

# Ownership Report 2018



We invest pension assets  
to make them grow

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# We invest pension assets to make them grow

**FÖRSTA AP-FONDEN (AP1)** IS firmly based in Sweden, but executes its mandate around the world. This means that British real estate projects, American technical innovations and Japanese basic industry are all part of our day.

We manage part of the capital in Sweden's national income pension system. Our assets of more than SEK 320 billion are distributed across equities, fixed-income securities, real estate, infrastructure, private equity funds and hedge funds. We invest sustainably and long-term, and practise responsible ownership.

70 St Mary Axe in London's financial district is home to the sustainability-oriented real estate project in which AP1 has invested via CityHold. The property, dubbed the 'Can of Ham', is one of many examples of how the Fund manages Swedish pension assets.

# We take responsibility for our returns and our environment

Första AP-fonden (AP1) worked on a broad front in 2018 to further develop its sustainability work. New legal requirements with a focus on improvements are consistent

Developments in the field of sustainability continued at a fast pace in 2018, and this also had an effect on AP1.

“Taking sustainability into account is one of the core beliefs from which we work in our asset management. We integrate sustainability into our investments so as to increase returns and reduce financial risk in the long run,” says CEO Johan Magnusson.

**“We contribute to new methods to integrate sustainability into investments.”**

Over the past year AP1 further developed its sustainability work through an overarching internal process, partly by formulating specific sustainability beliefs.

“The beliefs sum up our approach to sustainability in clear principles that can be applied in practice throughout the organisation,” says Magnusson.

The UN’s global Sustainable Development Goals guide AP1. There are, however, many goals and they are general, which means they need to be prioritised.

“We consider seven of the UN goals to be particularly relevant to our operation. Some of these are important in our dialogue with the companies in which we invest, where they serve as tools for change in the companies. The other goals relate to areas where we can look for investments that will contribute

both to the Fund’s return and to a more sustainable society,” says Magnusson.

On 1 January 2019, the changes to the National Pension Insurance Funds (AP Funds) Act came into force. The act states that the funds should be managed in an exemplary way through responsible investment and responsible conduct. This represents a tightening of the law compared with earlier, as the equivalent formulation before was that the AP Funds must take the environment and ethics into account.

“The requirements on exemplary conduct place a greater emphasis on improvement, which is consistent with our own ambitions,” says Magnusson.

To prepare for the changes to the AP Funds Act, AP1 worked intensively with the other AP Funds to clarify the act’s requirements on acting in an exemplary way from a sustainability perspective. The collaboration between the Funds encompasses core values for asset management, as well as guidelines on reporting goal attainment and which assets funds should not be invested in.

As before, the guidelines for deselecting investments are primarily based on international conventions signed by Sweden.

“Furthermore, AP1 is choosing not to invest in a hundred or so companies that produce tobacco, nuclear weapons, thermal coal or oil sands, even though these companies do not directly breach international conventions.

We are also excluding companies that produce cannabis for non-medical use,” says Ossian Ekdahl, Chief Active Ownership Officer.

When it comes to nuclear weapons, the Fund excludes companies that go against the spirit of the Treaty on the Non-Proliferation of Nuclear Weapons, the aim of which is to rid the world of nuclear weapons in the long term. Examples of non-compliance include working on modernisations and upgrades to existing nuclear weapons.

“The decision to deselect coal for energy, as well as oil sands, is based on the fact that these types of energy have the worst climate impact per unit of extracted energy. We do not consider investments in tobacco production to be compatible with the spirit of the Framework Convention on Tobacco Control,” says Ekdahl.

**“AP1 is a dedicated owner.”**

AP1 actively contributes to developing new methods for integrating sustainability in investments. There are three examples of this from 2018.

The Fund initiated a unique project to highlight human rights in its investment analyses. This pioneering work is based on UN criteria and is taking place in collaboration with US asset management firm Arabesque.

Another innovative collaboration makes it possible to consider sustainability when making investments on emerging markets. In 2018, AP1 and asset management firm BlackRock started a special fund for developing the ability to combine financial metrics and



Johan Magnusson, CEO of AP1, and Ossian Ekdahl, Chief Active Ownership Officer, summarise sustainability in 2018.

sustainability data on these markets where the companies' own information is often inadequate.

“Together with other financial institutions and several academic ones, we began a pilot study looking at the impact of climate change on decisions regarding strategic portfolio allocation. The study is one of the first of its kind. Better knowledge about how climate change can affect risks and returns is important for our long-term return,” says Ekdahl.

AP1 is a dedicated owner and exerts its influence by voting at shareholders'

general meetings and participating in nomination committees. In 2018 we took part in 37 Swedish general meetings and voted in 570 foreign ones. Particular attention was paid to the companies Eltel, Hexagon, Munters, Nordea, Starbreeze and Stillfront.

An EU directive regarding shareholders' commitment will be introduced into Swedish law in 2019. In 2018, the Fund took part in a reference group to help adapt the legislation to Swedish conditions.

In 2019, Ossian Ekdahl is Chairman

of the AP Funds' Council on Ethics. The Council on Ethics is working to ensure that companies in the Funds' foreign holdings act responsibly. Moving forward the AP Funds will continue to discuss the AP Funds Act's new goals on exemplary conduct in its management with the Council on Ethics.

“We see that the requirements placed on us as owners are continuing to be raised, which we welcome. Dialogue and advocacy represent our main opportunities to contribute to better companies with good return potential,” says Magnusson.

# Sustainable value creation – a basis for our mandate

AP1's mandate is to manage the assets to the greatest possible benefit of current and future Swedish pensioners. Sustainability is an integral part of the Fund's management.

The AP Funds shall manage a part of the pension assets and generate a high return so as to balance any gap between contributions and disbursements and help to keep the pension system stable in the long term.

