

Ownership Report 2017



Active ownership is profitable

Sustainable value creation is fundamental to the ability of Första AP-fonden (AP1) to create the best possible return, and sustainability is therefore one of our investment beliefs.

By sustainable value creation we mean that companies and other organisations in which the Fund invests must be profitable in the long term. They can do this by, for example, dealing with environmental and climate matters, social issues and corporate governance in a positive way.

AP1 always prioritises the overriding goal of delivering the best possible return on pension savers' money. We are convinced that the best way of achieving that goal is by considering sustainability aspects in our investments.

This approach chiefly means that AP1:

- influences the companies it owns in a desirable direction;
- integrates sustainability issues in its investment process.

We also want to be as open as possible about what we do and how we approach active ownership. This is why we publish an ownership report every year, which you are now reading.

Johan Magnusson, CEO



Johan Magnusson,
CEO of AP1.

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The Fund maintains close contacts with its Swedish companies, including Atlas Copco.



Brief facts about Första AP-fonden

FÖRSTA AP-FONDEN (AP1) MANAGES roughly one quarter of the capital funded in the Swedish national income pension system. It is the Fund's mission to create a return on the capital by investing in different assets.

The return shall be maximised, while at the same time maintaining a low level of risk. AP1's ambition in the field of sustainability is high.

To fulfil its mission, AP1 invests in a broad portfolio of assets worldwide. Diversification

brings opportunities for a return and spreads the risk.

At the end of 2017 the Fund managed assets totalling SEK 333 billion, primarily consisting of equities, fixed-income securities, real estate, infrastructure, private equity funds and hedge funds.

The net assets influence the pensions that can

be paid out from the income pension system, but they are also used to even out differences between contributions and disbursements. This means that the Fund has an important, value-creating role for both existing and future pensioners in Sweden.

Return after
expenses

9.6%

Net assets

SEK 333 bn

657

general meetings

“We make companies better by owning them”

Första AP-fonden is an active owner that wants to take responsibility. One pertinent question we always ask ourselves is: What does it mean if we own equity, as compared to another player?

We care and actively engage with the companies. With this in mind, we prefer to stay on and exert an influence rather than abandoning companies that are not well managed. Sustainability issues are key, and the best way for us to drive these issues is through ownership.

Having said this, our main focus is always the long-term return. We have to generate a 4 per cent real return on the capital we manage, and we fulfil this mission while also considering ethics and the environment.

However, we cannot do everything alone. We need good data about how the companies' work on sustainability issues is being conducted and what results they are achieving. This is why we are often involved in calls for greater transparency and consistent reporting from the companies. Our asset managers must observe but do not have to be specialists in human rights or carbon dioxide emissions; their focus is on evaluating the future risks and opportunities posed by the investments.

New collaborations on climate

Unfortunately climate issues have not become any less important during the year, and carbon dioxide has continued to be heavily debated in many quarters. Like the other AP Funds, we have been working on these issues for a long time.

In 2017, AP1 signed up to Climate Action 100+, a five-year, global initiative for investors. The initiative targets the 100 companies that are judged to have the largest carbon footprint globally.

Climate Action 100+ aims through dialogue to influence the companies to

communicate how they intend to steer their operations towards the objectives in the Paris Agreement, curb their emissions of greenhouse gases and improve openness on climate-related reporting. To date, more than 200 investors have signed the initiative. AP1 has pledged to engage in dialogue with at least one of the companies that Climate Action 100+ wants to influence.

“Our asset managers don't have to be specialists in human rights.”

Fact gathering for this work is made easier by the recommendations presented by the Task Force on Climate-related Financial Disclosures, TCFD, on how climate-related risks should be reported. They improve the ability to assess the risks and opportunities associated with different companies and markets.

Another new feature in 2017 is the OECD's principles for investors, which state practical ways that investors can monitor their sustainability risks. The principles are called Responsible Business Conduct for Institutional Investors (RBC). AP1 is working with the other AP Funds to integrate RBC risks into its management, partly by influencing companies with regard to their disclosures.

Strength to influence

For a few years, AP1 has concentrated its portfolio in the equity markets we manage ourselves. Now we only have

holdings in just under 30 Swedish companies, but we have larger holdings in each one. This has a major impact on our ownership work, and we participate in more nomination committees. This gives us greater opportunities to have an influence.

Ahead of the 2018 general meetings, the Fund is taking part in 13 nomination committees with other owners to try to find the best possible composition for the companies' boards. The Swedish system of owner-led nomination committees works very well but it should be nurtured and developed further. This is a key component in active ownership for us because a good board is fundamental to the companies achieving sustainable profitability.

More difficult to recruit

I therefore regret that since the change in taxation of board members' fees in 2017, it has become more difficult to recruit board members. This is particularly true for small companies, but is also noticeable to some extent in larger companies.

“We're often involved in calls for greater transparency from companies.”

In 2017 the Fund focused a lot of attention on the company Eltel. The former CEO and former Chairman of the Board were not discharged from liability at the general meeting and were then, together with the company's auditors, the subject of inquiries. The



“Good data on companies’ sustainability work is needed,” says Ossian Ekdahl, Chief Active Ownership Officer at AP1.

“It’s important to consider which external assignments are suitable for CEOs.”

nomination committee worked actively to find a new board that could help to investigate the problems and thereby create profitability.

Hexagon also had an eventful year. President Ola Rollén was arrested, which had repercussions for the nomination committee as he was also a board member. Preparations had to be made in case a guilty verdict was returned. Fortunately the verdict was not guilty, which means that Ola Rollén can continue in his roles as board member and President of Hexagon. AP1 does, however, consider it important that boards of all companies carefully consider which external assignments are suitable and permitted for CEOs and management.

Nordea announced that its board

will propose a relocation of its headquarters to Helsinki at its general meeting in April 2018. As one of the bank’s major owners, AP1 has carefully analysed the pros and cons of such a move. Our conclusion led us to vote yes at the general meeting. Read more about the three companies on page 15.

In early 2018, venture capital fund Cevian sold its holding in Volvo Trucks, in which AP1 also has a financial interest, to a non-Swedish player. This prompted a general debate about the terms for ownership. The Fund’s attitude is that non-Swedish owners are welcome to invest in Swedish companies but that it is important that all owners comply with Swedish legislation, rules and practices concerning corporate governance.

AP1 collaborates with other owners on many issues, often in companies where we would like to effect change. One area where we are happy to collaborate with non-Swedish pension funds is remuneration issues. Many companies pay extremely high levels of remuneration to their CEOs, and we are working to bring about more modest remuneration in the long run.

