

1999

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2001

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2004

Annual Report

2005

2006

2007

2008

VER

VALTION ELÄKERAHASTO
STATENS PENSIONS FOND
THE STATE PENSION FUND

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The State Pension Fund

Established in 1990, the State Pension Fund (VER) is an off-budget pension investment 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.

2005 in Brief

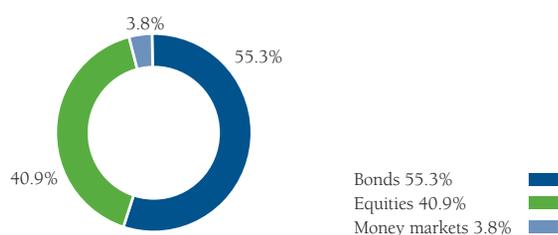
The investment portfolio's value was around EUR 8.2 billion at the end of 2005, up from EUR 6.9 billion at the end of 2004.

The investment portfolio is divided into fixed-income investments and equities. Fixed-income investments accounted for 59 per cent of the portfolio, and equities for 41 per cent, while fixed-income investments amounted to EUR 4.8 billion and equities to EUR 3.4 billion. The corresponding figures for 2004 were EUR 4.1 billion and EUR 2.8 billion.

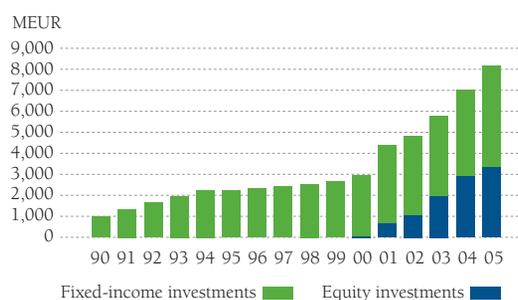
Investments yielded a return of 14.9 per cent in 2005, against 9.6 per cent a year earlier. The return on fixed-income investments was 5.4 per cent (7.0 per cent) and the return on equity investments 30.8 per cent (14.4 per cent).

Operating expenses amounted to 0.05 per cent of total assets.

VER's investment portfolio breakdown



Trend in VER's investments



Amount of assets under management, MEUR

	2005	2004
State Pension Fund's investments, total	8,201	6,867
Fixed-income investments	4,848	4,113
Equity investments	3,353	2,754

Income from investment operations, %

	2005	2004
Return on investments	14.9	9.6
Fixed-income investments	5.4	7.0
Equity investments	30.8	14.4

The State Pension Fund 2001–2005

	2001	2002	2003	2004	2005
Total investments, MEUR	4,427	4,841	5,795	6,867	8,201
Fixed-income investments, MEUR	3,754	3,777	3,821	4,113	4,848
Fixed-income investments, %	85%	78%	66%	60%	59%
Equity investments, MEUR	673	1,064	1,974	2,754	3,353
Equity investments, %	15%	22%	34%	40%	41%
Income from investment operations, %					
Return on investments	4.3	-0.4	9.4	9.6	14.9
Fixed-income investments	5.2	7.2	4.0	7.0	5.4
Equity investments	-11.5	-26.7	20.7	14.4	30.8
Operating expenses (% of average capital)	0.02	0.04	0.05	0.05	0.05
Personnel	3	7	11	13	15
Income from pension premiums, MEUR	1,186	1,285	1,324	1,380	1,462
Net premiums, MEUR	364	404	408	431	296
Transfer to state budget, MEUR	829	881	917	952	1,175
Balance sheet total, MEUR	4,514	5,198	5,898	6,620	7,337
Pension provisions, MEUR	52,600	54,200	55,100	56,300	57,600
Funding rate % ¹⁾	8%	9%	11%	12%	14%

1) Investments/pension provisions

Award for Pension Investment Operations

The State Pension Fund has been granted an award for operating the best pension investment scheme in Finland. VER was ranked number one in Finland by the Investment & Pensions Europe (IPE) magazine. It was also among the top three finalists for the European Best Public Pension Fund award.

According to the jury, the development of VER's portfolio structure and investment operations during recent years proved decisive. The Fund has developed the management of its investment operations and assets to match international standards. Special attention has also been devoted to risk reporting within VER's operations.

VER began the gradual diversification of its assets in late 2000 by entering the equity market. At present, some

40 per cent of VER's assets are invested in equities. Among other things, the good return on the investment portfolio is based on investments in small growth companies. In the future, VER aims to further diversify its assets to real estate and venture capital funds.

Many pension funds all over Europe participated in the competition, arranged by the IPE magazine, its fifth industry-wide competition. ATP of Denmark was ranked the best pension fund in Europe and received the Best Public Pension Fund award.



Timo Löyttyniemi, Managing Director of VER, at the IPE magazine's award ceremony.

The State Pension Fund's 15th Anniversary

The State Pension Fund celebrated its 15th anniversary in Helsinki in May 2005. Almost two hundred experts from the financing and pension sector attended the anniversary seminar.

In his opening address, Eino Keinänen, Chairman of VER's Board of Directors, emphasised the significance of funding with regard to preparations for increased State pension expenditure. Over the years, a fund established for accounting purposes has developed into an independent organisation that emphasises persistence and high professional skill. The increase in funded assets has made VER into a significant Finnish pension investor.

The keynote speaker at the seminar was Erkki Liikanen, Governor of the Bank of Finland. Mr. Liikanen was Minister of Finance when VER was established. He cited two factors as background for establishment of the Fund: firstly, a rapid increase in the State's pension expenditure for which funding preparations were deemed necessary and, secondly, the national economy's generous surplus, to be used for purposes other than routine public expenditure.