The pension system is structured in such a way that it cannot make a loss over time. It does, however, happen that pension contributions paid in are not sufficient in the short term to pay out disbursements, which is the case at present. This is when the difference is balanced out by withdrawing funds from the First, Second, Third and Fourth AP Funds (AP1-4).

It is therefore the task of AP1 to

secure income pensions by creating the highest possible return. We strive to be a world-class pension manager, and to perform on the same level as leading global asset managers.

Our asset management should result in the return on net assets developing better than average pay. The real, i.e. inflation-adjusted, return shall be higher than 4.0 per cent after expenses, measured on a rolling ten-year basis. The risk shall be low in the long term.

## Control and mandate

The AP1 Board of Directors establishes the return target and decides the level of

financial risk the Fund should take. The Board specifies on a general level how much capital should be invested in equities and fixed-income securities respectively. It also establishes which deviations from the goals and which asset classes are permitted. The starting point for the Board's decisions is the AP Funds Act. The Board's guidelines are broken down into several levels at AP1.

The Fund's operation is continuously monitored in its operating activities via internal control and internal auditing. The Fund is also scrutinised annually by external auditors, and by the Swedish Government.

## Investment beliefs guide the way

AP1's investment beliefs set out frameworks for how the portfolio should be composed. The beliefs are applied both in assessing new investments and in evaluating existing ones. One of the six investment beliefs is sustainable value creation.

### Diversification

We invest worldwide and in many different types of asset. The aim is to spread the risks and to create several options for generating returns.

### Long-term approach

A long-term approach creates more opportunities to take risks, and thereby create returns. The risks are balanced over time.

### Risk premiums

Risk-taking on the financial markets is assumed to yield a positive return over time. The risk premium is the extra return earned in relation to risk-free interest.

### Inefficient markets

An information advantage and meticulous analysis provide opportunities for higher returns on less well-analysed markets.

### Cost efficiency

AP1 should act on a commercial basis and have low costs in relation to the profit it makes.

### Sustainable value creation

Focus on sustainable value creation makes it possible to increase returns and reduce financial risk in the long term.

We believe that well-managed companies have greater potential than others.

The Funds shall manage the funds in an exemplary way through responsible investment and responsible conduct. We consider sustainability to be the responsible use of natural resources, human resources and financial capital, and we are working on improvements within ESG (Environment, Social and Governance).

We exercise active ownership through voting, appointing boards, dialogue, legal proceedings, influencing legislation and, as a last resort, exclusion.

Housing company Willhem, which is owned by AP1, strives to ensure that its properties and tenants are happy and healthy on the financial, environmental and social plane. Willhem is therefore an example of how AP1 integrates sustainability into its investments.



# Guidance for sustainability

AP1 is a major investor that plays a key role in society. The Fund's sustainability work reflects this influence by taking a great many frameworks into account.

One key starting point for AP1's active ownership is the National Pension Insurance Funds (AP Funds) Act. Since 1 January 2019, the legal wording states that the Fund must manage assets in an exemplary way. Decisions must not be influenced by government policies, whether industrial or economic. In addition to the act, the Fund follows a number of principles, goals and collaborations. Here are a selection. A more detailed description is available on [www.ap1.se](http://www.ap1.se).

## International frameworks

### *UN – Global Compact*

Minimum requirement for sustainable enterprise, linked to international conventions.

### *UN – UNGP*

Guidelines for human rights

### *UN – Sustainable Development Goals (SDGs)*

Global development goals for all parts of society.

### *UN – Principles for Responsible Investment (PRI)*

Guidelines for investors on integrating sustainability issues into asset management.

### *OECD – guidelines*

OECD principles for investors, called Responsible Business Conduct, provide practical guidance on sustainability risks.

### *International Corporate Governance Network (ICGN)*

A global cooperation to raise standards in active ownership.

### *Global Reporting Initiative (GRI)*

Guidelines for reporting sustainability.

### *The Amsterdam Group*

A number of Western European institutional owners who work together to promote sustainability.

### **Industry initiative**

#### *Extractive Industries Transparency Initiative (EITI)*

An initiative for open reporting in the extractive industries, primarily oil companies, aiming to avoid corruption.

#### *Global Real Estate Sustainability Benchmark (GRESB)*

An organisation that collects and compares sustainability data on real estate and infrastructure on behalf of investors.

### **Climate commitments**

#### *CDP*

Asset managers place requirements on the world's biggest listed companies to disclose emissions of greenhouse gases.

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

A European collaboration between investors.

#### *Montreal Carbon Pledge*

A commitment for investors to report their portfolios' carbon footprint.

#### *Investor Platform for Climate Actions*

Investor collaboration to reduce climate change.

#### *Transition Pathway Initiative*

Investors evaluate companies' preparedness regarding the climate, including data for Climate Action 100+.

#### *Climate Action 100+*

An investor collaboration that engages

in dialogue with the more than 100 companies that are deemed to be the biggest emitters of carbon dioxide globally. The data is obtained from the TPI.

#### *Task Force on Climate-related Financial Disclosure (TCFD)*

A group of experts providing recommendations on reporting climate-related risks.

### **Initiatives based in Sweden**

#### *The AP Funds' Council on Ethics*

A collaboration between the First, Second, Third and Fourth AP Funds (AP1, AP2, AP3 and AP4) to influence non-Swedish companies to improve their sustainability work.

#### *Sustainable Value Creation*

A collaborative project between institutional investors and Nasdaq OMX.

#### *Institutional Owners Association and the Swedish Securities Council*

Contribute to self-regulation on the capital market.

#### *StyrelseAkademien*

Promotes professional board work that creates value.

#### *The Remuneration Academy*

Strives to ensure remuneration systems in companies are effective, balanced and relevant, and perceived as legitimate.

#### *Sweden Sustainable Investment Forum (SWESIF)*

An independent networking forum for organisations that work for or with sustainable investments.



