



Andra AP-fonden
Second Swedish National Pension Fund - AP2

Sustainability and Corporate Governance Report

July 1 2014 – June 30 2015



Photo: Anders Deros

CEO's report

During the year, we have finalized a long-term strategy for our sustainability programme. Expectations concerning the Second AP Fund and how it should address sustainability issues are high, whether talking about the general public, the board or, in particular, our own staff. But we can't do everything: we must focus our resources. We have elected to empathise primarily on a number of areas that we consider of key significance in generating a better long-term return.

The Funds broad focus is on making sustainability integral to the asset management process. Our vision is that sustainability shall become integral to all of the Fund's analytical and decision processes. Areas we shall especially focus on are: climate, corporate governance, diversity and transparency/reporting. The Fund possesses extensive expertise and experience in these areas, having been engaged in these issues for a considerable period of time.

Focus on climate

Over the past year, we have further advanced our position in terms of sustainability, something that has also attracted international attention. For instance, the index published in the spring by the Asset Owners Disclosure Project – which rates the world's 500 largest investors according to how well they manage climate risk in the portfolio – ranked the Fund eleventh in the world. In-house efforts continue concerning the analysis, from a financial perspective, of the carbon-emission risks associated with our portfolio. This year's agenda features an analysis of power-generating companies. We are of course encouraged by the favourable attention our work has attracted.

The first time we measured our portfolio's carbon footprint was as early as 2009, something we repeated in 2014. We hope eventually to be able to present a carbon footprint that includes all asset classes. During 2015, the Fund has actively lobbied investors to standardize the way the carbon footprint is measured. In connection with this concern, we have also participated in a number of seminars/workshops, at which this issue has been discussed. I do look forward to the United Nation's 2015 Paris Climate Conference COP21 (Conference of Parties 21) in December, and am hopeful that this time the participating nations will be able to agree on a new climate treaty.

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Sustainable bonds

When the Second AP Fund started to invest in 'green bonds' in 2008, we were among the first to invest in this asset class.

Today, we have almost SEK 3.5 billion invested in this type of bond. During the year, we have also made our first investment in a 'social bond'. It seems likely that the market for sustainable bonds is still only in its infancy and we are determined to continue to participate in and contribute to the development.

Diversity on boards

The Female Index, produced by the Fund since 2003, shows that the proportion of women represented on the boards of companies quoted on the Stockholm Stock Exchange continues to rise and now amounts to 27.9 percent, compared to 24.7 percent in 2014. It is highly encouraging to witness the greatest increase in female board members since 2004. It demonstrates that investors and nomination committees have shouldered greater responsibility. I am convinced that our work on the Second AP Fund's Female Index, as well as the data reported here, has helped promote progress in this area. There is still much to do, but I hope and believe that this issue has now acquired the consistent focus necessary to ensure more rapid development in future, and that the available competence and expertise is put to better use in the work of corporate boards.

During the annual general meeting (AGM) season, as well as being heavily engaged in the diversity issue as related to boards of directors, we have focused on a dialogue with nomination committees and their ability to motivate their proposals. Prior to companies' AGMs, we wrote to several nomination committees, later following up these letters at a number of AGMs during the spring. We have also studied how the nomination committees in these companies motivated their proposals in 2015, compared to the previous year, and were disappointed to learn that little had changed. We shall therefore continue to pursue this issue over the coming year as well.

Shareholders' proposals at the BP, Shell and Statoil AGMs

During the year, we will increase the number of foreign companies in which we exercise our voting rights, from 500 to some 750. We are also actively involved in raising various questions at these AGMs, including the climate issue. In the spring, in partnership with a large number of other investors, we presented a shareholder proposal at BP's and Shell's AGMs. Together with the Fourth AP Fund, we also tabled a similar proposal at Statoil's AGM. The proposal addressed the idea that companies should expand reporting on their greenhouse emissions, the assessment of project portfolios in terms of relevant post-2035 scenarios, their plans regarding research and development into low-carbon energy solu-

tions and how they intend to integrate sustainability as part of their strategic key performance indicators and bonus systems.

The boards of all the above-mentioned companies recommended shareholders to support the proposal. At the Statoil AGM, it gained the support of 99.95 percent of participants, while the figures for the Shell and BP AGMs were 98.9 and 98.28 percent respectively. Here again, I feel able to claim that our and other long-term investors' consistent commitment and cooperation on these issues has made a real contribution.

Proposed new regulations for AP funds

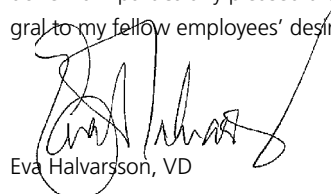
The proposed new regulations for the AP funds, currently being circulated for comment, feature a fairly extensive section on responsible investment. The preface to the Act that currently regulates the AP funds, and which has done so since 2001, states that the funds shall consider ethics and the environment, without abandoning the broad goal of a maximum return on assets. This wording has worked well, in giving the funds some freedom of interpretation and thereby opportunities for adapting their role as responsible investors in pace with the changing concept of sustainability.

An assessment of the Funds' ESG activities conducted by McKinsey in the spring of 2014, commissioned by the Swedish Government, confirmed that the funds and their joint Ethical Council are among the leading pension funds in the world in this field, and that current wording has fulfilled and continues to fulfil its purpose.

The Second AP Fund is already a responsible and committed investor that operates in the manner suggested in the document currently under consideration. We are firmly convinced that companies founded on long-term sustainability are also those that, over the long term, generate the best return on investment for Sweden's pensioners!

In our response to the circulated document, we shall be commenting in detail on the new proposal. I can state right now that the AP funds, compared to many other investors, have already come a long way in terms of responsible investment and responsible governance – and that we strive for constant improvement in this area.

In this year's version of the Fund's Sustainability and Corporate Governance Report, we have further expanded the section in which we report on our own efforts within the field of sustainability, to be still more transparent and to present what we are doing and what we have achieved. I am satisfied with what has been achieved so far, while being well aware that much remains to be done. I am particularly pleased that sustainability has become integral to my fellow employees' desire to see the Fund develop!



Eva Halvarsson, VD

A coastal landscape featuring a rocky shore in the foreground with several white, umbelliferous flowers. The sea is a deep blue, and a small white sailboat is visible on the horizon under a clear blue sky. A dark blue speech bubble is overlaid on the lower left side of the image.

Sustainability at AP₂

The Second AP Fund's sustainability programme comprises the environment, ethics and corporate governance. The sustainability programme is designed to create and protect values. As an asset manager, the Fund is determined to address a range of factors involving the environment, ethics and corporate governance, as they either provide a better basis for analysis and investment decisions or promote diversification. The Fund's goal as an asset owner is to generate confidence by promoting a solid ethical and environmental approach while also contributing to the development of sound practice in fund management issues.

By actively addressing and integrating environmental, ethical and corporate governance issues in its operations, the Second AP Fund can generate value. The collective term that the Fund uses to embrace these issues is sustainability. Investors also use the acronym ESG (Environmental, Social and Governance).

The Fund believes sustainability to be important, convinced that a commitment to sustainability issues can generate and protect value. Integrating sustainability factors into analyses and investment processes generates broader and better decision data.

The Second AP Fund's framework

The Second AP Fund is a state agency whose operations are governed by the National Pension Insurance Funds (AP Funds) Act (2000:192). One of the AP Funds' key tasks is to maximize return while maintaining a low level of risk. The investment strategy shall accommodate the impact of pension disbursements while addressing the level of reserves that will be required to service these outflows.

It is important that the Second AP Fund shall enjoy the confidence of the general public and shall act in a responsible manner. This is reflected by the wording in the preface to the National Pension Insurance Funds Act, which states that the AP Funds shall take ethical and environmental concerns into account, but without ignoring the overall aim of an enhanced return on investment. Sustainability and responsible behaviour are both key priorities for the Fund. A proactive approach to the environment, ethics and corporate governance is the way to secure the goal of a solid risk-adjusted return on investment.

Governance policy

The Second AP Fund's operational approach to sustainability and corporate governance issues is based on the Fund's governance policy and its ten investor principles. These principles comprise structural matters, corporate governance, the environment – and ethics. The governance policy also defines the Fund's core values,

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

This governance policy clarifies what the Fund expects of its portfolio companies, as well as what these same companies may expect of the Fund as an investor. 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 UN's Global Compact, the Swedish Companies Act and the Swedish Code for Corporate Governance.

The governance policy also describes the principles to which the Second AP Fund subscribes and that it employs as a framework in its efforts to promote sustainability, both within its portfolio management organization and in a range of governance activities. The Second AP Fund supports and actively promotes implementation of the UN's Principles for Responsible Investment (PRI). It signed up to these Principles as early as 2006, when they were first established. PRI provides various instruments and activities to support investors in implementing the Principles and to facilitate cooperation between investors. By the end of June 2015, more than 1 200 investors had signed up to these Principles. PRI conducts an annual questionnaire, in which all signatories report on how they are implementing these principles in practice.

The Second AP Fund has also undertaken to implement the Principles for Responsible Investment in Farmland (Farmland Principles). These were drawn up by the Second AP Fund in association with a group of international investors, all of which are PRI signatories. The Principles provide institutional investors who invest in agricultural assets with a framework for dealing with environmental, ethical and governance issues. They are also intended to increase transparency in connection with such investments. The Second AP Fund's report on the implementation of these Principles may be found on page 15.

As of September 2014, PRI acquired administrative responsibility for the Principles, which have subsequently evolved into PRI's 'Guidance for Responsible Investment in Farmland' ('Guidance'). Consequently, with effect from January 2015, reporting on implementation of the Guidance will be conducted as part of PRI's standard reporting procedures. To increase transparency, PRI will compile a special report on agricultural investments. Further details are available at www.unpri.org

Organization 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 a governance group that comprises members of the Fund's executive management, the head of Swedish equities and the sustainability analyst. This group is responsible for the strategic and operational aspects of the Fund's corporate governance activities.

The Fund's sustainability programme (ethics and environment) is conducted by a sustainability group that comprises the Fund's Chief Investment Officer (CIO), the sustainability analyst and the Head of Communication. This group is responsible for determining the strategic priorities to be addressed in dealing with sustainability issues. The governance and sustainability groups define goals and draft action plans for their respective spheres of responsibility, monitoring progress on an ongoing basis.

Reports on the activities of the governance and sustainability groups are submitted to the Fund's executive management, activities that are subject to the ongoing approval of the rest of the Fund's staff. The Second AP Fund board receives a report on the progress of the Fund's sustainability and governance activities at every board meeting.

Environmental and ethical 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

- commitment
- action
- 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. The aim of the Fund's sustainability programme is to establish and preserve values of benefit to the pension system.

Part of the Swedish State's core values

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

” As part of the Swedish national pension system the Second AP Fund's principles of engagement, active ownership and change are based on the same core values as those espoused by the Swedish State.

Conventions Sweden has signed

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

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 organizations. Furthermore, this responsibility shall apply even when countries in which the companies operate are signatories to conventions or feature less stringent legislation.