Mr. Liikanen covered several aspects of the effect of ageing and pension reforms on pension expenditure, the financial markets, and particularly the international real interest rate. Longer life expectancy and more retirement years will have their effects on pension savings.

Smaller younger age groups will reduce the proportion of working adults to pensioners, while greater life expectancy, particularly in the years after retirement, increases the need for the working population to save money on its own initiative.

Pension funds are among the most important players in the financial markets. Mr. Liikanen saw the distribution of pensions between funding systems and pay-as-you-go systems as one of the most crucial factors shaping the future of the financial and capital markets. In his opinion, arranging pension cover purely through a funding system will become problematic as the size of the funds increases.

Matti Krats, Chairman of the Federation of Salaried Employees Pardia, addressed the seminar on behalf of employee organisations. According to Mr. Krats, the funding of State sector pensions has been developed jointly with employees. He found it justified that employment pension assets be invested in Finland on the basis of the historical return and future outlook of Finnish equities; however, sufficient international diversification should not be forgotten.

After extending the Government's greetings, Ulla-Maj Wideroos, Minister of Finance, stated that VER is one of the Government's many ways of preparing for future challenges and that it has been successful in its tasks; the Fund's assets have increased and return on investment has been very high.

Mark Tapley, Research Fellow from Cranfield School of Management in England, presented an international view of the challenges and strategies of pension investment. He emphasised the significance of diversification, particularly with regard to equity investments, in order to limit Finland's share of the overall risk exposure of the pension system.



According to Eino Keinänen, Chairman of VER's Board of Directors, the Fund has become a significant Finnish pension investor emphasising persistence and professional skills.



According to Ulla-Maj Wideroos, Minister of Finance, VER has succeeded in its task: the Fund's assets have increased and returns have been very high.

VER's Investments Were Successful

The operations of the State Pension Fund developed favourably in 2005. The return on our investment portfolio increased to 14.9 per cent and we received significant international recognition for our work. We also continued to build and expand our investment portfolio and diversify our assets.

The investment environment was favourable for pension investors in 2005. Both major investment markets – fixed-income and equity – developed positively during the year. Return from the equity market amounted to some 30 per cent over the year. During previous years, VER's equity weighting had been gradually increased to 40 per cent. Therefore, we were able to benefit from the equity market's buoyant trends. We will continue to diversify our investment portfolio. Real estate funds are a particularly interesting instrument and, since VER has no direct real estate investments, we have a good opportunity to diversify the structure of our portfolio using real estate securities. A substantial structural reform is taking place in the real estate market. An increasing share of real estate is being transferred to the ownership of investors, and real estate investments are being channelled through indirect investments like mutual funds. The currently low level of interest rates has boosted this structural reform. In order to balance our investment portfolio, we need other investment targets besides conventional fixed income and equity investments.

We are prepared to increase the share of other investments as well. Last year, we made additional investments in index-linked bonds, infrastructure funds, as well as European and Finnish venture capital funds. The aim of using these instruments is to reduce fluctuations in our investment portfolio. Some of these investments are of a long-term nature and currently have rather minor significance within the overall portfolio. Their balancing effect will only be evident over a few years.

During recent years, we have built a sufficiently large and competent organisation modelled on international high-quality pension investors. VER has received major international recognition for its work, the Investment & Pensions Europe (IPE) magazine having declared VER the "Best Pension Fund in Finland". The grounds for this award included successful portfolio construction, a high return on investment and high-quality external reporting. VER also numbered among the top three finalists for the IPE's European Best Public Pension Fund award.

Fifteen years have passed since the establishment of the State Pension Fund. We celebrated our anniversary at a seminar in May 2005. VER's role has developed over the years alongside the Finnish pension system, and we are currently the fourth largest pension investor in Finland. It seems that the amount of pension assets has continued to increase in recent years. According to an estimate by the International Monetary Fund, international institutional pension assets within the OECD countries amount to approximately USD 15 trillion.

The success of investment operations is affected by strategic choices over allocation, tactical weighting and the selection of investment targets. Last year, we were successful in all of these.

We can be satisfied with 2005. The structure of our investment portfolio and competent staff have helped us achieve good overall returns. Diversification of our portfolio has required a great deal of professional skill, and risk management and the development of the related processes remains important to us. I would like to thank our staff and partners for a successful year.



TIMO LÖYTTYNIEMI Managing Director



The State Pension Fund Organisation

Board of Directors



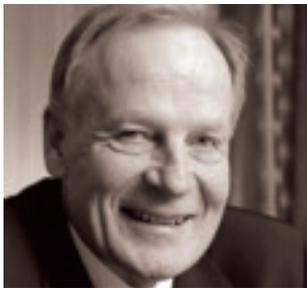
Eino Keinänen
Chairman



Teuvo Metsäpelto
Vice Chairman
State Labour Market Director
Ministry of Finance



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



Matti Krats
Chairman
Federation of Salaried
Employees Pardia



Raimo Rannisto
Chairman
Joint Organisation
of State Employees VTY



Elina Selinheimo
Budget Counsellor
Ministry of Finance



Jukka Wuolijoki
Director General
State Treasury



Experts
Veikko Liuksia
Senior Adviser, Legal Affairs
Ministry of Finance



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

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Senior Adviser, Legal Affairs
Ministry of Finance

