

Sustainability  
and Corporate  
Governance Report

2017

# Long-termism and sustainability

---

AP4 believes that a sustainability perspective is a prerequisite for long-term success in asset management. It is for this reason that AP4 integrates sustainability, with focus on the Climate & Environment and Corporate Governance, in its investment processes. We describe our work in these areas in this Sustainability and Corporate Governance report.

AP4 supports the Task Force on Climate-related Financial Disclosures' (TCFD) work on advocating for climate-related reporting to be public, transparent and uniform. AP4's work on managing risks and opportunities associated with the transition to a low fossil fuel society is described both in our Climate Report, in accordance with TCFD's recommendations, and is included as part of this report.

AP4's mission is to contribute to the financial security of current and future pensioners in Sweden by managing part of the national pension system's buffer capital. AP4's long-term perspective, responsibility as an owner and strong commitment to sustainability create opportunities for high returns at a low cost. In this way AP4 works for more secure pensions.



# Contents

---

Letter from the CEO	4
Sustainability analysis a precondition	5
AP4's sustainability framework and new sustainability policy	6
The UN's sustainability goals are part of AP4's framework	8
AP4 and the UN's SDGs	9
Environmental goals	10
Climate & Environment - a focus area	11
The AP Funds' carbon footprint	12
An owner that influences companies to improve	14
Goals of corporate governance	15
Ownership work in 2017	16
Active corporate governance in Japan - interview	18
No investments in tobacco companies	19
The Council on Ethics of the AP Funds	20
Stakeholder dialogues and transparency	22
Partnership and initiatives	24

The Sustainability and Corporate Governance Report summarizes the past year's work with regard to sustainability and corporate governance in AP4's management carried out during 2017. This report is one of three reports that together describe the work carried out by AP4. The two other reports are the AP4 Annual Report and the Ethical Council Annual Report. The reports can be downloaded at [www.ap4.se](http://www.ap4.se).

Global Reporting Initiative (GRI) publishes international guidelines for sustainability reporting that are used by companies and organizations all over the world. AP4 has reported as far as possible in accordance with GRI's guidelines version G4 level "Core" and the sector-specific addition for Financial Services. The GRI report was not audited by a third party. Read more at [www.ap4.se](http://www.ap4.se).

# Letter from the CEO

---

Developments in sustainability are unfolding at lightning speed in the investor community — in the corporate sector as well as in the political system. It is thereby becoming increasingly meaningful to analyse and understand the global sustainability challenges and the implications they entail. It is for these reasons that we at AP4 in 2017 adopted a new sustainability policy that takes a holistic approach to sustainability, with Climate & Environment and Corporate Governance as our special focus areas.

The new sustainability policy broadens and deepens the integration of sustainability in AP4's work, making it a natural component in all of our investment processes. We are also working on further developing our strategies to reduce the carbon footprint of our investments and on broadening them to cover a wider definition of resource efficiency. Aside from the work on reducing the climate and environmental risks in our portfolio, we intend going forward to channel more focus and strength to identifying dedicated investments that benefit from strong sustainability trends and can thereby generate favourable long-term returns. For a long-term investor like AP4 it is a necessity as well as a responsibility to both manage risks and capitalise on opportunities associated with the shift to a sustainable world.

In the international investor community AP4 was early to conclude that environmental and climate challenges will have a major long-term impact on investments' return potential and risk. As early as 2012 we began developing and investing in accordance with low-carbon strategies. AP4 also became a significant investor in green bonds at an early stage and has thereafter actively supported development of this market.

However, the political decision-makers' ability and decisiveness to create broad international accords and rules — such as relevant pricing of CO2 emissions — will be entirely decisive in the work on steering towards more sustainable development. In all actuality, investors' assessments of both risks and opportunities are based on an expectation that the political system will succeed in taking its responsibility.

AP4 has a long tradition of dedicating great focus and energy to corporate governance. I would assert that we are a pioneer in this area. We adopted our first owner policy as far back as 1986. This was the first owner policy in Sweden, and also very early in an international perspective. AP4 was also a key player when Sweden's first nomination committee was formed (Volvo, in 1993), and we were also involved in the formation of the Swedish Institutional Owners Association (IÄF). IÄF is one of the principals of the Swedish Corporate Governance Board, which has played a central role in the Swedish model of self-regulation and for the promotion of a well-working stock market.

Today active corporate governance is AP4's most important tool for influencing and interacting with the companies in which we own shares. We are constantly developing our approach in an effort to continuously live up to our ambition to be a responsible and value-creating owner that is engaged in a close and relevant dialogue with company boards and managements. To exemplify our active corporate governance work, I can mention that ahead of next year's AGM season, AP4 is active on 31 nomination committees and that in 2017 we voted at 73 Swedish AGMs and at 896 AGMs internationally.



Niklas Ekvall  
CEO

# Sustainability analysis a precondition

---

**Sustainability affects us and the world we live in. AP4 believes that integrating sustainability aspects in investments is a precondition for its ability to generate sustainable returns over time.**

## Can always be done a little better

Integration of sustainability aspects in asset management to ensure that sustainability is taken into account in investment analyses and decisions is important and necessary for a long-term pension manager. AP4 has worked with sustainability for many years. It is work that is constantly evolving and that can always be done a little better. During 2017 the asset management operations conducted considerable development work focusing on how AP4 integrates sustainability in the various investment processes.

## Sustainability in focus

During the year several projects were conducted with the aim of integrating sustainability aspects in the day-to-day asset management activities in a more structured and systematic way. AP4 conducted the following activities during the year, among others:

- Drafted and adopted a sustainability policy, which serves as a joint framework and support in the integration of sustainability in asset management activities. The UN's and global Sustainable Development Goals are part of AP4's framework for integrating sustainability in asset management
- Declared that AP4 works with two sustainability focus areas - Climate & Environment and Corporate Governance - for which overarching external goals are being set
- Within the framework of the Climate & Environment focus area, conducted development work of investment strategies in the management of global equities
- Identified and worked on deepening the integration of sustainability aspects in the respective asset classes and asset management strategy

- Began work with scenario analyses of climate-related risks and opportunities in AP4's assets

## Owner initiatives in partnership

AP4 participates in global partnerships and owner initiatives in a number of different areas to promote sustainability around the world. Owner initiatives address many different sustainability aspects, such as for example urging companies to refrain from negative climate lobbying, advocating for stock markets around the world to apply sustainability reporting guidelines, demanding that oil companies work to reduce the negative environmental impacts of their operations, and joining in initiatives focusing on gender equality and human rights.

