



# CORPORATE GOVERNANCE REPORT 2011

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## Responsible investors contribute to positive change

The Fourth National Pension Insurance 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.

The Fund's corporate governance work:

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

The Fund believes that good ethics and attention to environmental concerns are prerequisites for companies achieving sustainably healthy returns.

The Fund believes that active, responsible owners are needed to drive change for the better and induce companies to become more responsible. This applies to both Swedish and foreign companies.

If the Fund disposes of shares in a company, the problems in question do not disappear and the unsatisfactory state of affairs persists. Disposal of the company is the absolute last resort when achieving change is not possible in any other way.

In other words, the Fund believes that it is more responsible to remain as 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, make follow ups, and act to ensure that the unsatisfactory state of affairs is remedied. The Fund makes a positive difference by getting involved as a responsible, active owner.

The Fund supports the Principles for Responsible Investment (PRI), a United Nations initiative for responsible investment. The purpose of the PRI is to bolster companies' and investors' responsible behaviour in terms of ethical and environmental issues.

The corporate governance report covers the period 1 July 2010 – 30 June 2011.

# A constructive and flexible investor

AP4 has been an active and committed investor for many years. Since the Swedish Code of Corporate Governance (the Code) was introduced in 2005, a number of institutional investors have served on the nominating committees of listed companies. One effect of this work is that boards in general today have

- a larger number of independent directors,
- broader expertise and experience, and
- a greater proportion of women.

The work on nominating committees has also contributed to a more open and constructive dialogue between companies and their various shareholders on meeting matters other than board election. This has resulted in, for instance, remuneration programmes and new share issue and buyback mandates being better devised.

## Institutional investors – an important complement to principal and minority shareholders

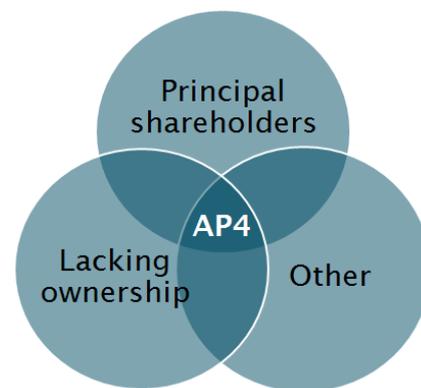
In the experience of the Fund, institutional investors like AP4, which takes active responsibility as an owner, are needed. Without institutions as a complement to principal and minority shareholders, corporate governance would certainly not be developed to such a high degree or work as well as it does on the NASDAQ OMX Stockholm exchange. The dialogue between the companies and the different categories of shareholders has evolved to a great extent in recent years, leading to clear improvements in the proposals submitted to the meetings.

The Swedish nominating committee system does, however, come under criticism from time to time because, for instance, the institutional investors on the NASDAQ OMX Stockholm exchange cannot assume responsibility as an owner that is on a par with that of entrepreneurs, the private or industrial principal shareholders. The institutions are referred to as being too anonymous, passive, ineffective, short sighted, and so on.

Financial institutions, for example the AP Funds and different types of mutual fund companies, vary from each other and pursue different questions to varying degrees, as is also the case in the other shareholder categories. Financial institutions belong to a category of shareholders that cannot and indeed should not assume responsibility as an owner in the same way as a private or industrial principal shareholder. The large institutional shareholders involved can nevertheless contribute constructively to an equally large extent and fulfil an important role as owner of the companies.

## Different types of shareholder structure

In its corporate governance role, the Fund works with companies with different types of shareholder structure. The work is primarily conducted in nominating committees, but also through dialogues with the companies alongside the nominating committee work. A simplified picture of the Fund's role as investor and the different shareholder structures among listed Swedish companies is shown in the diagram. Over the last five-year period, the Fund has been a highly committed shareholder and been active in all of these different shareholder structures.



*Diagram of AP4's role as investor and different types of shareholder structure found among listed Swedish companies.*

## Private and industrial principal shareholders

There are a number of listed Swedish companies today with clear private and industrial principal shareholders, who assume an active role in the company's nominating committee and board. The Fund appreciates such companies and readily owns shares in them.

Long-standing relationships have been built up with some of these principal shareholders, mainly through work on nominating committees. By demonstrating responsiveness, commitment and a long-term approach, the Fund has gained the respect of these principal shareholders and has received much more of their attention than its holdings would indicate.

In many cases, the principal shareholder could easily have voted through its own proposals using its own majority, without taking into consideration the view of an institution such as the Fund. However, they have chosen to listen to the views of smaller shareholders and amended

proposals before sending out the notice of the meeting, clarified proposals at the meeting or promised to make changes by next year. Some of these companies invite the largest institutional shareholders to discuss questions ahead of the meeting each year.

#### Lacking ownership

The opposite of companies with clear principal shareholders are companies with a dispersed shareholder structure that are lacking in a clear principal shareholder, and which do not have a private or industrial minority shareholder stepping forward to take on the role of principal shareholder. These companies can, in simple terms, be described as lacking ownership.

The Fund has, in certain such cases, stepped in as principal shareholder alongside another institution. This requires extensive knowledge about the company, commitment and a lot of time. It can also require the traditional role of investor to be extended, resulting in a long-term insider situation emerging. The Fund has been an insider in one company for a year and a half, and during this time the holding has been placed in a special corporate governance portfolio. During this time, the board has been partially replaced, with international expertise added and new auditors elected.

The Fund has also supported the company in its work relating to comprehensive changes, with the appointment of a new management team, an improved financial position and control, and the introduction of a new remuneration system.

#### Other

In this context, a large group of companies can be categorised as "Other". These companies can sometimes move between the other two shareholder categories described above, or have one or several small but dominating shareholders.

The "Other" shareholder category requires the Fund to be even more flexible, constructive and prepared to assume different roles. For instance, supporting and strengthening a minority shareholder that takes on the role of principal shareholder. Or, consciously influencing such a shareholder promoting an interest of its own without taking into account the best interests of the company and other shareholders. It can also be a matter of assuming joint responsibility as owners alongside some other institutions, which can last for a few years.