Implementing PRI principles

The implementation of PRI principles is an ongoing process, one which requires that the Second AP Fund shall consistently address sustainability issues, both in its role as asset manager and as

asset owner. The Principles are about the following: integrating sustainability issues as part of investment analyses and decision processes (First Principle); acting as active owners (Second Principle); encouraging better sustainability reporting by companies (Third Principle), collaborating with other investors (Fourth and Fifth Principles) and reporting on progress (Sixth Principle). Integration, dialogue, collaboration and reporting are key words for these Principles and for the Second AP Fund's sustainability programme.

PRI principles	Examples of what the Second AP Fund does
1 We will incorporate environmental, social and corporate governance (ESG) issues into investment analysis and decision-making processes.	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. Collaborates also with other Swedish and international investors.
6 We will each report on our activities and progress towards implementing the Principles.	Publishes an annual Sustainability and Corporate Governance Report and also reports on PRI in the Annual Report and on the website. Reports on dialogues with foreign companies in the joint Annual Report of the Ethical Council. Responds to the PRI's annual survey and makes it available public at the PRI website.

A photograph of a forest path covered in fallen autumn leaves. Sunlight filters through the trees, creating a dappled light effect on the path. The path leads into the distance, flanked by dense green foliage and trees. A blue speech bubble is overlaid on the right side of the image, containing the text "Sustainability in the investment process".

Sustainability in the investment process

Integrating sustainability into asset management is about factoring sustainability issues into analytical and decision processes. This also enables the Fund to reduce risk and increase its potential for increased return. The Fund believes that companies focused on long-term sustainability will also generate a solid return in the long term.

The Fund is firmly convinced that companies with long-term sustainable business models generate a higher long-term value for their owners. All things being equal, such investments also incur less risk. Companies able to integrate factors as ethics and the environment into their long-term business development will have an advantage over their competitors and are more likely to generate long-term value for their owners. A proactive approach to ethics, the environment and corporate governance is therefore the means to achieving the goal of a solid risk-adjusted return.

The Fund's definition of sustainability

The sustainability programme implemented by the Second AP Fund derives from the nature of its mission and involves acting over the long term, to preserve and add value to its invested assets – based on an economic, environmental and social perspective.

Sustainability integral to asset management

The Fund's overall objective is that sustainability must form an integral part of all analytical and decision processes. This work has been ongoing in a structured form for several years now.

The Second AP Fund is responsible both for the management and governance of the capital assets in its care and is actively engaged in addressing the related environmental, ethical and corporate governance issues from both perspectives. By encouraging portfolio companies to address ethical and environmental issues, the Second AP Fund can help them identify the opportunities and risks, at an early stage, which can affect long-term return. The Second AP Fund believes that a responsible long-term approach to the environment, ethics and governance enhances the value of companies. By integrating an analysis of environmental, ethical and corporate governance factors with its economic analysis, the Fund's asset managers are able to generate better data for investment decisions.

As a manager of Sweden's national pension assets, the Second AP Fund is responsible to all those who at one time or another have worked in Sweden for ensuring that the assets managed enjoy solid and sustainable economic growth. The Second AP Fund shall act in a manner that best satisfies the demands of its overall mission.

During the year, the Second AP Fund arranged a number of seminars and training sessions to create better understanding

and awareness of sustainability issues among its staff. This is important in facilitating the integration of sustainability factors in the Fund's everyday activities.

Focus areas

During the year, the Fund has decided that its sustainability activities should focus primarily on a few priority areas that are considered essential to achieving a better long-term return. The idea to focus the Fund's resources on a number of areas is to achieve results in areas of financial relevance.

The Fund's broad priority is:

- The integration of sustainability as part of the asset management process.

The Fund's specific priorities are:

- Climate
- Corporate governance
- Diversity
- Transparency/reporting procedures.

The Fund possesses extensive expertise and experience in these selected priority areas, having been engaged in these issues for a considerable period. It expects to focus on these priorities for a long time to come.

The work carried out in these priority areas, will target companies in which the Fund has invested most heavily and/or those in which it controls a substantial interest and in sectors deemed to pose considerable risks in terms of financial sustainability. This policy derives from the recognition that the work must focus on those areas and companies of key financial importance to the Fund. This work may be conducted in collaboration with other investors, with a view to securing improvements within a particular sector and/or within an individual company. The process of addressing selected areas of priority will also be conducted in-house. The Fund believes this is the best way to achieve its broad goal of integrating sustainability as an essential element of all analytical and decision processes, which is also compatible with its mission.

The long and short-term goals for the individual areas of priority, as well as the activities planned for achieving these goals, have been broken down and are stated in detail in the Fund's

A selection of the Second AP Fund's sustainability goals 2015

Priority area/Asset class	Goal 2015	Monitoring method/Key performance indicator
Reporting		
Swedish equities	Evaluate progress for ten largest Swedish holdings regarding sustainability, based on Fund's equity interest	Analysis and dialogue shall be completed
	Increase percentage of Swedish companies reporting to CDP	Companies that report, of those received letters from the Fund, %
Private equity funds	Increase percentage of private equity funds that submit ESG reports by 20 percent	ESG reports submitted, %
Conventional real estate	Increase GRESB questionnaire response rate to at least 50% of the Fund's Swedish exchange-listed real-estate companies	Companies that responded, %
	That the Fund's non-listed real-estate companies and funds respond to the GRESB questionnaire for 2015	Companies that responded, %
Agricultural-and-forest real estate	Improve reporting	Result of Fund's questionnaire to managers of agricultural-and-forest investments
	That a third-party audit be made of agri real estate in Brazil	That it is implemented
	Reporting as per PRI's Guidance for Responsible Investment in Farmland	Reported in Fund's Sustainability and Corporate Governance report
Chinese Series A equities	All Chinese asset managers shall report on ESG	Chinese asset managers who report on ESG, %
Climate		
Global equities	Evaluate Fund's financial climate risks by analysis of power sector	Analysis and report clear and communicated
Conventional real estate	That the Fund's aggregated "GRESB Scores" are improved	GRESB score
	Determine energy consumption and carbon footprint from the Fund's non-listed real-estate portfolio and listed Swedish real-estate companies	GRESB indicators
Agricultural-and-forest real estate	Explore possibility of measuring the carbon footprint from agriculture	
Other	Determine and evaluate the Fund's carbon footprint	Reporting in the Fund's Annual Report and Sustainability and Corporate Governance report
	Lobby to standardize calculation of carbon emissions	
Diversity		
Swedish equities	To promote increase in percentage of women on boards of companies where the Fund is represented on the nomination committee	Percentage of women on these boards
Corporate governance		
Swedish equities	Exercise voting rights in all companies that meet the Fund's criteria for participation in the AGM	Percentage of companies in which the Fund exercised its voting rights
Global equities	Vote at AGMs of 750 foreign companies	Number of AGMs the Fund voted on
	Write 50 follow-up letters to companies where we have voted against the board's proposals	Number of letters sent

annual business plan for sustainability and in the action plans drafted for individual asset classes.

Sustainability module in a new risk-assessment system

The Fund has implemented an ESG platform that is used to generate comprehensive sustainability analyses of companies and sectors. Detailed data on specific issues such as carbon emissions is also available for more thorough analysis. The platform is integrated into a new risk-assessment system and will in the next phase be utilized to gain clearer insight into the Fund's sustainability risks at portfolio level.

Equities

Progress on integrating sustainability issues into the active in-house management process and into the investment process for Swedish equities continued during the year. The asset management process is based on a fundamental analysis, in which sustainability aspects are factored in when valuing companies. These may include taxes, forthcoming regulations and governance issues. The work of including a growing amount of sustainability data in analyses and investment processes continues. During 2015, work has started on integrating how external suppliers rate companies in terms of sustainability.

Global equities are under quantitative management. The models used have been developed in-house and embrace a number of different factors, including sustainability. During 2015, a project is being launched to determine whether additional ESG factors can be integrated into this model.

All companies included in the Second AP Fund's portfolio of equities are screened twice yearly, to identify those that contravene international conventions and guidelines. This analysis is conducted by an external consultancy. The results are analysed by the Fund. The Fund also has a governance group that works on governance issues.

Private equity funds

The Fund has a structured process for analysis, evaluation and follow-up which, as well as sustainability, embraces economic, risk and performance analysis. This process can also be applied to the Fund's investments in non-listed real estate, as well as forest and agricultural assets.

The Second AP Fund is engaged in an ongoing process that seeks to develop ways to evaluate and monitor sustainability reporting by private equity funds. Over the year, the Second AP Fund has conducted numerous dialogues with private equity funds concerning sustainability and reporting procedures. It is clear that sustainability is attracting increasing attention and many private equity companies are adopting a systematic approach to the issue. Around 60 percent report back in some form on how they are working with sustainability.

Since 2014, the Second AP Fund is represented on the Private Equity Advisory Committee (PEAC), which acts as an advisory organ in support of the PRI's work in the field of private equity. This committee is tasked with offering advice on strategies and activities, monitoring the implementation of PRI principles within the private equity sector and assisting with guidance and tools. A current work-in-progress, in which the Fund has played an active role, involves the drafting of a questionnaire on sustainability, which can be used prior to investment.

ILPA

ILPA (Institutional Limited Partners Association) is a global organization for investors in private equity funds, that is focused on promoting issues of joint interest to investors in the private equity industry. ILPA provides training, establishes 'best practice', drives its own research projects and offers opportunities for investors to exchange ideas and experience.

The Second AP Fund is an active member of the ILPA and was the first institution outside North America to be represented on the board. The Fund has also played an active role on the training committee.

During the year, the Fund became a signatory to the ILPA's principles. These were established in 2009 and updated in 2011. They may be classified under three main groups:

- Alignment of interest
- Governance
- Transparency.

Green and social bonds

The Second AP Fund made its first investment in 'green bonds' in 2008. Green bonds are intended to finance projects that help mitigate climate change or aid countries in their attempts to adjust to it. The market for green bonds continues to expand and the number of players issuing these types of bond will grow still further. This form of investment suits the Second AP Fund well, as it coincides with the Fund's approach to climate change, contributes to a diversification of the portfolio and is attractive to long-term investors.

Over the past twelve months, the Second AP Fund has increased its investment in green bonds and, as at June 30 2015, held bonds to a value of SEK 3.4 billion.

During the year, the Fund also made its first investment in a 'social bond', amounting to USD 20 million. The bond was issued by the Inter-American Development Bank (IADB) and will be used to fund loans to projects in Latin America and the Caribbean. The projects are designed to combat poverty by enhancing the quality of children's education and helping young people to enter the labour market. For more about green bonds, turn to pages 34-36.

Conventional real estate

A multitude of sustainability issues are of importance in the real-estate sector. Energy is a central issue, since conventional real estate accounts for as much as 30 percent of global emissions of greenhouse gases and up to 40 percent of energy consumption. To better monitor and evaluate progress on sustainability within its real-estate investments, the Second AP Fund joined the Global Real Estate Sustainability Benchmark (GRESB) in the spring of 2014.

