



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

# Corporate Governance Report

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# Our long-term mission is to achieve the best of both worlds

*Eva Halvarsson, CEO of the Second Swedish National Pension Fund, discusses corporate governance issues.*

*How do you view the fact that the Fund is expected to take ethics and the environment into account in selecting its investments, without compromising its broad objective of maximising return on investment?*

I see no problem with this, although it does mean we must adopt a broader timescale. You could say our mission is to achieve the best of both worlds. We must generate a solid return on investment, while implementing a consistent policy of responsible and sustainable investment.

*Surely this means that ethics and the environment are not allowed to impinge in any way on overall return?*

We are convinced that a responsible approach to sustainability is fully compatible with a solid return on investment.

*Does this apply to all Fund investments?*

Our investment strategy determines the extent to which it is feasible to integrate sustainability issues in a manner that creates value. During the year, we have reviewed ways in which we can further integrate sustainability as part of the Fund's asset management activities and this process will continue. At the present time, sustainability aspects are most easily integrated into the investment process where the Fund is engaged in the active management of assets and adopts an active risk.

*But a large part of the Fund's assets are managed against index?*

Management of assets against index means that the size of the Fund's various portfolio assets reflect the composition of the share index selected. Consequently, in many instances, variations in our portfolio are less the result of an active investment decision and more the result of the relative proportion of the share index that the various companies represent. In such cases, the work on corporate governance issues is of a different nature. We screen all our investments to determine if our portfolio companies contravene any convention to which Sweden is a signatory.

*How have you integrated the sustainability aspect with regard to the forest and agricultural investments in which the Fund invested during the year?*

A thorough sustainability analysis has been integral to the decision to invest in these assets. The process has included the analysis of guidelines, policies and processes, a study of how the work is organised and integrated into management systems and the degree of expertise and experience available to conduct sustainable forestry and agriculture.

*As a shareholder, how are you able to effect change?*

Our primary instrument for effecting corporate change is to establish a dialogue with the companies. To effect change, we must be active and persistent. This also means that we must sometimes endure criticism, as when we refrain from selling off our stake in a company that has contravened a convention, law or regulation, or which in some other way has acted in conflict with our corporate governance policy. It is by remaining a shareholder and in concert with other shareholders that we can influence the company and thereby make a difference by promoting positive change.

*You are sometimes criticised for failing to make your voice heard at AGMs. Why are you so silent?*

We maintain an ongoing dialogue with several companies with a view to changing aspects that are in conflict with our governance policy. These dialogues are most intensive during the autumn and spring, in the run-up to the AGMs. For instance, we engage in numerous discussions with companies concerning incentive programmes and have noted improvements in several programmes during the year. We feel that AGMs do not provide the best forum for such dialogues and that the best results are to be achieved through direct dialogue with the company in question. We nevertheless occasionally express an opinion at an AGM if, for example, questions remain to be answered. In cases where we vote against a board proposal, we always detail our reasons at the AGM.

*This year's Female Representation Index reveals an increase in the proportion of women who hold positions both on boards of directors and on executive managements. Are you satisfied with progress in this field?*

It is pleasing to note that both boards of directors and executive managements feature increasing numbers of women. Progress remains slow, however. This year we have seen an increase in the percentage of women in executive management, which is important, as these represent a vital recruitment source for seats on corporate boards. Another positive trend is that the percentage of women among younger managers is on the rise.

*How do you react to the idea of introducing a quota system to boost female representation on company boards?*

We are convinced that the optimum board composition, and consequently the best board performance, is the result of a successful mix of gender, age, background, experience and competence. The Fund stresses the importance of increasing the percentage of women on the boards of publicly listed companies, although at this point in time we do not feel a quota system offers the sole route to success. In our work with nomination committees, we have had no difficulty in recruiting women with a background appropriate to board assignments.



Photo Nils-Olof Sjöden

*Al Gore visited the Fund in autumn 2010. Tell us about it!*

Al Gore has visited the Fund on a couple of occasions and it is always interesting to meet him. What was especially pleasing about this visit was that he, on our initiative, visited Gothenburg University's School of Business, Economics and Law, where he gave a lecture on sustainable capitalism. He shared his ideas with students on how financial returns can be generated in a long-term and responsible manner.

*Corporate governance is subject to an increasing amount of regulation. What are your views on this?*

Within the EU, there are proposals to introduce broader and more stringent regulation of corporate governance, which I feel are unnecessarily detailed. It is all too easy to make a general claim that what we have in Sweden is good but, if I were to highlight anything in particular, I must say I think the form we have adopted, involving a mix of legislation and self-regulation as enshrined in the Swedish Corporate Governance Code, works very well. I believe it is difficult to regulate corporate governance at EU level, due to national differences concerning legislation, codes of conduct and ownership structures. There is also a risk that the introduction of general regulations at EU level will result in an erosion of proprietary rights.

*Finally, the Second AP Fund is celebrating its tenth anniversary this year. In terms of corporate governance, what do you feel has changed most in the past ten years?*

I think we have seen many improvements but, if forced to highlight just one, it would have to be the introduction of more formalised nomination committees. A nomination committee shall safeguard the interests of all shareholders. For shareholders, the committee represents an important opportunity to ensure that companies field the best possible board of directors. In turn, this also helps us attain our long term objective of a high return on invested capital and to ensure that we maximise 'our' share of Swedish pension assets.

Eva Halvarsson  
CEO

Chief Executive's review	2
Forest and agricultural investments	4
Female Representation Index	8
Corporate governance in Asia	10
Second AP Fund as active investor	14
PRI – What does the AP2 do	18
Collaborating on sustainability	20
Spotlight on governance from start	22
Sustainable capitalism	23

#### **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 in excess of SEK 220 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 more than 50 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.







