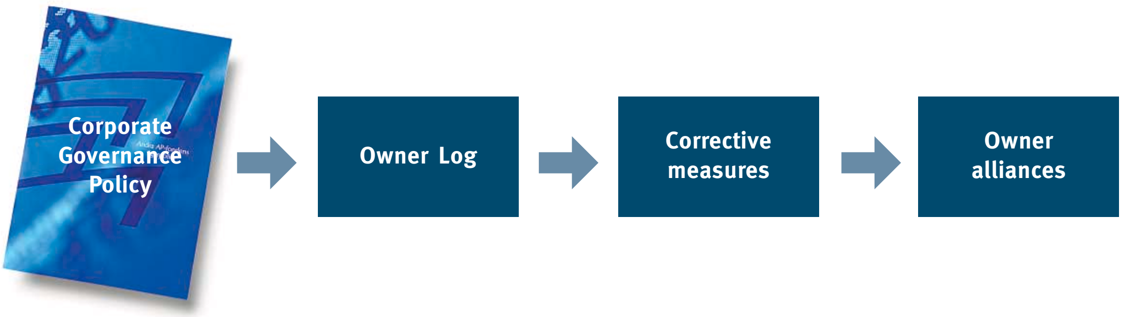
Andra AP-fonden

Second Swedish National Pension Fund - AP2

Corporate Governance Report Six months ending June 30th 2005

New corporate governance policy

In the first six months of 2005, the Second Swedish National Pension Fund/AP2 (hereafter named as "the Second AP Fund") has presented a new corporate governance policy. It has been adapted to comply with the new code of conduct for corporate governance and therefore contains fewer formal requirements than earlier. Instead, the Fund is focusing on value-generating issues such as capital, corporate and ownership structures, the nomination process, the composition of the board, incentive programmes, leadership issues, infomation, corporate culture and ethics and the environment. Based on an analysis conducted in consultation with capital asset managers at the Fund, the Fund has selected a number of corporate-specific issues that it wishes to pursue as a major shareholder in portfolio companies.



During the AGM season, the Second AP Fund has participated in and voted at 49 Swedish annual general meetings and has also voted by proxy at the AGMs of 29 of its 50 largest non-Swedish portfolio companies. The Fund has also been represented on the election committees of 16 companies (Artimplant, Capio, Castellum, Electrolux, Feelgood, Handelsbanken, Karobio, Oriflame, Pergo, Proact, Sardus, Skandia, Volvo, Vitrolife, Wedins and WM-data).

The Swedish Corporate Governance Code

The impending introduction of the new Code had an impact on annual general meetings during the spring, although not formally implemented at major companies until July 1st 2005. Some companies (such as Sardus) have already introduced separate sections on corporate governance (corporate governance reports), as prescribed by the Code, in this year's interim reports. The Code also requires owners to report their position on important issues, something the Second AP Fund already does, partly by means of regular statements on its website, and partly by means of this Corporate Governance Report and the Annual Report.

At AGMs, the Chairman of the Board has consistently reported on the work of the Board, as have the Chairmen of the Audit and Remuneration Committees. Furthermore, the audit process is now described more comprehensively than was earlier the case.

It is interesting to note that the election committees appear to have found a viable format, even though routines and working methods may vary widely from one company to another. Board evaluations are now standard, even if there are still some boards that conduct no more than a general evaluation.

The quality of the work carried out by election committees varies, mainly depending on when the process is initiated. In several instances, recruitment firms have been consulted in connection with the nomination of new candidates. This is something that is likely to increase in future.

Composition of the board

For the past four years, the Second AP Fund has monitored the degree of female representation on the boards and executive managements of exchange-listed Swedish companies. This study, conducted in association with Nordic Investor Services, demonstrates that female representation on corporate boards has increased from 14.9 to 15.9 percent. At the same time, there has been a decline in the number of women on executive managements, from 12.3 to 11.6 percent.

On boards where the Second AP Fund is represented on the election committee, female representation has increased from 21.9 to 23.3 percent.

Incentive programmes

When it comes to stock-related incentive programmes, three interesting trends are clearly discernible. The first is that companies are very keen to establish such programmes in plenty of time prior to their annual general meetings. The Second AP Fund has been informed about incentive programmes operated by about 20 companies, and has therefore been able to influence how they are formulated. In several cases, our comments have resulted in adjustments to such programmes.