## Corporate governance work in 2011

### In the best interests of the company and its shareholders

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 with the purpose of contributing to a healthy return on investments.

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.

### Guidelines on the Fund's ownership role

The Fund's work on corporate governance issues is guided by the Ownership Policy adopted by the Fund's board. The policy is also reviewed annually by the board. The ownership policy directs that ownership issues are to be dealt with by AP4's CEO or another employee at the Fund, as delegated by the CEO.

The purpose of the ownership policy is to lay down guidelines to the Fund's employees as to how the Fund is to act with regard to ownership issues in order to promote the Fund's overall goal, which is to generate the best possible return over time on behalf of pensioners in Sweden, and thereby to contribute to the stability of the pension system.

The ownership policy shall safeguard the best interests of shareholders and individual companies. The policy shall take into account the unique circumstances and needs of each individual company and aim at contributing in the long run to maximising AP4's long-term return.

The ownership policy is formulated on the basis of the legislation that governs the Fund's activities and on *the Swedish Code of Corporate Governance (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 "comply or explain" principle, which gives companies the right and opportunity to diverge 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).

## Dialogue is the main tool

The Fund's main 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 can promote 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.

The Fund also conducts dialogues with companies in the event of an incident or suspicion of an unsatisfactory state of affairs. The Fund believes that active responsible owners are needed to drive change for the better and induce companies to become more responsible. This is true of Swedish companies as well as foreign. You can read more about these dialogues in the sections on "Environmental and ethical issues in asset management" on page 10, and "Ethical Council" on page 14.

### Fundamental values

The shared fundamental values of the four AP Funds, regarding environmental aspects and the ethical dimensions of companies' operations, have been further developed during the year. These values originate from the principles of commitment, action and change with a view to making a difference.

The Funds make a difference by proactively encouraging sustainable growth in areas that promote long-term high returns, and engaging in companies with problems that have been identified and are deemed tangible and well-documented. This is a responsible, ethical approach to acting as an owner.

If the Funds bring their ownership to an end, the problem in question does not disappear and the unsatisfactory state of affairs persists. Therefore, disposal of the Funds' holdings is the last resort, when the possibility of influence is deemed futile.

As part of the Swedish pension system, the AP Funds' principles regarding commitment, action and demand for

change are based on the same fundamental values as the Swedish state. Core elements of these fundamental values are democracy, equality, freedom and dignity of the individual, and sustainable growth. This is in accordance with what is written in the Constitution. The fundamental values of the Swedish state are also expressed through the international conventions ratified by Sweden, including conventions regarding the environment, human rights, labour law, corruption and inhumane weapons, through the support provided by Sweden to initiatives such as the UN Global Compact and the OECD's Guidelines for Multinational Enterprises, and through Sweden's standpoints in matters of international law. Combined with the Swedish state's fundamental values, the international conventions constitute essential instruments for the Ethical Council in its work to ensure that the AP Funds have the necessary regard for environmental aspects and ethical dimensions in their operations.

By using international conventions as a starting point and working with other investors, the Fund can serve as part of an international collaboration in financial markets that ensures that attention is drawn to convention violations and that problems are addressed.

Read more about the Ethical Council on page 14.

### Excluding companies

Dialogue is the Fund's main 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 choose to dispose of the company. 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 – are divested in an orderly manner.

In accordance with its fundamental values, AP4 excludes companies from its investment universe that are directly involved in the production or marketing of anti-personnel mines and cluster munitions. A company may also be disposed of if it violates the *UN Global Compact* or the *OECD's Guidelines for Multinational Enterprises* and where 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 2011). 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

The ownership policy adopted by the Fund's Board summarises the guidelines for corporate governance in Swedish and foreign companies *Ownership Policy 2011* starts with guidelines regarding Swedish stock market companies.

At mid-year 2011, the Fund had a Swedish equity portfolio with a market value of approximately 41 SEK billion. That makes AP4 one of the 10 largest institutional investors in the Swedish stock market. The Fund has shares in about 130 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, and
- 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<sup>1</sup>

The Fund's guidelines for corporate governance in foreign companies are set forth in *Ownership Policy 2011*.

At mid-year 2011, the Fund had around SEK 88 billion invested in around 1,700 foreign stock market companies. The holdings in these companies are relatively small, even when AP1-AP4 combine their holdings to work together under a shared name, the Ethical Council. The AP Funds have worked together regarding environmental and ethical matters since 2007 to give weight to their pursuit of ownership issues among foreign stock market companies.

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.

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<sup>1</sup> ESG (Environment, Social and Governance) is often the term used for issues pertaining to the environment, ethics and corporate governance.

# 2011 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 July 2010 through June 2011, the Fund was represented at 61 Swedish shareholder meetings including 58 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 engagement with 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.

In addition to meetings where the Fund is physically represented, the Fund votes by proxy (submitted in writing) in companies listed on Swedish stock exchanges but which are legally domiciled in another country. During the period, the Fund has voted by proxy in nine cases.

## Executive remuneration

The ownership policy adopted by the board stipulates that remuneration to senior executives is primarily a concern of the company's board and not an issue where the concrete details should be decided by the AGM. Under the Companies Act (2005:551), the AGM shall set guidelines for remuneration. However, the board is responsible for total remuneration (that is, the sum of fixed and variable remuneration, including pension and other benefits) being well-balanced and adapted to the company's circumstances.

Remuneration issues have always been a priority in the Fund's work on corporate governance, and they have become increasingly important, both as a governance issue *per se* and against the background of the debate in society over recent years concerning remuneration at listed companies. The standards laid down in the government's Guidelines on Employment Conditions for Senior Executives in the AP Funds have also played a significant role in the process.

In these guidelines, the government has made clear that the total remuneration for senior executives in the AP Funds shall be reasonable and well-balanced. It shall also

be competitive, capped, fit-for-purpose and shall play a part in maintaining good ethics and a healthy organisational culture. Incentive-based remuneration shall not be paid to senior executives of the AP Funds; however, it may be paid to other employees.

