

Annual Report 2017



The forest is an important raw material for manufacturing in the hygiene industry, which can be found in Första AP-fonden's equity holdings.

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Första AP-fonden reports the economic, environmental and social impact of its own operations as part of the annual report. Certain information is also reported on the website, in the Ownership Report, and in the annual report of the AP Funds' Ethical Council. The sustainability reporting is based on Global Reporting Initiative guidelines, GRI Sustainability Reporting Standards Core option, including the industry-specific supplement Financial Services (FS). A full GRI index can be found on our website at www.ap1.se

Brief Facts about Första AP-fonden

FÖRSTA AP-FONDEN 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 effect the pensions which are being 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

SEK **7,4** bn

into the pension system



Highlights of the Year

Net investment income for 2017 means that AP1's return exceeds the long-term target of an annual real return of 4.0 per cent after expenses over rolling ten-year periods.

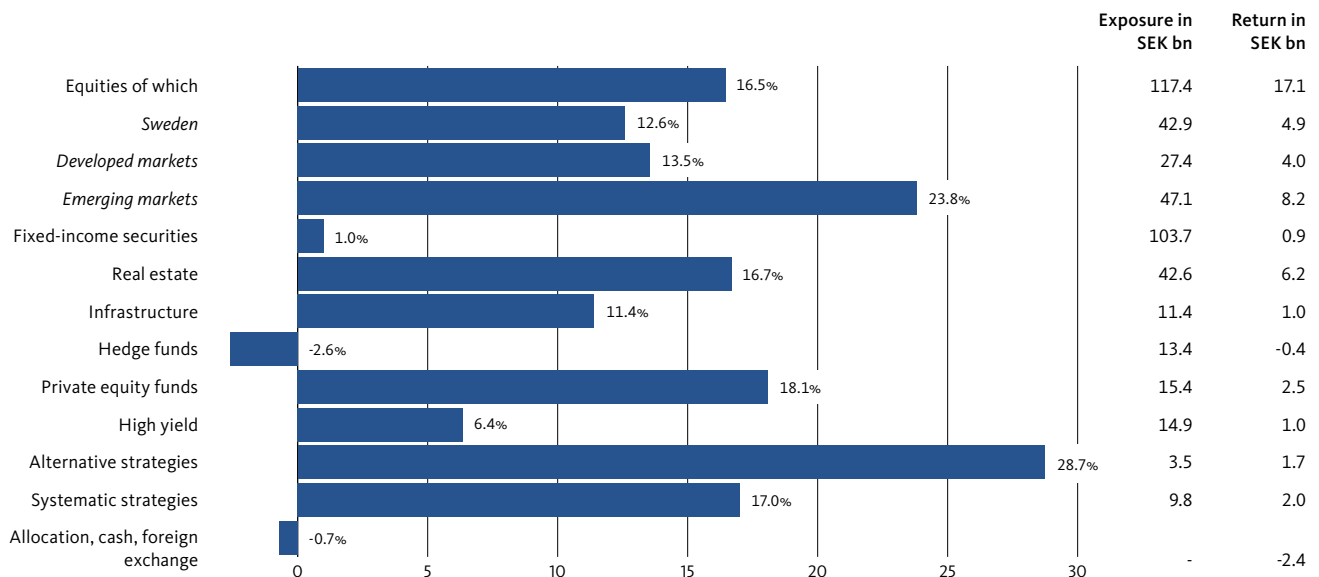
- Net investment income after expenses for 2017 was SEK 29,349 million (26,965). This equates to a return of 9.6 per cent (9.3).
- In real terms, the return was 7.8 per cent (7.6) in 2017.
- The average annual real return after expenses for the past ten-year period was 5.0 per cent, which is higher than the target of 4.0 per cent.
- Management generated an excess return of SEK 3.5 billion (4.2) above the Fund's strategic benchmark (see pages 9 and 28 respectively). The main contributors in absolute money terms were equities and real estate.
- AP1's total portfolio value on 31 December 2017 was SEK 333 billion.
- Since 2009 AP1 has disbursed SEK 44 billion, of which SEK 7.4 billion in 2017, to cover the contribution deficit in the income pension system.
- The Fund's administrative expenses fell to SEK 445 million (458), equalling 0.14 per cent (0.15) of average assets under management.
- During the ten-year period 2008-2017, the Fund's return exceeded the income index by 3.0 per cent a year on average.
- In 2017 AP1 extended its investments in emerging markets and reduced its exposure to the US dollar in favour of the Swedish krona.
- During the year AP1 was also particularly active in the area of real estate, with a range of direct investments, such as:
 - an increased holding of retail properties in Secore Fastigheter
 - continued expansion in real estate company Willhem
 - a new joint venture with Elo with a focus on Finnish commercial properties

Five-year overview – summary	2017	2016	2015	2014	2013
Return before expenses, %	9.7	9.5	4.1	14.8	11.3
Expense ratio, %	0.14	0.15	0.17	0.17	0.14
Return after expenses, %	9.6	9.3	4.0	14.6	11.2
Net investment income after expenses, SEK bn	29.3	27.0	11.3	36.4	25.7
Net flows, SEK bn	-7.4	-6.6	-4.9	-5.1	-6.9
Closing net assets, SEK bn	332.5	310.5	290.2	283.8	252.5
Exposure, %					
Equities	37.9	34.1	34.7	48.9	49.2
of which Swedish equities	12.9	12.3	12.3	11.6	12.0
Fixed-income securities ⁽¹⁾	31.7	29.8	30.2	30.9	31.2
of which fixed-income securities in other assets	0.5	2.5	2.3	3.3	1.5
Real estate	12.8	12.6	11.5	8.8	8.8
Infrastructure	3.4	3.0	2.9		
Hedge funds	4.0	5.0	4.8	5.9	4.9
Private equity funds	4.6	4.7	5.0	4.4	3.3
High yield	4.5	4.5	2.9		
Alternative strategies	1.0	5.0	4.4	5.6	4.8
Systematic strategies	3.0	4.5	5.2		
Special investments ⁽²⁾		0.5	0.7		
Foreign exchange	25.3	22.1	31.3	35.1	29.2
Share of external management, %	32.5	31.8	31.0	34.6	37.1

⁽¹⁾ Investment grade bonds (fixed income incl. cash funds in accounts = 32.54% for 2017)

⁽²⁾ As of 2017, Special investments are reported under Equities

Return by asset class in 2017



Another good year in an uncertain environment

For Första AP-fonden (AP1), 2017 was another year when we were able to record a strong net investment income of SEK 29.3 billion after expenses, which equates to a return of 9.6 per cent.



to 20 per cent of net assets. During the autumn, AP1 submitted its consultation response with detailed comments. On the whole the proposal is positive, as it represents more modern, flexible rules that provide better conditions for achieving our long-term return target.

To deal with increasingly challenging external conditions, we are striving continuously to refine and develop our portfolio. Measures in 2017 have included extending our investments in emerging markets, where we deem opportunities for strong returns to be better than in developed foreign markets, for example, which are characterised by high valuations. Our exposure to the US dollar decreased slightly during the year in favour of the Swedish krona, a trend we believe will continue.

Real estate and infrastructure are important elements in our portfolio of alternative assets. During 2017, we invested for instance in a British infrastructure company that focuses on modernising the water and sewerage system in and around London. The aim is to secure the water and sewerage facilities, and also to limit environmental impact.

AP1 is continuing its goal-conscious sustainability work with a clearly integrated approach, whereby we regard sustainability to be one of several natural and key criteria when assessing investments. This applies not only to new investment, but also as we continuously evaluate our portfolio. One of our investment beliefs is that companies which regard sustainability as a business-critical factor have a better

With the 2017 results, since the beginning in 2001 we have exceeded our target 4 per cent real average annual return after expenses on a rolling ten-year basis. The return for the past ten-year period was 5.0 per cent.

Sweden has a robust national pension system, and I am of course delighted that AP1 can help to secure its stability. While our total net assets reached their highest ever volume of SEK 333 billion at the end of 2017, during the year we paid out SEK 7.4 billion to cover the contribution deficit in the national income pension system.

The Fund's management created an annual excess return of SEK 3.5 billion compared to its benchmark (see pages 9 and 28 respectively), and the main contributions in absolute terms came from equities and real estate.

The global economy grew progressively stronger during the year, and is increasingly synchronised across the various regions. At the same time

consumer price development was unexpectedly subdued, and monetary policy austerity was modest. This laid a fertile foundation for high valuations and inflated asset prices. Nevertheless, there is a clear trend for monetary policy austerity and this is a rising threat to the economy, as inflation is expected to increase. We have long predicted that it will be increasingly difficult to achieve a return on assets under management that is strong in the long term.

“Return for the year was 9.6%”

In 2017, the Swedish Ministry of Finance presented a proposal for modified investment rules for the AP Funds. The proposal includes several changes that increase the chances of strong returns, including a reduction in the lower limit for fixed-income securities from 30

foundation for delivering good return and lower risk.

