

## CORPORATE GOVERNANCE REPORT 2010

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## AP4 AT A GLANCE

The Fourth Swedish National Pension Fund (AP4) is one of five buffer funds in the national pension system. The Fund's brief is to manage Fund capital so as to generate the best possible return over time for Swedish pensioners and thus support the stability of the pension system.

### 2010 GOALS

Based on its brief, AP4 has formulated two overall goals.

- The Fund's total return in real terms – that is, adjusted for inflation – shall average 4.5% per year over a 10-year period. According to the Fund's analyses, this is the return required for the pension system's assets and liabilities to balance in the long run.
- The Fund shall achieve an average active return – that is, a return exceeding its benchmark index – of 0.5 percentage points per year .

### OPERATIONS

The Fund is a governmental authority whose operations are regulated in the Swedish National Pension Funds Act. The Government appoints all nine of the Fund's Board members, and the Ministry of Finance continually supervises and evaluates the Fund's operations.

The Fund shall independently formulate its targets and strategies. By law, the Fund's Board of Directors and operations are not to be controlled by Government directives or by national business or other economic policy interests.

Environmental and ethical issues must be taken into account without compromising the goal of best possible return.

### FUND CAPITAL

In June 2010, Fund capital totalled SEK 196 billion.

The Board has decided that the Fund will best fulfil its long-term asset management brief by holding a large proportion of publicly quoted equities, Swedish and foreign, which accounted for 57% of assets at mid-year.

Approximately 38% of the assets was invested in interest-bearing securities carrying low risk, such as government bonds.

The remaining 5% or so was invested in other assets such as real estate, private equity funds, and other alternative investments.

# AP4's WORK WITH CORPORATE GOVERNANCE 2010

## RESPONSIBLE INVESTORS CONTRIBUTE TO POSITIVE CHANGE

AP4's brief is to manage Fund capital so as to generate the best possible return over time for the benefit of those insured in the retirement pension system and thus support the stability of the pension system.

The Fund's corporate governance work shall:

- originate in the Fund's duty to protect and grow the capital invested so as to contribute to a healthy return on investments,
- safeguard the best interests of shareholders and individual companies,
- take into account the unique circumstances and needs of each individual company,
- exercise the rights and obligations of its ownership role in a responsible and sustainable manner,
- take into account environmental and ethical issues without compromising its goal of maximising returns, and
- promote the development of good practice in securities markets.

The Fund believes that good ethics and attention to environmental concerns, in tandem with responsible active ownership, are prerequisites for companies achieving sustainable healthy returns.

The Fund believes that active responsible owners are needed to drive change for the better. This is true of Swedish companies as well as foreign. Active owners are also needed to induce companies, such as those that violate conventions, to become more responsible.

If the Fund were to sell its shares in a company that has violated a convention, for example, the problem would be unlikely to disappear; so the Fund retains the holding. In other words, the Fund believes that it is more responsible to stay a shareholder and try to influence the company, making demands and driving change for the better. When the Fund pursues such demanding interaction with the company's management and board, more investors hold the company to account, follow up, and act to ensure that the company will improve. The Fund makes a positive difference by getting involved as a responsible active owner.

AP4 supports the Principles for Responsible Investment (PRI), a United Nations initiative for responsible investment. The purpose of PRI is to bolster companies' and investors' responsible behaviour on environmental and social issues. Each year, the PRI Initiative conducts a study of its members' progress and activities in environmental, social and corporate governance (ESG)<sup>1</sup>. Members represent a significant portion of the capital invested worldwide. AP4 ranked exceptionally well in this survey.

<sup>1</sup> Issues related to the environment, business ethics, and corporate governance are often referred to as ESG (environmental, social and corporate governance).

## INDEPENDENT INVESTOR

AP4 has an extraordinary position as an investor in the Swedish securities market, because of its non-political, independent position as prescribed by law. The Fund belongs to no commercial sphere or group but works solely in the best interests of each company and its shareholders.

Through the years, the Fund has been extremely active in the development of modern Swedish corporate governance, which facilitates and benefits the Fund's possibilities for garnering support for its standpoints.

## DIALOGUE THE NO. 1 MEANS

The Fund's chief tool in its role as investor is direct dialogue with the boards and management of and other investors in the companies concerned. Dialogue often revolves around pending proposals on which a shareholders' meeting (annual or extraordinary) must decide. The aim of the Fund is to work early on for more transparent disclosure, resolve any differences of opinion, or reach a compromise, to be able to vote for the final proposal at the meeting.

One prerequisite for the success of such dialogue is that it be conducted with absolute trust between the parties. Thus it is not feasible to disclose all discussions conducted in the Fund's day-to-day work on corporate governance. If the discussions do not lead to a change, the Fund promotes its viewpoints at the shareholders' meeting through comments, dissenting opinions, or by voting against the proposal itself.

Dialogue can also originate in work on a nominating committee, through in-depth discussions about the work of the board and the board's composition. In the long run, strategy and finance issues may also be discussed. Sometimes these discussions can become in-depth and continue for a long time. Naturally, such special cases lead to an insider situation, which is handled according to the Fund's routines and internal rules.

Often smaller companies are where the Fund can make a difference and contribute to changing and developing the board, the aim in the long run being to create better conditions for a healthy return on the Fund's investment.

