



## **NEW CHALLENGES**

As the dust settles after the past two years' financial crisis, 2010 posed new challenges. DIP ended the year with an overall return of 9.9 % which is considered satisfactory. The result is positive compared to DIP's expectations for the year.

Throughout the year DIP maintained a balanced investment profile with equities, bonds, credit bonds as well as real estate which proved to be a reasonable decision. DIP's active investment strategy not only contributed positively, it also affected the result negatively.

Due to the fall in interest rates during the first six months of 2010, DIP achieved handsome returns on bonds and credit bonds, but the pension fund was also affected by investments in European government bonds with the crisis in Greece and Ireland. During autumn the long-term interest rates rose, while the equities followed suit at the end of the year.

After "Choice of Pension" in 2006, when the basic interest rate for the majority of the members was reduced from 4.5 % to 1.5 %, DIP is a financially strong pension fund. Viewed from the accountancy standpoint the cut in the basic interest rate not only meant that DIP does not have to set aside as large provisions for the members' pensions as before - even though the paid pensions were actually increased. It also placed DIP in a financial position where the pension fund is able to face the coming years' challenges by way of the members' increased longevity and the more risk sensitive capital requirements under Solvency II which is an updated set of regulatory requirements for pension and insurance companies operating within the EU.

In 2010 membership increased, and payments to the pension fund once again broke the record. At the end of the year DIP had more than 19,000 members who all have a share in the DKK 29 billion that DIP manages. Contributions rose by more than 7 % compared to 2009 which is a strong increase in light of the contributions made in 2009.

The positive growth demands continued development of the pension fund in order for DIP to be able to offer all members - both new and existing ones - relevant products at the same time as they get their fair share of the reserves along with payment of the pensions. The development is carried out with priority to keeping low costs.

## **THE LOGICAL CHOICE**

DIP's strategic goal is to become the logical choice for MSc's and BSc's in Engineering. This necessitates that the pension fund is able to provide attractive pensions to the members – both present and future ones.

Accordingly, DIP continuously works with developing its products to be able to offer the members increased flexibility at low cost.

DIP's work is based on surveys showing that the Danes prefer a reliable source of income when they retire. Consequently, DIP has chosen life annuity, which gives the member a lifelong pension payment every month after retirement, as its main pension product. As we all live longer and are more active when we retire there is an increased need for a sound economy for a longer period of time. The life annuity is a good way of sharing risk with ones colleagues and thereby obtain the highest possible pension throughout life.

### **New pension Regulations with flexible benefits**

During 2010 DIP worked on launching the new Regulations 4 with accompanying insurance terms which include;

- Life annuity as basic cover
- Flexible insurance cover on disability and accident
- Flexible insurance cover for spouse or cohabitant on death
- Annuity certain and endowment policy as alternative savings schemes

- Possibility of choosing between three investment profiles for annuities certain and endowment policies
- Possibility of adjusting the pension upward against a lower insurance cover if the retirement pension is not high enough
- Health insurance to members admitted under company schemes - this offer will at a later point be communicated to all DIP's members

It is DIP's intention to give the members on Regulations 1, 2 and 3 the opportunity of opting for Regulations 4 during 2012.

The new Regulations also gave DIP the possibility of establishing pension schemes for all employees in engineering companies. The purpose is to give all engineers the opportunity of lifelong membership of the pension fund. The possibility of establishing company schemes is not possible until 2011, but already in the autumn 2010 the pension fund had a number of queries from interested companies.

### **Increased cooperation**

In 2010 DIP implemented a new member system which is developed in cooperation with six other pension funds. This has been done to obtain economies of scale through cooperation with others, and in the years to come ensure continued development of the system at a reasonable price.

DIP also implemented a new Member Web providing the members increased possibilities of simulation of their pensions as well as improved self-service. In 2011 it is also DIP's intention to give the members increased freedom of choice in determining their benefits package.

DIP cooperates with the other academic pension funds - in particular the Pension Fund for Danish Lawyers and Economists and the Medical Doctors' Pension Fund on investments. Accordingly, the three pension funds will be sharing premises from 2012 for the purpose of finding more common solutions.

## **INVESTMENTS**

### **A satisfactory return in a turbulent year**

In 2010 DIP achieved a satisfactory return of 9.9 %. The return increased gradually over the year which is a reflection of different incidents' influence on the development. As a total the result can be ascribed to the positive returns from investments in equities and credits, while the South European government bonds affected the returns negatively.

The year must be seen in light of the previous two years when the financial crisis imposed heavy strains on the global economy. In this context 2010 gave much less cause for concern, however, the consequences of the financial crisis became apparent throughout the year with the challenges of the European economies - especially Greece and Ireland. Both countries have accumulated such big debt burdens that it has been necessary to support the economies.