GRESB is an organization that conducts an annual questionnaire to assess how real-estate companies and real-estate funds address seven aspects of sustainability. These are management, policy and reporting, risks and opportunities, follow-up and environmental management systems, environmental indicators (energy, greenhouse-gas emissions, water and waste), building certification and dialogues with stakeholders. In 2015, more than 700 companies participated in the survey. The companies were then compared with their competitors and classified under four categories: Green Starters, Green Talk, Green Walk and Green Stars.

In the spring of 2015, the Second AP Fund again asked non-listed real-estate companies/funds, as well as all Swedish-listed real estate companies, in which the Fund had invested, to respond to the GRESB questionnaire. Five of the seven non-listed companies/funds responded. Four of twenty listed companies responded. This was the second year that the Fund had asked companies to respond to the questionnaire. As a member of GRESB, the Second AP Fund can access companies' answers via a web-based system, allowing the Fund to compare the real-estate companies/funds in which it has interests with various benchmark groups.

Of the non-listed companies/funds, three companies received a Green Star classification, confirming that they have policies and management systems in place and are actively engaged in the implementation, and in reducing their environmental impact. Another received a Green Walk rating, meaning that the company is actively addressing the issues but needs to strengthen its policies and control systems. One was rated as a Green Starter, which means that the company needs to develop its sustainability

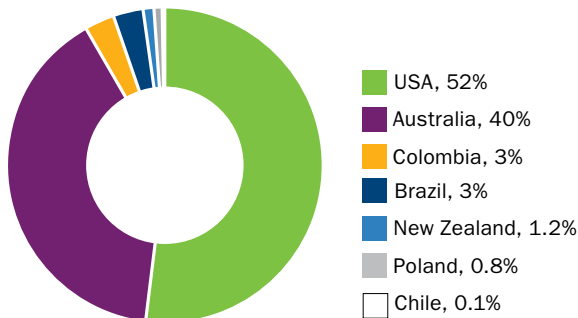
programme. Next year, the Second AP Fund will follow up on the GRESB questionnaire results, company by company.

Investments in forest real estate

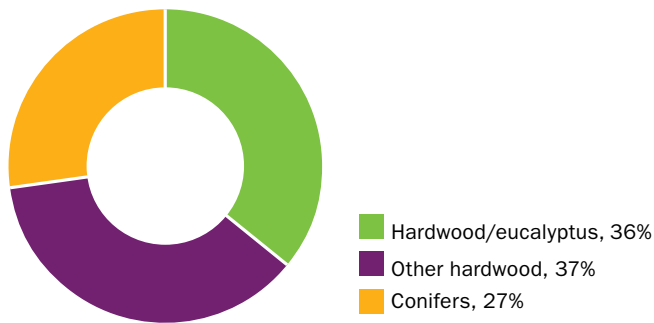
As an asset class, forest offers both diversification and a stable, long-term return. The Second AP Fund has invested in forest since 2010. As of December 31 2014, 0.3 percent of the Fund's total capital was invested in forest assets. The Fund's participation in these forest investments amounts to 66 000 hectares. The greater part of these investments are in Australia and the USA, in forest real estate that produces saw timber and pulpwood.

The Fund has three external asset managers: New Forests, Molpus and Global Timber Resources. New Forests invests in Australia and New Zealand, Molpus in the USA and Global Timber Resources in Europe, Latin America and the USA. Last year's investment in Global Timber Resources involved a diversification of the portfolio, both geographically and towards a faster growing variety of tree. The pie charts at bottom left illustrate geographic distribution as well as that between deciduous and coniferous forest assets.

Geographic distribution, forest (hectares)



Production distribution, forest (hectares)



All figures as at June 30 2015.

Sustainability certification a requirement

Where possible, the Second AP Fund makes it a condition that fund managers should certify forest real estate in compliance with one of the international sustainability certification systems, Forest Stewardship Council (FSC) or the Programme for Endorsement of Forest Certification (PEFC). If the forest assets cannot be certified – as in the case of biomass plantations not covered by FSC or PEFC certification – they will be managed in compliance with the certification principles implemented by these organizations.

Managers of the Second AP Fund's forest investments

New Forests, a fund manager founded in 2005, specializes in forest assets. It is also engaged in finding markets for the ecosystem services the forest offers. Right from the start, sustainability issues have been central to New Forests' business concept. New Forest has a declared ambition to achieve a leading position in sustainability. Consequently, the fund has sustainability policies and management systems in place and ensures that its forest assets are certified sustainable by independent agencies. The fund also collaborates with various stakeholders concerning the environment and social sustainability. New Forests' sustainability reports are available at www.newforests.com.au

The Second AP Fund has invested in two New Forests funds that focus on Australia and New Zealand. The predominant tree varieties are eucalyptus and pine.

Second AP Fund's forest real-estate holdings

	No. of hectares	Share of total, %
Certified forest real estate, in compliance with FSC and/or PEFC	62 600	95
In process of certification, in compliance with FSC and/or PEFC	3 500	5
Sustainably cultivated forest assets, in compliance with FSC and/or PEFC, but where such assets cannot be certified	40	0

Molpus has been managing investments in forest real estate in the USA since 1996 and has a long tradition of sustainable forestry. Molpus also has policies and management systems for promoting sustainability. It applies the Sustainable Forest Initiative (SFI), which is the American certification programme within the Programme for Endorsement of Forest Certification (PEFC). Since 2011, the fund has adopted multisite certification, which means that an independent agency conducts an annual audit of approximately a third of the real estate assets and that new real estate is included as it is acquired. In some cases, Molpus can also choose to certify its assets in compliance with the Forest Stewardship Council (FSC). These audits are available on the SFI website at www.sfiprogram.or

The forest real estate assets in Molpus' funds feature a mix of coniferous and deciduous varieties, with oak, maple, poplar, spruce and pine predominating.

Global Timber Resources is a company that the Second AP Fund owns jointly with TIAA-CREF and other institutional investors. During the first year, the company has invested in Poland, Colombia and Chile. The day-to-day management of these forest real-estate assets is handled by GreenWood Resources Capital Management, in which TIAA-CREF is a majority shareholder. GreenWood was founded in 1998 and is heavily engaged in developing plant materials, with a focus on fast growing tree varieties such as poplar.

Forest storage of carbon dioxide

Molpus also conducts analyses to determine whether forest real estate might be appropriate for inclusion in 'carbon projects'. If the anticipated regrowth significantly exceeds felling volumes, the fund calculates the value of directly extracted forest products relative to the value of the forest as a carbon sink (that the forest naturally lowers the carbon dioxide content). In order to be able to sell the carbon credits that the forest generates, a functioning market and regulatory system is needed. The USA operates the Climate Action Reserve (CAR), a national programme for managing carbon credits. For one of these forest real estates, Molpus is working to secure a permit to sell carbon

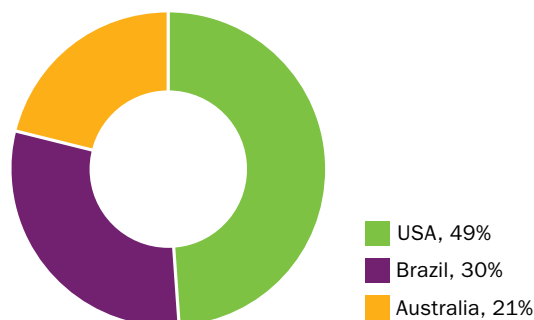
credits and is engaged in a comprehensive process designed to calculate just how much carbon dioxide this particular forest asset can absorb.

The methods employed to calculate the amount of carbon dioxide that can be stored are still under development. New Forests has produced figures stating the number of tons of carbon dioxide stored in the forests it manages. The Fund's share of the total CO₂e stored by these forest assets is around five million tons.

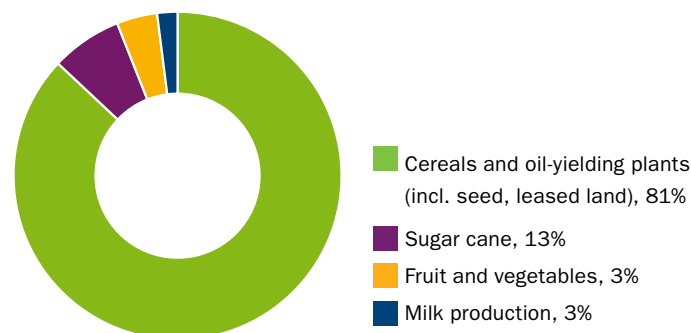
Agricultural real estate

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

Geographic distribution (hectares)



Type of crop (hectares)



All figures as at June 30 2015.

The Second AP Fund's agricultural investments

Investment in agricultural real estate forms part of the Second AP Fund's strategy for diversifying the overall portfolio. As of December 31 2014, 1.7 percent of the Fund's capital assets were invested in agricultural real estate. The Second AP Fund has elected to invest in agricultural real estate by establishing joint ventures with other investors, a form well suited to the Fund's long-term investment approach. The Fund has invested USD 100 million in Teays River and USD 450 million in TIAA-CREF Global Agriculture (TCGA). It has also undertaken to invest USD 750 million in TIAA-CREF Global Agriculture II.

The Second AP Fund's representative on the board of TIAA-CREF Global Agriculture is actively engaged in improving the company's work with sustainability. The Fund's representative is, among other things, a member of the ESG committee. The Board has decided to let an independent firm of auditors review the operations of TIAA-CREF Global Agriculture. During 2014, an audit was initiated of tenant farmer operations on TCGA's agri-

cultural estates in Brazil. The audit will take into account the company's own policies, the PRI's Guidance for Responsible Investment in Farmland, and national legislation.

TIAA-CREF Global Agriculture owns agricultural real estate in Australia, Brazil and the USA, while Teays River invests exclusively in the USA. As of June 30 2015, these two companies had invested in agricultural estate totalling 527 450 hectares. The Second AP Fund's shares of these agricultural estates correspond to an area of farmland covering approximately 95 700 hectares. In a breakdown of the Second AP Fund's total portfolio of agricultural investments, USA accounts for 49 percent, Brazil for 30 percent and Australia for 21 percent. As illustrated in the pie chart on page 13, cereals and oil-yielding plants are the largest crops.

The Second AP Fund cultivates no land. The land is leased either to local farmers/companies or administered by external managers for the joint-venture companies. Where farmland is leased to a tenant farmer, the farmer decides which crop is to be cultivated and is responsible for both its production and sale.

