel (7 Jan. 2004); and Oona Lievonen, M.Sc.(Econ), Portfolio Analyst (1 June 2004).

Investment Consultative Committee

The Investment Consultative Committee consists of investment industry professionals and economic experts. The SPF's Board of Directors appointed the Consultative Committee on 21 August 2003 for a three-year period from 1 October 2003 to 30 September 2006. The Chairman of the Consultative Committee is Professor Eva Liljeblom, the Vice Chairman is Paavo Prepula and its members are Vesa Puttonen, Professor; Liisa Jauri, Managing Director; Topi Piela, Managing Director; Tuire Santamäki-Vuori, Chairman; and Jari Sokka, Planning Director. The Investment Consultative Committee's term in office ends on 30 September 2006.

The Consultative Committee's task is to evaluate SPF's investment plan and reports on implemented investment operations, and to issue statements on these to the SPF's Board of Directors. The Investment Consultative Committee convened twice in 2004.

Oona Lievonen and Antti Huotari
Mika Pesonen, Musse Habbaba and Jukka Järvinen
Tiina Tarma

Seija Kettunen and Tiina Tarma
Sami Lahtinen
Mira Forsell and Esa Artimo

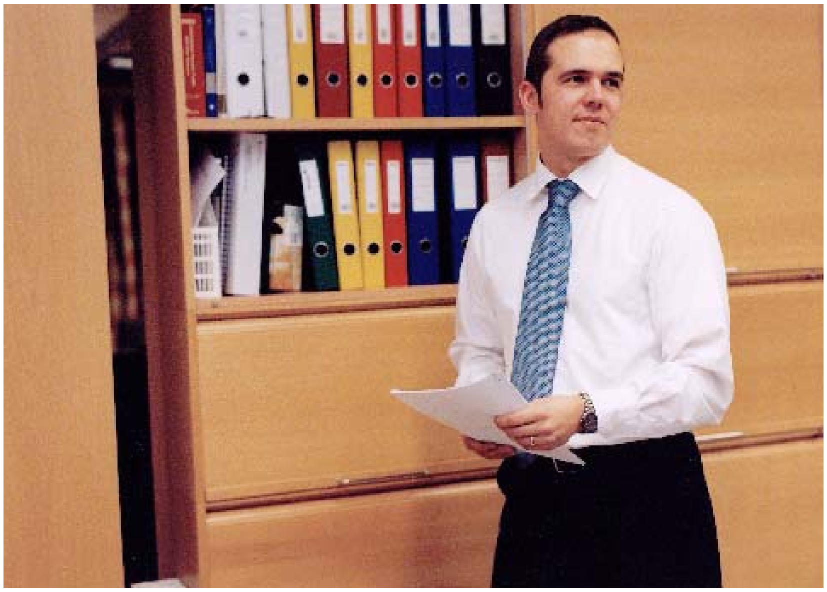
Investment Activities – Economic Environment

The upswing in the global economy that began towards the end of 2003 continued in 2004.

The vigorous growth in the global economy began to plateau towards the end of the year. However, trends have not been uniform: contrary to the United States', China and Russia's rapid growth, the euro zone and Japan began to stagnate in the summer. The marked increase in oil prices coupled with stronger currency rates put the brakes on growth in these regions. On the other hand, higher oil and raw material prices were a sign of continuing vigorous growth in China in particular. For a brief spell in October, oil prices exceeded 50 dollars a barrel, but towards the end of the year the price fell back to around 40 dollars.

Increases in consumer prices accelerated in 2004 both in the euro zone and the United States, but euro zone price increases tailed off as the euro appreciated. In the United States the trend was due not only to increasing oil prices but also to vigorous economic growth, facilitating price increases. For this reason, the United States Federal Bank changed the focus of its monetary policy from a stimulatory to a more neutral one midway through the year, and by the year-end it had raised its central bank interest rate from 1 per cent to as much as 2.25 per cent. Also, the Bank of England and the People's Bank of China controlled booming growth by increasing interest rates. The European Central Bank indicated its intention to increase interest rates towards the end of the year, should the inflation rate continue to exceed its targeted level. In Japan, the Central Bank continued to adhere to its zero interest rate policy. The US dollar weakened markedly in relation to the euro and yen towards the end of the year, due to investors'






concerns over the accelerating growth rate of the nation's trade and current account deficits and its ability to cover them in future. The US dollar weakened partly due to central banks choosing the euro for their currency reserves. The Central Bank of Japan slowed down the yen's appreciation through currency trading interventions in 2004, enjoying particular success at the beginning of the year through selling yen and buying US dollars, which it invested in United States sovereign bonds.