### **Key market events of the year**

Three events dominated 2010;

- Interest rate trends - rise/fall
- European instability - problems with debt troubled countries
- The US - another monetary policy easing

### **Interest rate trends - rise/fall**

During 2010 the interest rate reached a new all-time low. Until August the interest rate on 10-year Danish government bonds fell by 1.5 %. The fall in interest rates occurred almost at the same time as the interest rate fall in Germany. The interest rate trends in Denmark have since been slightly increasing. This reflects to a certain extent a more natural level for the interest rate which at the close of the year was 3.0 % with an overall fall of 0.6 %.



The situation is still uncertain, and unpredictable incidents may influence the Danish interest rate trends considerably.

### **European instability - problems with debt troubled countries**

The debt crisis in Europe was without doubt the biggest issue of the autumn.

In August Irish and Portuguese bonds came under particularly strong pressure and weakened against the other countries.

There were strong rumours that Ireland had to seek EU/IMF rescue. For some time it seemed that Ireland could handle the financial situation, but the weakness in the Irish banking system forced the Irish to the negotiating table. In November 2010 they applied for a financial rescue package from the EU and the IMF.

### **The US - another monetary policy easing**

The US continued easing monetary policy with a new round of Quantitative Easing (QE) where government bonds are purchased while the purchase of mortgage bonds is reduced to ensure high market liquidity.

The overall purchase amounts to approx. USD 600 billion and runs until the summer 2011.

The easing was a wish to keep the interest rate at a low level and stimulate the domestic economy, and the value of the dollar was not mentioned. There is no doubt, however, that FED wants to keep the dollar rate low.

It is assessed that the US economic stimulus package has supported the market and created calmness in respect of the belief in future economic development, and in this way the QE program has if not only had a positive influence on the market psychology.

### **Investment strategy**

DIP has a long-term investment strategy for the purpose of ensuring the members the highest possible pensions.

DIP has adopted an active investment strategy based on the expectation that this yields the best return long term. An active investment strategy imposes requirements on the asset management to obtain a return above the markets invested in.

In order to reduce risk on the asset side, DIP works with a diversified strategy and invests broadly in both different asset classes and different regions.

The investment strategy is determined by the Board on basis of an ALM study.

The allocation of assets into different asset groups is essential for the overall return and risk - and more important for the overall return than which assets DIP specifically invests in within the single asset group.

The portfolio is built with consideration to balancing return and risk and diversification by asset groups, countries and industries.

### **Risk appetite**

DIP has adopted a relatively high risk profile based on the pension fund being solvent, and on the assumption that this gives the best possible return long term to the benefit of the members.

DIP has currently a high solvency ratio with a low probability of bankruptcy. The new, more risk sensitive capital requirements under Solvency II, which are about to be implemented throughout Europe, do not seem to cause DIP problems at present. All other things being equal this provides possibilities of taking risks on the asset side to optimize the return. Long term the prospects of increased longevity means that the provisions are put under pressure.



DIP tests regularly the pension fund's financial ability to withstand stress scenarios by way of simultaneous changes in interest rates and exchange rates, fall in equity prices etc.

Despite higher costs, the active investment strategy is expected to yield a better return compared to an indexed strategy. However, it also creates the risk of both negative and positive fluctuations relative to the market.

The overriding risk for DIP is not being able to meet its pension commitments. And in the current investment climate this may be a challenge. Denmark has through many years experienced a falling interest rate scenario and consequently rising bond prices. In case of a rise in interest rates DIP will lose money on its bond portfolio, and accordingly the pension fund has presently adopted a high risk profile with investments in both equities and credit bonds equaling a total of approx. 48 % of the assets at the end of 2010.

DIP's risk profile diverges from the comparable pension funds. This is primarily due to the fact that DIP does not hedge the interest rate risk, as the majority of the pensions are based on a conditional guarantee. Besides, DIP has substantial equity and credit bond holdings compared to others. Consequently, some diversity of the return must be expected, but seen over a longer period of time DIP must outperform the average return of comparable pension funds.

### **Responsible investments**

Based on the aim to invest responsibly, DIP's Board has decided on the following wording;

- DIP wants to have a responsible investment policy by in practice meet the social expectations that can and will be made to institutional investors managing funds on behalf of others.
- DIP complies with Danish legislation and the international conventions that Denmark has acceded to. DIP also wants to comply with Danish policy as expressed by the Government and Parliament.
- DIP does not participate in in campaigns, but takes up possible problems with the portfolio managers to reach a positive outcome.
- DIP believes to achieve the best investments when the company managements incorporate a commercial and financial reasonable approach to their considerations.
- DIP emphasizes having business partners who are both qualified and respected.

In 2009 DIP signed up to the UNPRI which is a network of investment organizations under the UN engaged in environmental, social and corporate governance issues related to investment decisions.

Accordingly, DIP has committed itself to live up to principles for responsible investments, and at the same time exert influence on others to do the same.

### **Investment result 2010**

In 2010 DIP achieved a return of 9.9 % which is considered satisfactory. The return is primarily due to the development in equities and credit bonds, but in general all investments yielded positive returns apart from European government bonds.

The overall return for Danish government and mortgage bonds was 5.6 % against a benchmark of 6.0 % which is the result of an underweight in government bonds which generated the best performance during the year. The mortgage bond portfolio itself is ahead of its benchmark by approx. 0.4 %.