During the year, the Fund's employees received training in various areas, including Agenda 2030 and how its development goals can be used as governance instruments in the operation. Alongside our 'sister funds' (AP2-4), during the autumn we held a stakeholder dialogue, inviting representatives of different target groups to discuss on which sustainability issues the AP Funds should focus. The results will form input data in a materiality analysis which we will conduct during 2018.

“The proposal represents more flexible rules”

One vital part of our ESG work is the G for Governance, i.e. how we as shareholders take responsibility for the companies we own. In 2017 we took part in 28 Swedish general meetings and voted in 629 foreign ones. We are a relatively large shareholder in more and more smaller companies, and altogether we are on 12 nomination committees ahead of the 2018 general meetings, which is a good way for us to influence the companies. One of the issues brought to the fore in 2017 was the importance of the company boards ensuring that the CEO and executive management focus mainly on their operational, day-to-day tasks. We also continue to raise the issue of effective, business-based incentive programmes for company management groups, as well as diversity in the boards.

As a state-run AP Fund, it is essential that we run our business cost effectively. It is clear that we perform well in international comparisons in terms of administrative expenses. It is also pleasing to note that we reduced our overall costs for the second consecutive year. In 2017 we reduced our expenses for



CEO Johan Magnusson can look back on another strong year in 2017.

“We are strengthening our technical and mathematical expertise”

premises, for example, by decreasing our office space by 25 per cent. Our productive cooperation with the Second, Third and Fourth AP Funds continued during the year. Several liaison groups meet on a regular basis, the main aim being to identify synergies, to streamline costs where appropriate, and to mutually benefit from shared experiences and working methods.

“Sustainability is a key criterion in assessing investments”

All in all, ten employees were recruited to AP1 during 2017, six of whom were women and four men. We are for instance strengthening technical and mathematical expertise in the Fund, as increasingly high demands are being placed in this area. In modern asset management, the importance of

rule-based, quantitative management is increasing in scope and significance.

A large number of development projects were initiated during the year, and efforts to make AP1 a world-class pension fund continued. Feedback from employees through several channels such as CEO breakfasts, employee days, progress reviews and 'pulse-checks' during the year brought some valuable comments and ideas, so that we can further strengthen the good momentum that I feel we have at AP1.

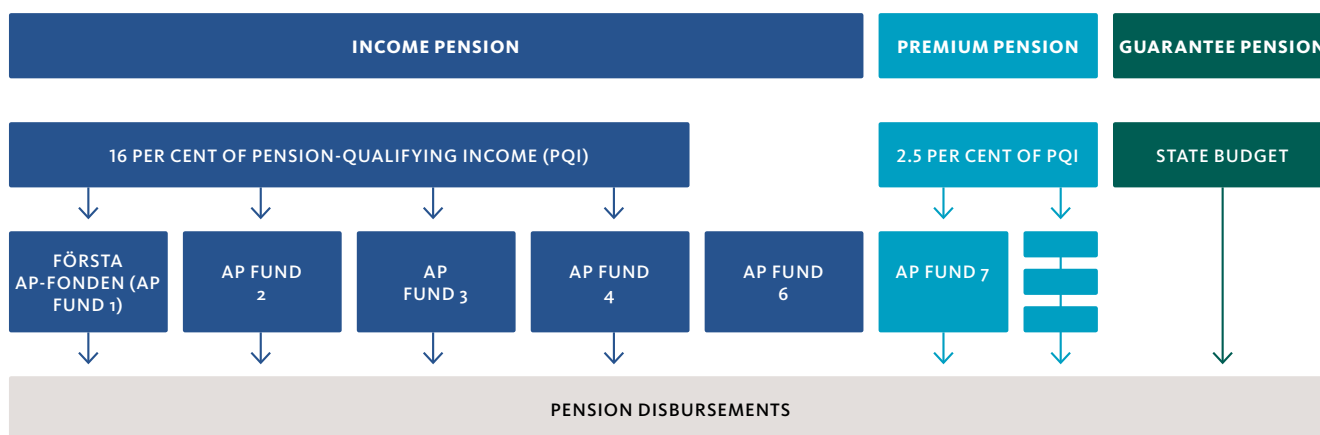
It is a tremendous privilege to lead Första AP-fonden's operation. I look forward with confidence towards continuing to work with all our competent, professional employees, so that in an increasingly challenging world we can go on delivering good returns and thereby forming an important part of the Swedish national income pension system.

Stockholm, February 2018
Johan Magnusson

Important role as a reserve for Swedish pensions

Första AP-fonden (AP1) is part of Sweden's national pension system. AP1 shall manage the pension assets to the greatest possible benefit of Swedish pensioners. Good performance by the Fund helps to create stability across generations.

The national pension system



Första AP-fonden contributes to income pension, part of the national pension system.

Mandate:

To secure income pension

Everybody who has worked in Sweden is entitled to a pension from the national pension system, which consists of income pension, premium pension and guarantee pension. Första AP-fonden (AP1) is important to income pension.

The size of an individual's income pension is determined by how much he or she has worked during their life, i.e. the overall size of the contributions paid into the system. The contributions and the return on them cover the pension disbursements.

In some years, however, the disbursements may exceed the contributions for the overall pensions in all of Sweden. In such cases, AP1 and others serve as reserves. Every year, some of the pension contributions are trans-

ferred into the Fund, and the Fund's assets act as a buffer for any imbalance between contributions and disbursements. The Second, Third and Fourth AP Funds have the same role.

Pension contributions have not been high enough in recent years, so on balance AP1 has paid money into the pension system. The net disbursements are expected to continue for a long time. This shows that the return on the Fund's assets is important in creating stability in the pension system.

Target:

Return, risk and informed choices

AP1 aims to maximise the return on the pension assets it manages. In the long term, the pension assets should develop as well as average pay in Sweden, but AP1 wants to deliver a higher return so as to minimise the

effects of any imbalances that may arise in the pension system.

AP1's target is to generate real return, i.e. an inflation-adjusted average annual return, which is higher than 4.0 per cent after expenses, measured over rolling ten-year periods. The average return over the past ten years has been higher than the target level.

With a long-term approach, the Fund has many investment options and can deal with short-term fluctuations in the level of return. Risk is also limited through informed choices and concentrated portfolios.

Sustainability aspects are integrated into the Fund's investment decisions, and are one of many important criteria in achieving a high return. Sustainable companies are well managed, and investments in such companies probably lead to higher returns and lower risk.



AP1's target is to generate a real return which is higher than 4.0 per cent over rolling ten-year periods. This target has been exceeded for each of the past ten years. The photo shows one of polymer group Trelleborg's test centres.

We ourselves also aim to work in a cost-effective way. Costs should be low in relation to the outcome achieved.

**Fund governance:
Responsibility at different levels**

Thanks to a clear division of responsibility within AP1, the operation can be monitored and developed.

The Board of Directors decides on the target for real return, and what level of financial risk the Fund should take – the risk preference. This is expressed in an overarching division of assets into equities (65 per cent) and fixed-income investments (35 per cent). Divergence levels and permitted asset classes are also defined here.

The CEO defines a strategic benchmark for the Fund's management in the long term (ten years) based on the Board's risk preference, investment beliefs and guidelines in general. This 'strategic asset allocation' spreads the risk with 43.5 per cent equities, 30 per cent fixed-income assets and 26.5 per cent alternative investments. This benchmark is, over time, expected to generate a better and less volatile return than the Board of Directors' risk preference. The CIO defines the strategic focus for asset management over three to five years, and it is implemented by the investment organisation.

Follow-up is primarily conducted by the people who were involved in the

investments. One person is always in charge. In addition there is internal control and internal auditing. The Fund is also scrutinised annually by external auditors and the Government.

**Vision:
A world-class pension fund**

AP1 strives to be a world-class pension fund. Our return should be on a par with other outstanding international pension funds. A fund governance model of international top class, a good reputation internationally for responsible investments and a clear focus on optimising asset management are all factors in achieving this.

Will there be enough money?

The Swedish pension system is financially robust. The system is structured in such a way as not to make a loss over time. The size of future disbursements is determined by the length of time Swedes work, and how many of us are working.

One common question about the pension system is whether there will be enough money. The answer is yes. There will be enough money, because it is not technically possible for the pension system to lose money over time; it is not allowed to be under-financed. Swedish pensioners will receive as much pension as the system allows. This structure means that the system often receives positive attention in international contexts.

The pension system will not, therefore, run out, since it is based on the assets and liabilities being in balance. The amount of money in the system, i.e. how much can be disbursed to each individual, will however still be determined by the total amount of salaries and wages paid in Sweden. The higher the working population and the more of us working, the greater the total pension disbursement can be.

The money being paid into the pension system today is paid out to today's pensioners. So the proportion of a person's pay reserved for pension is not saved for that particular person's pension, but is only entered in that person's

Assets and liabilities in the income pension system



individual account. The pension system's debt to everyone who will retire is the sum total of all individual accounts. Those of us working today, therefore, have a right to be paid a pension in the future.

