



*Andra AP-fonden*  
Second Swedish National Pension Fund - AP2

# Corporate Governance Report

JULY 1 2012 – JUNE 30 2013



# CEO's report

*The Second AP Fund is convinced that a responsible long-term attitude to the environment, ethics and corporate governance enhances the value of companies. By addressing these issues in administering our portfolio of assets, we establish a better basis for analysis and investment decisions. Adopting a proactive approach also enables us to help portfolio companies earlier identify opportunities and risks that can impact on asset performance and also our return.*

The Second AP Fund's long-term asset management strategy is to continue to diversify the portfolio to secure greater stability in terms of return on investment. One consequence of this strategy is increased investment in emerging markets and alternative asset classes. This places considerable demands on ensuring that our internal processes adapt and develop to keep pace with change and on the need to develop our portfolio management operations to handle new markets and asset classes. Ethics, the environment and corporate governance have always played key roles in our strategy, and we have established a stable platform to work from. This is an ongoing process, driven not only by events in the world around us but especially by our own conviction, determination and ambition that we always can and will do better.

## **New market**

During the summer, as the first Swedish investor, the Fund was granted an investment quota that would enable direct investment in China's domestic equities market. This is a new market for us and one which we need to learn more about. Among other things, the Fund sent a representative this autumn to participate in a group study visit to China arranged by ACGA (Asian Corporate Governance Association), of which the Fund has been a member for the past twelve months. During this trip, of which we were one of the instigators, the group will visit the Chinese regulatory authorities, as well as a number of companies. In the past year, the Fund has also conducted a review to determine how ethics, the environment and corporate governance can be made an integral part in the analysis of these investments.

## **Better integration**

During the year, we have also carried out a thorough review of the processes and routines on which the Fund's investment decisions in unquoted assets are based. One consequence has been the creation of a structured process for analysis, evaluation and follow-up, which embraces not only ethics, the environment and corporate governance, but the economy, risk and performance analysis. This process is also employed for the Fund's investments in real estate, as well as forest and agricultural assets.

## **Criticism about transparency**

In the spring, Swedwatch published a report in which the Second AP Fund is criticized for not specifying the exact location of its agricultural investments in Brazil. Swedwatch also felt that the Second AP Fund should conduct regular inspections of the farms and that public oversight should be increased. The Fund has naturally listened to the points made by Swedwatch and for this

reason, in collaboration with TIAA-CREF, will be arranging a trip for NGOs to visit several farms in Brazil. We shall also be reviewing further possibilities for increased transparency in connection with these investments.

## **Exchange of ideas**

As part of our strategy for maintaining momentum in promoting the integration of ethics, the environment and corporate governance in our investments, we collaborate closely with Generation Investment Management. The visit Al Gore and David Blood made to the Fund during the summer presented an excellent opportunity for a valuable exchange of ideas. Also during the summer, the Fund received a visit from South Korean pension fund NPS, which was interested in learning about and gaining insight into the way we integrate sustainability into our analytical and investment processes.

## **Collaboration with other investors**

The Fund has long collaborated with other investors. We are convinced that this is the right way to operate, one reason being that, in global terms, we are a fairly small investor, sometimes needing to join up with others to make our voice heard. Even from a national Swedish perspective, we consider this a strength. For example, we have collaborated with IÄF (Institutionella ägares för- ening/Swedish Institutional Investors' Association) on a joint referral concerning an increase in the share capital of publicly quoted companies. And at the Scania AGM in the spring, we were one of several institutional investors who were jointly critical of the fact that the board no longer felt any need for a nomination committee.

While on the subject of nomination committees: a lively debate erupted in the Swedish media in the spring, when a well-known CEO and board director openly criticized the Swedish system of nomination committees. Personally, I consider it self-evident that those who have invested capital in a company should also participate in determining who will be entrusted with deciding on what the company's future strategy should be. I am convinced it is appropriate to make a clear distinction between those who submit proposals for new members of the board and those who already sit on the board. In Sweden, we have now been engaged in developing this model for the past ten years, and a growing number of European countries are now becoming aware of its existence.

An example of international collaboration between investors is a framework that the Fund has participated in drafting for private-equity companies, concerning reporting on ethics, the environment and corporate governance.



Photo: Nils-Olof Sjödén

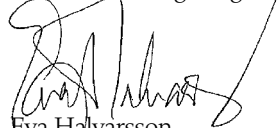
### The AGM – an important forum

We naturally consider that AGMs provide an important forum where shareholders can exert their influence. That we may sometimes seem rather quiet at AGMs in Sweden, and not make our voice heard, is a consequence of the fact that our own dialogues with the companies are conducted largely prior to the AGM, with the aim of changing and developing whatever may conflict with our governance policy and perception of the company. We do not feel that AGMs are the right place to conduct these dialogues. Our experience is that we achieve the best results through direct dialogue with the individual company. However, we do sometimes opt to express an opinion at an AGM, in cases where we believe questions remain to be answered. If we decide to vote against a board proposal, we always justify our reasons for doing so at the AGM.

### Close to our hearts

Gender equality and diversity are key elements in establishing a sustainable society. The Women’s Index, which is compiled annually by the Fund, reveals that the ratio of women on corporate boards is declining for the second year in succession and is currently at 22.3 percent. In contrast, the ratio of women in executive managements is increasing steadily and is currently at 17.2 percent. Although the decline in the percentage of women represented on corporate boards is only marginal, I nevertheless feel it is a worrying trend that, in principle, we have now reverted to the level we were at in 2010. As investors, we must seriously – and to a much greater extent – discuss what can be done to reverse this trend. What is pleasing is the increasing number of women in executive management positions, especially in light of the fact that this group constitutes the primary recruiting base for future board members.

We shall continue our efforts as an active investor, while at the same time maximizing the return on the invested assets of Sweden’s pensioners. This year, our award of the Second AP Fund’s prize for finance and sustainability, to two students from Gothenburg University’s School of Business, Economics and Law, gave me particular pleasure. The topic their paper addressed referred to the opportunities that environmental data can present to investors seeking a higher risk-adjusted return.

  
Eva Halvarsson  
CEO

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### AP2 adopts a long-term approach in creating a capital buffer for the Swedish national pension system

The Second AP Fund is one of northern Europe’s largest pension funds, managing assets totalling almost SEK 250 billion of Sweden’s national pension assets, which are invested worldwide. The Fund is the largest of the Swedish National Pension (AP) Funds.

You could say the mission is to achieve the best of both worlds. The Fund is tasked with generating a solid return on investment, while implementing a consistent policy of responsible and sustainable investment.

The Fund enjoys a solid return and a high degree of cost efficiency compared to similar funds in Sweden and elsewhere. Key factors are the Fund’s long-term asset management strategy and a consistent focus on efficiency in all its activities.

The Second AP Fund is an attractive employer, numbering almost 60 members of staff, all of whom work in Gothenburg. The Fund employs some of the foremost in their respective fields, including portfolio managers, analysts and other specialists.

# Governance activities at the Second AP Fund

*The Second AP Fund's governance activities embraces environmental, ethical and governance issues. The Fund's efforts are designed to create value. In its role as asset manager, it must focus on a range of sustainability factors, which either provides a more solid basis for analysis and subsequent investment decisions, or present opportunities for diversification. In its role as investor, the Fund must build credibility by promoting good ethics and an environmentally responsible attitude, as well as contributing to the development of good practice in the management of assets.*

Through active involvement in (and integration of) environmental, ethical and governance issues in its everyday activities, the Second AP Fund creates value. In referring to these issues, the Fund commonly employs the collective term 'sustainability'. An alternative used by the investment community is the acronym ESG (Environmental, Social and Governance). The investment community has adopted the acronym ESG (Environmental, Social and Governance).

The Second AP Fund considers sustainability to be important, convinced that seriously addressing sustainability issues can create and preserve value. Including sustainability factors in analyses and investment processes provides a broader and better basis for decisions. As an asset owner, the Second AP Fund adopts a proactive approach, to promote conditions appropriate to a more sustainable and responsible financial market.

## **Corporate Governance Policy**

The Second AP Fund's operative involvement in governance issues derives from its corporate governance policy and its nine principles. These principles comprise structural factors, corporate governance, the environment and ethics. The governance policy also defines the

Fund's core values, and details the guidelines and initiatives to which the Fund is a signatory, or which it employs in pursuing its sustainability aims. This governance policy is determined annually by the board of directors and is published on the Fund's website at [www.ap2.se](http://www.ap2.se)

The Second AP Fund's engagement in corporate governance issues is founded on regulations and conventions such as the OECD's Guidelines for Multinational Enterprises and Principles of Corporate Governance, the United Nations Global Compact, the Swedish Companies Act and the Swedish Code for Corporate Governance.

The governance policy also describes the principles to which the Second AP Fund subscribes and that it employs as a framework in its efforts to promote sustainability, both within its portfolio management organization and in a range of governance activities. The Second AP Fund supports and actively promotes implementation of the UN's Principles for Responsible Investment (PRI). It signed up to these Principles as early as 2006, when they were first established. PRI provides various instruments and activities to support investors in implementing the Principles and to facilitate cooperation between investors. By the