The European government bonds yielded a poor return of minus 13.8 % against a benchmark of plus 2.2 %. The portfolio's majority of peripheral countries are the weak point, and especially the holdings in Portugal and Ireland have suffered strongly.

At the beginning of 2011 DIP had not changed the portfolio composition.



It is assessed that the European cooperation is sufficiently strong, and that the European Central Bank with the European politicians are so dedicated to the European Union that the single currency structure will survive, and the institutions will weather the storm.

It is likely that we will see future interest margins within the Eurozone, but it is assessed that they will be reduced over time, and consequently these bonds are still attractive in the overall portfolio composition.

With a return of 9.9 % the non-Euro government bonds did not match the benchmark return of 12.4 %.

DIP's portfolio of credit bonds has contributed positively with a return of 17.1 %. The credit bond markets recovered in the autumn after the markets in general were affected by the turmoil following the Euroland debt situation. A substantial investor demand contributed to the performance along with globally falling interest rates. On the European high yield market the credit spreads have narrowed with approx.120 basis points, while the narrowing in spreads on the American high yield market was just under 25 bp.

The narrowing in credit spreads occurred despite the fact that new issues hit a record high. The positive development is expected to continue - however, at slower pace than seen so far. This is a result of the companies being financially sound after a period of consolidation, where debt was repaid or refinanced to postpone the time of repayment.

Especially at the close of the year we saw a buoyant equity market, and DIP achieved a return of 22.8 % before currency hedging and 19.9 % after against a benchmark of 19.7 %. The progress was broad-based both domestic and abroad, however, Danish equities peaked with a return of 34.7 %. DIP's equity portfolio represents a total of approx. 30 %. Despite the handsome result, DIP's equity managers did in general - with a few very positive exceptions - have a difficult time outperforming their benchmarks. DIP's currency hedging had a negative effect due to the rise in the USD in 2010. DIP hedges the USD, YEN and GBP with 80 % for equities and 100 % for bonds.

DIP's real estate portfolio, which mainly consists of directly owned property, but also indirect investments in both Danish and foreign real estate funds, yielded a low return of 1.6 % in 2010.

Within the alternative investments private equity yielded a return of 16.7 %, while forest investments generated a return of 11.2 %. Alternative bond investments generated a return of 37.7 %, however, these investments only represent a small part of DIP's portfolio.

#### Allocation of investment assets

(DKKm)	Market values		Allocation
	2009	2010	2010
<b>Asset groups</b>			
Danish equities	1,096	1,441	5 %
Foreign equities	5,893	7,697	27 %
Danish bonds	11,579	10,380	36 %
Danish index-linked bonds	337	273	1 %
Foreign government bonds	2,569	2,723	9 %
Credit and EM bonds	2,854	3,637	12 %
Real estate	1,911	1,962	7 %
Alternative investment assets	612	928	3 %
<b>Total</b>	<b>26,851</b>	<b>29,041</b>	<b>100 %</b>



### **Prospects for 2011**

It is DIP's expectation that the global growth will be slightly positive throughout the next year without hitting the growth rates from 2004-06 of 4-5 %, or move into recession. This is usually a favourable situation for equities and for ensuring coupon payments on credit bonds.

The cautious, but positive expectations are ascribable to the fact that it seems as if the US is back on its feet kick-started by an extremely boost of the economy. At the same time the Republicans gained greater leverage at the midterm elections which means that already implemented tax cuts are extended. Both individuals and companies will benefit from the tax cuts.

The emerging markets are also picking up, and the expectations to GNP growth are somewhat higher here than in the US and Europe.

In Europe the dividing line between north and south is distinct. The countries in the south of Europe struggle with the repercussions of the financial crisis by way of debt and high unemployment, while especially Germany is experiencing growth and a prospering export industry. Consequently, the expectations here are modest.

A substantial uncertainty for DIP is the interest rate trends, as the pension fund's bond portfolio will be badly affected by rising interest rates. At the same time there are a number of unclarified questions about the current global economic situation, and focus on the debt issue in both the south of Europe and the US may create instability.

### **Expectations for 2011 return**

Despite the optimism at the beginning of the year, there are still many unsolved problems. It is difficult to predict the future, but DIP expects a modest, but positive investment result for the year. It is, however, subject to great uncertainty, as a rising interest rate scenario is not unlikely.

DIP has increased its equity portfolio, as the predominant uncertainty seems to have diminished, and the majority of the companies throughout the year have presented interim statements confirming that they are financially sound. DIP also expects the credit bond exposure to benefit the return - even though it will not be at the same level as in 2010.

Accordingly, DIP expects a return ensuring that the pension fund also in future can meet an interest rate payment of at least 5.3 %.

## **PENSIONS**

In 2010 DIP experienced a 4 % increase in membership to 19,047 members at the close of the year, and the pension fund passed the milestone of 19,000 members. It is positive that engineers still see DIP as an attractive pension provider, and the pension fund can grow to the benefit of all members.

