



**THE ETHICAL COUNCIL OF THE  
AP FUNDS ANNUAL REPORT 2016**

 **ethical council**

A COLLABORATION BETWEEN  
FIRST-FOURTH AP-FUNDS





**Dialogues make a difference, page 10**

The Ethical Council of the AP Funds' point of departure is that the AP Funds should not invest in companies which can be linked to systematic violations of international conventions ratified by Sweden.



**Increased sustainability for palm oil, page 24**

The Ethical Council of the AP Funds has participated for a number of years in a collaboration between international investors, coordinated through the UN Principles for Responsible Investment (PRI), which works for greater sustainability in palm oil production.



**An industry facing major challenges, page 26**

The Ethical Council of the AP Funds receives many questions about mining companies and mines around the world. The mining industry is facing major challenges on several levels, but is a key element in both the global economy and Swedish industry.

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# THE ETHICAL COUNCIL OF THE AP FUNDS IN BRIEF

The Ethical Council is a collaboration between the First, Second, Third and Fourth AP Fund, which have a mandate from the Swedish Parliament to create a high return at a low risk for current and future pensioners. The Ethical Council works to contribute in a positive way to the AP Funds' long-term returns by encouraging corporate social responsibility in business as regards environmental and social issues.

The four AP Funds are long-term, responsible and committed owners, that want to encourage the companies to take responsibility. It is the AP Funds' view that over time, well-managed companies provide higher returns at lower risk. The collaboration in the Ethical Council of the AP Funds therefore aims to contribute in a positive way to long-term returns by exerting influence on companies and industries to pursue sustainable value creation. The Ethical Council of the AP Funds cooperates with regard to the companies in the Funds' portfolios of listed equities, especially the non-Swedish holdings.

**PROACTIVE COOPERATION**  
– promotes sustainability in companies

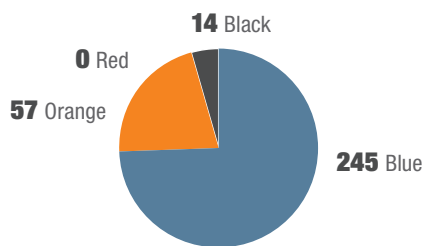
**DIALOGUES AND MEETINGS IN THE EVENT OF INCIDENTS**  
– where international conventions are violated

**EXPERIENCE EXCHANGE**  
– between companies and investors

## THE ETHICAL COUNCIL'S DIALOGUES 2016

### Status of company dialogues

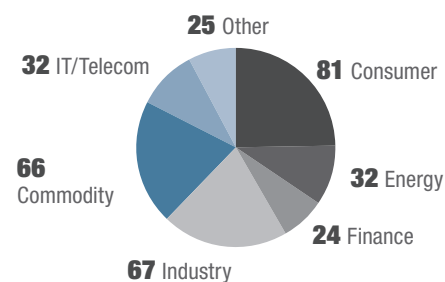
Total of 316 companies



A description of the colour coding can be found on page 10.

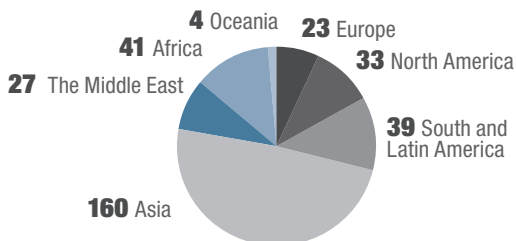
### Sectors

Total 327 events



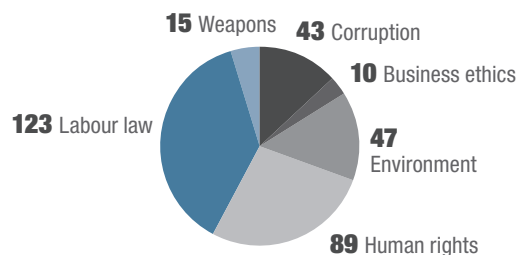
### Events per region

Total 327 events



### Number of events

Total 327 events



During 2016, the Ethical Council conducted proactive and reactive dialogues with 316 companies world-wide. In many cases, these dialogues involved more than one area of sustainability.

# STATEMENT FROM THE CHAIRWOMAN

## THE ETHICAL COUNCIL'S WORK CONTINUES TO EVOLVE

**The First, Second, Third and Fourth AP Fund decided in 2007 to jointly conduct dialogues on ethical and environmental issues with their non-Swedish, listed holdings. This collaboration has been on-going for 10 years, and although the purpose of the Ethical Council of the AP Funds remains the same, much has happened. This is true for how we work within the Ethical Council, but perhaps more importantly, it is true for how companies today address these issues.**

When the Ethical Council began its work, its activities mainly comprised reactive dialogues. Today, we still work with reactive dialogues but most of the Ethical Council's time and resources are allocated to proactive work, encouraging companies to act and work responsibly, structured and systematically with sustainability, and to become more transparent in what they do. The goal is to prevent and minimise any incidents and problems in companies' operations. The Ethical Council's proactive work takes place primarily through industry and investor initiatives.

### **We prioritise and mobilise resources**

The number of areas that responsible investors can engage in is large and continuously growing. To become engaged in all areas and in all companies is not possible, and more importantly, not efficient. It is therefore better to prioritise.

The areas and companies that we choose to work with are selected on the basis of AP Funds' holdings, their mandate and values, but consideration is also given to our ability to make a positive difference. The choice of focus areas does not mean that other areas are less important. Rather, this is the result of a conscious strategy to allocate resources where we judge they are of most use.

In order to conduct more reactive dialogues – and dialogues that are more professional – we have chosen to enter into an enhanced collaboration with the ethics consultancy company GES Investment Services. The purpose of this deeper collaboration is to create a useful, efficient, high-quality process as regards monitoring, information gathering, and commitment.

### **Proactive projects**

For several years, the Ethical Council has been actively involved in a number of proactive projects. During the year, we have travelled to meet companies on site to discuss sustainability issues within the framework of these projects. In connection with PRI's annual meeting in Singapore, a representative of the Ethical Council, together with several other investors, visited palm oil

companies. During the autumn, members of the cocoa industry gathered at a conference in Abidjan in the Ivory Coast. Investors were also invited and one representative of the Ethical Council participated. In connection with the conference, visits to, and individual meetings with, cocoa companies were organised.

### **Climate in focus**

In 2016, the issue of climate was also the focus of the Ethical Council's efforts in many of the company dialogues we conducted, but also through our involvement in the Institutional Investors Group on Climate Change (IIGCC). Together with several other investors, the four AP Funds wrote a letter to G20 member governments where we included a recommendation that they ratify the Paris Agreement.

In 2015, all AP Funds agreed on a standardised reporting method for carbon footprints. It is gratifying to note that more and more Swedish and non-Swedish investors are welcoming the initiative and now report in the same way as the AP Funds. In this way, we have been able to contribute to a higher degree of standardisation amongst investors.

### **Re-inclusion and exclusion**

In 2016, the Ethical Council recommended the AP Funds to exclude one company, Zijin Mining, and re-include one company, Singapore Technologies.

Zijin Mining was excluded because the company can be linked to serious, negative environmental impacts which contravene the UN Convention on Biological Diversity. The exclusion was made on the recommendation of Ethical Council of the AP Funds as dialogue with the company did not lead to the desired result.

Singapore Technologies was the first company that the AP Funds excluded on the basis of their links to violations of the UN Conventions on Anti-Personnel Landmines and Cluster Munitions. After reviewing the company's operations, the Ethical Council found that it could no longer be linked to violations of these conventions and

**“The number of areas that responsible investors can engage in is large and continuously growing.”**



the Ethical Council therefore recommended the AP Funds to re-include the company. Both recommendations were followed by the four AP Funds.

### **Companies' tax management – a sustainability issue**

How companies manage tax has been a much discussed issue recently. It is a complex sustainability issue involving tax regulations and tax authorities in many countries. In order to stimulate a healthy dialogue on tax issues, the Ethical Council invited Swedish companies and investors to a seminar on company taxes in November 2016.

### **Cooperation on corporate governance**

The point of departure for the Ethical Council's work is company dialogues related to ethical and environmental issues. During 2016, this cooperation was expanded to include certain issues relating to corporate governance. This progression is natural since questions concerning ethics, the environment and corporate governance often go hand-in-hand. Which issues and companies the Ethical Council considers suitable for this cooperation will be decided on a case-by-case basis.

### **Further development of core values**

During the year, the Ethical Council continued working on the core values which form the basis of the Ethical Council's work with sustainability and now corporate governance as well. As a part of the Swedish pension system, these core values build upon the core values of the Swedish state, where democracy and sustainable development are central parts in accordance with the wording of the constitution. The Ethical Council's core values also build on the international conventions ratified by Sweden. You can read about these core values in their entirety on page 7.

### **Implementation of the "Ruggie Principles"**

The Ethical Council has started a project for the implementation of the UN Guiding Principles on Business and Human Rights, the so-called "Ruggie Principles". The focus has been to identify a structure that makes it possible for the Ethical Council to define a reasonable approach to these principles. The project will continue throughout 2017.



