Andra AP-fonden
econd Swedish National Pension Fund - AP2

AP2 – Corporate Governance Report

JULY 2008 – JUNE 2009

Successful AGM action for a better environment

Leading real-estate company in tune with the environment

Principles for responsible private equity investors

Portfolio's carbon footprint evaluated

This is the Second AP Fund*

The Second AP Fund's broad aim is to maximize the Swedish pension assets for which the Fund is responsible.

The Second AP Fund manages Swedish national pension assets, involving a global portfolio of investments. The Fund is one of five "buffer funds" within the Swedish national pension system.

As per June 30th 2009, the Second AP Fund had assets under management of SEK 182.5 billion. Fund capital was distributed accordingly: equities (52 percent), fixed-income securities (40 percent) and alternative investments (8 percent).

The Second AP Fund, established in 2001, is located in Gothenburg. The Fund's board of directors is appointed by the Swedish Government.

The Second AP Fund is a young, innovative organization, with a strong team spirit and a responsible task. This makes it a stimulating place to work.

* The Second AP Fund is officially translated as the Second Swedish National Pension Fund/AP2. In body text, for conveniance, this is shortened to the Second AP Fund and, in some cases, AP2.

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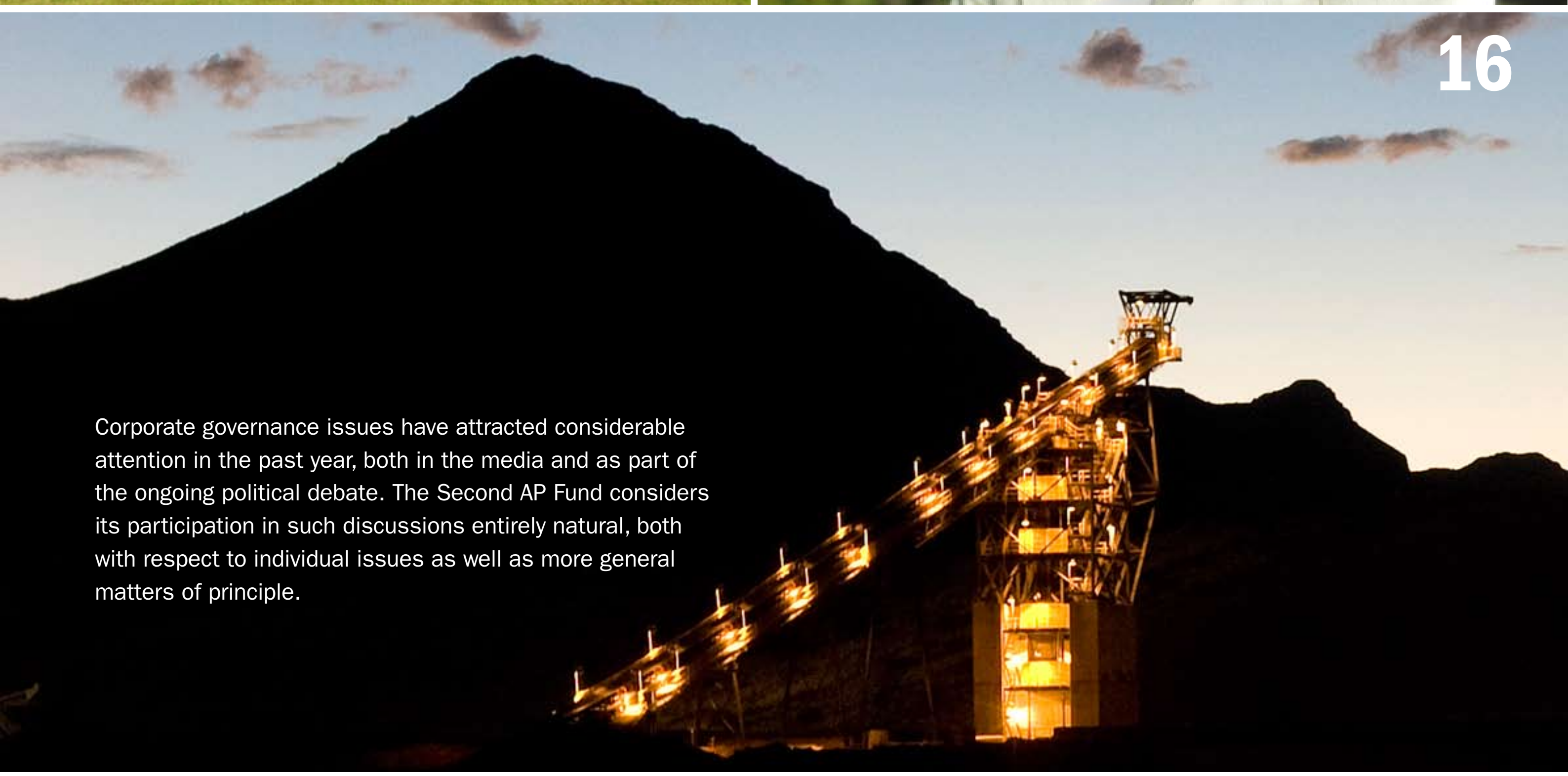
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Corporate governance issues have attracted considerable attention in the past year, both in the media and as part of the ongoing political debate. The Second AP Fund considers its participation in such discussions entirely natural, both with respect to individual issues as well as more general matters of principle.


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Challenging times demand active governance

Corporate governance issues have attracted considerable attention in the past year, both in the media and as part of the ongoing political debate. This is partly a consequence of the global financial crisis and subsequent recession. It is positive that corporate governance issues are in focus. Given the fact that a large part of its assets are invested in equities, it is entirely natural that the Second AP Fund actively participate in such discussions, both with respect to individual issues as well as more general matters of principle.

Remuneration debate

An area that has been a subject of particularly lively debate is the amount of remuneration and bonuses paid to top executives in publicly quoted companies. An important issue, it is a natural topic of discussion at a time of reduced profits, personnel cutbacks and general economic gloom.

This said, it is important that such a debate is conducted in an objective manner, and based on a broader perspective than the figures for the last quarters. As an institutional investor, it is important that the Second AP Fund can rely on the fact that the remuneration models employed by its portfolio companies will, even in a longer perspective, enable them to continue to recruit and retain the best qualified personnel.

Consequently, during the spring, the Fund has updated its corporate governance policy concerning its position on the issue of variable remuneration paid to executives in portfolio companies. We believe it is important that corporate remuneration models promote the long-term and sustainable development of these companies. Based on this principle, we shall continue to participate in discussions concerning the formulation of what we consider appropriate remuneration systems for each portfolio company.