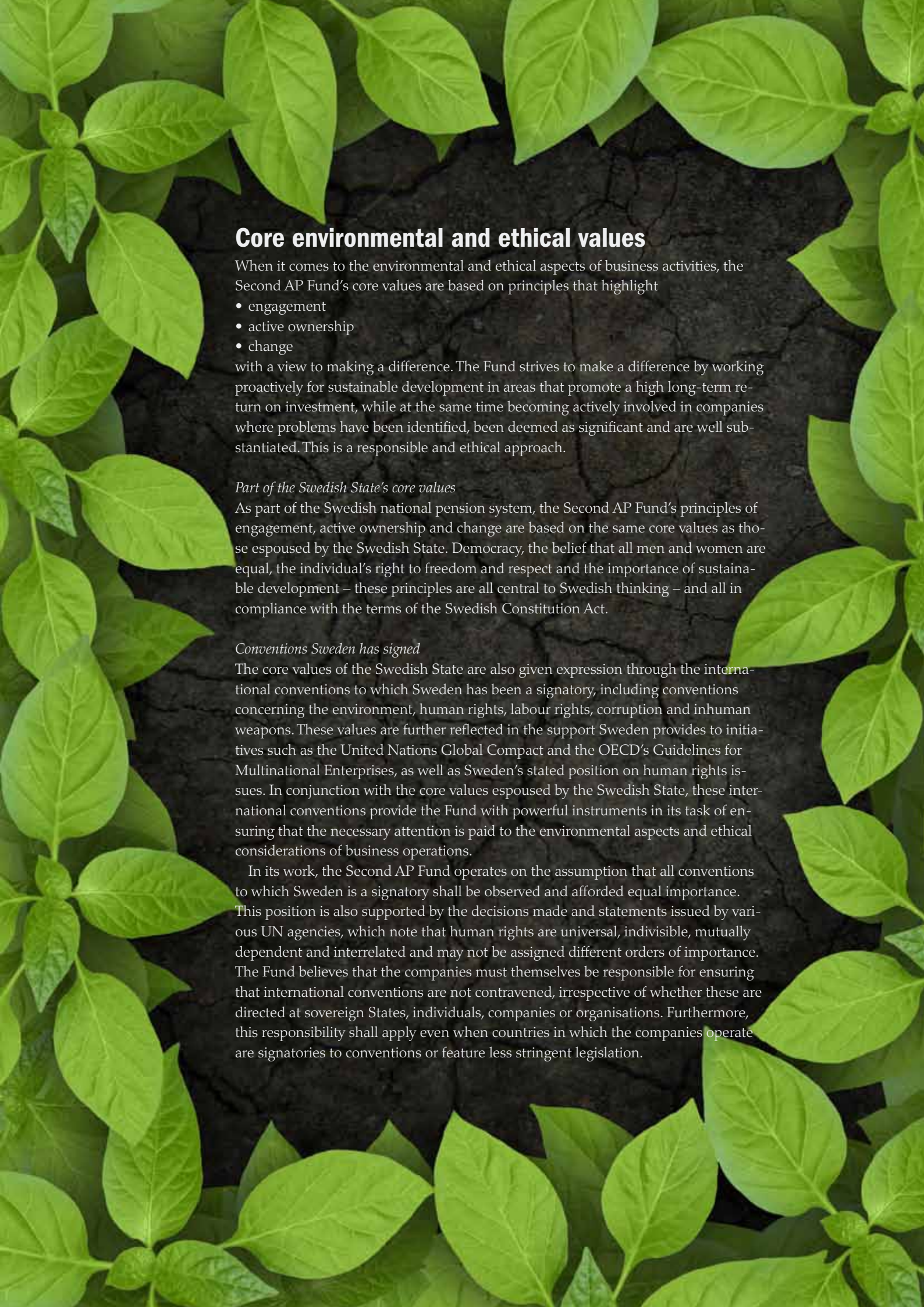
end of June 2013, more than 1 000 investors had signed up to these Principles. PRI conducts an annual questionnaire, in which all signatories report on how they are implementing these principles in practice.

The Second AP Fund has also undertaken to implement the Principles for Responsible Investment in Farmland. These were drawn up by the Second AP Fund in association with a group of international investors, all of which are PRI signatories. The Principles provide institutional investors who invest in agricultural assets with a framework for dealing with environmental, ethical and governance issues. They are also intended to increase transparency in connection with such investments. For this reason, it is incumbent on all investors who have signed up to these Principles to report annually on how they have been implemented during the past year. The Second AP Fund's report on the implementation of these Principles may be found on page 14. Further details of the Principles for Responsible Investment in Farmland are available at [www.unpri.org](http://www.unpri.org)

## **Organisation and responsibilities**

The Second AP Fund's board of directors determines guidelines and policies pertaining to governance issues, entrusting





## Core environmental and ethical values

When it comes to the environmental and ethical aspects of business activities, the Second AP Fund's core values are based on principles that highlight

- engagement
- active ownership
- change

with a view to making a difference. The Fund strives to make a difference by working proactively for sustainable development in areas that promote a high long-term return on investment, while at the same time becoming actively involved in companies where problems have been identified, been deemed as significant and are well substantiated. This is a responsible and ethical approach.

### *Part of the Swedish State's core values*

As part of the Swedish national pension system, the Second AP Fund's principles of engagement, active ownership and change are based on the same core values as those espoused by the Swedish State. Democracy, the belief that all men and women are equal, the individual's right to freedom and respect and the importance of sustainable development – these principles are all central to Swedish thinking – and all in compliance with the terms of the Swedish Constitution Act.

### *Conventions Sweden has signed*

The core values of the Swedish State are also given expression through the international conventions to which Sweden has been a signatory, including conventions concerning the environment, human rights, labour rights, corruption and inhuman weapons. These values are further reflected in the support Sweden provides to initiatives such as the United Nations Global Compact and the OECD's Guidelines for Multinational Enterprises, as well as Sweden's stated position on human rights issues. In conjunction with the core values espoused by the Swedish State, these international conventions provide the Fund with powerful instruments in its task of ensuring that the necessary attention is paid to the environmental aspects and ethical considerations of business operations.

In its work, the Second AP Fund operates on the assumption that all conventions to which Sweden is a signatory shall be observed and afforded equal importance. This position is also supported by the decisions made and statements issued by various UN agencies, which note that human rights are universal, indivisible, mutually dependent and interrelated and may not be assigned different orders of importance. The Fund believes that the companies must themselves be responsible for ensuring that international conventions are not contravened, irrespective of whether these are directed at sovereign States, individuals, companies or organisations. Furthermore, this responsibility shall apply even when countries in which the companies operate are signatories to conventions or feature less stringent legislation.



day-to-day management of these issues to the Fund's CEO. The CEO is backed by an ownership group featuring members of the Fund's executive management, the head of Swedish equities and the sustainability analyst. This group is responsible for the strategic and operational aspects of the Fund's corporate governance activities. The ownership group targets and drafts action plans and monitors progress on an ongoing basis. At every meeting, a report on the Fund's governance, ethics and environmental activities is submitted to the board of directors.

#### **Implementing PRI principles**

The implementation of PRI principles is an ongoing process, one which requires that the Second AP Fund shall consistently address sustainability issues, both in its role as asset manager and as asset owner. The Principles are about the following: integrating sustainability issues as part of investment analyses and decision processes (First Principle); acting as active owners (Second Principle); encouraging better sustainability reporting by companies (Third Principle), collaborating with other investors (Fourth and Fifth Principles) and reporting on progress (Sixth Principle).

Integration, dialogue, collaboration and reporting are key words for these Principles and for the Second AP Fund's efforts.

#### **Sustainability integral to asset management**

The Second AP Fund believes that a responsible long-term approach to the environment, ethics and governance enhances the value of companies. This is why corporate governance, ethics and

the environment also play an important role in the Fund's asset management activities, as they provide a more comprehensive basis for analyses and investment decisions. By encouraging portfolio companies to address ethical and environmental issues, the Second AP Fund can help them identify the opportunities and risks, at an early stage, which can affect long-term return.

During the year, the Second AP Fund arranged a number of seminars to create better understanding and awareness of sustainability issues among its staff. This is important in facilitating the integration of sustainability factors in the Fund's everyday activities.

#### **Equities**

Progress on integrating sustainability issues into the active in-house management of Swedish equities continued during the year, based on a specially developed model that analyses the relative position of portfolio companies from the viewpoint of global mega trends. The sustainability analysis assesses how the individual company organizes its efforts to promote sustainability, the policies adopted and the way they are implemented, as well as how each company manages the opportunities and risks associated with pursuing a policy of sustainability. During the year, given the fact that this model is fairly labour intensive, the Fund has explored the possibility of modifying it, to enable analysis of a greater number of companies. This has proved difficult, because the information available in data bases is not readily adaptable for qualitative analysis. The available data is usually quantitative (e.g. the volume of dangerous waste) or binary

(e.g. the existence/absence of a corporate policy on sustainability). Data enabling the assessment of an individual company's potential in terms of product and market development is scarce. This work has provided the Fund with an insight into the type of data available, and discussions are ongoing as to how this data can be exploited to better understand how the risks and opportunities associated with sustainability might affect the overall portfolio. The work of including a growing amount of sustainability data in analyses and investment processes continues.

All companies included in the Second AP Fund's portfolio of equities will be screened twice yearly, to identify those that contravene international conventions and guidelines. This analysis is conducted by an external consultancy. The results are analysed by the Fund.

#### **Green bonds**

Over the year, the Second AP Fund increased its investment in 'green bonds' and, as at June 30 2013, held bonds to a value of approximately SEK 1 billion. More about the Fund's investments in green bonds on page 22.

#### **Private equity funds**

For several years now, the Second AP Fund has participated in the debate over how private equity companies can be better at integrating sustainability factors in their day-to-day operations. In the past year, the Fund has in association with private equity industries in eleven other countries, developed a framework that investors can use concerning how private equity companies are to report on ethical, environmental and governance



issues. The Second AP Fund has taken these issues into account when evaluating private equity funds. During the year, the Fund has also developed a structured process for analysis, evaluation and follow-up which, as well as sustainability, embraces economic, risk and performance analysis. This process can also be applied to the Fund's investments in real estate, as well as forest and agricultural assets.

A study has also been carried out during the year to determine the performance of the Fund's current portfolio of private equity companies in terms of sustainability issues, both within their own organizations and with regard to the companies in their portfolios. This study revealed that all the companies addressed sustainability to some extent, when assessing their portfolio companies. It also demonstrated considerable differences in the way that fund managers deal with such issues. The good news is that all these private equity companies consider these issues, in some form, when adding new companies to their portfolios.

**An active investor**

A large part of the Second AP Fund's capital assets is placed in equities in Swedish and foreign companies, making the Fund a significant investor. The Fund is also a political and non-affiliated, both with respect to the investment communities and in terms of having special status among Sweden's state agencies, as defined in law, enabling it to perform as an active and long-term investor. Investors' commitment and interest in the long-term development of portfolio companies is a key require-

1

**PRIs principles**

We will incorporate environmental, social and corporate governance (ESG) issues into investment analysis and decision-making processes.

**Examples of what the Second AP Fund does**

Includes ESG data in analyses and decision making processes in our active internal asset management.

Works on developing models and tools for ESG that are geared to different investment strategies.

Includes ESG in the analyses of new funds and portfolio managers. Questions about ESG form part of the yearly evaluation of external asset managers.

2

We will be active owners and incorporate ESG issues into our ownership policies and practices.