Furthermore, the government states in these guidelines: "In companies in which the AP Funds have an ownership stake, directly or via a company, the AP Funds and the company concerned should actively seek in dialogue with other owners to ensure that the guidelines are applied to the extent possible".

In the ownership policy for the Fund, adopted by the Fund's board in 2009 immediately after the government's guidelines were announced, the Fund's board clarified and tightened the requirements for remuneration programmes including an element of incentive-based remuneration. As a state pension fund, it is particularly important that the actions of the Fund in these areas should inspire trust. Against that background, the way the Fund evaluates proposed remuneration programmes has been further standardised and tightened. Every remuneration programme on which the Fund votes is evaluated in detail in terms of the requirements stated in the Fund's ownership policy. The dialogues conducted by the Fund and other institutions with companies on remuneration issues have brought about an improvement in proposals presented.

The Fund is of the view that incentive-based remuneration programmes aimed at senior executives shall be in harmony with the long-term interests of shareholders. They are to reward positive, long-term achievements, but also work in the opposite direction. When the desired performance is not delivered, total remuneration should be less. Incentive-based remuneration shall therefore require clear-cut and measurable achievement. The remuneration shall also have a ceiling.

The Fund therefore makes stringent demands on the structure, evaluation and transparency of the programmes. They should be both "definable and defensible". In the ownership policy, the Fund's board decides in detail what should be paid special attention in order for the Fund to be able to vote in favour of proposals at an AGM.

## Dialogues on remuneration

As the result of the Fund and other asset owners being involved in the remuneration issue over several years, incentive programmes have gradually improved in terms of transparency and linkage to performance. In the great majority of cases, discussions between the board and shareholders contribute to improving 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 2011 was companies'

proposals for remuneration and incentive programmes for senior executives. The Fund was in contact and dialogue with a large number of companies at whose meetings the Fund participated.

Following extensive discussions with many companies prior to last year's AGMs, the Fund noted a clear improvement in remuneration programmes this year. Although the Fund was in dialogue with more or less as many companies ahead of this year's AGMs, there were fewer questions that required discussion before meeting notices were sent out, or before the meeting. Most companies are responsive and take on board shareholders' views. The Fund has therefore not needed to submit comments or vote against any proposed programmes at the meetings in the spring.

### 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 a share issue can drastically change the ownership structure of a company.

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.

In many cases, companies have taken on board viewpoints regarding share issues without preferential rights, and justify this more often by referring to the share issue only being used as payment to acquire companies.

As early as in 2010, AP4 voiced criticism to Ratos regarding a 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. Nonetheless, the resolution was approved. Prior to this year's 2011 meeting, alongside some institutions, the Fund was in discussion with the company regarding the proposal that was to be tabled at the meeting. The discussion led to Ratos choosing to change the proposal further so that its scope was reduced, and the Fund was thus able to vote in favour of an authorisation.

### Authorisations for buybacks and sale of own shares

One of the tasks of company boards is to work to achieve a carefully balanced capital structure. A company acquiring its own shares is one of the means available to this end. Proposals for share buybacks shall be well justified, as shall the terms under which the board may exercise any such authorisation.

AP4 does not believe that the sale of repurchased shares in the stock market should be allowed, except when it is done to hedge the company's share-based incentive programme. In the event of several share series, it is always the cheapest that shall be repurchased.

The Fund contacted a number of companies ahead of the meetings and indicated that the buyback mandates were unclear and urged the companies to clarify the mandates. This resulted in the Chairs, in accordance with the Fund's wish, clarifying at the meetings of Ratos, Kinnevik, Tele2 and MTG, that the cheapest share shall be repurchased.

### Problem-free meetings

For many years, the Fund and other institutional investors have held successful dialogues with companies regarding dubious proposals and, consequently, it has been possible to address many disagreements and issues before the meetings. The result of these long-term efforts and of this year's dialogues is that the Fund has not voted against any proposals at this year's AGMs.

As already mentioned, in a number of cases companies have changed or clarified their proposals in accordance with the wishes of the Fund. Examples of such relate, for instance, to authorisation for buyback mandates, as described in more detail above.

### Shareholder meetings outside Sweden

The guidelines followed by the Fund for voting at meetings outside Sweden are described in "Corporate governance in foreign companies" in *Ownership Policy 2011*. The guidelines are inherently general, to allow local laws, customs, rules, and the like to be taken into account.

### Procedure for voting abroad

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 450 foreign meetings

In 2009, the Fund commenced voting at meetings outside Sweden as a pilot project, and voted at 252 foreign shareholder meetings, mainly in the US and Europe. In 2010 and over 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.

In 2010, the Fund voted at around 400 shareholder meetings and in 2011 the Fund intends to vote at around 450 shareholder meetings. The Fund has roughly 1,700 foreign holdings in all. Per June 2011, the Fund had voted at 383 shareholder meetings in the same countries as in previous years.

### Meeting statistics (January – June 2011)

No. of meetings	383
No. of agenda items	6,861
AP4 voted against proposal submitted (%)	24
AP4 abstained from voting due to a lack of or inferior information (%)	7
Remuneration questions that AP4 voted against or whereby it abstained from voting on the proposals submitted (%)	72

## Issues in focus

Issues that the Fund emphasises at shareholder meetings include:

- shareholders' rights to vote for their entire holding, submit their own proposals and propose their own agenda items
- independence of board members, that the CEO and board chair 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
- environmental and ethical issues.

During 2011, the Fund voted in favour of numerous shareholder proposals, including on environmental and ethical issues

# Nominating committees

Participation in the work of nominating committees is a vital tool for exercising shareholder influence for a financial institution. The principal task of a nominating committee is to propose a solidly assembled board of directors; besides expertise and experience, diversity is important.

The Fund also has a responsibility towards the companies in terms of participating in nominating committees, because the Fund places demands on the companies to follow the *Swedish Code of Corporate Governance (the Code)*, which requires the companies to have a nominating committee.

## Tradition of work on nominating committees

AP4 has been working to enhance good practice on the stock market for many years. For example, the Fund was one of the institutions involved more than 15 years ago when a new market practice, nominating committees, was established through the formation of the nominating committee for Volvo.