# Sustainability beliefs

AP1's investments focus on the following aspects of sustainability:

## Integration

Taking account of sustainability issues in the investment process puts us in a better position to achieve our mission. We believe that well-managed companies have greater potential than others to generate a good return at a low risk over time.

## Prioritisation

We prioritise selected areas of sustainability. The overriding aspect is not to violate any international conventions or national laws. Otherwise we weigh up aspects that are important to the portfolio, where;

- the risk and return are significantly affected
- major sustainability effects are achieved in relation to invested capital, or
- the risk of a damaged reputation is considered to be significant.

## An overall approach

We consider the companies' entire



Electricity distribution company Ellevio is part of the Fund's asset portfolio.

value chain. Sustainability analyses are conducted on everything from raw materials to scrapping, rather than on what is easiest to gauge. Genuine improvements in the companies we own are more important and more profitable than improvements in the portfolio's key ratios solely from changed ownership of securities.

## Influence

By being an active, long-term owner, we can try to influence companies we

own in a desirable direction when it comes to sustainability. To maximise the impact, we work with other investors.

## Openness

Greater transparency in sustainability provides us with a better body of basic data when deciding on investments. We promote the development of better, more relevant sustainability reporting, both among the companies and ourselves.

# Ownership policy

The sustainability beliefs permeate the ownership policy. These two documents steer the Fund's conduct and decisions.

## Voting rights

The right to vote in shareholders' general meetings must be unrestricted and changes in voting rights must be voluntary.

## Equal treatment

Shares granting equal financial rights should always be treated equally. Minority shareholders must be protected.

## Capital structure

The capital structure should be appropriate considering the profit

potential. Capital that is not used effectively should be distributed to the shareholders.

## Company boards of directors

Company boards are appointed by the shareholders. Board members should have the right expertise and a high level of integrity. The composition of the board should promote diversity. Remuneration should be reasonable, market-based and reflect the demands set.

## Remuneration

Remuneration to senior executives should benefit the company and be reasonable, market-based and openly justifiable to the company's stakeholders.

## Audit and internal control

The auditors are appointed by the shareholders. There are high demands on their independence from the company and its management.

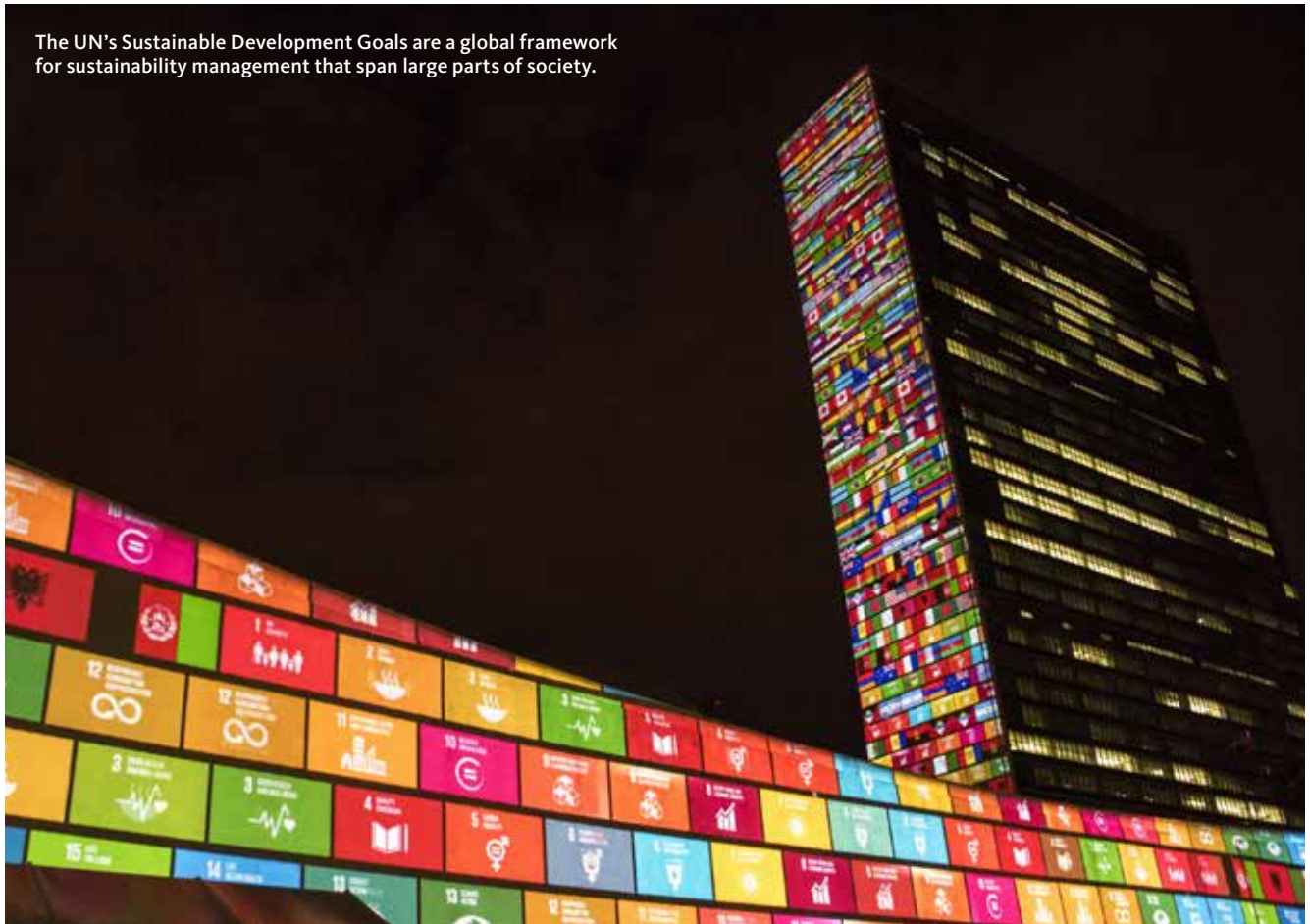
## The environment and social issues

If an operation can be associated with infringement of a convention Sweden has ratified, the Fund should influence the company and if nothing else works exclude it from investments.