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

Seppo Väänänen
Chief of Negotiations
Federation of Salaried
Employees Pardia

Ilkka Alava
Secretary of Economic
and Social Policy
Trade Union for the Public
and Welfare Sectors JHL
(Joint Organisation of
State Employees VTY
until 22 November 2005)

Pekka Saarinen
Budget Counsellor
Ministry of Finance

Timo Laitinen
Head of Division, Insurance
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Tuire Santamäki-Vuori
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Trade Union for the Public
and Welfare Sectors JHL
(Trade Union for the Municipal
Sector KTV until 22 November
2005)

Jari Sokka
Executive Director
The Local Government
Pensions Institution

The State Pension Fund

Managing Director
Timo Löyttyniemi

Secretary
Mira Forsell
(on leave of absence)

Secretary
Nina Laakso

Administration
Head of Administration
Seija Kettunen

Controller
Paula Mauno

Legal Counsel
Tiina Tarma

Portfolio Analyst
Oona Lievonen

Fixed-Income Investments

Head of Fixed-Income
Jukka Järvinen

Deputy Director
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

Other Investments
Portfolio Manager
Ilkka Tomperi

Investment Activities

Economic Environment

The upswing in the global economy continued strongly in 2005. The strength and dynamic nature of the accompanying economic growth were surprising, even though oil prices increased rapidly and the United States gradually tightened its monetary policy. Thus, the effect of oil prices on the global economy seems to have diminished. Furthermore, the growth of the global economy had a wider base, with Japan apparently regaining its position amongst economic powerhouses such as China and the United States.

Increases in consumer prices accelerated in the first half of 2005 both in the euro zone and the United States. However, base inflation rates remained almost unchanged in both areas. The increase in prices in the United States was not solely due to increased oil prices but was also affected by production bottlenecks created by strong economic growth. For this reason, the US Federal Reserve continued to increase its Federal Funds rate. GNP growth in the euro zone stood close to one per cent, while the United States indicated growth of approximately 3.5 per cent.

Growth in the euro zone failed to gain the expected momentum, even though the ECB pursued a reflationary monetary policy for the second year in a row. Japan seemed to have broken free from its deflationary spiral, and the Bank of Japan gave its first hints at a potential end to its zero interest rate policy in 2006.

A greater interest rate difference between the United States and the euro zone and expectations of stronger economic growth in the US strengthened the dollar in relation to the euro and yen. The dollar was further strengthened by a temporary tax exemption granted to US businesses for repatriating the earnings of their foreign subsidiaries in 2005.

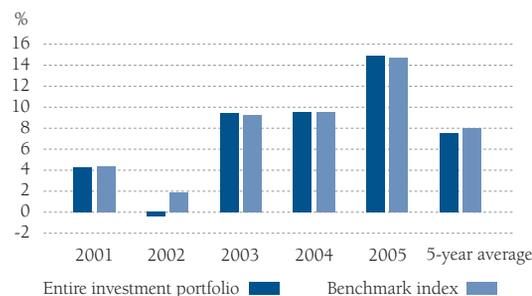
The State Pension Fund's Investment Portfolio and its Development

VER's investment portfolio grew significantly in 2005, reaching a year-end market value of EUR 8,201 million (EUR 6,867 million at the end of 2004). The portfolio's time and capital-weighted returns, calculated according to the GIPS standard, were 14.9 per cent. This figure includes all investment activity expenses. During the same period, the portfolio's benchmark index yielded 14.7 per cent, while in 2004 the investment portfolio's yield came to 9.6 per cent.

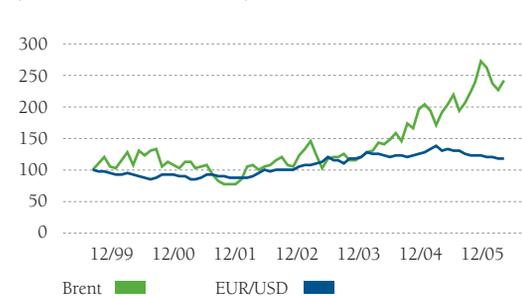
Fixed-income investments' market value totalled EUR 4,848 million at year-end, being close to a neutral weighting, while the fixed-income portfolio yielded a return of 5.4 per cent (benchmark index 5.1 per cent). Return on equity investments totalled 30.8 per cent last year (benchmark index 30.4 per cent). At the end of 2005, the market value of equity investments was EUR 3,353 million.

The entire investment portfolio's tracking error, calculated over a period of 12 months, came to 0.5 per cent, i.e.

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



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



Source: Reuters

the portfolio's return was almost equal to that of the benchmark index. Jensen's alpha for the portfolio was positive, and the portfolio's risk-adjusted yield was better than that of the benchmark index. The Sharpe indicator was 2.85, while the portfolio's beta was 0.9, indicating that its risk level was below that of the benchmark index, 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.

Ownership Policy

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

VER monitors its portfolio companies and their success so as to be able to take a position on these issues and the principal resolutions brought before General Meetings. VER can, to the extent it deems appropriate, get in touch with other institutional investors in matters concerning resolutions at individual companies' General Meetings or other matters of general importance.