The second trend is that such programmes now include some form of performance criteria as standard, linked either to corporate or individual performance. This is also the result of pressure exerted by institutional shareholders, including the Second AP Fund.

The third trend points towards a shift from options to equities as underlying instruments for such programmes.

The result of the latter two trends is that these programmes are generally less tax efficient for company and individual alike. This derives from the fact that programmes structured in this way generally result in the individual being subject to income tax rather than capital tax. This in turn makes the company liable for social costs on incentive payments. Furthermore, from the company's point of view, the gratuitous hand-out of equities (as opposed to options) in recognition of superior performance involves a greater financial commitment.

It is especially pleasing to note that SEB, about whose options programme the Second AP Fund expressed a number of reservations during the bank's AGM in 2004, has accommodated the Second AP Fund's wishes in a number of important respects in its new incentive programme. The new programme is equities-based as opposed to options-based, includes a performance requirement and an incentive for long-term investment by executive management.

Capital structure

Due to strong balance sheets and solid cash flows, the level of dividends paid out by many companies has risen, and many of them have implemented extensive redemption programmes (Gambro, Atlas Copco, Sandvik and TeliaSonera). The number of repurchase programmes has stayed at approximately the same level, but there is a clear trend indicating that investors prefer dividends/redemption to repurchase programmes. Exchange-listed companies also need to focus on capital structure, driven by the purchase estimates issued by private equity funds, where such estimates are partly based on an assumed increase in the level of borrowing and a distribution of dividends.

Few "hot" issues

Apart from Skandia's Ramkvist settlement, AMF Pension's protests against SEB's system of remuneration and the discussions surrounding the ownership of Pergo, few controversial issues were raised at this year's AGMs. It is surely no coincidence. Experience from the turbulent AGMs of recent years, where unwelcome attention has served to distract the managements and boards of companies for limited periods, perhaps having a prejudicial effect on their business activities, has ensured that boards and owners are very keen to secure firm support for their actions, to avoid open confrontation at the annual general meeting.

Corporate deals

The absence of corporate acquisitions among exchange-listed Swedish companies is also worthy of note. Here too, the increased influence of shareholders who are averse to corporate deals with excessive price tags is evident. Another important factor, of course, is how the acquisition market was to a great extent dominated by private equity funds during the spring.

Swedish corporate governance culture abroad

In many instances, the Swedish code features specifically Swedish solutions. One example is the fact that the election committee is not a part of the board but is comprised of representatives for the shareholders. In Anglo-Saxon countries, the election committee is part of the board. Cross ownership and differential voting rights are other factors that contribute to Sweden's low ranking in the international corporate governance stakes.

It is serious when the FTSE corporate governance index, drawn up in association with Institutional Shareholder Services, ranks Sweden last of twenty industrial nations with respect to corporate governance. Sweden is rated 1.00 on a five-point scale. This is a consequence of the Swedish Companies Act and traditional practice, but also of an inability to clarify the benefits of the Swedish system.

The Fund's voting at AGMs

During the first six months of 2005, the Second AP Fund has voted at 49 AGMs of Swedish exchange-listed companies. In no case did the Fund vote against the board's proposals. During the first half, the Second AP Fund also voted at 29 AGMs held by companies listed on foreign exchanges. The Fund voted against the board's proposals (or supported proposals by other shareholders) at the AGMs of 13 companies. In several cases (Toyota Industries, Total, BNP Paribas), the issue addressed was incentive systems. In the case of Citigroup, Nestlé and Pfizer, the issue was the role of the chairman. At the Wal-Mart AGM, the Second AP Fund voted to implement a clearer system for reporting on remuneration paid to the company's executive management, on the company's sustainability programme and on the remuneration awarded to personnel with respect to gender and ethnic background.

Environment and ethics

The Fund has cooperated with Sustainable Asset Management, SAM, which manages some SEK 700 million of the Fund's assets. A programme has been initiated to promote a transfer of competence, to ensure that Second AP Fund asset managers adopt a consistent approach in addressing sustainability issues when making investment decisions. The Second AP Fund applies SAM's methods for evaluating sustainability criteria in its dialogue with its largest Swedish holdings. The Fund has conducted an environmental and ethical analysis of 50 of its 100 largest foreign holdings, an analysis that has formed the basis for subsequent dialogue with several of these companies.

The Second AP Fund has also participated in the Carbon Disclosure Project, an initiative whereby some 100 major fund managers place demands on the world's 500 largest exchange-listed companies regarding their position with respect to a number of "greenhouse" issues.

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