Today *the Code* 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 being established 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, contributing in the long run 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. An assessment is subsequently performed 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 usually 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 on the board and 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 2011

During 2011, the Fund was involved with 11 nominating committees for listed Swedish companies holding AGMs in 2011, including one as chair. This was a larger number of nominating committees in listed companies than for all the other AP Funds combined.

### A good board of directors

The Fund emphasises, as it has done previously, the importance of diversity in boards, and stresses that diversity is not just about gender, but also for instance age, background, nationality and experience.

Changes in boards must always originate from the needs of the individual company, with diversity, expertise, continuity and smooth operation all being important factors to consider so that they are carried out at the right time. It is important to bear this in mind when commenting on, for instance, the seemingly slow increase in the proportion of women in the boards of listed companies.

### AP4 contributes to diversity

In its work on nominating committees, the Fund places great emphasis on the needs of the individual company, and in this framework, the nomination of women directors has had high priority. The result has been positive, with an increased proportion of women taking up directorships.

The proportion of women directors increased for companies where the Fund participated in the work of the nominating committee, averaging at around 32% in such companies, compared to about 24% 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 25%, compared to the 2011 average of about 28% on the stock exchange.

Following a comprehensive change process last year in the nominating committees in which the Fund participated, there are few changes in the boards this season. Thus, the proportion of women barely improved.

Company	Proportion of women in %	No. of newly elected women	No. newly elected total
Beijer Electronics	28	0	1
Concordia	0	0	0
Connecta	50	0	0
Metro	38	0	0
Micronic	33	0	1
Nordea	33	0	0
New Wave Group	33	0	0
Poolia	40	1	2
Ratos	25	0	0
Svolder	40	0	0
TradeDoubler	43	0	0

## 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 shall 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 of directors. The procedure for appointing the nominating committee is also decided then. The main task of the committee is to submit proposals to the board at the next AGM. All shareholders can submit proposals to the nominating committee regarding suitable candidates for the company's board.

Usually the meeting decides that the committee will consist of the shareholders with the largest holdings at the end of August or September. 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 usually hold their first meetings during 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 three to five largest shareholders are usually asked whether they wish to be represented on the nominating committee. AP4 largely always participates 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 makes it easier for the committee 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 do we need", "What experience and expertise do we already have – and what do we lack", "How smoothly does the board 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 shortlist 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

## ESG<sup>2</sup> provides sustainable return

The Fund believes that good regard for ethics and the environment, and sustainable value creation are prerequisites for companies achieving sustainable healthy returns. The Fund believes that active, responsible owners are needed to drive change for the better and induce companies to become more responsible. This applies to both Swedish and foreign companies.

## Are ESG mandates profitable in the short term?

The Fund's brief – creating the best possible return for Swedish pensioners – is a guiding principle for all of the Fund's mandates, including those with an ESG orientation. ESG mandates in which the Fund invests are expected to create return at least equal to non-ESG-oriented mandates.

Academic research and studies on ESG mandates so far show no clear positive connection between ESG orientation and healthy relative return. The research provides no clear or consistent evidence to indicate that ESG mandates are equally or more profitable. It is just as easy to claim the opposite, i.e. that ESG mandates provide a poorer relative return.

The Fund is monitoring the current research and studies in the field and continues to evaluate ESG investments in the same way as other potential investments. The Fund pursues ESG integration in asset management, because it ensures risk awareness and capitalises on business opportunities in the area of ESG.

## Fund's ESG-related work pursued on several fronts

The Fund's work on environmental and ethical matters is pursued in asset management within the different asset classes by the Fund's corporate governance unit and through the Fund's commitments in the Ethical Council. Read more about the Ethical Council on page 14.

The Fund's corporate governance unit pursues and coordinates its work relating to ethics, the environment and corporate governance. This work includes pursuing dialogues with companies regarding ESG and exercising corporate governance by voting the Fund's shareholdings at shareholder meetings. The Fund's representatives on the Ethical Council work in the corporate governance unit.

## Integrating ESG into asset management

The Fund's different asset classes and management models provide different conditions for how work relating to sustainable value creation (ESG) can be pursued in the context of each management mandate. Responsibility for integration work, with the goal of fully integrating ESG into management, lies with each management unit. The management unit reports on the integration work to the business manager and CEO. The work is pursued in close collaboration with the corporate governance unit, which is responsible, for instance, for conducting dialogues with companies regarding ESG.

## ESG in global equities management

Global equities management is separated into alpha and beta categories. Alpha management (active management) is conducted by assignment of AP4 by external managers with tailored absolute return mandates. Beta management (index management) is primarily conducted internally. The Fund's internal alpha and beta management thus focuses on the selection of outside managers, portfolio construction and index management.

## Index management consistent with PRI principles

In their recommendations to index managers, the Principles for Responsible Investment (PRI) state that passive management is consistent with PRI's principles, and that passive managers can take responsibility mainly through voting their holdings and by engaging in dialogue with problematic companies. By integrating ESG factors into index design, managers can take a further step in such integration.

PRI also establishes that long-term investors can involve themselves not only in individual companies, but also in activities that are more long-term in nature, such as encouraging companies to manage climate issues, anti-corruption and ESG transparency optimally.

The Fund has met the requirements regarding voting, dialogue with problematic companies and activities of a long-term nature for many years. This work is described in more detail in the section on the Ethical Council and Shareholder meetings outside Sweden.

The work relating to further integrating ESG into management by taking ESG factors into account is described below.

<sup>2</sup> ESG (Environment, Social and Governance) is often the term used for issues pertaining to the environment, ethics and corporate governance.

## Quantitative ESG data integrated into management

The global equities management is of the opinion that regard for ESG should be an integrated part of the management. Quantitative ESG data from an international ESG supplier has been integrated into the internal risk and portfolio management system. All of the management's holdings, around 1,700 companies, are ranked based on the companies' corporate governance, environmental impact and ethical behaviour.