# Sustainability in focus with investments in forest and agriculture

*In the past year, the Second AP Fund has invested both in forest and agriculture. The intention has been to broaden the strategic portfolio and thereby reduce risk. Sustainability issues have played a central role in the assessment of these investments.*

The driving force behind the Second AP Fund's investments in forest and agricultural real estate is a wish to broaden the strategic portfolio and thereby reduce overall risk. It is believed that these investments will generate a stable return given the fact that population growth, increased urbanization and growing prosperity are increasing demand for forest and agricultural products. This asset class is also considered relatively insensitive to fluctuations in the business cycle, while covariance with assets such as equities is deemed low.

"Investments in forest and agricultural real estate may also be seen as a means of reducing portfolio risk with respect to possible environmental and climatic change," notes Tomas Franzén, Chief Investment Strategist (CIS) at the Second AP Fund.

The availability of arable land is already limited and there is a risk of it becoming still scarcer due to environmental and climatic change. If this scenario is realised, the value of such real estate is likely to rise. A reallocation of assets in the strategic portfolio from equities to forest and agricultural real estate will also contribute to a less carbon-dioxide-intensive portfolio.

## **Sustainability issues addressed from the start**

In the search for appropriate funds or investment partners, sustainability issues have figured in analyses from the very start. As a responsible investor, it is important that the Second AP Fund's portfolio managers also view sustainability issues as relevant to long-term growth creation. Another important aspect to keep in mind is the need to ensure that the countries in which investments are made have clearly defined legal systems and structures.

"For example, there must be no doubt as to who is the rightful landowner," states Tomas Franzén.

## **Two forest funds**

In 2010, the Second AP Fund invested in two forest funds, one in the USA and one operating in Australia/New Zealand. Both funds incorporate sustainability concerns as part of their investment strategies. This means that all forest assets will be certified in compliance either with Forest Stewardship Council (FSC) or US Sustainable Forest Initiative (SFI) norms. Both systems involve certification by an independent third party, who confirms that the forest assets are managed in compliance with a code of principles for sustain-

able forestry. Both forest funds also strive to derive additional value from their forest assets, including the provision of forest land for wind turbines and recreation. In future, it may be relevant to utilise the forest's capacity to act as a carbon sink, with the possibility of trading emission rights.

## **Move towards increased certification**

The assessment conducted by the Second AP Fund prior to investment in these forest funds involved an analysis of the portfolio managers' policies and organisation concerning sustainability, as well as an evaluation of the demands made by the different certification systems. Information on aspects of sustainability is included in the funds' reports to the Second AP Fund.

As an investor, the Second AP Fund hopes to encourage more landowners to certify their forest assets. According to data from the FSC, slightly less than three percent of forest in Asia is FSC certified, with only just over one percent in Australia/New Zealand. In Sweden, some 50 percent of forest is certified.

## **Agriculture – an industry of the future confronted by challenges**

Forecasts predict that the global population will reach eight billion within the

next 20 years. To meet the expected increase in demand for agricultural products, agricultural productivity will need to rise by 25 percent. To achieve this, the agricultural sector will require some serious investment.

As a long-term investor in agricultural real estate, the Second AP Fund can contribute to increased food production by promoting the introduction of environmentally smart and efficient technology. One example could be the introduction of efficient irrigation systems. The Second AP Fund has also contributed to the development of a code of principles for investors concerning responsible agricultural investment (see page 7).

#### **Second AP Fund agricultural investment**

The Second AP Fund has invested in both an American agricultural fund and a joint venture with US pension fund TIIA-CREF. This joint venture company will invest in the USA, Australia and Brazil, all of which are food exporting countries. Investments will be made in farmland suitable for a range of different crops: vegetables, fruit, nuts, cereals and sugar cane. This farmland will first and foremost be leased to farmers, meaning the lessee will decide what crops are to be grown.

For the Second AP Fund, it is important that sustainability issues should be addressed both when evaluating new agricultural real estate and when ensuring that the land is farmed in a sustainable manner. Fertile land is a limited resource, making it important that those who lease land farm it in a manner that conserves or improves its fertility. One way to reduce the risk of soil erosion and improve soil quality is the use of no-till agriculture.

#### **How to ensure sustainability?**

At present, agriculture lacks the broad systems of certification that are found in forestry. The Second AP Fund therefore believes it important to find fund managers that share its views on responsible investment.

As part of the evaluation process, the Fund has therefore conducted a detailed analysis of fund managers' policies and of their implementation, as well as how various sustainability issues are managed. For example, this involves determining what routines have been put in place to ensure that soil quality is not compromised, that farm workers' human rights are respected, the degree of awareness of how climate change will affect growing conditions and so on. The Fund has visited farms in the USA, Australia and Brazil to gain insight into the way land is farmed.



Photo The Molpus Woodlands Group, LLC



Photo The Molpus Woodlands Group, LLC



## International collaboration based on principles for responsible agricultural investment

In parallel with its evaluation of agricultural funds, the Second AP Fund was part of an international investor-group which has been engaged on developing principles for responsible investment in farmland.

“The idea has been to develop a framework that will enable institutional investors to integrate factors pertaining to sustainability in their agricultural investments,” states Christina Olivecrona, Sustainability Analyst, who represents the Fund on the working committee.

These principles address the environment, working conditions, human rights,

land rights and business ethics. Furthermore, signatories to these principles shall report on how these principles are implemented. In addition to the Second AP Fund, the following investors have been involved in developing these principles: ABP (Netherlands), APG (Netherlands), ATP (Denmark), BT Pension Scheme/Hermes EOS (Great Britain), PGGM (Netherlands) and TIAA-CREF (USA). In September 2011, a working committee was launched within the framework of the United Nations Principles for Responsible Investment (PRI), tasked with continuing the work of disseminating awareness

of the principles, as well as supporting their implementation and development, a process in which the Second AP Fund will participate.