Decisive meeting in Copenhagen

Corporate governance involves far more than remuneration issues. The need to deal with global warming poses huge challenges for companies throughout the world. When the world's leaders convene in Copenhagen this winter to discuss a continuation of the Kyoto Protocol, one of the key items on the agenda will be the need to achieve consensus about a proposed future system for global trade in carbon emission rights.

A system like this will increase the costs associated with carbon dioxide emissions. Companies will have to develop new technology and climate-smart products to avoid being overtaken by competitors. As investors, we must be quicker than others in identifying the companies that will benefit from, or be negatively affected by, such developments. This in turn will affect these companies' growth and development potential and, consequently, their share value.

We chart our portfolio's footprint

We have initiated an ambitious project to determine our portfolio's 'carbon footprint'. By collating data from the approximately 2 700 companies in our portfolio, based on the size of our interests in respective companies, we have calculated the total carbon footprint for our combined portfolio holdings.

This analysis has also been based on three scenarios to indicate possible variations in the rate at which the price charged for carbon emissions might increase. There is no doubt that the price will rise – the question is when and by how much, and its impact on companies and industries.

For those who work at the Second AP Fund, the integration of sustainability issues in our day-to-day activities is entirely natural. We are convinced that a solid return on the pension assets under management is dependent on a long-term commitment to environmental sustainability. For us, there is no contradiction between a solid financial return and a healthy environment. Quite the reverse: they are mutually necessary.

Successful initiative at AGM

One example of our long-term commitment to environmental issues is our involvement in the US company Freeport-McMoRan Copper & Gold and its mining operations on Papua in Indonesia.

The company has been unable to provide convincing assurances that it manages its waste products in a satisfactory manner and we, together with a number of other investors, have therefore demanded that it co-opts a person with environmental expertise onto its board of directors. This joint resolution was presented at the AGM in June, and received 32 percent of the votes.

The fact that the proposal we supported received the backing of so many other shareholders was a considerable success and, according to US regulations, means that we can reiterate the same resolution at next year's AGM. This puts pressure on the company to respond and promises a real possibility of eventual success.

Increased share of real estate

In an increasingly changeable world, it is important to constantly review portfolio

composition with respect to different asset classes. To stay abreast of this development, the Second AP Fund increased its exposure in real estate through the acquisition of Vasakronan by AP-fastigheter, which is owned jointly by the four large 'buffer funds'. The 'new' Vasakronan is far and away the largest real-estate company in Sweden. Added to our 50-percent holding in Norrporten, this makes real estate an important part of our strategic portfolio.

Our increased investment in real estate involves increased environmental responsibility. Buildings account for about 40 percent of total carbon emissions. Vasakronan and Norrporten therefore implement a systematic and active environmental policy, which is also crucial to the long-term return on investment. Commercial tenants are exhibiting a growing tendency to place demands on green real-estate management. Failure to satisfy these demands can lead to the risk of lost market share and profitability.

Responsibility and a healthy return are fully compatible

This link between economic development and environmental responsibility is one of the greatest long-term challenges we face as pension fund managers. The way these two factors are so inextricably linked has never been more obvious. This also marks the first economic downturn when environmental issues have not been swept aside by other priorities. We all gain in the long term. This also places demands on those of us who work at the Second AP Fund, to ensure that we stay in the forefront when it comes to evaluating the sustainability policies of portfolio companies. This is the best way we can assure the security of future pensions, in conjunction with sustainable development.

Eva Halvarsson
CEO

Trucost

Trucost Plc is an environmental research organisation, established to help companies and investors understand the environmental impacts of business activities. Trucost provides data and analysis on company emissions and natural resource usage and presents these in financial as well as quantity terms. Trucost provides data on over 4,500 companies worldwide, including complete coverage of the FTSE All-Share, S&P 500, Nikkei 225, DJ STOXX and MSCI indices.

Trucost has the support of an International Advisory Panel of leading academics in the fields of economics and the environment. Further details at www.trucost.co.uk

Checking the footprint while staying one step ahead

In December 2009, the world's leading decision-makers will gather in Copenhagen to discuss an extension of the Kyoto protocol. The goal is to achieve an international agreement about reducing the emission of greenhouse gases and thereby prevent global climate change.

The EU has established the goal that the average global temperature shall rise by no more than 2°C. This will require rapid and extensive action, involving measures such as a global system of emission rights and massive investment in new technology.

"Clearly, there is no doubt that the cost of generating CO_2 emissions is going to escalate. The longer we wait, the higher the price we will have to pay," says Christina Olivecrona, Environmental Consultant at the Second AP Fund.

Climate change will have an impact on companies, governments and ordinary people throughout the world. Increased costs will pose a serious challenge. They will affect both the sales and market value of companies. The winners will be those companies able to respond to the challenge, perhaps by adopting new technology. Other companies could face difficulties.

"We face a situation that in some respects mirrors the challenges faced during the oil crises of the 1970s, but one in which the long-term effects are much more difficult to predict," notes Tomas Franzén, Chief Investment Strategist at the Second AP Fund. "This places real demands on a pension fund like the Second AP Fund."

Fund's carbon footprint evaluated

To address this issue, the Second AP Fund has launched a project to assess the level of CO_2 emissions generated by the companies in its portfolio, referred to as its 'carbon footprint'. This process involves a number of different steps, the first being the collation of data from all portfolio companies. "We have utilized the carbon emissions data supplied by Trucost, as well as the database established within the framework of the Carbon Disclosure Project. For portfolio companies that had no such data (some 30 percent), we have estimated emissions based on type of industry and company size," states Thomas Ekström, Quantitative Analyst at the Second AP Fund.

This data was then analysed, based on the Fund's holdings in some 2 700 companies, to determine the total carbon footprint of its combined interests.

"This survey involves extremely complex material and requires expertise in processing large quantities of information to extract relevant decision data. We have

Carbon Disclosure Project

The Carbon Disclosure Project (CDP) is an initiative that yearly request climate information from publicly quoted companies on behalf of institutional investors. The CDP exists to gather and disseminate data that will motivate investors, companies and governments to act, to prevent serious climate change. In 2009, the CDP received the support of 475 institutional investors. A questionnaire was distributed to 3 700 companies around the world on the subject of carbon emissions and the risks and opportunities arising from climate change.