Following the integration, the global equities management thus has data, tools and expertise to perform back testing, i.e. measure the impact of quantitative ESG data on the portfolios. This gives the management the opportunity to implement both positive and negative screening based on ESG factors.

With the help of the back testing tools, the management has studied the efficiency and impact on return of ESG on different types of management mandates. This work has contributed to a deeper understanding of the strengths and indeed the pitfalls related to how ESG can be integrated into different management mandates.

Evaluations of different ESG mandates with a quantitative orientation have led to the Fund's intent to establish a portfolio of companies with a relatively low carbon footprint.

## Green CO2 portfolio

Lower carbon dioxide (CO<sub>2</sub>) emissions to reduce the greenhouse effect is an area in which rapid progress is expected. With a functioning market and pricing on emission rights, companies with lower emissions and who act better than competitors will have a financial advantage.

The work of the global equities management, with positive screening in terms of companies' environmental impact through CO<sub>2</sub> emissions, has resulted in the Fund's intent to establish an index portfolio consisting of companies with a relatively low carbon footprint. This CO<sub>2</sub> index portfolio will be developed alongside a collaboration partner, and the goal is for further international investors to be part of this investment.

## Continued evaluation of green mandates

The global equities management continues to evaluate and seek suitable models for ESG mandates, and study ESG effects on return and risk. ESG mandates in which the Fund invests shall be expected to create at least equally good return as non-ESG-oriented mandates.

As part of the ongoing management and the work to identify suitable management mandates, the global equities group is in contact with international investment banks that focus on ESG. The group also monitors academic research in the field.

## ESG in Swedish equities management

The Swedish equities management is pursued based on fundamental research. ESG matters form part of the management's assessment of the share price risk and potential of the various companies. The Fund's managers discuss environmental and ethical issues with management teams, sending clear signals about how important these issues are to AP4.

### ESG – part of the analysis

The task of gathering information to support analysis and decisions is pursued and implemented by the Swedish equities group. The Fund's corporate governance unit, the Ethical Council (through the corporate government unit) and an outside consultant also contribute to this process.

The main source of information of the Swedish equities management is the regular company visits carried out among the majority of the portfolio holdings. The ambition of the management is to assess the risks/opportunities in terms of the environment and ethics that exist in the companies, in the same way that other risks/opportunities are addressed in the fundamental company research.

### ESG increasingly important for companies

In the years during which the Swedish equities management has actively worked with environmental and ethical issues, a positive trend has been noted among the companies. For a few years, the companies have been working in a more structured manner with ESG, and responsibility for these issues, whose significance has increased, has shifted higher up in the organisations. The companies' transparency in the area of ESG has also increased, now often constituting long sections of the annual report that address these matters or separate sustainability reports. The ambition of the management is to monitor the information provided by the companies regarding their work relating to ESG, and follow up with potential questions.

It may also be the case that companies take the initiative themselves to invite investors to discuss sustainability issues. These meetings are usually highly informative. 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.

### Information from different sources

The management uses the Fund's counterparts (banks and brokerages) to highlight ESG issues. Interest in including ESG in research reports has increased among counterparts. The Fund expects that, in future, ESG factors will be integrated into the research of banks and brokerages to an increasing extent.

The Swedish equities management works closely with the Fund's corporate governance unit, often with daily

contact regarding ESG-related matters, as well as joint weekly meetings. At these meetings, topics reported and discussed include relevant matters from company visits carried out by Swedish equities, the corporate governance unit or the Ethical Council (through a representative of the Fund's corporate governance unit).

The management also appoints the help of an external consultant for screening the Fund's Nordic company universe twice a year. On a daily basis, the consultant also seeks and gathers relevant information from a large number of sources, for instance various UN sources, media and the reports of different voluntary organisations and interest groups. The intention is to pick up on any violations by the companies of international conventions regarding, for instance, the environment, human rights and corruption.

### Work process in the event of an incident

Swedish and Nordic listed companies on the whole are well managed enterprises that nurture their brands and conduct their business in a sustainable manner. In a few exceptional cases, though, environmental or ethical incidents have occurred. When such instances or suspicions of an unsatisfactory state of affairs come to the attention of the Fund, the management and corporate governance unit immediately check with each other regarding the situation and contact the company's management to verify facts.

The corporate governance unit usually handles the ongoing contacts with the company regarding ESG matters, in close collaboration with the management. The Fund requests information about the actions the company is taking to solve the problem and ensure that the risk of anything similar occurring again is low. 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. They have usually been constructive, and the companies take care to provide pertinent information and to solve the problems.

## ESG in fixed income management

The fixed income management pays constant attention to companies that can fail in their management of ethical and environmental factors in their operations. Corporate bonds issued by companies with material shortcomings in terms of environmental and social issues can give rise to a series of risks in the management, for instance in the form of potential future compensation matters. The fixed income management views avoiding these issuers as a priority area.

### Low-risk bonds

The fixed income management's exposure to corporate bonds issued by non-financial companies is currently limited to less than 5% of the total fixed income portfolio. It is primarily in this segment that risks of an ESG nature can arise.

The Fund's rating criteria and other credit rules therefore ensure that these investments are only made in companies with high ratings.

All positions are traded actively, and a consequence of this is that the fixed income management reviews the holdings on a daily basis.

Collaboration is also in place with a large number of credit analysts, who also flag potential risks and situations in which the company might be held to account through contingent liabilities. Such risks are of great significance to the value of the bonds, and analysis of these is used directly to support the management.

Information is exchanged between the Fund's fixed income management and global equities management regarding foreign companies with risks in the area of ESG. The fixed income management also receives the results of the bi-annual screening commissioned by the Fund to identify companies that can be associated with violations of international conventions.

### Green bonds

The fixed income management takes a positive view to green bonds, but currently lacks holdings in this class of asset. The evaluation criterion for an investment in a green bond is that it shall be competitive and expected to create return at least equal to that of a traditional bond. The goal originates from the Fund's brief – creating the best possible return for Swedish pensioners.