So that stability is guaranteed in the pension system, it contains an automatic balancing mechanism, or 'brake'. This means that pensions are adjusted upwards more gradually at times when liabilities exceed assets, as happened in 2010, 2011 and 2014 for example.

If assets then again exceed liabilities, a re-adjustment is made. Much of the effect of the brake outlined above has been recouped in recent years.

When pension contributions are

insufficient, the difference is made up from the AP1-4. The AP Funds are there to manage the funded pension assets, so that the pensions are affected as little as possible by applying the brake. A strong development in the national economy and a large working population place lower demands on high returns in the AP Funds, and vice versa. A rising value in the Funds' assets has allowed the automatic balancing to be avoided several times. Thus the Funds have an important, value-creating role to play.

Due to the high rate of retirement, over the past year Funds AP1-4 have all made net disbursements to the pensioners. This is expected to continue for many years to come. In the vast majority of years, however, the return for the year is enough to cover the net disbursements, and the assets do not decrease.

All in all the First, Second, Third and Fourth AP Funds account for 14 per cent of the assets in the pension system, approximately SEK 1,400 billion. The remaining 86 per cent, or SEK 7,700 billion, can be said to be the value of all future payments into the system. At the present time, assets are about 4 per cent more than liabilities.

Why funds with different numbers?

AP1, AP2, AP3 and AP4 all serve the same purpose as a buffer in Sweden's national pension system. The Funds are divided so as to spread the risks in asset management. All the Funds follow the same statutory investment rules, but each Board chooses the focus of its investments within the boundaries of the National Pension Insurance Funds (AP

Funds) Act. There are some differences between Funds in terms of allocation into asset classes.

The Fifth AP Fund was discontinued when the system was reformed in 1998. The Sixth AP Fund is also a buffer fund, but it invests only in unlisted companies and is now. The Seventh AP Fund is the state actor in the premium pension system.



Own allocation for the best results

Diversification and a long-term approach are two mainstays in AP1's investment strategy. Risk-taking on the financial markets yields a positive return over time.

In AP1's asset management, different aspects are compared to achieve the target of at least 4 per cent real return on the pension assets.

The Board decides what level of financial risk the Fund should take, the risk preference. This is expressed in an overarching division of assets, which is based on the investment rules in the National Pension Insurance Funds (AP Funds) Act. The Act stipulates that the portfolio should maintain a risk

level equivalent to a portfolio where 65 per cent of the assets are invested in equities, and 35 per cent in fixed-income instruments.

The purpose of the fund management is to achieve a better outcome than passive management according to the overarching asset allocation. The management organisation therefore specifies the allocation into different types of assets, so as to increase diversification and find more opportunities for

yielding returns.

The allocation aims to maximise the investment yield, based on the risk preference established by the Board of Directors.

Första AP-fonden's long-term approach is a contributing factor in generating a high return; it allows more opportunities and reduces the financial risk over time. Simultaneously, however, risk-taking is pivotal to the possibility of achieving a return. But simply because the overall focus is long term, this does not mean the Fund has to forego interesting investments in the short term.

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 on the financial markets yields 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

Investment rules*

The National Pension Insurance Funds (AP Funds) Act's investment rules for AP1 state that:

- investment decisions may not be influenced by government policies, whether industrial or economic
- consideration shall be given to environmental and ethical matters without compromising the overall objective of attaining a high return
- the Fund's investments in regulated Swedish markets may not exceed 2 per cent of the total market value
- the Fund may hold no more than 10 per cent of the votes in any single listed company
- at least 10 per cent of assets must be managed externally
- at least 30 per cent must be invested in fixed-income securities with a high credit rating
- no more than 5 per cent may be invested in unlisted securities
- no more than 40 per cent of assets may be exposed to foreign exchange risk
- no investments in commodities may be made

*The investment rules are currently under modification; see the text box on the next page.

Dual perspective

Investment decisions are made both top-down, and bottom-up; both processes create value. With the top-down approach, the percentage of capital reserved for each asset class, such as 12 per cent in Swedish equities, is decided first. With the bottom-up approach, the manager responsible for Swedish equities, for example, strives to identify the best equities within set parameters.

Qualified analysis

Within its internal active management, the Fund focuses on a few equities. Even though there are many investments overall, there are far fewer than with many other financial players, since concentrated portfolios are relatively uncommon.

Internal portfolio management builds knowledge in the organisation, while also facilitating collaboration with boards and management teams. AP1's asset managers are sector generalists, which means that they focus on



The long-term perspective gives AP1 more freedom of choice. AB Volvo is in the equity portfolio.

certain sectors of which they have broad and in-depth knowledge.

Internal management is cost effective, and portfolio management combines an assessment of potential value

and risk. The investments are assessed primarily on their ability to produce a good return over time.

AP1 works with carefully selected external managers for small cap

equities on developed markets, and on emerging markets. These managers are engaged to supplement the Fund's in-house expertise with knowledge and local presence.

AP1 also has a portfolio of fixed-income assets, which by law are principally bonds with a high credit rating, which means a lower return, particularly bearing in mind current low interest rates. However, the Fund also owns bonds that yield a higher return. The current fixed-income market imposes stringent demands on expertise and active investment choices in order to create the best possible outcome.

AP1 also has an extensive operation with systematic, more technically oriented management, where we use mathematically oriented solutions to optimise investment decisions.

In addition to equities and fixed-income securities, AP1 focuses on alternative investments such as real estate, infrastructure, private equity funds and other assets that are not liquid, i.e. not easy to sell quickly. This is a good way of exploiting our long-term approach, and is a possibility not shared by many other investors.



“Modified investment rules are on their way”

Mikael Angberg, Chief Investment Officer

In autumn 2017, the Swedish Ministry of Finance presented a proposal for modified investment rules for the AP Funds. AP1 was one of the 25 or so consultation bodies.

We are very pleased to hear that investment rules for the AP Funds are about to change. It gives us greater opportunities to diversify our investments and adjust the risk level, which means we have a better foundation for achieving our goals,” says CIO Mikael Angberg.

“The requirement to have at least 30 per cent of the assets in fixed-income securities is a restriction, since the expectations on return for these are extremely low. A reduction from 30 to 20 per cent would mean a lot. A planned easing in the restrictions on unlisted investments is also a good thing. In that segment we will be able to change the allocation between different types of assets, partly as the limit of investing a maximum of 5 per cent in private equity funds is scheduled to be removed.”

Equities are AP1's largest class of asset. The portfolio includes equities in Autoliv, which operates globally in vehicle safety solutions.



A portfolio tailored for long-term returns

During 2017, investments in emerging markets increased. There was also a shift from US dollars to Swedish kronor, and a renewal of the financial toolbox.

For several consecutive years, Första AP-fonden has exceeded its return target by a fair margin. The expectation over the next ten years, however, is that the average return on net assets will be considerably lower than the target 4 per cent, given the current general division of assets.

The Fund organisation's task is to refine the overarching allocation goals so as to generate the highest possible re-

turn at limited risk. This is a constantly ongoing process, which in 2017 entailed adaptation through greater diversification, for example.

Modified investment rules in Sweden's National Pension Insurance Funds (AP Funds) Act are expected, in the longer term, to allow scope for higher risk in the portfolio. This does not mean that the Fund will necessarily change its risk profile, but in the long

term it is likely that higher risk-taking will be the best path to high returns. Moreover, higher-risk investments can be balanced by other investments that carry lower risk.

Emerging markets attractive

Equities are AP1's largest class of asset. It includes selected Swedish holdings, equities on developed markets primarily in the US and Europe, and emerging markets.

During 2017, the Fund has moved capital from developed markets to emerging markets. At the beginning of the year holdings in emerging markets accounted for 8 per cent of the total portfolio, while at the end of the year they accounted for just over 14 per cent.

The foundation for strong development is deemed to be better on emerging markets than in the US and Europe. Stock exchanges on developed markets are characterised by high valuations, while those on emerging markets are more attractive.

AP1 has a broad exposure to emerging markets, with the emphasis on Asia. Certain regions are regarded as particularly attractive. AP1 takes a long-term view of investments in emerging markets, and plans to maintain a relatively high exposure there. At present the Fund is working with external managers on these markets due to a lack of resources.

New asset manager with ESG focus

The foundation of AP1's portfolio of fixed-income assets is bonds with a high credit rating. There are, however, more high-return alternatives.

During the year, the Fund 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. The aim is to strengthen the geographical spread, and AP1 can also see an advantage in Hermes integrating sustainability aspects in its credit investments.

Alternative investments in real estate and infrastructure remain of interest to AP1. In infrastructure, the Fund is under-exposed to directly owned assets.