Incorporates ESG factors as part of its Corporate Governance Policy.

Conducts dialogues regarding ESG issues with Swedish and foreign companies.

Exercises its vote at Swedish and foreign AGMs.

Participates in nomination committees.

Monitors portfolios to detect violations of international conventions and guidelines.

3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Supports a range of initiatives geared to improving corporate reporting procedures, including the Carbon Disclosure Project, the Extractive Industries Transparency Initiative, the Global Compact and the Sustainable Value Creation Initiative.

Asks all external managers to respond to questions concerning ESG in its annual review.

4

We will promote acceptance and implementation of the Principles within the investment industry.

Encourages external fund managers to become signatories of the PRI.

Participates in conferences.

Includes questions pertaining to PRI in procurement tenders, where relevant.

5

We will work together to enhance our effectiveness in implementing the Principles.

Collaborates with the First, Third and Fourth AP Funds in the joint Ethical Council, which is responsible for conducting dialogues with foreign companies. The Ethical Council also collaborates with international investors in pursuing dialogues with companies and proactive initiatives.

6

We will each report on our activities and progress towards implementing the Principles.

Publishes an annual Corporate Governance Report and also reports on PRI in the annual report and on the website.

Reports on dialogues with foreign companies in the joint annual report of the Ethical Council.

Responds to the PRI's annual survey and makes it available public at the PRI web site.

ment in promoting higher growth in value. As a long-term investor, the Second AP Fund has an important role to play on the world's capital markets.

This is why the Fund adopts an active approach to issues that aim to promote good corporate governance, solid ethics and care of the environment, as well as best practice in asset management. In its relations with publicly quoted companies, as well as active participation prior to and at Swedish and foreign AGMs, the Second AP Fund engages in dialogues with the boards and executive managements of its portfolio companies.

In Sweden, the Second AP Fund focuses first and foremost on governance issues in companies where it is one of the largest shareholders and in companies where it has most capital invested. In the case of companies outside Sweden, the Fund concentrates on ethical and environmental issues, operating through the joint Ethical Council of the AP Funds. Work concerning other governance issues at foreign portfolio companies involves cooperation with selected partners in addressing items of key importance to the Fund.

The Fund shall further promote good corporate governance by collaborating with other investors on matters of principle and through active participation in the drafting of policies, regulations and standards.

#### **Dialogue a vital tool**

As an active investor and asset manager, dialogue is a vital tool, both in relation to companies and to society in general. The Second AP Fund conducts regular dialo-

gues with its portfolio managers, as well as with Swedish and foreign companies, on issues concerning the environment, ethics and corporate governance.

However, the Second AP Fund does not restrict its discussion of sustainability issues to companies and portfolio managers alone. The Fund's own personnel participate in conferences and give presentations for students at universities. In 2011, keen to encourage student interest in finance and sustainability, the Second AP Fund inaugurated a prize for students at Gothenburg University, to be awarded for the best essay on finance and sustainability. For more details, turn to page 24.

Dialogues with foreign companies are arranged under the auspices of the joint Ethical Council of the Swedish National Pension Funds. The companies with which the Council conducts dialogues are identified by means of the twice-yearly screening made of all the Fund's holdings in equities, conducted to determine whether any of the portfolio companies are contravening any international conventions. This review is conducted by an external consultancy. Should a company in which the Fund has invested be shown to be in breach of a convention, the Fund's basic response is to exploit its influence as a major investor to ensure the cessation of any breaches, to promote the implementation of preventive systems and to see that measures are taken to preclude any future infringements. By adopting an active approach to corporate governance and exerting its influence as a key investor when conventions are infringed, as well as demanding

change where required, the Fund can make a real difference. Only in cases where none of this can be achieved does the Fund consider disposing of its holding in the company.

#### **Referrals**

In early 2013, the Second AP Fund, in collaboration with members of the Institutional Investors Association, submitted a referral in response to a Swedish Ministry of Justice memorandum entitled "Increase of share capital in publicly quoted companies". In their answer, the members of the Association supported the proposed changes to the legislation. The Association emphasized that rights issues should be the main alternative where issues are concerned. Directed issues may be acceptable only in the case of exceptional circumstances.

During the year, the Fund also submitted its comments on the European Commission's proposal for a Directive to promote greater balance in the gender distribution of the boards of publicly quoted companies. Although the Second AP Fund concurs in the belief that increased diversity and a more balanced gender distribution among boards would benefit the companies and their shareholders, the Fund does not feel that the Commission's proposal should be implemented, since it is not compatible with the Swedish model of corporate governance. A key point made by the Fund was the importance of ensuring that shareholders are provided with the actual opportunities required to enable them to exercise their rights as investors. One example of how this can be achieved is





provided by the Swedish model, featuring investor-controlled nomination committees. The Fund feels that the European Commission should strive to promote the development of a similar model in other European countries.

In another submission made during the spring, the Fund commented on the European Commission's proposed Directive on the reporting of non-financial and diversity information. The Second AP Fund believes it is important that companies are transparent. This applies

particularly to environmental and human rights issues. The Second AP Fund therefore considers that the rulings in this part of the proposed Directive are reasonable. Nevertheless, it is important to ensure that the increased reporting requirement does not become a bureaucratically onerous process.

Concerning the other part of the Directive, containing the proposal that companies should implement a gender-equality policy with regard to the composition of company boards, the Fund

felt it would not be appropriate to introduce such a policy as part of the Swedish corporate governance model, given the fact that board composition in Sweden is determined by shareholders at the company's AGM.

#### **Excluded companies**

The Second AP Fund has decided not to invest in twelve companies that are in breach of international conventions and where dialogue with these same companies has led to no improvements.

Excluded companies	Excluded year	Country	Type of violation
Alliant Techsystems Inc	2008	USA	Can be linked to breach of convention against use of cluster bombs
Elbit Systems Ltd	2010	Israel	Can be linked to infringement of international humanitarian rights in conflict with the fourth Geneva convention
GenCorp Inc	2008	USA	Can be linked to breach of convention against use of cluster bombs
General Dynamics Corp	2008	USA	Can be linked to breach of convention against use of cluster bombs
Hanwha Corp	2008	South Korea	Can be linked to breach of convention against use of cluster bombs
L-3 Communications Hlds	2008	USA	Can be linked to breach of convention against use of cluster bombs
LockheedMartin Corp	2008	USA	Can be linked to breach of convention against use of cluster bombs
Poongsan Corp	2008	South Korea	Can be linked to breach of convention against use of cluster bombs
Raytheon Company	2008	USA	Can be linked to breach of convention against use of cluster bombs
Singapore Technologies Engineering	2001	Singapore	Can be linked to breach of Ottawa convention against use of anti-personnel mines
Textron Inc	2008	USA	Can be linked to breach of convention against use of cluster bombs
Walmart	2006	USA	Can be linked to infringement of human rights

After the report period AP2 has decided to also exclude the companies Freeport McMoRan Copper & Gold Inc., Incitec Pivot Ltd. and Potash Corp. Read more about companies excluded by the Fund on the Ethical Council website at [www.ethicalcouncil.com](http://www.ethicalcouncil.com)

# The AGM season – 2012/2013

*The AGM is the primary forum in which shareholders are able to exercise their influence. Being able to exercise your voting right at the AGM as a shareholder provides one of the most important opportunities available for influencing a company. This is why the Second AP Fund is active at both Swedish and foreign AGMs.*

## Corporate governance in Swedish companies

### Swedish AGMs

The Fund has holdings in some 200 Swedish companies. It has decided that it is impractical to attempt to attend and vote at the AGMs of all the companies represented in its portfolio of Swedish equities. In determining which AGMs to attend, the Fund employs the following criteria:

- Companies that are among the Fund's 20 largest holdings.
- Companies in which the Fund's voting rights exceed one percent of capital.
- Companies in which the Fund is among the ten largest shareholders.
- Companies with controversial issues on the agenda.

The Second AP Fund exercised its voting rights at a total of 47 AGMs of Swedish publicly quoted companies during the period 2012/2013. The Second AP Fund and other institutional investors have for many years enjoyed a positive and constructive dialogue with Swedish publicly quoted companies, which have included discussions about many of the issues raised at AGMs. During the 2012/2013 AGM season, the Second AP Fund voted against board proposals in two companies: Scania and Lundin Petroleum.

### Scania

At Scania, the nomination committee proposed that the company should no longer have a nomination committee. The Second AP Fund is of the opinion

that the Swedish nomination committee system, which offers shareholders increased opportunities for influencing the composition of the board, is unique – and should be protected. According to the Swedish Corporate Governance Code, companies shall have a nomination committee, the members of which shall safeguard the interests of all shareholders, including those of small shareholders. Consequently, the Second AP Fund saw no reason why Scania should not have a nomination committee and therefore voted against the committee's proposal. However, subsequent to voting, the nomination committee's proposal was approved.

### Lundin Petroleum

The Fund also voted against the proposal presented by the board of Lundin Petroleum, which involved changing the incentive programme previously agreed in 2009, offering leading executives shares instead of cash. The Second AP Fund voted against the original proposal for a long-term incentive programme, when it was presented for approval by the AGM in 2009 and again in 2010, justifying its opposition because of the programme's lack of any clear performance requirements, or any requirement of individual effort. The Fund also felt that the incentive programme should not be linked exclusively to the Lundin Petroleum share price. It was worried that this could result in extremely large sums, since it understood that no ceiling had been placed on the amount that

the programme might pay out. The Fund now felt no adequate reason existed for supporting this change to the programme and therefore chose to vote against the proposal. The Board's proposal was not approved by the AGM.

### Issues in focus

During the year, the Second AP Fund has maintained its focus on remuneration issues and engaged in a number of dialogues with corporate boards, concerning the formulation of incentive programmes, with a view to promoting improvements. For several years now, the Second AP Fund has stressed the importance of increasing the number of women on the boards of publicly quoted companies and duly observes this principle when participating in the nomination process. The Fund also feels that nomination committees should draft a concrete plan to attain the most appropriate board composition, with respect to gender, age, background, experience and competence.

The Second AP Fund has participated in a working committee of the International Corporate Governance Network (ICGN), which during the year drafted guidelines for promoting gender equality on corporate boards. These guidelines highlight ICGN's belief that gender equality is an important issue for investors, in that it increases the effectiveness of boards and thereby contributes to companies' long-term sustainability. The guidelines are intended to promote dialogues

between companies and investors, contributing to a more equitable gender balance on corporate boards.