## GUIDELINES FOR OWNERSHIP

AP4's Board reviews its guidelines for corporate governance annually. The ownership policy is formulated based on the legislation that governs the Fund's activities and on the *Swedish Corporate Governance Code (the Code)*. *The Code* summarises the principles that for many years were voluntary standard practice in the Swedish stock market. *The Code* is constructed according to the principle of "comply or explain", which gives each company the right and possibility of diverging from it.

The Fund believes that a justified divergence can be better for a company than compliance with a particular rule in *the Code*. The guidelines are summarised in the Fund's ownership policy and are posted on the Fund's website [www.ap4.se](http://www.ap4.se).

## FUNDAMENTAL VALUES

AP4's fundamental values for its active ownership and investing activities build upon the basic ethics that the Swedish state has expressed by signing various international conventions, including those on human rights, labour, corruption, and inhumane weapons, as well as the principles in the *UN Global Compact* and the *OECD Principles for Multinational Corporations*.

These fundamental values include contributing to a good environment for present and future generations. AP4's standpoint is a natural consequence of the Fund being an agency of the Swedish government and part of the Swedish retirement pension system.

### Conventions

The Fund assumes that all conventions Sweden has signed are equally important and thus shall be observed. This assumption is backed by resolutions and statements from various UN bodies that emphasise that human rights are universal, indivisible, mutually dependent, and are interrelated such that they cannot be ranked in order of importance. By tying the Fund's demands on companies to international conventions and by collaborating with other investors, the Fund can serve as part of an international collaboration in global financial markets that ensures that violators of conventions are called to task. Such actions can make these conventions more effective.

The conventions concern subjects such as:

- labour law (child labour, slave labour, health and safety, freedom of association, discrimination based on sex, race, age, or religion, working hours),
- the environment and biological diversity,
- arms, and
- bribery and corruption.

### Screening the Fund's holdings

To discover companies that violate conventions or are guilty of suspected infringements, AP4 commissions "screenings" of the Fund's holdings. A major screening of all holdings is done twice annually, between which surveillance is ongoing.

### Excluding companies

Dialogue is the Fund's primary tool for influencing company behaviour. Change can take time, but if the company proves uninterested in changing or if the process of change takes an unjustifiably long time, the Fund can exclude the company from its investment universe. Such a decision means that the Fund's holdings of all securities issued by the company – regardless of whether they are managed internally or externally – shall be divested in an orderly manner.

In accordance with its fundamental values, AP4 excludes companies from its investment universe if the companies are directly involved in the production or marketing of anti-personnel mines or cluster munitions. A company may also be excluded if it violates the *UN Global Compact* or the *OECD Principles for Multinational Corporations* and the Fund has conducted a dialogue with the company to no avail.

A list of excluded companies appears on the last page of this report (as of 30 June 2010). For up-to-date information on companies excluded, visit the Fund's website on [www.ap4.se](http://www.ap4.se).

## AP4'S OWNERSHIP POLICY

AP4's ownership policy (2010) contains two main chapters: *Ownership policy for the Fourth Swedish National Pension Fund* and *Corporate governance in foreign companies*.

*Ownership policy for the Fourth Swedish National Pension Fund* deals primarily with Swedish stock market companies. The Fund has a Swedish equity portfolio with a market value of approximately 35 SEK billion. That makes AP4 one of the 10 largest institutional investors in the Swedish stock market. The Fund has holdings in about 140 listed Swedish companies, with the largest holdings being in smaller companies.

Work on corporate governance puts priority on companies in which the Fund has a significant shareholding or is one of the largest shareholders.

The Fund also strives to play an active role in issues of principle in the area of corporate governance.

The Fund exercises active ownership in Sweden by:

- voting in shareholder meetings,
- serving on nominating committees,
- conducting a dialogue prior to shareholder meetings,
- conducting a dialogue with companies' boards, management teams, and other investors,
- developing processes and practice in corporate governance,
- participating in the development of the Swedish stock market's system of self-regulation, and
- supporting organisations and projects that promote ESG.

*Corporate governance in foreign companies* presents the Fund's guidelines for its foreign holdings. The guidelines are based on the *Ownership policy for the Fourth Swedish National Pension Fund*.

The Fund has about SEK 80 billion invested in foreign stock market companies. The holdings in these companies are relatively small, so the Fund's possibilities for active corporate governance are more limited. The Fund has holdings in about 1,700 listed companies outside Sweden.

Important tools outside Sweden include exercising voting rights at AGMs and cooperating with other institutional investors to put more weight behind the pursuit of key questions of principle.

The Fund exercises corporate governance outside Sweden by:

- voting in shareholder meetings,
- submitting or supporting shareholder proposals at shareholder meetings,
- conducting a dialogue with companies' boards, management teams, and other investors, and
- supporting organisations and projects that promote ESG.

In the field of the environment and ethics, AP4 has chosen to pursue its dialogues with foreign companies through the Ethical Council. The Ethical Council is a collaborative effort of AP1, AP2, AP3, and AP4 intended to be able to pursue environmental and ethical issues with greater weight outside Sweden. Read more on page 11 or on the Ethical Council website [www.etikradetapfonderna.se](http://www.etikradetapfonderna.se)

## 2010 SEASON

The shareholders' meeting is the shareholders' principal forum, and voting rights are among the most important and effective means a shareholder has to influence a company.