Shift to kronor

An increasing conviction that the Swedish kronor ought to grow stronger in the longer term, primarily against the US dollar, led to a change in the Fund's currency positions in 2017. The Fund's previous high exposure to the dollar has been successful, but it decreased during the year.

AP1 operates actively on the foreign exchange market, although it is not obvious which alternatives are better than

the krona. Monetary policy in central banks affects the markets for US dollars, pounds sterling and Japanese yen. Brexit is creating particular uncertainty regarding the pound.

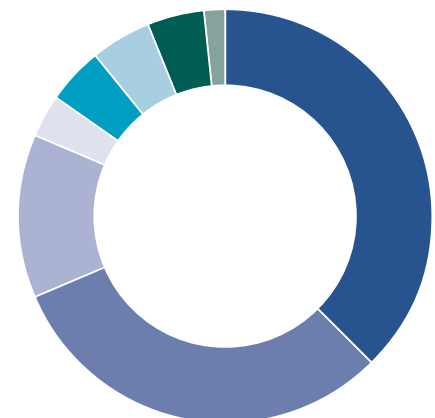
Hedge funds and leverage

AP1 invests in hedge funds to streamline its asset management and balance the risk in equities, which are highly volatile. Preparatory analyses have been conducted to increase the element of internal management, leverage and derivatives, which enable greater exposure without expensive funding of capital. The proportion of the capital encompassed by leverage remains low, just over 1 per cent, but is expected to increase.

In recent years the Fund has invested heavily in reinforcing the information systems. Some new systems are already in place, enabling the management organisation to be more active in its work of allocating risk in a controlled manner. The possibility of further improving the overall perspective of the portfolios has increased.

Reallocation of holdings presupposes a clear, transparent cooperation between the Fund's overarching allocation goals and the more operational investment work, where positions cannot

Assets by class



- Equities 37.9%
- Fixed-income securities ⁽¹⁾ 31.2%
- Real estate 12.8%
- Infrastructure 3.4%
- Hedge funds 4.0%
- Private equity funds 4.6%
- High yield 4.5%
- Other 1.6%

⁽¹⁾ Investment grade bonds (fixed income incl. cash funds in accounts = 32.5% on 31 Dec 2017)

always be changed at short notice. Improved information systems contribute to this interaction.



"We bring sustainability issues to the fore"

Majdi Chammas, Head of External Management

Following a comprehensive global tender process, Hermes Investment Management was appointed one of AP1's high-yield asset managers.

"The Hermes philosophy and process are well suited to our portfolio. We are convinced that Hermes will be able to take advantage of the benefits that are available to long-term investors as part of a global remit. Moreover, the team is at the forefront when it comes to integrating environmental,

social responsibility and corporate governance issues in its investment process. Hermes has an innovative mindset for pricing sustainability risks," says Majdi Chammas, AP1's Head of External Management.

"As a major institutional investor, we have an opportunity to influence the industry as a whole and bring sustainability issues to the fore, while also striving for the highest possible return on assets."

The turbulence starts to settle down

The situation on the financial markets has long been exceptional, with high returns. The financial landscape is changing, but it is uncertain exactly how this will affect management outcomes.

Första AP-fonden invests in a wide variety of asset types around the world. Consequently, various external factors affect the return on the Fund's assets, the principal ones being growth and interest rates.

Fundamentally, economic growth and interest rates have an effect on all holdings, i.e. equities, fixed-income securities and alternative investments, such as real estate and infrastructure. High growth is generally positive and often goes hand in hand with higher interest rates, although interest rates are also governed by monetary policy.

A synchronised economic upswing has been noticeable around the world since 2016. Meanwhile, interest rates have remained low or negative. This is an exceptional situation. The financial markets have long been affected by the

systemic crisis brought about by sub-prime mortgage lending in the American financial sector in 2008. Central banks around the world have stepped in to rescue the situation. They have reduced short-term key interest rates and bought bonds with long maturities, which has squeezed the long-term interest rate. The result is a historically low rate of interest.

Time for the central banks to step back

It is now time for the central banks to start winding down their support and their extensive holdings of fixed-income securities, and this will have consequences for other players on the market. Because of the enormous volumes in play, policy errors can have dramatic effects. The economic upturn could be slowed by too sudden increases in in-

terest rates. At the same time though, interest rates do need to go up.

In the short term, the equity market is affected by surprises and psychology, both positively and negatively. Summer 2016 is a case in point, when many years of weak growth was followed by stronger growth, thus driving the market positively.

In the longer term, share price performance is influenced most by the level of valuation. Depending on region, at present the level of valuation is high to medium in relation to company earnings.

Since company margins, globally speaking, are historically high and also higher than they may be assumed to be on average, return opportunities on the equity market are weak in the longer term. The same applies to fixed-income securities under low interest rates.

For real estate, the combination of high growth and low interest rates has long been very positive and has driven up property prices. The future scenario is not so positive.

The investor sphere of the western world is dominated by the US, where the stock exchange is highly valued. The US economy has picked up and growth is relatively good, albeit unevenly distributed regionally. At present, growth is highest in oil-producing areas.

The situation globally is positive, and company earnings in Europe are expected to continue improving.

The economic cycle bottomed out globally in 2009, but Europe subsequently had a debt crisis of its own, which primarily affected the southern parts. The bottom has been reached,



"Harder to achieve high returns"

Mats Larsson, Strategist

"We've been saying for several years now that it will be increasingly difficult to achieve good long-term returns on the Fund's assets. Even so, we have continued to deliver strong results. This is a clear illustration of how the short and long term are not always interdependent. However, every year of good return eats a little into the future return,"

says Mats Larsson, Strategist at AP1. The length of the economic cycle will now likely be crucial to continued development, and right now we are in the middle of a positive trend. The greatest risk is that monetary policy support is being phased out, which could cause disruption on the markets. The Chinese debt situation is also a cloud on the horizon."



As a global investor, AP1 is influenced by many external factors.



but economies are not booming. The European banking sector is in worse condition than its American counterpart, and this is affecting companies'.

The situation now looks brighter in the European stock exchange, but if the US weakens, Europe weakens too.

Interesting emerging markets

Emerging markets have grown more interesting on the stock exchange, with many attractive valuations and company earning capacity stabilising.

These markets represent around 12 per cent of the global market value. Emerging markets do, however, include the massive economy that is China, a country that affects the global economy.

China has built its economic growth on exports and investments in infrastructure. Its rate of growth is now levelling off. The Chinese economy is becoming more like that in the West, where private consumption is more important and greater emphasis is being placed on investment returns.

China has large debts

and great environmental challenges. Growth could also be slowed by the fact that these aspects of the economy are a higher priority than they were before.

Asia's other major investment market is Japan, which has had economic problems since the late 1980s and also has a complicated population structure. There are, however, signs that the repair phase is now coming to an end.

Global growth being challenged

In the very long term, economic growth is affected by changes in population size and in work productivity, i.e. production per person.

The levelling-off of the population increase, or even a decrease in the population, is therefore a challenge, especially in the West. Productivity has also been relatively low here for the past decade. One explanation lies in the monetary policy. Indebted companies are not being punished with high interest rates, and substandard businesses are not being eliminated. On the positive side, technologi-

cal developments are supporting long-term productivity development.

Political influence

Apart from monetary policy, political circumstances are of significance to the markets to the extent that they affect the earning of securities. Events of importance to society at large are not always as important for the financial markets. Right now the political situation is less significant because the economic situation is relatively stable.

Many expected that Trump's election as US president and Britain leaving the EU, Brexit, would have adverse consequences for the markets.

Instead the Trump effect was a boon for the equity market, with hopes of economic incentives. Trump was also lucky as the economy was picking up when he took office.

Nor has there been any noticeable Brexit effect beyond the foreign exchange market. At company level there are however differences in equity valuation between those companies affected and not affected by Brexit.

Well-managed risk favours Swedish pensioners

To achieve good returns on its pension assets, Första AP-fonden has to take risks. This must, however, be done under close control and within defined limits. Risk management is an area of constant focus at the Fund.

AP1's goal is to achieve 4 per cent real average annual return on its assets, and successful asset management presupposes a level of risk-taking.

The Fund's Board decides the return target. It also states what level of financial risk the Fund should take, the risk preference. This is expressed in an overarching division of assets into equities and fixed-income securities.

In addition, there is a defined mandate regarding tolerance for divergences. Both of these internal risk limits and limit values, which are defined in the National Pension Insurance Funds (AP Funds) Act, are checked on a daily basis.

Two categories of risk

AP1's two main categories of risk are financial risk and operational risk.

Operational risk relates to processes, IT systems and corporate culture. Mapping and control of internal processes clarifies the division of work tasks and responsibility for risk in the organisation. This includes responsibility for handover, and that the person who owns the process follows it up so as to minimise the operational risk.

Financial risk includes credit risk, i.e. counterparty risk and issuer risk, as well as liquidity risk, and these risks are carefully monitored. Market risk should be taken under controlled forms, for example by ensuring that the portfolio is well diversified between different classes of assets. It is measured in terms of volatility, for example, and covariance in asset classes is taken into account to balance the total risk in the portfolio. Unlike operational risks, which should



be minimised, the aim with market risks is to optimise them.