### Principles for Responsible Investment in Farmland

- Principle 1  
Promoting environmental sustainability
  - Principle 2  
Respecting labour and human rights
  - Principle 3  
Respecting existing land and resource rights
  - Principle 4  
Upholding high business and ethical standards
  - Principle 5  
Reporting on activities and progress towards implementing and promoting the Principles
- [www.unpri.org/commodities](http://www.unpri.org/commodities)

# Number of women on boards and executive managements rising

*The Second AP Fund's annual Female Representation Index reveals that the percentage of women on boards and executive managements is the highest since measurement started in 2003. The percentage of female board members continues to increase, while the percentage of women in executive positions is rising again, following last year's decline.*

The proportion of women represented on the boards of publicly quoted Swedish companies has risen from last year's 22.2 percent to 22.9 percent. Female representation in the board room is most prevalent in the service and consumer products industries. The lowest recorded levels are found in the telecom and commodities industries, 16.5 and 14.4 percent respectively. It is worth noting that there has been a sharp overall rise in the percentage of women on the boards of publicly quoted companies, from 6.1 percent in 2002 to this year's figure of 22.9 percent.

## **Slow development at senior executive level**

Progress within executive managements is slower, where female representation during the same period has only risen from 11.1 to 15.3 percent. Female chairs and CEOs remain a rarity.

"What is pleasing is that the number of women represented both on boards of directors and executive managements is on the rise, although progress remains slow. This year, we once again see an increase in the percentage of women in executive management positions, which is important in view of the fact that these constitute a recruitment base for company boards," notes Eva Halvarsson, CEO of the Second AP Fund.

Another positive trend is that the relative percentage of women is higher among younger managers. The greatest proportion of female managers – some 30 percent – is found between the ages of 25 and 49. Between the ages of 50 and 54, this figure falls to below 22 percent, after which there is a sharp decline to less than 10 percent. The proportion of female managers in the private sector is on the increase, although the number of women who drop out on the way to the top is still notable. In the private sector, about 30 percent of employees are women, although only one in four holds a management position. Only one in seven holding positions in executive managements is a woman.

Even so, a number of factors point towards positive development in future.

"A highly positive development is the rise in the number of women applying for courses of study in disciplines that represent the traditional pool of expertise from which company executives and board members are recruited – from 20 percent to no less than 40 percent in the past 30 years. This demonstrates that the will is there and that we can look forward to greater diversity, something I truly welcome," says Eva Halvarsson.

Data from the Second AP Fund's Female Representation Index is used in the Fund's corporate governance work.

## **International comparison**

How does Sweden compare with other countries in terms of the number of women represented on the boards of publicly quoted companies? The '2011 Women on Boards Report' published by governance research and ratings firm Governance Metrics International reveals that Sweden is rated one of the top three countries (the other two being Norway and Finland) among the countries surveyed. The Report also shows that the percentage of women represented on boards throughout the world is on the rise, if slowly. This rise is most notable in Europe, where several countries have started to introduce quota systems. One of these is France, where the target is 20 percent female representation on boards within three years. The current figure is 12.7 percent. Spain, where the current figure is 9.3 percent, has also introduced quota legislation. Worst in Europe when it comes to the proportion of women on the boards of publicly quoted companies is Italy, where the possibility of a quota is under discussion. The percentage of women on boards in Italy has declined in recent years and is now at 3.7 percent.



**Background data**

The Female Representation Index has been compiled jointly by the Second AP Fund and Nordic Investor Services since 2003. The Index is intended to contribute to an objective debate about ways of increasing the percentage of women serving on the boards and executive managements of publicly quoted Swedish companies. The aim is to broaden the recruiting base and the diversity of boards and executive managements, which will create better companies and enhance their share value.

The study measures the percentage of women serving on the boards and executive managements of publicly quoted Swedish companies, as well as the total number of employees, and is conducted following the conclusion of the Swedish AGM season, between April and June each year.

In all, the 2011 Female Representation Index comprises 250 companies quoted on the Stockholm Stock Exchange, involving the corresponding number of chairs and CEOs, and 1 645 seats on boards. This adds up to a total of 1 727 senior executives.



## Corporate governance in Asia

*Learning from the 1997-1998 Asian economic crisis, regulators and the corporate community in several Asian countries have taken important steps to improve accounting standards, increase transparency in disclosure of material information, strengthen structure of corporate boards, and ease barriers to proxy voting. However, the near meltdown in the banking and financial systems in the United States and western Europe in recent years, where corporate governance practices set the standard for the rest of the world, hesitancy to follow international practices has set in and, in some cases, progress actually been reversed.*

At the start of the new millennium, Asian governments introduced a large number of new regulations to address corporate governance issues. This was the result of lessons learned from the 1997-98 economic crisis. Country after country introduced regulations governing the publication of data that could affect the share price, as well as board composition, the protection

of shareholder rights and the right to vote at AGMs.

“Prior to the crisis, corporate governance issues were at best treated as a Western bureaucratic construct that lacked relevance in terms of economic development and growth in Asia. At worst, they were seen as a hindrance to Asian entrepreneurial initiative,” states Linda Tsao Yang,

who chairs the Asian Corporate Governance Association.

The Asian crisis also meant that those who had earlier promoted the idea of introducing more clearly defined regulations for corporate governance were able to advance their positions. These more stringent regulations applied especially to auditing and accounting.

Continue on next page



The idea was to minimize the risk of a repetition of lax practices that contributed to the crisis.

#### **Singapore and Hong Kong in the front line**

Singapore and Hong Kong were and continue to be at the front of this development. Most markets have nevertheless followed their lead in adapting to IFRS (International Financial Reporting Standards) and ISA (International Standards on Auditing) norms. One aspect involves safeguarding the independence of external auditors by limiting assignments unconnected with the audit process and the length of auditors' contracts and ensuring that corporate boards institute audit committees and arrange audit committee meetings from time to time to hear reports from external auditors but from which executive management is excluded.