Members of Swedish corporate managements do not, from an international perspective, receive high levels of remuneration. This is partly because Swedish institutional investors demand transparent, well-structured remuneration systems. In 2017 another step was taken in this area when the Institutional Owners Association stipulated that Swedish listed companies must notify their owners and invite them to engage in a dialogue on the remuneration programmes the boards will propose at the general meetings.

Commitments for a more sustainable world

A growing number of principles, goals and collaborations provide guidance on implementing and reporting sustainability. In 2017, new additions to the framework were made by OECD and TCFD.

The various terms used today in the field of sustainability complement each other by referring to different sectors of society, such as nations, industries, companies or investors. Their focus also varies slightly when it comes to implementation or reporting, corporate governance or climate issues, for example.

The very first part of the framework for sustainability came back in 1976 when the OECD formulated guidelines for responsible ownership in multinationals, guidelines which have since been updated several times.

Several decades later, in 2000, the UN presented the Millennium Development Goals for emerging countries, with the aim of improving people's lives and laying a foundation for sustainable global development in the world.

At the turn of the century, the National Pension Insurance Funds (AP

Funds) Act was written and adopted. The act forms the basis for AP1's mandate from the Swedish Parliament. It stipulates that the Fund must achieve a high return for a low risk while also taking into account the environment and ethics.

The formation of frameworks, goals and groups of experts etc. has subsequently accelerated. Första AP-fonden has many relevant frameworks, which is a reflection that the Fund has significant capital in many different asset classes.

The UN is still a driving force and is behind several initiatives. The basic framework for AP1's sustainability work is the UN's Global Compact, which has ten principles for corporate sustainability that are linked to international conventions. Another central concept is the UN's 17 global Sustainable Development Goals from

2015, which encompass the whole of society and supersede the Millennium Development Goals of 2000.

In addition to adhering to international principles, AP1 has responsibilities as a Swedish Government authority, which include meeting requirements on openness and clear reporting of its operation.

As a major owner, the Fund has both an opportunity and a duty to influence development in operations in which it has participating interests. AP1's ownership policy consists of principles for corporate governance and the companies' social and environmental responsibility. Through sustainable investments and active ownership, AP1 helps to meet the world's global challenges.

AP1 continuously strives to develop systems for prioritising and gathering data on sustainability.



Platforms for sustainability work

International frameworks

Global Compact

The UN's minimum requirements on corporate sustainability, known collectively as the Global Compact, are linked to international conventions on human rights, labour and employment conditions, the environment and anti-corruption. The Swedish state supports the Global Compact, and

Första AP-fonden's Ownership Policy refers to this framework. AP1 expects all companies to live up to the ten principles.

Responsibility for human rights is detailed in the UN Guiding Principles which state, for example, that companies are expected to respect human rights even when the nation does not. The UNGP Reporting Framework has guidelines on reporting.

Sustainable Development Goals

The UN's 17 global Sustainable Development Goals (SDGs) were unanimously adopted by the member states in 2015. The goals are a part of Agenda 2030. There are a total of 169 interim goals in the sub-groups.

For the SDGs to be achieved, governments, civil society and the private sector must work together. Sweden wants to be a leading country in this work.

AP1, together with several of Europe's largest pension funds, has endorsed Sustainable Development Investments (SDIs), a viewpoint about the importance of investing in solutions that contribute to the UN's SDGs.

Principles for Responsible Investment

The Principles for Responsible Investment (PRI) are also a UN initiative. The PRI comprise guidelines for processes relating to responsible investments and has been endorsed by 1,700 significant investors, including AP1. The PRI are a framework in day-to-day efforts to integrate sustainability issues into management and investors' own organisations. The Fund completes an annual survey on how the principles are implemented.

OECD guidelines

The OECD has long had guidelines for sustainability in multinationals.

Responsible Business Conduct (OECD)

In 2017 the OECD introduced a new set of principles for investors, Responsible Business Conduct for Institutional Investors (RBC), specifying practical ways in which investors can monitor and manage their sustainability risks. AP1 is working with other AP Funds to integrate RBC risks into its work.

International Corporate Governance Network (ICGN)

A global cooperation to raise standards in active ownership. The ICGN is working for better corporate governance globally and for shareholders to have a greater influence.

Global Reporting Initiative

GRI contains guidelines for reporting

sustainability. AP1 applies the GRI (see www.ap1.se) and recommends that its portfolio companies do the same.

Industry initiatives

Extractive Industries Transparency Initiative (EITI)

An initiative for open reporting in the extractive industries, primarily oil companies. The initiative aims to make it easier to track states' licensing

revenue from the extractive industries so as to avoid corruption.

Global Real Estate Sustainability Benchmark (GRESB)

GRESB is a global, industry-driven organisation that collects and compares sustainability information for real estate companies and funds on behalf of investors. AP1 requires that real estate companies and real estate funds report to GRESB.



The framework for sustainability work is extensive and growing.

Climate commitments

CDP (the former Carbon Disclosure Project)

Major asset managers impose demands on the world's biggest listed companies to report emissions relating to the climate challenge. The Fund supports the collection of carbon dioxide and water data.

Institutional Investors Group on Climate Change (IIGCC)

A European investors group that collaborates on climate issues by putting forward investors' views and engaging companies, authorities and other investors in the issue.

Montreal Carbon Pledge

Under this pledge AP1, together with many other investors, undertakes to measure and report its portfolio's carbon footprint annually.

Transition Pathway Initiative (TPI)

A global initiative of major investors that focuses on how companies act on climate issues and how well prepared they are for a world with a low carbon footprint. AP1 is a member of the initiative's steering group. See also page 20.

Climate Action 100+

A five-year global initiative for investors from 2017, aimed at engaging in dialogue with the 100 companies that are deemed to have the largest carbon footprint globally. The data is obtained from, amongst others, the TPI.

Task Force on Climate-related Financial Disclosure (TCFD)

The TCFD is a group of experts commissioned by the G20 to propose how climate-related risks should be reported. In the longer term, AP1 aims to report in accordance with the recommendations.

Initiatives based in Sweden

AP Funds' Council on Ethics

A collaboration between the First, Second, Third and Fourth AP Funds (AP1, AP2, AP3 and AP4) to influence



Volvo Trucks is a company that is actively working on climate issues.

non-Swedish companies to improve their sustainability work.

Sustainable value creation

A collaborative project between 17 of Sweden's largest institutional investors and Nasdaq OMX to highlight the importance of companies working in a structured way and reporting sustainability issues.

Institutional Owners Association

A collaboration between AP Funds, insurance-company and bank-related funds etc. The association is one of the principals for Swedish self-regulation on the capital market through the Association for Generally Accepted Principles in the Securities Market.