At mid-year 2011, the green bond market amounted to around USD 4.5 billion, which can be compared with the total market of US government bonds of around USD 7,500 billion. The capital raised through green bonds, with issuers such as the World Bank and EIB (European Investment Bank) are earmarked for environmentally friendly projects such as reducing carbon dioxide emissions.

There are only a few green bonds with an issue size sufficient to be held as liquid funds within the fixed income management's mandate, and these have been issued at relatively expensive levels. The market trend is however monitored continuously for potential investments, either through the primary or secondary market.

### Integration of quantitative ESG assessment initiated

Work has commenced within the fixed income management to integrate a quantitative ESG assessment in the portfolio system.

The goal of the work is to be able to systematically screen the portfolio regarding ESG factors to be able to carry out comparative studies between indexed and actual portfolio holdings. It is expected to enable a more

advanced evaluation of existing and potential portfolio designs.

The work on enhancing the fixed income management's portfolio system, with the purpose of supporting ESG analysis of the portfolio, is expected to be completed in 2012.

## ESG in real estate

In the last few years, the Fund has expanded within real estate as a strategic asset class. It has chosen the strategy of directly owning property companies, because this is deemed to be the most cost-effective and transparent method, thus providing better expected return.

Vasakronan and Rikshem (previously Dombron) together constitute the majority of the Fund's real estate exposure. The Fund owns 25% of Vasakronan, which is Sweden's largest real estate company. As of 2011, Rikshem is co-owned by the Fund and AMF, each owning 50%. Rikshem manages and develops residential properties and is expanding in the residential and public property segments. Typically, public properties comprise long-term rental contracts, and a municipality or county council is usually the tenant. In addition to Vasakronan and Dombron, AP4 owns 15% of real estate company Hemfosa.

### Greener real estate

As an active owner, AP4 wants to contribute to systematically sustainable environmental work at property companies.

An important focal area for systematic environmental work in such companies is energy consumption. Energy costs are a major expense item and reduced energy consumption is also positive for the environment. According to the Swedish Energy Agency, properties account for around 35% of energy consumption in Sweden, with heating and cooling accounting for almost 60% of a property's total energy consumption.

### Vasakronan – a good example

Vasakronan has been prioritising environmental issues and pursuing them successfully for several years. The company works actively to be at the forefront of the industry and to identify solutions that lead to sustainable social progress and satisfied customers.

### Policies and measurable goals

Vasakronan's sustainability work is an integrated part of its day to day operations. Its environmental work is coordinated with business planning and carried out with the help of an environmental policy, goals, procedures and process manuals. The company has clear and measurable short-term and long-term goals in the field of sustainability, both centrally and locally in different units.

Ongoing follow-up of policies and goals is an important part of the work. Clear requirements increase the need for expertise and gathering actual values. An important part

of the basis for decision making and means of control is follow-up of actual values, calculations and analyses.

### Lower energy consumption is positive for the environment and customers

For a long time, Vasakronan has been working actively to reduce energy consumption at its properties.

Thanks to goal-oriented work with efficiency enhancement, Vasakronan has sharply reduced heat energy consumption in its properties to a level around 26% lower than the national average for premises. An example of an umbrella goal is that energy usage in Vasakronan's property holding is to be 50% lower than the industry average. This can be achieved, for instance, by energy-saving investments such as more efficient installations, enhancements and adjustments through optimising operation, and ensuring the properties' technical systems are run as intended. For extensions and new property construction projects, tough demands are placed on the choice of technical solution and other factors that affect energy consumption.

### Choice of material and documentation

Choice of material in new property construction projects, conversions, tenant adaptations and maintenance are of significance to a building's environmental impact.

Vasakronan pursues systematic, long-term work in terms of choosing materials and limiting the use of chemicals. Its buildings are well documented, and the chemicals and pollutants that may be present in materials are dealt with according to set plans in e.g. conversions. This work has helped to largely avoid environmental problems such as moisture damage and problem buildings.

## ESG in alternative investments

### The Fund helps create industry practice

During 2010, the Fund's management began working to integrate the UN's newly issued recommendations for unlisted investments, *PRI Responsible Investment in Private Equity – A Guide for Limited Partners*. The purpose of the recommendations is to enhance companies' and investors' responsible behaviour on ethical and environmental issues. Thus, the Fund is contributing to the creation of a common, industry-wide standard for handling ESG issues in unlisted investments.

### Work process

The management commenced the integration of ESG by going through the guidelines and policies regarding ESG among all of the Fund's external managers of unlisted investments. The latter were also informed that the Fund supports the Principles for Responsible Investment (PRI).

Since then, the Fund's management has been routinely informing potential external managers of unlisted investments that the Fund supports PRI. If an external

manager has not yet signed PRI, they must state why, and the Fund will urge them to also support and sign the PRI.

The Fund also requests the external managers' ESG policies and studies them.

In the assessment of unlisted investments, a risk assessment on ESG factors is performed. Such a risk assessment includes how the external manager works on ESG issues and whether the operations in for instance countries and sectors carry greater risks of different types.

### ESG guidelines generally prevalent in 2010

The overview at the end of 2010 showed that the majority of the Fund's portfolio in venture capital funds, 90%, was managed by external managers with an ESG policy. However, only a couple of managers, corresponding to around 6% of the portfolio, had endorsed the PRI. At the same time, a number of the external managers were working with the matter internally and intended to endorse the PRI during 2011, for which the Fund expressed support.

### More managers endorsing PRI

During 2011, the Fund's focus has been on ESG and PRI among managers who have established new funds. The managers have also drawn up ESG policies and evaluated PRI on establishing the funds.

During the first six months of 2011, the Fund invested in venture capital fund Priveq 4. Priveq intends to endorse the PRI during 2011.

At the end of 2011, it is expected that largely all of the Fund's managers will have an ESG policy, and that a significant part of the capital will be managed by managers who have endorsed the UN's PRI. See table on the following page.

### ESG policies and PRI among the Fund's venture capital managers

Prop. of managed cap.	2010 Dec	2011 Dec (forecast)
Has internal ESG policy	90 %	approx. 100%
Has endorsed PRI	6 %	approx. 60%

### Fund pursues openness in reporting

The Fund wishes to promote increased openness in reporting by venture capital managers regarding ESG. The Fund has held discussions with other institutional investors regarding increased transparency in terms of ESG in reporting.