The State Pension Fund's Investment Portfolio and its Development

The SPF's investment portfolio grew significantly in 2004, reaching a year-end market value of EUR 6,867 million (EUR 5,795 million at the end of 2003). The portfolio's time and capital-weighted returns calculated according to the GIPS standard was 9.6 per cent. The returns figure includes all investment activity expenses. During the same period, the portfolio's benchmark index yielded 9.6 per cent, while in 2003 the investment portfolio's yield came to 9.4 per cent.

Fixed-income investments' market value totaled EUR 4,113 million at year-end, having a neutral weighting (60 per cent of total allocation at year-end). The fixed-income portfolio yielded a return of 7.0 per cent (benchmark index 7.2 per cent).

The return on equity investments totalled 14.4 per cent last year (benchmark index 13.9 per cent). At the end of 2004, the market value of equity investments was EUR 2,754 million.

The entire investment portfolio's tracking error, calculated over a period of 12 months, came to 0.4 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 Sharpen figure was 2.2, while the portfolio's beta was 0.9, indicating that its risk level was below that of the benchmark portfolio, and that it was less volatile than the benchmark index. The risk indicators for the investment portfolio are calculated over a 12-month period based on monthly figures.

General Investment Activity Principles

The State Pension Fund is an off-budget State fund whose mandate is set out in the State Pension Fund Act. The State Pension fund exists to provide for the State's future pension liabilities and to 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, after the Fund is partly dissolved, in a controlled manner.

The SPF is a so-called buffer fund, i.e. the Fund does not incur pension liabilities that must be covered individually as for the pension companies under the Employees' Pensions Act. Therefore, the SPF is not subject to regulations governing its solvency. When making investments, the SPF must ensure that the investments are secure, deliver a high return and can be converted into cash, whilst ensuring that they are appropriately diversified. Investments have been diversified in a manner similar to that of other employment pension schemes.

The State Pension Fund's Board of Directors confirms its 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. The realisation of investment activities is compared with a benchmark index in accordance with a neutral basic allocation.

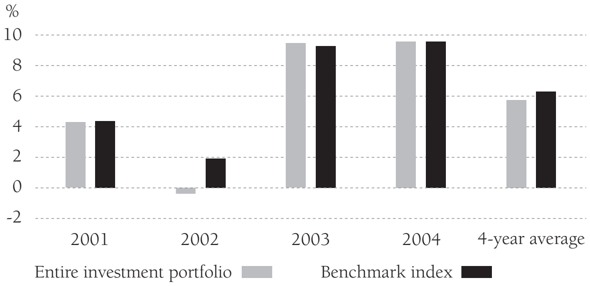
The State Pension Fund is a long-term investor, a so-called buffer fund, which can adopt an investment policy allowing the return on investments to vary considerably over the short term. Investment decisions are taken on the basis of the Fund's required return and the yield potential of prospective investments,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

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

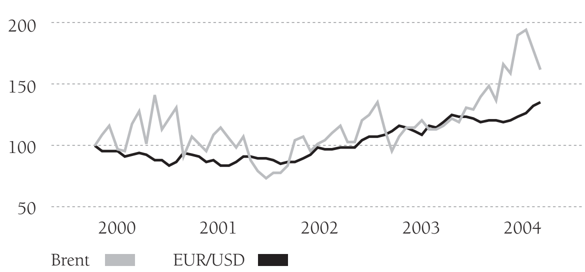
The international GIPS standard is applied to the calculation of the fund's returns. GIPS is a standard aimed at employing uniform methods to yield and risk calculations, thereby arriving at comparable yield and risk figures.

The State Pension Fund maintains a lean organisation and clear operational focus in order to save costs and maintain a streamlined administration. The Fund has outsourced custodial and clearing investment functions as well as yield and risk calculations. The State Treasury is responsible for the SPF's bookkeeping and preparation of its financial statements, and it also handles in-

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



Trend in the brent and euro/dollar exchange rate (31 Dec. 1999=100)



Source: Reuters

formation management and payroll administration duties as well as security and other support services.

Ownership Policy

The SPF prepared its ownership policy principles in 2004, stating that the SPF 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.

The SPF monitors its portfolio companies and their success so that it is able to take a position on the success of these companies and possibly on the principal resolutions brought before General Meetings. The SPF can, to the extent it deems appropriate, get in touch with other institutional investors in matters concerning resolutions from individual companies' General Meetings or other matters of general import.

State Pension Fund employees do not participate in the administration of listed companies in which the Fund holds shares. However, the SPF can appoint a representative to a nomination committee consisting of shareholders.

Social Responsibility

The SPF's investment activities adhere to an investment policy in favor of sustainable development, because companies adhering to the ideology of sustainable development have often proved successful in their operating environments.