Key performance indicators for PRI's Guidance for Responsible Investment in Farmland, %

Guideline 1 Promoting environmental sustainability

Environmental integrity	Percentage of farmland accurately assessed	100
Chemicals management	Percentage of farmland featuring detailed information on insecticides and fertilizers	83
Soil health	Percentage of farmland subject to regular testing for quality, pH and nutrients	99
Sustainable agricultural practices	Percentage of farmland managed according to research-based techniques such as those featured in Good Agricultural Practices (GAP)	100
Water management (referring to farming that relies on irrigation)	Percentage of farmland featuring detailed data on water consumption	85
	Percentage of these farms that implement water conservation techniques	100
Energy and fuel conservation	Percentage of farmland that employs different approaches to cut energy and fuel consumption	100
Land protection	Percentage of farmland that only uses land previously developed for agricultural purposes	100

Guideline 2 Respecting labour and human rights

Labour compliance	Percentage of tenant farmers/operators that observes national labour legislation	100
Health and safety	Percentage of farms that has permanent crops and has certified health-and-safety programmes	25

Guideline 3 Respecting existing land and resource rights

Ownership and local land rights	Percentage of investments featuring a formal registration of title to land and where an investigation has been conducted to verify previous ownership history	100
	Percentage of agricultural activities operating in compliance with legislation for the protection of native rights	100

Guideline 4 Upholding high business and ethical standards

Investment ethics	Percentage of investment staff to have participated in an annual course in business ethics	(TIAA-CREF) 86 (Teays River) 90
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Guideline 5 Reporting on activities and implementation

See section below

If the farmland features a more permanent form of cultivation, such as an orchard, it is looked after by an agent, appointed by the external manager. The majority of the acreage owned by the joint-venture companies is leased out to tenant farmers. Most of the investments made in Teays River, however, are managed directly by the operative companies.

Reporting on implementation of PRI's Guidance for Responsible Investment in Farmland

In the autumn of 2014, PRI acquired responsibility for administering the Principles for Responsible Investment in Farmland, developed in 2011, in whose development the Second AP Fund was involved. Following their integration into the PRI initiative, these Farmland Principles have evolved into PRI's 'Guidance for Responsible Investment in Farmland'. PRI encourages all signatories with farmland investments to implement the principles stated in its Guidance. One consequence of this integration is that reporting on implementation of the Guidance will not be conducted separately, but will be included in the PRI's normal reporting procedures. To further transparency, the PRI compiles a separate farmland report ('Responsible Investment in Farmland'; www.unpri.org/publications). It is hoped that this will facilitate monitoring and assessment when determining the extent to which individual investors are implementing PRI's Guidance for Responsible Investment in Farmland. PRI's working committee on farmland investment is tasked with monitoring and reviewing the guidelines.

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

The **First Guideline** concerns the need to support environmental sustainability by promoting measures that, for example, reduce the risk of soil erosion and ensure improved water management. The water issue is crucially important, both in environmental and economic terms. One of the managers has stressed the degree of effort involved in securing access to water and what is being done to achieve greater efficiency in water management, citing the construction of water storage tanks and the introduction of more effective irrigation techniques.

A key requirement linked to this principle is the performance of an environmental assessment, before agricultural real estate can be acquired. These assessments are conducted by an external party. The use and storage of insecticides and fertilizers is believed to constitute the greatest risk. In the case of agricultural real estate in the USA, managers emphasize the importance of protecting wetlands and of respecting US water protection legis-

lation. The consultant commissioned to conduct the audit, if required, shall propose measures to reduce the risk of environmental impact. If this audit determines that the agricultural asset features a medium to high risk in terms of environmental impact, the fund manager shall conduct six-monthly checks to ensure that corrective measures are being implemented as planned.

In Brazil, several of the tenant farmers are affiliated to various sustainability initiatives related to different crops, such as Bonsucro (sugar cane), the Round Table on Responsible Soy Association, the Better Cotton Initiative and the Brazilian Responsible Cotton Program.

The **Second Guideline** addresses respect for labour and human rights. In precisely the same way as for the environment, an assessment is conducted by the Fund's managers to determine any risks or impact associated with the operations. This forms an integral part of the evaluation process prior to the acquisition of agricultural real estate. Areas of interest identified by these assessments in Brazil include the need for a safe work environment and living conditions. Audits are conducted at the farms to ensure that conditions are in compliance with national legislation and the managers' own policies. Another area of potential risk is the conditions experienced by migrant and/or seasonal workers.

The **Third Guideline** addresses the use of, and rights of ownership to, land and other natural resources. Such issues are often especially important in developing countries, where systems that determine who is formally entitled to farm and/or own the land may not always exist.

In those countries where the Second AP Fund has agricultural investments (Australia, Brazil and the USA), Brazil is the only one where it can be difficult to determine who is the rightful owner of an agricultural property. For this reason, TIAA-CREF's operators in Brazil conduct thorough research to establish the rightful owners of the land from the present day all the way back to its original sale by the government. Techniques utilized in this process include geo-references (GPS coordinates) and satellite images. The asset manager also engages in a dialogue with representatives from the local community and landowners. Prior to acquisition of an agricultural property in Brazil, the manager will have assured that the investment will have no negative impact on the local environment and that no uncertainties exist concerning the rightful ownership of a property. Since 2000, Brazil has instituted a requirement that, in the case of a transfer of ownership, all properties shall be registered using GPS coordinates.

The **Fourth Guideline** addresses business ethics. Managers and operators shall respect and implement processes that combat all forms of corruption. Laws shall be respected even when weakly implemented. Employees have received training to deal

with corruption issues. Managers shall require employees to observe the legislation and regulations devoted to good business ethics. The majority of managers and operators in the USA have attended courses on American corruption legislation, enshrined in the Foreign Corrupt Practices Act.

No misdemeanours or disputes have been reported in connection with the agricultural investments made by the joint-owned companies in the past year.

The **Fifth Guideline** concerns reporting on activities and implementation of the Guidance for Responsible Investment in Farmland. The Second AP Fund has elected to include this report in its annual Sustainability and Corporate Governance Report. This is now the fourth year that the Fund has reported on its progress in implementing the Guidance.

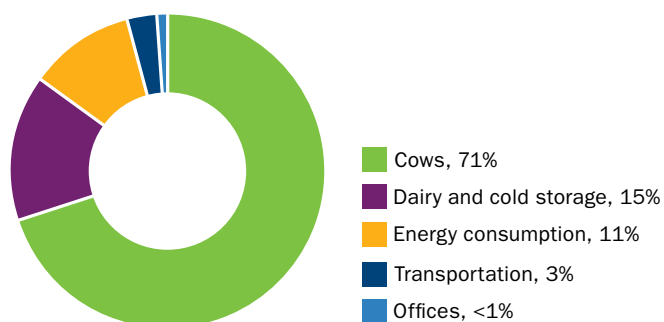
TIAA-CREF's reports on how it has implemented the Guidance may be downloaded from www.tiaa-cref.org

Since 2012, Aurora Organic Dairy, one of Teays River's investments, has published a comprehensive sustainability report, which is available at www.auroraorganic.com/corporate-responsibility/

Climate impact from milk production

One of Teays River's investments is Aurora Organic Dairy, a U.S. producer of organic milk which operates farms in Colorado and Texas, and a processing facility in Colorado. Since 2008, Aurora has been conducting life-cycle analyses covering the entire production chain, from feed cultivation to retail sales. These life-cycle analyses address water quality and waste management, as well as energy consumption and greenhouse emissions.

Carbon (CO₂e) emissions from milk production, %



Integration of sustainability in the investment process

Asset class	Analysis	Implementation 1. Integration in analytical and decision processes	2. In-house monitoring/external reporting
Equities			
Swedish equities	●	●	●
Foreign equities (excl. emerging markets)	●	●	●
Equities emerging markets	●	●↑	●
Fixed income			
Fixed-income securities	●	●↑	●
Fixed-income securities, emerging markets	●	●↑	●
Alternative investments			
Real estate			
Farmland	●	●	●
Forest	●	●	●
Conventional properties	●↑	●	●
Private equity funds	●	●↑	●
Alternative credits	●	●	●
Alternative risk premiums	●	N/A	N/A
Chinese A-shares	●	●↑	●

● Yes

● Partially

● No

↑ Change compared to last year

● Yes
 ● Partially
 ● No
 ↑ Change compared to last year

Analysis – The Fund has conducted a situational analysis and identified viable growth potential.

Implementation:

1. Integration in analytical and decision processes – The Fund's estimate of the extent to which integration has been achieved.

In the case of externally managed assets, sustainability shall form an integral part of the agreements.

2. In-house monitoring/external reporting – Monitoring of the Fund's sustainability measures (incl. external asset managers).

The 2014 life-cycle analysis reveals that manufacturing a litre of milk generates 2.1 kg of CO₂e. This figure comprises the entire chain, from crop cultivation to sale to the consumer. In its efforts to reduce climate impact, Aurora focuses on the links of the chain it can influence directly: crop cultivation, animal husbandry, transportation of milk to the dairy, as well as the dairy process and cold storage. Compared to 2012, emissions in these operations have been cut by 9 percent. The company's goal is to reduce normalized greenhouse emissions by 15 percent by 2017, compared to 2012.

A high proportion of the company's greenhouse emissions are generated directly by the cows. This is primarily a consequence of methane build-up when cows chew the cud, as well as the management of manure. In farming operations, the use of fertilizer and

tillage also contributes to methane and nitrous oxide emissions. Aurora Organic Dairy has developed its own system for gathering emissions data on cows' cud chewing, by registering the cows' ages, what and how much they are eating, and by measuring their lactation cycles. The company also uses additional measures to reduce greenhouse emissions, including using the manure generated in the dairies as fertilizer on Aurora's own farms and composting the manure.

Aurora Organic Dairy is also dedicated to reducing energy consumption and greenhouse emissions from other aspects of its operations, such as its agricultural machinery.

Sustainable investments

The Second AP Fund invests about SEK 11 billion in assets/funds that pursue a business strategy based mainly on sustainability.

Investments featuring sustainable strategies

	Strategy	Asset class
Generation Im Global Equity Fund	Invests in companies based on a sustainable approach	Unit trust
Generation Asia Fund	Invests in companies based on a sustainable approach	Unit trust
Generation Climate solution	Invests in companies based on a sustainable approach	Private equity fund
R/C Pattern Energy Feeder	Invests in renewable energy	Private equity fund
Riverstone Renewable (two funds)	Invests mainly in power production from renewable energy sources	Private equity fund
Khosla Venture (three funds)	Invests in innovations that have a positive impact on social development	Private equity fund
Khosla Venture Seed (two funds)	Invests in innovations that have a positive impact on social development	Private equity fund
International Bank For Recon & Develop	Green bonds	Fixed-income securities
European Investment Bank	Green bonds	Fixed-income securities
African Development Bank	Green bonds	Fixed-income securities
Export-Import Bank of Korea	Green bonds	Fixed-income securities
KFW	Green bonds	Fixed-income securities
Nordic Investment Bank	Green bonds	Fixed-income securities
City of Gothenburg	Green bonds	Fixed-income securities
Agence Francaise Develop	Green bonds	Fixed-income securities
Kommunalbanken As	Green bonds	Fixed-income securities
Asian Development Bank	Green bonds	Fixed-income securities
Stockholms Läns Landsting	Green bonds	Fixed-income securities
NRW Bank	Green bonds	Fixed-income securities
Region of Ile De France	Green bonds	Fixed-income securities
Nederlandse Waterschapsbank N.V.	Green bonds	Fixed-income securities
Bank Nederlandse Gemeenten N.V.	Green bonds	Fixed-income securities
Rikshem AB	Green bonds	Fixed-income securities
Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V.	Green bonds	Fixed-income securities
Ontario Province, Canada	Green bonds	Fixed-income securities
Inter-American Development Bank	Social bonds	Fixed-income securities
ICO - Instituto de Credito Pfcial	Social bonds	Fixed-income securities
Molpus Woodlands Fund	Forest assets	Real estate
New Forests Australia New Zealand Forest Fund	Forest assets	Real estate
New Forests Australia New Zealand Forest Fund II	Forest assets	Real estate
TIAA-CREF Global Timber	Forest assets	Real estate

Climate



Climate issues – and climate change in particular – present enormous risks, as well as opportunities, for long-term investors like the Second AP Fund. Climate change is expected to have a major impact on long-term investment. The Second AP Fund is engaged in an ongoing project of fossil energy and financially-related climate risks and, during the year, among other things, this has resulted in a decision to no longer invest in 20 energy companies. During spring, the Fund was ranked eleventh in the world among investors according to how well they manage climate risk in the portfolio.