### **The UN's Sustainable Development Goals, Agenda 2030**

The AP Funds work in different ways to contribute to the UN's 17 sustainable development goals and report on this in their respective annual reports and/or sustainability reports. During 2017, the Ethical Council will select a few areas based on these goals which are suitable for prioritisation, and conduct company dialogues related to these.

In the Annual Report for 2016, the Ethical Council has further increased transparency in the dialogues, and we welcome continued dialogue with companies, NGOs, and other stakeholders regarding how we can further improve our reporting.

I would like to take this opportunity to thank my colleagues on the Ethical Council for this past year, and extend warm wishes to Peter Lundkvist of the Third AP Fund as he takes over as Chair in 2017.

Gothenburg, January 2017

**ULRIKA DANIELSON**  
Ethical Council Chair, 2016

# STATEMENT FROM THE SECRETARY GENERAL

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## 10 YEARS IN RETROSPECT; LOOKING AHEAD 10 YEARS

The Ethical Council of the AP Funds will celebrate its 10-year anniversary in 2017, and much has happened in the area of responsible investment during this time. In 2007, the UN's PRI project for responsible investment had just begun, and the AP Funds were among the first institutions to sign up to the six principles. Today, the PRI has approximately 1,600 signatories from virtually the entire global financial sector.

### So what has happened over the last ten years?

The point of departure for the AP Funds and the Ethical Council has always been to resolve problems, and in the long-term improve companies' work with regard to the environment, ethics, and human rights in order to contribute to better handling of the global challenges we all face. We are convinced that they will become better investments in the long-term if this happens. Initially, there was resistance. The traditional view of so-called ethical investments has been to exclude, and "naming and shaming."

Reality, however, is different. The primary development over the last ten years is that listed companies world-wide have developed relations with their owners, the institutional capital. I remember how a conference call was ten years ago. A number of lawyers let you know they were on the line and then you spoke with someone from investor relations who was not familiar with the problem. Today, we most often speak directly with the person or group responsible for the problem area or the project where improvement is needed. If we notice that there are not enough resources or if motivation is lacking, we escalate the problem up through the company hierarchy to bring about the improvements.

### Responsibility and sustainability pay off

Many of the companies where the AP Funds have investments have become much better at taking responsibility for their operations. They are not perfect – there are no perfect companies. But insight into and understanding of the challenges we face has changed fundamentally. The Ethical Council of the AP Funds has been repeating the same message for ten years – that responsibility and sustainability pay off in the long-term – in dialogues with hundreds of companies. Has it mattered? I am convinced that it has, but we haven't carried the torch alone. Media, authorities, civil society, and not least, the companies' own employees have all been watching businesses and making similar demands. Our experience has been that when we all pull together in the same direction, healthy, long-lasting change becomes possible. This is how we need to work.

### And in ten years?

The world is constantly evolving. As I write this during the winter of 2016/2017, the world is still perplexed by the outcome of the American presidential election and the Brexit referendum. Whether this reflects a protest against globalisation, or a longing for the return of well-paid factory or coal-mining jobs, I don't want to speculate over. Neither do I want to predict how it will turn out, but my desk is overflowing with reports about digitalisation that is destroying old structures, robotics in all its many forms, an energy transition to a society that uses little fossil fuel, and hopefully nothing gets in the way of this trend. I believe it is difficult to stop these developments.

### The UN Guiding Principles

During the autumn, I participated at a conference on the UN Guiding Principles for Business and Human Rights, teeming with representatives from business and civil society, and investors. Professor John Ruggie, the individual responsible for drafting the framework, asked bluntly during the conference: Where are the states?

Nation states are under pressure; both the USA and the United Kingdom are currently preparing to lower taxes on businesses, and they are not alone. At the same time, it is my experience and the experience of many others that regulatory authorities are needed more than ever if we are to eradicate corruption, poverty, child labour, etc. I am convinced that we need more global collaboration to steer this in the right direction.

The Ethical Council of the AP Funds will continue to work to ensure that the investments that the AP Funds make are responsible, and we will continue to work for greater global collaboration – not less. I hope that you, like me, are looking forward to the next ten years – it's going to be exciting!

Stockholm, January 2017

**JOHN HOWCHIN**  
Ethical Council's Secretary General



# CORE VALUES

## THE AP FUNDS' CORE VALUES FOR SUSTAINABILITY AND CORPORATE GOVERNANCE

The mandate of the First, Second, Third and Fourth AP Fund is to create high long-term returns at a low risk, thereby contributing to secure pensions for current and future Swedish pensioners. It is the AP Funds' view that high long-term returns at a low risk can be achieved if consideration of sustainability is included in the business, the AP Funds' own organisation as well as in the investment process.

The core values of the AP Funds and the Ethical Council as they relate to environmental factors and ethical dimensions in business, are based on the principles of commitment, action and change in order to make a positive difference.

The Ethical Council makes a positive difference by proactively working for sustainable development within areas that promote high long-term returns, and through involvement with companies where problems are identified, assessed as substantial, and well-documented. This is a responsible and ethical approach. The goal of the Ethical Council's sustainability efforts is to create and protect value for the benefit of the pension system.

As a part of the Swedish pension system, the core values of the First, Second, Third and Fourth AP Fund build on the core values of the Swedish state, where democracy and sustainable development are central parts in accordance with the wording of the constitution. The AP Funds' core values also build on the international conventions ratified by Sweden.

It is the opinion of the AP Funds that those companies in which the AP Funds invest are themselves responsible for ensuring that they do not contribute to violations of international conventions, whether these target nation states, individuals, or companies and organisations. This responsibility also applies even if countries where

### Sustainable development is central to the AP Funds' framework. The framework consists of:

- **The Swedish constitution**, which is built on democracy, fundamental rights and freedoms, the equal value of all human beings, and the right of all individuals to be free and live with dignity.
- **UN international conventions** which Sweden has ratified regarding the environment, human rights, labour law, corruption and inhumane weapons, etc.
- **International guidelines** that Sweden supports, for example, the UN Global Compact, ILO and OECD guidelines for multinational companies.
- **Sweden's position** on international legal issues.

companies are active have not ratified conventions, or where regulation is weak.

In those cases where Sweden supports a new convention or a revision to an existing convention, but where formal ratification has not yet occurred, the AP Funds will act as though ratification were already in place. The AP Funds will continuously monitor the progress of the ratification process of the new or revised conventions. If Sweden has not ratified a convention within a three-year period from the point when Sweden originally supported the same, then the AP Funds can review the basis for their policies in those questions affected by the new or revised conventions.

The AP Funds' work with sustainability and corporate governance is conducted in such a way as to create and protect value for current and future Swedish pensioners. The AP Funds make a difference by working proactively for sustainable development, by taking action, and by making demands for transparency and positive change. This contributes to the AP Funds' ability to fulfil their mandate.

### The Ethical Council is involved in industries and companies where:

- **Serious and systematic problems** in the industry have been identified.
- **Violations of international conventions** have been identified, assessed as substantial, and well-documented.
- **A company's circumstances** are of such a serious and systematic nature that a dialogue is justified.

# WORK PROCESS

## ETHICAL COUNCIL'S WORK PROCESS

The Ethical Council contributes to reducing risk and increasing the long-term returns from the AP Funds' investments. The work of the Ethical Council is based on the principles of commitment, action and change, where the objective is to be long-term, responsible, committed owners. It is through our commitment as owners that the AP Funds can influence companies to run their operations in a sustainable way.

Steps in the work process	Proactive dialogues	Reactive dialogues (In the event of suspected violation of conventions)
<b>1</b> Screening of the AP Funds' company holdings	The Ethical Council systematically monitors around 4,000 companies. Media, other investors, interest organisations and UN organs constitute some of the sources.	
<b>2</b> In-depth review	The Ethical Council conducts an inventory and overall analysis of companies, industries, problem areas and investor initiatives.	Around 100-300 companies are audited in-depth annually for suspected association to violation of international conventions.  Audits are conducted by GES Investment Services on behalf of the AP Funds and around one hundred other investors.
<b>3</b> Choice of company for a dialogue and objective for the dialogue	The Ethical Council selects companies and potential proactive projects. The choice of focus areas does not entail taking a basic position that certain areas are less important, but rather a deliberate strategy to apply the Ethical Council's resources where they are deemed to be of most use.	With the help of GES Investment Services, the Ethical Council conducts dialogues with companies where problems are substantial and well-documented.  The Ethical Council also cooperates with other investors to conduct dialogues with companies relating to alleged violations of conventions. By way of exception, the Ethical Council conducts dialogues independently.
<b>4</b> Dialogue work	In-depth company analyses and possible comparisons are made regarding minimum requirements and best practices for respective industries.	Further steps are taken to exert pressure, often in cooperation with other investors, by submitting shareholder proposals at AGMs and voting at AGMs.
<b>5A</b> The objective of the dialogue has been achieved	The dialogue is concluded.	The dialogue is concluded. Special monitoring of the company is conducted for five years.
<b>5B</b> The objective of the dialogue has not been achieved	The dialogue continues.	If the Ethical Council's dialogue has not yielded the desired result after a maximum of four years, the Ethical Council recommends the AP Funds to divest holdings in the company. A divestment decision is made by each AP Fund individually. The Ethical Council checks annually if the situation has changed and whether the company conducts business in line with international conventions.