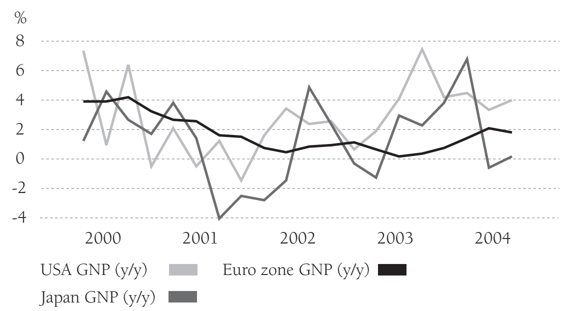
When selecting potential investment targets, the SPF uses sustainable development indices as a basis for comparison. The SPF invests primarily on the basis of the expected return from the investment target, but between two companies equal in this respect, the one selected for the portfolio will be that represented in any sustainable development index. At the end of 2004, two thirds of Nordic portfolio investments and almost 90 per cent of direct equity investments in the Europe ex-Nordic portfolio were targeted at companies belonging to a major international sustainable development index. These indices and their composition are monitored on a regular basis.

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 ILO has confirmed on a trilateral basis.

SPF total portfolio return 31 Dec. 2004

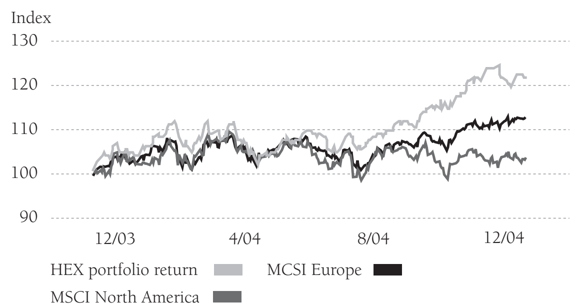
	12 mths, %	4-year average, %
Fixed income	7.0	5.8
Benchmark index	7.2	6.7
Difference	-0.2	-0.9
Equities	14.4	-0.8
Benchmark index	13.9	-2.1
Difference	+0.5	+1.3
Entire portfolio	9.6	5.7
Benchmark index	9.6	6.3
Difference	+0.0	-0.5

GNP trend in the United States, Euro zone and Japan



Source: Reuters

Trend in the equity markets 2004



Source: Reuters

Fixed-Income Investments

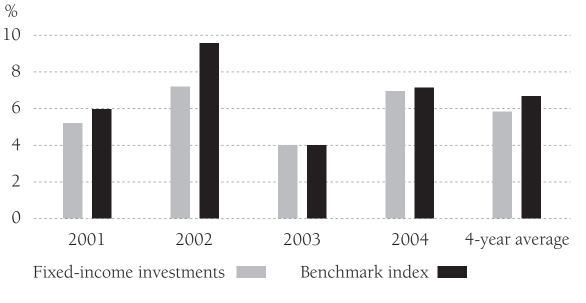
Fixed-Income Market in 2004

The fixed-income market turned out more positive than expected in the first quarter of the year, with decreasing interest rates at all points of the yield curve. Key reasons for this included very much lower-than-expected unemployment figures, indicating an improvement in employment rates. Reports on employment rates issued in the second quarter of the year indicated considerably more positive economic trends, which made interest rates swing upward and the yield curve become less steep. The State Pension Fund maintained fixed-income investments close to neutral weighting throughout most of the first quarter.

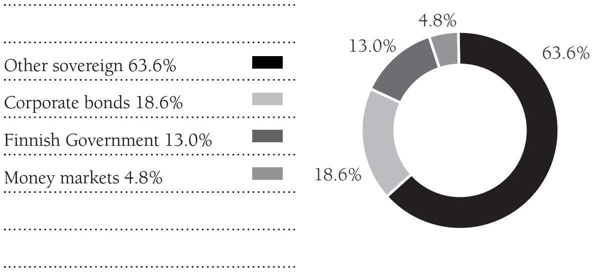
The latter half of 2004 was positive for fixed-income investments. At the beginning of the period, interest rates declined slightly across the entire yield curve, which also began to climb more rapidly, causing the longest maturities on the curve to yield less in relation to shorter maturities. Towards the end of the year the long-term end of the curve declined and the curve became less steep when the published financial data supported long-term fixed-income investments in particular. Simultaneously, speculations on interest rate increases raised the shortest-term interest rates. Sovereign bond issuance remained active during the period. The credit ratings of Italy and Greece were downgraded and that of Spain upgraded in 2004, but these rating adjustments did not have any major influence in the interest rate spread of these countries in relation to German sovereign bonds. The demand for inflation-linked bonds remained solid throughout the year, still exceeding supply in the euro zone in particular. Due to high demand and undeveloped markets, inflation-linked sovereign bonds yielded higher returns than nominal sovereign bonds.