### SWEDISH MEETINGS

During the period January through June 2010, the Fund was represented at 56 Swedish shareholder meetings including 52 annual general meetings (AGMs). The meetings of companies in which AP4 has a significant holding have top priority.

Many of the proposals addressed at shareholder meetings (AGMs or extraordinary meetings) are the result of a dialogue and winning commitment among the major shareholders prior to the meetings. This enables shareholders to air their views on the content of proposals and the background information for decisions presented.

The premise for the Fund is to clear up any ambiguity or differences of opinion before the shareholders' meeting so that the Fund can support the final proposal at the meeting.

If a final proposal is not acceptable despite this preparation, the Fund can vote against the proposal or abstain. Yet another alternative used is to vote in favour of the proposal but with a position statement or a dissenting opinion recorded in the minutes.

### Executive remuneration

The ownership policy stipulates that remuneration to senior executives is primarily a concern of the company's board. Under the Companies Act (2005:551), the AGM shall set guidelines for compensation. However, the board is responsible for total remuneration (that is, the sum of fixed and variable compensation) being well-balanced and adapted to the company's circumstances.

Incentive-based pay programmes aimed at senior executives shall be in harmony with the long-term interests of shareholders. The programmes are supposed to reward favourable long-term performance but also have a reciprocal effect; that is, when the desired performance is not delivered, total remuneration should be less.

This puts stringent demands on the structure, evaluation, and transparency of the programmes. They should be "definable and defensible". For these reasons, the Fund emphasises several points in its ownership policy that should be paid special attention for the Fund to be able to vote in favour of proposals at an AGM.

### Remuneration in a European context

It is also well to bear in mind that major Swedish corporations increasingly seek international experience when recruiting senior executives. The corporations are then competing with international companies for recruits. In a European context, these Swedish companies across the board have demonstrated great restraint in setting remuneration and the proportion of incentive-based pay for their CEOs.

The remuneration for a CEO at a major Swedish corporation averages only 40% of what a CEO receives in a comparable rival company in Europe. The remuneration structure also differs widely. As a rule, more than two

thirds of a European CEO's pay is incentive-based, while on average less than one third of a Swedish CEO's remuneration is variable.<sup>2</sup>

### Dialogue on remuneration

As the result of several years' involvement by the Fund and other asset owners in the remuneration issue, incentive programmes have gradually started to improve in terms of transparency and linkage to performance. In the great majority of cases, discussions between the board and shareholders contribute to the design of the programmes. One evident trend is that the proportion of programmes with individual contributions and/or conditions on performance has increased noticeably.

One focus of the Fund's work on corporate governance, prior to the AGM season in spring 2010, was companies' proposals for remuneration and incentive programmes for senior executives. The Fund was in contact and dialogue with the majority of the companies at whose meetings the Fund participated. In several cases, these dialogues resulted in less generous terms as well as improved disclosure on the part of the companies. In a few cases when the dialogue with the company was not sufficiently successful, the Fund chose to vote against the proposals submitted.

### AP4 disapproves of share issues without preferential rights

For the Fund, equal treatment of shareholders is a fundamental principle that means new shares should be issued through preferential rights for existing shareholders.

Thus the Fund disapproves on principle of any general authorisation to issue shares without preferential rights for shareholders.

The Fund believes that shareholders should take part in deciding to whom, at what price, and on what terms a private placement shall be carried out, because such a drastic measure can change the ownership structure of a company.

At 2010 AGMs, the Fund has encouraged company boards not to exercise any authorization received to issue shares for cash consideration or convertible debt instruments without preferential rights, if such has been granted by the meeting. In the future, the Fund will continue to be restrictive in approving such general authorisation for issues without preferential rights.

For the company, the advantage of securing a blanket authorization from shareholders at the AGM is chiefly shorter execution times and lower costs compared to convening an extraordinary meeting if the board wishes to exercise the mandate.

The shareholders, whose capital is at risk of being diluted on unknown terms if another party gains preferential rights to buy into the company, perhaps at a discount, relinquish their ability to make their voice heard.

In contrast, it is easier for the Fund to accept a blanket authorisation for minor non-cash issues without preferential rights for the acquisition of small companies or small parts of companies.

<sup>2</sup> Hallvarsson & Hallvarsson. *Swedish CEO compensation in an international context 2006-2008*

## Meetings where the Fund voted against a board's proposal

The meetings where the Fund either voted against proposals submitted or in some other way voiced a different view were as follows.

### Acando

AP4 voted against the board's proposal for an incentive programme for the company's executive management. Nonetheless, the proposal was passed.

The structure of the proposed incentive programme meant that management could miss the targets set for the first few years but still receive the maximum payout for all years if they achieved the targets for the last year alone. This included the initial years when the targets might not be met.

### Alliance Oil

AP4 voted against the nominating committee's proposal for board fees. Nonetheless, the proposal was passed.

The proposal means an increase of 50%-100%, to USD 120,000 for members of the board and USD 180,000 for the chairman of the board. The level of the fees alone is indefensible in a comparison with companies listed in Sweden with a similar size, structure, and operations.

