

Fund Governance Report 2015

The Fourth Swedish National Pension Fund (AP4) total return in 2015 amounted to 6.8 percent after expenses. Fund capital increased to SEK 310 billion. All investment horizons contributed positively to the Fund's performance. Active management outperformed the Index for the seventh consecutive year.

The Business

The Fourth AP Fund (AP4) assets are state funds allocated by law for such special management referred to in Chapter 9. § 8 of the Constitution of Sweden. AP4 is a government agency and business activities are regulated in governmental law (2000:192) regarding the public pension funds (hereinafter "LAP"). The implication of the law is that AP4's funds may only be utilized by the State to finance income-related retirement pension, unless Parliament resolves otherwise.

AP4 shall independently formulate its objectives and strategies. AP4's Board of Directors and business operations are by law not to be controlled by government directives or by business policy or economic political interests. Environmental and ethical issues must be accounted for without compromising the goal of the best possible return.

The difference between the AP funds and other government agencies are significant. For example, the AP Funds are more independent than most other agencies. Laws regulate the AP Funds' business activities, and the Funds have their own boards that are responsible for the business. External auditors audit the AP Funds. The government adopts annually the AP Funds' income statement and balance sheet. On behalf of the government the AP Funds are also evaluated every year resulting in a report to parliament.

AP4 is a government agency and in many aspects the Swedish Code of Corporate Governance is not applicable to the Fund because of the significant differences between public and corporate law. Therefore, the Fund Governance report is limited to the elements that may be considered relevant to AP4.

The Board

AP4's Board of Directors shall consist of nine members and no deputies. The government appoints members, of which one member is proposed by the employers' organization and two members are proposed by the employees' organizations. The government appoints the chairman and vice chairman from among the members not nominated by the employee/employer organizations.

Board Directors

On January 22, 2015 Göran Zettergren and Heléne Fritzon were appointed as new members of the Board following Helene Hellmark Knutsson and Roger Mörtvik who during the fall of 2014 declined re-election.

The government ruled on May 30, 2015 that all of the Fund's Board members be re-elected. The board members are Monica Caneman, Chairman, Jakob Grinbaum, Vice Chairman, Ing-Marie Gren, Stefan Lundbergh, Sven Hegelund, Erica Sjölander, Maj-Charlotte Wallin, Göran Zettergren and Heléne Fritzon.

Remuneration committee

Since 2010, the board has a Remuneration Committee consisting of three members. The committee's task is to advise the Board and prepare remuneration issues as regards the CEO and senior management. The Remuneration Committee also addresses issues relating to AP4's remuneration principles and other terms of employment for all employees.

Risk committee

In late 2012, the Board established a Risk Committee consisting of three members. The committee's task is to further improve communication and understanding of the business' financial risks. The Risk Committee was established when the Board delegated an extended mandate to the Strategic management.

Remuneration

The government determines the Board members' fees. Full-year remuneration amounted to SEK 100 000 for the Chairman, SEK 75 000 for the Vice Chairman and SEK 50 000 for each of the other members. The compensation for the Risk Committee and Remuneration Committee is SEK 50 000 each allocated equally between their respective three members.

In addition to the regular remuneration, the Chairman received SEK 40 000 for representing AP4 in Nordea's Nomination Committee during the year.

The Board's mandate applies until that time AP4's balance sheet and income statement for 2015 have been adopted. AP4's Board members are presented in more detail in AP4's annual report and on www.ap4.se.

Rules of Procedure

The Board is responsible for AP4's organization and the management of the Fund's assets. The Board establishes guidelines for its work as well as instructions for the CEO. These basic documents, together with ethical guidelines for employees and rules regarding own transactions with financial instruments, are revised annually.

The Board's work 2015

During the business year, the Board held seven formal protocolled meetings. As shown in the table below, attendance remained high and averaged 89 percent. During the autumn/winter the Board conducted an evaluation of their work. The CEO and other employees of AP4 attended the meetings as presenters and as Board secretary.

The focus of the Boards work in 2015 continued to be the Pension Group's proposals regarding changes in the pension fund system and AP4's response submitted at the end of October 2015. The Boards work also focused on AP4's sustainability strategies and low carbon strategies and investments, monitoring of AP4's strategic investments and follow-up of AP4's regulatory framework.

Between Board meetings the CEO usually writes information memos in order to provide the Board with continuous information.

In November the board established an action plan for the coming year in accordance with the Rules of Procedure.

Management

AP4's Board of Directors has delegated responsibility for the ongoing management to the CEO. The CEO has a management team to support decision-making, and at the end of 2015 consisted of the CEO and six employees. The management team as per December 31, 2015 is presented in the annual report found at www.ap4.se.

Employee Compensation

The Board, through the Remuneration Committee, determines the terms of employment of the CEO. All employees have individual employment contracts. The Board has adopted a policy for remuneration and other employment terms.