Read about the Second AP Fund's annual Women's Index at [www.ap2.se](http://www.ap2.se)

#### Nomination committees

The Second AP Fund favours having a representative on the nomination committees of portfolio companies, as this provides a valuable opportunity to exercise investor influence. The Fund practices a policy of accepting all invitations to participate in the nomination process. Its ownership group decides who shall represent the Fund on the various nomination committees, based on whoever is best qualified for the task. Since nomination committees commonly consist of the three to five largest investors in a company, the Second AP Fund's nomination committee assignments vary, depending on the size of its holding in the portfolio company.

Prior to the start of the 2013 AGM season, the Second AP Fund was represented on Opus Prodox' nomination committee, as chair, as well as on the nomination committee for Melker Schörling AB.

#### Corporate governance in foreign companies

##### Foreign AGMs

Since 2008, to improve the governance of its foreign investments, and in cooperation with the First, Third and Fourth AP Funds, the Second AP Fund has operated

a joint electronic voting platform, based on the AP Funds' governance policies. Most issues are managed automatically via the voting platform, with the exception of matters such as remuneration issues, which are forwarded to the funds for individual assessment. Each fund decides individually as to how it will vote. The Fund exercises its voting rights mainly in companies active on eleven foreign markets: Australia, France, Italy, Japan, Canada, the Netherlands, Switzerland, Spain, Great Britain, Germany and the USA. The criteria for determining the companies in which the Fund should exercise its voting rights derive mainly from the MSCI global index. There are other criteria too, such as when the Fund is engaged in a dialogue on a specific issue with a company and/or when the Fund has submitted a shareholder proposal for consideration by the AGM.

During the 2012/2013 season, the Second AP Fund exercised its vote at 502 AGMs held by 490 different foreign companies, via proxy voting. Among other issues, the Fund voted against proposals concerning remuneration in 63 percent of these foreign companies.

##### Letters to companies

During 2012/2013, with a view to further improving communication with its foreign portfolio companies, the Second AP Fund has written letters to some 50 of these companies, clarifying the AP funds' views on active governance and the importance

of exercising voting rights. In these letters, the Fund has also explained why it was unable to support the recommendations of certain boards on specific proposals. In several cases, these letters have resulted in further contact with the companies in question, sometimes by letter but also in the form of teleconferences.

Further details of how the Second AP Fund voted on specific issues may be found at [www.ap2.se/en/corporate-governance-/corporate-governance-reports/](http://www.ap2.se/en/corporate-governance-/corporate-governance-reports/)

#### Voting at foreign AGMs

Number of foreign AGMs at which the Fund exercised its voting rights	502
Agenda items	6 698
Proposals which the Fund voted against, %	17
Remuneration issues where the Fund voted against proposals submitted for approval by the AGM, %	63



### Collaboration with other investors

Collaboration with other investors is important in ensuring that dialogues with portfolio companies are successful, as well as in encouraging a move towards more responsible investments. The Second AP Fund collaborates both with Swedish and foreign institutional investors.

#### The Ethical Council

The Ethical Council is a joint council that was formed by the First, Second, Third and Fourth AP Funds in 2007. The Ethical Council monitors and analyses the AP Funds' portfolios of foreign equities, to identify infringements of international conventions to which Sweden is a signatory. The work of the Ethical Council is based on the principles of engagement, active ownership and change, with the aim of making a difference. The Ethical Council identifies companies that can be linked to violations of a convention and takes concrete action to persuade companies to deal with any such alleged violations and to implement preventive systems and measures to preclude any future violations.

The Ethical Council is also proactive in the prevention of violations by engaging in dialogues with individual companies and by promoting a range of initiatives that target specific industries or issues. Dialogue is one of the Ethical Council's most important tools in exerting its influence on companies. The Ethical Council is convinced that active governance is the best way to achieve change. If the AP Funds simply sell their holdings, the problem doesn't go away and the unsatisfactory state of things remains unchanged. As a final resort, the Ethical Council can recommend that the funds exclude a company from their investment universe, when any prospect of achieving change seems hopeless. The Second AP Fund chaired the Ethical Council in 2012, passing this role to the Third AP Fund in 2013. Read more at [www.ethical-council.com](http://www.ethical-council.com)

#### Swedish and foreign investors

In addition to cooperating with its fellow AP funds through the Ethical Council, the Second AP Fund also collaborates with other Swedish and foreign investors. It is also a member of and actively supports various Swedish and international initiatives focused on the environment, ethics and corporate governance.

The Fund also collaborates with other investors on influencing new legislation, mainly within the field of corporate governance. These forms of collaboration are becoming increasingly important as a means to influence and effect change and thereby improve share value over the long term.

In light of the growing focus on emerging markets, the Second AP Fund chose to become a member of ACGA (Asian Corporate Governance Association) during the year. ACGA is a non-affiliated, not-for-profit member organization that works with investors, companies and supervisory authorities to promote effective corporate governance throughout Asia. ACGA was established in 1999, based on the conviction that good corporate governance is fundamental to the long-term growth of Asia's economies and capital markets.

#### Collaboration on the climate issue

Through its membership of the IIGCC (Institutional Investors Group on Climate Change), the Fund collaborates with other European investors on climate issues. The idea is to make the voice of investors heard in the climate debate and to make companies, government agencies and other investors aware of the long-term risks and opportunities associated with climate change. The climate issue is important to the Second AP Fund as a long-term investor. At present, there is considerable uncertainty about the future regulations and framework for reducing the emission of greenhouse gases and stimulating alternative energy sources. This makes it difficult for companies to make profitable investments and for investors

to calculate the potential risks and returns. The IIGCC provides an effective platform for communicating investors' wishes concerning climate issues. It is also a good way for the Fund to acquire the latest information on climate related investments. Read more at [www.iigcc.org](http://www.iigcc.org)

More about the Second AP Fund's memberships and initiatives at [www.ap2.se/en/corporate-governance-/memberships-and-initiatives/](http://www.ap2.se/en/corporate-governance-/memberships-and-initiatives/)

### Sustainability reports from companies

#### Demand for data on emissions

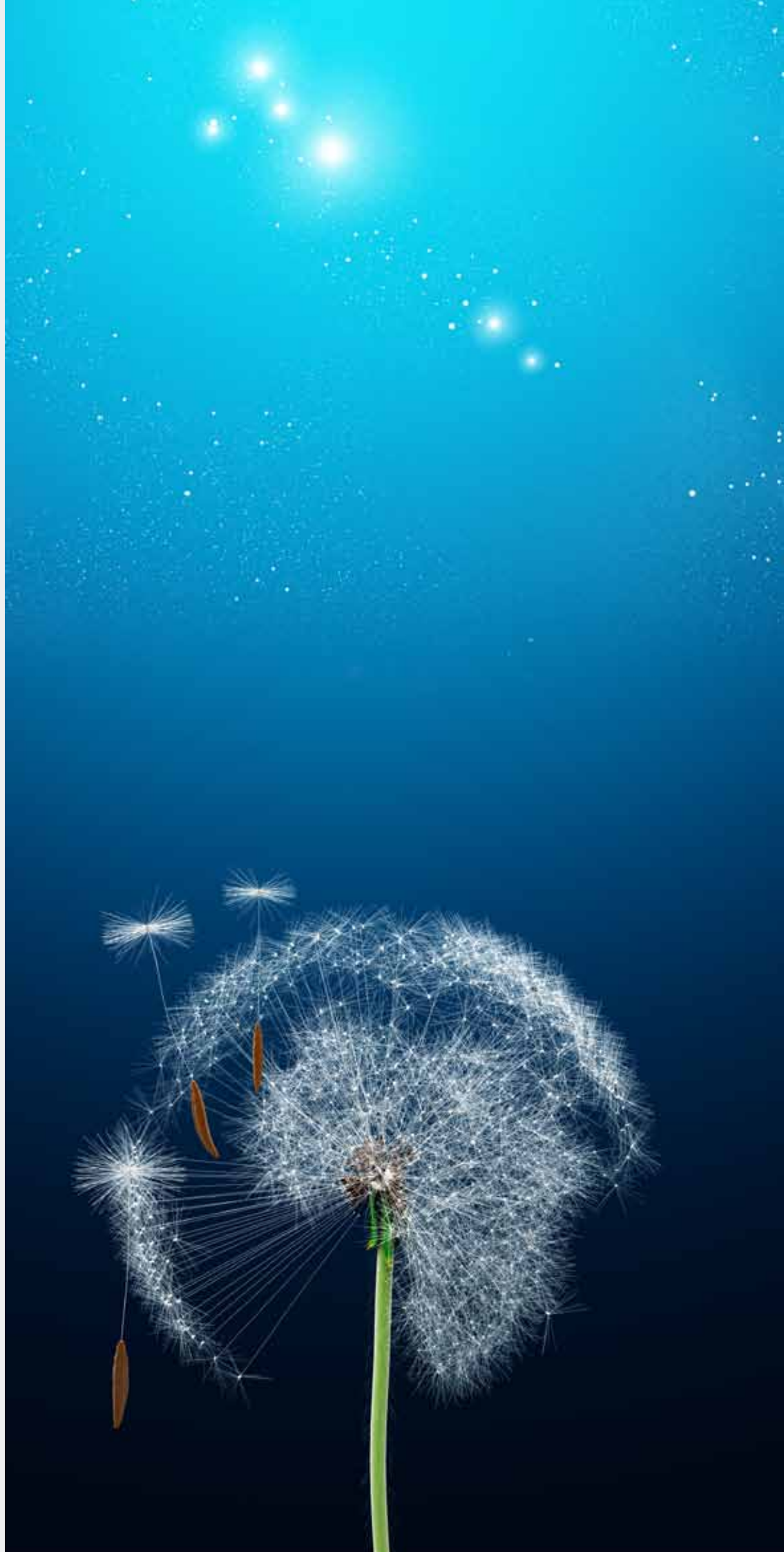
The Second AP Fund is also a member of the CDP (Carbon Disclosure Project). The CDP is an initiative whereby some hundred major fund managers require that the world's largest publicly quoted companies provide reports on their greenhouse emissions and how they are addressing the climate challenge. The CDP aims to make the data-gathering process more efficient by bringing together a large number of investors to sign a joint demand for the provision of regular data and reports on companies' emissions of greenhouse gases. More at [www.cdproject.net](http://www.cdproject.net)

#### Reports from external asset managers

The Second AP Fund's annual review of external asset managers has addressed sustainability issues for some years now. These issues are also addressed when awarding new mandates.