The Swedish Securities Council

Part of Swedish self-regulation, within the framework of the Association for Generally Accepted Principles in the Securities Market. Issues statements, gives advice and information on issues relating to companies' and other players' conduct on the Swedish equity market.

The Remuneration Academy

Strives to ensure remuneration systems in companies are effective, balanced and relevant, and perceived as legitimate by the company's various stakeholders. The academy also aims to help deepen and broaden public debate on the issue of remuneration. AP1 is a partner to and member of the Remuneration Academy.

Sweden Sustainable Investment Forum

SWESIF is an independent networking forum for organisations that work for or with sustainable investments in Sweden. Its aim is to raise awareness and interest in sustainable investments among institutional asset owners and managers.

AP1's total commitments

A more detailed description of AP1's commitments can be found at www.ap1.se.





Responsible investors and engaged owners

Första AP-fonden is a responsible investor and engaged owner. Through sustainable investments and active ownership, AP1 helps to meet global challenges. Resource efficiency is the focus of investments.

AP1's mission is to deliver long-term high returns at a low level of risk. This has to be achieved while simultaneously taking into consideration ethics and the environment, but not at the expense of the return goal.

AP1's Board of Directors has established four working methods and goals for sustainability:

Continuous competence development

Employees are continuously trained in sustainability as their actions are central to ensuring high-quality evaluations of investment objects.

Regular sustainability reviews

The portfolio is continuously scrutinised from a sustainability perspective.

Dedicated investments

The Fund seeks investments with a sustainability focus, in particular innovative initiatives for resource efficiency.

Increased transparency

The results of the Fund's sustainability work are reported transparently possible. Employees are encouraged to spread knowledge of the working method.

Integrated investment decisions

Sustainability aspects are an integral part of investment decisions, focusing on resource efficiency, in other words responsible usage of natural resources, human capital and financial capital.

AP1's commitment is based on the conviction that companies and other operations that effectively deal with sustainability issues improve their chances of achieving higher long-term gains through better growth, lower risk and reduced costs. Sustainable investments are beneficial to returns, pensioners and the planet.

Natural resources

The Fund aims to contribute to reduced demand for finite natural resources such as air, water, minerals, fossil fuels and land.



Resource efficiency often leads to lower production costs, higher

productivity and new business opportunities.

Human resources

The ability to attract, motivate and engage employees is pivotal to a company's success, as is dealing with individuals, organisations and communities that are affected by the company's operations. These factors can determine a company's success.

Financial capital

Shareholder and creditor capital should be used considering risks from a broader perspective, as well as anticipated return. Investors, companies and individuals should comply with financial legislation and practices, for instance regarding taxes. There must be no corruption, in any form.

Influence on companies leads to progress

Första AP-fonden aims to exercise its active ownership and make a positive contribution to developments in the portfolio companies. Also, in Sweden in particular, the Fund is a major owner that can impose demands.

AP1's actions with regard to corporate governance are based on a business-oriented approach and knowledge about the individual company. Its work is steered by what is best for companies and shareholders, and thereby also for those insured in the pension system.

Since well-managed companies often show higher profitability and lower risks

than others, it is in AP1's interests to influence the companies in a positive direction. Actively influencing the companies is prioritised over excluding them from future investments.

AP1 requires that the companies it invests in follow national and international conventions, national legislation and relevant corporate governance co-

des. Companies also have to meet the requirements stipulated in the Fund's own ownership policy (see separate box). For unlisted companies in which AP1 has significant voting power, special owner directives are adopted in addition to this. In these companies the Fund also has representatives on the boards.

Första AP-fonden's Ownership Policy

The ownership policy can be found in its entirety at www.ap1.se. A summary is provided here.

Voting rights

AP1 works to ensure that the right to vote at general meetings is unrestricted. Any changes in voting rights must be voluntary.

Equal treatment

Shares granting equal financial rights should be treated equally in a financial respect. Minority shareholders must be protected.

Capital structure

Companies should have a capital structure that is appropriate with regard to the company's ability to generate profits. Capital that is not used effectively should be distributed

to the shareholders.

The companies' boards of directors

Shareholders shall appoint a board of directors. The board members shall have the right expertise and a high level of integrity, and must always have the company's best interests at heart. The composition of the board shall promote diversity. Remuneration should reflect the demands set.

Remuneration

Remuneration to senior executives should benefit the company and be reasonable, market-based and moderate enough that it can be openly justified to the company's stakeholders.

Audit and internal control

The auditors are appointed by the

shareholders at the general meeting. Strict requirements should be made regarding the independence of external auditors from the company and its management.

The environment and social issues

If an operation can be associated with infringement of a convention Sweden has pledged to comply with, the Fund should influence the company. If these means prove ineffective the Fund should exclude the company from its investment sphere.

Information disclosure

The operations should maintain an open and continuous dialogue with the shareholders, with information that is accurate, clear, objective and trustworthy.



Voting at general meetings is one of the key tools in exerting owner influence. Photo from

Voting:

The main way of exerting influence

AP1 utilises its right to vote at general meetings to the greatest extent possible as this is one of shareholders' key tools in exerting owner influence. The Fund's aim is to vote at all general meetings in Swedish companies, and as far as is practically possible in non-Swedish companies.

The Fund votes in line with the principles set out in its ownership policy. The shareholders' right to vote and submit proposals should be unrestricted, and they must also have their questions addressed. If a proposal gains a majority of the votes, the Fund deems the company to be obliged to carry the decision through.

The issues that AP1 focuses on the most are board elections and remuneration issues because they have a great impact on the company's development and profitability. The Fund makes its opinion known when the CEO's remuneration package is designed so that the company is being steered in the wrong direction. Board fees must be well balanced. The fees should be neither too high nor too low.

The Fund's active portfolio management involves concentrated portfo-

lios, which means that the Fund owns equities in between 25 and 30 Swedish companies and just under one hundred companies in the rest of the developed world. In addition, there are a number of quantitative portfolios and growth markets where the fund owns equities in approximately 2,000 companies.

Sweden

In Swedish companies, the shareholders have the right to vote and make proposals to the general meeting of shareholders. In 2017 AP1 voted at all general meetings of the companies in which it owns equities, i.e. 28 companies.

Corporate governance in Sweden follows the Companies Act, with a clear division of roles between owners, board and executive management, as well as far-reaching owner influence.

Most Swedish companies inform their major shareholders in advance of the proposals the board intends to put forward at the meeting. This gives the owners an opportunity to convey any viewpoints. It is therefore very rare that major shareholders vote against the board's proposal. In some cases, the Fund itself has to take the initiative to discuss a matter with the board.