### Issues in focus

At the end of 2011, the Fund plans – as it did during 2010 – to follow up on ESG status among the Fund's external managers of venture capital funds. With significant improvements in terms of the prevalence of ESG policies, focus in 2011–2012 will be on implementing ESG guidelines in practice. The Fund will then focus on the following areas regarding ESG:

- responsibility
- goals
- view of risks
- contingency planning, control systems, follow-up
- impact on incentive structure

## Ethical council

AP4 believes that well-managed companies, which work actively on environmental and social issues, create sustainable value and are hence good investments in the long term. Environmental, social, and governance issues, often referred to as ESG matters, are a vital part of the Funds' operations.

The Ethical Council is a collaborative venture between the First, Second, Third and Fourth AP Funds. It was launched in 2007 to conduct preventative and follow-up work within ethical and environmental aspects of the Funds' investments. The Council enables the Funds to jointly pursue change for the better in foreign companies associated with violations of international conventions regarding the environment and human rights.

Because the four AP Funds work together and conduct dialogues jointly abroad under one name, the Ethical Council, the Funds are perceived as a more influential and

stronger owner abroad, which increases their possibility to influence companies to make lasting improvements.

This cooperation also means that the four AP Funds' work is more efficient in terms of time and costs. This increased efficiency is expressed in several reactive and proactive company dialogues, and in an increased amount of international investor initiatives. Thanks to their collaboration, the Funds can participate in more conferences, share their experiences and working methods, and monitor the trend in the field of ESG.

Since the Ethical Council was founded, the Funds have established contacts with a number of experts and expanded their international contact network to strive for the AP Funds being at the forefront of developments.

## Members of the Ethical Council

The Ethical Council consists of an ordinary representative from each AP Fund, with the right to a deputy. AP4's representatives on the Ethical Council work in the corporate governance unit.

The chair is alternated between the Funds, with the change taking place at the turn of each year.

The Ethical Council also has a full-time secretary general. The secretary general's most important tasks are coordinating the Ethical Council's dialogues with companies and the investor initiatives supported by the Council, and involvement in developing the Ethical Council's strategies. External consultants are also used, along with internal resources from the different Funds when needed.

## Active owners

The four AP Funds invest globally in diversified portfolios consisting of several thousand companies. A large part of the Funds' holdings is indexed, which means that the Funds have a dispersed ownership with relatively small holdings in different companies.

Two important tools for active corporate governance used by the AP Funds are voting at shareholder meetings and pursuing direct dialogues together through the Ethical Council with a small number of selected companies.

The AP Funds believe that an active responsible owner of companies contributes best to change by influencing through dialogue and at shareholder meetings. If the Funds sell their shares in a company, the problem does not disappear and the violation continues. Disposal is therefore the last resort when dialogue has not yielded the desired result.

## Voting at shareholder meetings

The AP Funds vote individually at foreign shareholder meetings in accordance with each Fund's ownership policy. In 2011, AP4 will vote at around 450 foreign shareholder meetings.

The shareholder meetings vote on several important proposals that can make a difference in how the companies' operations are governed and controlled. The number of shareholder meetings at which the Fund exercises its right to vote is being gradually increasing in order to maintain the quality of the Fund's standpoints.

Read more about foreign shareholder meetings on page 8.

## Dialogue – The best tool for positive change

Dialogue is the Ethical Council's most important tool for encouraging companies to act responsibly. The dialogues are aimed at the company addressing the documented

infringement and bringing it to an end. In addition, the AP Funds, as long-term investors, want to see the company implementing measures and establishing systems of prevention to avoid future infringements. Pursuing such a change process requires discipline and a good measure of patience.

When the established goals for the dialogue have been reached, the company is then subject to special monitoring for five years.

## Qualitative direct dialogues

Qualitative dialogues are highly time- and resource-intensive, so the Ethical Council does not have the resources itself to conduct active shareholder dialogues for all of its foreign holdings where violations of conventions are suspected. It therefore prioritises active dialogue with 10–15 companies per year. The companies selected for dialogue have problems that are deemed manifest and well documented, and where the Ethical Council's involvement can make a difference.

## Choice of companies for dialogue – a systematic process

The Ethical Council's aim is to hold an active dialogue with companies that violate conventions with the goal of persuading them to take action.

The Ethical Council's working method is based on screening the equity portfolios of the four AP Funds regarding violations of international conventions. This screening is performed with the help of an external consultant, who searches for and gathers relevant information from a large amount of sources on a daily basis, for example various UN sources, media and the reports of different voluntary organisations and interest groups. The equity holdings of the AP Funds are matched against this database, and in cases of reported incidents regarding violation of international conventions, the companies in question are examined more closely.

The Ethical Council selects a number of companies for direct dialogue. Besides these companies with which the Council is in dialogue, the consultant of the Council is commissioned to conduct dialogues with a further approximately 200 companies on behalf of the Council and other customers.

In spring 2011, the Ethical Council published an annual report that describes its work in detail.

Read more on the Ethical Council's website:

[www.ethicalcouncil.com](http://www.ethicalcouncil.com)



A COLLABORATION BETWEEN THE FIRST, SECOND,  
THIRD AND FOURTH SWEDISH NATIONAL PENSION FUNDS

# Promoting development in environment, social and governance (ESG)

## The fund's response to the EU commission's green paper on corporate governance

In the wake of the latest financial crisis, the EU Commission is investigating what can be done to prevent similar crises arising again. The Commission therefore issued its Green Paper on Corporate Governance in Financial Companies, to which the Fund has responded and commented on.

### In favour of harmonisation

AP4 is in favour of harmonising corporate governance within the EU because this will increase transparency and efficiency in the markets. The differences between different countries' corporate governance systems are examples of barriers that can be lowered in the internal market.

There are great differences today between the Member States in terms of legislation, self-regulation and ownership structures, which means that common European rules for corporate governance might prove difficult to establish.