## Council on Ethics of the AP Funds – successful collaboration

AP1, AP2, AP3 and AP4 collaborate in the Council on Ethics of the AP Funds to influence foreign companies to work for improvement in the area of sustainability. The Council's continuing work encompasses preventive and reactive dialogues with foreign companies — some 200 dialogues every year — as well as industry-wide projects, and international collaborations and initiatives. Read more about the Council on Ethics of the AP Funds on page 20.

## Coordination of carbon footprint reporting

AP4 and other AP Funds measure and report the carbon footprint of their investments yearly as part of their broader work on addressing climate change. While measuring carbon footprint provides important knowledge, it also has limitations as a metric. The AP Funds have a council for cooperation composed of representatives from each of the AP Funds to coordinate and monitor developments surrounding climate reporting. AP4's carbon footprint over time is reported in the table on page 13 and on [www.ap4.se](http://www.ap4.se).

# AP4's sustainability framework and new sustainability policy

---

## **Sustainability is a key investment belief in AP4's investment philosophy and guides our work with sustainability in our asset management.**

AP4's overarching goal is that sustainability shall be an integral part of all internal investment processes. This is necessary in order to ensure well-balanced and controlled risk over time and to be able to achieve a high return. AP4 has a broad sustainability perspective in its asset management, where essential sustainability aspects in the areas of climate and the environment, social responsibility and corporate governance are taken into account. This is work we have conducted over a number of years and which is under constant development.

In 2017 AP4 adopted a new sustainability policy that takes a holistic approach to sustainability, with Climate & Environment and Corporate Governance as our special focus areas. AP4's sustainability policy serves as a joint framework and supports integration of sustainability in asset management activities. The UN's Sustainable Development Goals are part of AP4's framework for integrating sustainability in asset management. The sustainability policy provides guidelines for the asset management organisation's work on integrating sustainability aspects, such as the environment, social responsibility and corporate governance, in the investment operations.

Integrating sustainability aspects in AP4's asset management in an effective and structured manner requires the setting of priorities, as AP4 cannot work at the same level of depth with all sustainability issues. It has been determined that making an active choice of areas to focus on from an investor perspective and with support of a sustainability policy will raise the quality of our work, promote the right use of resources, and create opportunities for favourable risk-adjusted returns and enable an effective and structured integration. AP4 has therefore – in addition to a broad implementation of sustainability in its portfolio – chosen to work more in-depth in two focus areas: Climate & Environment and Corporate Governance.

The sustainability policy describes – among other things – AP4's view of sustainability and sustainable development, the context for its work with sustainability, its approach for integrating sustainability in asset management, criteria for the selection of focus areas in sustainability, and the prioritised focus area Climate & Environment. The sustainability policy has been formulated to facilitate a broader and deeper integration of sustainability in the asset management and to ensure that sustainability is taken into account in all of our investment processes.

We are also working on further developing our low-carbon strategies to reduce the climate risk and carbon footprint of our investments and on broadening our global equity strategies to cover a wider definition of resource efficiency. On top of the work on reducing climate and environmental risks in our portfolio, we will channel more focus and strength on identifying dedicated investments that benefit from strong sustainability trends and can thereby generate favourable long-term returns. For a long-term investor like AP4 it is a necessity as well as a responsibility to both manage risks and capitalise on opportunities associated with the shift to a sustainable world.

The sustainability policy (in Swedish) can be downloaded from [www.ap4.se](http://www.ap4.se).



Integrating sustainability aspects in asset management contributes over time to better management of risks and opportunities, and thereby to returns. AP4 uses active corporate governance to secure asset values.

# The UN's sustainability goals are part of AP4's framework

**The UN's Sustainable Development Goals (also called the Global Goals or SDGs) are important for investors, as they help stimulate investments that can contribute to solutions to major global problems. At the same time, they help set the conditions for long-term sustainable development.**



## **Contribute to achievement of the Global Goals**

Through its sustainability work and its investments, AP4 can contribute to the achievement of the UN's Sustainable Development Goals in various ways. AP4 works with two focus areas in its investments — Climate & Environment and Corporate Governance. These are two areas in which AP4 is supporting the UN's Global Goals in various ways.

## **Sustainable Development Goals part of sustainability policy**

During the year AP4 focused on increasing the integration of sustainability in its asset management. A framework for this was adopted in the form of a sustainability policy. In this work it was determined that the UN's Sustainable Development Goals shall serve as a framework for AP4's asset management and investments.

## **Climate change is a real threat**

Climate change, water shortages, social unrest and population migrations are all factors that pose a risk to economic stability and growth. The investor community is now rapidly beginning to understand the necessity of including sustainability in investment assessments. Climate & Environment is one of AP4's two focus areas. AP4's choice of focus areas was based on a number of criterias. One of the most important was that the climate and environment are fundamental preconditions for all life and for the ecosystems that we know today. Protecting the climate and environment is thus a vital precondition for being able to achieve other global sustainability goals.

## **AP4 and the UN's Sustainable Development Goals**

The goal is that AP4, within the areas that the Fund is active, will continue to develop activities that can contribute to higher returns for Sweden's pensioners at the same time that AP4 contributes to a more sustainable world. AP4 today has investments or works continuously in a number of sustainability areas that support the Global Goals. For a number of years AP4 has had several overarching goals within its two focus areas of Climate & Environment and Corporate Governance, which contribute to ensuring that this work is prioritised, measured, monitored and developed.