AP1 views positively the idea that

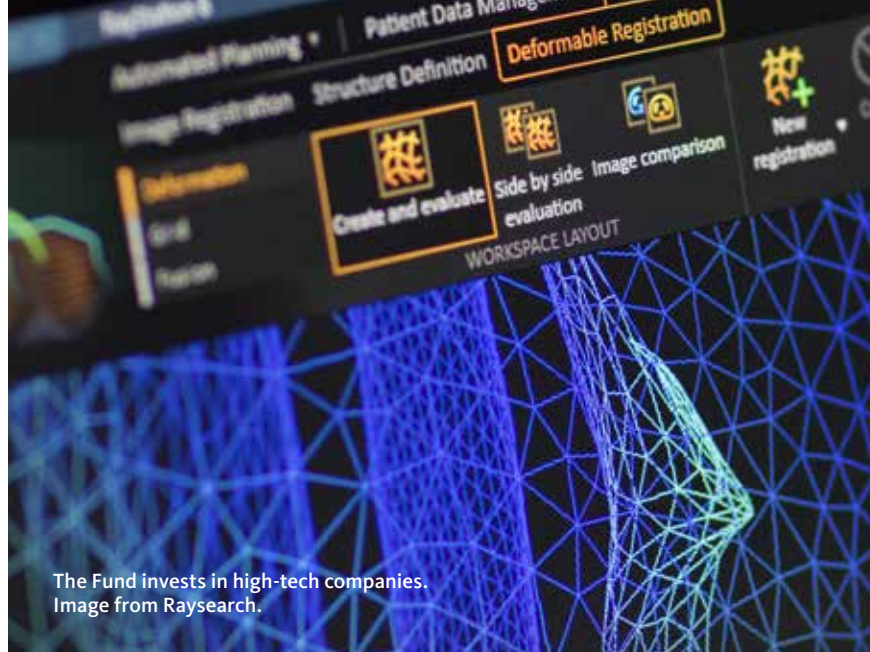
at Swedish AGMs board members should be voted for on an individual basis. This is becoming increasingly common in Sweden, which brings it closer in line with other countries, and simplifies the process primarily for non-Swedish owners.

Developed markets outside of Sweden

In developed markets outside of Sweden, in 2017 AP1 focused its efforts on being able to vote in a lot of companies. The Fund managed to vote at around 95 (65) per cent of the 629 (282) general meetings in total.

For votes outside of Sweden, the Fund brings in external expertise to analyse the meeting's agenda and produce basic data for decision-making. AP1 currently works with the international Institutional Shareholder Services (ISS) and the Swedish company Nordic Investor Services. Based on recommendations and the Fund's ownership policy, the Fund decides how to vote in each individual case.

Outside of Sweden the conditions differ from the Swedish Companies Act. In the US, for instance, the CEO and board chairman are often the same person. Outside of Sweden, a certain number of votes behind a



The Fund invests in high-tech companies.
Image from Raysearch.

cooperation in the AP Funds' Council on Ethics. Contact is made directly with non-Swedish companies where the Fund has noticed particularly high risks to sustainability in its holding.

Legal proceedings: The US dominates

Through its legal actions, AP1 helps to maintain good corporate governance and an efficiently functioning capital market. When necessary, AP1 takes legal action against companies to recover losses. The most common situations are where the company's management and/or board has acted in an irresponsible manner in relation to its owners. In 2017 the Fund recovered approximately SEK 25 million.

Legal proceedings are particularly common in the US, where owners are generally in a weak position and there is a tradition of conducting this kind of process. They do, however, occur in other countries too.

Exclusion: The last resort

If attempts to engage in dialogue with a company due to infringements of a convention fail to result in the problems being resolved within a reasonable time, normally four years, the company is excluded. This means that AP1 sells its holding and excludes the company from future investments.

In most cases a decision to exclude a company is made alongside other investors, primarily through the AP Funds' Council on Ethics. If several institutional investors exclude a company, improvements are generally made because the company does not want to be associated with the problems.

AP1's exclusion list for listed shares and fixed-income securities contains around 20 or so companies whose securities the Fund's asset managers may not invest in. The list is published at www.ap1.se and companies have been gradually added to it since 2001.

The list is based on two different types of criteria: infringements of international conventions, and AP1's own assessment of which companies are not suitable for investment.

proposal are also often required for it to be put forward at the meeting. The owners cannot, therefore, always vote on important issues.

Abroad the Fund often votes against the boards' recommendations. This is particularly true for remuneration issues and if the same person is proposed to be both the board chairman and CEO. The Fund's position in the vote is in many cases followed by an explanatory letter to the company; around 50 such letters are sent every year.

Emerging markets outside of Sweden

The Fund needs to have wide-ranging knowledge of each company and country to be able to vote on emerging markets. Collecting information is difficult and requires a lot of resources.

The Fund does, however, vote to a certain extent through carefully selected external asset managers. The aim is for this type of voting to increase.

Board appointment: Important influence on the nomination committee

AP1 is not represented on the boards of listed companies. The Fund is, however, participating in more and more nomination committees and actively contributes to proposing candidates for the boards of Swedish listed companies where the Fund is one of the main owners.

In most cases the nomination committee's work runs smoothly when the major owners agree on the board composition needed. In other cases

something unexpected happens which involves additional work.

Ahead of the 2018 AGM season, AP1 is therefore participating in the nomination committees of 13 Swedish companies – an increase on the year before when it took part in eight.

AP1's view is that the board composition should be adapted to the company's current situation and the need for e.g. expertise in a particular area or geographical market. People elected onto the board must complement the other members. Generally speaking, the Fund strives to create a diversity of mindsets on the boards.

Dialogue: Constructive discussions

Through dialogue with the companies, other investors and decision-makers, AP1 strives to influence the development of its investments. Dialogue is to be preferred above exclusion of companies from the Fund's portfolio and investment sphere. The starting point is that problems in a company do not disappear just because the Fund sells its shareholding, whereas dialogue can help to rectify the problems, which also lays the foundation for the value of the company to increase.

The Fund's contact with Swedish companies takes places on several different levels, primarily with the board and its chairman, but also with the management team and the investor relations department.

Dialogue is also maintained with non-Swedish companies, often through

Three companies in focus

Ahead of the 2018 AGM season, three companies are in focus for Första AP-fonden's work in its nomination committees: Hexagon, Eltel and Nordea.

Eltel

In winter 2017 AP1 joined Eltel's nomination committee. Immediately afterwards it emerged that the information provided by the company did not correspond to reality. The former CEO and former board chairman were denied discharge from liability at the general meeting in June. These people are now the subject of inquiries to establish whether or not the company can claim damages from them. At the same time the company's auditors were investigated by the Swedish Inspectorate of Auditors.