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

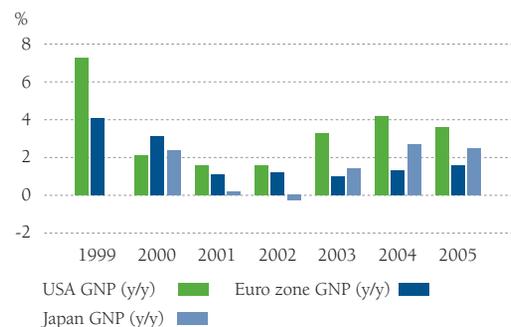
Social Responsibility

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

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

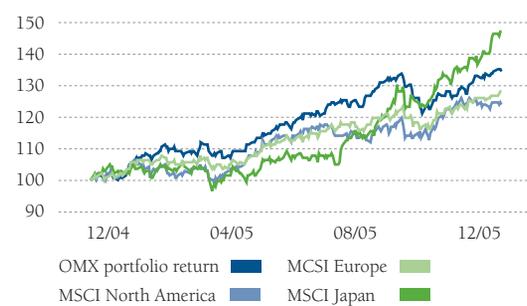
The investment policy also provides for negative evaluation so as to avoid making direct investments in companies deriving a substantial share of their turnover from the alcohol, tobacco, firearms, pornography or gambling industries. The same pertains to countries and enterprises which do not respect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

GNP trend in the United States, euro zone and Japan



Source: Reuters

Trend in equity markets 2005



Source: Reuters

Fixed-Income Investments

Fixed-Income Market in 2005

The fixed-income market produced a moderate return in 2005. Within the euro zone, long-term interest rates in particular, with a maturity exceeding 10 years, decreased in 2005. This was affected by high market liquidity, the persistently low level of central bank rates, as well as expected amendments to asset-liability regulations for European pension investors. Upcoming amendments will increase investors' interest in long-term fixed income investments exceeding 10 years. Flatter interest rate curves represented another significant feature of the fixed income market. This was particularly true in the United States, where the Federal Reserve continued to increase its regulatory rate.

The interest rate gap between the United States and the euro zone became wider for both short- and long-term rates, the German 10-year rate reaching a low of 3.0 per cent in late September, a high of 3.8 per cent being recorded in mid-March. Interest rate curves became less steep on both sides of the Atlantic.

The corporate bond market continued to develop strongly from the beginning of the year until early March when fear of strong interest rate increased and a downgrade in the credit rating of General Motors, which issued a profit warning, caused greater sovereign bond divergence. More active offerings by issuers and extraordinary ultra-long-term corporate bonds weakened the corporate bond market further, widening

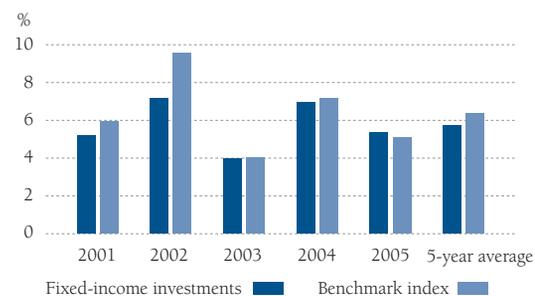
the gap to as many as 82 basis points in May. The expected downgrade of General Motors' credit rating to junk bond status took place in May. This was reflected in the recovery of the Investment Grade bond market but weakened the High Yield market. During the spring and early summer, the development of the corporate bond market was favourable as investors returned to the market. They began to develop cold feet again during the latter half of the year.

The State Pension Fund's Fixed-Income Investments in 2005

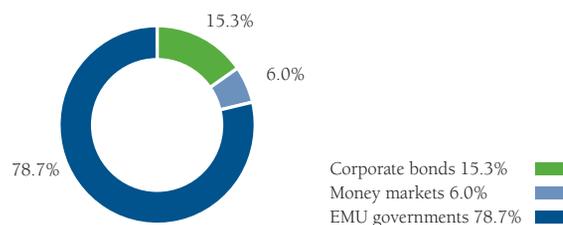
The State Pension Fund's fixed-income investment portfolio yielded 5.4 per cent, while the benchmark index yielded 5.1 per cent. The Fund outperformed its benchmark index due to its understanding of interest rates and allocation at the sub-portfolio level, as well as investments in emerging bond markets. Its fixed-income portfolio was maintained close to the duration of the benchmark index for the entire period. Sovereign bonds were clearly overweight while corporate bonds were underweight. The corporate bond portfolio mainly comprised of bonds with a high credit rating, the share of inflation-linked bonds in the EMU portfolio being further increased, and their share of the entire fixed-income portfolio totalling more than 10 per cent.

Money market investments were kept slightly underweight in the first half of the year and at a neutral weight during the

Return on fixed-income investments compared with the benchmark index



Fixed-income instruments by sector on 31 December 2005



latter half. The view of the interest rate curve for the longest maturities was neutralised during the latter half of the year. The corporate bond risk was reduced during the period under review by divesting high-beta corporate bonds and almost all High Yield bond funds. More emerging market funds were acquired in the corporate bond portfolio during the year.

The fixed-income portfolio's volatility was 2.8 per cent, while the corresponding figure for the benchmark index was 2.9 per cent. The portfolio's beta was 0.9 and the tracking error 0.3. Risk indicators for the fixed-income portfolio are calculated on monthly returns over a period of twelve months. Calculated at market values, VER's fixed-income portfolio grew from EUR 4,113 million at the beginning of the year to EUR 4,848 million. During the year, bonds were acquired for EUR 2,909 million while money market investments totalled EUR 1,113 million in the corresponding period.