### Second AP Fund reports

It is important that the Fund report its own activities and on sustainability issues in an open and comprehensible manner. In addition to its Corporate Governance Report, information is available in the Annual Report and on the website. More detailed information on the work of the Ethical Council may be found in its Annual Report. Further details of how the Fund has implemented the PRI principles may be found in the responses to the annual questionnaire conducted by PRI. The Second AP Fund's responses are available on the PRI website.



# Report on implementation of Farmland Principles

*In September 2011, the Second AP Fund, in collaboration with a group of international investors, launched the Five Principles for Responsible Investment in Farmland. The Principles address the following areas: the environment, labour rights, human rights, land rights and business ethics.*

All investors who have signed up to the Principles are pledged to submit an annual report on progress with the implementation of these Principles. It is hoped that this will increase transparency concerning the investments of institutional investors in agricultural assets. The Second AP Fund has elected to include this report as an integral part of its annual Corporate Governance Report. This is the second year in which the Second AP Fund has reported on its actions in implementing the Farmland Principles.

## AP2's agricultural holdings

Sustainability factors are central to the Second AP Fund's investments in farmland. The Fund's strategy is to invest in large-scale agricultural real estate in countries that possess clearly-defined legal structures. This disqualifies many geographical regions for investment. At present, the Second AP Fund invests in Australia, Brazil and the USA.

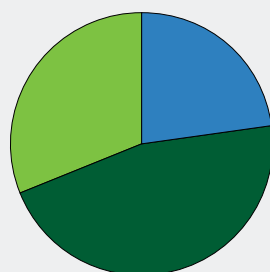
Investment in agricultural real estate forms part of the Second AP Fund's strategy for diversifying the overall portfolio. The Second AP Fund intends to invest about 1.5 percent of its assets under management in forest and agricultural real estate. As of June 30 2013, one percent of the Fund's capital assets were invested in agricultural real estate.

The Second AP Fund has elected to invest in agricultural real estate by establishing joint ventures with other investors, a form well suited to the Fund's long-term investment approach. The Second AP Fund has undertaken to invest USD 100 million in Teays River and USD 450 million in TIAA-CREF Global Agriculture. The Fund has an equity interest of 11 percent in Teays River and 23 percent in TIAA-CREF Global Agriculture. TIAA-CREF Global Agriculture owns agricultural real estate in Australia, Brazil and the USA, while Teays River invests exclusively in the USA. As of June 30 2013, these two companies had invested in agricultural estate totalling some 237 000 hectares. The Second AP Fund's share of this agricultural estate corresponded to an area of farmland covering approximately 50 000 hectares.

In a breakdown of the Second AP Fund's total portfolio of agricultural investments, Brazil accounts for 46 percent, Australia for 31 percent and the USA for 23 percent. In the past year, the greatest increase in acreage has been in Brazil. As illustrated in the diagram below, cereals and oil-yielding plants are the largest crops. As a percentage of the overall portfolio, sugar cane has increased compared to last year. This derives from the acquisition of additional agricultural investments in Brazil.

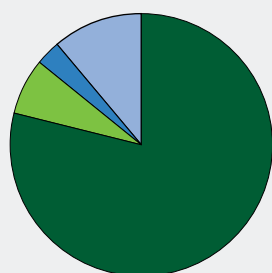
The Second AP Fund cultivates no land. The land is leased either to local farmers/companies or administered by external managers for the joint-venture companies. Where farmland is leased to a tenant farmer, the farmer decides which crop is to be cultivated and is responsible for both its production and sale. In Brazil, several of the tenant farmers are affiliated to various sustainability initiatives related to different crops, such as Bonsucro (sugar cane), the Round Table on Responsible Soy Association, the Better Cotton Initiative and the Brazilian Responsible Cotton Program. If the farmland features a more permanent form of cultivation, such as an orchard, it is looked after by an agent, appointed by the external manager. The majority of the acreage owned by the joint-venture companies is leased out to tenant farmers. Most of the investments made in Teays River, however, are managed directly by the operative companies.

Geographic distribution



■ USA, 23%  
■ Brazil, 46%  
■ Australia, 31%

Type of crop



■ Cereals/oil-yielding plants/cotton, 79%  
■ Milk production, 7%  
■ Fruit/vegetables, 3%  
■ Sugar cane, 11%

All figures as at June 30 2013.





Lettuce cultivation in California. Photo: Jessika Ingvarsson

### The Farmland Principles

The Farmland Principles were launched in September 2011 by the Second AP Fund and ABP (Netherlands), APG (Netherlands), ATP (Denmark), BT Pension Scheme/Hermes EOS (Great Britain), PGGM (Netherlands) and TIAA-CREF (USA). These Principles are intended to provide institutional investors with an ESG (Environmental, Social and Governance) network for agricultural investments, and to increase transparency concerning such investments. As of June 30 2013, a total of 20 investors had signed the Principles. It is a requirement that all signatories of the Farmland Principles are also PRI signatories.

The Farmland Principles are administered by a steering committee, made up of representatives from those investors who originally drafted the Principles. During 2012, the work of the steering committee was led by the Second AP Fund, a role which was taken over by TIAA-CREF in 2013.

The steering committee for Farmland Principles works closely with PRI. PRI supports the Farmland Principles by spreading information about them and participating in the development of tools for their implementation.

### Implementation of the Farmland Principles

The Second AP Fund maintains an ongoing dialogue with its managers, as well as visiting its agricultural assets several times a year. Every year, with a view to gaining a comprehensive impression of the way managers are applying the Principles in practice, they are required to respond to a questionnaire about how they are implementing the Farmland Principles. A summary of these responses is provided below.

#### The First Principle

The first principle concerns the need to support environmental sustainability by promoting measures that, for example, reduce the risk of soil erosion and ensure improved water management. One requirement linked to this principle is the performance of an environmental assessment before agricultural real estate can be acquired. All agricultural real estate acquired by the joint venture company has been subject to an environmental assessment to identify environmental risks and any environmental impact. These assessments are conducted by an external party.

The greatest potential risks are thought to be those associated with the use and storage of fertilizer and insecticides. Regarding farmland in the USA, the mana-

gers also stress the importance of protecting wetlands and of observing US legislation concerning the conservation and protection of water resources. As required, the consultant commissioned to conduct the assessment also recommends measures for reducing risks and impact on the environment. If the agricultural asset is judged to present an average or high risk, the manager conducts follow-up assessments every six months, to ensure that the planned corrective measures are being implemented.

The farm managers are committed to maintaining soil quality and reducing the negative impact of for example surface runoff containing fertilizer and agricultural chemicals. No significant changes in environmental quality have been identified. Action has also been taken to support wildlife at a number of agricultural sites.

#### The Second Principle

The second principle addresses respect for labour and human rights. In precisely the same way as for the environment, an assessment is conducted by the Fund's managers to determine any risks or impact associated with the operations. This forms an integral part of the evaluation process prior to the acquisition of agricultural real estate. Areas of interest identi-



Vineyard in California. Photo: Jessika Ingvarsson

fied by these assessments in Brazil include the need for a safe work environment and living conditions. Audits are conducted at the farms to ensure that conditions are in compliance with national legislation and the managers' own policies. Another area of potential risk is the conditions experienced by migrant and/or seasonal workers.

To ensure that the working conditions in Brazil are compatible with current legislation and "best practice", third-party audits were conducted at all agricultural investments in 2010 and 2011.

During 2012, TIAA-CREF conducted a health-and-safety audit of all agricultural investments in Australia.

#### The Third Principle

The third principle addresses the use of,

and rights of ownership to, land and other natural resources. Such issues are often especially important in developing countries, where systems that determine who is formally entitled to farm and/or own the land may not exist. In those countries where the Second AP Fund has agricultural investments (Australia, Brazil and the USA), Brazil is the only one where it can be difficult to determine who is the rightful owner of an agricultural property. For this reason, TIAA-CREF's operators in Brazil conduct thorough research to establish the rightful owners of the land from the present day all the way back to its original sale by the government. Techniques utilized in this process include geo-references (GPS coordinates) and satellite images. The asset manager also engages in a dialogue

with representatives from the local community and landowners. Prior to acquisition of an agricultural property in Brazil, the manager will have assured that the investment will have no negative impact on the local environment and that no uncertainties exist concerning the rightful ownership of a property.

Since 2000, Brazil has instituted a requirement that, in the case of a transfer of ownership, all properties shall be registered using GPS coordinates.

#### The Fourth Principle

The fourth principle addresses business ethics. Managers and operators shall respect and implement processes that involve counteracting all forms of corruption. Laws shall be respected even when weakly implemented. Employees have re-



ceived training in these issues with view to combating corruption. Managers shall require employees to observe the legislation and regulations devoted to good business ethics.

The majority of managers and operators in the US have attended courses on American corruption legislation, known as the Foreign Corrupt Practices Act. No misdemeanours or disputes have been reported concerning agricultural investments made by the joint-owned companies in the past year.

#### The Fifth Principle

The fifth principle concerns reporting on activities and implementation of the Farmland Principles. This principle is relevant to managers who have signed the Principles. TIAA-CREF published its first report on the implementation of the Farmland Principles in autumn 2012 and is publishing a new report in autumn 2013. The reports may be downloaded from [www.tiaa-cref.org](http://www.tiaa-cref.org)

Over the past year, the Second AP Fund has chaired the PRI's working committee on agricultural investment. During 2012, the committee produced a case-study report entitled "Responsible investment in farmland: a compendium of case studies". TIAA-CREF contributed a case study on land and resource rights, while the Second AP Fund has described its work on the assessment of farmland asset managers from an ESG perspective. The report may be downloaded at [www.unpri.org](http://www.unpri.org)

#### Criticism about lack of transparency

In April 2013, Swedwatch (a Swedish non-affiliated research organization), published a report entitled "Investment without oversight", in which the Second AP Fund is criticized for not specifying the exact location of its agricultural investments in Brazil, making it difficult for external parties to confirm the extent to which the Second AP Fund lives up to the Farmland Principles. Swedwatch believes that the Second AP Fund should

conduct regular inspections of these farms and that public oversight should be increased.