The nomination committee worked hard to set up a new board with the right experience and knowledge, which can work alongside the management to bring Eltel back to profitability.

Hexagon

When Hexagon's President Ola Rollén was arrested in autumn 2016 and later prosecuted for insider offences in Norway, this had repercussions on the nomination committee's work.

Appointing and potentially dismissing a President is a matter for the board rather than the owners. Ola Rollén, however, was also a member of the board, and the nomination committee therefore needed to carefully consider what measures would be required in the event of a guilty verdict. It would also be troubling for AP1 to own a company in which a board member, and President,



had been found guilty of white-collar crime.

In early January 2018, Rollén was acquitted on all points (the verdict has been appealed). The court found that he neither possessed nor used insider information. He can therefore continue both as President and as a board member with AP1's full confidence.

The Fund has, however, expressed that it is important that the boards of Hexagon and all other companies carefully consider which external assignments for Presidents, CEOs and

management are suitable and should be permitted.

Nordea

In 2017, Nordea announced that its board will propose at the general meeting in March 2018 that the bank's headquarters be relocated from Stockholm to Helsinki.

After carefully considering the pros and cons has AP1 decided to vote yes to the board's proposal. The main reason we voted yes is that the Fund has confidence in the board which has come to the conclusion that a relocation is in the best interests of Nordea and its shareholders. We agree with the board that the stability achieved by Nordea becoming part of the European banking union is important.

The fact that Nordea intends to keep an owner-led nomination committee and employee representatives on the board has also been important in the Fund's decision.

AP1's nomination committees ahead of the 2018 general

- Cantargia
- Ellevio
- Getinge
- Hexagon
- IAR systems
- Kindred Group
- Oriflame
- Recipharm
- Starbreeze
- Stillfront
- Swedish Match
- Trelleborg
- Vasakronan





The collapse of the dam in Fundão, Brazil, is one of the issues to involve the AP Funds' Council on Ethics, of which AP1 is a part.

Council of Ethics a key factor for sustainability

Första AP-fonden has been working in the AP Funds' Council on Ethics for ten years. The aim of the Council on Ethics is to continue to influence companies towards greater corporate sustainability through dialogue.

The focus of the Council on Ethics' work is non-Swedish companies, because there is a greater need for collaboration between funds outside of Sweden than within Sweden. Each AP Fund has such good relations with the Swedish companies that it can exert an influence in its own name.

The AP Funds' Council on Ethics

becomes involved in industries and companies where serious, systematic problems and/or violations of international conventions have been identified, are deemed to be palpable and are well documented.

The Council on Ethics works both preventively and reactively. Problem areas and incidents are systematically

mapped and analysed. A selection of companies and areas are selected for more focused action.

The fundamental principle of the Council on Ethics is primarily to influence companies in the right direction, and only as a last resort to recommend that they be excluded from the Funds' investments.

Dialogue for influence

Dialogue is the Council on Ethics' most important tool. If questions put to the companies are not answered, the process is escalated. This type of action is rarely needed in Swedish companies, but things can be quite different in other countries.

If, despite the dialogue, changes cannot be brought about, the Council on Ethics considers recommending that the company be excluded. The equities are sold and investments are no longer permitted in that company. The AP Funds decide themselves on exclusion on an individual basis, but they have followed the Council on Ethics' recommendations in all cases.

Increasingly proactive

Over time, the proactive elements of the Council's work have become increasingly common. Recently the Council on Ethics has, for example, become involved in sectors such as mining, palm oil, cacao and tobacco.

The AP Funds' Council on Ethics

works on a broad front worldwide, which is a natural consequence of the Funds' diversified investments.

In 2017, special attention was paid to Brazil when the Council on Ethics visited the country. There was a follow-up of the case involving oil company Petrobras. Several far-reaching legal cases relating to corruption have been ongoing against the company for several years. AP1 has been involved in the legal proceedings. Guilty verdicts have been passed and significant improvements have taken place.

The collapse of the Fundão dam in Brazil in 2015 is being followed up, along with the measures subsequently taken by the mining giants Vale and BHP Billiton.

Dialogue has also continued with one of the world's largest chicken producers, Pilgrim, regarding health and safety in Brazil and the US.

Other examples of issues relevant to the AP Funds' Council on Ethics relate to Nestlé in Thailand, including efforts to improve traceability in the fishing

industry and working conditions for migrant workers.

Corruption and the working environment

The Council also engages in dialogue regarding anti-corruption in the oil industry in Nigeria, corruption and working conditions at Samsung in China, the situation for the indigenous population in connection with the laying of oil pipes through the US, and working conditions for guest workers in the construction industry in Kuwait.



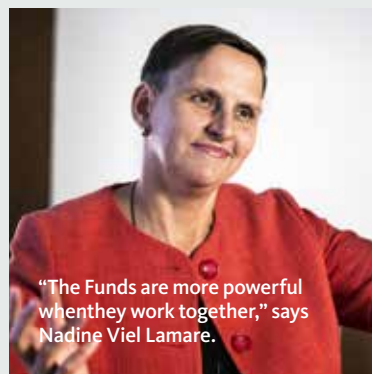
The annual report for the AP Funds' Council on Ethics is available from April 2018 at www.etikradet.se.

Working together produces results

Sustainability efforts become clearer and more powerful when the four AP Funds work together.

"The Funds have the same core values, and work more efficiently and more powerfully together than they do individually. For non-Swedish counterparties and business partners, it is also easier to have a single contact rather than four different ones," says Nadine Viel Lamare, Head of Sustainable Value Creation at AP1, and the first chair of the Council on Ethics.

What eventually became the AP Funds' Council on Ethics was a response to the occasion when AP1 became aware of problems with human rights in the American



"The Funds are more powerful when they work together," says Nadine Viel Lamare.

hotel chain Marriott.

"The Fund owned a very small percentage of Marriott's equities, but we decided to take action. It was a long process, but it produced results. Marriott took measures and the case had a ripple effect on

other hotel chains."

The example became a model both for AP1's own sustainability work, and that of the other three AP Funds. It also marked the beginning of the AP Funds' Council on Ethics.

According to Nadine Viel Lamare, it is clear that the Council on Ethics enjoys great trust.

"Ten years ago the violations were more obvious. Our work is needed now to point out bad conditions where they may not be so visible. The problems are greatest on the emerging markets. There is tremendous power when the Funds and our asset managers work together to deal with the same issues in those companies."

The two-degree goal in focus

Companies with a credible strategy for reducing their climate impact, reduce their risks and may, therefore, be interesting investments. Advanced climate research is used to create data for assessing the climate maturity of companies.