## Information disclosure

The operations should seek an open dialogue with the shareholders, with information that is accurate, clear, objective and trustworthy.

The UN's Sustainable Development Goals are a global framework for sustainability management that span large parts of society.



## Our view of the UN's SDGs

AP1 has pledged to invest in accordance with the UN's Sustainable Development Goals (SDGs).

The goals are very wide-ranging and the Fund has therefore chosen to focus on the seven goals that are deemed to be most relevant to a long-term investor commercially, while helping to create a positive change in society at the same time.

### Dialogue

Placing the emphasis on dialogue with companies, as a tool for change, rather than on excluding securities is a fundamental approach for AP1. Such dialogue often focuses on the following UN goals:

- 5 – Gender equality
- 8 – Decent work and economic growth
- 16 – Peace, justice and strong

institutions (with a focus on the sub-area of corruption and bribery)

### Dedicated investments

Dedicated investments comprises the areas where the Fund actively seeks investments that could contribute to a more sustainable society, while the return must also be high. Four of the UN's goals have been selected here for guidance:

- 7 – Affordable and Clean Energy
- 9 – Industry, innovation and infrastructure
- 11 – Sustainable cities and communities
- 12 – Responsible production and consumption

These areas include much of what is also important in other goals, such as sustainable energy generation and energy management, health and

well-being together with good education and decent working conditions.

AP1 is looking for investments that benefit from a shift towards a more sustainable society and are also attractively priced. Within goal 9, 'Industry, innovation and infrastructure', this could relate to train operators, real estate for care or other community functions, or power distribution in developing countries, for example.

In goal 11 'Sustainable cities and communities', this might include sustainability consultants, electric cars, air purification technology or catastrophe bonds. Potential investments under goal 12 'Responsible production and consumption' might be companies in the collaborative economy, waste management companies or food ingredients that prolong freshness and therefore reduce waste.

# Carbon footprint

Carbon footprint reporting is part of the Fund's annual performance reporting.

Every year, AP1 reports on the carbon footprint in its investments using four indicators. Three of them are calculated based on the Funds' holding percentage in the companies. The fourth indicator is a weighted average, reported in accordance with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD).

The carbon footprint calculations are carried out using data for direct emissions, Scope 1, and indirect emissions from energy, Scope 2.

The basic unit for reporting is the

number of tonnes of carbon dioxide equivalents (tCO<sub>2</sub>e). The same indicators are used for the other three AP Funds. The results of the various Funds are, however, not fully comparable. AP1 is a driver in developing metrics for carbon footprint, which is still in its early stages as a process and does have limitations.

During 2018, AP1 has changed its supplier of data and calculations from Trucost® to MSCI. Consequently, the figures for 2018 are not fully comparable with previous years.

The Fund's carbon footprint has worsened between the 2017 and 2018 year-ends. This is partly due to the fact that the Fund sold its holdings in companies that produce tobacco, coal and oil sands, and companies involved in the modernisation of nuclear weapons. Many of these companies have a stable share price development (low volatility). Some of the Fund's systematic strategies replaced these shares with other equities with low volatility, which proved to have a higher carbon footprint.

	Absolute carbon footprint (tCO <sub>2</sub> e)		Carbon intensity in relation to market value (tCO <sub>2</sub> e/SEK m)		Carbon intensity in relation to turnover (tCO <sub>2</sub> e/SEK m)		Carbon intensity, weighted average relative to turnover is multiplied by the company's percentage of the portfolio (tCO <sub>2</sub> e/SEK m)		
	Absolute	Relative <sup>(1)</sup>	Absolute	Relative <sup>(1)</sup>	Absolute	Relative <sup>(1)</sup>	Absolute	Relative <sup>(1)</sup>	
Sweden	106,000	-31%	3.1	-31%	4.4	-38%	4.3	-14%	
Developed markets	705,000	37%	20.3	37%	38.2	67%	41.2	88%	
Emerging markets	982,000	-32%	24.5	-32%	36.2	-26%	29.5	-26%	
<b>Total</b>	<b>1,756,000</b>	<b>-12%</b>	<b>16.1</b>	<b>-12%</b>	<b>24.8</b>	<b>-9%</b>	<b>25.2</b>	<b>14%</b>	
<b>Year-on-year comparison</b>							<b>2018</b>	<b>2017 <sup>(2)</sup></b>	<b>2016</b>
Absolute carbon footprint equating to the owned share of the companies' aggregate emissions (millions of tCO <sub>2</sub> e)							1.8	1.6	1.7
Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' market value <sup>(3)</sup> (tCO <sub>2</sub> e/SEK m)							16.1	12.8	14.2
Carbon dioxide intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' turnover (tCO <sub>2</sub> e/SEK m)							24.8	20.6	24.7
Carbon intensity, weighted average, where the companies' carbon intensity relative to turnover is multiplied by the company's percentage of the portfolio based on market value (tCO <sub>2</sub> e/SEK m)							25.2	24.2	N/A
Charted market value as a percentage of total net assets							34%	39%	39%

<sup>(1)</sup> The 'Relative' columns show the extent of the portfolios' carbon footprint in relation to that of the benchmark portfolios.

Negative figures mean that the Fund's portfolio has a footprint lower than that of the benchmark portfolios.

<sup>(2)</sup> The 2017 figures published in the AP1 Annual Report 2017 have been adjusted.

The table above shows AP1's carbon footprint according to the above metrics for the listed part of the equity portfolio. That portfolio makes up 34 per cent of the Fund's total portfolio. For 2018, 71 per cent of the carbon footprint in the total portfolio is based on reported emissions. For 23 per cent of the portfolio, the calculations are based on estimated data. A summary of the calculations is published on [www.ap1.se](http://www.ap1.se). The calculations are performed by MSCI. The carbon footprint from AP1's office operation and its employees' travel has been offset since 2015.