The Fund's systems support is under constant development. A recently implemented risk system clarifies in detail how the financial risks are distributed. The system enables AP1 to more efficiently calibrate these risks using established analysis models. It also builds readiness to take a higher level of risk, which is expected to be possible in the future when

the investment rules in the AP Funds Act change.

The working culture in AP1 should include risk awareness. Employees should have a particular interest in the Fund's reputation. Maintaining a high degree of confidence in the AP Funds is crucially important in ensuring lasting trust in the pension system.

Three lines of defence

The operational structure in the area of risk is based on three lines of defence.

The first line is the management organisation, alongside Back Office, which are the risk owners jointly responsible for managing investments.

The second line of defence is the Risk Management unit, which supports the organisation and monitors, checks and reports risk to the Board.

The third line is the internal auditor.



"Risk management crucial to returns"

Katarina Höller, Head of Risk

"Asset management is growing ever more complex. Financial instruments are developing and there are more and more derivatives. This calls for advanced systems and good procedures. Our work on risk is crucial in ensuring we can do a good job and deliver a return," says Katarina Höller, Chief Risk Officer at AP1.

"The Fund's work in this area includes risk control, risk analysis, fresh thinking, and a culture where every employee takes responsibility for managing risk. We have to take risks, but they must be controlled."

The manufacturing industry is one sector
with a long history of representation in
AP1's holdings.

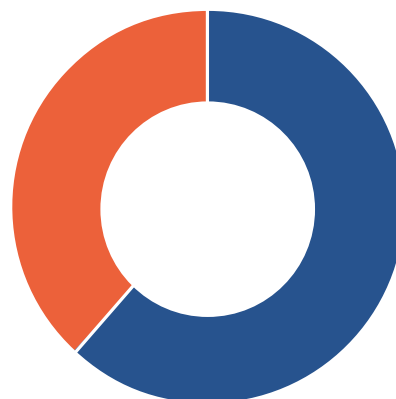


Technical know-how increasingly vital

AP1's pension assets are managed by a group of qualified personnel. More and more of them have a technical of mathematical background.



Every employee plays a key role.



62% men 38% women

Of AP1's employees, 62 per cent are men and 38 per cent women.

A high level of education is the recurring theme for AP1's personnel. Increasingly, people are being recruited who have a technical background, especially in programming. Advanced information systems are a success factor for an international asset manager.

More than one in five employees has an international background. This diversity is an asset, both with regard to expertise and dynamics. It is also positive that the percentage of women is on the increase; more new recruits during the year were women than men. The average age of all employees on 31 December 2017 was 45.

Contributing to public welfare

AP1 is a small, cost-effective organisation in which each employee plays a key role. The Fund's global focus and large assets under management impose stringent demands on cutting-edge expertise and long experience.

Good interaction between qualified co-workers is vital if the Fund is to deliver good returns, and it also boosts well-being in the workplace.

Employee surveys show that the knowledge-intensive environment makes the Fund an attractive place to work. Moreover, many employees value the



"I value the Fund's focus on training"

Caroline Lindstrand, Controller

"During the year I attended a leadership course tailor-made for specialists at the AP Funds. I've now developed in my own role and also enjoyed some natural networking with colleagues at other Funds," says Caroline Lindstrand, Controller at AP1.

"I value the Fund's focus on training. The idea is to offer personal leadership

development also to personnel who do not manage others, which can only be a good thing. Greater insight into the Fund's values and deeper self-insight have been interesting themes. AP1 works in a special area, bearing in mind our social responsibility.

The knowledge-intensive environment makes the Fund an attractive place to work."



opportunity to contribute to public welfare. AP1 plays a key role for current and future pensioners. The Fund is also a major player on the financial market, which gives it influence in the field of sustainability issues, for instance. Working at Första AP-fonden therefore entails uniting investments with the creation of value for society.

During the year, the Fund's ethical policy was clarified to stress that employees are expected, in every way, to act in a way that consolidates trust in the Swedish pension system generally, and in AP1 specifically. Every year the Fund's employees certify in writing that they act in accordance with prevailing guidelines.

Greater clarity

Communication initiatives during the year have helped to create greater clarity and safeguard the culture. From the beginning, the new intranet WhatsApp was characterised by high activity. The system is easy to use and is already a well-used channel for discussions and knowledge transfer.

Brief employee surveys have been in-

troduced to supplement the more comprehensive annual one. Another new feature is the CEO breakfasts, in which the CEO regularly meets a number of employees for an informal discussion.

Good efforts on the part of employees, such as successful investments or projects, are highlighted to show good examples and provide affirmation.

Health and fitness are natural parts of everyday life at AP1. The physical and psychosocial working environment is continuously monitored and reviewed. The Fund's office space was condensed during 2017, giving rise to new contact spaces and opportunities for better communication. The renewal also contributed to greater cost efficiency.



"Maths and programming are fascinating"

Ludvig Lamm, Systems Developer

"This is a tremendously enjoyable job. I help to develop the Fund's systems to ensure they're of a high technical standard. This year for instance we've created a beta portfolio for trends," says Ludvig Lamm, Systems Developer and Quantum Analyst at AP1's unit for Asset Allocation.

"I'm a mechanical engineer with a

master's in applied mathematics, with various financial courses on the side. I was originally hired by AP1 as an IT consultant, but soon accepted a job offer. I find maths and programming fascinating, so this is the ideal workplace for me. I learn a lot every day from highly skilled colleagues, and I'm developing in both IT and finance."

Sustainable investments good for returns

Through sustainable investments and active ownership, Första AP-fonden helps to meet the world's global challenges.

AP1's mission is to deliver long-term high returns at a low level of risk. Sustainability aspects are an integral part of investment decisions, focusing on responsible usage

of natural resources, human capital and financial capital.

One of our investment beliefs is that sustainable investments are good for

returns, pensioners and the planet.

AP1's Board of Directors has established four working methods and goals that permeate the operation.



Continuous competence development

Employees are continuously trained in sustainability, since this is a fast-developing area.



Dedicated investments

Investments with an explicit sustainability focus are actively sought. The focus is on innovative initiatives for greater resource efficiency and good returns.



Regular sustainability reviews

The portfolio is continuously scrutinised from a sustainability perspective, as part of general efforts to assess the Fund's holdings.



Greater transparency

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



"Switching is crucial to profitability"

"AP1 is a large shareholder in Vasakronan and we appreciate that they impose clear demands. A switch to sustainable business is a prerequisite for high profitability in the long term. In the environmental field, there is quite simply no alternative. It's also important, however, to act sustainably as regards people and society," says Anna Denell, Head of CSR at Vasakronan.

"Vasakronan continues to successfully reduce its energy use, and during the year has further invested in solar panels, battery storage tests and DC networks, for example. There is also a focus on reducing the environmental impact from our construction, for instance with strict targets to reduce building waste and increase the proportion of reused/recycled and renewable material."

Carbon footprint

All the AP Funds provide annual data on their investments' climate emissions, where this is possible. Carbon footprint data has.

	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.

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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.

Since 2015, the AP Funds have had a liaison group, to coordinate the Funds' carbon footprint reporting. All of the three indicators which were chosen for reporting carbon footprint in listed companies are calculated based on the AP Funds' holding percentage in the companies.

In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD) presented recommendations for climate reporting. They are voluntary and apply to companies and investors alike. Investors are recommended to report carbon footprint using the weighted average carbon intensity metric. The parameter calculates carbon footprint by multiplying the companies' share of the portfolio (based on market value) by the company's carbon intensity in relation to turnover, and then adding them together. Consequently, share of ownership is irrelevant in the figure. To stay in line with the TCFD, the AP Funds have decided also to include this metric (no. 4 below) in AP Fund reporting.

All the AP Funds report 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 of the AP Funds is calculated for holdings as at 31 December using the latest available CO₂ data for direct emissions (Scope 1) and indirect emissions from energy (Scope 2). No adjustment is made where emissions are double-counted. 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 companies that buy the electricity. The formulas for calculating the above metrics can be found on the AP1 website.

Because the AP Funds' investment strategies and allocation to different financial assets differ, the carbon footprint from fund investments vary as well. The difference is further 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 carbon footprint calculations affects the results to some extent. Consequently, the carbon footprint figures between AP Funds are not fully comparable.

It is clear that development is still under way in this area. During the year, several of the AP Funds took part in discussions with international investors regarding carbon footprint. These discussions revealed a consensus 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 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.

Corporate governance a priority for the Fund

AP1 exercises active ownership partly by voting at shareholder meetings, board nominations via nomination committees and direct dialogue with companies.

Första AP-fonden is an engaged, visible owner that cares about knowing its companies well. The Fund works in various ways to contribute to their development and thereby achieve high returns.