As a member of the CDP, the Second AP Fund has access to the CDP's database, which contains the companies' responses, dating from 2002. Further details at www.cdproject.net

"There is no doubt that the cost of CO_2 emissions is going to escalate. The longer we wait, the higher the price we will have to pay."

developed new software, as well as a new methodology," Thomas Ekström continues. The companies responsible for the highest carbon emissions are found in the power generation and energy sectors, as well as in the commodities and general industry sectors.

"Once gathered, we must analyse this data to determine the scale of the costs these companies may expect to incur, as the cost of CO_2 emissions increases, and how well prepared they are to meet this challenge," explains Tomas Franzén.

Three scenarios

In its report World Energy Outlook 2008, the International Energy Agency (IEA) describes three possible climate scenarios. These scenarios are based on three different levels of carbon tax for generating CO_2 emissions.

The first scenario assumes that no dramatic action will be taken and that things will continue as before – a 'business-as-usual' scenario. This scenario assumes a carbon tax of USD 30 per tonne – but applies only to countries within the EU.

"This sounds like an inexpensive approach, at least initially, but in the longer term is likely to lead to highly significant costs, as the effects of global warming become increasingly difficult to ignore. With this scenario, the average global temperature may be expected to rise 6°C by 2100," notes Christina Olivecrona.

In the second scenario, the target is to stabilize the average increase in global temperature at no more than 3°C higher than at present. To achieve this would require a tax of USD 40 per tonne carbon in 2020, rising to USD 90 per tonne by 2030 in OECD countries.

To achieve the target for the third scenario - to stabilize average global temperature at just 2°C higher than now - would, according to the IEA, require a tax of USD 180 per tonne by 2030.

However, the creation of a global system of emissions rights is still a long way off, and most indicators suggest that this will evolve step by step. The EU assumes that all OECD-countries will have implemented national systems no later than 2013, and that these systems will first be linked to each other, before becoming part of a global system, in 2020.

Increased costs provide greater incentive

"McKinsey, the management consulting group, has produced estimates that indicate that certain reductions in emissions can already be implemented today, without costing the companies anything and, in many cases, can actually save them money.

The Second AP Fund has evaluated the combined carbon emissions generated by its portfolio companies. This project has engaged a large number of experts, inside and outside the Fund, including Chief Investment Strategist Tomas Franzén (left), Analyst Thomas Ekström (centre) and Environmental Consultant Christina Olivecrona (right).

This applies mainly to the type of emission source where efficiency measures cut energy consumption and thereby reduce costs," says Christina Olivecrona.

Raising the tax on CO_2 emissions further increases the incentive to cut them. The IPCC (Intergovernmental Panel on Climate Change) calculates a carbon tax of between USD 20 and USD 50 per tonne will be needed to persuade the energy industry to invest in CO_2-efficient solutions. However, if the development of new technology is to be profitable, the tax levied on CO_2 emissions must be more than USD 70 per tonne.

Impact on a company's market valuation

The Second AP Fund's analysis of the carbon footprint produced by the combined activities of its portfolio companies has led to a more profound understanding of the cost of carbon emissions. If companies are forced to pay for their emissions, it will have an impact on their profits and cash flow. If these costs are realized, the stock market will take them into account, and their impact on future profits, when valuing the individual companies.

"Sharp increases in carbon costs could potentially affect the way we structure our strategic portfolio. However, the main impact will be on the approach we adopt in the active management of our investments," notes Tomas Franzén. "It would involve adding the environmental factor to our valuation models."

In Tomas Franzén's view, the difficult part will be developing models that can determine the extent to which the market has already factored environmental costs into its calculations or not.

"Basically, it once again comes back to being able to identify price inefficiencies that can be exploited by buying low and

selling high, to ensure that Sweden's pensioners gain the highest possible return on their invested capital."

Difficult to learn from history

To identify these price inefficiencies, the Second AP Fund utilizes quantitative data, as well as making a broad analysis of the market.

"The quantitative valuation models base their analysis on a company's current valuation and its historical development. The problem is, we don't always know if this historical perspective provides us with the tools we need to predict the future, yet we are always forced to rely on and refine the tools we have," explains Thomas Ekström.

Tomas Franzén draws a comparison with the oil crises of the 1970s:

"One approach might be to study the rise in oil prices at that time, to determine their impact on the oil companies and, especially, on the transport industry. Other factors that could help in predicting the future are the introduction of taxes and tariffs."

Another possibility is to study historical technology shifts, to learn how they have affected companies, industries and markets.

In all these cases, there are companies that have both won and lost in the wake of such developments. The companies that have found themselves trapped in old technology and that have failed to adjust to changing conditions have lost market share, or may even have gone out of business. At the same time, every major shift in business climate has presented opportunities for new companies to enter the market.

"The 'only' requirement is to be able to identify which these companies are, before it becomes public knowledge. Even though it is always difficult to forecast the future, analyzing the combined carbon footprint of our investments is an important first step," concludes Tomas Franzén.

The Second AP Fund's internal environmental programme

The Fund's environmental programme embraces more than just its portfolio companies. In 2008, the Second AP Fund introduced an environmental management system, based on the City of Gothenburg's environmental diploma scheme. The system applies the same fundamental concepts as the major ISO 14001 and EMAS systems, but is better suited to smaller organizations. The Fund was awarded its environmental diploma in early 2009. During 2009, the Fund aims to cut its electrical energy consumption by 20 percent and consumption of copying paper by 10 percent. The Fund will also review its travel arrangements, with a view to cutting its travel-related carbon emissions by 10 percent.

Tomorrow’s winners will be green

What percentage in increased carbon emission costs will consumers tolerate? Which companies would gain from transition to a sustainable society?

Society will have to undergo radical change if it is to achieve the target of limiting the rise in average global temperature to 2°C. We can be sure that several carbon-efficient techniques will be on offer. The changing attitudes of environmentally conscious consumers will require the development of climate-smart products and services.

People in general are demonstrating a growing awareness of sustainability issues. This has led to increased demand for ‘green’ products and services. This suggests that companies best informed about consumer preferences also enjoy the best prospects of success in tomorrow’s marketplace. For the Second AP Fund, this naturally makes it essential to identify such companies at the earliest opportunity – preferably, before anyone else does.

Johanna Stål, one of the three founders of Camino – a lifestyle magazine that promotes a sustainable lifestyle – is particularly well versed in consumer attitudes and responses to sustainability issues. When she and her colleagues Caroline Petersson and Tobias Jansson launched Camino three years ago, the idea was to inspire people by packaging sustainability issues in the form of a lifestyle magazine.