# The Fund deselects more investments

AP1 is deselecting investments in nuclear weapons, tobacco, coal and oil sands. The general level of ambition regarding sustainability is also being raised with the introduction of changes to the AP Funds Act.

The latest version of the AP Funds Act, which was introduced on 1 January 2019, includes a new section stating that funds should be managed in an exemplary way through responsible investment and responsible conduct.

The act's previous formulation stated that the AP Funds must consider the environment and ethics. The change imposes higher demands as regards sustainability issues, but still with the basic premise not to compromise the overarching goal regarding risk level and returns.

AP1 has long been working to integrate sustainability into its investments. The requirements on exemplary conduct place greater emphasis on improvement, which is consistent with the Fund's own ambitions.

The act's new wording does not go into detail about exactly what exemplary management entails. Swedish

parliament tasked the four AP Funds with clarifying this point jointly, which they accomplished through an intense collaboration in autumn 2018. An evaluation of the work on exemplary conduct will form part of the parliament's annual review of the AP Funds.

Cooperation between the Funds encompasses common core values for asset management, common guidelines for reporting on how the sustainability objective has been achieved, and common guidelines on which assets funds should not be invested in.

Exemplary management requires the Funds to integrate sustainability factors such as the environment, social aspects, corporate governance and business ethics in the various operations. It relates both to the own organisation and to the management of the net assets.

The shared core values for the AP Funds are based on the constitutional

values of governmental operations: democracy, legality, objectivity, freedom of opinion, respect, and efficiency and service. The Funds have crystallised the meanings of these principles for their operations.

## Deselecting companies

When it comes to which assets funds should not be invested in, the Funds have drawn up common guidelines, which mainly relate to international conventions signed by Sweden.

In the shared core values, it is noted that the principle of legality means that the AP Funds must observe the international conventions ratified by Sweden and the international agreements backed by Sweden. These therefore form the basis for assessing which assets funds should not be invested in.

A Fund may remain an owner even if a company does not meet the set requirements, with the aim of trying to influence the company in a desirable direction. In the same way, a Fund may decide to exclude investments on other grounds.

Each Fund thus interprets how the guidelines affect that Fund's portfolio, and makes any adjustments to its holdings accordingly.

AP1 no longer has investments in companies that produce nuclear weapons, tobacco, coal or oil sands, even though these companies do not directly breach international conventions. We do not consider such ownership to be exemplary, as it goes against the spirit of conventions. Around a hundred companies are affected in total.

Furthermore, since autumn 2018

## Three industries removed from the portfolio

AP1 no longer has investments in companies that produce:

### Nuclear weapons

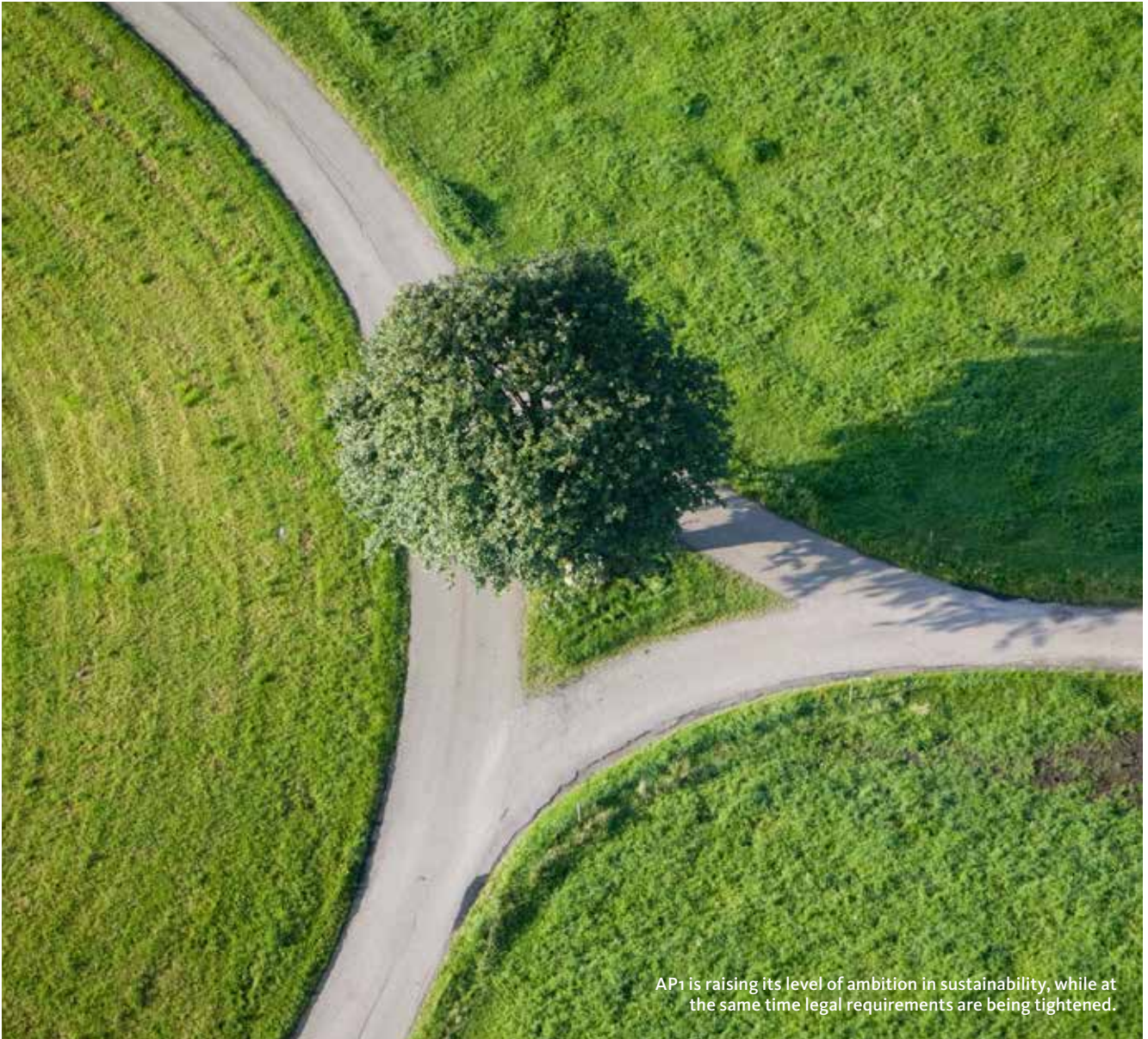
We do not invest in companies with operations that are not in line with the spirit of the Non-Proliferation Treaty, the aim of which is eventually to rid the world of nuclear weapons. We include the modernisation and upgrading of existing nuclear weapons in this category.