Första AP-fonden is part of the steering group of the Transition Pathway Initiative, TPI, a project that aims to obtain forward-looking data on climate issues, partly by evaluating how companies' business strategies relate to the two-degree goal. The focus is unique and the project is run in collaboration

with world-leading climate scientists.

TPI was launched at the beginning of 2017 and during the year some of the industries with a major impact on the climate were analysed, including the cement industry where the focus was on the 20 largest companies. The top ranked company was LafargeHolcim, which has a strategy in line with, or even better than, the two-degree goal.

A group of companies receive high ratings using TPI's analysis model. At the same time some companies show no sign at all of adapting their strategies to the climate challenge. It was not pos-

sible to analyse all of the companies due to insufficient access to information.

TPI also analysed the 20 largest companies in the oil and gas, power supply, mining and steel sectors. Efforts continue in other industries too.

The analyses from the TPI initiative will be used by AP1 in e.g. its investment analysis and in dialogues with companies to influence their sustainability work, partly within the framework of Climate Action 100+ whereby contact is made with 100 or so of the companies that are deemed to have the largest carbon footprint globally.

Cows eat outdoors all year round

In New Zealand, AP1 owns dairy farms where the cows can graze outside all year round, and therefore feed almost exclusively on grass. This is advantageous from a climate perspective, while at the same time the milk has a higher

nutritional content and can be sold at a higher price.

The Fund's investments in agriculture in New Zealand are managed by Southern Pastures, which views sustainability as essential to creating value in the long

term. Efforts are under way, among other things, to increase biological diversity with beehives at all of the farms. The use of antibiotics will decrease. One farm is switching to completely organic farming, where antibiotics are not permitted at all.

Innovative approach on high-yield



Fraser Lundie, Head of Credit at Hermes Investment Management, with Tina Rönnholm, Portfolio Manager at AP1.

A new asset management collaboration is creating more opportunities for Första AP-fonden to consider sustainability when it invests in corporate bonds on non-Swedish markets.

In 2017, AP1 commissioned British company Hermes Investment Management to manage some of its corporate bonds with a lower credit rating. The mandate for this high-yield holding encompasses around SEK 3.3 billion.

“Hermes’ long-term philosophy and process is a good fit for our broad, high-yield portfolio because its team is at the forefront when it comes to integrating environment, social responsibility and corporate governance issues in its investments. Hermes has an innovative, industry-leading approach to pricing sustainability risks in terms of credit risk surcharges,” says Tina Rönnholm, Portfolio Manager with responsibility for external high-yield investments at AP1.

The collaboration therefore brings together two long-term investors to

deliver a strong return to AP1’s stakeholders, while also considering the effects on society in general.

“AP1 is one of the most innovative,

forward-looking pension funds. Like us they think that creditors have the same interest as shareholders in seeing companies’ environmental, social responsibility and corporate governance work develop, and that active involvement can facilitate this development,” say Fraser Lundie and Mitch Reznick, Heads of Credit at Hermes Investment Management.

Hermes has access to many different sources, including its own sustainability reports and credit analyses of listed companies. Another source are the specialists at Hermes EOS, Equity Ownership Services, who work actively on company influence. Hermes’ PRI rating of A+ and membership of the UN Global Compact are further demonstrations of its expertise and commitment to sustainability issues.

In addition to its focus on sustainability, AP1 wants the collaboration with Hermes to help strengthen the geographical spread of its high-yield exposure, and therefore sees benefits in choosing an asset manager that invests globally in this segment.

Sustainability in Cityhold’s new properties

In 2017, real estate company Cityhold, which is part-owned by AP1, acquired a property in Amsterdam and one in Berlin from real estate developer OVG. At the same time a business agreement on future acquisitions was signed.

OVG is one of Europe’s leading players with a focus on sustainability and energy efficiency, and has developed “The Edge” in Amsterdam, the world’s most sustainable

building. The collaboration with OVG contributes to Cityhold’s strategy for becoming a leader in Europe when it comes to sustainable real estate.

For the second consecutive year, Cityhold received a Green Star award from Global Real Estate Sustainability Benchmark,GRESB, the leading player for measuring sustainability in the real estate sector.

Asset management taking sustainability into account

Första AP-fonden's asset management takes account of ethics and the environment. Natural resources, human resources and financial capital must be used responsibly.

Equities

AP1's key tool in evaluating sustainability aspects in the equity portfolio is good knowledge of the companies. Concentrated equity portfolios, primarily in Sweden, create a good foundation for analysing and influencing companies.

In Sweden, the Fund engages in an active dialogue with many of its companies. Abroad, on developed markets in primarily Europe, the US and Asia, the Fund manages approximately 80 companies itself, which means that the holding is concentrated and provides good opportunities for insight.

On emerging markets external asset managers invest in equities on behalf of the Fund, since AP1 does not have the same opportunities to monitor the companies there. The Fund engages in dialogue with its external asset managers to develop methods to integrate sustainability aspects into their investments. Dedication and expertise among external partners are increasing.

The entire Fund's listed equity holding is screened every six months by external experts, to see whether any companies can be associated with breaches of international conventions. The company is then studied more closely and discussed in the AP Funds' Council on Ethics. If necessary a dialogue is initiated. On the recommendation of the Council on Ethics, the company can be excluded from future investments.

Potential investments in listed equities are also analysed continually based on broader sustainability risks using a special database. If the Fund does invest in companies with a particularly high sustainability risk, an action plan must be drawn up to monitor or reduce the risk.

The carbon footprint of all listed companies is measured yearly using a method that is common to the four AP Funds.

In addition to the actively managed listed equities, AP1 has equity holdings that are managed according to systematic strategies supported by mathematical models. IT-based sustainability filters are used here for certain strategies in order to build an improved portfolio regarding the management of financially important sustainability risks and carbon dioxide emissions, as well as a more stable valuation.

Fixed-income securities

Companies that issue fixed-income securities are scrutinised by AP1 in the same way as the equity holdings mentioned above. This means that knowledge is gained through contacts with companies and asset managers, and that the companies are subject to screening twice a year, as well as ongoing analysis using technical sustainability filters.

Real estate

AP1 has good knowledge of the sustainability in its portfolio of wholly and

part-owned real estate companies. The annual survey and associated industry mapping from the Global Real Estate Sustainability Benchmark, GRESB, also show that the Fund's companies are performing well with regard to sustainability.

The Fund is a major owner of Vasakronan, a leading company in the field. The wholly owned housing company Willhem also works actively on sustainability issues. AP1 is progressively increasing its holding in the real estate sector, where eco-friendly initiatives like energy saving often also lead to cost reductions.