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

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

Major fixed-income investments on 31 December 2005

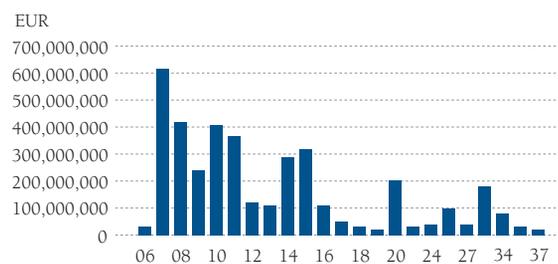
	EUR	Percentage of fixed-income portfolio
Government of Italy 1.6.2007 (3.0%)	160,808,791	3.6
Government of Italy 1.2.2020 (4.5%)	144,171,201	3.3
Government of France 25.10.2032 (5.75%)	138,041,233	3.1
Government of Greece 21.6.2007 (3.25%)	132,947,616	3.0
Government of Finland 15.9.2010 (2.75%)	129,627,808	2.9
Government of Ireland 18.4.2016 (4.60%)	114,612,000	2.6
Government of the Netherlands		
15.7.2008 (5.25%)	108,075,205	2.4
Government of Portugal 17.8.2007 (4.875%)	104,989,795	2.4
Government of Germany 10.10.2008 (3.50%)	102,305,890	2.3
Government of Spain 31.10.2011 (5.35%)	101,302,890	2.3

Interest rate trends



Source: Reuters

Maturities of bonds in VER's fixed-income portfolio



Equity Investments

The Market Year and Equity Investments in 2005

Equity markets yielded excellent returns in 2005. The return on the State Pension Fund's equity portfolio, including the Other Investments category, was 30.8 per cent (14.4 per cent in 2004). The benchmark index of VER's equity portfolio, which is a combination of the benchmark indices of the sub-portfolios, increased by 30.4 per cent. The publicly quoted part of the equity portfolio, excluding real estate funds, hedge funds and venture capital funds, yielded a return of 31.5 per cent. Outperformance of the benchmark index was mainly attributable to overweighting the Asian equity market and judicious choices of companies made within the Nordic portfolio.

VER's equity portfolio increased from EUR 2.8 billion to EUR 3.4 billion during the year. The neutral share of equity weighting within VER's investment portfolio remained at 40 per cent for the entire year, meaning that the proportionate share of equities was not increased further during the year.

The equity portfolio's beta was 0.9. 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 tracking error was 1.5 per cent while the information ratio was 0.6. Risk indicators for the equity portfolio are calculated over a 12-month period based on monthly figures.

The strong growth of the equity market was based on a combination of low interest rates, strong economic growth and improving corporate earnings. Not even the increased oil prices and moderate increase in interest rates during the latter half of the year were able to interrupt economic growth or earnings improvement. Strong corrective movements were evident in almost all markets in April and October 2005 but these turned out to be short-term downswings. In spite of the increases in share prices, the general level of prices remains moderate in long-term comparisons.

The Nordic equity markets saw a strong upswing as the euro weakened in relation to the US dollar and began to boost

exports. Metal and engineering companies' prices increased particularly strongly in the Nordic countries. Increased energy prices also buoyed up energy companies. On the other hand, forest companies were not a particularly successful investment in 2005. The Nordic portfolio yielded a return of 33.4 per cent (22.0 per cent in 2004). The benchmark index, a combination of the Finnish and Swedish stock exchange indices, yielded 32.5 per cent.

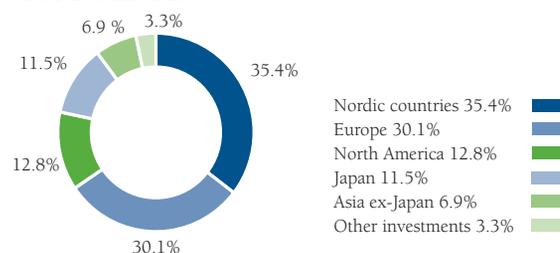
Economic growth was sluggish in Europe but the prices of export companies saw marked increases. During the latter half of the year, a brighter economic outlook reinforced investor confidence. VER's European portfolio (excluding the Nordic countries) yielded a return of 27.7 per cent (13.6 per cent in 2004). The benchmark index, MSCI Europe, yielded 26.9 per cent. During the year, funds investing in small and medium-sized companies yielded good returns. Their weight was reduced during the latter half of the year. Investments in the Russian stock exchange were also profitable.

Approximately one third of VER's investments in Europe (excluding the Nordic countries) are made in value companies. The determination of value companies includes consideration of dividend yield and the price/bookratio and price/expected earnings per share.

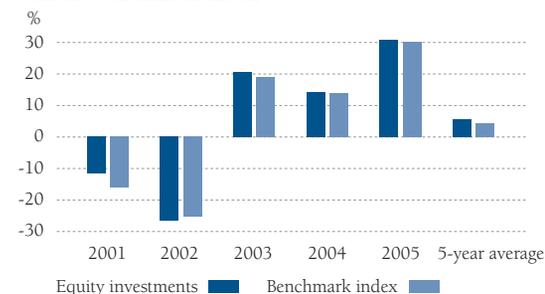
In North America, share prices increased by only a few per cent measured in local currency. Due to the strengthening of the dollar, VER received returns of 22.4 per cent from the United States (4.0 per cent in 2004), almost on a par with European investments. The benchmark index MSCI North America yielded 23.5 per cent. The North American portfolio was kept underweight for the entire year.