The portfolio's carbon footprint

As early as 2009, the Second AP Fund conducted an extensive project to analyse its portfolio's carbon footprint. By gathering data from all the companies in the portfolio, based on its holdings in each company, it was possible to calculate the total carbon emissions generated by its combined holdings. For the Fund this analysis contributed to a more profound understanding of the cost of carbon emissions. If companies are forced to pay for their emissions, this will impact on their profits and cash flow. The market value of these companies will be affected by the impact such costs may have on future profits.

In 2014, the Second AP Fund once again analysed and calculated the portfolio's carbon footprint. The Fund's equity holdings represented 2 04 000 tCO₂e, which approximates to 17 tCO₂e per million Swedish kronor in invested assets. This analysis is based on data from MSCI pertaining to the carbon emissions released by portfolio companies in 2013. The Fund has decided to use data detailing the companies' direct emissions and indirect emissions from purchased energy (Scope 1 and 2 according to Greenhouse Gas Protocol, www.ghgprotocol.org). The cal-

culated carbon footprint has been based on the Fund's participating interest in portfolio companies as of December 31, 2014.

Since no established standards yet exist for calculating carbon footprints, there are considerable discrepancies in the way fund managers choose to calculate and present such footprints. Such discrepancies also arise because estimates have to be made about non-reporting companies, while no data at all is available from others. There are also challenges associated with the risk of doubling-up emissions, as when those from energy companies are calculated twice: as direct emissions generated by the energy company and as indirect emissions for the company purchasing the electricity. Another aspect is whether responsibility for carbon emissions should be assigned exclusively to its equity holdings or should also be offset against its liabilities.

During 2015, the Fund has been instrumental in promoting standardization of the way in which the carbon footprint should be calculated by investors. To this end, the Fund has participated in a number of seminars/workshops where this issue has been discussed. The First, Second, Third and Fourth AP Funds will report using the same method of calculation for 2015.

Second AP Fund's carbon footprint as of December 31, 2014

	Companies' emissions of greenhouse gases (Scope 1 and 2)				Carbon intensity in relation to companies' turnover			
	(tCO ₂ e) ¹	Adjusted for companies' debt ² (tCO ₂ e)	Amount of capital for which data is available (%)	Market value of Fund portfolio for which CO ₂ e data is available (SEK m, Dec 31, 2014)	Based on portfolio weight (tCO ₂ e/USD m) ³	Based on Fund's participation right (tCO ₂ e/USD m) ⁴	Based on Fund's participation right, debt-adjusted emissions (tCO ₂ e/USD m) ⁴	Carbon intensity in relation to the Fund's investment based on participation right, debt-adjusted emissions (tCO ₂ e/SEK m) ⁵
AP2 portfolio of listed equities	3 621 000	2 204 000	92.82	127 562	226	243	199	17.28
MSCI All Country World Index					208	237	198	14.86

¹ CO₂e (carbon equivalent) is a unit of measure that enables a comparison between the climate impact of different greenhouse gases.

² The company's emissions multiplied by the ratio 'market value/enterprise value'.

³ The sum of portfolio weightings multiplied by the ratio 'corporate carbon emissions/turnover'.

⁴ The sum of the Fund's share of portfolio-company emissions, divided by the sum of the Fund's share of these companies' turnover.

⁵ The sum of the Fund's share of its portfolio-company emissions, divided by the total market value of the Fund's holdings in listed equities.

Source: MSCI ESG Research/The Second AP Fund

The table on page 19 presents the carbon footprint for the Second AP Fund's portfolio of listed equities, both when companies' total carbon emissions are assigned exclusively to the equity holding and when dispersed between equities and liabilities. The Fund has elected to employ different ratios in reporting the portfolio's carbon intensity to show the complexity of calculating carbon intensity.

The Second AP Fund hopes eventually to be able to present a carbon footprint that comprises all asset classes. The Fund has initiated a dialogue with fund managers about the feasibility of calculating carbon storage and carbon emissions. New Forests, one of the Fund's asset managers focused on timberland investment, has calculated the total carbon stock for its forest assets. The Second AP Fund's share is 5 147 601 tCO₂e. However, this figure relates to the amount of carbon stored in the trees, not the amount absorbed during a year. The Fund has also invested in green bonds that finance projects which, among other things, help cut carbon emissions.

Over several years now, through its membership of the CDP (Carbon Disclosure Project), the Second AP Fund has required the world's largest publicly quoted companies to report on their greenhouse emissions and other related data on how they are tackling the challenge of climate change. The Second AP Fund is keen to see that companies improve their climate reporting, given its realization of the importance of measuring and managing climate-related risks and opportunities. Consequently, during 2015, the Fund has participated in an initiative launched by the CDP and, in association with 13 other investors, has written a joint letter to some 100 Nordic companies, asking them to submit reports on their greenhouse emissions to the CDP.

Financial climate risks

Since the autumn of 2013, the Second AP Fund has had an in-house working committee dedicated to addressing questions relating to fossil energy and climate change. The committee started by establishing the Fund's position on investment in fossil energy and by analysing the financial climate risks posed by coal and energy companies. In October 2014, as a result of this analysis, the Fund decided to terminate investment in a total of 20 energy companies, 12 of which were involved in coal production.

Some 40 percent of global electricity generation is based on coal, the form of energy that is the worst pollutant, both in terms of climate and human health. Emissions from carbon-based electricity generation account for approximately a third of global greenhouse emissions. This means that the sector is in the spotlight for climate regulations throughout the world. For this reason, over the past year, work on determining the climate

risks associated with the Fund's holdings has focused on the energy sector, with the emphasis on companies that produce, transmit, distribute and/or sell electricity. A key aspect of this process is to assess whether the climate risks faced by the companies have been factored into their market worth.

In electricity generation, balance between production and consumption is essential. Furthermore, the energy sector is often subject to official regulation, in light of the fact that it provides services vital to economic and social development. Consequently, in its analysis, the Fund must also consider what regions these companies operate in. The amount of renewable energy available is growing and becoming increasingly competitive around the world. On some markets, there is a move towards more decentralized production, as when consumers install their own solar panels. The Fund's working committee will present its analysis in autumn 2015.

Shareholders' proposals at the BP, Shell and Statoil AGMs

In the spring, in partnership with a large number of other investors, the Second AP Fund presented a shareholder proposal at BP's and Shell's AGMs. Together with the Fourth AP Fund, the Fund also tabled a similar proposal at Statoil's AGM. The proposal addressed the idea that companies should expand reporting on their greenhouse emissions, the assessment of project portfolios in terms of relevant post-2035 scenarios, their plans regarding research and development into low-carbon energy solutions and how they intend to integrate sustainability as part of their strategic key performance indicators and bonus systems.

The boards of all the above-mentioned companies recommended shareholders to support the proposal. At the Statoil AGM, it gained the support of 99.95 percent of participants, while the figures for the Shell and BP AGMs were 98.9 and 98.28 percent respectively.

Also during the spring, in a joint appeal with 18 other investors, the Fund wrote to Shell, challenging it to resign from industry organizations in Europe and the USA that are sceptical about the threat of climate change and who lobby against the company's own goal of lower carbon emissions.

No 11 in the world for climate-risk management

In the spring, the index published by the Asset Owners Disclosure Project, which rates the world's 500 largest investors according to how well they manage climate risk in the portfolio, ranked the Fund eleventh in the world.

Corporate governance



The AGM is the main forum where shareholders can exert their influence. As a shareholder, the ability to exercise one's voting right at the AGM offers the best way to influence a company – which is why the Second AP Fund is active at both Swedish and foreign AGMs.

A considerable portion of the Second AP Fund's capital is invested in Swedish and foreign equities, making the Fund a significant shareholder. The Fund is also non-political and independent, both in terms of ownership and of its special status among Swedish agencies regulated by law, allowing it to act as a committed and long-term investor.

Shareholder commitment and interest in a company's long-term development is a crucial requirement for better value growth. As a long-term investor, the Second AP Fund fulfils an important function on the world's capital markets. Conse-

” The Second AP Fund has maintained its focus on remuneration issues and engaged in dialogues with boards, concerning the formulation of incentive programmes to promote improvements.

quently, the Fund is actively engaged in promoting good corporate governance, high ethical standards and an enlightened environmental approach, as well as best practice within asset management. In its contacts with publicly quoted companies, the Second AP Fund is active in the run-up to and during Swedish and foreign AGMs, as well as engaging in dialogue with the boards and executive managements of its portfolio companies.

In Sweden, the Second AP Fund works mainly with companies in which it is one of the largest shareholders or in which it has

invested the most capital. In the case of companies outside Sweden, the Fund mainly addresses ethical and environmental issues via the Ethical Council. Other shareholder issues of special interest to the Fund, when related to foreign companies, are handled in collaboration with selected partners.

The Second AP Fund also promotes good corporate governance by collaborating with other investors on matters of principle and through active participation in the development of policies, regulations and standards.

Corporate governance in Swedish companies *Swedish AGMs*

The Fund has holdings in some 140 Swedish companies. It has decided that it is impractical to attempt to attend and vote at the AGMs of all the companies represented in its portfolio of Swedish equities. In determining which AGMs to attend, the Fund employs the following criteria:

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

The Second AP Fund exercised its voting rights at a total of 48 AGMs of Swedish publicly quoted companies during the period 2014/2015. The Second AP Fund and other institutional investors have for many years enjoyed a positive and constructive dialogue with Swedish publicly quoted companies, which have included discussions about many of the issues raised at AGMs.

Nevertheless, the Second AP Fund voted against the election of Anders Nyrén to the board of SCA, in the conviction that, if the company was to be able to focus on the right priorities and restore trust, this would best be achieved without those individuals who had been connected with criticized 'business' trips, representation and so on. In connection with the same company, the Fund also put forward the view that retaining the same

chief auditor was inappropriate, given the need to demonstrate independence and restore faith in the company. The Fund therefore asked the nomination committee and board to reconsider the suitability of this choice.