The yield spread of corporate bonds in relation to sovereign bonds remained very narrow due to the high demand for corporate bonds in relation to their supply, companies' more solid balance sheet structure and the extremely low number of bankruptcies in 2004. The demand for risk via the derivative market rendered the yield spread even narrower, and the average yield differential of Investment Grade corporate bonds narrowed from approximately 64 basis points to about 48 during the year. Among the Investment Grade corporate bonds (on offer), only corporate bonds issued by American automotive companies (GM and Ford) showed a significant widening of spreads. Strong demand for High Yield bonds continued after the temporary sales boom that occurred in May. Similarly, emerging market bonds yielded high returns due to strong liquidity in money market and demand in the market. This instrument category was supported by decreasing debt burdens, current account surpluses and the improved economic prospects of emerging market nations, reflected in higher credit ratings granted to certain countries, such as Russia, which rose from the High Yield to Investment Grade category.

Return on fixed-income investments compared with the benchmark index



Fixed-income instruments by sector on 31 Dec. 2004



for the portfolio. The share of High Yield bonds was cut in November, in line with the tactical market outlook.

The money market portfolio remained overweight almost all year, which contributed towards decreasing the interest rate risk position in relation to the benchmark index. The last remaining bonds issued by the Government of Finland matured during the year, so that at the year-end the portfolio consisted solely of market-based investments. Fixed-income investments still included lower-yield direct bonds for the Government of Finland in 2004, which cut the yield of the fixed-income portfolio by an estimated 0.15 per cent. The money market portfolio's weight in the aggregate fixed-income portfolio came to 4.8 per cent at the year-end.

The fixed-income portfolio's volatility was 2.0 per cent, while the corresponding figure for the benchmark index was 2.3 per cent. The portfolio's beta was 0.8. Risk indicators for the fixed-income portfolio are calculated on monthly returns over a period of twelve months. SPF's fixed-income portfolio grew, calculated by market values, from EUR 3,821 million in the beginning of the year to EUR 4,113 million. During the year, bonds were acquired for EUR 3,911 million and sold for EUR 3,221 million, while money market investments totalled EUR 2,031 million in the corresponding period. Principally, the State Pension Fund makes its own direct fixed-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 90 per cent of the aggregate fixed-income portfolio.

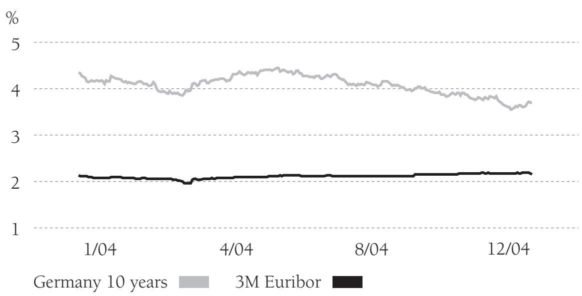
The State Pension Fund's fixed-income portfolio is entirely hedged from currency risks because the instruments we use are either euro-denominated or the mutual funds we use have hedged their currency risks.

The State Pension Fund's Fixed-Income Investments in 2004

The State Pension Fund's fixed-income investment portfolio yielded 7.0 per cent, while the benchmark index yielded 7.2 per cent. SPF kept fixed-income investments underweight in relation to equity investments almost throughout the year in its allocation, and SPF's fixed-income investment portfolio's duration remained slightly below the index duration until November, and at the very end of the year transferred to overduration. Finland-portfolio was kept underweight during the latter half of the year and, correspondingly, the EMU portfolio was kept overweight. This anticipated the future merging of portfolios as of 1 January 2005, and investments were diversified further into EMU country sovereign bonds, excluding those of Finland. More inflation-linked bonds were purchased for the EMU portfolio during the period, and their share of the entire fixed-income portfolio amounted to 5.0 per cent at the year-end.

The corporate bond portfolio remained slightly underweight almost all year, with high-quality Investment Grade rating bonds acquired as direct investments, while mutual fund investments focused on High Yield and emerging market bonds. Furthermore, a small number of convertible bond mutual funds were acquired

Interest rate trends in 2004



Source: Reuters

Major fixed-income investments on 31 Dec. 2004

	MEUR	Percentage of fixed-income portfolio
Government of Finland 4.7.2007 (5.0%)	178, 6	4.9
Government of France 25.10.2032 (5.75%)	137.3	3.8
Government of Finland 25.04.2009 (5.0%)	122.8	3.4
Government of Greece 21.06.2006 (2.75%)	122.3	3.4
Government of Germany 4.7.2034 (4.75%)	121.1	3.3
Government of Portugal 17.08.2007 (4.87%)	107.4	2.9
Government of Spain 31.10.2011 (5.35%)	101.7	2.8
Government of the Netherlands 15.07.2008 (5.25%)	99.5	2.7