"Singapore is the clear leader with respect to accounting and audit-related issues. The country is well in line with international norms. Unlike Hong Kong, Singapore also has an independent agency that monitors auditors. Hong Kong, Japan and South Korea are otherwise closest to Singapore concerning such issues," notes Linda Tsao Yang.

#### **India falls behind, China pushes ahead**

As an example of a country that still has some way to go, Linda Tsao Yang names India, which in recent years has suffered a large number of attention-grabbing accounting scandals. One reason is that Indi-

an auditing firms are relatively small and thereby lack resources to expertly audit the accounts of companies, especially those with complex corporate structures. Furthermore, India has failed to implement regulations to ensure auditors' independence and has yet to adapt fully to IFRS norms.

"In China though, things are moving in the right direction. A problem that has attracted some attention is the phenomenon of 'Reverse Merger', where Chinese companies exploit a back door to gain entrance to stock exchanges outside China. In the USA, this has resulted in the establishment of small groups of legal and accounting professionals, with companies that help Chinese companies conduct this type of transaction. Unfortunately, a number of auditing scandals have come to light in the wake of such transactions, which has created a negative impression of Chinese companies," Linda Tsao Yang notes.

She also adds that the risk of abuse in connection with reverse mergers is openly acknowledged in Hong Kong, where such transactions are now subject to regulation. Linda Tsao Yang assumes that the USA will introduce similar legislation.

#### **Torpedoed by the financial crisis**

As well as addressing these audit and accounting issues, several countries have introduced regulation in a number of other areas. Nowadays, most countries have established corporate governance codes, featuring a mix of obligatory and voluntary requirements within a number of

areas. In Taiwan, for instance, it has become easier for minority shareholders to nominate members of the board.

"In many places, however, developments in this field have stagnated in the wake of the financial crisis. This may derive from an awareness that US rules and regulations, previously seen as the gold standard in this field, had proved unable to prevent the virtual total collapse of the US financial system," says Linda Tsao Yang.

In South Korea, regulatory development has actually gone into reverse. Most notably, there has been a failure to enforce observance of the regulations already in place, and company bosses earlier sentenced for misconduct have been allowed to return to their posts.

"In this respect too, it seems as if the USA and the West in general have lost authority. In the aftermath of the financial crisis, we have seen all too clearly how very few of those in leading positions have been called to account for the catastrophic decisions that led to the crisis. Instead, it is the companies themselves and ultimately their shareholders who have paid the bill. This has served to undermine the credibility of US corporate governance regulation," stresses Linda Tsao Yang.

#### **Mixed progress**

Even so, progress has not ground to a total stop. In Singapore, proposals in the pipeline will enable shareholders to sue directors, as well as increase opportunities for voting by proxy. The latter will first and

foremost encourage greater commitment from foreign stakeholders.

The Hong Kong Stock Exchange recently proposed changes in its corporate governance code which included tougher rules for separate accounting with regard to a number of corporate governance issues and a requirement for increased commitment by the independent members of a board.

“Based on my own experience from the boards of Hong Kong based companies, I believe this can both strengthen the position of the independent board members while also enabling greater demands to be placed on them,” says Linda Tsao Yang.

How many of these original proposals will actually be implemented is uncertain, however, since certain aspects have met with fierce resistance from the publicly quoted companies.

In Taiwan, new regulations have been drafted that require publicly quoted companies to have a remuneration committee. The Taiwan Stock Exchange has also instituted a requirement that these companies shall to a greater extent communicate in English, to facilitate matters for foreign investors.

#### **Regulations increasingly applied**

Some years ago in China, two publicly quoted state-owned companies announced their decision to separate the role of chairman and CEO. This marked a step towards better living up to Chinese stock exchange requirements.

“The maintenance and observance of corporate governance regulations is a useful yardstick when judging how seriously a country takes such issues,” claims Linda Tsao Yang.

Places such as Singapore, Hong Kong and Japan have made considerable progress in recent years concerning the maintenance of such regulations. Some time ago, for example, a handful of minority shareholders in telecom company PCCW in Hong Kong got together and challenged the majority shareholders over a privatisation issue.

#### **Corporate structure poses a problem for insider rules**

Asian companies generally differ from their European and American counterparts in that ownership is in many cases more intensely concentrated to families or the State. This makes it more difficult for minority shareholders to influence such companies.

They also differ in terms of corporate structure. While companies in the West focus increasingly on their core business activities, Asiatic companies tend in many cases to be conglomerates. The publicly quoted company is often a holding company, which in turn owns all or parts of the subsidiary companies, which in their turn may themselves be publicly quoted.

“In many companies, the controlling family appoints the executive managements for its various companies. This

need not be a problem if transparency is good, but in many cases it is not,” Linda Tsao Yang explains.

One area where problems can acquire serious proportions is insider trading. This is also an area that Linda Tsao Yang feels is beset by numerous weaknesses, not least when it comes to observing and maintaining the rules. In her opinion, few misdemeanours are ever discovered and on the few occasions that they are, it is highly uncommon for anyone to be made accountable.



Linda Tsao Yang Chair of Asian Corporate Governance Association and former U.S. Ambassador and Executive Director to the Asian Development Bank (1993–1999).

# Second AP Fund as active investor

*The Swedish National Pension (AP) Funds' mission is to maximize long-term return, at low risk, on the pension assets under management, to ensure the best possible growth in pensions. The AP Funds shall not be influenced by commercial or politico-economic considerations. The Funds shall address environmental and ethical concerns, without compromising the overall objective of a high return on invested capital.*

A large part of the Second AP Fund's capital assets are placed in equities in Swedish and foreign companies, making the Fund a significant investor. The engagement and involvement of shareholders is crucial to the long-term development of companies in which they invest. For this reason, the Fund is therefore an active investor, with a view to promoting good corporate governance, thereby also contributing to better value growth.