AP4 has also worked for many years on lowering climate risk in AP4's assets, such as by being a pioneer in investing in low-carbon strategies. In 2014 AP4 was one of four co-founders of the Portfolio Decarbonization Coalition (PDC) together with the UN in the aim of encouraging investors around the world to put greater emphasis on sustainability in their investments. AP4 is active in owner initiatives that support the UN's Global Goals. These include initiatives urging companies to refrain from negative climate lobbying, initiatives advocating for stock markets around the world to apply sustainability reporting guidelines, initiatives demanding that oil companies work to reduce the negative environmental impacts of their operations, and initiatives focusing on gender equality and human rights. AP4's Sustainability and Corporate Governance Report and the Council on Ethics of the AP Funds Annual Report include presentations of the global Sustainable Development Goals that this work primarily supports.



# AP4 and the UN's SDGs

---

**Below are several examples of the United Nation's SDGs' areas where AP4 either has investments or works with on a continuously basis.**

## Goal 3. Good health and well-being

AP4 has sold tobacco. During 2016 AP4 took the business decision not to own shares in tobacco companies, since AP4 believes that there are risks that are determined to be incorrectly factored today and that shares in tobacco companies are considered to be overvalued. Thus far, the business decision has made a positive earnings contribution.

AP4 estimates that, over time, tobacco companies, due to increasingly restrictive regulations regarding tobacco products globally, will be valued differently, thus performing below the index. Tobacco companies may eventually become so-called stranded assets. It is an assessment that AP4 expects more and more investors will share. Read more on page 19.

## Goal 5. Achieve gender equality

AP4 has a long tradition through the nomination process, among others, to promote increased diversity in the boards of listed companies and to increase the number of women on the boards where they are underrepresented. The importance of having procedures and processes in place to contribute to increased gender equality in business is highlighted through ownership dialogues with companies.

AP4 evaluates investment strategies that include gender equality indicators; AP4 has a fund investment where the sustainability focus is gender equality.

## Goal 6. Clean water

The oceans and freshwater are a global resource, where water may also be a local geographic resource. Access to clean water is vital, which is why AP4 continuously follows-up on progress and evaluates various sustainability strategies focusing on water.

## Goal 8. Good working conditions and economic growth

To promote macroeconomic stability and a good investment environment, employment and decent work are key factors for sustainable development. AP4 participates in international governance initiatives and, through the AP Funds' Ethical Council, conducts dialogues with companies to promote decent work, protect the rights of workers, promote a safe and secure working environment, combat forced labor, child labor, modern slavery and human trafficking.

## Goal 10. Reducing inequality

To address inequalities between individuals and groups based on sex, age, ethnicity, and economic and social status. AP4 has an investment fund with a focus on children's rights.

## Goal 11. Sustainable cities and communities

Cities and settlements should be inclusive, secure, resilient and sustainable. Cities are often at the forefront of development and are a hub for innovation and new ideas. The rapid and large migration to cities poses new requirements that need to be addressed in an ecologically, economically and socially sustainable manner. AP4 owns 25 percent of Vasakronan, Sweden's largest real estate company and the company is an essential part of AP4's total property holdings. Vasakronan has worked for a long time with sustainability in its operations. The company has been awarded the highest rating - Green Star - the Global Real Estate Sustainability Benchmark (GRESB) which analyzes sustainability in real estate globally.

## Goal 12. Sustainable consumption and production

AP4 understands the importance of increasing awareness of the circular economy and the need for sustainable consumption of, among others, raw materials. This includes the need to plan for the reuse and reduction of waste prior to production start. This issue is emphasized through ownership dialogues that AP4 conducts with companies.

## Goal 13. Fighting climate change

AP4 has worked to reduce climate risk in the assets over many years, where approximately 22 percent of AP4's global equity portfolio is invested in low carbon strategies. AP4 also invests in green bonds that contribute to the financing of various sustainable projects.

AP4 is one of four founders of the Portfolio Decarbonization Coalition, PDC, together with the UN, among others. PDC is a coalition of investors and other stakeholders who urge investors globally to measure, publish and reduce their carbon footprint. PDC's goal is to make it easier for investors to quickly and easily streamline the carbon footprint in their portfolios and to develop "best practices" to achieve results. The PDC advocates transparency and the exchange of knowledge.

Together, the Swedish AP Funds have developed several indicators by which the AP Funds report their carbon footprint. Measuring the footprint is important because things that are measured increase the likelihood that they are also managed. The AP Funds coordination of indicators has attracted positive interest and attention in Sweden and internationally.

During the reporting period AP4 has also taken part in several owner initiatives, which support multiple global sustainability goals. Initiatives include, among others: urging companies to refrain from negative climate lobbying; calls on stock exchanges globally to apply the guidelines for sustainability reporting; support of initiatives requiring oil companies to work to reduce the negative environmental impact of their activities; and initiatives relating to human rights.



## Environmental goals

**Integrating sustainability aspects associated with the climate and environment in asset management has high priority. AP4 has a number of overarching goals for this work.**

AP4 shall:

### 1 Increase the share of investments that lower climate risk in the asset portfolio

During the year, the share of investments that lower climate risk in the asset portfolio increased to just under 31% of AP4's global equity investments.

The goal is to further increase the share of investments that lower climate risk in the asset portfolio.

### 2 Map out quantitative and qualitative indicators for Climate & Environment in AP4's assets

Work continuously to map out complementary indicators for Climate & Environment — both quantitative and qualitative — which can be used in asset management.

More indicators for climate risk are necessary as a complement to measuring carbon footprint, which only shows part of the exposure to climate risk in the asset portfolio.

### 3 Measure and disclose AP4's carbon footprint

The carbon footprint of listed shares shows certain aspects of the exposure to climate risk. AP4's yearly carbon footprint for holdings of listed shares is presented at [www.ap4.se](http://www.ap4.se).

### 4 Scenario analysis of climate-related risks and opportunities for AP4's assets

This work was initiated during the year and is continuing in 2018.

### 5 Help make the green bond asset class attractive and grow

AP4 shall contribute capital in new issues and create a liquid secondary market for green bonds when they meet AP4's criteria for sustainability and profitability.

At year-end AP4 owned green bonds with a market value of SEK 4.1 billion (4.9).

### 6 Spread knowledge about sustainability

The asset management organisation allocates time to share its knowledge and experience about low-carbon strategies and green bonds with other institutional investors. During the year AP4 gave presentations at the UN in New York and in connection with COP-23 in Bonn, among other venues.