# “WE HAVE AN IMPORTANT ROLE TO PLAY”

## John Howchin, the Ethical Council works with dialogue as a way to influence – why?

“Historically, the finance industry’s view of corporate governance has been focused on divesting as a way to influence companies. However, analyses show that this method is not effective. If we do not invest in a company, there are other investors who will. We believe that to influence through dialogue is a clearer and more effective way to take responsibility as an owner.”

## How does a dialogue work?

“A dialogue can be opened either as a reaction to a specific event or when contemporary social and environmental analyses direct our attention to a company. The dialogue itself often begins with a mail conversation, for example, with the sustainability manager or investor relations. We request facts and information, which we then follow-up in the next step via telephone or in a meeting. We establish goals for what we want to achieve with the dialogue. This continues until the incident has ended or the company has taken action.”



## And if this doesn’t happen?

“As a last resort, we can choose exclusion, but this rarely happens.”

## Does the Ethical Council always act on its own accord?

“Sometimes we pursue an issue together with other investors, but we can just as easily act independently. We cooperate often with other investors through our ethical consultant GES Investment Services. I would go so far as to say that we have a major role to play here, as we are perceived as serious, long-term and professional by non-Swedish companies and actors. It is not that common that investors work with as much commitment as the Ethical Council does.”

## To what degree does the Ethical Council pursue change within the area of sustainability?

“We are sometimes criticised for being passive, since various actors think we should be more dynamic when it comes to sustainability issues. But the AP Funds’ role is not to take an active political position; that’s up to the lawmakers and the politicians. Our role is first and foremost to ensure good returns on our capital in the long-term, while at the same time taking responsibility for ethics and the environment.”

## Do you see any change in the attitudes of companies toward dialogue relating to these issues?

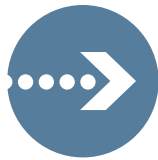
“Yes, my impression is that companies are realising to a much greater extent that these are important issues. The world outside is pushing for greater transparency and companies have to live up to this. I also believe that the Ethical Council has become more knowledgeable and hence better at conducting these dialogues.”



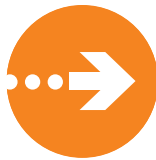
# COMPANY DIALOGUES

## SUSTAINABILITY DISCUSSIONS WORLD-WIDE

During 2016, the Ethical Council conducted proactive and reactive dialogues with 316 companies world-wide. In many cases, the dialogues involved more than one area of sustainability. The categorisation below describes the status of the dialogues.



**Proactive dialogue**  
A proactive dialogue that the Ethical Council has conducted with a company during the year or a dialogue relating to an incident that the company addressed adequately during the year. A total of 245 companies at the end of 2016.



**Commenced dialogue**  
A dialogue that the Ethical Council has conducted during the year due to an incident that occurred or where the company is part of a proactive project and where the Ethical Council believes the company has steps yet to take. Consequently, dialogues with these companies will continue. A total of 57 companies at the end of 2016.

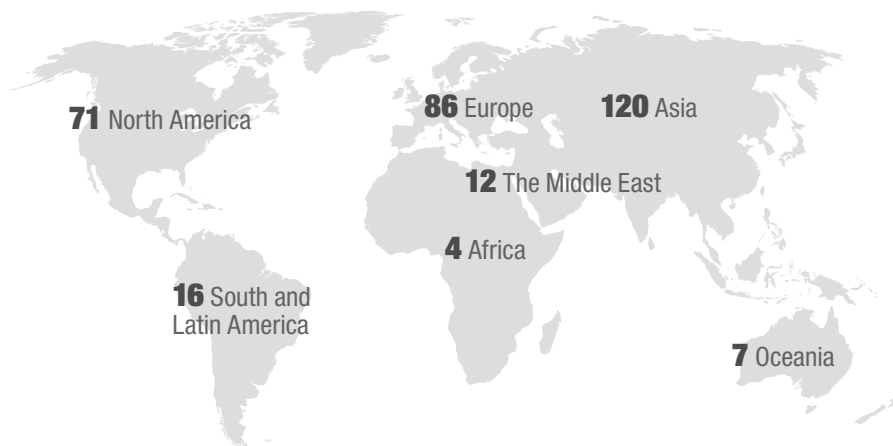


**Time-limited dialogue**  
A dialogue with a company where violations of a convention are verified. This company dialogue is time-limited and should last a maximum of four years. If the dialogue has not led to improvement after this time, the Ethical Council recommends the AP Funds to divest holdings in the company. There were no companies categorised red at the end of 2016.



**Excluded company**  
Companies that the Ethical Council has recommended the AP Funds to divest. The Ethical Council investigates annually whether the violation of international conventions that caused the divestment remain. The Ethical Council has recommended the AP Funds to exclude 14 companies. All recommendations of exclusions have been followed by the AP Funds.

### Company dialogues world-wide





# IMPROVEMENT DIALOGUES

The Ethical Council of the AP Funds' point of departure is that the AP Funds should not invest in companies which can be linked to systematic violations of international conventions ratified by Sweden. If systematic violations are reported, the Ethical Council commits to bringing about improvements in the company so that the violations cease. The following is a description of a number of the dialogues that the Ethical Council is conducting.

## THAI UNION GROUP – NESTLÉ

The prevalence of systematic forced labour and slavery in the Thai fishing industry has led to comprehensive actions from government authorities and the companies concerned.



Human rights violations in Thailand's fishing industry have been the focus of media and government authorities around the world. Fishing and fish processing companies have used forced labour and slavery in a vast and complex supply chain. The serious violations of human rights have led government authorities and branch actors to take measures to prevent further violations.

In November 2015, the government of Thailand adopted a new royal decree on the fishing industry and introduced monitoring and control measures for transshipments at sea. The government has also conducted a nation-wide survey of every fishing vessel flying the Thai flag, thus creating an updated database of 42,000 vessels which comprises the country's fishing fleet. The purpose of the new regulations is to give authorities powers to

combat illegal, unregulated and unreported fishing, and human trafficking. As a result of these measures, the US Department of the Interior upgraded Thailand in June 2016 from its position as the lowest ranking in the Department's

**“The Ethical Council has also continued dialogue with the Thai Union Group which has a strong focus on efforts to combat illegal fishing and forced labour.”**

annual report on human trafficking. However, development of technical resources to control fishing vessels only constitutes a first step toward introducing improvements over earlier systems.

In 2016, the Ethical Council followed up on discussions with Nestlé. The company is participating in the ILO's Working Group composed of representatives of the Thai government, local suppliers and international buyers. The group has developed a training programme for factories and fish farmers which aims to identify and end the incidence of forced and child labour in the supply chain. During the year, the training programme was introduced to a number of harbour and boat workers and the focus included handling of grievances.

The Ethical Council has also continued dialogue with the Thai Union Group which has a strong focus on efforts to combat illegal fishing and forced labour. The company is currently involved in discussions with the governments of Thailand and Vietnam regarding how labour migration of citizens can occur in the safest possible manner.

# VINCI

The situation concerning debt bondage for the constructions workers who have travelled to Qatar to build arenas to be used in the FIFA World cup is improving slowly, but much work remains to be done.



In March 2015, the French construction company **Vinci** was accused of using forced labour and threatening workers to stop their demands for better conditions at construction sites in Qatar, where **Vinci** operates through its subsidiary QDVC (where they own 49 percent).

Although **Vinci** has denied the accusations, the company has allowed for an external investigation of its impact on human rights (Human Rights Impact Assessment) in its Qatar operations. The assessment revealed that although QDVC has a satisfactory system in place, the recruitment process – where guest labourers paid illegal recruitment fees before arriving in Qatar – as well as the working and living conditions of subcontractors, was substandard.

During 2016, **Vinci** has supplied the Ethical Council with information about measures taken as a result of the assessment. For example, the company has started cooperating with recruitment organisations and governments in migrant workers’ home countries to overcome the problem of illegal recruitment fees and to establish a

process to help workers with debt restructuring.

Additionally, **Vinci** announced in September that they had adopted new guidelines on human rights that will apply to the company’s operations world-wide, including subcontractors. The company is currently working locally with its subcontractors to implement the guidelines. These measures are particularly

**“Vinci has addressed human rights and occupational health and safety legal issues...”**

relevant given the conclusions and recommendations from the International Labour Organisation (ILO). They sent a three person delegation to Qatar in March 2016 following a complaint that the country does not comply with the ILO’s Forced Labour Convention. The delegation was able to state that problems with working conditions are commonplace in small companies operating

as subcontractors. Furthermore, the delegation stressed the importance of cooperation between Qatar and the home countries of guest workers to tackle the issue of the high recruitment fees that workers pay.

The new Kafala law which came into force in December 2016, despite effecting better conditions for many guest labourers in Qatar, will have less significance for **Vinci’s** workers. For example, the new law facilitates guest workers being able to change jobs or leave the country without the consent of their employers. **Vinci** is already issuing such certificates to its workers with no questions asked – a principle which has been unusual among other companies.