The proposal also allows members of the board to participate in the same stock option programme as company management, which contravenes the *Swedish Code of Corporate Governance* and the statements of the Swedish Securities Council.

AP4 also voted against a proposal to authorise a new issue, including an issue without preferential rights for current shareholders. That proposal entailed a significant dilution of share value. Combined with the potential dilution resulting from resolutions previously passed, the proposal entailed a potential dilution of share value unacceptable to the Fund. The proposal was passed.

### Micronic

AP4 voiced criticism of the company signing a contract for the guarantee of a share issue in which the cost equalled 5% of the amount guaranteed. That is unusually high and increased the cost of the new share issue.

### Lundin Petroleum

AP4 voted against the board's proposal for a long-term incentive programme for management. The proposal lacked performance targets or demands for any form of individual investment. According to AP4's ownership policy, incentive programmes for senior executives shall be clearly tied to measurable performance or individual investment. The proposal was passed.

The Fund encouraged the board not to exercise the AGM's authorisation to issue shares for cash consideration or convertible debt instruments without preferential rights for shareholders.

### Orexo extraordinary meeting

The Fund carefully considered the issues before deciding to vote at an extraordinary meeting of shareholders in favour of a proposal for a new issue without preferential rights for current shareholders. At the meeting, the Fund's representative clarified that the vote should be regarded as a rare exception.

For AP4, equal treatment of shareholders is a fundamental principle that means new shares should be issued through preferential rights for existing shareholders. In this case, the issue brought a new shareholder into Orexo who was judged to be important for the company.

### Orexo annual general meeting

AP4 encouraged the board not to exercise the AGM's authorisation for a cash issue without preferential rights for shareholders.

### Ratos

AP4 voiced criticism of the proposal to authorise the board of directors to decide to issue, without preferential rights for current shareholders, no more than 30 million shares, corresponding to 19% dilution, to be used for company acquisitions. The proposal was passed.

AP4 encouraged the board not to exercise the AGM's authorisation to issue shares for cash consideration or convertible debt instruments without preferential rights for shareholders.

### Sectra

AP4 voted against the proposal to authorise the board of directors to decide to issue new shares without preferential rights for current shareholders. The authorisation also applied to cash issues without preferential rights, a major divergence from preferential rights.

AP4 also encouraged Sectra's board of directors not to trade in the company's own shares using repurchased shares. The board confirmed that that would not happen.

The Fund also encouraged the board not to exercise its ability to pay a price higher than market in share buy-backs.

AP4 encouraged the board to review the structure of its incentive programme by next year. The proposals concerned two incentive programmes – one for executive management and employees and another for outside directors – having identical terms and conditions. According to the *Swedish Code of Corporate Governance*, outside directors may not participate in programmes aimed at management or other employees.

### Tricorona

AP4 encouraged the board not to exercise its authorisation to issue warrants and/or convertible debt instruments after the AGM decided to grant the board the ability to decide to issue new shares, convertible debt instruments, or warrants.

### Vostok Nafta

AP4 encouraged the board to issue, prior to next year's AGM, a comprehensive report on the outcome of existing incentive programmes, and, if new incentive programmes are introduced, to submit a detailed presentation of the targets and performance requirements.

## SHAREHOLDER MEETINGS OUTSIDE SWEDEN

AP4's ownership policy (2010), *Corporate governance in foreign companies*, contains the guidelines the Fund follows for voting at meetings outside Sweden. The guidelines are inherently general, to allow local laws, customs, rules, and the like to be taken into account.

### Voting at meetings outside Sweden

Although the Fund uses an external party for the practical procedure of voting at such shareholder meetings, proxy voting outside Sweden is resource-intensive. Together with AP1, AP2, and AP3, the Fund uses a common and thus more cost-effective electronic proxy voting platform with separate voting accounts.

Each of the Funds has prepared instructions, in accordance with their own guidelines, on how that Fund will vote at the foreign shareholder meetings. Doubtful agenda items that do not fit into the automated voting templates or commercially motivated items on the meeting agenda are sent to each fund for assessment, decision, and manual voting.

### Voting at about 400 foreign meetings

In 2009, when the global proxy voting platform was a pilot project, AP4 voted at 252 foreign company meetings, mainly in the United States and Europe. In 2010 and the next three years, the goal is to gradually increase the number of shareholder meetings where the Fund individually exercises its voting rights. The number will be increased step-by-step to maintain the quality of the Fund's standpoints.

The Fund intends to vote at about 400 shareholder meetings during 2010. The Fund has roughly 1,700 foreign holdings in all. Through June 2010, the Fund had voted at 351 shareholder meetings.

### The meetings where AP4 votes

The fundamental criterion for selecting the shareholder meetings at which AP4 will vote is for the company to be included in the MSCI Developed Markets index. Other criteria are the company's size in the index, whether the Fund is in dialogue with the company and/or has submitted a shareholder proposal to the meeting, and whether the Fund supports an international initiative on an issue specific to that company.

### Statistics

At the 351 shareholder meetings where the Fund had voted through June 2010, the Fund voted on a total of 5,481 agenda items. The Fund voted against more than 18% of the proposals, submitted chiefly by boards. The Fund abstained from voting on more than 5% of the proposals submitted, usually because of too little or inferior information.