Equity Investments

The Equity Market in 2004

Regardless of stock market price fluctuations, equities yielded high returns in 2004. Stock prices bounced upwards, particularly in Asia, during the early part of the year. Investors transferred assets to equities, because they estimated that continuing solid economic growth would improve the performance of companies. In March, terrorist attacks in Madrid increased the record-low volatility of the market, and stock prices fell sharply in Europe for a couple of weeks afterwards. The stock market revival, which lasted one month, began towards the end of March, boosted by surprisingly high employment rates in the United States. In addition, the temporary weakening of the euro against the US dollar stimulated stock markets in Europe.

In April-May, the Asian stock market's upward trend of the early months of the year ended, as the duration of China's economic growth began to look questionable. Emerging market indices plunged as the increasing interest rate level scared investors into withdrawing assets from equities.

In the summer, the United States' poor employment rates troubled the stock markets until early autumn. Also, climbing oil prices cut forecasts for economic growth. When the result of the US presidential election became clear, the United States stock exchange received a strong boost while the clear weakening of the US dollar towards the end of the year cut returns from America for euro investors.

Trends in the stock markets monitored by the State Pension Fund were almost parallel until mid-August, but during the autumn the Nordic market clearly stood out from other key indices. In Finland, Nokia issued a positive profit warning in early January for the first time in years, which raised Nordic stock prices clearly. In early April, Nokia revised its sales prospects for the entire year, which pushed Nokia's shares into distinct decline. However, the company's stock began to rise again in mid-August thanks to promising sales prognoses for the remainder of the year.

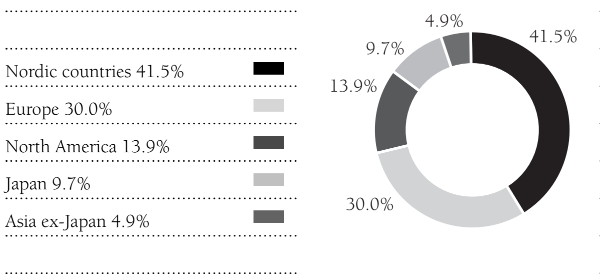
In Finland, investors became interested in additional dividends due to the good results from the corporate sector in the autumn. As in 2003, the Helsinki HEX Portfolio Index yielded the best return among SPF's benchmark indices last year, in spite of falls in Nokia's share value. Among the heavyweight index shares, banks and Fortum gained strongly throughout the year.

The State Pension Fund's Equity Investments in 2004

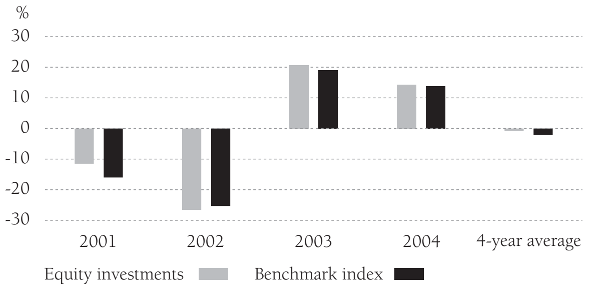
The State Pension Fund's equity portfolio returned 14.4 per cent in 2004, while the benchmark index returned 13.9 per cent. This outperformance of the benchmark index was due to overweighting the Nordic portfolio, successful investments in small-cap mutual funds and the judicious company choices made within the Nordic portfolio. The timing of trading was also a significant factor. This was the third year out of four during which the State Pension Fund's equity portfolio outperformed its benchmark index.

In 2004, the portfolio's Jensen's alpha was clearly positive, which meant that the portfolio yielded risk-adjusted added value in comparison with the benchmark index. The portfolio's track-

Equity portfolio breakdown by country on 31 Dec. 2004



Return on equity investments compared with the benchmark index



Source: Reuters

ing error was 1.6 per cent while the information ratio was 0.8. The risk indicators are calculated over a period of twelve months on the basis of monthly observations.

The State Pension Fund began investing in the equity market towards the end of 2000, increasing the share of equity weighting to 40 per cent of the entire investment portfolio over a period of four years, i.e. by the end of 2004. This gradual expansion of the equity portfolio in poor market conditions, and rising trends in share markets as of March 2003, led to the portfolio's market value exceeding the acquisition price by EUR 233 million at the end of 2004. Moreover, the SPF gained EUR 93 million in dividends and almost EUR 40 million more in sales profits than sales losses were realised over a period of four years. In sum, we can state that the realised and unrealised cumulative euro-denominated return on equity investments totalled approximately EUR 360 million at the end of 2004, while the equity portfolio's IRR annual return totalled 6.6 per cent between 2001 and 2004.