As an investor, the Second AP Fund actively participates in the run-up to and during Swedish and foreign AGMs, while maintaining a dialogue with the boards and executive managements of its portfolio companies.

The Second AP Fund's operational approach to corporate governance issues is based on its nine corporate governance principles. These principles comprise structural matters, corporate governance, the environment and ethics.

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 work on ethical and environmental issues 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.

## **The Fund's corporate governance tools**

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 and Principles for Responsible Investment (PRI), the Swedish Companies Act and the Swedish Corporate Governance Code. Since their establishment, the Fund has supported the UN's Principles for Responsible Investment (PRI). The environment, ethics and corporate governance are considered in conjunction with investment decision made by the Fund.

## **The environment, ethics and asset management**

A positive long-term approach to the environment and ethics enhances a company's value. The companies in which the Fund invests shall operate in compliance with regulations, conventions and legislation and shall also work proactively to achieve a healthy relationship with society at large. The Second AP Fund is positive towards companies that are members of the United Nations Global Compact and that actively implement its principles, incorporating them as a natural part of their everyday operations.

Portfolio companies shall also observe the OECD's Guidelines for Multinational Enterprises and Principles of Corporate Governance.

## **Second AP Fund's core 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 and 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. Even if the Fund divests its holdings in the company, this does not eliminate the problem, and the unsatisfactory state of affairs continues. This is why divestment of any Fund holding is considered only as a last option, when any hope of making a difference is deemed hopeless.

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 of 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 are all central principles. And all in compliance with the terms of the Swedish Constitution Act. The core values of the Swedish State are also given expression through the international conventions to which Sweden has signed, 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 important 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 irrespective of, if countries in which the companies operate, are signatories to conventions or feature less stringent legislation.

If companies in which the Fund has invested can be linked to the violation of a convention, the Fund shall first and foremost use its influence as an investor to ensure that such violation ceases, see that preventive measures are implemented and that appropriate action is taken to prevent future violations. Through engagement and by using its influence as an investor to respond when conventions are contravened, as well as making demands for change, the Fund can make a difference. Only if this proves impossible to achieve

will the Fund consider divestment of its holding in the company.

#### **Organisation and responsibilities**

The Second AP Fund's board of directors determines guidelines and policies pertaining to governance issues, entrusting day-to-day management of these issues to the Fund's CEO. The CEO is backed by an investor group featuring members of the Fund's executive management and the head of equities. This group is responsible for the strategic and operational aspects of the Fund's corporate governance activities. The investor group targets and drafts action plans and monitors progress on an ongoing basis. At least once a year, a report on the Fund's governance activities is submitted to the board of directors.

#### **Voting at AGMs**

During the period July 2010-June 2011, the Second AP Fund exercised its voting rights at the AGMs of approximately 50 publicly quoted Swedish companies and 450 foreign companies.

#### **Remuneration issues**

The Fund's corporate governance policy stresses that responsibility for formulating the individual company's system of remuneration in an appropriate manner devolves upon the company's board of directors. This form of remuneration shall serve to promote the sustainable long-term development of the individual company. It is important to emphasise that each remuneration programme is judged on its individual merits. During the year, the Second AP Fund engaged in a number of dialogues with company boards concerning the formulation of incentive programmes, with a view to promoting improvements. Among other things, a dialogue was conducted during the year on the topic of 'matching shares'. The Fund feels that the right to

acquire such shares must be performance-linked. The Fund voted against proposals relating to remuneration issues at just over 50 percent of the foreign AGMs at which it exercised its voting rights.

#### **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 investor 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 holdings in portfolio companies.

Prior to the start of the 2011 AGM season, the Second AP Fund was represented on just a single nomination committee, Opus Prodox, which it chaired.

#### **Increased diversity of boards**

The Second AP Fund stresses 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.

During the spring, the Second AP Fund conducted its annual survey to determine the number of women on the boards and executive managements of publicly quoted companies in Sweden. The survey revealed that female representation on corporate boards has risen to 22.9 percent.

From having declined in the previous year, the percentage of women in executive management positions has now also risen – to 15.3 percent – which is the highest level since the study started in 2003. The Fund conducts an ongoing dialogue with its portfolio companies concerning the composition of their boards.

#### Voting at 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.

The focus in 2011 has been on remuneration, on the need to separate the roles of CEO and chairman, on securing shareholders' rights concerning stock issue decisions to ensure that their rights are protected, as well as environmental and ethical issues.

#### Response to Green Paper

During the spring of 2011, the Second AP Fund and its fellow members in Institution-

ella ägares förening (IÄF), an association of Swedish institutional shareholders, submitted a response to the European Commission Green Paper on the corporate governance framework. In this response, the members of the IÄF stressed that the EU Commission should consider the marked differences in the regulations applied by different members of the EU, and promote good corporate governance by highlighting 'best practice'. The quality of Swedish corporate governance has attracted international attention and in several respects can serve as a useful template. However, several of the proposed detailed changes risk being counter-productive, if introduced as statutory regulations in all countries.

#### 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 prevent companies from contravening 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 the violation of a convention. The principles of engagement, action and change find concrete expression in dialogues and the exercise of pressure, to persuade companies to deal with documented breaches of conventions and to implement systems and measures to prevent future violations. Dialogues are one of the Ethical Council's essential instruments in influencing companies. Even if the Funds sell their holdings, this fails to eliminate the violations. As a final resort, the Ethical Council can recommend that the Fund exclude a company from its investment universe.