“We had all tired of the daily doses of doom and gloom, realizing that they served little purpose. Rather than stimulating people to action, they were actuallycifying them. Given the positive response our magazine received, we were clearly filling a need,” says Johanna Stål.

For Johanna, it’s all about inspiring and facilitating an individual’s choice of a sustainable lifestyle. She feels this need herself, but is aware that some encouragement will be needed before the idea really takes off.

“It must be easier for people to start new businesses and, in some instances, additional regulations may also be required to steer consumption in a sustainable direction,” she notes.

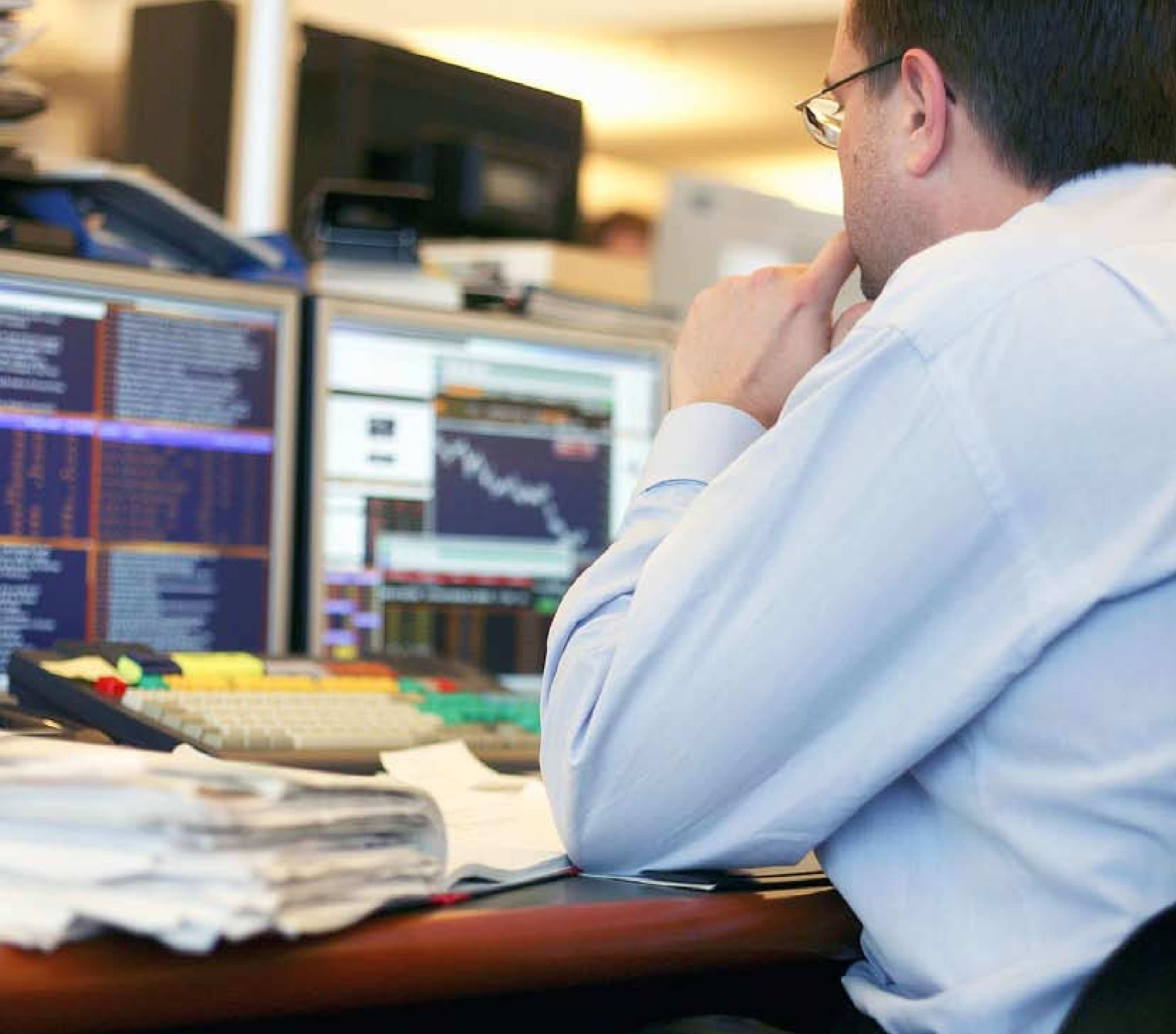
In common with many others, Johanna Stål highlights the service sector as the area of greatest potential.

“When discussing environmental issues, we often focus on new technology, but the service sector also offers considerable potential. This applies, for example, to rental and barter boutiques. Boomerang and Filippa K are just two companies that have already launched a form of bartering, where customers can hand in, swap or buy second-hand clothes.”

Johanna Stål highlights the transport sector, the food industry and housing as the three areas most in need of change.

“If we can solve the environmental impact of cars, cows and housing, we’ll have come a long way. The companies that come up with smart ideas in these areas have every prospect of success.”

Johanna Stål started lifestyle magazine Camino with two colleagues. The idea was, and is, to inspire people to embrace a sustainable lifestyle.



Private equity and long-term sustainability – incompatible?

PRI – The PRI (Principles for Responsible Investment) are a UN initiative. PRI promotes contact and an exchange of know-how between responsible investors throughout the world. Further details at www.unpri.org

In recent years, sustainability issues have gained relevance in an ever growing number of sectors and industries. In the private equity market, however, these issues have played a fairly obscure role: until very recently. During the past year, the UN's PRI initiative has drawn up a special code of principles for addressing the sustainability issues confronted by private equity companies.

PRI, which stands for 'Principles for Responsible Investment', comprises six principles that describe ways in which institutional investors can integrate sustainable business practices in managing their assets. By signing the Principles, investors agree to contribute to the development of these same principles by responding once yearly to a survey about how they apply them. During 2009, PRI has also published a guide for private equity companies.

Tom Rotherham, a consultant working for the London-based firm of Radley Yeldar, has led the work of developing this code of conduct for the private equity market.

"We initiated the process in 2008 and focused primarily on two things. The first was to create an awareness of these issues within the private equity sector. The second was to help the companies understand how these principles could be implemented under the special conditions that pertain within the private equity sector."

Favourable response from the industry

A meeting of some 40-45 people from a number of different private equity companies and investors, held in New York in March 2008, signalled an important step in this process. PRI's publication of a number of case studies from the private equity sector has also been highly significant.