The entire investment portfolio's neutral equity weighting increased from 35 to 40 per cent over the year, and the portfolio grew, measured in terms of market value, from almost two billion euros in the beginning of the year to EUR 2.8 billion. During 2004 the SPF purchased shares and mutual fund units for some EUR 700 million, while the sales respectively amounted to some EUR 270 million. At the year-end, the SPF held direct equity investments in almost 150 companies and fund units of almost 50 different mutual funds in its equity portfolio. The State Pension fund makes direct equity investments in the Nordic countries and Europe, having invested approximately one half of its entire equity portfolio in direct equity investments and the rest via mutual funds.

The equity portfolio is divided into five geographical areas. Last year, three of the sub-portfolios outperformed their benchmark index, while the largest of them, the Nordic equity portfolio, yielded 22.0 per cent, which clearly outperformed the benchmark index. In addition to Finnish companies, the portfolio is made up of Swedish, Norwegian and Danish companies. The Nordic equity portfolio was expanded steadily over the first part of the year, resulting in a clear overweight position. This overweighting, at a maximum of over three percentage points, was decreased in November–December.

Most investments in Europe (excluding the Nordic countries), were in index products at the year-end, with around one fifth invested in small company mutual funds and another fifth directly in European companies. The European portfolio investments yielded 13.6 per cent last year.

The SPF invested in North America solely via mutual funds, primarily through index funds and enhanced index funds, while less than one fifth of North American investments were in mutual funds investing in medium-sized or small companies. In euros, this portfolio yielded a return of 4.0 per cent. Investments in Japan (a return of 6.3 per cent) and the rest of Asia (a return of 5.6 per cent) were handled entirely via mutual funds.

The SPF itself has not used derivatives as part of risk management, because the Fund is a long-term investor which regards currency risks as part of the diversification of equity investments.

Major direct equity investments on 31 Dec. 2004

	MEUR	Percentage of equity portfolio
Nokia Oyj	91.8	3.3
Stora Enso Oyj	82.3	3.0
UPM-Kymmene Oyj	80.2	2.9
TeliaSonera AB	67.9	2.5
Fortum Oyj	66.7	2.4
Sampo Oyj	56.1	2.0
Nordea AB	56.0	2.0
Ericsson AB	37.6	1.4

Source: Reuters

Major direct mutual fund investments on 31 Dec. 2004

	MEUR	Percentage of equity portfolio
BGI Europe ex UK Index Fund	100.4	3.6
Mandatum Europe Enhanced Index K	87.0	3.2
Sampo Japani Osake K	76.1	2.8
Dow Jones Euro Stoxx ETF	74.9	2.7
Fidelity European Smaller Co.	69.9	2.5
Mandatum North America Enhanced Index	64.8	2.4
BGI US Index Sub Fund	64.1	2.3
Vanguard European Stock Index	63.5	2.3

Source: Reuters

The State Pension Scheme

In 2004, the State Pension Act covered roughly 180,000 people, of whom 130,000 were State employees. Benefits were paid to almost 300,000 people, and the State Treasury made around 24,000 pension decisions in 2004, paying out pensions of EUR 2.9 billion.

The State pension scheme covers not only State employees, but other groups, the largest of which comprises comprehensive and upper secondary school teachers who were born before 1970 and who entered service before 1999. Teachers entering working life in future are covered either by municipality or private sector pension scheme. The state pension system also covers some employees of private state-aided institutions.

State Pension Scheme Closer to the System Based on the Employees' Pension Act

The State pension system has been gradually revised as from the 1960s, mainly according to the same basic principles as the private sector system based on the Employees' Pension Act. The earnings principle, index-adjustment and the principle of accrued pension right were introduced to the State Pension Act. After the latest revisions, state pension coverage, having originally been slightly better than pension coverage pertaining to the basic principles of the Employees' Pension Act, is now equal to that of the municipal and private sector. In line with the pension reform that took effect as of 1 January 2005, differences in comparison with the private sector pensions system disappeared once and for all.

The common target for the employment pension reform is to keep Finns in working life for 2–3 years longer than at present, thereby ensuring pensions for future generations. In State workplaces, activities supporting well-being at work have been implemented for a long time, their guiding principle being to enhance working ability and care for the entire workplace so that fewer employees have to retire from State employment before they be-

State personnel are highly educated.
40 per cent have an academic degree and 93 per cent a vocational degree.
The corresponding figures for other employees are 16 and 78 per cent.

come eligible for an old age pension. Also, State Pension Scheme rehabilitation supports well-being at work. Entitlement to rehabilitation was expanded as of 1 January 2004.

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.