Meeting statistics	
No. of meetings	351
No. of agenda items	5,481
AP4 voted against proposal submitted (%)	18
AP4 abstained from voting due to a lack of or inferior information (%)	5
Remuneration questions that AP4 voted against or abstained from voting on the proposals submitted (%)	62

### Issues in focus

Issues that the Fund emphasises at shareholder meetings include:

- shareholders' rights to vote their entire holdings and to submit their own proposals and to propose their own agenda items,
- independence of board members, that the CEO and chairman of the board shall not be the same person, and that the board shall be elected for a period of one year,
- take-over defences,
- capital structure, for example, that shareholders shall be entitled to vote on share issues to ensure that their rights are safeguarded,
- executive remuneration,
- transparency, in other words open disclosure of information, and
- environmental and ethical issues.

During 2010, the Fund voted in favour of numerous shareholder proposals, such as on environmental and ethical issues.

### One resolution AP4 submitted

One example of a shareholder proposal submitted by the Fund was at the AGM of Freeport McMoRan Copper & Gold.

For many years, Freeport McMoRan has dumped tailings in a river near Grasberg, Indonesia. The Fund began discussing this with the company in 2008. Together with AP1, AP2, and AP3, the New York City Pension Fund, and the Dutch pension fund manager APG, AP4 submitted a shareholder proposal to the meeting in June 2010 demanding that the company appoint an independent environmental expert to the board. Although the proposal won about 32% of the votes at the meeting, considered extremely high support for a shareholder proposal, the company did not adopt the proposal. However, Freeport McMoRan has been prepared to discuss the issue and has produced fresh data about the problem and possible solutions. The Fund continues its dialogue with the company through the Ethical Council.

### A dialogue with a company

The Mayas in Guatemala, as well as other groups, have accused Canadian mining company Goldcorp of not respecting human rights or native people's rights and of polluting the water and contributing to tension, threats, and harassment in communities around the mine.

Together with a small group of investors, the Ethical Council has been in dialogue with the company about these problems. On the advice of this group, an

independent assessment was performed of how the company has addressed issues such as human rights and the environment in the area.

The company has commented on the investigation and the recommendations it contains. The company has also presented an action plan that the Ethical Council will follow up.

The Ethical Council has engaged Goldcorp in dialogue, leading the company to initiate an action programme that will improve the situation around the mine. The company is also updating its policy for how the company shall act in future mining projects. If the AP Funds had sold their shares in Goldcorp instead of getting involved and influencing the company to take action, it is doubtful the company would have addressed these issues.

## NOMINATING COMMITTEES

Participation in the work of nominating committees is a vital tool that financial institution can apply to exercise shareholder influence. The principal task of a nominating committee is to propose a balanced slate for the board. In addition to expertise and experience, diversity is important.

### Tradition of work on nominating committees

AP4 was one of the institutions involved more than 15 years ago when a new practice was established, nominating committees, through the formation of the nominating committee for Volvo.

Today the *Swedish Code of Corporate Governance* stipulates that every publicly quoted company shall have a nominating committee. Nominating committees promote a systematic nomination process, which AP4 believes has contributed to better boards in Swedish listed companies.

The Fund devotes considerable resources to ensure that Swedish listed companies have the best possible boards. A good board promotes each individual company's unique circumstances and needs, in the long run contributing to the best possible return for the Fund and other shareholders in the company.

### The nominating process

The work of the nominating committee often varies greatly depending on the company's particular situation.

The nominating committee starts by acquiring information about the company's situation and its future challenges. The committee performs an assessment of how board work has progressed during the past year. All or part of the board is often interviewed, and sometimes an outside consultant is engaged. The nominating committee meets in private with the CEO of the company.

The analysis of the company's current situation and future needs, complemented by the assessment of the work of the board, indicates if there is any need for change in the board and/or the expertise and experience that might be sought in a new board member.

The work of the nominating committee sometimes entails extremely work-intensive periods with many meetings and interviews with the company's existing as well as potential new directors. At other times, a few meetings of the nominating committee may be sufficient, when the need for change in the board is not so great.

### Nominating committees in 2010

During 2010, the Fund was involved with 14 nominating committees for listed Swedish companies holding AGMs in 2010, including two as chair. This was a considerably larger number of nominating committees in listed companies than for all the other AP funds combined.

### AP4 works for more women directors

As before, the Fund emphasises the importance of diversity in boards and so for several years has actively and successfully helped nominate female members to the boards of publicly traded companies.

The proportion of female directors increased for companies where the Fund participated in the work of the nominating committee, averaging more than 30% in such companies, compared to about 22% for other companies on the stock exchange. The proportion of women newly elected, in companies where the Fund has had representatives on the nominating committee, was a refreshing 50%, compared to the 2010 average of about 36% on the stock exchange.

Company	Proportion women %	No. of newly elected women
B&B Tools	20	0
Beijer Electronics	28	1
Connecta	50	2
Eniro	28	0
Metro	38	1
Micronic	33	1
New Wave Group	33	0
Poolia	60	1
Ratos	25	0
RnB	12	0
Svolder <sup>3</sup> (proposed)	40	1
TradeDoubler	43	1
Tricorona	14	1
Vostok Nafta	0	0

<sup>3</sup> Svolder's AGM is in November, after the publication of this corporate governance report.