The Second AP Fund takes account of the points made by Swedwatch concerning transparency. For commercial reasons, TIAA-CREF Global Agriculture has been unable to supply Swedwatch with the exact locations of agricultural assets, in light of the possibility of additional acquisitions adjacent to agricultural land that has already been purchased. As part of a strategy for increased transparency, the Second AP Fund, in collaboration with TIAA-CREF, will be arranging a trip for NGOs to tour several TIAA-CREF Global Agriculture's farms in Brazil.

In line with its ongoing development work, the Second AP Fund will be reviewing further possibilities for increased transparency in connection with these investments.

#### Current progress at FAO

The Second AP Fund is monitoring current progress on the formulation of the Principles for Responsible Agricultural Investment, in the context of food security and nutrition.

The Principles are developed by the Committee on World Food Security (CFS). As well as the member states of the FAO (Food and Agricultural Organisation), IFAD (International Fund for Agricultural Development) and WFP (World Food Programme), the CFS also includes representatives from NGOs and the private sector. The Principles are being drawn up by means of a consultative process, for approval by the CFS in the autumn of 2014.

These Principles are intended to contribute to the security of food supplies and nutrition. The Principles are intended for implementation by all those involved in or affected by investment in agriculture. They will be voluntary and non-obligatory, and shall be interpreted and applied in compliance with national and international legislation. The Principles will cover

all types of investment in the process chain and food systems.

In its report, Swedwatch recommends that the Second AP Fund align itself with these Principles. It is difficult to express any opinion about the new Principles, given the fact that they are not yet ready. The Fund has nevertheless submitted comments on the draft version of the Principles to the Swedish Ministry of Rural Affairs. The Second AP Fund is also a member of the working committee that has been formed to work on the principles responsible agricultural investment (rai), as a subcommittee of the steering committee for Farmland Principles.





# The number of women on corporate boards has declined for the second year in succession

*The 2013 edition of AP2's Women's Index reveals that the number of women on corporate boards has declined since 2011 and, according to this latest report, account for only 22.3 per cent. However, the number of women in executive managements continues to note a steady rise, to the current level of 17.2 per cent.*

Since 2011, the proportion of women employed by the 250-plus companies quoted on the Stockholm Stock Exchange has declined from 22.9 per cent to 22.3 per cent in 2013. This decline stems from the smaller companies, while the proportion of women employed by the 'large cap' companies has increased to slightly in excess of 25 per cent.

During the same period, there has been a rise in the level of female representation in executive managements and, in the past year, this increase has totalled a percentage unit, rising from 16.3 per cent to 17.3 per cent in 2013. The corresponding level for the 'large cap' companies is close to 19 per cent.

"It is troubling that the proportion of women on corporate boards has declined again this year, and in principle has reverted to the same level as noted for 2010. As investors, we must seriously – and to a much greater extent – discuss what can be done to reverse this trend. What is pleasing is the increasing number of women in executive management positions, especially in light of the fact that this group constitutes the primary recruiting base for future board members," states AP2's CEO Eva Halvarsson.

## **Change will take time**

If the pace of change noted over the past decade continues, it will be another 31 years before women fill 50 per cent of the seats on corporate boards. The corresponding forecast for achieving 50 per cent representation on executive managements is no less than 52 years: i.e. not until 2065.

There is a marked difference between male and female-dominated industries when it comes to the number of women in executive managements and, particularly, in the overall number of employees. Female representation is greatest in industries with the highest percentage of female employees. Companies in the services and consumer staples sectors boast the highest proportion of women on their boards, while the healthcare and media and entertainment sectors have the highest percentage of female executives. The Commodities sector is worst, with the lowest levels of women on company boards and in executive managements. Even so, there has been an increase in the number of women in executive management and now, men comprise less than 90 per cent of the exe-

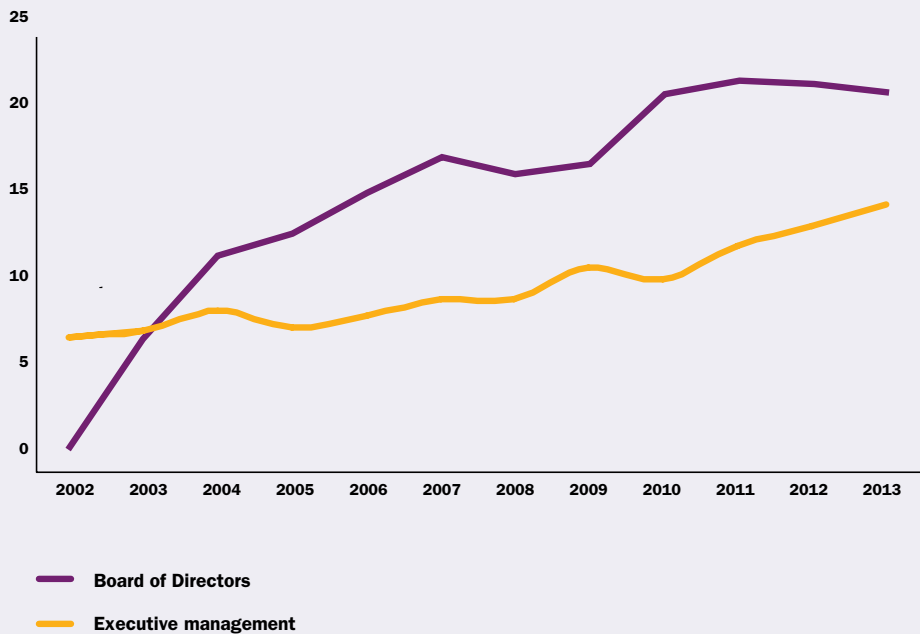
cutive managements of these companies. The number of women studying for degrees in fields that have historically been a source of recruitment for company management and board members has increased over the past 30 years; from just below 20 per cent to almost 50 per cent today. However, women tend to drop off in the transition from graduates to employees (almost a third), to managers (one fourth) and to Group management (one sixth).

## **International guidelines for diversity**

The Second AP Fund has been a member of the working committee of the International Corporate Governance Network (ICGN) which, during the year, drafted guidelines for promoting gender equality on corporate boards. These guidelines state ICGN's conviction that gender equality is an important governance factor in enhancing the efficiency of boards and, thereby, companies' long-term sustainability. These guidelines are intended to promote a dialogue between companies and investors, contributing to a more equitable gender balance on corporate boards.



Women's Index, %



**Background data**

Since 2003, in collaboration with Nordic Investor Services, AP2 has compiled an annual Women's Index. This Index is intended to promote a balanced debate as to how the percentage of women on the boards and executive managements of Swedish publicly quoted companies can be increased. The idea is to broaden the recruiting base and the diversity of boards and executive managements, improving the potential to create better companies and thereby raise their share value. The study measures the proportion of women represented on the boards and executive managements of Swedish publicly quoted companies, as well as the total number of employees, and is conducted following the conclusion of the Swedish AGM season in the period from April to June every year.

In all, the 2013 Women's Index comprises 253 of the companies quoted on the Stockholm Stock Exchange, which means an equal number of chairs and CEOs, and 1 671 board directorships. This brings the total number of senior executives included in the study to 1 751.





# Always gone her own way

*Salomeh Tafazoli was only 26 when she took on the manager role for the first time. Now, six years later, she is strategy and project manager at Volvo Trucks EMEA, and a member of the executive management. She is convinced we are on the verge of a generation shift, and that we shall see an accelerating pace of diversity in executive management and on corporate boards.*

When Salomeh Tafazoli became head of process development within the sales department of Volvo Trucks in 2007, she was one of the youngest managers in the company. Soon afterwards, she also acquired responsibility for logistics development on the commercial side of the business.

## **Diversity in her genes**

At the age of five, Salomeh came to Sweden from Iran with her mother and sister, and decided early to go her own way. For example, she chose the aesthetics programme at her upper secondary school, with special emphasis on drama and dance, rather than the more traditional course of study her mother would have preferred for her.

“My mother has always been a great support. Since I was very small, she has said that the only thing that could stop me was me. I had to find out for myself that my future did not lie with drama and dance, but I have absolutely no regrets about choosing the aesthetics programme. I learned a lot that remains important to me today, both professionally and in my private life,” says Salomeh.

After secondary school, Salomeh read international economics at Gothenburg University. This was followed by some further years of study and work within banking in the USA, before she returned to Gothenburg.

“I hadn’t meant to stay in Gothenburg for long, but was offered the chance to work close to the end-user and our truck business, which felt absolutely right to me. Most important of all – then and

now – was the benefit of being able to work with people,” notes Salomeh.

## **Awarded as future female leader**

In 2010, Salomeh was presented with the Future Female Leader Award by the Swedish executive organization Ledarna, and the career network Shortcut. The Jury motivated its decision in the following words: “Salomeh Tafazoli is the very symbol of a modern leader, who with a high degree of awareness ensures everything and everyone around her is given the opportunity for constant development; results, processes and people – and in particular – personal leadership. Through clear communication, a commanding presence and a sense of humour, she enlists the support of employees and fellow managers alike, and successfully implements projects at which others have failed.”

Salomeh’s skills as a manager are further confirmed by her top rating in Volvo’s annual staff opinion survey, where she polled the highest points a manager can be awarded.

## **Unique as a woman**

Although Salomeh has not personally experienced any major problems in working in male-dominated industries, she is an ardent advocate of gender and diversity issues and is actively engaged in them.

“I believe the question of diversity to be extremely important, and wish better data was available on the degree to which diversity affects corporate results. Sometimes the focus is rather too narrowly directed at the man/women

issue. I am also ardent about bringing more people from other cultures into companies. This is something that global companies need to do. But you can’t force people to change; you just have to have the right person in the right job. I wouldn’t want to be given a post simply because I’m a woman or because of my immigrant background. I want to be chosen because I’m the right person for the job,” states Salomeh.

Salomeh is convinced that we are going to witness dramatic change concerning the issue of diversity.

“I believe a generation shift is in progress and that society is changing. I expect to see an accelerated rate of change compared to what we have had until now.”

## **Diversity at Volvo**

Salomeh feels that Volvo is a company that has come a long way in terms of diversity, and which is strategically engaged in the issue. This view is supported by the existence of several diversity programmes within the Group, as well as a prize that is awarded annually to the individual who has worked most successfully to promote diversity within the company. It is a highly prestigious award.