Despite stricter tax rules in 2010 compared to 2009 - a lower tax ceiling and the adoption of the compensatory tax - DIP received large payments in 2010. The pension fund did not receive as many single contributions as in 2009, but on the other hand a large number of members transferred their schemes to DIP. Hence, transfers from other companies rose from DKK 13 million in 2009 to DKK 71 million in 2010.

### **Satisfied DIP members**

The research agency Userneeds completed in June 2010 a satisfaction survey of DIP and the large commercial pension companies. The survey confirmed that DIP has some of the most satisfied members of the pensions industry.

As much as 90 % of DIP's members declared themselves satisfied (43 %) or very satisfied (47 %) with DIP which is a result to be proud of. However, DIP should not be lulled into false security by the result, and the pension fund will continue working on improving services and products so the members also in future can expect a better pension in DIP than elsewhere.



### **Deposit interest rates**

In 2010 DIP introduced differentiated deposit interest rates for the first time. The reason for the difference in deposit interest rates for members on Regulations 3 on the one side and Regulations 1 and 2 on the other side must be put down to the financial crisis in 2008/09 disclosing an imbalance in the risk of the two groups.

This is not only due to the higher basic interest rate on Regulations 1 and 2, but also the fact that the technical basis for the pensions is unconditional.

In 2006 the members had the choice of opting for Regulations 3, where the basic interest rate is lower compared to the other Regulations. This turned out to be a success, and more than 90 % of the members opted for Regulations 3 taking 95 % of the retrospective provisions with them. The fact that so many opted for Regulations 3 liberated, at January 1 2007, funds previously tied up in strengthening of the retrospective provisions, and the collective bonus potential was increased by approx. DKK 2.5 billion. At this time DIP did not distinguish between collective bonus potential related to Regulations 3 and the old Regulations respectively. The number of members on the two old Regulations was considered so low compared to the pension fund's total business that the value of a division was negligible.

The collective bonus potential decreased during 2008 from DKK 3.9 billion at the beginning of the year to DKK 0.5 billion at year-end as a result of the financial crisis. Consequently, the small part of the collective bonus that proportionally related to Regulation 1 and 2 schemes was used up.

Even so, the members on Regulations 1 and 2 were added the same deposit interest rate as the members on Regulations 3 in both 2008 and 2009. The purpose of differentiated deposit interest rates in 2010 was to compensate for this imbalance. In the years to come DIP will closely follow the development in members on Regulations 1 and 2 and Regulations 3 and 4 respectively for the purpose of watching if redistribution from the members on Regulations 3 and 4 to the other members occurs.

### **Regulations 3**

For the members on Regulations 3 the pre-tax deposit interest rate was fixed at 5.3 %. The interest rate is fixed before tax as a result of the rules on payment of individual pension return tax. These rules imply that the tax is paid from the individual member's account after addition of the pre-tax interest rate.

A member without tax-exempt values obtained a net deposit interest rate of 4.5 % on Regulations 3.

### **Regulations 1 and 2**

For the members on Regulations 1 and 2 the pre-tax deposit interest rate was fixed at 3.5 %. A member without tax-exempt values obtained a net deposit interest rate of 3.0 %.

The preliminary deposit interest rates for 2011 are unchanged relative to 2010.

According to legislation DIP has divided the members into four interest rate groups based on the basic interest rate, and one of the groups are for the members on Regulations 3 and 4.

Furthermore, there is a group related to costs and several groups related to risk (longevity and disability).

### **Distribution between members**

An important element of the pension fund's work is to ensure that all members have an adequate insurance cover and the right pension compared to the paid pension contributions. DIP seeks a high degree of fairness among the members and maintains focus on the issue.

In 2010 the Danish FSA introduced a new Declaration of Contributions as part of the efforts to ensure a fair distribution of the surplus between the members.

Previously the pension fund could group members with different interest rate bases, insurances and costs. But in future the members must be divided into homogeneous groups according to interest rates, insurance risks and costs.



The individual member must be grouped within each area with other members having the same profile.

Consequently, DIP must calculate a result for each group, and the surplus within the single group can only be distributed between the members of the relevant group. This is to ensure that no members of the pension fund systematically pay for others.

### **Increased longevity**

When giving a pension commitment, the pension fund must allow for increased longevity of all age groups. The past 20 years the trends in longevity have increased strongly - a development that is likely to continue.

In 2010 the Danish FSA analyzed how longevity must be calculated. The analysis, which is a comparison of the average longevity for insured during the past 30 years, shows that especially the past 15 years have shown significantly increased longevity for all ages.

The new rules oblige DIP to include continued improvements in longevity for all age groups in the years to come - also dynamic improvements.

### **Pension supplement**

The pension supplement is a distribution of DIP's base capital. It is paid when DIP's financial situation allows for it to ensure an equal distribution between young and old members of the pension fund.

DIP is the members' pension fund, and the pension supplement is an instrument to distribute the members' funds when the financial situation allows for it.