Imposing demands

As a large player, AP1 can impose demands on the portfolio companies' boards to lead the operations in the desired direction to achieve higher returns. Representing many pension savers, who have not actively chosen AP1, entails a particular responsibility.

The Fund exercises active ownership by, for example, voting at shareholder meetings and nominating members for

the boards. As a major owner, the Fund is on the nomination committees of 11 Swedish companies, and is actively involved in the nomination process. The composition of the board should be adapted to the company's needs, the aim being to represent a good diversity of perspectives.

After the board elections, remuneration issues are the most important. The Fund acts if the remuneration package is deemed to be designed so that the management, and therefore the company, is being steered in the wrong direction. Remuneration to the board may also be questioned.

Internationally, consultants are

sometimes brought in to conduct analyses for active ownership. AP1 exercises its right to vote as often as possible.

Dialogue for influence

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 portfolio, although exclusion does occur as a last resort.

In Sweden, the Fund maintains contact directly at different levels in the companies. The dialogue with foreign companies often takes place through the AP Funds' Ethical Council.

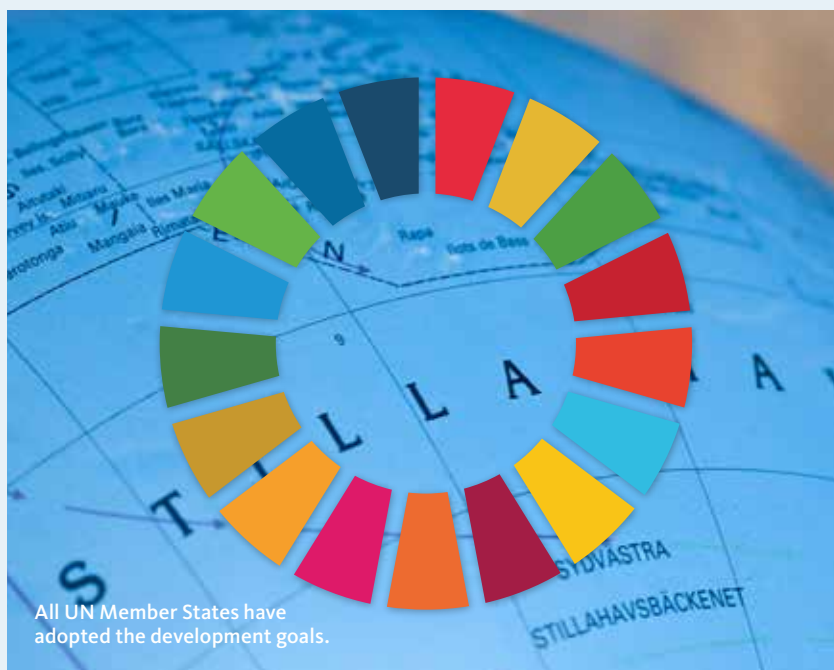
The UN sets the framework

The UN's Sustainable Development Goals are a global framework for sustainability management. There are 17 overriding goals encompassing 169 separate targets, which are to be achieved by 2030.

The goals include such areas as good health and well-being, gender equality, and creating sustainable cities and communities.

AP1's operations encompass many areas of society, and the Fund is naturally involved in many activities that help to achieve the UN's Sustainable Development Goals. The focus in the ongoing work on the goals is on prioritising and implementing goals in a sustainable way in the day-to-day operation.

The report of the AP Funds' Ethical Council, to be published in spring 2018, outlines on which Sustainable Development Goals the Ethical Council's discussions have their greatest potential influence.



The Ethical Council in an extended role

The Ethical Council of the AP Funds celebrated ten years in 2017. The Council continues to work to ensure that companies in the Fund's foreign holdings run their operations in a responsible manner.



"There is tremendous power when the Funds and our external managers work together," says Nadine Viel Lamare, Head of Sustainable Value Creation at AP1.

For AP1, the Ethical Council was created in response to a matter regarding the American hotel chain, Marriott.

"We had recently begun investing in foreign companies and found out that child sex trafficking was taking place at the Marriott hotel in Costa Rica. We owned a very small percentage of Marriott's equities, but we decided to take action," says Nadine Viel Lamare, Head of Sustainable Value Creation at AP1, and the first chair of the Ethical Council.

Influence is possible

"It was a long process, but it produced results. Marriott included consideration for human, and particularly children's, rights in its corporate policy and took action internally. It also had a ripple effect on other hotel chains."

The lesson from Marriott was that it is possible to influence poor conditions

in foreign companies, even as a minor shareholder. The example became a model for AP1's own sustainability work, and that of the other three AP Funds. It also marked the beginning of the collaboration that forms the basis of the AP Funds' Ethical Council.

"The Funds have the same core values, and work more efficiently and more powerfully together. For foreign counterparties and business partners, it is also easier to have a single contact rather than four different funds.

The fundamental principle of the Ethical Council is primarily to influence companies in the right direction, and only as a very last resort to exclude them from the Funds' investments.

"We maintain a dialogue and ask questions. If we don't get any answers, we get tougher as we go along. This is rarely needed in Swedish companies,

where there's a tradition of listening to the shareholders, but things can be quite different in other countries."

The dialogue is held in confidence and is not always transparent.

"We do however reveal the results once the talks are over," Nadine Viel Lamare explains.

Initially, the Ethical Council focused on individual events or situations revealed via different information channels.

"But since certain sectors and issues kept recurring, we also started doing our own mapping. The mining industry was first, and 20 or so companies were selected for a review of various sustainability aspects. Many of the companies wanted to talk to us, and on following up a couple of years later quite extensive changes had been made. But this wasn't always the case, and consequently one company was excluded from our investments."

More proactive

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

"Our role remains important, but it changes with time. Ten years ago the violations were more obvious and companies weren't necessarily taking the right kind of measures. Naturally it's great that things have progressed, but our work is needed now to point out problems where they may not be so visible. We need to be more proactive, in association with our partners. The problems are greatest on the emerging markets. There is tremendous power when the Funds and our external managers work together to deal with the same issues in those companies."

Dialogue to help prioritise sustainability issues

The AP Funds have an effect on people, the environment and society. To identify the most important sustainability issues, AP1, AP2, AP3 and AP4 held a stakeholder dialogue in 2017.



The dialogue involved representatives for the Funds' most important stakeholder groups, those greatly affecting or affected by the Funds' activities. It took the form of a workshop with around 60 people representing principals (civil servants from the Ministry of Finance and people from the pension group), beneficiaries, the community, industry colleagues, suppliers, employees and portfolio companies.

With the workshop, the Funds wanted to identify stakeholders' expectations and priority issues, pick up feedback on the Funds' current sustainability work, and capture the stakeholders' thoughts on sustainability work moving forward.

The joint dialogue was also an important knowledge-gathering exercise for the participants. The Funds provided

information about their joint mission and how it is linked to sustainability. Stakeholders had an opportunity to discuss the AP Funds' sustainability work with people with different backgrounds, interests and expectations of the work.

The workshop participants were asked to freely discuss which sustainability issues they deemed particularly important for the Funds to focus on. They also had a chance to consider and rank the sustainability issues which the Funds had identified in advance, and could also add their own questions.

All stakeholder groups agreed that the AP Funds' conduct in investments and asset management was most important, bearing in mind that this is where the situation can best be influenced. Long-term return was viewed as an overarching goal and not a sustainability goal specifically.