Issues in focus

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

During this year's AGM season, the Fund has placed special emphasis on diversity and, in particular, on the percentage of women on corporate boards. The Fund has both questioned companies' nomination committees before their AGMs, as well as commenting at AGMs. Read about the Second AP Fund's annual Female Index at www.ap2.se

In the run-up to the AGM season, the Fund has also written letters to nomination committees in Swedish companies with a view to encouraging them to better motivate their nominations. The Fund has followed up on this by expressing its dissatisfaction with poorly motivated nominations on several AGMs.

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. The Fund's governance committee decides who is to represent it, based on whoever is best qualified for the task. Since nomination committees usually consist of the three to

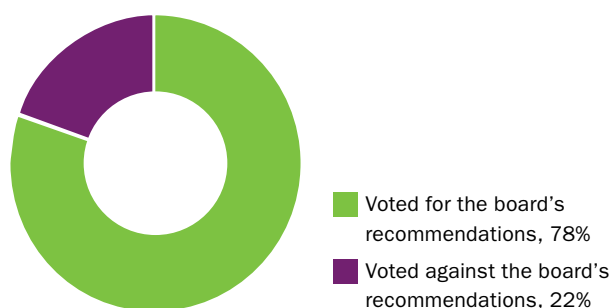
Nomination committees in which the Second AP Fund participated during the period 2014/2015

Company	Women on board, %	No. of newly elected women	Total change as per previous year
Opus Group	20	1	0
Kungsleden	57	0	0
Tele2	38	0	0
FormPipe	40	0	0
Flexenclosure	16	0	0
Midsona	43	2	2

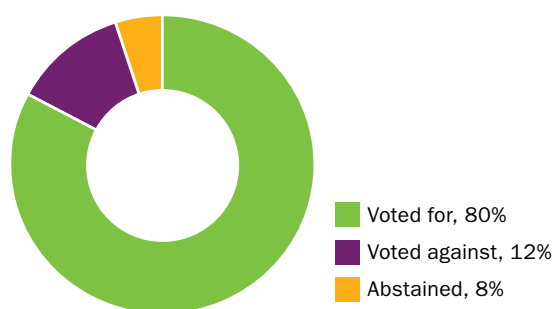
five largest shareholders in a company, the Fund's nomination assignment varies, depending on the size of its holding.

Prior to the start of the 2015 AGM season, the Second AP Fund was represented on the nomination committees of Opus Group, as chair, as well as on those of Kungsleden, Tele2, FormPipe, Flexenclosure and Midsona.

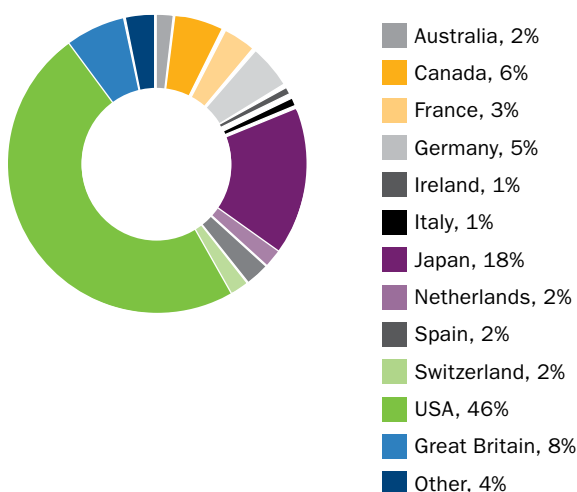
Voting in foreign companies 2015



Voting agenda items, July 1 2014 – June 30 2015



Voting per market, July 1 2014 – June 30 2015



Board and investor proposals that the Second AP Fund voted on in foreign companies, July 1 2014 – June 30 2015, number

Area addressed	Board proposal	Investor proposal
Auditors, financial reporting, formalia etc.	1 290	0
Board	6 820	28
Remuneration issues	963	70
Capital structure	496	7
Group structure, agreements, acquisitions etc.	133	0
Shareholder rights/governance	106	240
Sustainability	1	100
Other	0	44
Total	9 809	489

Voting at foreign AGMs, July 1 2014 – June 30 2015

	Number
No. of AGMs	738
Agenda items	10 298
Voted against board's recommendations	2 247

Corporate governance in foreign companies

Foreign AGMs

Since 2008, to improve the governance of its foreign investments, and in cooperation with the First, Third and Fourth AP Funds, the Second AP Fund has operated a joint electronic voting platform, based on the AP funds' governance policies. Most issues are managed automatically via the voting platform, with the exception of matters such as remuneration issues, which are forwarded to the funds for individual assessment. Each fund decides individually as to how it will vote.

On foreign markets the Fund mainly votes in the following eleven countries: Australia, Canada, France, Germany, Great Britain, Italy, Japan, the Netherlands, Spain, Switzerland and the USA. The criteria for determining the companies in which the Fund should exercise its voting rights derive mainly from the MSCI global index. There are other criteria too, such as when the Fund is engaged in a dialogue on a specific issue with a company and/or when the Fund has submitted a shareholder proposal for consideration by the AGM.

During 2014/2015, the Second AP Fund exercised its vote at 738 foreign AGMs, a 65 percent increase on the preceding year. The Fund employs an external party for the practical voting process and submits a written vote (proxy voting) using the electronic voting platform.

Letters to foreign companies

In collaboration with other international investors, the Fund has engaged in several dialogues on governance with companies during the report period. For instance, in conjunction with other investors, the Fund wrote jointly to Toyota's chairman to induce him and the board to withdraw a proposal to issue shares which would effectively restrict voting rights to Japanese investors.

The Fund has also participated in other initiatives relating to corporate governance in Japan. These have included writing to a large number of companies, urging them to improve their governance models. More about this on page 31.

During 2014/2015, for the third year in succession, to further improve communication with its foreign portfolio companies, the Second AP Fund has written to some 50 of these companies, clarifying the Fund's views on active governance and the importance of exercising voting rights. In these letters, the Fund has also explained why it was unable to support the recommendations of the boards on specific proposals. In several cases, these letters have resulted in further contact with the companies in question, sometimes by letter but also in the form of teleconferences. Further details of how the Second AP Fund voted on specific issues may be found at www.ap2.se/en/corporate-governance-/corporate-governance-reports/

For more about the Second AP Fund's involvement in presenting shareholder proposals at the Shell, BP and Statoil AGMs, turn to page 20.

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A man and a woman in business attire are looking at a folder together. The woman, on the left, has long dark hair and is smiling slightly. The man, on the right, has short dark hair and a beard, and is looking down at the folder. They are both wearing light blue shirts and dark jackets. The folder is brown and open, showing some papers. The background is a plain, light blue wall.

Dialogue is the
main tool

As an active asset owner and manager of capital, dialogue is a vital tool, both in relation to companies and to society at large. The Second AP Fund engages in regular dialogues with its fund managers, as well as Swedish and foreign companies, concerning the environment, ethics and corporate governance.

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

The Ethical Council

Dialogues with foreign companies are coordinated through the AP funds' joint Ethical Council. The Ethical Council is a collaboration between the First, Second, Third and Fourth AP Funds, which was launched in 2007. The companies with which the Ethical Council conducts dialogues are identified primarily in conjunction with the Fund's biannual screening of its total shareholdings, with a view to determining whether any portfolio company is in contravention of an international convention. This screening is conducted by an external consultant. This work is based on the principles of commitment, action and change, with the intention of making a difference. The Ethical Council identifies companies that can be linked to breach of conventions and focuses on persuading such companies to deal with confirmed breaches and to implement systems and measures to preclude future violations. Dialogue is a vital tool in enabling the Ethical Council to influence corporate behaviour. When companies in which the Fund has invested can be linked to the breach of an international convention, the Fund's core strategy is to exert its influence as an investor to ensure that such violations cease, that systems designed to prevent any recurrence are implemented – and that measures are taken to prevent any future violations. Through its commitment and by deploying its power as a major investor in reacting to breach of international conventions, as well as demanding change, the Fund can make a difference. Only in cases where this cannot be achieved the Fund will consider excluding its holdings in the company.

During 2014, the Ethical Council engaged in preventive and reactive investor dialogues with 300 companies around the globe.

More on this at www.ethicalcouncil.com

Collaboration with other investors

In addition to cooperating with its fellow AP funds through the Ethical Council, the Second AP Fund also collaborates with other

Swedish and foreign investors. During the year, the Fund has also exchanged ideas with Generation Investment Management and a number of others within the Fund's network about integrating environmental, ethical and corporate governance aspects into asset management.

The Second AP Fund is also a member of and actively supports various Swedish and international initiatives focused on the environment, ethics and corporate governance. The Fund also collaborates with other investors on influencing new legislation, mainly within the field of corporate governance. These forms of collaboration are becoming increasingly important as a means to influence and effect change, and thereby improve share value over the long term.

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

Collaboration on the climate issue

Through its membership of the IIGCC (Institutional Investors Group on Climate Change), the Fund collaborates with other European investors on climate issues. The idea is to make the voice of investors heard in the climate debate and to make companies, government agencies and other investors aware of the long-term risks and opportunities associated with climate change. The climate issue is important to the Second AP Fund as a long-term investor. At present, there is considerable uncertainty about the future regulations and framework for reducing the emission of greenhouse gases and stimulating alternative energy sources. This makes it difficult for companies to make profitable investments and for investors to calculate the potential risks and returns. The IIGCC provides an effective platform for communicating investors' wishes concerning climate issues. It is also a good way for the Fund to acquire the latest information on climate related investments. More at www.iigcc.org

Further details of the Second AP Fund's memberships and initiatives may be found at www.ap2.se/en

Reporting/transparency

To ensure the smooth operation of a financial market, it is crucially important that the data supplied to shareholders and other interested parties is high quality. Only through transparency and openness can investors form a relevant impression of a company's situation and thereby have a basis for as accurate an assessment of its worth as is possible. In accord with the EU directive, the Fund also believes that corporate annual reports should cover environmental, social and personnel related issues, as well as those involving human rights and corruption. Transparency and open reporting ensure investors acquire a better grasp of the risk and profit profile of the individual company.

” For several years, the Fund has driven and supported various projects dedicated to improving transparency and the quality of reporting.

For several years, the Fund has driven and supported various projects dedicated to improving transparency and the quality of reporting. Examples are the PRI and its Guidance for Responsible Investment in Farmland. In collaboration with the private equity industry in eleven countries, the Fund has also been involved in the joint development of a framework that investors can employ when requiring companies to provide better reports. The Second AP Fund has addressed these issues in its evaluation of private equity funds.

Transparency in the oil industry

The EITI (Extractive Industries Transparency Initiative) 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. Clear and open 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. Read more at www.eiti.org

Second AP Fund reports

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

Excluded companies

If the Second AP Fund has reason to suspect that any of the companies in which it has invested is acting systematically and seriously in contradiction of an international convention to which Sweden subscribes, or to which it has expressed an intention of subscribing, the facts shall be investigated. This investigation shall include a dialogue with the company in question. If the Fund's suspicions are confirmed, the company will be asked to provide an explanation and to draft an action plan. In evaluating the situation, the Fund shall consider the nature of the contravention and any action that may have been taken (or that may be planned), to ensure that a contravention of this type is not repeated. If contact with the company fails to yield a satisfactory response, the Second AP Fund shall determine whether the company is to be excluded from its investment universe, subsequent to a general assessment. The Second AP Fund may also decide to exclude a company if the Fund considers the circumstances to be so serious as to make exclusion unavoidable, even where no convention has or can be proved to have been contravened.