An interaction of several factors such as return, interest rate level and longevity meant that DIP did not pay the pension supplement in the autumn 2010. A low return in the past years, a record low interest rate, which increases the current value of the pension provisions, as well as the continued increase in longevity meant that DIP's financial situation in December did not allow for payment of the pension supplement.

### **Contributions and pensions**

The past year was overshadowed by 2009 which was influenced by the impacts of a number of fiscal measures; i.a. the disbursement of the SP funds, a reduction of the tax ceiling from 2010 and the introduction of the compensatory tax. The introduction of the DKK 100,000 cap on annuities certain meant on the other hand that DIP's main product, life annuity, was generally supported. All this combined with a total membership increase meant that contributions to life annuities rose from DKK 679 million in 2009 to DKK 728 million in 2010 which is an increase of 7.2 %. Besides that DIP received DKK 73 million for annuities certain. Total payments reached DKK 801 million compared to DKK 750 million in 2009. The pension payments in 2010 totaled DKK 1,120 million compared to DKK 1,060 million in 2009.

<b>Pensions (DKKm)</b>	<b>2010</b>	2009
Member contributions	<b>728</b>	679
Pension benefits	<b>1.120</b>	1,060

### **Membership**

The increase in membership continued in 2010, and at the close of the year DIP reached 19,000 members. The increase makes DIP a dynamic pension fund with a balanced age composition among the members.

DIP works continuously on ensuring continued membership growth and in 2010 this resulted in 751 new members. The pension fund must also in future be an attractive solution for new members and this is a challenge.



Consequently, DIP will in the years to come work on developing flexible products at a reasonable cost.

The increase in membership is to the benefit of all DIP's members. Through a large number of members it is possible to keep the costs at a low level which provides the opportunity of continuing the development of products to the members.

<b>Membership</b>	<b>2010</b>	2009
Total membership	<b>19,047</b>	18,296
Non-pensioners	<b>16,079</b>	15,433
Retirement pensioners	<b>2,868</b>	2,690
Disability pensioners	<b>100</b>	173

### **Company schemes**

In 2010 the Annual General Meeting adopted a new set of pensions Regulations providing the possibility of establishing pension schemes for all employees in engineering companies. This is a measure that primarily aims at the private sector where the engineering companies typically establish pension schemes for all employees in one collective scheme.

During 2011 DIP expects to enter into a small number of agreements with engineering companies.

Members admitted under company schemes are admitted according to the same conditions as DIP's other members.

The company schemes give the engineers the opportunity of achieving lifelong pension cover in DIP. At the same time the pension fund benefits from more members, as there will be more members sharing the insurance risk attached to the pension schemes.

### **Compensatory tax**

In 2010 the Danish Parliament adopted a compensatory tax on big pension payouts. The legislation took effect January 1 2011. The compensatory tax is imposed on retired members with a total pension exceeding DKK 362,800 annually.

This means that approx. 50 % of the members receiving a pension from DIP are subject to the compensatory tax as a result of the pension payment from DIP alone. Consequently, the pension fund has inquired the possibilities of reducing the compensatory tax for retired members. Many ideas have been investigated, but unfortunately none of them complied with current legislation.

However, members who are about to start their pension payments have the possibility of adjusting the payments over time to minimize the current compensatory tax.

### **Group insurance**

The group insurance includes cover in the event of disability, death, accident as well as certain critical illnesses. The group insurances are all included in a package giving a reasonable cover through the working life, and at the same time as there is a fair distribution of premiums among the different age groups. This must be seen in light of the fact that it is the old members who cost proportionally more, and consequently the insurance is phased out with increasing age.

DIP's group insurance premium is still very competitive. The annual cost of DKK 1,260 as well as the extent of the cover remain unchanged in 2011.



### **New member system**

At the beginning of 2010 DIP replaced an 18 year old member system. The new system is developed in cooperation with a number of pension funds and BEC - a Danish full service IT house operating IT systems for Danish financial institutions.

During 2010 DIP launched a new Member Web giving the members the possibility of keeping abreast of their contribution payments to DIP, their cover as well as possible pensions in payment. The Member Web is still under development with focus on the possibility of simulating different pension covers and electronic distribution of the annual pension overview to the members. DIP also works on a link up to e-Boks (electronic mail from private and public authorities).

One of the changes of the Member Web is that the future pensions are stated as projected pensions. The projections increase the comparability and improve transparency of the pensions industry.

### **Competitive prices and administrations costs**

DIP maintains competitive prices on pension contributions. Besides a monthly payment of DKK 30, the rates are; 2 % on payments to life annuities and 1 % on additional payments to annuities certain and endowment policies. DIP's prices are among the lowest on the pensions market.

In 2010 the overall pension administration costs represented DKK 941 per member compared to DKK 1,040 per member in 2009. This corresponds to a rate differential of less than 0.1 % relative to the members' savings.

The administration costs related to investment are deducted from the published return. DIP has an active investment strategy and has outsourced a great deal of the investment management. The overall direct and indirect administration costs related to investment represented just under 0.5 % in 2010.