The industry's response has been largely favourable, but Tom Rotherham can still see differences between the various players.

"Responses range from those who claim these principles to be completely irrelevant, to those who have already appreciated that addressing sustainability issues can boost profitability and must become an integral part of day-to-day-operations. The greater part of companies are somewhere in between, however, and tend mainly to act in response to perceived pressure from investors and others."

Structured approach often lacking

Tom Rotherham believes that many in today's private equity industry address the risks and opportunities associated with sustainability issues in some form, but that few approach the task in a structured manner.

"The difficult part is integrating these issues into the actual investment process. It requires the commitment of everyone in the company. It can also sometimes be difficult to know where to draw the line. Which issues should the private equity companies be responsible for and which are the responsibility of the portfolio companies?"

Financial crisis demands new thinking

Interest in sustainability issues appears to be continuing to rise, in spite of the financial crisis. Tom Rotherham concedes that the crisis naturally affects every aspect of the industry, but feels that sustainability issues now are more directly linked to companies' commercial goals and operations, rather than being treated as a means of satisfying external parties.

"I also get the impression that quite a number of companies find they are currently engaged in such major change processes that they might as well adopt a coordinated approach to sustainability issues at the same time," says Tom Rotherham.

"Another difference compared to earlier crises is that PRI and other instruments are now available. This helps companies to maintain a long-term perspective, even while having to spend much time and energy on resolving acute situations.

As for PRI, future efforts will focus mainly on three tasks:

1. Surveys to determine the extent to which private equity funds factor sustainability issues into their analyses of potential acquisitions.
2. Continuing to promote extended awareness of the issues, including the use of webinars to address practical ways in which the six Principles can be applied.
3. An assessment of how the Principles are implemented in practice, to provide the basis for a major update and revision in 2010.

Second AP Fund in the front line

The Second AP Fund was one of the first large fund managers in the world to sign and implement the PRI in its day-to-day operations. Anders Strömblad, who heads external fund manager relations at the Second AP Fund, which involves contact with a large number of private equity funds, describes his job.

The Second AP Fund has made 34 investments in private equity funds since 2001 and currently collaborates with 15-20 different private equity companies. This makes the Second AP Fund a significant international player, giving it an important voice in discussions concerning the demands made on private equity companies and their funds.

One of the first PRI signatories

One of the demands made by the Second AP Fund is that private equity funds with which the Fund collaborates shall, as far as is possible, act in compliance with national and international ethical and environmental guidelines. A clear policy shall also be in place to ensure that these undertakings are addressed in a serious manner.

It was therefore natural that the Second AP Fund should be one of the first PRI signatories in the world.

"Since then, we have pressured the private equity funds in which we invest to comply with the PRI. All the funds in which we invest have stated that they are prepared to operate in compliance with these Principles. Most have already included some of them in their investment models," notes Anders Strömblad.

The Second AP Fund monitors these funds to ensure that they comply with the Principles. This involves participation at AGMs, the analysing and monitoring of reports, monitoring the media and putting direct questions to the private equity companies.

Active in industry association

Over and above its day-to-day operations, the Second AP Fund is also involved in discussions as to how private equity funds can generally improve the integration of ethical and sustainability issues into their everyday activities. For six years now, the Fund has been a member of the ILPA (The Institutional Limited Partners Association), a non-profit organization which exists to help market players that invest in private equity funds. First and foremost, the ILPA provides a forum:

- to facilitate and increase a value-creating exchange of information
- to educate investors about private equity funds
- to promote the establishment and dissemination of research and standards in the private equity industry.

Demand for increased transparency

"We have been especially active in encouraging an increase in the amount of information issued by private equity companies," states Anders Strömblad. "What have they invested in? In what way have they developed their portfolio companies? What's the result?"

According to Anders Strömblad, the industry has long been fairly backward in this respect, but believes that the demand for greater transparency is growing all the time.

"Some companies have shown the way by starting to publish annual reports, for instance. One such example is the British firm Doughty Hanson. This reflects a general tendency within the industry."

"In the USA, the industry organization for private equity companies – the Private Equity Council – has drafted regulations for responsible investment. It has even stated that it will incorporate the PRI's Principles into its own code of practice. This is naturally a highly positive development," notes Anders Strömblad.

Private equity is a long-term investment

Anders Strömblad expects ethical and sustainability issues to be increasingly integrated as part of the ongoing investment process.

"Actually, these issues are highly relevant when investing in private equity, since in both cases it's about a long-term process. Private equity companies operate with investment horizons of 10–12 years."

Long-term considerations mean that investment decisions are only made after very thorough analyses that are based on clearly defined guidelines.

"For us to be interested in a private equity fund at all, the company behind it must naturally have a track record that demonstrates a high return, as well as demonstrating a long-term approach and continuity, both in terms of key personnel and investment strategy," notes Anders Strömblad.

Prior to the board's final decision concerning investment in a private equity fund, the Second AP Fund conducts a thorough evaluation. This is based on a large number of specific criteria, in which ethical and sustainability issues play an important role. Once the decision has finally been made, it is followed by an ongoing process that monitors the funds to ensure that they satisfy the various demands placed upon them.

"As well as monitoring the funds' progress in general, we also look at funds that are specifically focused on sustainable business activities. We have, for instance, invested in three funds that are focused on renewable energy sources. Naturally, we require the same level of return as on all our other investments. This is a sector that has noted sharp growth in recent years," concludes Anders Strömblad.

Successful AGM action for a better environment

How can waste from a mine located in inaccessible terrain at an elevation of 4 500 metres be managed effectively? How will the environment be affected when mine waste is dumped in a nearby river?

These are just some of the issues raised in connection with US mining corporation Freeport-McMoRan Copper & Gold's operations at the Grasberg mine in the province of Papua, in Indonesia. The company's waste management activities have been subject to criticism from international environmental organizations and investors for several years. They claim that they have not received adequate information about the long-term effects from dumping tailings in the nearby river.

It is unusual for a mine to dump its waste directly into a local river. This is illegal in most countries and in fact occurs only on Papua. Freeport-McMoRan claims that the terrain makes dumping waste in the river the only viable option, and that it has been granted permission by the Indonesian government. The environmental organizations claim that this creates both environmental and health problems for the local population living along the river banks and that it is in conflict with the UN Convention on Biological Diversity.

"The problem is that Freeport-McMoRan have yet to supply us with information that can support the contention that their operations are really conducted in compliance with local laws and international agreements, and that the company has failed to demonstrate that the damage to local inhabitants and the environment lies within acceptable parameters," states Carl Rosén, former head of Corporate Governance at the Second AP Fund.