### Tobacco

We do not consider investments in tobacco production to be compatible with the spirit of the Framework Convention on Tobacco Control, which aims to dramatically reduce tobacco consumption and the harmful effects of smoking tobacco.

### Carbon and oil sands

In our opinion, using carbon and oil sands for energy, which have by far the worst climate footprints, makes it difficult to achieve the climate goals set out in the Paris Agreement.



AP1 is raising its level of ambition in sustainability, while at the same time legal requirements are being tightened.

AP1 also excludes companies that produce cannabis for non-medical use.

**Reporting leads to development**

Reporting on how the sustainability goals are being achieved is a pivotal aspect on the endeavour towards exemplary conduct. Anything that is measured can be studied and followed up.

Each AP Fund publishes an annual and a half-yearly report, as well as a sustainability report. Reporting and valuation have gradually been adapted to International Financial Reporting Standards (IFRS). The reporting strives to follow the Global Reporting Initiative (GRI) international standard.

The Funds also report annually on the UN-supported Principles for Responsible Investment (PRI), the Task Force on Climate-related Financial

Disclosures (TCFD), their own carbon footprint cooperation, and the UN global Sustainable Development Goals (SDGs).

**Council on Ethics takes the discussion further**

In 2019, AP1’s Ossian Ekdahl, Chief Active Ownership Officer, is Chairman of the AP Funds’ Council on Ethics. The Council on Ethics is working to ensure that companies in the Funds’ foreign holdings work responsibly.

The fundamental principle of the Council on Ethics is primarily to influence companies in the right direction, and as a last resort to recommend that they be excluded from the Funds’ investments. Each AP Fund considers the recommendations and makes its own decision on exclusion.

“During the year, the AP Funds will continue to discuss the AP Funds Act’s new goals on exemplary conduct in management, together within the Council on Ethics,” says Ekdahl.

# Many steps that lead in the same direction

AP1's efforts to promote sustainability and active ownership are the culmination of many decisions, initiatives and contacts. The following pages show a selection of activities from 2018.



## Research for the climate

Together with other financial institutions, in 2018 AP1 began a pilot study into the impact of climate change on decisions regarding strategic portfolio allocation. The study is one of the first of its kind.

“Better knowledge about how climate change can affect risks and returns is important to our long-term return figure. Participating in this study will give us a more in-depth understanding and be an important part in how we develop our climate strategy,” says Mikael Angberg, Chief Investment Officer at AP1.

The investors involved analyse how

different global warming scenarios could affect the long-term composition of their portfolios. The project combines academic research into climate-related risks, linked to global warming, with macroeconomic risk factors such as growth, inflation and interest rates.

The project enables future reporting in line with the Task Force on Climate-related Financial Disclosure (TCFD). TCFD is a collaboration between AP1, a.s.r., OPTrust, Pensioenfond van de Metalektro (PME), Philips Pensioenfond and Ortec Finance. A number of academic institutions are also involved.

## Companies in focus

Special attention was paid to the measurement company Hexagon and the two gaming companies Stillfront and Starbreeze in 2018.

In Hexagon the legal proceedings regarding the President, Ola Rollén, continued. After being arrested for insider trading, he was acquitted in January 2018. He could therefore continue both as President and as a board member with AP1's full confidence. However, an appeal was launched against the acquittal and the case is being resumed in spring 2019. AP1 became a major owner of Stillfront in 2018 and joined the nomination committee. Proposing a new board demanded extensive discussions, in which the Fund played an active role. The Fund is of the view that changing many board members simultaneously is not a good idea, which unfortunately did end up happening at Stillfront.

At the end of the year the Fund was involved in Starbreeze, which applied for a corporate reorganisation. It was necessary to appoint several new board members, since some of the old ones resigned when the company encountered problems.

# EU influences Swedish corporate governance

In 2018, AP1 played an active role in how the EU Shareholder Rights Directive will be incorporated into Swedish law.

Sweden is at the forefront of the field and is affected less by the changes than many other EU nations. Some issues have, however, been raised.

The directive contains stricter requirements on disclosing remuneration to senior executives, which is welcomed by AP1. However, the Fund questions the section stating that a report on remuneration paid has to be presented at the shareholders' meeting, where it can be rejected. We do not consider this to be compatible with Swedish legislation.

Other proposed changes relate to the majority needed for decisions on new share issues to senior executives. The requirement has been lowered, which AP1 opposes for the reason that the minority shareholder protection serves an important purpose in the Swedish system, where shares can have different voting rights.



AP1 welcomes the EU's stricter requirements on disclosing remuneration.

## “We have a good partnership with the Fund”

AP1 is building close relationships with its companies, including Recipharm.

Recipharm is one of the world's biggest companies within contract manufacturing and the development of pharmaceuticals.

The company has been publicly listed in Stockholm since 2014, with AP1 as a major owner and active on the nomination committee.