Prior to the establishment of the State Pension Fund, state offices and institutions knew very little about pension costs, since all pensions belonging to the State pension system were paid directly from appropriations reserved for the State budget. The purpose of pension contributions paid to the State Pension Fund was to enhance awareness within State employer units of the costs of pension security.

The sum corresponding to pension contributions for 1990 was transferred directly from the State budget to the State Pension Fund, and state offices and institutions paid pension contributions to the Fund for the first time in 1991. Pension contributions were also set for other employers covered by the State Pension Scheme. Municipalities, whose staff in the educational sector have traditionally been covered by State pension security, were the last to be included in the new scheme. As from 1993, employees covered by the State Pension Scheme have also paid an employees' pension contribution to the State Pension Fund. Pension fund duties were entrusted with the State Treasury, which handled them until 2000. The State Treasury, bearing operational responsibility for State pension security, determines the pension contribution percentages for State offices and institutions each year, and collects pension contributions for the Pension Fund. At first, all State employers made the same collective contribution, but as of 1997 the State pension scheme introduced employer-specific pension contributions, the size of which are determined in accordance with the employer's staff numbers, broken down by gender and age, the number of disability cases and lower pensionable ages.

To begin with, the SPF was a fund for accounting purposes, and its assets were managed by the State. Active investment in fixed-income instruments began in 1995, and from 2000 staff have been employed for the Fund, after investment activities expanded from fixed-income instruments handled by the State Treasury to equity investments. Investment activities are directed by the Board of Directors appointed by the Ministry of Finance, including both employer and employee representatives.

In the first few years, the State borrowed a large amount of assets from the SPF, but this has not happened since 1994. Instead, the State has transferred assets from the Pension Fund to the State budget annually, as permitted under law. State pensions are paid out from appropriations reserved for the purpose in the State budget. In 2004, the State's pension liability totalled approximately EUR 56 billion.

In the State pension system, the State Pension Fund is responsible for funding pension assets, and the State Treasury grants and pays out all pensions falling within the State Pension Scheme. The SPF's funding objective is in proportion to State pension liabilities and, in accordance with the target specified in the State Pension Fund Act of 2004, the State Pension Fund must have funds covering 25 per cent of the State's full pension liability. Pensions are not paid out from the State Pension Fund. Instead, all pensions falling within the State Pension Scheme are paid out from appropriations made in the State Budget each year.

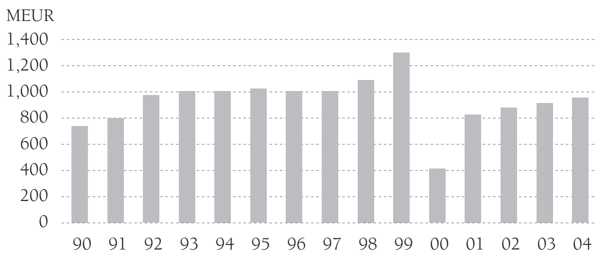
A key factor controlling the growth of the Pension Fund is the transfer from the Pension Fund to the State budget. In order to ensure the SPF's growth, the law stipulates a specified amount for this transfer, which is 40 per cent of annual state pension expenditure. By the end of 2004, a total of over EUR 13 billion in SPF assets had been transferred to cover the State budget.

Current value of pension entitlements
and pension assets in 2000

EUR billion	Private sector	Public sector SPF	Public sector Others	Public sector Total	Private and public sector total	SPF 2004
Current value of pension entitlements	210	51	56	107	317	56
Pension assets	57	4	12	16	73	7
Degree of funding	27%	8%	23%	15%	23%	12%

Source: Finnish Pension System 2003 and SPF

Asset transfers from SPF from 1990 to 2004



The State Pension Fund's Supervision

Ministry of Finance

According to the State Pension Fund Act, the Ministry of Finance shall appoint a Board of Directors for the SPF for a term of three years at a time, and can dismiss Board members. Correspondingly, the Ministry of Finance annually appoints auditors for the SPF and approves its financial statements. Reporting on the SPF's operations is included in the activity report submitted to Parliament by the Ministry of Finance on its administrative sector.

Board of Directors

Under the State Pension Fund Act, the Fund's Board of Directors consists of a chairman, vice chairman and a maximum of five members. The Board must possess sufficient expertise on investment activities and three of its members are appointed on the basis of a proposal by the most widely represented central organisations covering civil servants and Government employees.

In accordance with the State Pension Fund Act and the Fund's regulations, confirmed by the Ministry of Finance, the task of the

Board is to determine the Fund's investment principles and to prepare an investment plan. The Board oversees adherence to these principles and investment restrictions, and implementation of the investment plan on a quarterly basis or, if necessary, more frequently.