**Vinci** has addressed human rights and occupational health and safety legal issues in Qatar, and their efforts have not gone unnoticed. Amnesty International has noted that **Vinci** is one of the companies that has demonstrated real interest in improving the situation for its guest workers.

However, the work must continue and the Ethical Council plans to follow-up the dialogue with **Vinci** in 2017.



# MATTEL

Supply chains for some of the world's largest brand names and companies remain in focus. An area the Ethical Council works with on an on-going basis.



The Ethical Council has been engaged in dialogue with toy manufacturer **Mattel** for several years with regard to the company's subcontractors in China, and the persistent reports on poor working conditions. The company is not alone in being the target of these allegations. Similar companies, such as Hasbro and Walt Disney Co., have also drawn attention in the same and comparable reports. This shows that the problem is pervasive throughout the industry in China. In addition to the companies, it is primarily the interest organisations behind the reports, i.e. China Labour Watch, SACOM and ICTI Care, who are participating in the debate. ICTI Care is an industry-supported, third-party organisation focusing

on improving ethics- and sustainability-related standards within the global toy and entertainment industry supply chain. Leading toy manufacturers are represented on the Board of ICTI Care and make use of their programme for a large

**“Hence increased transparency will continue to be one of the most important issues...”**

part of their audit and certification activities. However, ICTI Care's programme has also been the target of criticism and complaints, including for corruption and falsified audits.

**Mattel** has continued its efforts to improve guidelines for subcontractors, and has been open to other points of view and to reporting on the measures they are taking.

The Ethical Council is satisfied with the concrete improvements that **Mattel** has already achieved, and believes the company is on the right track.

Although **Mattel's** reporting had improved by the end of 2015, more needs to be done. Hence increased transparency will continue to be one of the most important issues to address in the company dialogue.

Additionally, the Ethical Council will follow developments within the Chinese toy industry in general and the cooperation between various parties.

# BHP/VALE (SAMARCO)

**A comprehensive action programme is in place to address the consequences of Brazil's largest environmental disaster through time, but much work remains to be done in the years ahead.**



The Fundão dam collapse in November 2015 resulted in 19 deaths, the complete devastation of the city of Bento Rodrigues, and a number of negative impacts along the entire 600 km length of the Rio Doce river as it makes its way to the ocean. The companies **BHP Billiton** and **Vale** have made extensive efforts to address both the immediate and long-term consequences of the dam catastrophe. In the basic agreement signed in March 2016 by the companies, the states of Minas Gerais and Espírito Santos, the federal government and the Federal Attorney General of Brazil, action programmes for socio-economic and environmental remediation were established.

The scope of these action programmes is extensive, as exemplified by the fact that the companies are still, one year later, handling compensation claims from those affected by the disaster. **Samarco** (jointly owned by BHP Billiton and

Vale) has prioritised the families directly affected by the collapse, identification of new locations for the three communities that must be rebuilt, and there is still support in the local community for resumption of mining operations as many livelihoods are dependent on the mine.

The measures have not yet reached those indirectly affected, located further away from operations, to the same extent. Much work remains to be done here.

Local prosecutors have filed charges against the companies and against individuals in respective companies (21 persons have been charged with premeditated murder) and are pushing for fines in the amount of USD 59 billion.

In August 2016, the investigation published its findings on the causes of the dam collapse, which showed that a series of errors and temporary reconstructions led to the accident in November 2015. After the disaster, **BHP Billiton** and **Vale** conducted

comprehensive internal investigations which resulted in changes to the management structure, and auditing and monitoring processes.

The collapse of the Fundão dam has had a major impact on the industry, as it followed on the heels of the previously publicised collapse of the Mount Polley tailing pond in 2014. The attention and the possible fines that companies risk facing has made the industry attentive to similarly-designed residual waste plants. The industry organisation, The International Council on Mining & Metals, has conducted a comprehensive investigation into similar facilities, even as many individual companies have conducted their own internal investigations. Hopefully, the work currently underway will limit the likelihood of dam collapses in the future.

The Ethical Council will remain committed to the action programmes and monitor developments.





## Adani

**Adani Ports and Special Economic Zone Ltd (APSEZ)** and **Adani Power**, former subsidiary of **Adani Enterprises**, are responsible for operation of the harbour and power plant in Mundra, India. The companies have for a long time failed to comply with environmental regulations, and taken advantage of unclear regulatory decisions which have allowed them to continue their operations. The local fishermen who have been directly impacted and deprived of their source of income have tried repeatedly to take **APSEZ** and **Adani Power** to court, but without success.

In October 2015, the Supreme Court in Gujarat (GHC) ruled that **APSEZ** and **Adani Power** must restore the damaged areas in Mundra and replant mangrove trees. None of the companies have chosen to comment on the court ruling or given any details about the impending replanting.

Since the court ruling, however, all three companies have updated their respective websites with information: **APSEZ** on the conservation of mangroves, **Adani Power** on handling of fly ash and **Adani Enterprises** on their views on sustainability including replanting and restoration of land habitats.

The Ethical Council will continue the company dialogues on the local population's situation and how to restore the mangrove swamps.



## Fast Retailing

After revelations about poor working conditions at the suppliers of Japanese clothing chain Uniqlo, the parent company **Fast Retailing**, in cooperation with the factories concerned, has implemented several improvement measures.

These measures include reduced overtime and payment of statutory overtime pay, as well as improved working conditions in factories by lowering the temperature, installing air conditioning, and repairing sanitation systems. According to the latest reports, there are still several issues that must be addressed or which have been inadequately addressed, such as the continuation of extensive, unpaid overtime, miscalculated wages, and fraud in connection with audits of social factors.

The Ethical Council will continue the dialogue with **Fast Retailing** and follow the company's efforts on these issues.





**JBS/Pilgrim's Pride**

In recent years, facilities for the production and processing of chickens owned by **Pilgrim's Pride** and other subsidiaries of **JBS SA**, have been fined repeatedly by authorities in the USA and Brazil. Among the health and safety violations identified by the US Occupational Safety and Health Administration (OSHA) at **Pilgrim's Prides** plants are: unsafe working conditions, deficiencies in testing and marking electrical equipment, deficiencies in implementation of satisfactory operational routines and processes with accurate instructions about safety features, exposure of workers to the risk of electrical shock, and failure to write referrals for work-related injuries in a timely manner. This has led to a number of fatal accidents at **Pilgrim's** facilities. The company has been fined several times. **JBS** has also been charged by Brazilian authorities in different states for various labour law violations at plants operated by subsidiaries in the country. Furthermore, child labour has been identified at one subsidiary.

The conclusions of the American and Brazilian authorities indicate that **JBS** and its subsidiaries systematically disregard their obligations and fail to take appropriate measures to respect the rights of workers and protect them from danger. The industry is marked by high health and safety risks, for example, an incidence of work-related illnesses that is higher than the average for all industries.

Considering the high-risk profile, the high frequency of fines, and serious allegations, the Ethical Council has demanded that **JBS** and **Pilgrim's Pride** demonstrate how they assess and handle health and safety issues. The Ethical Council will continue to follow up on these issues in 2017.



**Pegatron**

**Pegatron**, a subcontractor of Apple, has increased transparency related to working conditions at its factories and at those owned by the company's suppliers. The Ethical Council believes that the company's increase in communication is a positive sign of its willingness to take responsibility.

Discussions with **Pegatron** focus on the company's working conditions, management of risk in the supply chain, and the recurring reports of the company's inadequate handling of these issues. **Pegatron** has provided explanations related to handling of toxic chemicals at factories and training of workers. The company was initially reluctant to provide information on matters relating to auditing of suppliers or transparency in company reporting, but this is no longer the case. **Pegatron's** reporting in 2015 contained valuable information on these issues and the company was more accommodating compared to previous years.

Despite continuing reports on substandard conditions at several of **Pegatron's** factories, the company has addressed many problems over the last two years and major issues have been remedied.

**Pegatron** has actively cooperated with its customers and with third parties to improve working conditions, but despite this, there is a need for more transparency.

The focus of the Ethical Council in 2017 is improved reporting and transparency from the company.





### Yahoo Japan

**Yahoo Japan** is considered one of the world's largest providers of online ivory sales, and a large proportion of sales that take place on **Yahoo Japan's** websites are illegal or of dubious origin.

In early 2016, there was information indicating that **Yahoo Japan Corp.** (Yahoo Japan) was going to publish an update of the company's policy regarding sales of ivory products. However, it seems that the company's view of its responsibility in preventing trade in ivory products from endangered whale and other species remains unchanged. **Yahoo Japan** denies speculation that it has reevaluated its views on trade in elephant ivory.

**Yahoo Japan** believes that by following Japanese laws, it is meeting its environmental obligations as long as the company does not sell any items itself. They argue that sellers have the full responsibility for acquisition and sales of the products. Criticism has thus been directed against the company's practices as well as weak Japanese laws.

In March 2016, 32 environmental and conservation organisations wrote an open letter to **Yahoo Japan** with a request to protect elephants. According to some reports, more than 30,000 elephants are killed every year for their ivory, including by poachers in several African countries.

The Ethical Council will remain committed to this issue in 2017.