## **RISK MANAGEMENT**

The Board determines the risk management framework, while the day-to-day management supervises risks and ensures that the framework is complied with. DIP's main risk factor is being unable to meet its pension commitments. Accordingly, DIP calculates the market value of the pension commitments and assets daily. DIP also makes risk calculations based on the Danish FSA's stress scenarios as well as calculations of the individual solvency need. The risk management allows for both short and long term risk.

DIP is gearing up for the implementation of Solvency II at the end of 2012. The pension fund has participated in the QIS5 as a preparation for calculation of the new solvency regime. DIP's sample calculations at December 31 2009 and June 30 2010 both show a large excess cover, and it is assessed that the pension fund has an adequate base capital according to the new set of rules. During the year the pension fund has also taken further steps in the preparation for the new challenges at the end of 2012. This work has focused on the Board's role in determining risk appetite and individual solvency need as well as implementation of new rules for management of pension funds according the Danish Financial Business Act.

DIP's investment strategy is based on a relatively high equity portfolio, and the pension fund can afford this risk-taking approach which is expected to yield a better return long term. DIP seeks to reduce the overall investment risk by diversifying the investments to several asset groups both domestic and abroad and by diversifying the investments of the sub-portfolios.

The diversification to several asset groups is reflected in the framework of the total asset allocation, while the diversification of the sub-portfolios is determined by requirements to a minimum diversification and maximum investment of the single investment.



DIP is exposed to a number of risks;

- Financial risks
- Insurance risks
- Operational risks
- Business risks

In continuation of calculation of the individual solvency need, the Board has analysed the different risks and their possible impact on DIP's financial position

### **Financial risks**

The financial risks include primarily market risks, but also counterparty risks. The market risks were previously characterized by DIP's assets and liabilities being impacted differently by interest rate fluctuations. After "Choice of Pension" in 2006, when the majority of DIP's members chose a scheme with a lower basic interest rate, the interest rate sensitivity of the pension provisions has been reduced considerably. This has made DIP less sensitive to market changes, and the sound pensions should be ensured - even in periods with economic turmoil.

Today it is DIP's investments that are affected by changes in interest rates, equity prices, property values, exchange rates and interest spreads.

If the year's investment return is inadequate to cover the interest payment of the member savings and necessary strengthening of the pension provisions, the loss is first and foremost covered by the collective bonus potential and subsequently partly by the bonus potential from premium-free policy benefits. Finally, if this is not sufficient, the base capital is used.

The market risks are monitored regularly to ensure that the pension fund is able to withstand significant interest rate changes and price falls on equities. The counterparty risks are reduced by choosing well-established counterparties. In 2010 DIP has not suffered losses resulting from counterparty risks.

### **Insurance risks**

DIP's insurance risks relate to development in mortality, disability etc. Increased longevity means increased duration of the pension payments and this is the most significant insurance risk.

Viewed from the accountancy standpoint DIP is solvent with large reserves, as the value of the future pensions is calculated on a basic interest rate of 1.5 % for the majority of the members. On the other hand, it is DIP's intention to give the members pensions calculated on 4.5 % which is included with a one-year calculation rate of the announced pensions for the members on Regulations 3 and 4.

In 2008 DIP strengthened the market value of the pension provisions for cover of increased longevity further.

The situation is evaluated regularly for the purpose of future increases of the provisions if this proves necessary. In 2009 DIP introduced a new technical basis which allows further for the development in longevity.

It is DIP's conviction that this technical basis gives a better picture of the members' life expectancy and accordingly the magnitude of the pension payments. Consequently, the pension fund considers if the conditional basis of Regulations 3 should be used for recalculation of the pensions.

### **Operational risks**

The operational risks relate to losses caused i.e. by errors in IT systems, procedure errors and fraud. DIP reduces the operational risks by use of a distinct functional separation and in-house controls which are regularly up-dated. The operational risks are also reduced through co-operation with external managers.



### **Business risks**

The business risks cover strategic risks, reputation risks as well as other external factors. DIP keeps track of both the market development as well as regulatory changes. The business risks are considered low.

### **PROSPECTS FOR 2011**

2010 showed positive financial market trends. We still see low interest rates, but the equity markets yielded positive returns for the year.

DIP expects that both Denmark and other countries will experience continued relatively high - or maybe increasing - levels of unemployment during 2011. There is still uncertainty about a number of European countries' government finances which might result in renewed instability on the financial markets.

In the short run DIP expects continued slightly positive growth in both Europe and the US, while equities and bonds seem a little high priced in a number of markets in the developing countries. Consequently, DIP expects a moderate - but not high - positive return in 2011.

The development in 2011 reflects some uncertainty, and the expectations for the year must be seen in this context. After the close of 2010 there have not occurred any events influencing the final result.

### **Deposit interest rates**

DIP has fixed the preliminary deposit interest rates for 2011, and just like in 2010 the pension fund has announced differentiated deposit interest rates. For members on Regulations 3 and 4 the deposit interest rate is fixed at 5.3 %, and for members on Regulations 1 and 2 it is fixed at 3.5 %. The deposit interest rate is fixed before tax as a result of the individual tax calculation introduced in 2010.