# Climate & Environment

## - a focus area

---

**Awareness that our planet's resources are finite is increasing steadily. The climate and environment serve as the foundation for life as we know it today. It concerns essential and often global resources such as clean air and water, which all too often are taken for granted and are seldom priced correctly. The climate and environment are considered to have a material impact on the financial value of all of AP4's assets.**

### Priority focus area

For AP4 as a long-term investor, Climate & Environment is a natural choice as a priority focus area. Climate & Environment is the foundation for being able to achieve all of the UN's Global Sustainable Development Goals.

### Global threat

Climate change is about how greenhouse gas emissions and other emissions are having a negative effect on Earth's climate and leading over time to a higher average temperature. The climate affects our world, living environments and communities, and thereby also the profitability of all of AP4's investments. According to AP4's analysis, climate change is the overarching global threat to future returns and stable pensions. The expected effects of climate change are documented in many reports, as are assessments of how the Earth is will be affected by expected levels of temperature rise.

### Safeguard assets and the future

AP4's investments and work in the Climate & Environment focus area are aimed at lowering climate risk in the asset portfolio. This safeguards AP4's assets and returns in connection with an expected revaluation of, for example, carbon emissions and fossil fuel reserves and contributes to the shift to a climate-neutral society. The asset management organisation is working constantly

on developing and investing in various strategies in the Climate & Environment focus area and on contributing knowledge about low-carbon strategies and green bonds.

### Reduce climate risk in assets

In the shift to a climate-neutral society, AP4 believes among other things that greenhouse gas emissions will lead to rising costs for companies. Companies with large emissions and/or fossil fuel reserves will be negatively affected, and they will be valued and priced differently than today. It is for this reason that since 2012 AP4 is investing to lower the climate risk in its asset portfolio. Today a global platform is used for investments in low-carbon strategies, which have increased to 31% of the global equity portfolio as per year-end 2017. These investments reduce the climate risk in AP4's assets. Shares in companies with the relatively largest levels of carbon emissions in their respective sectors are being divested. This has resulted in a halving of the carbon footprint of these equity investments with limited risk-taking while maintaining an expected return relative to benchmark indexes.

### The environment – both a risk and business opportunity

Access to clean air, water and land is a life necessity. These are resources that AP4 believes will be priced more correctly in the future. Supply, the offering, regulation and pricing of such resources will affect the valuation of AP4's assets. The environment is an area with significant sustainability risks and business opportunities.

# The AP Funds' carbon footprint

---

## Coordination of carbon footprint reporting

AP4 and other AP Funds measure and report the carbon footprint of their investments yearly as part of their broader work on addressing climate change. While carbon footprint provides important knowledge, it also has limitations as a metric. The AP Funds have a council for cooperation composed of representatives from each of the AP Funds to coordinate and monitor developments surrounding climate reporting. In autumn 2015, AP4 – in cooperation with other AP Funds – presented a coordinated method of reporting their carbon footprint. The three indicators chosen for reporting the carbon footprint for listed equities are all calculated based on the AP Funds' share of ownership in the respective companies.

## Reporting of climate risks – TCFD

In December 2015 the Financial Stability Board formed a committee, the Task Force on Climate-related Financial Disclosures (TCFD), to come up with recommendations for climate reporting. In June 2017 the TCFD presented its recommendations. They are voluntary and apply for companies as well as investors. The framework is broken down into four areas: governance, strategy, risk management, and metrics and targets.

The TCFD's framework recommends that investors report carbon footprint using the weighted average carbon intensity metric. Using this metric, carbon intensity is calculated by multiplying a company's weight in the portfolio, based on market value, by the company's carbon intensity, and then adding these. The carbon intensity, per company, is calculated as the company's emissions in tons CO<sub>2</sub> divided by its sales in SEK million. Thus using this metric, the share of ownership has no significance. To align itself with the TCFD's recommendations, the AP Funds have decided to also include this indicator in the AP Funds' reporting.

## Carbon footprints are not fully comparable

The carbon footprints of various pension funds are hard to accurately compare with each other. For example, owing to differing portfolio values, asset allocations and investment strategies, the carbon footprints range in size from investor to investor. The differences are further accentuated by the underlying company information that must be adjusted, complemented or estimated, which means that the choice of source for carbon footprint calculations affects the result to some degree. As a result, carbon footprints are not fully comparable, neither among the various AP Funds nor compared with other investors.

## Carbon footprinting raises awareness and indicates trends

Measuring carbon footprints is important for raising awareness among investors about exposures in their portfolios. It can be a valuable metric to monitor over time for one and the same portfolio. The limitations include changes in asset allocation and portfolio values over time.

## Need for more quantitative and qualitative ways of measuring climate risk

In 2017 the council for cooperation evaluated various data providers' services surrounding carbon indicators for various asset classes and noted that development is evolving in this area. During the year several of the AP Funds took part in discussions with international investors on carbon footprinting. In these discussions a consensus was reached on the limitations of carbon footprint as a metric, due both to the lack of data and methodology and to the fact that the metric pertains only to certain aspects relating to climate risk in investors' portfolios. The AP Funds have therefore opted to wait with coordination regarding additional asset classes.



Carbon dioxide indicators	2017	2016	2015	2014	2013
Absolute carbon footprint, equivalent to owned share of companies total emissions (million tCO <sub>2</sub> e) <sup>1</sup>	2.35	2.60	2.45	2.80	3.28
Carbon dioxide intensity, absolute carbon footprint in relation to ownership share of companies' market cap <sup>2</sup> , (tCO <sub>2</sub> e/SEK m) <sup>1</sup>	11.5	14.5	14.0	16.2	23.1
Carbon dioxide intensity, absolute carbon footprint in relation to ownership share of companies' revenues, (tCO <sub>2</sub> e/SEK m) <sup>1</sup>	13.5	17.6	22.2		
Carbon dioxide intensity, portfolio-weighted mathematical average, (tCO <sub>2</sub> e/SEK m) <sup>1</sup>	15.3				
Identified market value as share of total fund capital, % <sup>1</sup>	56.5	55.7	56.4		
Identified market value as share of total equities, % <sup>1</sup>	97.2	95.5	99.8		

<sup>1</sup> Key ratio/figures are calculated for the assets in the balance sheet item Shares and participations, listed. Equity exposure via funds can be included to the extent that information is available about the funds' underlying holdings.