Working through the joint Ethical Council of the Swedish National Pension Funds, the Second AP Fund has for several years tried to establish a dialogue with Freeport-McMoRan.

"Until very recently, the information supplied by Freeport-McMoRan has been extremely limited. However, following pressure from a number of sources, including the Ethical Council, the company has opened up to some extent. Nevertheless, there are a number of major issues that

remain to be addressed," claims Carl Rosén.

For this reason, prior to the Freeport-McMoRan AGM in June 2009, the First to Fourth Swedish National Pension Funds, ABP in the Netherlands and the New York City Pension Fund joined forces behind a resolution demanding that an independent environmental expert be appointed to the board of directors. A total of 32.5 percent of the votes represented at the AGM backed the resolution.

"It is highly pleasing that we gained such massive support," says Carl Rosén. "This type of resolution normally attracts support equivalent to between three and ten percent of the voting rights when first presented for consideration by the AGM. This demonstrates that many investors consider that environmental issues should be important to mining companies and that environmental expertise should be represented on the board."

According to US regulations, a resolution must receive the support of at least three percent of rights holders' for it to be reintroduced at a subsequent AGM. Thanks to the massive support, the Second AP Fund and its colleagues can now pursue this issue further. According to Carl Rosén, prospects for establishing a dialogue that can provide investors and other interested parties with quality environmental data in good time prior to next year's AGM are good.

"The tremendous amount of support shown has of course inspired us to continue to address these issues, both in this specific case, as well as in other companies, where we have identified shortcomings with respect to the environment, ethics and human rights."

Further details in the report published by the joint Ethical Council, entitled The Environmental Impact of the Mining Industry, available at www.ethicalcouncil.com

Dialogue about 'greener' real estate

Real estate is an important asset class in the Second AP Fund's portfolio and a sector that offers considerable potential in the environmental context. It is also increasingly clear that the environment is an important factor in long-term profitability and value growth. For this reason, environmental issues are high on the Second AP Fund's agenda, in its dialogue with real-estate companies Vasakronan and Norrporten.

Towards the end of 2008, AP-fastigheter acquired Vasakronan, simultaneously changing its name. The 'new' Vasakronan is the largest real-estate company in Sweden, with assets valued at about SEK 75 billion. Vasakronan is owned jointly, in equal shares, by the First to Fourth AP Funds. Combined with its current 50-percent holding in Norrporten, this means that the Second AP Fund has dramatically increased its overall exposure in real estate.

In May and June 2009, the Second AP Fund engaged in dialogues with both Vasakronan and Norrporten. After these discussions, the companies and their strategies were analysed from a value-generating sustainable perspective.

Ambitious environmental goals

Both Vasakronan and Norrporten work actively to reduce their environmental impact. This work applies equally to new construction and the management of existing properties. The companies have also established ambitious goals concerning reductions in energy consumption.

"We have already reduced energy consumption to a level that is 26 percent below the industry average," states Vasakronan's managing director, Fredrik Wirdenius. "The long-term goal is to be 50 percent below the industry average."

Norrporten has instead chosen to make internal comparisons. Between 2006 and 2008, it cut energy consumption by six percent. The 2009 goal is to achieve a further reduction of four percent.

Structured approach

Both companies are environmentally certified in compliance with ISO 14001. Norrporten was certified in 2008 – a mere six months after the process had been initiated.

"The fact that we were able to implement such a comprehensive project in such a short time was because we already had systems and routines in place for working in a structured manner with environmental issues," says Anna-Karin Kammerling, Environmental Coordinator at Norrporten.

"We have to employ a structured approach to attain our goals. By monitoring energy consumption in every building, for example, we can rapidly identify any deviations from the norm and come up with solutions," explains Anna-Karin Kammerling.

Much is determined during the project phase

A building has an environmental impact both during the project phase and during its subsequent use. If the building is designed correctly from the start, this reduces its environmental impact during the rest of its life.

As an example of a typically innovative and climate-smart project, Norrporten chooses the new complex constructed for Bolagsverket (the Swedish Companies Registration Office), in Sundsvall.

"When we were planning the office, we discovered that it was located above an underground esker (a ridge of gravel created during the glacial period), featuring a very fine flow of groundwater. This is a renewable and unutilised resource that reduces our energy purchasing requirement by 90 percent. It involves minimal carbon emissions and also means that we save at least SEK 700 000 a year compared to the cost of purchasing district heating and cooling," says Norrporten's deputy managing director, Jan-Åke Stenström.

Vasakronan in brief

Focus: Real estate, incl. office premises, shops and residential properties in the Stockholm area, Gothenburg, Malmö, Lund and Uppsala.

Real-estate portfolio: 300 properties, amounting to a total area of some 3.2 million m².

Market value: About SEK 75 billion.

Head office: Stockholm.

Owners: First, Second, Third and Fourth AP Funds (equal quarter shares).

Norrporten in brief

Focus: Real estate, incl. office premises, shops and residential properties along the E4-corridor (from Luleå in the north to Hamburg in the south).

Real-estate portfolio: 138 properties, amounting to a total of some 1.1 million m^2.

Market value: About SEK 17 billion.

Head office: Sundsvall.

Owners: Second and Sixth AP Funds equally.

Upgrade of older properties

Plenty of opportunities for improving the environmental performance of older buildings also arise when carrying out conversion work. In the Pennfäktaren building, in Stockholm, Vasakronan is transforming an energy-guzzling 1970s property into an environment-smart glasshouse, with no CO_2 emissions and less than half the energy consumption.

"One of the things we are adding is 200 square metres of solar panels, which provide hot water for most of the year. Solar cells are also being installed on every floor, able to generate enough energy to provide eco-friendly lighting."

"The air-conditioning system also is eco-friendly and needs-regulated, and the lighting is controlled by daylight and proximity sensors," says Fredrik Wirdenius, referring to some of the investments made in the building.

Environmental certification of buildings in progress

The Pennfäktaren building is the first in Sweden to be certified in compliance with the international LEED system (Leadership in Energy and Environmental Design).

"We chose LEED because it is internationally recognised," notes Fredrik Wirdenius.

The number of systems for the environmental certification of buildings is growing all the time, although an industry-wide standard has yet to be established. Vasakronan is vigorously engaged in resolving this problem and has been one of the prime movers behind the establishment of the 'Sweden Green Building Council'. The Council intends to adapt one of the existing international environmental management systems, to enable comparison of the environmental performance of different buildings.