The different deposit interest rates reflect different degrees of risk of the pension commitments of the two groups - Regulations 3 and 4 on the one side and Regulations 1 and 2 on the other side.

When the members opted for Regulations 3 in 2006, they also opted for a basic interest rate of 1.5 % instead of an individual basic interest rate between 1.5 % and 4.5 %. Consequently, the result was an overall lower basic interest rate for the members on Regulations 3.

At the same time the technical basis is conditional on both Regulations 3 and 4. This means that the pensions can be changed if significant changes occur in i.e. the actual mortality and interest rate compared to the assumptions of the technical basis. Any possible changes must be based on unbiased reasons.

The low basic interest rate and the conditional basis result in quite a different solvency risk for the members on Regulations 3 and 4. The risk here is much lower as a result of the integrated flexibility. This appears from calculations made in connection with the introduction of contribution groups according to the new regulations from the Danish FSA. DIP has calculated the risk difference between the present group of members on Regulations 1 and 2 compared to the members on Regulations 3 and 4. The results of the calculations disclose a considerable difference between the two groups of members which leaves clear evidence for differentiated deposit interest rates for the members on Regulations 1 and 2 on one side and the members on Regulations 3 and 4 on the other side.

### **CORPORATE SOCIAL RESPONSIBILITY**

According to accounting legislation, corporate social responsibility means that a company voluntarily incorporates considerations to i.e. human rights, social conditions, environmental and climatic conditions as well as control of corruption in their business strategy and business activities.

Corporate social responsibility is part of the everyday life in DIP, and in January 2009 DIP signed up to the UNPRI.



UNPRI is a cooperation of professional investors working for promoting the principles of PRI. This means that the pension fund has committed itself to working with incorporating social responsibility in the investment processes, and in cooperation with other investors influence companies with ethical problems in a more positive direction. When a problem on social responsibility occurs DIP will, instead of selling its equities, start a dialog with the companies either directly or indirectly through the managers.

The support for the UNPRI has been on a steady increase the last years, and an increasing number of managers have also chosen to sign up to the principles in 2010.

Besides signing up to the UNPRI, DIP cooperates with Ethix which is a Swedish company screening the pension fund's portfolios to disclose possible problematic companies. This reporting is done twice annually and is used as a follow-up on possible problematic companies.

DIP uses screening in several portfolios where the companies are sold, but prefers commitment. Even though the pension fund only has minor equity holdings in large foreign companies, the cooperation under the auspices of the UNPRI might contribute to an overall influence of the single company.

In 2010 BP Plc. was expelled from DIP's European portfolio due to the oil disaster in the Mexican Gulf. Besides that several companies have been kept under surveillance. DIP has through the Danish portfolio managers asked about Lundbeck's sale of Pentobarbital in the US which has been used for executing prisoners by the US prison system.

Besides listed equity investments, DIP will in the year to come focus on corporate bonds, emerging market bonds as well as unlisted companies, as the UNPRI work also focuses on expanding social responsibility further than the corporations.

Besides the commitment to act as a responsible investor, DIP also faces organisational requirements related to protection of the environment and the employees.

DIP is characterized by being a small workplace that is very dependent on the employees' knowledge and commitment. Accordingly, DIP offers supplementary education to ensure the occupational skills and personal development.

## **PENSION GUARANTEES**

Throughout 2010 the media focus on guarantees in the pensions industry was intense. Is there a guarantee for the size and development of the pensions or not? The debate pinpointed the possibilities of changing actual guarantees to declarations of intent. This raises the question about the situation for the members of DIP?

### **By-laws**

All DIP's members are admitted on basis of the current By-laws. In article 17.4 it says about the pension fund's accounts that "Any loss that cannot be covered by the reserves of the pension fund will result in pension reductions". This wording is quite clear and says that if the pension fund's finances are not sufficient the pensions will be reduced.

However, the condition has historically been controversial as the Danish FSA previously was of the opinion that it was not operative. Consequently, other pension funds have removed it from their By-laws. In DIP's opinion the condition was valid, and it has been mentioned in a newsletter distributed to the members - and it is still the Board's conviction that it is valid. The handling of the question about guarantees in other pension funds - including the Danish FSA's decisions - confirms the Board's conviction.



### **Different technical bases**

In 2006 the majority of DIP's members chose a scheme based on a lower basic interest rate and a conditional basis. The conditional basis implies that the benefits can be reduced if a number of unbiased criteria are met over a period of time. This could be changes in longevity, investment return or legislation.

A minor number of members chose to stay on the old Regulations. There were also a number of retired members who had previously had their pensions recalculated, and at that point of time it was not profitable for them to choose the new pension scheme. The pensions belonging to the members who stayed on the old Regulations are not based on a conditional basis. Consequently, it is not possible for DIP - if it proves necessary in future - to reduce these pensions on basis of the conditions mentioned.

Accordingly, the different bases of calculation are the reason for the different deposit interest rates for the members on Regulations 1 and 2 on the one side and Regulations 3 and 4 on the other side.