“We have a good partnership with the Fund. Naturally it's based on rules and formal requirements, but also on more informal relationships,” says Lars Backsell, Board Chairman of Recipharm and joint founder of the company in 1995, together with Thomas Elderer.

“As we're relative newcomers on the stock exchange, it's valuable to have



Entrepreneur  
Lars Backsell,  
Recipharm.

access to AP1's extensive knowledge in areas such as board expertise and remuneration. As a growing, international company, we also appreciate the Fund's global network.”

The founders ran Recipharm for 20

years before it was time to broaden the ownership base.

“The stock exchange listing represented a significant change. We have the support of the Fund in the development process that this entails,” says Backsell.

As a player in the heavily regulated pharmaceuticals industry, meeting formal requirements is an everyday occurrence for Recipharm.

“We also have a long history of working with sustainability. We therefore consider it natural and essentially a positive thing that AP1 sometimes asks questions about this. It's clear that the Fund has ambitions regarding both sustainability and active ownership.”

Backsell also takes a positive view of the Fund's long-term investment strategy.



Ventilation company Munters is included in the Fund's portfolio of Swedish equities.

## Influence at Munters

AP1 may not hold positions on the board or own more than 10 per cent of the votes in listed companies. Nomination committees are therefore an important channel for exerting influence.

“Work in the nomination committees is our most important channel for helping the companies we own to develop in the best possible way, although we are also actively engaged in more informal dialogue as well,” says Johan Grip, Asset Manager in the industrial sector at AP1.

In the run-up to the 2019 AGM season, AP1 is represented on 11 nomination committees, which enables it to exert an influence, mainly by nominating board members. The principles for the nomination committee's work are established at the spring shareholders' general meeting and the work begins in the autumn.

“The first question that needs to be

asked is if any of the board members expect to leave, or if a new board member is needed for any other reason. Recruiting board members is an exhaustive process,” says Grip, who is on the nomination committee for Munters.

“The nomination committee's work there began intensively in autumn 2018. The company was facing challenges and needed to add operational expertise to the board and replace the chairman.”

A recruitment process was therefore carried out in a short time.

“Particular care has to be taken when recruiting a chairman. They have to have the right expertise for the situation,” says Grip.

Magnus Lindqvist was appointed the new chairman of Munters after an Extraordinary General Meeting in December. Johan Ek became a board member at the same time and was immediately appointed interim President and CEO



Johan Grip,  
Asset Manager.

by the new board.

The Munters' nomination committee is continuing its work up until the 2019 AGM.

“The nomination committee always submits a number of points. One is about remuneration to the board members, which is an important issue for us at AP1. In our opinion, the remuneration should be high enough to attract the relevant expertise, while we also have to be careful with shareholders' money.”





Data and technology can improve both the investments themselves as well as insight into sustainability.

## New measurement methods on emerging

An innovative collaboration is making it possible to consider sustainability when making investments on emerging markets.

Companies on emerging markets often fail to report adequately on sustainability. In 2018, AP1 and asset management firm BlackRock therefore started a special fund for developing the ability to combine financial metrics and sustainability data.

AP1 is initially investing SEK 880 million in the new fund, BlackRock Emerging Markets Equity Impact Fund, which is also available to other professional investors.

In the fund information is structured, filtered and validated using a

process for data-driven information processing. Investment decisions can then be based on more up-to-date sustainability data than the companies' own reporting.

AP1 can therefore invest in emerging markets while taking into account measurable environmental and social effects, without compromising the financial return.

“It is an innovative fund. Considering sustainability aspects is no longer an obstacle when investing in emerging markets. Data and technology can improve both the investments themselves as well as insight into sustainability,” says AP1’s Tina Rönnholm, Portfolio Manager in external management.

## Influence through voting

AP1 owns shares in 32 Swedish companies and voted in all of these during 2018, in some cases at both the Annual General Meeting (AGM) and Extra General Meetings (EGMs).

Following careful consideration, at the Nordea AGM the Fund voted in favour of the board’s decision to move the head office to Helsinki. AP1 has faith in the bank’s board, and concurs that becoming a part of the European banking union will create stability for Nordea. The fact that Nordea intends to keep an owner-led nomination committee and employee representatives on the board was also important.

In Eltel, the Fund remarked on the fact that the board proposed a new member without first consulting the nomination committee.

At the Munters AGM, AP1 voted against a remuneration programme that was not deemed to impose enough of a performance requirement.

Outside of Sweden, AP1 voted in 570 shareholders’ general meetings, i.e. in the majority of companies on developed markets. The Fund’s most frequent objections in 2018 related to remuneration without performance requirements, and cases where the board chairman and CEO are the same person. The standpoints were clarified in letters to the companies.

Voting on emerging markets calls for knowledge of each company and country. The Fund votes there to a certain extent through carefully selected external asset managers.

# Unique project on human rights

AP1 is a pioneer in highlighting human rights in its investment analyses. A unique project has been started up based on UN criteria.

AP1 has begun working with American asset management firm Arabesque, which is a leader in data for sustainability analysis of investments, and particularly the social aspects of a company's operations.

Arabesque will provide AP1 with daily sustainability data using its own S-Ray system. Thanks to a unique collaboration, a special metric will also be developed in S-Ray to quantify how well companies deal with human rights.

The point of departure is the UN Global Compact, which specifies minimum requirements for sustainable enterprise, and the human rights guidelines being developed in the United Nations Guiding Principles on Business and Human Rights, UNGP. According to these guiding principles, companies must identify their impact on humans, prioritise initiatives, take action, and gauge and communicate the effectiveness of the initiatives.

The parameter will be the first of its



type and will help AP1 to assess companies' performance in relation to the principles, and identify companies with high human rights risks. Professor John Ruggie, who formulated the UNGP – also informally known as the Ruggie principles – is involved in the development work. Advisors Shift, a group of experts on working with UNGP, are also working on the project.