<sup>2</sup> Market value of listed equity portfolios.

# An owner that influences companies to improve

---

**Being an active, responsible owner through its asset management is one of AP4's sustainability focus areas. The goal is for companies to be managed sustainably, responsibly and as efficiently as possible. This creates conditions for them to be successful and deliver long-term sustainable returns, which in turn contributes to stable pensions.**

## **Responsible owner**

Corporate governance is an expressed part of AP4's strategy to enhance returns. Areas that are commonly addressed include a company's strategy, sustainability work, board composition, capital structure, remuneration structure and transparency. In general AP4 believes that direct dialogue, preferably face to face, with company boards, management and other owners often works best. In order for dialogues to work and be successful, they are conducted in confidence between the parties and not via the media, for example.

AP4's work with corporate governance aims to:

- Contribute to favourable, long-term sustainable returns
- Safeguard the best interests both of shareholders and individual companies
- Take into account the unique circumstances and needs of each individual company
- Exercise the rights and obligations of AP4's ownership role responsibly and with a long-term perspective and
- Promote the development of generally accepted practice in the securities market. Well-functioning stock markets are essential for long-term investors to be able to generate high and long-term sustainable returns





## Goals of corporate governance

### AP4 adheres to the following principles in its corporate governance:

#### 1 Participate on nomination committees

AP4 participated on 31 nomination committees ahead of companies' 2017 Annual General Meetings and is participating on 31 nomination committees ahead of the 2018 AGM season.

#### 2 Interview all or certain board members in connection with board evaluations

In a nomination committee's evaluation of a board, AP4 advocates that the nomination committee conducts its own interviews to gain a deeper understanding of how well the board is working. This is an important complement to any written, self-assessments that the board may have commissioned or to an external board evaluation.

#### 3 Advocate for greater diversity among board members, especially in terms of gender balance

AP4 advocates for greater gender equality and diversity. On the nomination committees that AP4 participates on, at least one woman should be on the short list of nominations for new board members, and the nomination committee shall strive to ensure that the Swedish Corporate Governance Code's recommendations on the proportion of women are met.

On the nomination committees on which AP4 participated ahead of the companies' 2017 AGMs, 15 newly elected board members were women, corresponding to 52% of newly elected board members.

#### 4 Exercise voting rights at Swedish AGMs

AP4 takes its active owner responsibility and voted at the AGMs of 73 Swedish companies in 2017. AP4 gives priority to companies in which it has major holdings, has a large share of votes, and/or to issues of fundamental importance.

#### 5 Exercise voting rights at foreign companies AGMs

AP4 takes its active owner responsibility and voted at the AGMs of 898 foreign companies in 2017. AP4 gives priority to the largest companies in the respective markets, companies that the Council on Ethics of the AP Funds works with, and companies through which AP4 is supporting an international initiative.

#### 6 Support initiatives for the adoption of governance and stewardship codes internationally

AP4 is eager to provide constructive views and recommendations in connection with the adoption or updating of governance and stewardship codes.

# Ownership work in 2017

---

## Corporate governance in Sweden

AP4 is one of the ten largest institutional investors on the Stockholm Stock Exchange. AP4 has a long tradition of taking responsibility both as a long-term owner and for developing generally accepted practices in the Swedish stock market.

At year-end 2017 AP4's Swedish equity portfolio had a market value of approximately SEK 65 billion. AP4 was thus one of the ten largest Swedish institutional owners on the Stockholm Stock Exchange. The largest ownership stakes are in small and mid-cap companies.

AP4 exercised its voting rights at the AGMs of 73 Swedish companies and participated on the nomination committees of 31 Swedish companies. The Swedish equity portfolio is broken down into a number of sub-portfolios, and in all of the Fund's actively managed strategies, corporate governance is an important governance tool for achieving the best possible return.

AP4 works with corporate governance in Sweden by:

- Engaging in dialogues with company boards and company managements
- Participating on nomination committees
- Engaging in dialogues ahead of company Annual General Meetings
- Voting at Annual General Meetings
- Engaging in dialogues with other owners and organisation
- Working together with other owners and organisations to drive issues with greater weight
- Developing corporate governance processes and practices
- Participating in the development of the Swedish stock market's system of self-regulation
- Supporting organisations and projects that promote sustainability
- Being active in issues of fundamental importance in the area of corporate governance
- Contributing to the development of stock markets

## Diversity important for the best possible boards

Ensuring that companies have the best possible boards is one of AP4's most important duties as an owner. In this work AP4 bases its assessment on the needs of the respective, individual companies. AP4 is an active proponent of greater diversity and gender balance on company boards, as this creates better conditions for value creation. AP4 therefore advocates that at least one person of each gender shall be on the short list of new board candidates. Of the newly elected board members in the companies for which AP4 served on the nomination committee in 2017, 52% were women.

## Remuneration programmes more closely aligned with investors' viewpoints

With respect to remuneration programmes, ahead of the year's Annual General Meetings, AP4 – like a number of other major owners – held meetings with a number of companies regarding their planned remuneration programmes. At these meetings AP4 had the opportunity to set forth its views on the structure of programmes with respect to performance requirements and the companies' information practices, among other things. In cases where AP4 does not believe that the proposed programme is suitable, reasonable and effective, AP4 acts to bring about adjustments in the programme.

It is gratifying to note that most of the remuneration programmes proposed during the 2017 AGM season were of the character that AP4 could provide its support. However, for a number of companies AP4 was of the opinion that the maximum outcome of the remuneration programme, in strictly monetary terms, could be extraordinarily high in relation to the desired performance. AP4 pointed this out to the companies and underscored the importance of limiting the maximum, total outcome. In a few cases AP4 gave its support to the programmes after changes in their structure were made; in other cases we voted against the proposal.



One example is the company Sobi, where AP4 agreed to support the board's proposed remuneration programme after certain adjustments were made to the programme. AP4 had voted against previous years' programmes – both in 2015 and 2016 – since on these occasions AP4 did not receive support for its proposed adjustments to the programmes. In addition, at Sobi's 2017 AGM, AP4 urged the company's board – ahead of future years' programmes – to take a further look at the scope of the programmes, among other things with respect to the number of matching shares.