The proactive work of the Ethical Council involves participation in various industry and investor initiatives with a view to persuading companies to increase transparency, act more responsibly and address key issues involving ethics and the environment.

At the close of 2010, the Ethical Council was engaged in direct dialogues with some ten companies, in order to get them take action and to implement corrective measures. The Council's consultant conducted parallel dialogues, on its behalf and for other clients, with some 100 to 200 companies. One dialogue was completed during 2010, after the objectives that the Ethical Council had established had been fulfilled. The Ethical Council published its fourth annual report in the spring of 2011.

The Second AP Fund has within the Ethical Council collaboration participated in a number of investor initiatives. These have included involvement in the implementation of a PRI anti-corruption initiative, ongoing since 2010, in collaboration with another 20 investors. Contact has been established with about 20 companies, requiring them to increase their transparency regarding their anti-corruption efforts. Read more at [www.ethicalcouncil.com](http://www.ethicalcouncil.com)

#### Voting at foreign AGMs

Number of foreign AGMs at which the Fund exercised its voting rights	450
Agenda items	7 469
Proposals which the Fund voted against, %	22
Remuneration issues where the Fund voted against or abstained from voting on proposals submitted for approval by the AGM, %	74



# PRI – What does the Second AP Fund do

*The Second AP Fund signed the United Nations' Principles for Responsible Investment (PRI), when they were launched in 2006. This means that the Second AP Fund has pledged to work actively with environmental, social and governance issues. These are usually abbreviated in the acronym ESG (Environmental, Social, Governance).*

The PRI has had a major impact. In June 2011, more than 700 asset owners and investment managers had signed up.

The Principles are about incorporating ESG issues into investment analysis and decision-making processes (Principle 1), as well as being active owners and incorporating ESG issues into ownership policies and practices (Principle 2).

Good analyses are dependent on relevant ESG information. The third principle concerns disclosure on ESG issues by the entities in which institutions invest. PRI signatories also undertake to promote the Principles and cooperate on their implementation (Principles 4 and 5). Finally, all signatories are required to report on activities and progress towards implementing the Principles (Principle 6). Once a year, PRI distributes a survey to all signatories. The Second AP Fund's responses are available on the PRI website.

"During the year, the Fund has focused mainly on Principle 1, concerning the incorporation of ESG issues into investment analysis and decision-making processes," states Hans Fahlin, Chief Investment Officer (CIO) at the Second AP Fund.

## **ESG in asset management**

The Second AP Fund manages assets for anyone who has ever drawn a salary or earned a wage in Sweden. This makes it difficult, if not impossible, to define a number of specific ESG issues about which all beneficiaries can agree. For this reason, the general starting point for the Second AP Fund's work of incorporating ESG into the asset management process is to create value.

Value may either be created by composing a portfolio of many different asset classes which can utilise the risk premiums available on the financial markets, or through active management. Active management is based on the detection of temporary price inefficiencies, utilizing the fact that the market is not always efficient.

## **Dependent on investment strategy**

The institution's investment strategy is what determines the extent to which ESG can be incorporated to create value. The Second AP Fund employs both active management and enhanced indexing. It is the assets under active management that offer the greatest potential for incorporating ESG. As for the

Fund's in-house asset management activities, an active risk strategy is applied to parts of the portfolio of Swedish equities and fixed-income securities. A number of external mandates are also actively managed.

In its enhanced indexing, the Second AP Fund adopts little or no active risk, aiming instead to match various market indices. In such cases, the Second AP Fund exercises its governance responsibilities in a number of these companies by casting its vote at AGMs and engaging in dialogues with some of them. This is consistent with the results published in the PRI report concerning passive investments.

Attention is paid to ESG issues when engaged in active management if they are considered to have a financial impact on the company. The assessment focuses primarily on the companies' product development and market growth. The analysis focuses on what is relevant to companies' growth and cash flow. The Fund is engaged in developing models and tools for ESG that are geared to its investment strategy.

In its active management of fixed-income securities, the Fund has focused on invest-

ment in various 'green' bonds, as these fit well with the investment strategy. In analysing these bonds, the Fund's key parameters are potential return and creditworthiness. These green bonds were comparable in value to 'standard' bonds, but helped spread risk within the portfolio – also an important aspect of the decision-making process.

Several of the Second AP Fund's external fund managers employ active investment strategies. The Second AP Fund has developed a model for evaluating sustainability with respect to funds and fund managers. So far, the model has been used in evaluating forest and agricultural investments.

The work of incorporating ESG into investment processes is under constant development. As these issues become of increasing strategic importance to companies, they also gain importance for shareholders. The Second AP Fund is convinced that including ESG factors in the investment equation will generate better decision data and can thereby contribute to a higher return and improved risk management.

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 make it available public at the PRI web site.

# Collaborating on sustainability

*As well as the Ethical Council, described on page 17, the Second AP Fund is both a member and sponsor of various Swedish and international initiatives in the fields of sustainability, ethics and corporate governance.*

## **CDP (Carbon Disclosure Project)**

The CDP is an initiative whereby some one hundred major institutional investors demand that the world's largest publicly quoted companies shall report on their emissions of greenhouse-gases and other data related to how they manage the climate challenge. The CDP aims to enhance the efficiency of the data gathering process by involving a large number of investors in signing up to a collective request for data and reports on the emission of greenhouse gases. [www.cdproject.net](http://www.cdproject.net)

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

The EITI is an initiative sponsored by the extractive industries, especially oil companies. The need for transparent reporting and control is particularly important in countries that are rich in natural resources, but led by weak governments. More transparent reporting by the companies about what they pay and the governments of the host countries about the size of the revenues generated by the oil, gas and mining industries increases transparency within society and improves the prospects for economic control. In partnership with other international investors, the Fund supports EITI, sending a signal to countries and companies that are engaged in extractive operations that the shareholders place a value on the clear and open reporting. [www.eiti.org](http://www.eiti.org)

## **The Gothenburg Award for Sustainable Development**

The Second AP Fund sponsors 'the Gothenburg Award for Sustainable Development', which is an important part of the Fund's profile within the field of sustainability. The international award is given in recognition of achievements in sustainable development and was awarded for the first time in the autumn of 2000, at which time it was known as the Gothenburg International Environment Award. An independent jury selects the award winners within the various Award criteria. Award winners have ranged from environmental branding organisations and cooperatives to politicians and corporate executives.