The increase of share prices in Japan accelerated in the summer as corporate earnings started to improve. There have been substantial changes in the Japanese economy and the political atmosphere, and a lot of foreign capital has been attracted to the equity market. Japanese companies have turned their focus from mutual power politics to improving their bal-

Equity portfolio breakdown by country on 31 December 2005



Return on equity investments compared with the benchmark index



ance sheets and earnings. More attention is also being paid to dividend payment capacity.

Measured by the MSCI Japan index, the Japanese equity market yielded 45.1 per cent in 2005, clearly the highest level in the 2000s. The Japanese section of VER portfolio yielded 47.8 per cent (6.3 per cent in 2004). Japan was lifted from being slightly underweight to overweight within VER's portfolio late in the summer.

The strong economic growth that has continued in Asia for several years is no longer based on exports and outsourcing Western companies alone. Local consumption is increasing and constitutes a growing share of economic growth. Particularly in Southeast Asia, consumer goods manufacturers, banks and energy companies have benefited from increases in consumer wealth.

The equity markets in Asia (excluding Japan) yielded excellent returns in 2005. Although clear downward corrections were evident in April, August and October, the all-year return was 42.8 per cent (5.6 per cent in 2004) while the benchmark index yielded 40.7 per cent. The Asian equity markets were overweight in VER's portfolio for the entire year.

Approximately one half of VER's equity portfolio (excluding real estate, venture capital and absolute return funds) are managed as direct investments. The rest is invested in mutual funds. At the end of the year, the Fund had direct investments in 153 companies. The portfolio included shares of 46 mutual funds.

During the year, purchases of equities and funds amounted to some EUR 590 million and divestments to EUR 770 million. Including the Neste Oil shares distributed by Fortum as dividends, VER's direct equity portfolio gained EUR 58.1 million in dividends. Net realised sales gains in 2005 amounted to EUR 125 million.

VER began to build its equity portfolio in December 2000, the amount of equities being increased based on the bear market from 2001 to 2003. The realised and unrealised cumulative euro-denominated return on equity investments totalled EUR 1.2 billion at the end of 2005, while the equity portfolio's internal rate of return, accounting for increases in capital, totalled 13.0 per cent between 2001 and 2005.

VER does not use derivatives. Even the exchange rate risk associated with equity investments is consciously left open. So far, VER has considered the benefits of currency hedging to be minor in the long term. On the other hand, exposure to currency risk is regarded as part of the diversification of equity investments.

Other Investments

Until the end of 2005, VER's Other Investments category operated as part of the equity portfolio. The Other Investments category comprises investments in real estate and venture capital funds, as well as absolute return funds. The market value of the portfolio at the end of the year was EUR 110.2 million. The amount of open investment commitments was EUR 224.5 million. Within the amount of invested assets and open investment commitments, indirect real estate investments accounted for approximately 37 per cent, venture capital funds for approximately 48 per cent and absolute return funds for approximately 15 per cent of the total.

The best return within the Other Investments category was achieved in absolute return funds, yielding 6.2 per cent. In the initial phase, returns on investments in real estate funds and particularly in venture capital funds are hampered by the effect of management fees. During the year, VER also invested in mezzanine and infrastructure funds.

Major direct equity investments on 31 December 2005

	EUR	Percentage of equity portfolio
Nokia Corporation	92,700,000	2.8
Fortum Corporation	79,200,000	2.4
Stora Enso Oyj	61,776,000	1.8
UPM-Kymmene Corporation	59,616,000	1.8
Sampo plc	57,408,000	1.7
TeliaSonera AB	54,577,408	1.6
Ericsson AB	51,468,286	1.5
Nordea AB FDR	50,772,500	1.5
Neste Oil Corporation	35,820,000	1.1
SanomaWSOY Corporation	31,472,000	0.9

Major direct mutual fund investments on 31 December 2005

	EUR	Percentage of equity portfolio
BGI Europe ex UK Index sub Fund	117,120,948	3.5
Mandatum Europe Enhanced Index K	98,775,219	2.9
Sampo Japan K	94,955,706	2.8
Vanguard European Stock Index Fund	79,880,811	2.4
Dow Jones Euro Stoxx 50 ETF	76,293,000	2.3
Mandatum North America Enhanced	73,737,197	2.2
BGI Japan Index Sub Fund	71,494,494	2.1
Fidelity Asian Special Situation	69,283,277	2.1
S & P 500 ETF	57,021,107	1.7
BGI UK Index Sub Fund	56,800,950	1.7

General Investment Activity Principles

1.1 Background of the State Pension Fund (VER)

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

VER has a Board of Directors appointed by the Ministry of Finance that decides on the Fund's investment principles and is responsible for the Fund. VER employed 15 people in December 2005.

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

At the end of 2005, the Fund's capital at market value stood at EUR 8.2 billion. The Fund will be accumulated until the funded amount corresponds to 25 per cent of the pension liabilities arising from pensions based on years of service covered by the State Pension Scheme. More detailed provisions on the use of the Fund's assets will be enacted once the funding objective has been achieved. It is estimated that the Fund will achieve its funding target by the year 2020.

1.2 Investment Objectives

1.2.1 High Return, Security, Diversity and Liquidity

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

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

to clarify and develop its corporate image as an independent portfolio investor.

1.2.2 Expected Long-Term Return and Risk Level

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

1.2.3 Neutral Basic Allocation

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

The neutral basic allocation refers to a passive and feasible distribution of investments. At the end of 2005, the neutral basic allocation of VER's investment portfolio comprised 60 per cent of fixed-income investments (allowable variation 55–70 per cent) and 40 per cent of equity investments (allowable variation 30–45 per cent).