**“The focus of the Ethical Council in 2017 is improved reporting and transparency from the company.”**

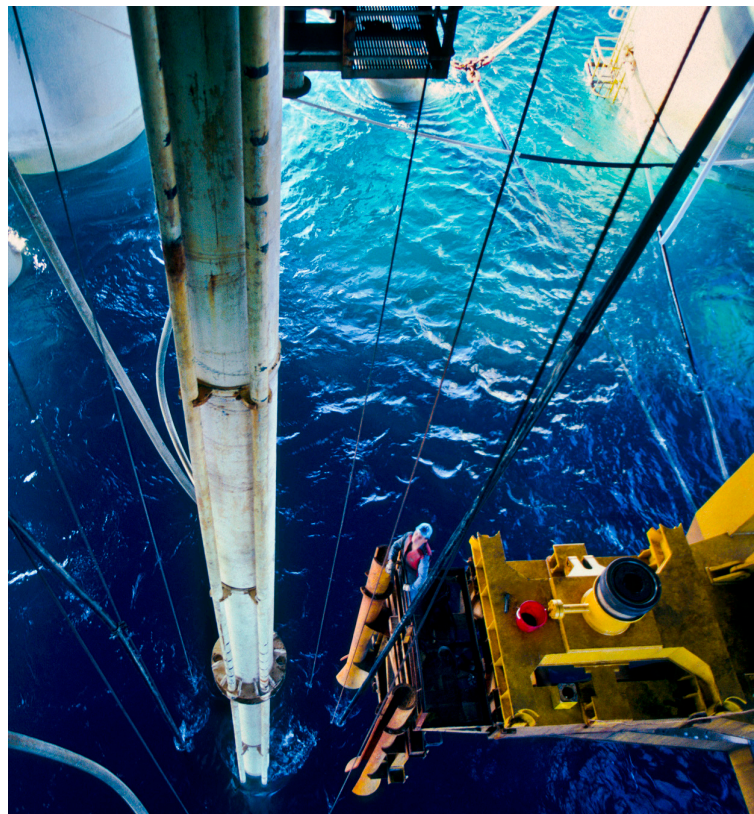


### Petrobras

In October 2014, a former executive at **Petrobras**, testified in a federal court in Brazil that from 2004 to 2012 corruption within the company was systematised. Since then, four former managers at **Petrobras** have been convicted for their involvement in the scheme, and another four have been charged. **Petrobras'** subcontractors paid bribes to a number of the company's managers who in turn transferred part of the money to Brazilian politicians. The federal police in Brazil have opened an investigation into the company's employees and its subcontractors, as well as Brazilian politicians. Around 100 persons have thus far been charged with corruption, money laundering and cartel formation.

**Petrobras** is cooperating with the investigative authorities and is implementing an improved anti-corruption programme throughout the entire company. Further follow-up of this implementation is required as well as an evaluation of the efficacy of the programme before the risk of corruption within the company can be considered to have diminished significantly. The company has also increased the number of employees who work to combat corruption.

The Ethical Council will continue its dialogue with the company.







### British American Tobacco

In June 2016, Swedwatch reported on alleged violations in the supply chain of **British American Tobacco** in Bangladesh, a subsidiary of **British American Tobacco (BAT)**. The report revealed problems with child labour, adverse health effects from pesticides, and unfair contracts. **BAT** answered Swedwatch with clarifications in the form of a number of documents.

An internal investigation by the company did not support the allegations presented in the report, but **BAT** plans to allow an independent third party audit during the harvest season in 2017. The Ethical Council will continue its dialogue with the company.



### Zijin Mining

**Zijin Mining Group Ltd** is a Chinese mining company that since May 2015 owns 47.5 percent of the goldmine Porgera on Papua New Guinea. Large amounts of waste are released from the mine's operations into a nearby river. The effects of this lack of waste management are linked to serious, negative environmental consequences that contravene the EU Convention on Biological Diversity.

Since 2013, the Ethical Council has attempted to establish a dialogue with **Zijin Mining** due to its lack of effort in the area of sustainability. The company has, however, not responded. The Ethical Council believes it is pointless to continue trying to initiate a dialogue, because of **Zijin Mining's** complete lack of response. Against this background, the Ethical Council recommended the First, Second, Third and Fourth AP Fund to exclude **Zijin Mining** from their respective investment universes. The AP Funds were unanimous in their decision to follow the recommendation.

**“First, Second, Third and Fourth AP Fund have excluded Zijin Mining.”**





# A SELECTION OF MORE COMPANY DIALOGUES CURRENTLY UNDERWAY

The Ethical Council of the AP Funds, together with GES Investment Services, conduct dialogues with a large number of companies around the world. Below are some examples of dialogues currently underway as well as the problem area raised.

Company	Associated with	Country of incident
<b>BARRY CALLEBAUT AG</b>	Child labour in the cocoa industry	Ivory Coast
<b>COAL INDIA LIMITED</b>	Repeated deadly accidents at workplace	India
<b>CROWN HOLDINGS</b>	Anti-union practices in several countries	Turkey, et.al.
<b>DEUTSCHE POST</b>	Violation of international labour standards	India
<b>FELDA GLOBAL VENTURES</b>	Labour rights issues	Malaysia
<b>FERROVIAL</b>	Human rights violations	Nauru
<b>FIAT CHRYSLER AUTOMOBILES</b>	Product recall as a result of fatal incidents	USA
<b>G4S</b>	Complicity in human rights violations in occupied territories	Israel/Palestine
<b>GLAXOSMITHKLINE</b>	Corruption	China
<b>HERSHEY</b>	Child labour in the cocoa industry	Ivory Coast
<b>HSBC HOLDINGS</b>	Recurrent incidents of money laundering	USA
<b>LEONARDO – FINMECCANICA SPA</b>	Corruption	India
<b>LINDT &amp; SPRUENGLI AG</b>	Child labour in the cocoa industry	Ghana
<b>MARKS &amp; SPENCER</b>	Violations of labour rights in supply chain	Cambodia
<b>MONDELEZ INTERNATIONAL</b>	Child labour in the cocoa industry	Ghana

<b>Company</b>	<b>Associated with</b>	<b>Country of incident</b>
<b>NESTLE SA</b>	Child labour in the cocoa industry	Ivory Coast
<b>NORILSK NICKEL</b>	Environmental and health impacts from metal mining	Russia
<b>POSCO</b>	Human rights violations and environmental degradation in steel projects	India
<b>POSCO DAEWOO</b>	Child and forced labour	Uzbekistan
<b>ROYAL DUTCH SHELL</b>	Human rights violations as a result of pollution and environmental damage	Nigeria
<b>SAMSUNG ELECTRONICS</b>	Child and forced labour	China
<b>SEVEN &amp; I HOLDINGS CO</b>	Violations of labour rights in several franchises	USA
<b>SEVERSTAL PAO</b>	Deadly workplace accidents	Russia
<b>TRANSOCEAN LTD</b>	Deadly explosion and major oil spill	USA





# PROACTIVE PROJECTS

## DIALOGUES IN THE EMERGING MARKETS

The Ethical Council has been collaborating with GES Investment Services since 2014 to conduct dialogues with 15 companies in the emerging markets. One of the companies is FEMSA with whom there has been meetings in Mexico, the most recent in June 2016. FEMSA is the largest public Coca-Cola bottler covering the entire Latin America and has a retail business with thousands of convenience stores and pharmacies.

One question that has been raised is potential health issues linked to the products, a priority issue in Mexico as the land is battling serious obesity problems in its population. FEMSA is aware of this issue and was one of the first bottling companies within the Coca-Cola network to promote new versions of drinks with fewer calories. Today, 40 percent of the product portfolio consists of low-calorie products. The dialogue is now focused on persuading the company to take on an even greater public commitment to higher sales targets for low-calorie products.

In addition to health questions, the dialogue has also dealt with working

conditions at the retail level, which has begun to yield results. FEMSA is analysing an increasing number of personnel-related indicators, like employee satisfaction and employee turnover. The disclosure in these areas has improved following the request of the Ethical Council and the company is building development and career plans to reduce employee turnover.

The Ethical Council has also raised the issue of water stress with the company. FEMSA has conducted water risk analyses for all its operations and analyses are updated annually. All operations have contingency

plans for water supply and FEMSA has implemented a comprehensive programme to mitigate water-related risks, primarily through reducing water consumption. The consumption has declined by approximately 20 percent over the last ten years. The company has improved access to water in the communities where it is active, taking into account the needs of the local community.

Together with other stakeholders, FEMSA is funding so-called water funds, which help local communities build water sheds and protect water resources.





# A LONG-TERM APPROACH CREATES IMPROVEMENTS IN THE COCOA INDUSTRY

**For several years the Ethical Council has conducted dialogues on child labour with some of the largest companies in the cocoa industry. According to various reports, more than two million children are engaged in hazardous work on cocoa plantations in West Africa. Together with other investors, the Ethical Council continued to work actively with this issue in 2016.**

Poverty is a root cause of child labour among cocoa farmers; thus one of the focus areas is to work to increase the incomes of cocoa farmers. Other important areas are access to schools and implementation of the Child Labour Monitoring and Remediation System (CLMRS). CLMRS is a system for capturing incidents of child labour and to support farmers to find alternative sources of labour or income, thereby preventing continued work for the child.