### Corporate governance internationally

Shareholder rights differ widely from country to country. Voting rights in companies outside of Sweden are often more limited than they are in Sweden. In its international holdings AP4 drives many issues related to shareholder rights that are considered to be obvious in Sweden.

AP4 is a relatively small shareholder globally, and its opportunities are therefore smaller to engage in a dialogue ahead of company AGMs in the same way it can in Sweden. AP4 is eager to collaborate with other owners in order to drive issues with greater weight.

AP4 works with corporate governance in foreign companies by:

- Voting at AGMs
- Submitting or supporting shareholder proposals at AGMs
- Engaging in dialogues with company boards, company managements and other owners
- Cooperating with other owners and organisations in order to be able to drive issues with greater weight
- Supporting organisations and projects that promote sustainability

AP4 believes that it is important that there is a clear division of roles between a company's board of directors and its management. For this reason, AP4 voted against a number of board recommendations where individuals were proposed to "sit on two stools", that is, to serve as both Chairman of the Board and CEO at the same time. Such a condition is relatively common in American companies, such as is the case with 3M, GE and Texas Instruments. AP4's opinion is that this is unsuitable and that it is important that the roles of Chairman and CEO are kept separate. In these roles there should be a clear division of responsibility, authority and control. The board is responsible for the company's long-term strategy, for appointing and dismissing the CEO, and for monitoring the CEO's administration of the company's affairs in accordance with the adopted strategy. The CEO is responsible for leading the daily operational activities. The CEO reports to the board of directors. In the companies referred to above, the result from their respective annual meetings is that one person serves in both roles, i.e., is both the Chairman and CEO of the respective company.



A more detailed account of AP4's work with owner issues during the 2017-2018 AGM season will be presented (in Swedish only) in the 2018 AGM season report.



Active corporate  
governance in Japan

## Interview with Ken Kobayashi, Kenji Iwamoto and Arne Lööw

Ken Kobayashi is Chief Investment Officer and Kenji Iwamoto is responsible for active owner dialogue of the TMAM-GO Japan Engagement Fund. The fund is a collaboration between the large Japanese insurance company Tokio Marine and the British firm GO Investment Partners, which is an external asset manager specialising in corporate governance. AP4 and Tokio Marine were the first investors in the fund in 2012.

Arne Lööw is responsible for AP4's corporate governance work.

**Two major changes have taken place in Japanese corporate governance during the last five years. In spring 2014 Japan's Stewardship Code was introduced, the first stewardship code in Japan, and in the following year Japan's Corporate Governance Code was introduced. Prior to the establishment of these two codes, corporate governance was virtually an unknown concept in Japanese investor circles. It is now a well-known concept.**

### How has equity stewardship developed in Japan in recent years?

**Kenji:**

In 2012, when Shinzō Abe was elected as prime minister, it signalled an important breakthrough for equity stewardship in Japan. Prior to this, the rules surrounding stewardship were details-steered and ad-hoc in their character. Under Abe's administration, the stewardship and corporate governance reforms have become more comprehensive and principles-based. The government introduced the Stewardship Code in 2014 and the Corporate Governance Code in 2015. The goal has been to promote long-term sustainable development of Japanese companies, which has been determined to be necessary for vitalising the Japanese economy.

### Has it had any effect on the stock markets?

**Ken:**

Yes, it has entailed significant changes for both Japanese companies and investors. For example, in 2012 only 45% of the largest companies on the Tokyo Stock Exchange (First Section) had independent directors. Today nearly all of these companies have them. The share of independent, external directors today is approximately 30% for these listed companies.

### How has the changed regulations affected your asset management?

**Kenji:**

As it turns out, 2012 was a very well-chosen point in time to start this fund, with focus on active stewardship. Today there is considerably greater awareness about ownership issues among listed companies, and it is much easier today to discuss such issues with company boards and company managements. Something that we feel is very important is that our relationship and dialogues with boards and managements are conducted with a mutual

understanding and in a constructive and long-term manner. We do not believe that driving stewardship issues from a short-term, confrontational activist strategy has any potential for success in Japan.

**Ken:**

Our responsibility as a long-term owner is to invest in good Japanese companies and to contribute to their favourable development by engaging in a dialogue with the company boards and managements and sharing our views on issues that affect the companies' long-term growth strategies, capital structures, competition analyses, corporate governance and board compositions.

### Japan's Stewardship Code is now being reviewed for a planned revision in 2018. What lessons have been learned, and what improvements do you foresee?

**Arne:**

For AP4 it is important as an international long-term shareholder that corporate governance is conducted in a proper manner with the shareholders' interests in mind. We are therefore happy to contribute constructive views and recommendations when codes are to be adopted or updated. With respect to Japan's codes, we have been asked by Japan's Financial Services Agency (FSA) to provide input on both codes on separate occasions, which of course we were happy to do. Among other issues, AP4 emphasised the importance of independent board members and the separation of the CEO and chairman roles. Publishing information in English helps international owners understand the companies; in this regard, the information from Japanese companies can be improved. Transparency among the companies is increasing, which is good, but I would like to see even more information about the companies' long-term strategies.

# No investments in tobacco companies

## Elevated risks in owning tobacco stocks

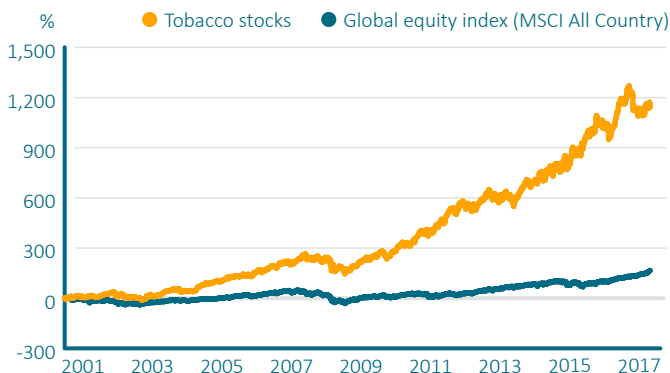
AP4 believes that rising long-term risks posed by greater regulation, among other things, will have a negative effect on tobacco company valuations in the future. These are risks that are determined to be incorrectly factored in today, and shares in tobacco companies are considered to be overvalued. Over time, tobacco companies therefore risk performing below the index. In view of this, in 2016 AP4 took the business decision to not own shares in tobacco companies.