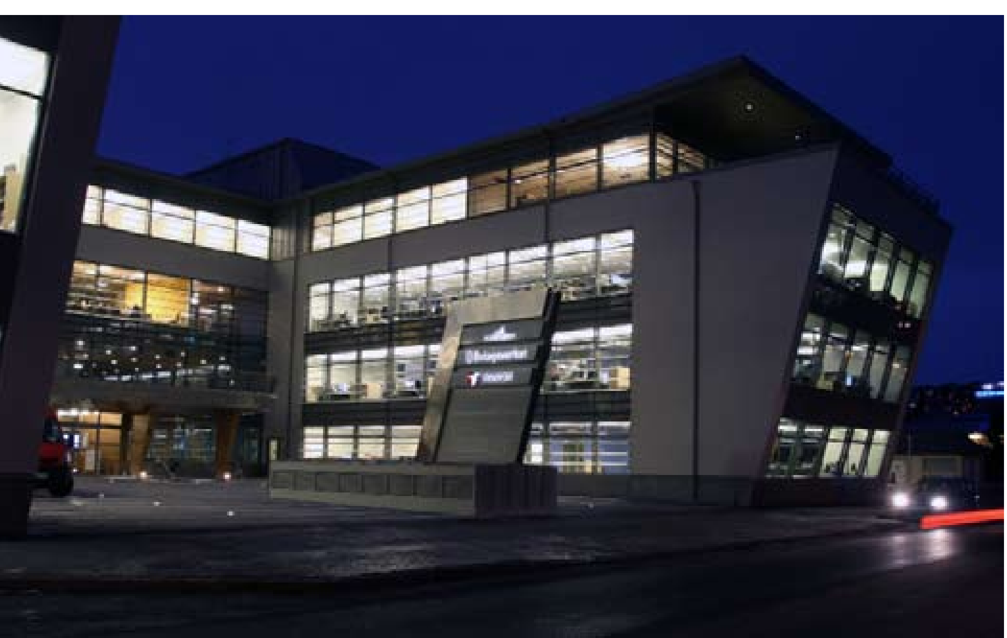
Customers are increasingly demanding

One reason a standard has yet to be established is that, to date, pressure from customers has simply not been strong enough. Until fairly recently, environmental considerations were closely associated with energy and cost savings that would benefit property owners, something not always welcomed by their tenants.

Nowadays the mood has changed, and corporate tenants are making ever greater demands on the environmental performance of their buildings. The first companies to make such demands featured environmental awareness as an integral part of their business concept.

These have been followed by the major multinationals, with their strong consumer brands.

"Increasing numbers are starting to talk about a need for the environmental classification of buildings, and I am sure this will become a general requirement within the next twelve months," says Jan-Åke Stenström. "If this thinking is to have maximum impact, however, a system will be needed that can also be applied to existing properties. Furthermore, we are working on models that make the relationship between environmental and economic thinking even more obvious. Once we get there, the pressure for change will be even greater."



The new Sundsvall office complex for Bolagsverket (the Swedish Companies Registration Office) is sited above an underground 'esker' (ridge of gravel created during the glacial period), featuring a generous flow of groundwater. Utilizing this source has reduced the need to purchase energy for heating and air-conditioning by 90 percent.

Corporate governance activities 2008/2009

The Second AP Fund's mission is to maximise return on invested assets. Exercising active governance of the companies in which the Fund invests is an important aspect of this task. By adopting a long-term strategy with respect to governance issues, the Second AP Fund contributes to the generation of sustainable growth, to the benefit of Sweden's pensioners.

In exercising its corporate governance responsibilities, the Second AP Fund is an active participant at the AGMs of Swedish and foreign companies and maintains a regular dialogue with the boards of directors and executive managements of its portfolio companies. During the period 2008/2009, the Second AP Fund has acted on a number of issues, addressing topics such as executive remuneration and, in concert with Sweden's other three major 'buffer' funds, has established guidelines for fund actions at foreign AGMs.

During the period July 1st 2008 to June 30th 2009, the Second AP Fund exercised its voting rights at the AGMs of 42 publicly quoted Swedish companies. In three instances, the Fund voted against discharging the board from liability, or against board proposals submitted for the approval of the AGM. Lundin Petroleum was one such example, where the Fund voted against an incentive scheme that lacked any performance-related requirement.

Remuneration issues

The pre-AGM season started by seeking support for some ten stock-related incentive schemes. Virtually all of them were extensions of previous incentive schemes and, after some adjustments, were submitted to the AGMs for approval.

The Swedish Government's new guidelines on 'Terms of employment for senior executives in the AP Funds' were published in April. Among other things, these guidelines express the Swedish Government's wish that the AP Funds, in collaboration with other investors, should strive for moderate levels of compensation for senior executives in portfolio companies, and to limit variable remuneration.

Pending the Second AP Fund board's response to the Government's guidelines, the Fund chose to abstain from voting on remuneration issues at AGMs where the topic arose.

The Fund's governance policy has been adjusted accordingly and states that the remuneration models adopted by portfolio companies shall promote their long-term and sustainable development. It is here worth emphasizing that each incentive scheme will continue to be evaluated individually, based on what is best for each company.

New share issues

During the first half of 2009, the Second AP Fund has participated in a number of new share issues on the Swedish stock market, thereby contributing some SEK 700 million to Swedish companies.

Carnegie

The Fund voted against discharging the previous board of D. Carnegie & Co (Carnegie) from liability. The board was active until December 2008, at which time a new board was elected. This was to prevent the blocking of future potential claims against the members of the previous board. The decision was based on an extensive investigation initiated by the Second AP Fund and a number of other major shareholders.

The takeover of the Carnegie subsidiaries by the Swedish National Debt Office in November 2008 led to the convening of an extraordinary general meeting. This derived partly from the need to draw up a balance sheet for liquidation purposes and partly because the board lacked plenary rights following a number of resignations.

Prior to the AGM, the nominating committee was engaged in nominating a new board that would be able to continue to operate the company. None of the former directors offered themselves for re-election and, in spite of considerable efforts to recruit suitable candidates, the nominating committee, chaired by the Second AP Fund's Carl Rosén, decided against nominating a new board. Instead, the Second AP Fund recommended appointing an official receiver, who would be tasked with completing the judicial processes initiated by the former board of directors.