## Visit to the Ivory Coast

In October, a representative of the Ethical Council travelled to the Ivory Coast, the world's largest producer of cocoa, where there have been reports of widespread child labour in communities where cocoa is grown. The Ivory Coast is the fastest growing economy in Africa with annual growth of 8.5 percent. The country has adopted a new law on compulsory basic schooling and a higher minimum age for work.

Many of the initiatives that have been implemented by the cocoa industry and other stakeholders in local communities where cocoa is grown aim to improve farmers' livelihoods, in particular through activities to increase productivity and create income. At an Ivory Coast conference on sustainable cocoa cultivation

attended by the Ethical Council, many participants spoke about the professionalisation of cocoa cultivation. The industry initiative CocoaAction has developed an economic model to understand cocoa farmers' labour input and yield and to find ways to make cocoa cultivation more profitable for cocoa farmers. Some companies have also started reporting larger harvests and increased income for farmers who have participated in their sustainability programme. Additional innovations for mechanisation, fertilizer and plant breeding are underway and will drive this trend.

Others feel that cocoa is too cheap to be sustainable and argue that in addition to sustainability programmes and innovations, companies simply need to pay farmers a higher price for their cocoa beans. To some extent, certification premiums aim to achieve just that, but at current levels, the effect on farmers' incomes should not be overstated. The certifiers that the Ethical Council met in the Ivory Coast claimed that productivity-enhancing activities, diversification, and better access to credit for farmers are also required.

## Positive trend

What emerged in the Ivory Coast, as it did in earlier dialogues with companies, is that CLMRS is quickly gaining ground. Since the International Cocoa Initiative (ICI) and Nestlé began working with CLMRS a few years ago, the system is now being disseminated by several companies as a part of the industry initiative CocoaAction.

All the efforts described above demonstrate strong commitment from the cocoa industry, governments and stakeholders to develop more sustainable cocoa production. However, calculations show that such initiatives only reach about 20-30 percent of local communities where cocoa is cultivated in the Ivory Coast. Little by little, more and more links in the cocoa supply chain are being reached, but for many cocoa farmers very little has changed. It is obvious that an escalation of current initiatives is necessary. Industry initiatives seek increased cooperation with international financial institutions and donors, but have also stressed an increased need for cooperation with the governments of cocoa-producing countries, as well as greater involvement from civil society.

The Ethical Council will continue dialogues and advocacy vis-à-vis the largest companies in the cocoa industry so that these continue to increase their efforts.



# SUSTAINABILITY CHALLENGES OF PALM OIL

**Palm oil is the most-used vegetable oil in the world. It is an important commodity in many different consumer products, for example, chocolate, cookies, ice cream, margarine and other food products. It is also used in make-up, soap, shampoo, laundry detergent and biodiesel. The AP Funds own companies that produce or use palm oil in their production.**

The Ethical Council of the AP Funds has participated for a number of years in a collaboration between international investors, coordinated through PRI, which works for greater sustainability in palm oil production. Above all, the Ethical Council and other investors place demands on international listed companies that they have policies, guidelines, routines, and systems for monitoring and control in place to ensure sustainable production.

Several of the large companies have had policies for many years, and are working to ensure that their production meets the stringent demands for sustainability. To do this, traceability is also required, i.e. knowledge of which palm oil plantations are a part of their supply chains. If companies know where the palm oil they use was cultivated, they can control and influence suppliers and subcontractors to take greater account of environmental and social aspects.

## A more sustainable market

To reorganise a global market to be more sustainable requires awareness, time, resources and education, often for both the consumers and the producers. The challenge is even greater when it involves several production conduits with many medium-, small- and micro-sized producers as well as consumers who are not yet ready to pay for sustainability.

China and India purchase half of all palm oil produced globally. The demand for the more expensive certified sustainable palm oil from these two countries is relatively low. Demand for certified sustainable palm oil comes

primarily from Europe and to some extent from the USA. An increase in demand and a willingness to pay are prerequisites if there is to be a breakthrough in sustainable production.

Several international investors, including a representative of the Ethical Council of the AP Funds, visited Indonesia in 2016. This group of investors met with and discussed sustainable palm oil production with large and small palm oil tree growers and major palm oil producers, and also visited plantations. The group also met representatives of the federal and regional governments of Indonesia, various NGOs such as WWF Indonesia, and local human rights activist organisations, and other stakeholders.

Sustainable production is a complex issue and a major challenge in Indonesia. The country has a large and growing population who is striving to quickly attain a higher standard of living. There are several political challenges, for example, the strengthening of functionality, control and coordination of federal and regional administrations and societal structures. The state bears a great responsibility when it comes to land utilisation. Greater transparency is necessary in regard to land registers and the issuance of permits for deforestation, as well as monitoring, sanctions, and incentives for citizens so that preservation-worthy rainforests are not cut down. Corruption also presents a major challenge.

Despite rapid destruction of rainforests over the last 20-30 years, there are still forests with biological diversity that warrants safeguarding. However, reorganising for sustainable production takes time, requires knowledge, and costs money. One long-term challenge lies in teaching the local population gentler and more effective ways to cultivate the land in order to reduce utilisation of the slash-and-burn agricultural method, and thereby reduce deforestation.



### Facts

Palm oil trees are cultivated near the equator and approximately 80 percent of all palm oil comes from Malaysia and Indonesia. Cultivating palm oil trees and selling palm oil fruits for oil production is an important source of income for many small family businesses, and small-, medium- and large-sized local companies in these countries. In Indonesia, for example, small-scale agriculture and family businesses account for approximately 40 percent of the country's palm oil production.



## TRIP TO NEW YORK

# WOMEN REPRESENT AN IMPORTANT TREND

An annual gathering in New York provides good insight into the work to promote gender equality in the USA. The meeting gives investors a chance to meet female board members in American and international companies.

**“An increasing number of women are being appointed as board members on the basis of their competence and merits – rather than through the enforcement of gender equality policies.”**

– General Secretary, John Howchin

The driving force behind the initiative, Sarah Teslik, formerly of the Apache company, has over the last few years developed the Women in Governance network, and in June 2016 gathered together 150 investors and board members from the USA, Asia and Europe. The Ethical Council of the AP Funds was also represented by a woman. A few men also participated, including the Ethical Council’s General Secretary, John Howchin.

One of the programme’s agenda items dealt with how major companies work with human rights and climate change.

One of the leading consultancy companies in attendance described

how they evaluate American boards and their competencies, strengths and weaknesses. The focus was on what investors value with regard to recruitment and evaluation processes.

One panel debate consisting of four board members deliberated over what makes a board function well, or not. One of the conclusions was that shorter mandate periods are important for adapting board competency to technology shifts.

In one workshop, around 30 company representatives discussed company strategies, presidential election, Swedish companies and much more.

### Concluding reflections:

- Women on boards stated with conviction that they had been approached, nominated and appointed on the basis of their competency and merits.
- Several women testified that they had experienced that they had broken new ground and shattered the glass ceiling. On the other hand, the journey had been tough, fraught with battles, and even withdrawals.
- Some board members described how they had left boards where they felt they had not been respected for their competency, but rather had been appointed for show.
- Board members are interested in building relations with investors and they understand that we share many challenges.
- According to conference participants, the USA had developed and increased its understanding of the importance of board members’ responsibility regarding sustainability issues.



# THE MINING INDUSTRY

## AN INDUSTRY WITH MAJOR CHALLENGES

The Ethical Council of the AP Funds receives many questions about mining companies and mines around the world. The mining industry is facing major challenges on several levels, but is a key element in both the global economy and Swedish industry.

Human beings have been mining for thousands of years and will likely continue mining for a long time to come. Today, there is much focus on materials like lithium, cobalt, and other minerals that play a part in efforts to deal with climate change and the transition to a low-carbon society. Batteries and wind power plants also depend on what is produced from mining. Iron ore and copper are necessary as countries in emerging markets become industrialised and electrification spreads. The clearest example during the last twenty years is perhaps China. Bridges, an electricity grid, steel beams in buildings, refrigerators, etc. – all depend on access to minerals. Billions of people are still waiting for electricity and a refrigerator.

### Potentially large impact

Mines impact their surroundings regardless of how well they are planned or how many dialogues take place with the local population and others whose daily lives are affected by a mine's existence. A mine entails extensive physical changes in the near environment with large quantities of waste, and can even involve dams, transport, noise pollution, and changes in access to land and water. Every mine's conditions and challenges are unique in terms of its geographical location.

### Long-term commitment

During the ten years since the Ethical Council of the AP Funds was founded, mining companies have been in focus, and the Ethical Council has conducted dialogues with many of them. During a three-year period, the

Ethical Council implemented a comprehensive proactive project, where some twenty global mining companies were analysed on the basis of the mining industry's own guidelines for best practice, as drawn up by the International Council on Mining & Metals (ICMM). All aspects were covered, including due diligence for human rights and the environment, corruption, biodiversity and the rights of indigenous peoples. Results from this comprehensive project were reported on an ongoing basis in the Ethical Council's annual reports for the years 2011 – 2014. The Ethical Council's view of the mining industry has become much more positive since then, as companies have in general become better at addressing these issues, and have, for example, recruited more personnel to work with them.