## Tobacco stocks historically very profitable

In Sweden and many other countries it is currently legal to produce and sell tobacco despite the high costs to society — costs that are seldom compensated by tobacco taxes.

Tobacco stocks have essentially outperformed the index throughout the entire 20th century, that is, they have performed better than the market as a whole. Tobacco stocks have therefore historically been profitable to own and have given investors a relatively high and stable return.

## Tobacco stocks compared with global equity index



## Positive earnings contribution over time

Thus far, AP4's business decision to not own shares in tobacco companies has made a positive earnings contribution. In 2017, as well, the active position has developed favourably.



Tobacco stocks have historically generated a high return.

# The Council on Ethics of the AP Funds - promoting dialogue

---

**The Council on Ethics of the Swedish National Pension Funds is a collaboration between AP1-AP4 aimed at encouraging foreign companies to make improvements in sustainability.**

## **Continuous work — approximately 200 company dialogues**

The Council on Ethics of the AP Funds strives to influence companies around the world to pursue corporate social responsibility to ethical, environmental and sustainability issues that are of major importance for people and communities, and for the companies' own value creation. Through dialogues and talks, the Council on Ethics becomes engaged both preventively and in connection with incidents. In this way the AP Funds can prevent problems, violations and accidents in various companies and industries. The AP Funds believe that long-term value is created by sustainable companies, which contributes to development and to sustainable pensions. The Council on Ethics' ongoing work involves both preventive and reactive dialogues with foreign companies — some 200 dialogues a year — as well as industry projects, international collaborations and owner initiatives. Company dialogues focus on how companies deal with difficult issues in their operations, including corruption, human rights, labour rights, health and safety, pollution and biodiversity. The Council on Ethics of the AP Funds conducts preventive projects in areas such as human rights and anti-corruption.

## **Celebrating ten years of close collaboration**

The Council on Ethics of the AP Funds is a successful collaboration between the AP1, AP2, AP3 and AP4, and celebrated its ten-year anniversary in 2017. In connection with this, two highly attended seminars were held on responsible and sustainable investments:

- About climate change with Al Gore and Johan Rockström
- About responsible investments, human rights and the environment

## **Annual report describes work**

The work of the Council on Ethics of the AP Funds is described in an annual report that is published in spring each year. For further information, visit its website: [www.etikradet.se](http://www.etikradet.se). The Council on Ethics of the AP Funds advocates for a strengthening of human rights in companies' activities. Human rights shortcomings are a problem in many sectors, especially in industries with long supply chains and production in countries with weak legislation and compliance. The fishing industry is one example, where the Council of Ethics is working through owner initiatives to improve working conditions and remedy sub-standard conditions.

## **The AP Funds core values for sustainability and corporate governance**

The AP Funds have a mandate from the Swedish Parliament to create a high return at a low risk for current and future pensioners. It is the AP Funds' view that, over time, well-managed companies provide higher returns at lower risk if sustainability is included in the business, both in its own organisation as in the investment process.

As part of the Swedish pension system, the core values of AP1-AP4 build on the core values of the Swedish state, where democracy and sustainable development are key tenets 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 they do not contribute to violations of international conventions, whether these target nation states, individuals, companies or organisations. This responsibility also applies even if countries where 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



## Council on Ethics Swedish National Pension Funds

is already in place. The AP Funds will continuously monitor the progress of the ratification process of the new or revised convention.

If Sweden has not ratified a convention within a three-year period from the point when the nation originally supported it, the AP Funds can review the basis for their guidelines in those issues relating to the new or modified convention.

The AP Funds' work on 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 towards sustainable development, taking action and making demands for transparency and

positive change. This contributes to the AP Funds' ability to fulfil their mandate.

### Companies recommended for exclusion

Below is a list of the companies recommended by the Council on Ethics for exclusion by the Fund in question. The recommendation for exclusion also applies to listed subsidiaries.

The Council on Ethics has the annual routine of urging these excluded companies to act in compliance with the international conventions.

Company	Country	Sector	Year
Elbit	Israel	Aerospace and defence	2010
Freeport McMoRan	United States	Metals and mining	2013
Hanwha	South Korea	Chemicals	2008
Incitec Pivot	Australia	Chemicals	2013
L-3 Technologies Inc	United States	Aerospace and defence	2008
Larsen & Toubro	India	Industrial	2015
Motorola Solutions	United States	Telecom	2015
Nutrien	Canada	Chemicals	2013
Orbital	United States	Aerospace and defence	2008
Poongsan Corp (Inkl Holding)	South Korea	Metals and mining	2008
Textron	United States	Aerospace and defence	2008
Walmart Stores Inc	United States	Food and staples retailing	2013
Zijin Mining	China	Metals and mining	2016

# Stakeholder dialogues and transparency

---

**A stakeholder is a party who is affected by or has interests in AP4's operations. In its varying roles as a governmental authority, AP Fund and investor, AP4 has many different stakeholders. In meetings and dialogues with our stakeholders, AP4 explains its operations, listens to views and takes in the opinions of others about its work.**

## **Meetings with stakeholders, dialogues and materiality review**

Through their operations and investments the AP Funds have an influence on people, the environment and society. To learn about which sustainability issues that AP4's stakeholders consider to be the most important, every couple of years AP4 conducts a materiality review among its stakeholders. In 2017 AP4, together with AP2, AP2 and AP3, invited representatives from various stakeholder groups to a joint workshop for dialogue and a materiality analysis. Approximately 60 persons participated in the workshop, representing principals (representatives from the Ministry of Finance and persons from the pensions group), beneficiaries, society (such as stakeholder organisations and labour market parties), industry colleagues, suppliers, employees and portfolio companies.

The AP Funds' objective with the workshop was to identify stakeholders' expectations and prioritised issues, obtain feedback on the AP Funds' current sustainability work, and to hear stakeholders' thoughts on the continued sustainability work.