Max Matthiessen's representative on the nominating committee protested the decision and tabled an independent proposal for a new board of directors, which the AGM approved. The Second AP Fund protested the AGM's decision.

Voting at the AGMs of foreign companies

Over the past ten years, the trend towards pension funds shouldering greater responsibility for the corporate governance of their portfolio companies has been clear. These developments have involved a shift from a national to an international perspective. Following the IT bubble and a number of corporate scandals at the beginning of the new millennium, the demands made on institutional owners were tightened up, and it seems likely that the current financial crisis will lead to additional demands.

The Second AP Fund exercised its vote in some 60 companies around the world in 2008.

The Second AP Fund is determined to maintain high quality in the way it acts at foreign AGMs. This demands resources, however, and the four major 'buffer' funds have therefore joined forces in a pilot project to establish a neutral central voting facility. The way this functions in practice is that every fund is assigned a separate voting account within the system, these accounts being managed by the central facility. The central facility informs individual funds/fund managers about dubious or commercially-motivated issues and the fund managers then instruct the central facility as to how they shall vote.

An analysis of the voting at foreign AGMs will be carried out in autumn 2009.

Second AP Fund participation in nominating committees 2008/2009

The Fund has been represented on the nominating committees of 13 companies: Carnegie, Kungsleden (chairman), Biotage, Castellum, Elekta, Haldex, Hexagon, Intrum Justitia, JM, Lundin Petroleum, Meda, Oriflame and Vostok Gas. The Fund's representative resigned from the Carnegie nominating committee in December 2008, after the AGM.

Number of women on boards and in top management

Long-term value growth assumes that a company attracts the most competent staff and that it develops and utilises such competence in the best possible way. This assumes that the company utilises the entire skills pool, without excluding women, for example. If 50 percent of the population are not given the same opportunities, the risk that this competence will be lost is considerable.

For this reason, and for the fifth year in succession, the Second AP Fund conducted a survey to determine the number of women on the boards and in executive managements of publicly quoted companies. Only minor changes were noted: women accounted for just under 20 percent of board members, while the number of women in executive management positions rose slightly, to 14 percent.

The Fund is engaged in a dialogue with a number of companies where female representation is limited, concerning selection processes for executive management and seats on the board.

Protecting shareholder rights

Another issue that the Second AP Fund has pursued for several years is the protection of shareholder rights. The Fund has focused first and foremost on two aspects.

1. Review of takeover regulations in Sweden

Näringslivets Börskommitté (NBK/the Swedish Industry and Commerce Stock Exchange Committee), which administers and develops the takeover regulations covered by Swedish self-regulation, completed a review of the regulations in 2009. The Second AP Fund has participated in a reference group that is cooperating with NBK on this issue. The most important change concerns strengthening the protection of class 'B' shareholders in takeover situations.

2. Possibility to nominate board members in the USA

Traditionally, shareholders' rights in the USA have been weak compared to many other countries. Among other things, shareholders have in practice lacked any possibility of nominating their own board members.

Many believe this is part of the explanation for the high levels of remuneration in American companies, something that has even spread to non-American companies. Many European pension funds have worked for several years to bring about a change and, in June 2009, the US administration presented new legislation to simplify the nomination of board members.

Joint Ethical Council

The joint Ethical Council of the Swedish National Pension Funds was established in 2007 and published its second annual report in the spring of 2009. The Ethical Council is engaged in monitoring and analysing the foreign portfolios of the AP Funds, to ensure that the companies in which they invest are not involved in infringements of international conventions to which Sweden is a signatory.

The Council has established routines for monitoring foreign holdings. Some 10-15 companies are placed on a 'dialogue list', in cases where the Funds believe they will be able to exert influence, encouraging them to institute new routines that can prevent future incidents or infringements of conventions.

During the year, four companies – Sodexo, PetroChina, Thales and Grupo Ferrovial – were removed from the dialogue list, after they introduced routines to preclude further infringement of international conventions. This clearly demonstrates that the dialogue method works.

The Ethical Council's annual report can be downloaded from www.ap2.se

Excluded companies

Wal-Mart and Singapore Technologies are two companies that have already been excluded from the Second AP Fund's investment universe. In September 2008, the Fund had excluded a further nine companies, which market cluster bombs in contravention of a ban on cluster bombs to which Sweden is a signatory. These are Alliant Techsystems, Gencorp, General Dynamics, Hanwha, L-3 Communications, Lockheed Martin, Poongsan, Raytheon and Textron.

Founding signatories of PRI

In 2006, the Second AP Fund, together with some 30 other major fund managers, was a founding signatory of the United Nation's Principles for Responsible Investment (PRI). The extent to which these Principles have since been observed was monitored during 2008 and published on the PRI website at www.unpri.org

Within the framework of PRI, the Second AP Fund has also participated in a project with a number of private equity companies, with a view to joint development of better principles for addressing ethical and environmental issues in connection with investment in and ownership of companies.

Carbon Disclosure Project

The Second AP Fund is a member of the Carbon Disclosure Project. This is an initiative adopted by some 100 major asset managers, who demand that the world's largest publicly quoted companies report on their greenhouse gas emission and other data pertinent to managing the climate challenge.

Göteborg Award

In autumn 2008, the Göteborg Award for Sustainable Development, of which the Second AP Fund is a sponsor, was presented to Professor Theo Colborn, Margot Wallström, First Vice President of the European Commission, and scientists Jan Ahlbom and Ulf Duus, for their achievements in revealing, defining and combating the damaging impact of chemicals on the ecosystem and human health. Further details at www.goteborgaward.com

Memberships

The Second AP Fund is a member of the International Corporate Governance Network (GIGN), the European Corporate Governance Institute in Brussels and Sweden's SNS Corporate Governance Network.

Official report on the AP Funds' commitment to ethics and the environment

At the close of 2008, the Swedish State published 'Ethics, the Environment and Pensions', a report determining the extent to which the AP Funds take ethics and the environment into account when making their investments. The report concluded that the Funds had addressed these issues in a satisfactory manner, while noting the potential for continued development and improvement. The report nevertheless declared that the Funds' role in helping to provide solid pensions by achieving high long-term returns, thereby adding to the security enjoyed by current and future pensioners, constitutes a fundamentally ethical goal in itself.

Other sources of information

The Second AP Fund's Corporate Governance Policy & Annual Report 2008, www.ap2.se

The joint Ethical Council of the Swedish National Pension Funds, www.ethicalcouncil.com

Principles of Responsible Investment, www.unpri.org · Carbon Disclosure Project, www.cdproject.net

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