Effective 2014, the Ethical Council has introduced a four-year time limit for reactive dialogues conducted with companies where convention violations have been verified by external experts. If the objective of the dialogue has not been attained within four years, the Ethical Council recommends that the AP funds dispose of their holdings in the company.

The Second AP Fund has decided to exclude fourteen companies that are in breach of international conventions and where dialogue with these same companies has led to no improvements.

Excluded companies

Company	Year excluded	Country	Violation
Agrium	2014	Canada	Can be linked to breach of UN's International Covenant on Civil and Political Rights and International Covenant on Economic, Social and Cultural Rights
Barrick Gold	2014	USA	Can be linked to breach of UN Convention on Biological Diversity
Freeport McMoran Copper & Gold Inc.	2013	USA	Can be linked to breach of UN Convention on Biological Diversity
Elbit Systems Ltd	2010	Israel	Can be linked to breach of international human rights in contravention of the Fourth Geneva Convention
Hanwha Corporation	2008	South Korea	Can be linked to breach of Convention on Cluster Munitions
Incitec Pivot Ltd	2013	Australia	Can be linked to breach of UN's International Covenant on Civil and Political Rights and International Covenant on Economic, Social and Cultural Rights
L-3 Communications Holdings, Inc.	2008	USA	Can be linked to breach of Convention on Cluster Munitions
Motorola Solutions	2015	USA	Can be linked to breach of international human rights in contravention of the Fourth Geneva Convention
Orbital/Alliant Techsystems Inc.	2008	USA	Can be linked to breach of Convention on Cluster Munitions
Poongsan Corporation	2008	South Korea	Can be linked to breach of Convention on Cluster Munitions
PotashCorp	2013	Canada	Can be linked to breach of UN's International Covenant on Civil and Political Rights and International Covenant on Economic, Social and Cultural Rights
Singapore Technologies Engineering	2001	Singapore	Can be linked to breach of Ottawa Anti-Personnel Mine Ban Convention
Textron Inc.	2008	USA	Can be linked to breach of Convention on Cluster Munitions
Walmart	2006	USA	Can be linked to breach of human rights

The world around us



Active on governance issues in Japan

In April 2015, the RI (Responsible Investors) ASIA 2015 conference was held in Tokyo. On the agenda was the topic of Japanese corporate governance and the transformation it is experiencing at present. One of the invited participants was the Second AP Fund's General Counsel, Martin Jonasson.

Text: Lars Mattsson

"The Second AP Fund has substantial holdings in Japanese equities. This is why we should take a keen interest in these matters – both by networking and in direct dialogue with our portfolio companies, the Tokyo Stock Exchange and other policy makers," says Martin Jonasson.

Right now, the interest in governance issues in Japan is considerable.

"A 'stewardship code' and a corporate governance code have both been developed in a very short time. My impression is that many are surprised at the energy with which these codes have been implemented. As international investors, we must benefit from the momentum generated and employ it in an attempt to steer development in what we believe to be a desirable direction," notes Martin Jonasson.

Initiative for growth

The background to these changes is the fact that the Japanese economy has been marking time for the past twenty years, even though the product portfolios of the country's extremely large multinationals generate a never-ending stream of export successes. The diagnosis reached by Prime Minister Shinzo Abe and his advisors highlights inadequate corporate governance as a fundamental weakness. The need to deal with the problem has been assigned top priority.

One example of the nature of these deficiencies in governance is the way the boards of Japanese companies are structured. There is a range of different models. Boards numbering close to 20 directors are not uncommon, featuring an internal distribution of responsibilities that can be difficult for an outsider to understand. Furthermore, external and independent directors are a rarity.

"One reason for this is the anxiety that the recruitment of board members from outside the company may be interpreted as a sign of weakness – that one's own organization lacks the necessary competence," comments Martin Jonasson.

This situation is slowly but steadily changing. The Second AP Fund is actively engaged in this issue, in dialogue with its portfolio companies.

Dialogue for gradual change

"It is important to be respectful when conducting this dialogue, but it is also important to be concrete. We cannot expect to fly in from Sweden, attend a few meetings and then, we have a new governance model. Instead of demanding a radical transformation, we promote the idea that at least a third of the companies' boards should consist of independent directors. We also want to focus more on how control of the companies is structured. This means that the boards should devote more attention to strategic considerations and acting as a support to executive management," states Martin Jonasson.

Another weakness of Japanese governance is an historic aversion to distributing liquid assets to shareholders, which means that balance sheets grow or, in the worst-case scenario, that the money is used to keep faltering businesses viable. This has contributed to ensuring that companies' return on equity is low, when seen from an international perspective. Ultimately, this has an impact on the share price, which influences investors like the Second AP Fund. This is why it is so important to push for a change, according to Martin Jonasson.

"As well as helping protect the value of our investments, this dialogue enables us to see our own model in a more objective light. There is still plenty of room for improvement here in Sweden. Some of the proposals put forward in Japan could prove useful to us too," concludes Martin Jonasson.

Game-changing women

– Companies with women directors tend to improve in performance

There has been lots of media coverage on the need to have more women on company boards, but there has been little headway on it. Indeed, the Corston-Smith Asean-5 Gender Diversity Study shows that more than half of the companies listed on Bursa Malaysia and the Jakarta Stock Exchange still do not have a single woman director.

The study, which covers 3,054 companies in Corston-Smith's universe, was done over 13 years, that is, from 1998 to 2010. All in all, it covers the top 75% of all listed companies in five major Asean countries, namely Malaysia, Indonesia, Singapore, Thailand and the Philippines. Among them, only Singapore - despite its small size - has improved slightly, with just under 50% of all its companies surveyed without any female representation.

The participation of women on boards is dismal and it shows that the region's women today are still hitting the glass ceiling despite more of them being better educated. Statistics from the United Nations (UN) showed that the number of South-East Asian women who make it to universities ranges between 48% and 56%. Women in the Philippines, for example, have over 57% among their working women in decision-making positions, and its university enrolment rate is 54%.

But while Malaysia has a slightly higher enrolment rate than that, that is, 56%, only 25% of working Malaysian women are decisionmakers, according to the same UN figures.

In all, the percentage of women directors within Corston-Smith's universe of companies is only 10% for the Philippines; 9.6% for Thailand; 8.2% for Indonesia; 7.1% for Malaysia and 6.2% for Singapore.

When reviewing the impact of women's participation in public listed companies, we performed a regression analysis to examine the association between the percentage of women on boards with the performance of the company. The performance indicators that we reviewed were revenue, market capitalisation, earnings per share, net profit, return on equity (ROE) and return on assets.

Interestingly, the regression analysis showed that all six variables are positively correlated with female representation on boards for both Malaysia and the Philippines. Most notably, for

every 1 percentage point increase of women on boards resulted in an increase in ROE by +2.26% for Malaysia, and by +1.41% for the Philippines. All five countries showed a positive correlation between revenue and women on boards. That is, for every one per cent increase in the percentage of women on Boards will increase revenue between 0.12% (Thailand), 0.14% (Indonesia and the Philippines), and 0.16% (Malaysia and Singapore).

We then went a step further and looked at those companies that had 3 or more women directors on their boards. Although the sample size is much smaller, (as there are very few companies in the region that have three or more women on their boards), the analysis showed better results. The regression models showed higher coefficients than our earlier survey of at least one woman on boards; this indicates that three or more women on board further improve the performance of the company.

Similar results have been reported in companies beyond Asean. There is now clear financial proof that women directors contribute positively to effectiveness of a company's performance.

Already, many such studies around the world have resulted in a wave of reforms to include women on boards. Resistance to the status quo of all-male boards is natural but, happily, even that is changing in Asean, albeit rather more slowly than in, say, the Scandinavian countries such as Denmark, Finland and Sweden.

In Malaysia, the target of 30% women on corporate boards by 2016 was announced in July last year. Since the announcement, we have seen the formation of a women director's registry, as well as government funding for training of women directors. In Prime Minister Datuk Seri Najib Tun Razak's recent budget (on 28th September 2012), RM50mil has been allocated, among other things, to train 500 women directors.

According to our universe, this is equivalent to doubling the number of existing directors in the top public listed companies. This new supply of directors is expected to address any demand issues that companies require to meet the new 30% target.

All this is positive but the most progressive move we have seen is that various GLCs (government linked companies) are putting women from their senior management positions onto their unlisted company boards, to get these women “board ready” for their main public listed companies. This is a very proactive way of training individuals to be ready for their roles on the main company’s board, as well as hopefully into the various C-suite (chief executive level) positions.

What we would like to see, however, is more of a buy in from the chairmen and CEOs of the Malaysian public limited companies. They all seem to accept that women directors do add value to board meetings and to companies’ performance, but that is as far as they will go for now.

We also don’t see many companies list out what skill sets they are looking for, and if they are actually looking for women directors with that specific skill set to join and add value to their companies’ boards. We urge these companies to articulate clearly their criteria for women directors to the investing public.

Some argue that the influx of women on corporate boards would displace older board members altogether. We do not agree that a member of the board should be retired only because he is more senior than the other members. We strongly believe that strong personalities and having someone with the “corporate memory” is extremely important and valuable for continuity. What we do suggest is that if people have been serving for a long time, they need to change their roles from being independent to non-independent.

We maintain our view that this whole exercise of including women directors is about broadening your talent search for better board members and ultimately demanding better corporate performance. We would like to see more chairpersons and CEOs speak out and support gender diversity, as it is obvious that this is purely a business case that gets better results and is about being more competitive.

Shireen Muhiudeen is the founder, managing director of Corston-Smith Asset Management in Malaysia, a fund management company that makes investment decisions based on corporate governance. She has been ranked among the most influential asset managers in the Asia-Pacific region and has published a book called *Governance Matters*. In recognition of her work in the industry, she was named one of the 25 most influential women in the Asia-Pacific region for asset management by *Asian Investor*, a regional publication, in June 2011 and in March 2014, she was honoured by *Forbes Asia* as one of the 50 Asia’s Power Businesswomen 2014.

Shireen Muhiudeen accepts speaking engagements whenever she can to reinforce her commitments, writes articles and is a frequent commentator on global finance in media.



Shireen Muhiudeen

A success spelled Green Bonds

In 2008 the first bond ever labeled as a 'Green Bond' was issued by the World Bank, with the Second AP Fund as one of the initiating investors. Since then, a global market for green bonds has evolved, with over USD 80 billion in gross issuance. The Second AP Fund has interviewed Heike Reichelt, head of investor relations and new products at the World Bank, who explains the main reasons behind the success.

Text: Lars Mattsson

But to start with, let's get a picture of what green bonds actually are. In brief, green bonds are a fixed income product that helps mobilize private capital for climate projects.