“This initiative is the first of its kind on the investor side. Almost all of the social aspects covered by the ‘S’ in ESG relate to human rights, but few people in the financial industry recognise this,”

says Professor Ruggie, alluding to ESG, an abbreviation for Environmental, Social and Governance.

S-Ray is being developed with the assistance of machine learning and big data. The company processes data from 7,000 companies, 200 ESG parameters and 50,000 sources in 15 different languages.

“This is a welcome complement to the other sustainability data we currently use. Having the latest rating on any given day is of tremendous value,” says Ossian Ekdahl, who is responsible for active ownership at AP1.

## Board members need courage

In 2018, AP1 contributed in various ways to discussions on board expertise and the role of the nomination committee in identifying the right expertise and qualities.

In October the Fund took part in a panel on the theme of courage. The panel emphasised that nomination committees should look for board members with integrity, so that the members can deal with conflicts between different interests, for example. In AP1's view, the company's best interests should come before the interests of the main owner, management or board.

The importance of having the courage

to say no was also a theme at a seminar on board expertise arranged by StyrelseAkademien and AP1 during the spring.

“The hardest thing for a nomination committee is to find people who can work together in a constructive way, in good times and bad. Their personal characteristics are more important than the various areas of expertise they can show on paper,” explained Helena Stjernholm, CEO of Industrivärden at the seminar.

The average age in company boards is relative high, but the panel expressed concern that young board members may lack the necessary maturity and experience.

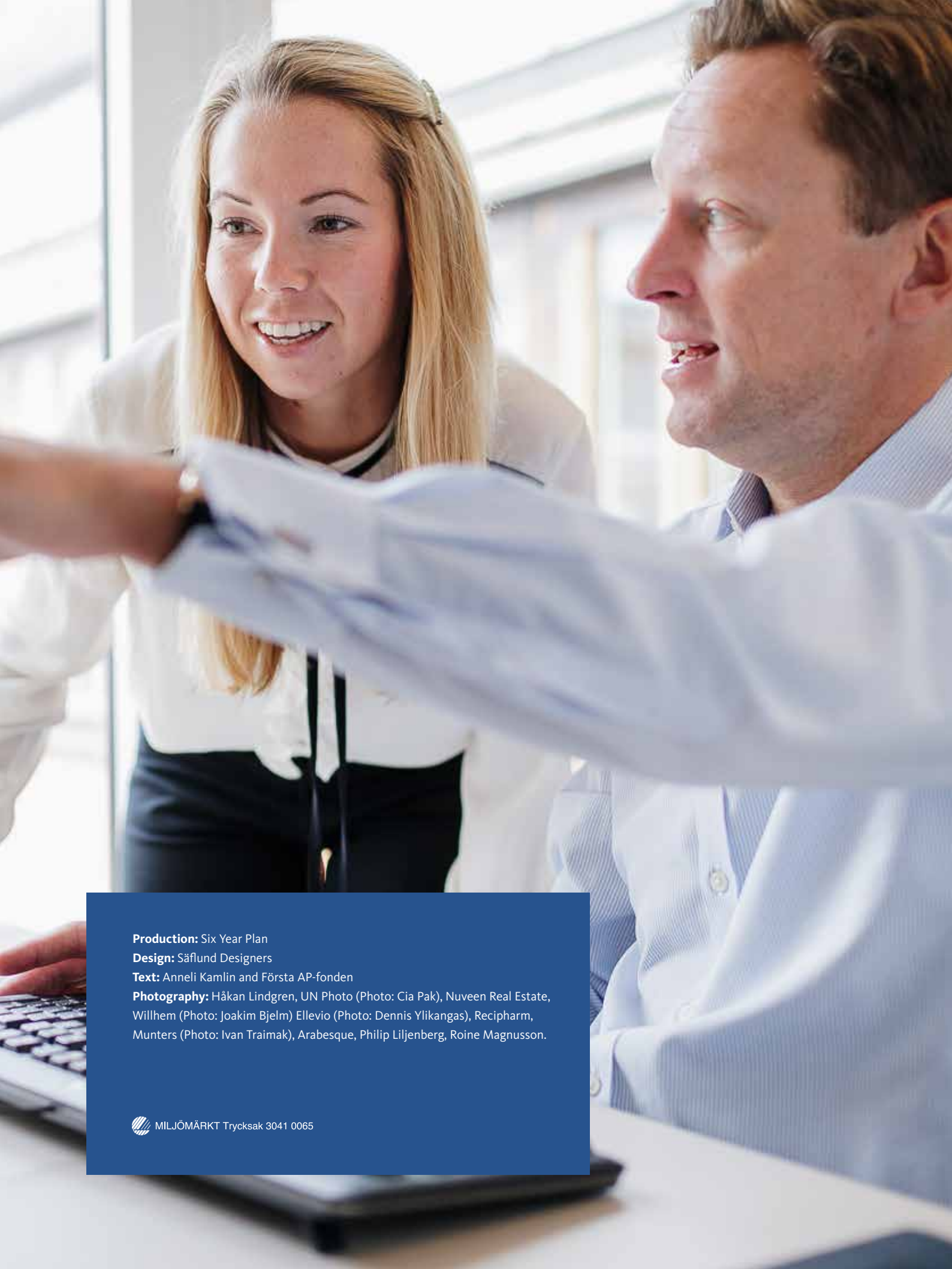
The role of the nomination commit-

tee includes identifying the strategic challenges faced by the company and identifying the most suitable people to manage them.

“We talk about ‘being’ on a board, but there's a lot of hard work and great responsibility involved,” said Stjernholm.

There was a general consensus that board fees should be increased to improve recruitment opportunities.

The Fund arranged a round-table talk at Almedalen Week. The theme was how boards can help develop trade and industry. The discussion was well received and was followed-up in the autumn.



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