“Diversity is important in the world of business and industry. We need people who see things in different ways. The world is changing and we must change with it – we cannot do this without diversity,” concludes Salomeh.

# Green bonds

## – a growing form of funding

*The Green Bond concept was launched in 2008 by the World Bank's institute International Bank of Reconstruction and Development (IBRD) and SEB as a form of funding. In the same year, as one of the earliest investors, the Second AP Fund made its first investment. Today, the Fund's investments in green bonds total SEK 1 billion.*

In 2008, the World Bank launched its "Strategic Framework for Development and Climate Change" to help stimulate and coordinate public and private sector activity in combating climate change. The World Bank's Green Bond is an example of innovation within this framework. It has been conceived as a way to finance projects that either mitigate climate change or help countries to adapt to its consequences.

"We remain satisfied with our investments, since we are supporting projects that are environmentally responsible without forgoing a reasonable return or increasing our credit risk," says Ole-Petter Langeland, who heads Fixed Income Securities at the Second AP Fund.

### Must meet specific criteria

Member states that borrow from the World Bank to finance a climate change project, and which satisfy the selection criteria, are entitled to support in the form of 'green bonds'.

It is the World Bank's environment specialists who identify, select and monitor projects supported by the finance raised from green bonds. Eligible projects must meet specific criteria for low-carbon development.

### Funded projects

Today, green bonds provide the funding for some 40 projects in 17 countries. These projects include investment in environmentally appropriate heating for rural communities in China, a solar-and-wind power project in Mexico and another for an environmentally friendly mass transit system in the Colombian capital city of Bogota. Further details at [www.worldbank.org/projects](http://www.worldbank.org/projects)

### First in Asia

As well as investing in green bonds issued by the World Bank, the Second AP Fund has invested in a similar bond issued by the EIB (European Investment Bank). In 2013, the Fund also invested in

the first Asian initiative with respect to green bonds, issued by KEXIM (Export-Import Bank of Korea) in collaboration with SEB and Merrill Lynch.

"It is pleasing to note how this market continues to grow, as does the number of players issuing this type of bond. This form of investment suits us well, in that it subscribes to our perception of the need to combat climate change, contributes to further diversification of the portfolio and fits our strategic profile as a long-term investor," states Ole-Petter Langeland.

Source: [www.worldbank.org](http://www.worldbank.org), [www.seb.se](http://www.seb.se)

### Examples of mitigation projects deemed eligible for support from green bonds include:

- Solar and wind installations.
- Funding for new technologies that permit significant reductions in greenhouse gas (GHG) emissions.
- Rehabilitation of power plants and transmission facilities to reduce GHG emissions.
- Greater efficiency in transportation, including fuel switching and mass transport.
- Waste management (methane emissions) and construction of energy-efficient buildings.
- Carbon reduction through reforestation and avoided deforestation.

### Examples of adaptation projects deemed eligible for support from green bonds include:

- Protection against flooding (including reforestation and watershed management).
- Food security improvement and implementing stress-resilient agricultural systems (which slow down deforestation).
- Sustainable forest management and avoided deforestation.



Photo: Flexenclosure

## Solar and wind powered mobile phone networks

*Since 2009, the Second AP Fund has been an investor in Swedish company Flexenclosure, which has developed technology that enables base stations in mobile phone networks to be operated on renewable energy, in the form of solar and wind power.*

Flexenclosure's technology enables mobile network operators to reduce operating costs and carbon emissions at base stations by as much as 95 per cent, by utilizing solar and wind power. First and foremost, the technology has been developed for mobile networks in developing countries, in areas that either have no electrical power at all or where it is unreliable.

"The Flexenclosure product E-site resolves the energy supply problem for base stations located where there is no

access to a mains network. E-site is one of the first products for base stations to be powered by renewable energy instead of diesel generators. E-site combines wind and solar energy to power the base stations and can store any surplus energy in batteries as required," says Jonas Eixmann, Head of Equities at the Second AP Fund.

During the spring of 2013, IFC (International Finance Corporation), which is part of the World Bank, also invested in Flexenclosure. The IFC promotes sustainable private investment in developing

countries as a way to reduce poverty and improve people's living conditions. The Second AP Fund and Sweden's Industrifonden, both of which already had holdings in the company, made additional investments during the spring. The new capital will be used for the further development of Flexenclosure's green telecom and IT solutions.

Flexenclosure's primary market is Africa and among the clients are global companies such as Ericsson, Airtel, MTN and Zain.



# Korean pension fund learns about sustainability

South Korean pension fund NPS (National Pension Service) is one of the world's largest of its kind and the largest investor in South Korea. NPS has appointed a group to manage responsible investments, which will oversee the development of sustainability policies within the fund. As part of this new commitment, the group is visiting pension funds in Europe, to learn how already established operations deal with sustainable investments and strategies.

At the end of June, the group visited the Second AP Fund, to gain an insight into how we integrate sustainability into our analytical and investment processes, and to learn more about the development of the Fund's strategic portfolio. Our visitors included representatives from NPS, the Korean Ministry of Health & Welfare and Seoul Business School.

The Second AP Fund has for some time had a joint interest with NPS and Tishman Speyer in American real estate company US Office Holdings.

Visitors from NPS with representatives from AP2.

Photo: Christina Olivecrona



Photo: Caroline Eking

# Paper on finance and sustainability gains award

The Second AP Fund's Finance and Sustainability Award has been presented for the first time and has been awarded to students Sabina Eliasson and Jonas Wannefors. They have been selected to receive the Award, worth SEK 20 000, for a paper illustrating ways in which investors can utilize environmental data to create a higher risk-adjusted return on investment.

It was last year that the Second AP Fund instituted a prize designed to encourage students at Gothenburg University's School of Business, Economics and Law to write papers on finance and sustainability. The papers are to combine models/theories of business economy, asset management and corporate valuation with aspects of sustainability.

A jury at the School of Business nominates papers after assessing their academic quality. The Award-winning paper is then selected by the Second AP Fund's Award Committee.

"There has been a clear rise in student interest for business economy and sustainability. This year, greater numbers of students have chosen to write their papers on this subject," notes Professor Martin Holmén, Centre for Finance (CFF), who chairs the jury.

The award committee motivated its choice for the 2013 Award in the following terms: *"In their joint paper 'Are environmental friendly companies a good investment? A portfolio study of companies' financial and environmental performance', Jonas Wannefors and Sabina Eliasson have constructed a number of portfolios featuring different levels of environmental performance, to determine whether they are correctly valued in line with current price-setting theories as applied to financial assets. In their study, they have analysed financial performance related to eco-efficiency and environmental management.*

*Jonas and Sabina have done a thorough job, both in covering the available literature and in conducting their portfolio analyses. Their study has illustrated the opportunities that environmental data can present to investors seeking a higher risk-adjusted return on investment."*

"We find it both enjoyable and important to encourage students to think along these lines. For some years now, we have enjoyed close collaboration with Gothenburg University's School of Business, Economics and Law and with Chalmers Institute of Technology, also in Gothenburg, and we believe the Award is just one more example of how we can focus jointly on a subject of urgent interest," says CEO Eva Halvarsson, the Second AP Fund.

# Chairman of international advisory board

*The French EDHEC-Risk Institute is one of the world's leading centres of risk research in the field of asset management. Since the time of its establishment in 2001, the Institute has been cited no less than 36 500 times in international asset management journals. The work of the Institute is supported by an international advisory board which, in 2013, appointed a new chairman, Tomas Franzén, Chief Investment Strategist (CIS) of the Second Swedish National Pension Fund.*

Text: Lars Mattsson

"I have been a member of the advisory board for a number of years and it is both stimulating and honored to be entrusted with its chairmanship", says Tomas Franzén.

The board's role is to act as advisor to those responsible for the EDHEC-Risk Institute's research programme and to evaluate research findings, with a view to determining their potential for practical benefit within the international financial industry.

## Ongoing dialogue with the financial industry

The EDHEC-Risk Institute, inaugurated in 2001, has step by step established itself as one of the leading players in its field in the world. This research centre strives to maintain an ongoing dialogue with the asset and risk management community, willingly sharing its expertise. Every

month, its newsletter is received by more than 1.5 million subscribers throughout the financial industry. The EDHEC-Risk Institute also conducts regular industry surveys, provides consultancy services and organizes conferences for institutional investors.

"For institutional investors such as AP2, it is important that research that addresses risk and asset management issues is impartial and non-affiliated. The academic research being carried out in this area provides a good example. EDHEC RI fills an important function, bridging the gap between the worlds of theoretical and applied research", says Tomas Franzén.

## Pioneer index research

This dynamic interchange with the financial industry is of central significance to the EDHEC-Risk Institute, in that it pro-

notes greater understanding among researchers about what is relevant and applicable in the financial sector.

"The Institute strives to come up with solutions that can be used by as many asset managers as possible," notes Tomas Franzén.

Typical of this is the pioneer index research that the EDHEC-Risk Institute lies behind. Quite simply, it has led to the fact that many can now develop their own combinations of benchmark-index, according to the 'open source' principle.

"Ultimately, it offers increased freedom of choice, lower risk and reduced costs – geared to the investor's unique investment strategy and investment horizon. This is thoroughly in line with our requirements at the Second AP Fund," states Tomas Franzén.

## International expansion

The EDHEC-Risk Institute has steadily expanded its international activities. Operations outside Europe have developed in the past few years and the Institute now has a campus in Asia too. In May 2013, Tomas Franzén gave the opening address at the EDHEC-Risk Days Asia conference in Singapore, attended by some 600 professional investors.

In autumn 2013, the Institute will be broadening its activities in the USA, where it has initiated collaboration with the universities of Princeton and Yale. During autumn the institute will have its inaugural EDHEC-Risk Days North America, in New York.

More about EDHEC-Risk Institute at [www.edhec-risk.com](http://www.edhec-risk.com)



Mr. Tomas Franzén, Chief Investment Strategist (CIS) at the Second AP Fund, assumed the chairmanship of the EDHEC-Risk Institute's research council at the start of 2013. Photo: EDHEC

# Sustainability issues increasingly important to private equity companies

*Until a few years ago, sustainability issues played a fairly limited role in the private equity industry. In 2009, however, a special guide highlighting these issues in the private equity sector was published as part of the UN's PRI initiative and, during the spring, new guidelines have been finalized on the reporting of sustainability issues.*

The Second AP Fund has invested in private equity funds from the very start, since its inception in 2001. Today, the Fund has invested in a total of 63 private equity funds and collaborates with 32 private equity firms, involving a total investment of SEK 18 billion. The Second AP Fund is a significant player in this sector and an important voice in discussions about the demands that should be placed on these private equity firms.