It must also be considered that new legislation might risk giving rise to increased administrative costs and less effective corporate governance in certain countries. This could lead to the EU countries becoming less competitive globally.

### "Comply or explain"

The Fund prefers guidelines/legislation based on principle to detailed legislation. The Fund believes that the principle of "comply or explain", which gives each company the right and opportunity to diverge from a recommendation, should be used.

Corporate governance rules should take national legislation into account while safeguarding the best interests of shareholders and the company.

The Fund therefore recommends that the EU strives to identify measures that can allow and encourage self-regulation.

## The sustainable value creation initiative

Sustainable value creation is a collaborative project between a group of Swedish institutional investors, which together represent holdings of approximately 20% of the capital on the NASDAQ OMX Stockholm. The purpose of this collaborative project is to highlight the importance of Swedish listed companies working methodically on sustainability matters.

The collaborative project was launched in 2009 with a questionnaire sent out to the 100 largest companies on the NASDAQ OMX Stockholm, with the companies responding to questions about responsible and sustainable business operations. The focal areas of the Sustainable value creation initiative include the companies' internal guidelines, implementation, compliance and the responsibility of the board.

The questionnaires were addressed to the chairs of the companies to highlight the importance of companies working in a structured manner on sustainability issues. The companies that participated in the survey received individual feedback on their participation.

It is hoped that the survey can act as an instrument to guide companies in their work on sustainability issues and help with the analysis of the companies. Thus this initiative also helps generate better information for investment decisions.

Sustainability analysis can help reduce risks, generate savings, or help businesses capitalise on commercial opportunities.

### Activities

In 2010, the Sustainable value creation initiative held a seminar with an opening speech by Carl-Henric Svanberg, followed by a round table discussion with a focus on sustainable value creation at the companies.

In spring 2011, the 100 largest companies on the NASDAQ OMX Stockholm participated in a second survey with questions about responsible and sustainable business activities.

### Sustainable value creation initiative receives award

In March 2011, the Sustainable value creation initiative received the Teamwork of the year award at the Financial Hearing Awards. The investors behind the Sustainable value creation initiative shared the prize with the Capital markets day in Shanghai.

Read more on the Sustainable value creation initiative's website: [www.svcinitiative.com](http://www.svcinitiative.com)



## Board members' dealings

Following a seminar on the NASDAQ OMX Stockholm on criminality among board members, the issue was discussed in several nominating committees. One of the questions highlighted was how shareholders should act to ensure that they have correct and sufficient information about the people they nominate for boards.

AP4 therefore invited institutional shareholders to a discussion, with a view to agreeing if possible on how the assessment of board member dealings can be addressed in nominating committees. A lot can be gained from developing best practice in this area. The reputations of the companies and shareholders alike are at stake if boards include individuals with a dubious past.

The meeting commenced with the head of legal and market surveillance of NASDAQ OMX's European stock market operations providing an account of how the stock exchange manages the inspection of board members' dealings.

This interesting discussion resulted in the NASDAQ OMX, in its Q&A for listed companies, adding a requirement for companies to inform the nominating committee if a board member has a criminal record. The advantage of this solution is that the shareholders on the nominating committee do not need to deal with sensitive information and request information from the criminal register. This task is now the responsibility of the companies.

## Swedish institutional investors' association

Institutionella ägares förening (IÄF), the Swedish institutional investors' association for regulatory issues in the stock market is an association with 14 of the largest institutional shareholders in Sweden, 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 IIA was formed to facilitate collaboration on developing good practice in corporate governance, and to nominate members to the self-regulatory bodies to influence, for instance, the development of *the Swedish Code of Corporate Governance (the Code)*. This is vital work that influences the development of and confidence in the Swedish stock market and publicly traded companies.

Work is under way in the EU to harmonise corporate governance. In 2010, the Green Paper on Corporate Governance in Financial Companies was presented. The IIA has submitted its comments requested by the EU Commission on the proposed green paper.

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

# International cooperation

### Principles for Responsible Investment (PRI)

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 ethical and environmental issues, and the PRI serves as a framework for investors in their daily tasks of integrating ESG issues into asset management and 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 to contributing to driving developments in the ESG area, the PRI also helps to increase contacts and knowledge exchange on ESG issues between responsible investors around the world.

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

PRI's six principles	
1	incorporate ESG issues into investment analysis and decision-making processes
2	be an active owner and incorporate ESG issues in the Fund's ownership policies and practices
3	seek appropriate disclosure on ESG issues by the entities in which the Fund invests
4	promote acceptance and implementation of the Principles within the investment industry
5	work together to enhance our effectiveness in implementing the Principles
6	report on the Fund's activities and progress implementing the Principles

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

### Carbon Disclosure Project (CDP)

The Carbon Disclosure Project (CDP) is an international collaborative project to reduce companies' impact 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 emissions. 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 on and disclosure of emissions of greenhouse gases.

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

### Extractive Industries Transparency Initiative (EITI)

The Extractive Industries Transparency Initiative (EITI) is an initiative for transparent disclosure in extraction industries. 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 from 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 control.

Together with other international investors, the Fund supports EITI, which sends a message 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 (ICGN)

The International Corporate Governance Network (ICGN) is a global cooperation to raise the standard 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. It 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 website: [www.icgn.org](http://www.icgn.org)

### Institutional Investors Group on Climate Change (IIGCC)

The Fund is a member of the Institutional Investors Group on Climate Change (IIGCC), which collaborates on climate change issues for European investors. The goal is to raise the investors' voices 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)

### Anti-corruption

The Fund has participated in an initiative focused on corruption through the Ethical Council and alongside a couple of large mutual funds. A fundamental analysis has been performed of a number of companies in terms of their actions to prevent corruption. The analysis resulted in around 20 companies being contacted.

# List of companies excluded from AP4's investment universe, 30 June 2011.

## Companies excluded 30/06/2011

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>3</sup> website: [www.ethicalcouncil.com](http://www.ethicalcouncil.com)

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

<sup>3</sup> The Ethical Council is a collaborative effort of AP1, AP2, AP3 and AP4.







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