### Challenges remain

Unfortunately, and despite this positive trend, mistakes will be made and accidents, such as the tragic Fundão mining accident described on page 14, will occur.

Despite several attempts, the Ethical Council did not succeed in establishing a dialogue with the Chinese mining company Zijin Mining, which is dumping large quantities of waste into a nearby river, and has therefore recommended the AP Funds to exclude the company. See page 18.

The mining industry will remain a branch with challenges in many areas, and the Ethical Council will continue to engage with mining companies around the world.

**“Today, there is much focus on materials like lithium, cobalt, and other minerals that play a part in efforts to deal with climate change and the transition to a low-carbon society.”**







# COOPERATION

## INTERNATIONAL COOPERATION IS IMPORTANT

**The Ethical Council was established in 2007 in order to cooperate on dialogues with listed, non-Swedish companies in the Funds' global portfolios. Because the AP Funds are relatively small shareholders in these global companies, the need to cooperate with others is greatest for these holdings. However, the AP Funds' cooperation extends far beyond the Ethical Council.**

The Ethical Council cooperates with international investors world-wide, primarily other pension funds, with respect to company dialogues and in proactive projects. The aim of this cooperation is to share experiences and to pursue joint advocacy, thereby wielding greater influence as an owner and more easily achieving the desired results and improvements in these companies.

### Cooperation on important issues

The AP Funds within the Ethical Council are also members in and support various organisations that work on issues that the Funds deem important. PRI is an organisation where one of their principles embraces cooperation. In addition to PRI, the AP Funds are members in and support CDP, EITI, and IIGCC.

Examples of the types of cooperation that the Funds were involved in within the Ethical Council in 2016:

- An initiative involving sustainability for shellfish. Sustainability is central for companies that produce, process or sell shellfish because of the significant risks that exist throughout the supply chain. The initiative targets ten companies with regard to the management of fish and shellfish throughout their supply chains.

- An initiative involving violations of human rights, primarily child labour, in cobalt mines in the Congo. A dialogue has been established with several companies that purchase this mineral. The aim is to get these companies involved in cooperation with other companies, but also through exerting influence on the local government to establish a supply chain devoid of child labour and violations of human rights.
- An initiative from IIGCC. In a letter to G20 governments, investors recommended that governments join/ratify the Paris Agreement, implement the recommendations investors made in an earlier letter in 2015, and improve the quality of climate-related financial information.
- The AP Funds are committed to supporting the UN's 17 global goals for sustainable development in cooperation with the Dutch pension funds APG and PGGM, and others. This basic position calls on institutional investors to invest in solutions which contribute to the goals. Read more on page 30.

PRI – the UN Principles for Responsible Investment is a global initiative for institutional investors that started in 2006. The aim of PRI is to support investors to take into consideration ESG issues (Environmental, Social and Governance) in investment decisions and ownership activities, thereby creating value for beneficiaries. Read more at [www.unpri.org](http://www.unpri.org)

CDP – an initiative where around one hundred major asset managers demand that the world's largest listed companies report their greenhouse gas emissions and other information related to how they are dealing with climate challenge. The aim of the CDP is to streamline data collection processes through a large number of investors collectively requesting data and reporting on greenhouse gas emissions. Read more at [www.cdproject.net](http://www.cdproject.net)

EITI (Extractive Industries Transparency Initiative) – an initiative within extractive industries, especially oil companies. The need for transparent reporting and governance is especially great in countries rich in natural resources, but where governments are weak. Clearer reporting from companies on what they pay and from federal governments on income derived from oil, gas and mining industries, increases openness in society and contributes to better conditions for financial governance. Read more at [www.eiti.org](http://www.eiti.org)

IIGCC (Institutional Investors Group on Climate Change) – IIGCC is a forum for cooperation on climate issues for European investors. The goal is to get investors' voices heard on climate issues, and to involve companies, authorities and other investors in order to draw attention to the long-term risks and opportunities that climate change presents. Climate change is an important issue for the AP Funds as long-term investors. There is currently a great deal of uncertainty surrounding future regulation and frameworks to reduce greenhouse gas emissions and to stimulate alternative energy sources. This makes it difficult for companies to make profitable investments and for investors to calculate risks and returns. IIGCC is an effective platform for advancing investors' concerns on climate change. It is also a good way for the Funds to acquire the latest information on various climate-related investments. Read more at [www.iigcc.org](http://www.iigcc.org)





# UN INITIATIVE

## AGENDA 2030

In September 2015, world leaders under the auspices of the UN agreed to work toward attainment of three overarching goals: to eradicate poverty, to reduce inequality and injustice in the world, and to solve the climate crisis. This agreement is called Agenda 2030, as the aim is to achieve these overarching goals by 2030. To attain these overarching goals, the UN has established goals for sustainable development within 17 different areas, with a total of 169 targets.

In the agreement, it is very clear that the UN expects that actors from all sectors of society contribute to the fulfilment of the development goals. Thus, both asset owners asset managers as well as companies are responsible for contributing to the fulfilment of these goals. No actor is expected to contribute to all the goals; rather they can choose which goals they will work with. It is possible to contribute to several of the goals through investments, for example goal 11 – Sustainable Cities.

The AP Funds and the Ethical Council work in different ways with the development goals. During the summer of 2016, the four AP Funds, together with a number of European pension funds,<sup>1</sup> agreed to invest in solutions which – in addition to giving a market return – contribute to one or more development goals. The AP Funds will report on the progress of this work in their respective annual reports.

The four AP Funds also collaborate with other

Swedish investors, the Swedish International Development Cooperation Agency (SIDA), and the Global Reporting Initiative (GRI) in what is called Swedish Investors for Sustainable Development (SISD). The aim of this collaboration includes to develop a number of indicators that long-term investors want companies in their portfolios to disclose in their sustainability reports.

A number of development goals do not relate to investment, for example parts of goal 16 which deal with anti-corruption. It is often possible to use these goals in discussions between investors and portfolio companies. The Ethical Council has already carried out projects in this spirit, for example, you can read about its anti-corruption efforts in the 2013 and 2015 annual reports and at [www.etikradet.se](http://www.etikradet.se). In 2017, the Ethical Council will prioritise several, suitable development areas from Agenda 2030, and within these areas conduct dialogues with the companies that the AP Funds invest in.



17 goals for sustainable development that will change the world by 2030.

<sup>1</sup>APG, PGGM, MN Services, Actiam and Kempen



# UN GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS

**During the autumn of 2016, the Ethical Council runs a project about the UN Guiding Principles on Business and Human Rights. The project's aim is to identify a structure for how the Ethical Council can work with these principles in its activities. Included in this work was a survey of how other institutional investors work with human rights issues.**

The UN Guiding Principles for Business and Human Rights are a tool for how companies shall manage and work with human rights. The guiding principles are based on three pillars: Protect, Respect and Remedy (see box below). The principles were adopted by the UN in 2011 and clarify the relationship between company and state responsibility for human rights. The principles are valid for all companies regardless of size, industry, or ownership structure, and also apply to institutional investors.

## Identify structures

In 2015, the UN launched a framework for how companies can report on human rights in accordance with these principles. Institutional investors such as the AP Funds are not always comparable with other types of companies, and therefore cannot approach the principles in the same way. The aim of the Ethical Council's project has thus been to identify a structure for how the Ethical Council can work with the principles in its activities. An important part of this project has been to conduct a situational analysis and to gather information from different actors, such as institutional investors in Sweden and Europe and consultants, on how they interpret and work with the principles.

According to the UN Guiding Principles, an organisation can cause, contribute to, or be linked to a potential or actual violation. The work of the Ethical Council is focused on dialogues with non-Swedish listed companies, in which one or more of the AP Funds have holdings. The screenings of the AP Funds' share holdings that are conducted twice per year, and with regular monitoring between screenings, aim to identify violations of conventions. In this way, companies which may cause, contribute to or be linked to actual violations can be identified. The AP Funds can, in their capacity as a minority shareholder in a company, be linked to violations that the company has committed. The Ethical Council is currently conducting 89 dialogues with companies regarding actual violations of human rights.

The Ethical Council runs a number of proactive projects where the aim is to raise the standard of sustainability efforts in a group of companies or within an industry. Examples of the proactive work that the Ethical Council conducts to prevent potential violations are projects relating to cocoa and palm oil, described on pages 23-24.

## Potential to influence

According to the guiding principles, it is important that the AP Funds use their influence and work to prevent and

reduce the risk for potential violations, and to mitigate the effects of actual violations. Through the Ethical Council, the AP Funds collaborate for the purpose of increasing their potential to influence companies, amongst other things. The Ethical Council also often collaborates with other investors in human rights issues in order to exert an influence.

The Ethical Council's project demonstrates that the UN Guiding Principles can be considered a relevant and useful tool for institutional investors to control risks associated with human rights. Even though the principles are accepted, they continue to be used and interpreted in different ways, which leads to a demand from institutional investors for specific guidance. The OECD is working with investors, NGOs and unions to create such a standard.