Neutral allocation of fixed-income investments at the end of 2005

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

Neutral allocation of equity investments at end of 2005

	Basic allocation weight %
Nordic countries	35
Europe	30
North America	15
Japan	10
Asia ex-Japan	5
Other investments	5

Additional restrictions imposed by the Board of Directors include the following:

- Direct fixed-income investments in instruments from an individual issuer may not exceed two per cent of the entire fixed-income portfolio.
- Money market investments may constitute a maximum of 25 per cent of the entire fixed-income portfolio.
- Finnish equities must constitute at least 50 per cent of the Nordic portfolio.
- Direct equity investments may constitute a maximum of 30 per cent of the Europe portfolio.
- The Pension Fund is not allowed to invest in more than five per cent of any company's shares and/or voting rights without a separate decision. Acquisition of any larger holdings is subject to discussion and resolution by the Board of Directors.
- The aggregate of direct fixed-income investments and direct equity investments made in instruments and shares issued by an individual company may not exceed three per cent of the entire investment portfolio. However, the calculation of the aggregate amount does not include money market investments with a duration of less than six months.

1.3 Investment Activities

1.3.1 The Pension Fund as a Portfolio Investor

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

VER operates as an independent portfolio investor. It does not participate in the administration of companies it owns. However, direct discussion contacts with corporate management increase VER's credibility as an investor and improve the Fund's expertise. VER may appoint representatives to General Meetings and nomination committees consisting of shareholders, supervising the interests of shareholders. VER prepared its own ownership policy in the spring of 2004.

Fixed-income and equity instruments belonging to the investment portfolio can be purchased and sold, but the liquidity of venture capital fund investments within the Other

Investments category is partly restricted. The Fund makes independent investment decisions without any parties external to its investment operations. Third-party advisors can be used as part of the investment process as necessary. The Fund's investments are always made in accordance with the best available information, understanding and assessments.

1.3.2 Monitoring of Investment Activities

The success of investment activities is analysed on a long-term basis, chiefly considering the portfolio from an overall perspective. The fixed-income and equity portfolios' performances are monitored separately, applying geographical criteria with the help of benchmark indices. Losses can also be realised from investments since, if there is a sudden change in circumstances, it is better to sustain a minor loss than allow the losses to grow.

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.

1.3.3 Outsourcing of Operations

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 functions as well as yield and risk calculations. VER has also outsourced accounting and payment services, some information management tasks, as well as security and other support services.

1.3.4 Risk Management

Investment risks are managed in various ways. Managed exposure to investment risks forms an essential part of investment activities. The aim is to optimise the expected return on VER's investment portfolio in proportion to the investment risk using modern portfolio optimisation methods. Investment risks are managed and limited by determining neutral allocation weights, ranges of variation and benchmark indices for each category of investments, as well as clear authorisations and limits for investment activities. The Board of Directors decides on authorisations and limits for investment activities.

The State Pension Scheme

In 2005, the State Pension Act covered roughly 180,000 people, 130,000 being State employees. Benefits were paid to more than 300,000 people, and the State Treasury made around 21,000 pension decisions, paying out EUR 3.2 billion in pensions.

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

The State pension system has been gradually revised since the 1960s, mainly according to the same basic principles as the private sector system based on the Employees' Pension Act. After the latest revisions, state pension coverage, originally slightly better than that pertaining to the basic principles of the Employees' Pension Act, now equals the municipal and private sector. In line with the pension reform that took effect as of 1 January 2005, differences in comparison with the private sector pensions system disappeared.

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 future pension expenditure, particularly that of the baby-boomer generation. 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.

VER was established by virtue of an Act confirmed in late 1989. 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 educational sector

staff have traditionally been covered by State pension security, were the last to join VER.

As of 1993, employees covered by the State Pension Scheme have also paid an employees' pension contribution to the State Pension Fund in addition to payments made by State employer units. The employees' pension contribution is equal for all, regardless of the employment pension scheme.

The State Treasury bears operational responsibility for State pension security, granting and paying out pensions, determining the pension contribution percentages for State offices and institutions each year, and collecting pension contributions. At the outset, all State employers made the same collective contribution, but as of 1997 the State Pension Scheme introduced employer-specific pension contributions, 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, VER was a fund for accounting purposes within the State Treasury, and its assets were managed by the State. VER's active investment in fixed-income instruments began in 1995, and from 2000 it has had its own staff, after investment activities expanded 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 VER, most recently in 1994. Since then, the State has transferred assets to the State budget annually, as permitted under law. These transfers have been crucial to regulating VER's growth, which is ensured by the legal stipulation of a maximum amount for such transfers (40 per cent of annual state pension expenditure). By the end of 2005, approximately EUR 14.4 billion in VER assets had been transferred to the State budget.

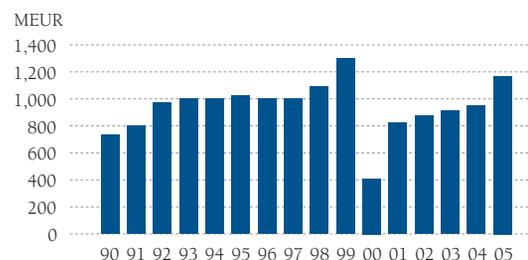
VER's funding objective is in proportion to State pension liabilities and, in accordance with the target specified in the State Pension Fund Act of 2004, the State Pension Fund must have funds covering 25 per cent of the State's full pension liability. The State's pension liability stood at EUR 57.6 billion in 2005 (EUR 56.3 billion in 2004).