### **FINANCIAL REVIEW**

In 2010 DIP came out with a DKK 454 million surplus against DKK 575 million in 2009 which is considered satisfactory. The result is better than expected at the opening of the year when there was great uncertainty whether we would see a negative development succeeding a very positive 2009, or if the recovery would result in improved financial markets.

It is recommended that the year's net result of DKK 454 million including results brought forward from previous years of DKK 5,390 million totalling DKK 5,844 million is carried forward to next year.

All in all the interest rate level has decreased during the year. This results in a change of the pension provisions, as the current value of the future pensions increases. The result is that the total reserves in the form of bonus potential on dormant pensions and collective bonus potential do not change in 2010. However, the base capital has increased due to the investment result.

The year's result of DKK 454 million is generated through an investment return of DKK 2,269 million plus member contributions of DKK 674 million less paid pensions of DKK 1,120 million as well as a change of the pension provisions including addition of bonus of DKK 881 million and change in the market value of minus DKK 549 million.

DIP is financially sound, but the pension commitments run for decades ahead. The members live longer, and there are no indications of this changing. This applies to all age groups of the pension fund which is positive. However, it also means that DIP must be able to pay pensions for a longer period of time.

The fact that the majority of DIP's members have pension schemes based on a basic interest rate of 1.5 % has made DIP's base capital strong, as the net asset value is based on the basic interest rate on Regulations 3. The members' total pensions also include the supplementary pensions which are calculated on basis of a one-year calculation rate. In the annual accounts the supplementary pensions are covered by i.e. bonus potentials and the base capital. There is no question about DIP's ambition to maintain the members' pensions, however, the pension fund has not issued actual guarantees.

In 2010 DIP paid DKK 1,120 million in pensions and added DKK 260 million in bonuses - the paid pensions include DKK 303 million in paid bonus. The bonus reflects primarily the difference between the deposit interest rate and the basic interest rate which for the majority of the members is 1.5 %.

The investment result in 2010 of DKK 2,632 million was lower than the result of DKK 3,330 million in 2009. The positive return is mainly due to the returns on equity and credit bond investments. The return on bonds was negatively affected by investments in Greek and Irish government bonds, however, the net results were positive.

The pension related administration costs are still very low - below 0.1 % compared to the deposit interest rate - which is very competitive. The costs have decreased compared to 2009, when DIP had costs related to replacement of the new member system.



The costs related to the investment activity are just below 0.5 % compared to the deposit interest rate. The costs reflect DIP's active investment strategy. The return and deposit interest rate are calculated after deduction of investment related administration costs.

## STATEMENT OF ACCOUNTS

The consolidated accounts include the pension fund as well as the wholly owned subsidiary Ejendomsselskabet DIP A/S and Pension Private Equity I K/S. The complete annual report is prepared in accordance with the Danish Financial Business Act.

(DKKm)	2010	2009
<b>Profit and loss account</b>		
Member contributions	728	679
Contributions to labour market funds	- 54	- 52
Investment return	2,632	3,330
PAL-taxation	- 363	- 454
Pension benefits	-1,120	- 1,060
Change in pension provisions and bonus	- 1,340	- 1,843
Change in provisions for unit-link contracts	- 10	- 5
Administration costs	- 19	- 20
<b>Result for the year</b>	<b>454</b>	<b>575</b>

## Balance sheet as at December 31

<b>Assets</b>		
Real estate	1,654	1,668
Equity etc.	13,297	10,018
Bonds	13,763	14,425
Mortgage bonds and debt instruments	0	3
Deposits in credit institutions	147	394
Investment assets attached unit-linked contracts	203	120
Other assets	412	465
<b>Total assets</b>	<b>29,476</b>	<b>27,093</b>
<b>Liabilities</b>		
Base capital	5,854	5,400
Pension provisions	20,089	19,370
Collective bonus potential	2,577	1,957
Provision for unit-link contracts	203	120
Other provisions	0	2
Debt	753	244
<b>Total liabilities</b>	<b>29,476</b>	<b>27,093</b>



## ACCOUNTING POLICIES

The accounting policies applied in the preparation of the consolidated accounts are unchanged compared to last year and set out below;

- All receipts and expenses are accrued in full and booked to the profit and loss account.
- Real estate is recognized at market value.
- Listed equities are recognized at market price and unlisted equities to fair market value.
- Listed bonds are recognized at market price and mortgage bonds and debt instruments to fair market value.
- Computing and inventory etc. are depreciated by the straight-line method over three years.
- Pension provisions are calculated at fair market value.

Audit of the annual report was performed by KPMG Statsautoriseret Revisionspartnerselskab without qualifications.

In the accounts the “retrospective provisions” amount to DKK 19,282 million.

As a consequence of increased longevity, DIP presently provides for the members living averagely longer than provided for in the basis of calculation on which the majority of the pension provisions are calculated. DIP makes use of the current interest rate level which results in total pension provisions of DKK 20,089 million and collective bonus potential of DKK 2,577 million.