The Fund encourages private equity funds to apply the principles of the UN's Global Compact and PRI (Principles for Responsible Investment). In 2009, PRI published a special guide for private equity firms that focused on sustainability issues, which the Second AP Fund participated in and supported. The Second AP Fund monitors and evaluates these funds on a continuous basis.

## **Better information**

A key question addressed by the Fund is the need for better information from private equity firms.

"We invest only in funds where we believe we will have access to all the information we need. We require that these firms demonstrate a high degree of transparency in their dealings with us. We have also striven to convince private equity firms of the need to provide external parties, such as the media, with more comprehensive information," notes Anders Strömblad, who heads External Managers at the Second AP Fund.

In the past year, the Second AP Fund has also participated in a cooperative venture that has involved a large part of the private equity industry, leading to the crea-

tion of a framework for reporting on sustainability issues. A total of 40 investors from 11 countries, 20 private equity federations and 10 leading private equity firms has been involved in the project, which has been led by Hermes, CalPERS, PGGM, IFC and APG.

## **Framework for reporting on sustainability**

The framework for reporting on sustainability issues has been developed to help private equity firms better understand the reasons behind investors' requests for data that applies to sustainability factors. It is also designed to help rationalize the types of question that investors increasingly ask private equity firms about sustainability.

The framework comprises eight objectives that are common to several of the investors who seek more structured sustainability data when considering their private equity investments. The first five objectives concern a private equity fund's due diligence-process, while the remaining three concern the reporting process throughout its entire existence. Guidance is also given concerning the provision of data about unexpected events which could place the reputation of an investor, private equity firm or portfolio company at risk.

Questions based on this framework for reporting on sustainability issues now form part of the Second AP Fund's evaluation of new private equity firms.

## **Evaluation on sustainability issues**

During the year, the Second AP Fund distributed a questionnaire to all external managers of the private equity funds with which the Fund collaborates. The questionnaire asked managers how they work

with the issue of sustainability. This work has promoted greater integration of sustainability issues in the management of private equity firms. These questions were based on the framework for the reporting of sustainability issues, as described above.

"We have long asked questions about sustainability, but have now adopted a uniform approach to furnish us with a reliable situation assessment for all our external managers," says Britta Ersman, who heads private equity investments at the Second AP Fund.

"In our dialogue with private equity firms," she continues, "we are noticing that sustainability issues are now placed much higher on the agenda. They have become more integral to the funds' analyses of portfolio companies than they were some five years ago. The private equity firms have also recognized how important it is that investors request this type of information. Corporate governance has always been an important issue for these funds – poor governance costs money. They have now also realized that inadequate attention to ethics and the environment can be costly too."

The Second AP Fund would like to see private equity firms become even more transparent. Many already do a lot with regard to sustainability, but may not yet fully appreciate the need to talk about it outside their own fund.

"Funds that fail to take sustainability issues seriously will struggle to gain access to institutional capital. 'Private equity' is not so private anymore: it's becoming more 'public'," says Britta Ersman.





During the spring, the Second AP Fund has reviewed its entire private equity investment process, to make it more efficient. Improvements include more effective utilization of the Fund's in-house competence and the adoption of a broader view of risk in managing this type of investment. In addition to the portfolio management the Fund's financial, legal, compliance, risk management and performance analysis departments, as well its sustainability analyst, are now involved in the private equity investment process.

# Al Gore on the key drivers every long-term fund manager should be aware of

*In his latest work, *The Future – Six Drivers of Global Change*, former US Vice President Al Gore defines the key drivers behind the tide of change washing over the world. In the long term, these drivers are expected to have a major impact on individuals, companies and society at large. Consequently, they are also of significance to asset managers who invest in the long term, such as the Second AP Fund. To find out more, we interviewed Al Gore and his colleague David Blood at fund manager Generation Investment Management.*

Text: Lars Mattsson

Nine years ago, Al Gore was asked whether he could define the key factors driving the major global changes that impact on our day-to-day lives, regardless of our geographical location. His reply was speedy and well-formulated.

“But I felt it had been incomplete,” notes Al Gore. “Travelling back to the US, I devoted some more thought to the matter, considering other and equally important aspects that ought to be addressed. It was a long trip, so I had plenty of time to think.”



Mr. Al Gore

## Impact on Generation's investment model

Back home, the question kept nagging him. At the time, Al Gore, David Blood (former CEO of global asset management at Goldman Sachs) and a number of other partners were engaged in developing an investment model for Generation. A distinguished global investment fund that adopts a long investment horizon, Generation bases its investment decisions on a fundamental analysis in which sustainability issues play a key role. Generation's ability as a 'stock picker' – the ability to pick the right companies to invest in, from a broad index – has contributed to a solid risk-adjusted return.

“I shared my thoughts with David and the others at Generation. We engaged in many interesting discussions that had a direct impact on our investment model,” states Al Gore.

Our clients also expressed some interest, especially how the implications of climate change should be addressed from an investment perspective.

## Analyzed 15 000 pages of facts

The need to discover more about these drivers has been a regular recurrence since then. Two years ago, Al Gore decided to summarize these thoughts in the form of a book.

Working with his team of researchers, he gathered all the facts generated by this research. The mass of data amounted to some 15 000 pages of facts. His living room became the hub of the entire process.

“We moved out all the furniture, set up whiteboards and installed data systems that could break down all the information into a manageable volume,” says Al Gore.

“We stand at a crossroads in terms of determining our future,” says Al Gore. “We can either give up or become more engaged in our future, by making informed decisions. My hope is that the book will enable as many people as possible to see and understand the background to and interrelationships between the changes that we must expect.”



## We stand at a crossroads in terms of determining our future.

This will make it easier to accept collective responsibility.

“This is my contribution to the process. Of course, as a project, charting and summarizing the future is full of risks. But refraining even from attempting to do this is yet more of a risk. We can still control our future, at least to a great extent. We cannot afford to miss this opportunity”, says Al Gore.

### Six drivers that affect us all

The Future has been warmly received by the critics, immediately becoming one of the ten most sold books on the New York Times bestseller list, when published in spring 2013. The book centers around six driving forces that impact on the present and the future. They may be summarized as follows.

- The migration of labor from East to West, in conjunction with a shift towards the automation of production through the use of robots.
- The shift in power from West to East and from national governments to or

ganizations and companies, yet also to guerilla and terrorist organizations.

- The growth of the Internet, which has contributed to a massive dissemination of information, offering the global population radical new opportunities for interconnecting.
- Advances in biotechnology that enable the creation of new organisms, materials and fuels.
- Demographic change, including population growth and the movement of people within and across national borders.
- Climate change, that derives from a sustained high level of greenhouse emissions.

### Everything is interconnected

All the factors in Al Gore’s analysis are interconnected. Climate change is possibly the most critical element, because of its huge impact on the whole of humanity. Nowadays, some 85 percent of our energy comes from fossil fuels.

“Every year, we generate global greenhouse emissions equivalent to the fallout of 400,000 Hiroshima bombs. The laws of physics tell us this is unsustainable. If we are to achieve the global targets set for CO2 emissions, we must leave the oil where it is – in the ground. This will have a dramatic effect on the valuation of oil deposits,” says Al Gore.

In fact, this type of insight has already had an impact on stock valuations. During 2013, institutional investors such as SPP/Storebrand have reduced their exposure in fossil-based and CO2-generating investments with a view to securing a long-term stable return. This sales pressure has contributed to the decline in the oil index over the past year – and this during a period when the S&P Global 1200 Index rose sharply. According to Al Gore, however, there is potential for a still greater decline.

“The general impression has been that oil should feature as a natural element of a diversified portfolio. The reality is not





## Making the right investment decisions in today's world is not easy.

quite so simple when you look at the risks. A sum of around USD 15-16 trillion is tied up in 'sub-prime' assets, in the form of fossil fuel assets. Previous experience of sub primes witness that the risks cannot be covered up. When the market becomes fully aware of this, the price adjustments we are likely to see will have some serious economic consequences," concludes Al Gore.

### Lessons for long-term asset management

These six drivers may prove important to long-term investors like the Second AP Fund.

"Definitely – especially since the Second AP Fund's investment strategies are based on a 'top-down' analysis, in which an understanding of the long-term

changes that affect society, markets and individual segments is of crucial importance," states David Blood.

By adopting a broader focus when conducting an investment analysis, in which attention is paid to the key factors that drive growth, investors similar to the Second AP Fund can not only avoid a number of risks but can also nudge development in the right direction by, among other things, exerting its influence through active corporate governance.

"In this respect, the Second AP Fund has an important role to play," notes David Blood.

### Increased uncertainty makes severe demands on the analytical process

All the change factors cited by Al Gore present considerable opportunities – and equally considerable challenges. Seen from an investor's perspective, this creates uncertainty. This affects the work of analysts, something that investors with long investment horizons should be aware of, if not already. Generation has addressed this issue in its investment model.

"Making the right investment decisions in today's world is not easy. We must ensure our colleagues are able to include as many factors as possible in their analyses," states David Blood.

It is largely about creating an environment that promotes an ongoing learning process. Basically, it is a matter of establishing a learning culture.

The work of preparing the Fund was initiated in autumn 2003. The first step was to finalize the Fund's mission and core values. All 16 members of staff were involved in this process, which has had a significant impact on the culture of the Firm.

### Systematic monitoring to learn more

Generation adopts systematic monitoring, to ensure mistakes are learned from, rather than sweeping them under the carpet.

"For instance, we have something we call 'confessions of an analyst', which means that others can avoid making the same mistakes," says David Blood.

This is a way of avoiding the 'hubris trap', which can fell even the most self-effacing analyst.

"All who work for us know it is best if we put ego aside. Regardless of how good our track records may seem on an individual basis, nobody knows everything. But answers can always be found. This marks a major cultural difference, one that requires an open attitude," notes David Blood.



Mr. David Blood





**Andra AP-fonden**  
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