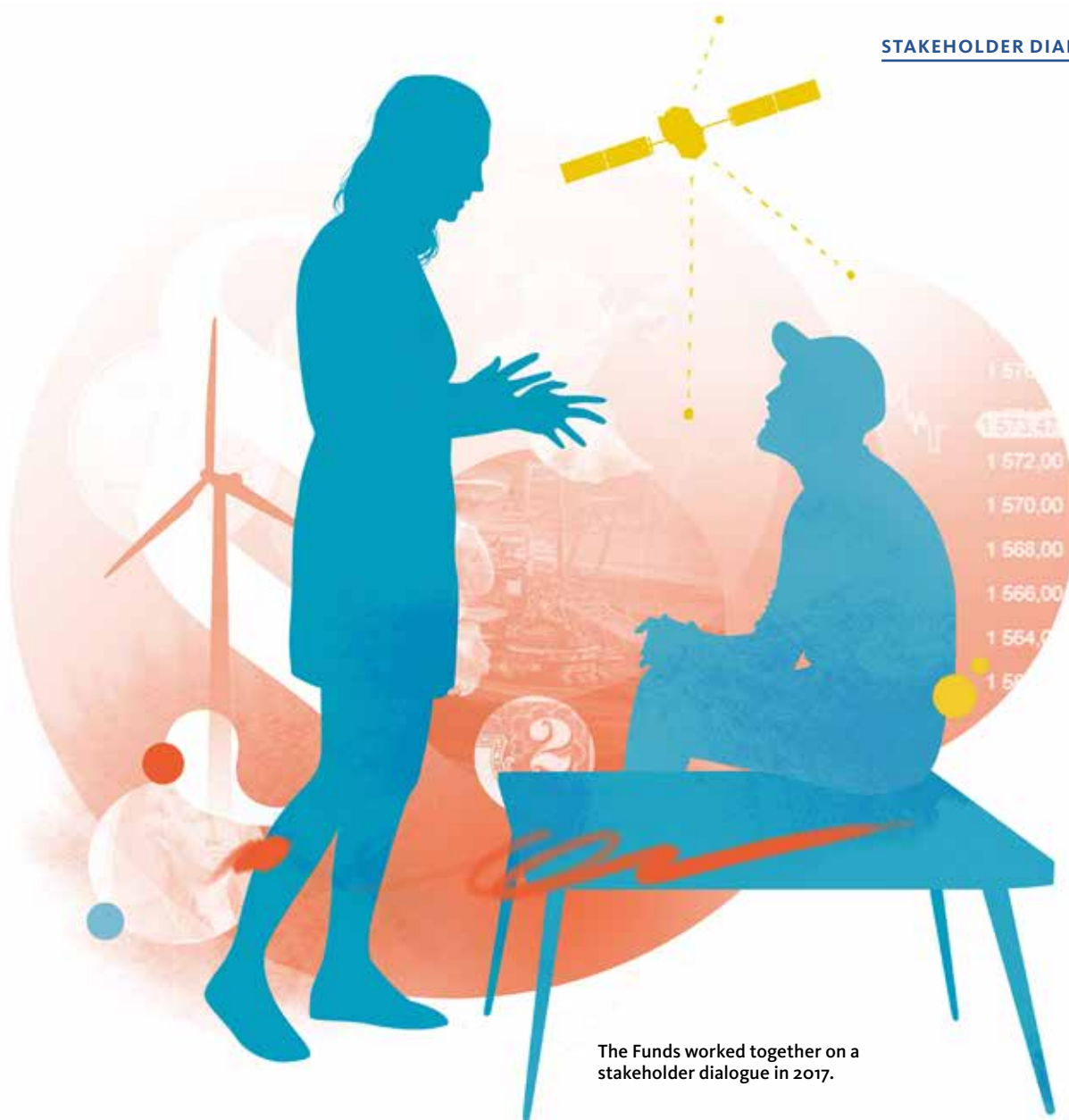
Three priority issues

It was noted that the choice of prioritised sustainability issues varies with the different companies and funds in which the AP Funds invest. There were however three issues that were highlighted as being particularly important and high priority:

- indirect environmental impact
- indirect climate impact
- human rights

Several participants deemed a business ethical approach to be a critical foundation for the operation. Business ethics and rule compliance were rated highly





The Funds worked together on a stakeholder dialogue in 2017.

by industry representatives and suppliers, and were also raised by beneficiaries and the community group.

Other issues that were deemed important were a sustainable supply chain, diversity and gender equality, and anti-corruption. All groups bar the industry colleagues considered these to be among the most important sustainability issues.

The industry colleagues highlighted the UN's global Sustainable Development Goals, which encompass all sustainability-related issues. Other stakeholder groups saw these goals as a tool and framework for working with sustainability.

The question of working conditions was raised by most of the groups. The industry colleagues also regarded

internal expertise and transparency as being particularly important, alongside business ethics and rule compliance. The matter of internal expertise was, however, viewed by some groups more as a tool rather than an issue in itself.

The concept of human rights was discussed, and the discussion focused partly on broadening the term to also encompass diversity, gender equality and working conditions.

Direct environmental and climate impact were deemed a lower priority. Matters of corporate tax and cyber security were also regarded as being a lower priority for the AP Funds in relation to the other sustainability issues.

A request for communication

The stakeholder groups pointed out

that the AP Funds could increase trust with greater transparency and more active communication. This would especially cause future beneficiaries to feel secure. Showing the positive relationship between sustainability and long-term returns would boost confidence.

The importance of working together was also highlighted. Collaboration is needed to achieve positive effects. This could be collaborations with other shareholders or another player, and the collaboration could take a number of different forms.

Each AP Fund intends to draw up a shortlist of prioritised sustainability goals based on its own circumstances. This work, along with establishment of the materiality analysis, will continue in 2018.

Directors' Report

The Board of Directors and the CEO of Första AP-fonden hereby submit their Directors' Report for 2017. The Directors' Report, together with the annual accounts and notes have been reviewed by the auditors of the Fund. The review covers pages 28 to 49.

AP1's net investment income for 2017 was SEK 29,349 million (26,965), which means a return after expenses of 9.6 per cent (9.3). Measured over the last ten-year period, the return was 6.0 per cent. This equates to an average real return of 5.0 per cent a year, exceeding the long-term target of a real return after expenses of 4.0 per cent over rolling ten-year periods.

Transfer to the Swedish Pensions Agency

In 2017, the Fund transferred SEK 7.4 billion (6.6) to the pension system to cover the deficit in pension contributions in relation to pension disbursements. Since 2009, the Fund has paid SEK 44 billion to the Swedish Pensions Agency to cover the deficit in pension disbursements.

Control and mandate

The Board of Directors of AP1 bears full responsibility for the operations of the Fund and is responsible for the Fund's organisation and management of Fund assets. The work of the Board is regulated in the National Pension Insurance Funds (AP Funds) Act. The Board has delegated a management mandate to the CEO, who establishes the asset management framework. The mandate is expressed in a risk tolerance. This is manifested in an overarching asset allocation (65 per cent equities and 35 per cent fixed-income assets) and limitations as to how much the asset allocation can be deviated from. The limitations are expressed both as exposure limits and limitations in terms of forecast tracking error. Read more in the risk management plan for 2017 at www.ap1.se.

Asset allocation and results of the Fund's management

Within the framework of the management mandate, the CEO of AP1 decides on the management orientation and asset allocation in the form of a strategic asset allocation (43.5 per cent equities, 30 per cent fixed-income assets and 26.5 per cent alternative assets). The CEO's strategic asset allocation forms the basis of the management organisation's work on allocation and management. In 2017, the management generated an excess return before expenses in relation to the

Fund's strategic benchmark of 1.2 percentage points (1.4), which equates to SEK 3.5 billion (4.2).

Cost efficiency through cooperation with other AP Funds

Smoothly functioning, healthy competition has been made possible through four independent buffer funds. This competition has resulted in cost-effective management. It has also resulted in the economic power inherent in the net assets being more widely distributed and not becoming too concentrated. In areas that do not jeopardise competition between the funds, the AP Funds can cooperate to achieve cost savings, synergies and efficient use of resources. There is also value in securing a relevant exchange of experiences, knowledge and working methods between the organisations.

The increased collaboration between the AP Funds, which was initiated in 2016 by the Managing Directors of the First, Second, Third and Fourth AP Funds, continued in 2017. This work takes place in different established forums in nine areas, with a varying composition of representatives from the various AP Funds.

Some of the groups also include the Sixth and Seventh AP Funds.

The common denominator in these collaborations is that they are run based on the added value created by the collaboration, both for each individual Fund and for the Funds together. The various coordination groups are Communications, Legal & Compliance, Accounting, Administration, Risk & Performance, HR, IT and Back Office. There is also the Ethical Council of the AP Funds, which mainly focuses on screening and dialogue with foreign listed companies to influence the companies on environmental and ethical issues.

Sustainable value creation

AP1's ambition in the field of sustainability is high. The Fund is convinced that investments in sustainable companies entail a lower risk and probably generate a higher return in the long run. Sustainability aspects are integrated into investment decisions and the work as an engaged owner. AP1's entire asset management is steeped in its ambition to generate long-term sustainable value growth.

Net investment income for 2017 before expenses in local currency

	Contribution, SEK bn	Contribution, percentage points	Portfolio return, %
Equities	17.1	5.6	16.5
Sweden	4.9	1.6	12.6
Developed markets	4.0	1.3	13.5
Emerging markets	8.2	2.7	23.8
Fixed-income securities	0.9	0.3	1.0
Real estate	6.2	2.0	16.7
Infrastructure	1.0	0.3	11.4
Hedge funds	-0.4	-0.1	-2.6
Private equity funds	2.5	0.8	18.1
High yield	1.0	0.3	6.4
Alternative strategies	1.7	0.6	28.7
Systematic strategies	2.0	0.7	17.0
Allocation, cash, foreign exchange	-2.4	-0.7	-0.7
Total	29.8	9.7	9.7

Asset classes

Equities

AP1's listed equity portfolio was valued at SEK 117.4 billion at year-end, equating to 35.3 per cent of the total portfolio. The equity portfolio comprises SEK 42.9 billion in Sweden, SEK 27.4 billion in foreign developed markets and SEK 47.1 billion in emerging markets. Swedish equities and equities in foreign developed markets are managed internally, while emerging markets are handled by external managers. There are also investments in listed equities under other assets in the systematic strategies sub-portfolio in the amount of SEK 9.8 billion. The return on the equity portfolio for 2017 was 16.5 per cent, which equates to SEK 17.1 billion.