### AP4 eager to see more women in management

At present, there is an unfortunate shortage of women in top management at Swedish companies, that is, in the positions that usually serve as the pool for recruiting competent board members. There are many capable women in private enterprise in Sweden that as yet do not have executive responsibilities. More women are needed on executive management teams if the pool of female recruits to board rooms is to grow. Consequently, companies must actively and systematically work to capitalise on women's expertise and cultivate more female executives.

### The board represents the shareholders

The board of directors in a company are the elected representatives of the shareholders. The directors are selected based on their expertise and experience, to take care of and to bear ultimate responsibility for the individual company and the interests of shareholders in the best manner possible. Shareholders in a company should always have the right to choose the directors they consider most suited for the board assignment in question.

## NOMINATING CYCLE

### SPRING

Companies usually hold their AGMs in the spring. That's when the meeting elects the company's board. The procedure for appointing the nominating committee is also approved then. The main task of the committee is to submit proposals to the board at the next AGM. Any shareholder can submit to the nominating committee their proposal as to who would be a suitable director.

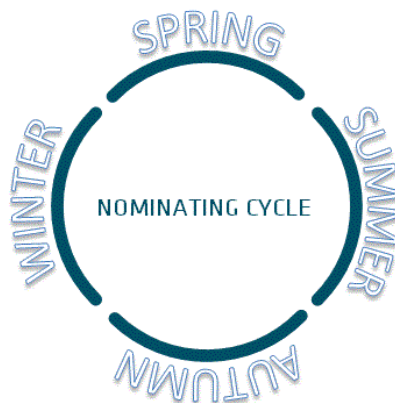
Usually the meeting decides that the committee will consist of the shareholders with the largest holdings at the end of the third quarter. Sometimes the AGM elects the members of the committee directly. AP4 considers both models workable. The choice of model may depend on shareholder structure or whether the committee has initiated comprehensive change.

### SUMMER

The new boards will have had their first meetings by early summer. The individual members of the board should have become well-oriented in the company's operations so as to make the best contribution from their own expertise and experience.

### AUTUMN

At the end of August or September, the 3-5 largest shareholders are usually asked whether they wish to be represented on the nominating committee. AP4 always attempts to participate in the nominating committees to which it is invited.



Then the work of the committee takes off. The committee meets with the chairman of the board, who explains how the board works and the key strategic issues the company will be facing. As a rule, the nominating committee also meets with the company's CEO, who presents the company's future strategy, for example. This enables the committee more easily to find suitable board candidates with the expertise that will be needed by the company's board. The committee performs or receives the assessment of the board and its work. The assessment is sometimes done by outside consultants. The committee then discusses the composition of the board. Questions that the committee explores include, "How many directors does the board need", "What experience and expertise does the board already have - and what does it lack", "How smoothly does the board work/function as a group", "How is diversity on this board".

### WINTER

The nominating committee's search for appropriate board candidates begins.

A long list of suitable candidates is produced with suggestions from the committee and perhaps from an executive search firm. The short list is then drawn up. Potential candidates are interviewed. The nominating committee decides on proposals to the AGM for new members of the board and whether any directors will resign. The proposal is submitted to the AGM for approval.

# ENVIRONMENTAL AND ETHICAL ISSUES IN ASSET MANAGEMENT

## SWEDISH EQUITIES MANAGEMENT

### Proactive dialogue

Swedish equities are managed internally at AP4 by portfolio managers who closely follow the Swedish companies. The Fund continuously works to integrate analyses of environmental and ethical issues, also called sustainability analyses, in their traditional fundamental analyses of companies. The purpose is to value any risk or potential in a company related to environmental and ethical issues.

The Fund believes that this risk/potential should be valued and integrated in the analysis, just as managers do with other risks and potential. Estimating and valuing environmental and ethical risks and potential require knowledge and a dialogue with the companies.

The Fund's corporate governance group assists portfolio managers in this process of analysis and valuation of environmental and ethical factors, by preparing questions that can be used in dialogue with companies, and by taking part in visits to companies and discussing the issues with company management. The objective is for environmental and ethical issues to be a natural part of the discussion when portfolio managers visit companies. It can be difficult to quantify these factors, but as portfolio managers gain knowledge, their risk assessments improve and are naturally integrated into investment decisions.

Dialogue with company management is often upbeat, and knowledge of sustainability issues among senior executives is considerably greater today than it was a few years ago. It is clear that these issues now have a higher priority not only among asset managers but also in companies. Because the Fund's managers discuss environmental and ethical issues with management teams, clear signals are sent about how important these issues are to AP4.

It has become more common for companies to take the initiative themselves to invite investors to come and discuss sustainability issues. These meetings are usually extremely informative and upbeat. Usually the most ambitious companies arrange such meetings and they provide a frame of reference that can be used in meetings with less ambitious companies.

### Reactive dialogue

Swedish listed companies on the whole are well managed enterprises that nurture their brand and conduct their business in a sustainable manner. In a few exceptional cases, though, environmental or ethical incidents have occurred. When the Fund learns of such occurrences or suspects an unsatisfactory situation, the Fund's corporate governance officers contact the company's management team to verify the facts.