The Award is presented in association with Gothenburg City and eleven other sponsors, one of which is the Second AP Fund, the others being Carl Bennet AB, Elanders AB, Eldan Recycling, Folksam, Handelsbanken, KF, Nordea, PEAB, DB Schenker AB and SKF.

This autumn, the Award will be presented for the twelfth year in succession, this time to Kofi Annan, former Secretary-General of the United Nations, and Sue Edwards – for their achievements in connection with the Tigray Project. Originally a local initiative, this project has focused on the needs of smallholders in northern Ethiopia, and has resulted both in increased crops and reduced environmental damage. [www.gothenburgaward.com](http://www.gothenburgaward.com)

## **Sustainable Value Creation Initiative**

In autumn 2009, the Second AP Fund joined up with fourteen other Swedish institutional investors to establish the Sustainable Value Creation Initiative, with the aim of encouraging Swedish publicly quoted companies to adopt a sustainable business approach and create long-term value. The Fund's main reason for participating in this initiative is a belief in the importance of encouraging Swedish companies to actively manage the environmental and social impact of their business operations, with a view to managing risks and costs, as well as exploiting the potential business opportunities. The investors behind this initiative were presented with the 2010 Financial Hearings Award for Årets Samspel, an award shared with Capital Market Day in Shanghai. [www.hallbartvardedskapande.se](http://www.hallbartvardedskapande.se)

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

ICGN is a global network that focuses on corporate governance issues. ICGN is committed to ensuring that shareholders acquire enhanced rights to exercise their votes at AGMs and gain a stronger position with respect to corporate executive managements. ICGN drives development in the corporate governance field by formulating recommendations about responsible governance. ICGN also promotes a broader interface and exchange of knowledge between countries and investors. [www.icgn.org](http://www.icgn.org)



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

IIGCC is a forum for European investors on climate issues. The Group is committed to voicing investors' views on climate issues and to helping companies, government agencies and fellow investors appreciate the long-term risks and opportunities associated with climate change. The climate issue is of crucial importance to the Second AP Fund as a long-term investor. Currently, there is considerable uncertainty about future regulations and the framework envisaged for cutting greenhouse emissions and stimulating alternative sources of energy. This makes it difficult for companies to invest profitably and for investors to predict risk and return. IIGCC provides an efficient platform for promoting investors' wishes concerning the climate issue. It is also a good way for the Fund to stay abreast of the latest information on various climate-related investments. [www.iigcc.org](http://www.iigcc.org)

### **IÄF (Institutionella ägares förening)**

Institutionella ägares förening (the Institutional Investors' Association) for regulatory issues in the stock market is a collaborative venture that includes the AP Funds, insurance companies and bank-related funds. The institutional investors' association was formed to facilitate cooperation on the development of best practice in corporate governance and to influence the development of the Swedish Corporate Governance Code and other guidelines. It is vital work that influences the development of and confidence in the Swedish stock market and publicly quoted companies.

### **SWESIF (Swedish Forum for Sustainable Investment)**

SWESIF is an independent networking forum for organisations working to promote or engaged in sustainable investment in Sweden. SWESIF aims to increase awareness of and interest in sustainable investment among institutional investors and asset managers. Sustainable investment embraces investment that, as well as financial factors, incorporates factors such as the environment, social responsibility and corporate governance, or other global factors, in the investment process. SWESIF's aim is to see that sustainable investment becomes an established item on the agendas of decision-makers in politics, industry and the financial market, and to ensure that sustainable investment is awarded general recognition. SWESIF is committed to an exchange of the latest information, ideas and expertise, while also promoting increased networking and cooperation between members and other interested parties. [www.swesif.org](http://www.swesif.org)

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

A global initiative for institutional investors, the United Nations' Principles for Responsible Investment were launched in 2006. The idea was to encourage investors to address ESG (Environmental, Social and Governance) issues in their investment decisions and, when exercising their ownership rights, to thereby create value on behalf of their beneficiaries. By August 2011, more than 900 organisations had become signatories to these Principles. The signing of these Principles by the Second AP Fund should be seen as a declaration of its support of the PRI, and of its intention to observe these Principles within the broader framework of its assignment. The Fund believes that environmental and ethical issues form a crucial part of the investment process. Furthermore, the PRI also help to

drive development in the ESG field and contribute to an exchange of expertise on ESG issues, while improving contact between responsible investors worldwide.

Within the general framework of the PRI, the Fund has participated in a project with a number of private equity companies on the joint development of improved principles for dealing with ethical and environmental issues associated with investment in and ownership of companies. For more on PRI, turn to pages 18-19.

[www.unpri.org](http://www.unpri.org)

The Second AP Fund also participates in other cooperative ventures and networks, with a view to promoting good governance and influencing shareholder value in the long term.