"Today, international institutional investors have trillions of USD under management and are developing strategies that explicitly assess climate risks and opportunities in different asset classes", says Heike Reichelt and explains that green bonds were developed to meet demand from institutional investors looking for investment options for their fixed income portfolios.

A closer link between source and purpose

A back-to-back comparison between 'ordinary' bonds and their green siblings shows no differences when it comes to financial aspects. The credit quality of World Bank green bonds is identical to other World Bank bonds (AAA/Aaa), and investors are not taking specific country or project risk.

The main difference derives into eligible investment projects and a transparent process for reporting. This provides a closer link between the source of funds from the investors, and the environmental and social purpose of the investments they support.

"Investors can show their stakeholders, that they are making financially sound investments, and also supporting these climate activities through their investments", clarifies Heike Reichelt.

An urgent matter

"Climate change affects all of us – not just vulnerable parts of the population and those living in developing countries that the World Bank serves. But they are the ones who are hit hardest. They feel the effects of extreme and volatile weather patterns most, including food shortages and higher food prices when crops are affected by droughts and flooding."

According to Heike Reichelt, this development will only get worse – and by how much depends on what the world does to

support climate-smart investments and change incentives. That's key to finding a global climate solution and a cleaner, safer and healthier planet for everyone.

This is where Green Bonds fit in, by mobilizing private sector financing for climate activities.

"And there's an important signaling effect as well: the fact that there are investors out there looking for these types of investment products and asking for detailed metrics on environmental performance will change incentives".

Proceeds are earmarked for eligible green projects

The World Bank's green bond proceeds are earmarked to support only eligible green projects. They undergo a rigorous review and approval process including early screening to identify environmental and social impacts and designing concrete mitigation actions.

The progress, outcomes and impacts of projects are monitored throughout implementation and the ultimate effectiveness of all projects is evaluated in terms of the objectives they were set to achieve.

Personal favorite project so far

By June 30, 2015, the World Bank had 77 green bond eligible projects supported by green bond proceeds. The total committed amount for these projects is USD 13.7 billion.

"My favorite project is an eco-farming project in China, where methane gas generated from animal waste on rural farms is used to provide gas for light, cooking and heating in homes. The project has many benefits, but in terms of greenhouse gas metrics, the expected savings are about one million tons of CO₂e per year, which is equivalent to taking 210,000 passenger cars off the road", says Heike Reichelt.

One other example is a project in Mexico on efficient lighting and appliances and one in Colombia to modernize the bus system.

World Bank in brief

The World Bank, rated Aaa/AAA by Moody's/S&P, is an international organization that was founded in 1944. It functions as a global development cooperative, owned jointly by 188 countries. The World Bank offers its members funding, expertise and project coordination support, to enable them to achieve equitable and sustainable economic growth in their national economies, and to develop effective solutions to pressing regional and global, economic and environmental problems. The World Bank has been issuing bonds on the international credit markets for over 65 years, to fund its sustainable development initiatives and to make a positive impact.



Heike Reichelt

“The Colombia project will massively improve efficiency and safety of riding a bus in Colombia, and improve air quality, in addition to reducing greenhouse gas emissions”, says Heike Reichelt.

Growing number of investors and issuers

For a market to succeed, one of course need demand from investors. Since the AP funds and other Scandinavian investors first asked for green bonds, many more investors have joined the green bond market – across Asia, Europe and North America – and appreciate having different issuers to choose from.

Although recognized as the first issuer of the ‘green bond’ that has been used as a model and replicated by others, World Bank is far from being alone in the market these days. The World Bank is still a leader with over 100 green bond transactions in 18 currencies and a total issuance of about USD 8.5 billion between 2008 and June 2015.

Among other issuers, there are other multilateral development banks, energy and utility companies, large industrial corporations and banks as well as governmental bodies and local organizations – and the European Investment Bank (EIB). It is also considered to be a pioneer together with the World Bank in the field of green bonds.

Playing a crucial role

The World Bank has been playing a crucial role in building the green bond market, by setting the foundation and acting as a catalyst through a transparent process. This means that investors

have high quality, tradable fixed income products that meet their financial needs and support climate actions. At the same time issuers can broaden their investor base and raise additional financing, while creating awareness when it comes to green projects according to Heike Reichelt.

“From our point of view, the total volumes aren’t as relevant as the diversification of issuers and the incredible amount of dialogue among capital market participants that the green bond market has generated, leading to a better understanding of and need for climate finance”.

She underlines investors’ huge importance for the market development: “As a matter of fact, the first green bonds were developed in response to specific requests and in close collaboration with Scandinavian pension funds, like the Second AP Fund and SEB – all in line with our demand-driven strategy”.

Bright future for green bonds

According to Heike Reichelt, the prospects for green bonds are good. And more important: This will lead to positive effects when it comes to the global climate, and investing in projects that benefit society in general.

“The interest this market has sparked has helped changing how investors think about their investments and how issuers think about the projects they are financing. As long as investors continue to ask questions about the expected social and environmental impact of their investments, issuers – especially corporates – will change their behavior, step by step”, concludes Heike Reichelt.

Sharp increase of green bonds in portfolio

At the close of the first half 2015, the Second AP Fund held green bonds to a value of SEK 3.4 billion in its portfolio. This marks an increase of almost 80 percent on the previous year.

Text: Lars Mattsson

"Investing in green bonds is a way for the Second AP Fund to implement sustainability issues within asset class fixed-income securities. We firmly believe that long-term value is created by integrating sustainability as part of the investment process," says Lars Lindblom, a portfolio manager at the Fund.

Sustainability without compromising return

At present, the Second AP Fund has no specific exposure in green bonds, which are equated with other bonds, and are therefore managed together with standard fixed-income investments.

"We don't compromise concerning the yield requirement for green bonds. However, we would rather choose a green bond than its equivalent. This is because we are driven by genuine concern. We see climate change as a serious challenge and believe that the Fund, in its role of long-term investor, can affect global environmental impact via this type of instrument," notes Lars Lindblom.

This fits well with the Fund's governance requirements – to consider ethical and environmental concerns without compromising the return on investment.

Ongoing contact with issuers

The Second AP Fund has played an active role in developing the global market for green bonds, in dialogue with issuers and banks. The Fund's accumulated expertise makes it an attractive participant in and speaker at conferences and as an advisor to borrowers who wish to know more.

"Borrowers often consult us when considering whether to issue green bonds," says Lars Lindblom.

As the percentage of green bonds in the Fund's portfolio grows, so does the need for monitoring.

"We maintain ongoing contact with issuers to monitor the situation and pursue an active dialogue, to discuss our wishes for how they report on the impact of the projects our investments help to fund," states Lars Lindblom.

"Just in its infancy..."

The growth of benchmark indices for green bonds and specific green-bond funds is one of many indications that the market has made huge strides in a short time.

As the market for green bonds grows, the choice of other bonds that focus on sustainability is also expanding. One such example is the 'social bond'.

"The market for sustainable bonds is probably just in its infancy. It is important to get into the market early, broadening the scope of our efforts to integrate sustainability into the management of our fixed-income investments," says Lars Lindblom.



Lars Lindblom

Green bonds in brief

The first green bond was issued by the World Bank in 2008. Investment in green bonds means that institutions (issuers) lend capital to fund climate projects in fields such as energy optimization, renewable energy and environmental technology, having a positive impact on health, the climate and the environment.

Bulletin board

The Fund's Finance and Sustainability Prize

The Second AP Fund enjoys close cooperation with Gothenburg University's School of Business, Economics and Law and, with this Finance and Sustainability Prize, hopes to encourage students to select topics within this field for their theses.

This year, the SEK 20 000 Prize was awarded to Anna Adlarson and My Hammarström for their paper "As a financial instrument, do green bonds promote sustainable development?" In motivating the Prize, the jury said:

"The authors highlight an area of investment that will very probably grow in coming years and which is of considerable interest to institutional investors such as the Second AP Fund. This is therefore an area of increasing relevance about which investors should inform themselves. The paper has made an impressive contribution to increasing knowledge of green bonds."

Read the jury's complete motivation on www.ap2.se

Female Index 2015

The proportion of women represented on the boards of companies quoted on the Stockholm Stock Exchange continues to rise and now amounts to 27.9 percent, compared to 24.7 percent for the preceding year, being the second largest increase since the Fund launched the Female Index in 2003. The percentage of women on executive managements is rising steadily and the figure for this year was 19.5 (18.4) percent.

This year's Female Index reveals something of a shift between various industry sectors compared with earlier figures. The finance and consumer-goods sectors have the highest proportion of female board members, while the media and finance sectors have the highest proportion of senior female executives. The media industry has the lowest number of women on its boards. The commodities sector, which traditionally has featured the lowest proportion of women on both boards and executive managements, has increased female representation on boards to 18.2 (13.6) percent and on executive managements to 14.9 (13.8) percent.

Read the entire report at www.ap2.se

Diversity with Mitt Liv

During 2015, the Second AP Fund has joined the Mitt Liv (My Life) mentoring programme. This means that, every year, five employees are given the opportunity to act as mentors to academics with a foreign background, who lack a job appropriate to their qualifications. This is expected to provide better insight into and understanding of the Swedish labour market and job application process, and to generate professional contacts and networks.

Established in Gothenburg in 2008, Mitt Liv is a social enterprise company that strives for increased diversity and integration on the Swedish labour market. The mentor programme creates meetings between people that open doors for international competence.

The decision to sponsor Mitt Liv forms part of the Second AP Fund's diversity programme and is grounded in the core values of acting on the principles of commitment, action and change, in the hope of making a difference.

Sponsor of Gothenburg Award for Sustainable Development

As part of its commitment in the field of sustainability, the Second AP Fund, in association with ten other organizations, sponsors the 'Gothenburg Award for Sustainable Development'. The international Award is given in recognition of achievements in promoting sustainable development and was awarded for the first time in the autumn of 2000. Award winners have ranged from environmental branding organisations and cooperatives to politicians and corporate executives.

The theme for 2015 is 'Energy conversion – solar energy and energy optimization'. This year's recipients are solar cell entrepreneur Jeremy Leggett, from Great Britain; Beate Weber-Schuerholz, former mayoress of Heidelberg, and Peter Hennicke, the German pioneer in energy optimization. The Award is worth a million Swedish kronor.

Christmas donations to relief organizations

For the past twelve months, the Second AP Fund's employees have been able to individually choose from a number of relief organizations to which they wish to make a Christmas donation. Each employee is able to choose which organization to support. The choice has been limited to five: Médecins Sans Frontières (MSF) (47%), Cancerfonden (33%), WWF (12%), Hjärt-Lungfonden (7%) and Mentor (1%). The figures in parentheses indicate the percentage of the total donation that the individual organization received in 2014.



The Second AP Fund adopts a long-term approach in creating a capital buffer for the Swedish national pension system

The Second AP Fund is one of northern Europe's largest pension funds, managing assets totalling more than SEK 300 billion of Sweden's national pension assets, which are invested worldwide.

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 about 65 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.



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