Private equity funds

Unlisted equities are owned by AP1 via private equity funds. The sustainability maturity of the Fund's most important business partners as regards private equity funds and the potential to include sustainability aspects in the agreements have been mapped. This mapping is used as a basis for continued dialogue.

Agriculture

AP1 has only limited investments in agriculture, but analyses of sustainability factors are pivotal because this sector is associated with sustainability risks. The aim is to ensure that agriculture is carried out in a responsible manner. The analysis uses the UN's list of Principles for Responsible Investments (PRI) for agriculture: environment, working conditions, human rights, land rights and business ethics.



The Fund's wholly owned real estate company Willhem is performing well in sustainability.

Hedge funds

AP1 engages in dialogue on sustainability with hedge funds, often starting with tangible examples that are deemed to be particularly associated with risks. Hedge funds with a longer investment horizon are asked to report to AP1 if they invest in companies on the Fund's exclusion list. In the short term, it is not always possible to completely avoid these companies. In hedge funds, AP1 is one of many owners and in some cases there are many transactions.

Infrastructure

Sustainability factors are often pivotal in infrastructure, due to the importance

of the investments to society. The Fund continually evaluates opportunities for new investments and influences the sector primarily through its choice of holdings. As a major owner, the Fund also has direct opportunities to exert

an influence.

The assessment and investment process for infrastructure is developed in association with other responsible European and North American pension funds.

Investment beliefs

Första AP-fonden's investment activities shall be characterised by:

- Diversification – Enables improved risk-adjusted return
- Long-term approach – Opens up opportunities to achieve higher returns over time
- Risk premiums – Risk-taking is assumed to yield a positive return over time
- Inefficient markets – Meticulous analysis provides an information advantage and opportunities for higher returns on less well-analysed markets
- Cost efficiency – Lower costs increase the total return
- Sustainable value creation – A focus on sustainable value creation can create opportunities for increasing the return and reducing the financial risk in the long term

The challenge of measuring carbon footprint

Första AP-fonden supports the development of new methods that result in relevant parameters for ascertaining climate impact.

Climate issues continue to be highly relevant. Global efforts in this area of sustainability work are primarily aimed at opportunities to restrict carbon dioxide emissions.

Following the UN climate talks in Paris in 2016, there is a global agreement to limit the average temperature increase to less than two degrees Celsius so as to avoid harmful effects on the climate system. It is already considered to be too late to stop global warming altogether.

AP1 has measured the carbon footprint of its equity portfolio since 2015, and in 2017 it began doing so for corporate bonds too. As in previous years, the footprint was lower than for each benchmark stock exchange index.

The Fund takes a very positive view of the development of new methods for measuring emissions. Relevant measurement methods pave the way for improvements, both in the overarching climate work and in the Fund's own investment decisions. Access to clear,

easy-to-use measurement methods enables the Fund to set exact requirements on companies that are analysed in connection with investments. Measurement possibilities do already exist, but they are far from perfect. AP1 is contributing in different ways to the continued development of the methods, but it can achieve more by working with like-minded organisations.

Ideally the measurements would span the entire life-cycle perspective, such as a steel beam's entire path from

The AP Funds' carbon footprint

All of the three indicators which were chosen as a basis for the AP Funds' combined reporting of their carbon footprint are calculated based on the Funds' holding percentage in the companies. However, a fourth indicator has also been included in accordance with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) from June 2017. This indicator calculates carbon dioxide intensity without taking the holding percentage into account.

All the AP Funds now report the carbon footprint for the equity portfolio using the following metrics:

1. Absolute carbon footprint for the equity portfolio equating to the owned share of the companies' aggregate emissions (tCO₂e).
2. Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' market value (tCO₂e/SEK m).

3. Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' turnover (tCO₂e/SEK m).

4. Carbon intensity, weighted average, where the companies' carbon intensity relative to turnover is multiplied by the company's percentage of the portfolio based on market value (tCO₂e/SEK m).

The carbon footprint is calculated the latest available CO₂ data for direct emissions (Scope 1) and indirect emissions from energy (Scope 2). No adjustment is made for double counting. For instance, emissions that come from a power company are sometimes counted both as a direct emission for the power company, and as an indirect emission for the buyers of electricity.

The carbon footprints for the different AP Funds are not fully compa-

rable due to differences in investment strategies. The difference is bolstered by the fact that the underlying company information sometimes has to be adjusted, supplemented or estimated, which means that the choice of supplier for calculations affects the results.

During 2017, the liaison group has evaluated different data providers' services, and it is clear that development is still under way in this area.

Several of the AP Funds have taken part in discussions with international investors. A consensus emerged in the discussions on the limitations of carbon footprint as a parameter, both due to the lack of data and methodology, and because the parameter only captures certain aspects pertaining to climate risks in the Funds' portfolios. As a result, the AP Funds have decided to await further coordination regarding more classes of assets.

the ore being extracted from the mine to re-use or scrapping. Such a measurement method is, however, not expected to be available for several years.

Current measurement methods also provide little information on how well a portfolio is positioned for a transition to a low-fossil society, which is key information for a long-term pension fund.

Influence as an owner

When it comes to climate, as with other sustainability issues, AP1 takes the view that it has the best opportunities to exercise influence as an active owner. The Fund prioritises driving change from within, through dialogue, over excluding companies from its investment sphere. If a shareholding has a different owner to AP1, this does not mean that the climate situation will improve if the new owner takes a more passive approach.

The Fund also collaborates in various ways with other players in the field of climate. One of the latest collaborations is



Discussions on measurement methods are essential in the field of climate.

the Transition Pathway Initiative, TPI, a global initiative of major investors that focuses on how companies act on climate issues and how well prepared they are for a world with a low carbon footprint. AP1 is a member of the steering group. Another new collabo-

ration is Climate Action 100+, a 2017 global initiative for investors aimed at engaging in dialogue with the 100 companies that are deemed to have the largest carbon footprint globally. The data is obtained from the TPI, see page 20.