# Spotlight on governance from start

*Even ten years ago, when the Second AP Fund was launched, it was already clear that governance issues would play a key role in the Fund's activities. It was also clear from an early stage that, when it came to governance issues, the rest of the world had great expectations of the new AP Funds.*

The AP Funds' mandate states that they shall maximise return while also taking ethics and the environment into account. It was therefore clear that governance issues would find their way onto the agenda at a fairly early stage and the aim was that they should contribute to the Fund's value creation. The Second AP Fund's first governance policy was finalised in 2001, a mere five months after it opened its doors, initially focusing on five distinct areas: the Fund's stance on shareholders' influence and rights in a publicly quoted company, the Fund's stance on issues related to the board of directors and executive management of a publicly quoted company, the Fund's stance on the issue of transparency

and external credit market communication as practised by a publicly quoted company, the Fund's view on relations with other shareholders and the Fund's course of action in situations where a portfolio company acts in violation of sound business practice.

In 2001, the Fund participated in some twenty Swedish AGMs, made several visits to companies and conducted active checks on the actual situation at some ten companies, whose actions had in one way or another raised doubts related to ethics, the environment and/or observance of sound business practice. On the basis of the accumulated data, the Fund divested itself of two holdings where the information supplied was deemed inadequate to ensure reasonable respect for ethical or environmental concerns.

## **An eye-opener**

"When we launched the Fund, we had our hands full just getting it up and running: governance issues were not our first priority. This soon changed however. I remember a call from the country's largest newspaper, Dagens Nyheter, asking about a Swedish company in which we had invested – it was an eye-opener," notes Lennart Jonsson, the Fund's first head of corporate communications and governance.

The following year, in 2002, the governance role of institutions was in the limelight yet again. The appropriateness of the pension and options programmes implemented by a number of Swedish companies was called into question, and

the collapse of the US companies Enron and Worldcom further exacerbated the debate over the role and responsibilities of owners. Consequently, there were growing demands that institutions and pension funds should play a more active role in ownership. With all this going on, governance issues acquired an increasingly important role at the Second AP Fund.

"To gain competence in the field, we visited a number of large international pension funds, to study how they tackled governance issues," says Lennart Jonsson.

## **Criticised options programme**

The number of Swedish AGMs in which the Fund participated doubled in a year. It also exercised its voting rights at a number of foreign AGMs.

2002 was the year when Tomas Nicolin, the then CEO of the Third AP Fund, openly criticised Skandia's extensive options programme, after Skandia's executive had showed scant interest in the Fund's views on the programme, views which had been expressed at an early stage. This resulted in the withdrawal of the proposed options programme at the AGM.

"In the case of Skandia, several institutional investors took a clear stand on a specific issue and acted as one. This was significant, because it demonstrated that we really could influence companies," states Lennart.

The Fund was an early participant in the debate concerning the need to increase the percentage of women on corporate boards, and has subsequently become closely associated with this issue.



Photo Caroline Eking



## Sustainable capitalism

“We came into contact with Nordic Investor Services and its then CEO, Carl Rosén, and together established the Female Representation Index. We wanted to promote objective debate on ways of increasing the percentage of women on the boards and executive managements of publicly quoted Swedish companies,” says Lennart.

This involvement in governance issues continued to grow and to gain increasing importance and, in 2005, the Fund published its first Corporate Governance Report, which was specifically designed as a means of stating its position on and interpretation of issues in the field of corporate governance.

Clear evidence that the Fund’s efforts in the corporate governance field had proved successful was provided by a 2007 UN report which highlighted the Second AP Fund and 14 other pension funds in different parts of the world for producing concrete strategies as to how sustainability issues could be incorporated as part of the investment process.

Lennart Jonsson concludes with his impression of how the approach to governance issues has changed in the ten years that have passed since the Fund was launched:

“A lot has happened in the past years. Most importantly, the way investors operate has become far more professional and, from a social perspective, the governance issue has become still more important. Investors have also become subject to greater external pressures, from the general public as well as the media. Especially pleasing is the degree to which these issues have become an integral part of fund management – something that was far from self-evident when the Fund was formed ten years ago.”

*‘Sustainable capitalism’ is a concept that defines a form of capitalism where the price of goods and services reflects all costs involved, including environmental and social costs. The challenge is to create an economic system that incorporates ecological and social sustainability, thereby creating long-term value.*

‘Sustainable capitalism’ was the theme of a seminar arranged by the Second AP Fund in association with Gothenburg University’s School of Business, Economics and Law on October 25th 2010. The key speaker was Al Gore.

Al Gore stressed that capitalism is the best way to organize economic activities. To ensure its sustainability, however, external effects (negative and positive) must be internalised, i.e. must be factored into the broader economic equation. Climate change provides one example of a negative external effect. In most countries, no levy is raised on carbon emissions. The costs incurred in the wake of climate change affect all nations, companies and individuals, regardless of the levels of carbon emissions for which they may individually be responsible. These climate changes will have an impact on business operations and on government responses. It is therefore vital that we take these additional factors into account, even though no price may yet have been put on them. Mr Gore also talked about the short investment horizons favoured by financial markets, stressing the unhealthy way CEOs and CFOs award priority to interim reports, in preference to consideration of longer term objectives. If the true strength of capitalism is to be realised, it must be

implemented in harmony with long-term and sustainable value creation. In his address to the students, Mr Gore encouraged them to challenge their lecturers by asking questions about finance, economics, business and sustainability.

Eva Halvarsson chaired the subsequent panel debate between Al Gore, Chairman of Generation Investment Management; David Blood, Senior Partner of Generation Investment Management, and Björn Stigson, Chairman of the World Business Council for Sustainable Development.

David Blood claimed sustainability is not a ‘feel-good factor’, but that integration of a sustainability and financial analysis should be considered best practice for active fund managers responsible for concentrated portfolios of equities. Generation Investment Management is currently cooperating with business schools in the USA to increase the understanding of sustainable capitalism. Björn Stigson also stressed the importance of sustainability at business schools. Furthermore, he noted that ‘business-as-usual’ is not a viable option, for industry or the world as a whole. By the end of the seminar, the place was buzzing with positive energy and the participants were challenged to become a part of the solution. We all have a choice – we can all contribute to change.



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