The total compensation for an employee consists of a fixed salary, variable salary, pension and other benefits.

Variable compensation is only paid if AP4 demonstrates a positive total comprehensive income for the year, and may amount to a maximum of two months of their salary. Variable compensation can be attained when clear and measurable objectives have been achieved. Variable compensation is based on group-oriented quantitative targets and the individual employee's measurable contribution, determined over a rolling three-year period. The CEO, senior management and those

responsible for compliance do not receive any variable remuneration.

Other benefits constitute a very limited value and are offered to all employees. Examples include health insurance, group insurance and fitness contributions. AP4 also has four parking spaces that employees can use whereupon they are taxed on the benefit.

Details of the remuneration levels for the CEO, management team and other employees, and the outcome of variable salaries for 2015 are detailed in Note 6 of AP4's annual report. Furthermore, AP4's work with remuneration issues is presented under the section "Remuneration at AP4" in the Annual Report.

Policies

Since 2012 the First, Second, Third, Fourth, Sixth and Seventh AP Funds have had a common policy for remuneration terms and conditions, employee benefits, representation and travel that have been adopted by the respective National Pension Fund Boards. The common overall policy complements AP4's more detailed, internal, personnel policies and guidelines.

Audit

The government appoints AP4's auditors. Peter Nilsson PwC AB held the appointment in 2015. The assignment applies until the Fund's 2015 income statement and balance sheet are adopted, and also involves a special appointment for PwC AB to coordinate the audit of the AP Funds. The auditors submit a report on their audit, and they report directly to the Board partly through a written audit report and partly by oral presentation. The auditors attend at least one Board meeting per year. The auditors also report orally to the Finance Ministry annually.

Internal Audit

AP4's Board adopts an investment policy and a risk management plan for the business operations on an annual basis. Together with LAP, these governing documents form a framework for the Fund's risk tolerance.

The risk and investment strategy has been modeled in relation to AP4's overall goal to create the best possible return over time, thus contributing to the stability of the pension system.

- The investment policy describes, among other things, AP4's management focus through Board resolutions for the Normal portfolio (the reference portfolio), return target, risk profile and risk mandates for the Strategic and Tactical management. These constitute a general framework for the business.
- The risk management policy describes the division of responsibilities and authority for investment decisions, the principal operational risks and the monitoring and control of the same. The main risks are financial and operational risks.

The Board appoints a risk committee that works to further improve the communication and understanding of the business' financial risks.

Three Lines of Defense

AP4's day-to-day risk management and control is decentralized from all operational elements of the organization. It follows the principle of three lines of defense. This principle distinguishes between the functions that own the risks (first line), functions for the monitoring, control and compliance (second line) and functions for independent audits (third line).

Financial and operational risks are monitored and controlled in an independent unit, Business and Risk Control (second line of defense). The unit reports directly to the CEO and the Board.

The unit establishes the risk processes and provides methods for risk identification, risk quantification, risk analysis and the reporting of both financial and operational risks. Business and Risk Control has the task to ensure that regulatory investment policies, investment management policies and risk management policies, together with other decisions by the CEO, are complied with.

Business and Risk Control is separated into three functions: risk control, risk analysis and compliance.

The **Risk Control** function is responsible for monitoring and controlling financial risks such as credit- and liquidity risks. The function is also responsible for monitoring operational risks in the management organization, and to otherwise ensure compliance with the rules relating to these risks.

The **Risk analysis function** is responsible for analyzing, controlling and reporting, primarily of market risks.

The **Compliance function** audits the operations based on compliance with rules, laws and other regulations and policies, instructions and internal rules, including ethical guidelines.

Other Information

A more detailed description of various financial and operational risks is provided in the section Risk Management in Three Steps, as well as in Note 20 of AP4's Annual Report 2015. The report is available at www.ap4.se.

2015 BOARD MEETINGS

	Feb 18	Apr 14	Jun 11	Jul 10 (telecon)	Aug 20	Oct 14	Nov 24	Remuneration, Tkr
Monica Caneman, Chairman ¹	x	x	x	x	x	x	x	117
Jakob Grinbaum, vice Chairman ²	x	x	x	x	x	x	x	91
Ing-Marie Gren, Director ²	x	x	x	x	-	x	x	67
Stefan Lundbergh, Director ²	x	x	x	x	x	x	x	67
Maj-Charlotte Wallin, Director ¹	x	x	x	x	x	x	x	67
Heléne Fritzon, Director	x	x	-	x	x	-	x	50
Göran Zettergren, Director	x	x	x	x	x	x	x	50
Sven Hegelund, Director ¹	x	x	x	x	x	x	x	67
Erica Sjölander, Director	x	x	-	x	x	x	x	50

¹ Remuneration includes compensation from the Remuneration committee.

² Remuneration includes compensation from the Risk Committee.