The Fund requests information about the actions the company is taking to solve the problem and ensure that nothing similar occurs again. If the problem is not resolved immediately, the Fund follows up on the issue to ensure that

the company has an action plan with measures to remedy the unsatisfactory state of affairs.

The Fund may also ask to meet the people responsible at the company to discuss problems that have arisen. Sometimes these meetings are held together with other investors. These meetings have usually been constructive, and the companies take care to provide pertinent information and to solve the problems.

## GLOBAL EQUITIES MANAGEMENT

AP4's global equities management was restructured in 2009, so that previous work integrating sustainability analyses in internal analyses and information for decisions was no longer applicable.

The current management process is primarily based on internal and external indexing of assets. Thus the integration of sustainability analyses will be implemented using a different model. This work has commenced.

## ALTERNATIVE INVESTMENTS

During the year, the Fund's management of alternative investments began working to integrate the UN recommendations for unlisted investments, the PRI's *Responsible Investment in Private Equity – A Guide for Limited Partners*. The purpose of the recommendations is to enhance companies' and investors' responsible behaviour on environmental and social issues. Thus the Fund is contributing to the creation of a common industry-wide standard for handling ESG issues in unlisted investments.

Asset management maintains a dialogue with the Fund's external managers and informs them that AP4 supports the PRI. If any external portfolio managers have not yet signed the PRI, they must state why, and the Fund will urge them to also support and sign the PRI. Asset management requests the external managers' ESG policies and studies them. In the assessment of unlisted investments, asset management performs a risk assessment on ESG factors. Such a risk assessment includes how the external managers work on ESG issues and whether the operations carry greater risk, such as by country or sector.

## ETHICAL COUNCIL

The Ethical Council is a collaborative effort of AP1, AP2, AP3, and AP4 that began in 2007. The Funds are convinced that well managed companies that work actively on environmental and social issues are better investments in the long run. Environmental, ethical, and corporate governance issues, often referred to as ESG, are a vital part of the Funds' brief.

The aggregate capital of the four Funds, more than SEK 800 billion, enhances their ability to influence a company through the Ethical Council, compared to individual efforts. This cooperation means that the Funds' work is more efficient and cost-effective. Increased effectiveness emerges, for example, through more dialogues with companies, more numerous international investor initiatives, and more conferences where the Ethical Council is represented.

### Active dialogue with other owners

Through active dialogue with other owners, often with other investors, the Ethical Council attempts to influence the companies and drive change for the better on environmental and social/ethical issues. Dialogue can be time-consuming as well as trying, but experience to date shows that it is a powerful tool that yields results. The Ethical Council has concluded that it is easier to make an impact as an active responsible shareholder in the company through dialogue and at shareholder meetings. If the Funds sell their shares in a company, the problem

does not disappear, because the infringement continues. So exclusion is the last resort when dialogue has not yielded the desired results.

The Ethical Council uses a systematic process to identify, review, and select the companies with which to conduct a dialogue and determine the goals to be achieved through the dialogue. The Ethical Council is monitoring several cases in which companies have been linked to violations of international conventions and principles. The Ethical Council is in active dialogue with a dozen or so of these with the aim of persuading them to take action.

In 2010, the Fund resolved to exclude Elbit Systems Ltd from its investment universe. However, by that time the Fund had no investment in the company. The decision was made after dialogue conducted by the Ethical Council with the company did not yield the desired results. The company develops, supplies, and maintains a customised surveillance system for certain parts of the West Bank barrier under construction and can thus be linked to violations of fundamental conventions and norms.

In spring 2010, the Ethical Council published an annual report that describes in detail its work.

Read more on the Ethical Council's website [www.etikradetapfonderna.se](http://www.etikradetapfonderna.se)

## PROMOTE DEVELOPMENT IN ENVIRONMENTAL, SOCIAL, AND GOVERNANCE AREAS

### Sustainable value creation

Sustainable value creation is a collaborative project that AP4 launched in the autumn of 2009 together with 14 other Swedish institutional investors. Together these investors represent holdings of approximately 20% of the capital on the NASDAQ OMX Stockholm exchange.

The purpose of this project is to highlight the importance of Swedish listed companies working methodically on sustainability for long-term value creation. Sustainability analyses can help reduce risks, generate savings, or help businesses capitalise on commercial opportunities. Thus this initiative helps generate better information for investment decisions.

The 100 largest companies on the NASDAQ OMX Stockholm exchange were asked to participate in a survey with questions about responsible and sustainable business activities. The companies' internal policies, reporting, and board accountability were highlighted in the survey.

The questionnaires were addressed to the companies' chairmen to highlight the importance of companies working in a structured manner on sustainability issues.

The results of the survey were announced in a report published in January 2010.

Read more on the sustainable value creation website [www.hallbartvardeskapande.se](http://www.hallbartvardeskapande.se)

### Institutional investors' association

The *institutional investors' association for regulatory issues in the stock market* is an association for institutional investors, including AP4. The association is a collaborative effort of the AP Funds, insurance companies, funds associated with banks, and other investors.