The project highlights the importance of the Ethical Council having a clear understanding of how the AP Funds' global investments can impact human rights, that there are processes in place to identify risks for impact, and that the Ethical Council and the AP Funds clarify the importance of the companies in which they invest having routines in place to address and remedy potential violations.

## UN Guiding Principles for Business and Human Rights

The framework consists of three principles to guide companies in their work with human rights.

### The framework stresses

- states' duty to protect human rights (**Protect**)
- corporate responsibility to respect them (**Respect**)
- and joint responsibility to remedy problems (**Remedy**).

States still bear the fundamental responsibility for safeguarding of human rights, but the principles have clarified how companies should act. Companies should also undertake a screening of how their operations can affect human rights, which for investors can facilitate analysis of companies' risk management and potential violations.

**For more information, see:** [www.business-humanrights.org](http://www.business-humanrights.org)

## CORPORATE GOVERNANCE

# CORPORATE GOVERNANCE IN THE ETHICAL COUNCIL

**“The Ethical Council is now taking another step and deepening its cooperation relating to corporate governance in non-Swedish companies. In this way, the Ethical Council can contribute further to the AP Funds’ mission.”**

For ten years, the First, Second, Third and Fourth AP Fund have cooperated successfully in the Ethical Council to conduct dialogues with companies associated with violations of international conventions that Sweden has ratified. The Ethical Council has carried out a number of proactive projects, for example vis-à-vis the tobacco industry and palm oil companies. In most cases, dialogues and projects have dealt with human rights and environmental issues. Within corporate governance, the AP Funds have collaborated on analyses and a platform for voting at non-Swedish AGMs.

The Ethical Council is now taking another step and deepening its cooperation relating to corporate governance in non-Swedish companies. In this way, the Ethical Council can contribute further to the AP Funds’ mission. In Swedish companies the AP Funds believe that their ability to influence is greater if the Funds act outside of the Ethical Council.

Research in this area clearly shows

that engagement in corporate governance has a positive influence on investors’ return and risk. An example of an issue that the Ethical Council is working on is that of Board Directors being independent in relation to executive management. In particular, the positions of CEO and Chairman of the Board shall not be held by the same person. If Board Directors and the Chair are insufficiently independent, the ability of the board to control deteriorates. Other important issues are remuneration to senior executives and the quality of companies’ financial and sustainability reporting

### Facts

Corporate governance includes:

- Shareholder rights
- Election and remuneration of Board Directors
- Remuneration of senior executives
- Dividends and capital structure
- Long-term, strategic corporate strategy, including sustainability.

## TAX AS A SUSTAINABILITY ISSUE

Tax planning and especially corporate management of taxes has been up for discussion a great deal recently. The media has drawn attention to many cases where companies followed the letter of the law, but perhaps not the spirit, so-called aggressive tax planning. Regulations have changed, both nationally and internationally.

To be able to conduct useful discussions about companies’ tax payments, it is important to distinguish between various actors’ responsibilities. It is the duty of political assemblies to create a regulatory framework where compliance on the part of companies is possible and perceived as fair.

Since many companies operate in several countries and therefore must adapt to the tax laws of many countries, the tax issue becomes very complex.

In order to stimulate a good dialogue on tax issues, the Ethical Council invited Swedish companies and investors to a seminar on corporate taxes in November 2016. Participants included Caroline Malcolm, who is responsible

for the OECD’s work on the global tax project – the so-called BEPS project – and Roger Persson Österman, who is a professor of tax law at Stockholm University. The Ethical Council and the AP Funds have also held discussions with the Swedish Tax Agency, among others, to exchange knowledge.

The AP Funds and the Ethical Council expect that investors, companies and individuals comply with tax laws. They thus have the right to reduce tax payments by acting within the limit of the laws, so-called tax planning. On the other hand, if a company in which the AP Funds invest resorts to aggressive tax planning, it entails an increased financial risk, which in turn impacts the value of the funds’ investment negatively. Increased openness and voluntary disclosure of taxes paid and corporate tax policies contribute to reducing risk, especially since it makes it easier for investors to analyse and assess companies’ tax risks. Read more about positions taken at [www.etikradet.se](http://www.etikradet.se)

## AREAS OF PARTICULAR FOCUS 2016

# THE ETHICAL COUNCIL ADDRESSES DIFFICULT ISSUES

The Ethical Council's guiding principle is to make a difference by being long-term, responsible and committed owners that influence companies to improve their efforts with regard to environmental and social issues. Some of the issues where the Ethical Council takes a basic position are difficult and controversial throughout society. In such situations, the Ethical Council formulates specific positions.

The AP Funds' shared core values for sustainability and corporate governance "...to make a difference through proactive commitment to sustainable development, action, and through demands for transparency and positive change..." are the foundation for the Ethical Council's work.

The Ethical Council's mandate is to monitor and influence companies to improve their efforts with regard to environmental and social issues. This also contributes to the Ethical Council gaining new insights and increased knowledge about companies and industries.

Some of the issues where the Ethical Council takes a basic position are difficult and controversial throughout society. This category of difficult issues includes investments in alcohol, tobacco, weapons manufacturing or gambling, and taxes, as well as how the Ethical Council views investments in some of the world's conflict zones.

**"...to make a difference through proactive commitment to sustainable development, action, and through demands for transparency and positive change..."**

When the Ethical Council takes a basic position, it is based on the AP Funds' shared core values and the joint framework for sustainability and corporate governance, amongst other things. The framework consists of the UN's international conventions and the AP Funds' mandate from the Swedish Parliament, etc.

Over the years, the Ethical Council has dealt with many difficult and controversial issues, where basic positions were jointly prepared in order to clarify the Ethical Council's views on these issues.

The Ethical Council states its basic positions on certain debated products and services. Read more about anti-personnel mines and cluster bombs, nuclear weapons, tobacco, the Western Sahara,

Israel and the Palestinian conflict, taxes and commercial gambling at [www.etikradet.se](http://www.etikradet.se)





# GOALS

## THE OBJECTIVES OF OUR WORK

The Ethical Council's objective is to use dialogue to contribute to improved sustainability efforts in non-Swedish listed companies. Through its work, the Ethical Council contributes to the AP Funds' objective of high long-term returns at a low risk from their managed assets, as the AP Funds believe that companies that work with long-term sustainability yield a better return. The Ethical Council's work should also contribute to the maintenance of public confidence.

Below are some of the Ethical Council's overarching goals for 2017.

Goals 2017	Monitoring methodology/Key indicators
Identify areas and projects that are suitable for cooperation within the Ethical Council.	Follow-up in the Ethical Council's annual report.
Prioritise, carry-out and monitor a number of proactive engagements with companies and industries, where there is relevance for the Ethical Council.	Follow-up in the Ethical Council's annual report.
Work together with contracted supplier to conduct reactive, incident-driven dialogues with companies in the AP Funds' portfolios.	Number of companies where the Ethical Council is engaged in dialogues.
The Ethical Council shall be actively engaged in approximately 20 company dialogues.	Follow-up in the Ethical Council's annual report.
Coordinate the work of the AP Funds with various international organisations, partnerships and initiatives in the area of sustainability.	Follow-up in the Ethical Council's annual report and website.
Draw up a separate plan for cooperation between the AP Funds in the Ethical Council with regard to corporate governance in non-Swedish companies.	Ensure implementation. Follow-up in the Ethical Council's annual report.
Continue to develop communication of basic positions on individual issues and the work of the Ethical Council in the annual report and on the website.	Follow-up in the Ethical Council's annual report and website.
Arrange a seminar in connection with the Ethical Council's 10th anniversary.	Activity completed.
Joint procurement of a voting platform.	Procurement completed.

**“The Ethical Council cooperates with international investors world-wide, primarily other pension funds, in terms of company dialogues and in proactive projects.”**

# MEMBERS OF THE ETHICAL COUNCIL

In 2016, the Ethical Council consisted of two members from each respective AP Fund. The Chairmanship, which alternates between the AP Funds, was held in 2016 by Ulrika Danielson from the Second AP Fund, and in 2017 was handed over to Peter Lundkvist of the Third AP Fund.



FROM LEFT TO RIGHT: Christina Olivecrona, Lil Larås Lindgren, Arne Lööv, Peter Lundkvist, Ossian Ekdahl, Nadine Viel Lamare, John Howchin, Ulrika Danielson, Pia Axelsson.

## The First AP Fund

[www.ap1.se](http://www.ap1.se)

**OSSIAN EKDAHL**

**NADINE VIEL LAMARE**

## The Second AP Fund

[www.ap2.se](http://www.ap2.se)

**ULRIKA DANIELSON**

**CHRISTINA OLIVECRONA**

## The Third AP Fund

[www.ap3.se](http://www.ap3.se)

**PETER LUNDKVIST**  
Chairman 2017

**LIL LARÅS LINDGREN**

## The Fourth AP Fund

[www.ap4.se](http://www.ap4.se)

**ARNE LÖÖW**

**PIA AXELSSON**

## The Ethical Council

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

**JOHN HOWCHIN**

Ethical Council's  
Secretary General

### For more information:

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