The Board of Directors is also responsible for decisions on
• supervision of the Fund
• staff decision-making authority
• internal guidelines required for Fund operations
• approving the Fund's annual budget
• approving and signing the Fund's financial statements
• issuing an annual report to the Ministry of Finance on Fund operations in the previous year
• appointing the Fund's managing director and other staff
• Fund organisation, internal administration and decision-making, unless it has transferred these duties entirely or in part to the managing director
• authorisations granted to the managing director and other Fund civil servants.

In addition, the Board decides on other matters of general and fundamental importance to the Fund, such as reporting procedures and the return and risk benchmarks presented in reports. The State Pension Fund's return and risk reporting has been outsourced to Mandatum Asset Management Ltd.

Investment Consultative Committee

The State Pension Fund's Board of Directors is responsible for the Fund and its investment activities. A Consultative Committee for Investments, consisting of investment industry professionals and respected economic experts has been appointed to assist the Board in decision-making concerning its investment plan.

The task of the Committee is to familiarise itself with the investment plan and to issue a statement on it prior to the Board's approval of the investment plan. The Committee must consider the structure and feasibility of the investment plan and assess whether the plan under review meets the targets and requirements set for it. The diversification targets for investment activities forms a special area of scrutiny. Furthermore, the Committee evaluates the investment activities undertaken and the related reports.

Official Supervision

Under the State Pension Fund Act, the Insurance Supervision Authority oversees the Fund's investment activities. Because the Fund is a state organisation, the National Audit Office also audits its operations and finances. The Insurance Supervision Authority's task is to oversee and audit insurance and pension institutions and other entities under its supervision, to ensure that they comply with the law and good insurance practices and follow the appropriate procedures. The Insurance Supervision Authority oversees and assesses organisations in respect of their financial position, management, supervision and risk management systems, operational prerequisites and changes in the operating environment.

The SPF is a so-called buffer fund, i.e. the Fund does not incur pension liabilities that must be covered as for funds under the Employees' Pensions Act. Key factors in the Fund's operations are the diversification of assets in order to reduce investment risks and the process of defining the investment horizon. Therefore, supervision by the Insurance Supervision Authority focuses on adequate diversification of the Fund's investment, management of investment risks, smoothly running processes and compliance with regulations.

Auditors

Each year, the Ministry of Finance appoints two auditors to audit the Fund's administration, finances and accounts. The auditors verify that the Fund's financial statements provide correct and adequate information on the its finances and the results of its operations. The auditors must also establish that the SPF's administration, management of assets and accounting have been arranged and handled in compliance with the regulations in force. The audit report will be submitted to the Fund's Board of Directors and Ministry of Finance.

Internal Supervision

When the investment plan is submitted for approval, the SPF's Board of Directors also approves the authority and restrictions of persons making investment decisions. Furthermore, the SPF has regulations approved by the Board, defining the managing director's and personnel's authority and decision-making rights. Similarly, the Board confirms the SPF's ethical guidelines and insider rules. The managing director oversees the operations of SPF's staff, making use of an external firm specialising in internal audits. Internal auditing reports to both the managing director and the Board of Directors, which oversees the managing director's activities. In addition to normal reporting, the Board can, should it so wish, consult both internal auditing and the external firm of independent public accountants.

Contact Information

The State Pension Fund

Managing Director
Timo Löyttyniemi
Tel. +358 9 2515 7010

Secretary
Mira Forsell
Tel. +358 9 2515 7019

Director, Administration
Seija Kettunen
Tel. +358 9 2515 7011

Legal Counsel
Tiina Tarma
Tel. +358 9 2515 7024

Portfolio Analyst
Oona Lievonen
Tel. +358 9 2515 7026

Fixed-Income Investments

Head of Fixed-Income
Jukka Järvinen
Tel. +358 9 2515 7012

Portfolio Manager
Antti Huotari
Tel. +358 9 2515 7017

Portfolio Manager
Sami Lahtinen
Tel. +358 9 2515 7025

Equity Investments

Head of Equities
Mika Pesonen
Tel. +358 9 2515 7013

Portfolio Manager
Esa Artimo
Tel. +358 9 2515 7016

Portfolio Manager
Jan Lundberg
Tel. +358 9 2515 7014

Portfolio Manager
Hans Parhiala
Tel. +358 9 2515 7015

Investment Assistant
Musse Habbaba
Tel. +358 9 2515 7018

Other Investments

Portfolio Manager
Ilkka Tomperi
Tel. +358 9 2515 7027

The State Pension Fund
Unioninkatu 13, FI-00130 Helsinki, Finland

Tel.
+358 9 2515 7019

Fax
+358 9 2515 7052

www.ver.fi

1990 1991 1992 1993 1994 1995 1996 1997 1998