| | Absolute carbon footprint (tCO ₂ e) | | Carbon intensity in relation to market value (tCO ₂ e/SEK m) | | Carbon intensity in relation to turnover (tCO ₂ e/SEK m) | | Carbon intensity, weighted average relative to turnover is multiplied by the company's percentage of the portfolio (tCO ₂ e/SEK m) | |
|--|--|-------------------------|---|-------------------------|---|-------------------------|---|-------------------------|
| | Absolute | Relative ⁽²⁾ | Absolute | Relative ⁽²⁾ | Absolute | Relative ⁽²⁾ | Absolute | Relative ⁽²⁾ |
| Sweden | 120,000 | -44% | 3.0 | -44% | 4.9 | -44% | 6.0 | -25% |
| Developed markets | 584,000 | -8% | 13.5 | -8% | 22.0 | -10% | 24.0 | 46% |
| Emerging markets | 863,000 | -36% | 22.1 | -36% | 34.3 | -43% | 47.5 | -32% |
| Total | 1,567,000 | -25% | 12.8 | -25% | 20.6 | -26% | 26.1 | -7% |
| Year-on-year comparison | | | | | | 2017 | 2016 | 2015 |
| Absolute carbon footprint equating to the owned share of the companies' aggregate emissions (millions of tCO ₂ e) | | | | | | 1.6 | 1.7 | 1.1 |
| Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' market value ⁽³⁾ (tCO ₂ e/SEK m) | | | | | | 12.8 | 14.2 | 10.1 |
| Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' turnover (tCO ₂ e/SEK m) | | | | | | 27.9 | 24.7 | 22.1 |
| Carbon intensity, weighted average, where the companies' carbon intensity relative to turnover is multiplied by the company's percentage of the portfolio based on market value (tCO ₂ e/SEK m) | | | | | | 26.1 | - | - |
| Charted market value as a percentage of total net assets | | | | | | 39% | 39% | 37% |

⁽¹⁾ The above values pertain to AP1's equity portfolio on 31 Dec 2017, market value SEK 130,872 million.

The market value as of 30 November 2017 has been used for unit trusts to the amount of SEK 7,033 million.

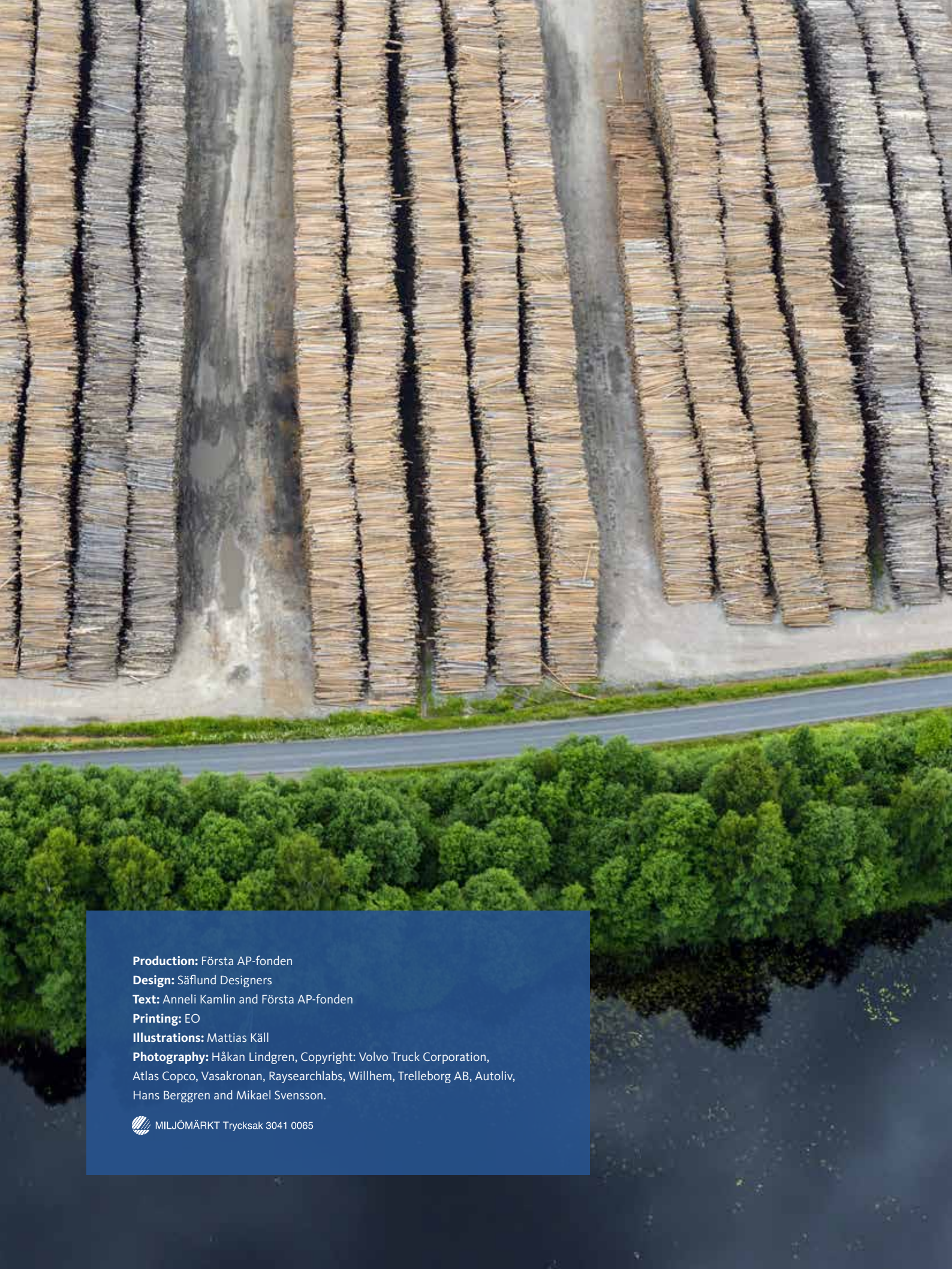
⁽²⁾ The 'Relative' columns show the extent of the portfolios' carbon footprint in relation to that of the benchmark portfolios.

Negative figures mean that the Fund's portfolio has a footprint that much lower than that of the benchmark portfolios.

⁽³⁾ Market value of listed equity portfolios.

The table above shows AP1's carbon footprint according to the above metrics for the listed part of the equity portfolio. That portfolio makes up 39 per cent of the Fund's total portfolio. For 2017, 59 per cent of the carbon footprint in the total portfolio is based on reported emissions, 28 per cent is calibrated data and the remaining 13 per cent is based on estimated information. The carbon footprint for the Fund's credit bonds has also been calculated for 2017. A summary of the calculations is published on www.ap1.se. The calculations were performed by Trucost®. The carbon footprint from AP1's office operation and its employees' travel has been offset since 2015.





Production: Första AP-fonden

Design: Säflund Designers

Text: Anneli Kamlin and Första AP-fonden

Printing: EO

Illustrations: Mattias Käll

Photography: Håkan Lindgren, Copyright: Volvo Truck Corporation, Atlas Copco, Vasakronan, Raysearchlabs, Willhem, Trelleborg AB, Autoliv, Hans Berggren and Mikael Svensson.



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