Sweden has a long tradition of self-regulation in which companies and other parties in the market jointly agree to the rules, in addition to those required by law, that should apply to companies and other players on the NASDAQ OMX Stockholm exchange.

The institutional investors' association was formed to facilitate cooperation on the development of best practice in corporate governance and to influence the development of the *Swedish Code of Corporate Governance* and other guidelines. It is vital work that influences the development of and confidence in the Swedish stock market and publicly traded companies.

Read more about self-regulation in the securities market on [www.godsedpavpmarknaden.se](http://www.godsedpavpmarknaden.se)

## Investor initiatives

In addition to work within the Fund and in the Ethical Council, AP4 supports an array of domestic and international initiatives to enhance corporate accountability. When many investors jointly support initiatives on key issues, we expect greater opportunities for shareholders to make an impact. Various types of appeals are increasingly common.

# INTERNATIONAL COOPERATION

## Principles for Responsible Investment

AP4 has signed a United Nations initiative for responsible investment: the Principles for Responsible Investment (PRI). The purpose of the PRI is to bolster companies' and investors' responsible behaviour on environmental and social issues, and the PRI serves as a framework for investors in their daily tasks integrating ESG issues into asset management in their own organisations.

To sign is to declare the intent of the Fund to support the PRI and to strive to take into account the PRI's principles within the framework of the Fund's brief.

In addition, the PRI contributes to driving development in the ESG area, increasing contacts and knowledge exchange on ESG issues between responsible investors around the world.

The PRI's six principles for responsible investment entail the following.

PRI's six principles	
The Fund shall:	
1	integrate ESG factors into asset management,
2	be an active owner and include ESG factors in ownership policies and documents/actions,
3	strive to obtain transparent disclosure on ESG issues from the companies in which the Fund invests,
4	work for the acceptance and implementation of the PRI by other investors and players in the financial industry,
5	cooperate with others to implement the PRI,
6	report on the Fund's activities concerning the PRI.

Read more on PRI's website [www.unpri.org](http://www.unpri.org).

## Carbon Disclosure Project

The Carbon Disclosure Project (CDP) is an international collaborative project to reduce companies' impacts on the environment and raise awareness of climate change.

To effectively reduce emissions, companies must know what they are releasing. One first step is to start measuring and documenting. Through CDP, investors urge companies to measure and report on their environmental impacts and their strategies for climate change. CDP is aimed at streamlining the process of data collection by having a large number of investors jointly sign a common request for data and disclosure of emissions of greenhouse gases.

Read more on CDP's website [www.cdproject.net](http://www.cdproject.net)

## Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (EITI) is an initiative for transparent disclosure in extraction industries, primarily oil companies. The need for transparent disclosure and management is especially great in countries with rich natural resources but weak governments.

More exact disclosure from the companies, about what they are paying, and the countries' governments, about their income from the oil, gas, and mining industries, will increase transparency in society and contribute to better conditions for financial management.

Together with other international investors, the Fund supports EITI, which sends a signal to countries and companies with extractive business operations that shareholders value clear and transparent disclosure of revenues.

Read more on EITI's website <http://eiti.org>

## International Corporate Governance Network

The International Corporate Governance Network (ICGN) is global cooperation to raise the standards of corporate governance worldwide. ICGN works for shareholders to win more rights to vote at shareholder meetings and a stronger position in relation to company management. ICGN drives development in the field of corporate governance by formulating recommendations on responsible corporate governance. ICGN also contributes to increasing contacts and knowledge exchange between countries and investors.

Read more on ICGN's web site [www.icgn.org](http://www.icgn.org)

## Institutional Investors Group on Climate Change

The Fund is a member of the Institutional Investors Group on Climate Change (IIGCC), which collaborates on climate change for European investors. The goal is to raise the investors' voice on climate change and to engage companies, government authorities, and other investors. The purpose is to address the long-term risks and opportunities that arise with climate change and to learn from up-to-date information on different climate-related investments.

Read more on IIGCC's website [www.iigcc.org](http://www.iigcc.org)

# List of companies excluded from AP4's investment universe, 30 June 2010

## Companies excluded 30 June 2010

Company	Year excluded	Country	Sector
Alliant Techsystems Inc.	2008	United States	Aerospace and defence
Elbit Systems Ltd.	2010	Israel	Aerospace and defence
GenCorp Inc.	2008	United States	Aerospace and defence
General Dynamics Corp.	2008	United States	Aerospace and defence
Hanwha Corp.	2008	South Korea	Chemicals
L-3 Communications Holdings, Inc.	2008	United States	Aerospace and defence
Lockheed Martin Corp.	2008	United States	Aerospace and defence
Poongsan Corp.	2008	South Korea	Mining and metals
Raytheon Company	2008	United States	Aerospace and defence
Singapore Technologies Engineering	2007	Singapore	Aerospace and defence
Textron Inc.	2008	United States	Aerospace and defence

You can read more information about the companies excluded on the Ethical Council's<sup>4</sup> website: [www.etikradetapfonderna.se](http://www.etikradetapfonderna.se)

As an annual procedure, the Ethical Council urges all excluded companies to act in accordance with the international conventions.

<sup>4</sup> The Ethical Council is a collaborative effort of AP1, AP2, AP3, and AP4.