## **Returns and sustainability of investments**

The joint dialogue between the AP Funds and their stakeholders also served to increase the level of knowledge for the participants themselves. The AP Funds informed about their joint mission and how it is coupled to sustainability. The stakeholders had the opportunity to discuss the AP Funds' sustainability work with

persons from different backgrounds, and with different interests and expectations on the AP Funds' sustainability work.

The workshop participants were asked to freely discuss which sustainability issues they felt were especially important for the AP Funds to focus on. They were also asked to take a position on and rank sustainability issues that were identified in advance by the AP Funds. They were given an opportunity to complement with any questions and views.

## **The return was considered as the overarching goal**

The stakeholders considered the return on the buffer capital to current and future Swedish pensioners as the overarching goal. All stakeholder categories were also of the opinion that it is the AP Funds' actions with respect to investments and asset management that are the most important regarding sustainability. This was in view of the fact that it is in these areas where the most material impacts are made.

## **Three priority issues**

It was ascertained that the choice of prioritised sustainability issues varies from company to company and among the externally managed funds that the AP Funds invest in. However, three issues were raised as particularly important and of top priority:

- the environmental impact of portfolio holdings
- the carbon footprint of portfolio holdings
- human rights

An ethical business approach was considered by several participants to be a basic precondition for operations. Business ethics and compliance were given high priority by industry representatives and suppliers, and were also cited by beneficiaries and the "society" category.

Other issues that were considered to be material were a sustainable supply chain, diversity and gender equality, and anti-corruption. All categories except for stakeholders of other investors considered these to be the most important sustainability issues.

Other investors cited the UN's global Sustainable Development Goals, which encompass sustainability issues. Other stakeholder categories viewed the SDGs as a tool and framework for working with sustainability.

The issue of working conditions was taken up by people in most categories. Other investors also viewed internal competency and transparency as particularly important issues apart from business ethics and compliance. However, the issue of internal competency was viewed by certain categories as a tool and not an issue by and of itself.

Human rights as a concept was discussed, and views were expressed that this may be a broader concept that encompasses issues such as diversity, gender equality and working conditions.

### **Preferences for communication**

The stakeholder groups noted that the AP Funds can raise the level of trust through greater transparency and more active communication. Most of all this would help make future beneficiaries feel secure. Showing the positive relationship between sustainability and long-term returns would strengthen credibility.

The importance of cooperation was also highlighted. Cooperation is needed to achieve good outcomes. This includes cooperation with other owners or other actors as well as various forms of collaboration.

### **Work continuing in 2018**

It was gratifying that the workshop showed a number of stakeholders that the AP Funds have very successful at communicating their sustainability work. In addition, the discussions gave valuable insights into the stakeholders' views on and priorities surrounding various sustainability issues. The lessons learned and results from the meeting have proven to be a valuable contribution to AP4's work on developing its priorities of sustainability aspects in its operations, reporting and communication.

### **Dialogue necessary for achieving sustainability**

Dialogue with AP4's stakeholders can take place in individual meetings, in group meetings, at presentations, conferences, and evaluations, and via the media. Through these dialogues AP4 gains a better understanding of its various stakeholders' expectations. The stakeholders, in turn, gain a greater understanding of the work the AP4 conducts, the frameworks that AP4 works in, and the risks and opportunities associated with how AP4 conducts its operations in both the short and long terms.

### **Transparency a watchword**

Transparency is a watchword for AP4 and essential for instilling trust, both as a major, long-term investor and as a government agency. AP4 has many different stakeholders, and to enhance external stakeholders' understanding, reviews and evaluations, high transparency is essential. AP4 takes great pains to be transparent in its reporting and communication as far as possible without being of detriment to its operations.

### **Reviewed and evaluated by several stakeholders**

The AP Funds' operations and oversight of such are regulated by law. The AP Funds' boards are appointed by the government. The board of each Fund monitors and evaluates the administration of the Fund on a continuous basis. External auditors review the operations and accounts yearly. The government conducts a special evaluation yearly in a process spanning several weeks where consultants interview, analyse and evaluate the operations and various specific areas within these. This review is summarised in a public report that is submitted to Parliament every year. The government's evaluation provides vital feedback and contributes to AP4's work on developing its operations. Additionally, the AP Funds are subject to reviews and input from the media and stakeholder organisations.

# Partnership and initiatives

---

By cooperation with other investors, AP4 gets more possibilities to influence the companies we invest in. Below are some of the partners and/or organisations that AP4 supports.



The **AP Funds' Ethical Council** is a collaborative venture between the First, Second, Third and Fourth AP Funds. The AP Funds work together to achieve improvements in foreign companies work with corporate governance.



The **IIGCC** is a forum for investors to collaborate on climate change and to conduct dialogue with companies, politicians and other investors.



**PDC** is a project for investors to measure and disclose their CO2 footprint and through different strategies to reduce their CO2 emissions. AP4 was one of the founders of PDC together with the UN (UNEPFI).



**PRI** is a UN-initiative for responsible investors, aimed at enhancing corporate and actors' responsible actions in the field of ethics and the environment. AP4 is the signatory of these principles since 2007.



**EITI** is an initiative for open reporting in the extractive industries to counter corruption.



**Investor Platform for Climate Actions** is an online platform to highlight the actions they are taking to curb climate change. PDC, IIGCC, PRI and CDP were the ones who launched the platform.





**Hållbart Värdeskapande** is a cooperation between 17 of Sweden's largest institutional investors and Nasdaq OMX Stockholm.



**ICGN** is a global cooperation to raise the standard of corporate governance worldwide. ICGN works for shareholders to win more rights to vote at shareholder meetings.



Through the initiative **Fossil Free Sweden**, Swedish stakeholders get the chance to visualize how they contribute to climate change.




**CDP** is an international collaborative project to reduce companies' impact on the environment and raise awareness of climate change.



**Climate Action 100+** is a five-year initiative led by investors to engage with the world's largest corporate greenhouse gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures.



**The Montreal Carbon Pledge** is an initiative to commit investors to measure and publicly disclose the carbon footprint on an annual basis.



AP4's mission is to  
contribute to financial  
security for today's and  
tomorrow's pensioners.