Current value of pension entitlements and pension assets

EUR billion	Private sector	Public sector			Private and public sector total	VER 2005
		VER	Others	Total		
Current value of						
pension entitlements	231	58	77	135	366	58
Pension assets	64	8	16	24	88	8
Funding ratio	28%	14%	21%	18%	24%	14%

Source: The Finnish Centre for Pensions and VER 2005

Asset transfers from VER from 1990 to 2005





The photograph shows Merit Palas, Lecturer at the Sibelius Academy (top left) and Tiina Viitanen, Information Officer at the Communications unit of the National Board of Taxation (top right). At bottom left you can see Lieutenant Jukka-Pekka Lumilahti employed by the command centre of the Gulf of Finland Coast Guard, with pensioner Enni Lapinleimu on the right.

Finland's universities and other institutions of higher education employ some 32,000 people. The tax authorities have 6,500 employees. The Gulf of Finland and West Finland Coast Guards employ more than 900 people in total. 24,000 primary school teachers are currently receiving State pensions.

Financial Statements

PROFIT AND LOSS STATEMENT	1.1.–31.12.2005	1.1.–31.12.2004
Operating income		
Other operating income		
Sales gains on equities and shares	196,827,217.33	70,193,134.46
Pension contributions from State offices and institutions	780,561,528.47	727,749,326.89
Other pension contribution income	380,576,010.53	379,276,804.93
Employees' pension contributions	301,250,252.20	273,170,719.91
Disability insurance contribution income	8,933,271.00	3,103,908.00
Write-downs on receivables from other operations	0.00	-7,764.76
	1,668,148,279.53	1,453,486,129.43
Operating expenses		
Materials, supplies and goods		
Purchases during the period	38,879.20	30,977.73
Personnel expenses	1,496,932.53	1,138,182.46
Rents	137,226.23	131,366.64
Outsourced services	1,619,874.93	1,491,112.83
Other expenses		
Other expenses	130,260.66	103,115.34
Sales losses on equities and shares	26,942,842.28	29,098,391.66
Depreciation	40,954.89	13,584.35
	-30,406,970.72	-32,006,731.01
SURPLUS I	1,637,741,308.81	1,421,479,398.42
Financial income and expenses		
Financial income	253,182,007.79	207,820,681.71
SURPLUS II	1,890,923,316.60	1,629,300,080.13
Income and expenses from transfers		
Income		
From trade and industry		
Transfer fees	1,398,675.37	44,461,153.10
From financial and insurance institutions		
Returns of pension entitlement	0.00	2,030.93
	1,398,675.37	44,463,184.03
SURPLUS III	1,892,321,991.97	1,673,763,264.16
SURPLUS/DEFICIT FOR THE PERIOD	1,892,321,991.97	1,673,763,264.16

Balance Sheet

ASSETS	1.1.–31.12.2005	1.1.–31.12.2004
Fixed assets and other long-term investments		
Intangible assets		
Intangible assets	2,460.38	943.71
Other long-term expenditure	888.16	1,121.36
	3,348.54	2,065.07
Tangible assets		
Machinery and equipment	20,474.93	35,353.79
Furniture and fittings	66,600.11	77,024.84
	87,075.04	112,378.63
Securities held as fixed assets and other long-term investments		
Purchases of bonds denominated in euros	4,053,121,218.33	3,300,347,198.73
Other long-term investments denominated in euros	1,956,527,670.34	2,005,558,182.21
Other long-term investments denominated in foreign currency	895,273,507.77	891,890,386.30
	6,904,922,396.44	6,197,795,767.24
Total fixed assets and other long-term investments	6,905,012,820.02	6,197,910,210.94
Current receivables		
Accrued credits and deferred charges	187,338,979.70	177,968,566.64
Other current receivables	13,127,466.00	4,184,100.07
Advance payments	0.00	1,628.50
	200,466,445.70	182,154,295.21
Financial securities and other short-term investments		
Purchases of bonds denominated in euros	210,595,672.56	194,719,979.38
Cash, bank deposits and other financial assets		
Joint account receivable from the State	1,437,775.63	3,456,881.05
Other bank accounts	19,770,847.27	41,293,333.87
	21,208,622.90	44,750,214.92
Total inventories and financial assets	432,270,741.16	421,624,489.51
TOTAL ASSETS	7,337,283,561.18	6,619,534,700.45

The State Pension Fund – Financial Statements

EQUITY AND LIABILITIES	1.1.–31.12.2005	1.1.–31.12.2004
Equity		
Fund capital	-12,488,805,221.12	-11,536,386,094.12
Accrued changes in capital	19,107,885,681.58	17,434,122,417.42
Budget transfers	-1,174,874,634.00	-952,419,127.00
Surplus/deficit for the period	1,892,321,991.97	1,673,763,264.16
	7,336,527,818.43	6,619,080,460.46
Liabilities		
Current		
Items to be rendered forward	22,581.76	17,035.27
Accrued charges and deferred credits	694,798.48	406,301.84
Other current liabilities	38,362.51	30,902.88
	755,742.75	454,239.99
Total liabilities	755,742.75	454,239.99
TOTAL EQUITY AND LIABILITIES	7,337,283,561.18	6,619,534,700.45

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