Fixed-income securities

AP1's fixed-income portfolio was valued at SEK 103.7 billion at year-end, equalling 31.2 per cent of net assets, with the majority invested in foreign securities. AP1 also has fixed-income securities through Fund holdings that are reported under other assets in the alternative strategies sub-portfolio. The return on the Fund's fixed-income portfolio in 2017 was 1.0 per cent, equalling SEK 0.9 billion.

Bonds with a lower credit rating

AP1's investments in bonds with a lower credit rating (high-yield investments) amounted to SEK 14.9 billion or 4.5 per cent of the total portfolio on 31 December 2017. The return on the high-yield portfolio for 2017 was 6.4 per cent, which equates to SEK 1.0 billion.

Alternative investments

Real estate

AP1's real estate holding was valued at SEK 42.6 billion at year-end, equalling 12.8 per cent of net assets. The main long-term focus of the Fund's real estate investments is running return from rent payments, and to some extent expected value appreciation. The return on the real estate portfolio in 2017 totalled 16.7 per cent, equalling SEK 6.2 billion.

Infrastructure

The Fund's investments in infrastructure amounted to SEK 11.4 billion at year-end, equalling 3.4 per cent of net assets. The return on the infrastructure portfolio was 11.4 per cent, which equates to SEK 1.0 billion.

Hedge funds

AP1's hedge fund portfolio was valued at SEK 13.4 billion at year-end, equalling 4.0 per cent of net assets. Investments in hedge funds are designed to generate a more diversified, robust portfolio, which tones down the effects of sharp price volatility in the rest of the portfolio. The return of the hedge fund portfolio was negative for 2017 at -2.6 per cent, equalling SEK -0.4 billion.

Private equity funds

AP1's investments in private equity funds amounted to SEK 15.4 billion at year-end, equalling 4.6 per cent of net assets. The Fund invests globally in private equity funds through external managers. The return on this asset class is expected to be higher than for listed equities over time. The return on the private equity portfolio for the year was 18.1 per cent, equalling SEK 2.5 billion.

Other asset classes

Alternative strategies

AP1's alternative strategies portfolio amounted to SEK 3.4 billion at year-end, equalling 1.0 per cent of net assets. Alternative strategies include a risk parity portfolio with the purpose of limiting macroeconomic risks without renouncing return opportunities and a portfolio consisting of alternative beta strategies designed to systematically obtain risk premiums. The return on the alternative strategies portfolio for 2017 was 28.7 per cent, which equates to SEK 1.7 billion.

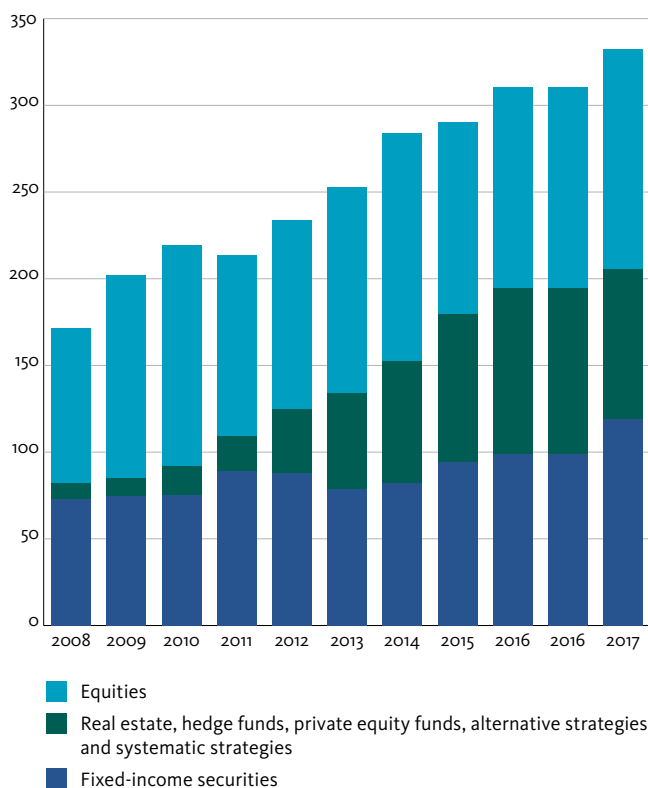
Systematic strategies

AP1's systematic strategies portfolio amounted to SEK 9.8 billion at year-end, equalling 3.0 per cent of net assets. Systematic strategies include investments in equities with low volatility in developed countries. The return on this portfolio was 17.0 per cent, which equates to SEK 2.0 billion during the year.

Foreign exchange

AP1 owns assets in different currencies. Currency is treated as a separate asset that is managed according to special foreign exchange strategies. The value and return on all foreign assets are translated into Swedish kronor. The majority of the Fund's foreign assets are protected, in terms of exchange rate fluctuations, using currency hedges. The return on the Fund's currency positions at the end of 2017 was -1.2 per cent, equalling SEK -3.6 billion.

Net asset performance 2008–2017, SEK bn



Expenses and expense ratio

	2017		2016	
	Expenses, SEK m	Expense level, %	Expenses, SEK m	Expense level, %
Personnel costs	131	0.04	118	0.04
Other admin. expenses	78	0.03	69	0.02
Operating expense	209	0.07	187	0.06
Commission expenses	236	0.07	271	0.09
Total expenses	445	0.14	458	0.15%

Foreign exchange return 2017

	Return, %	Return, SEK bn
Translation to SEK	-4.1%	-12.44
Currency hedges	2.9%	8.90%
Foreign exchange return		
Developed markets	-0.9%	-2.66
Emerging markets	-0.3%	-0.89
Total foreign exchange return	-1.2%	-3.55

Portfolio composition

Asset class	Portfolio value SEK m, 31/12/2017	Holding, %	Exposure, %	Portfolio value SEK m, 31/12/2016	Holding, %	Exposure, %
Equities	117,446.5	35.3	37.9	102,082.8	32.9	34.1
Sweden	42,922.3	12.9	12.9	38,141.4	12.3	12.3
Developed markets	27,436.6	8.3	10.7	35,366.5	11.4	12.5
Emerging markets	47,087.6	14.2	14.2	28,575.0	9.2	9.2
Fixed-income securities	103,721.8	31.2	31.2	84,765.0	27.3	27.3
Nominal, government	44,147.6	13.3	13.3	26,149.3	8.4	8.4
Nominal, credit	36,404.1	10.9	10.9	39,817.1	12.8	12.8
Real interest rates	23,170.1	7.0	7.0	18,798.6	6.1	6.1
Cash	334.1	0.1	-2.4	281.2	0.1	-1.1
Total listed investments	221,502.4	66.6	66.6	187,129.0	60.3	60.3
Real estate	42,581.0	12.8	12.8	39,043.2	12.6	12.6
Infrastructure	11,380.6	3.4	3.4	9,421.6	3.0	3.0
Hedge funds	13,407.3	4.0	4.0	15,412.3	5.0	5.0
Private equity funds	15,412.8	4.6	4.6	14,564.6	4.7	4.7
High yield	14,942.3	4.5	4.5	13,841.3	4.5	4.5
Alternative strategies	3,469.4	1.0	1.0	15,421.8	5.0	5.0
Systematic strategies	9,813.1	3.0	3.0	14,122.5	4.5	4.5
Special investments ⁽ⁱ⁾				1,578.8	0.5	0.5
Total portfolio	332,508.9	100.0	102.4	310,535.1	100.0	101.1
Foreign exchange exposure	84,008.0		25.3%	68,535.7		22.1%

⁽ⁱ⁾ As of 2017, Special investments are reported under Equities

Currency exposure, 31/12/2017

SEK m	USD	GBP	EUR	JPY	Others	Total
Shares and participations	49,710	4,693	11,360	2,496	38,350	106,609
Fixed-income securities	37,161	5,562	26,902	730	2,164	72,519
Other assets	31,686	1,461	4,521	58	1,360	39,086
Derivatives	-86,359	-5,310	-35,726	4,819	-11,630	-134,206
Total	32,198	6,406	7,057	8,103	30,244	84,008
Currency exposure, 31/12/2016	46,638	-5,362	-503	6,735	21,030	68,538
Currency exposure, 31/12/2015	66,401	-2,320	9,562	6,836	10,338	90,817

Ten-Year Overview

Net investment income and inflow, SEK bn	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Net assets at 31 December	332.5	310.5	290.2	283.8	252.5	233.7	213.3	218.8	202.3	171.6
Net flows from the pension system	-7.4	-6.6	-4.9	-5.1	-6.9	-3.8	-1.2	-4.0	-3.9	0.9
Net investment income for the year	29.3	27.0	11.3	36.4	25.7	24.2	-4.2	20.5	34.6	-48.0
Return, expenses and risk, %										
Return before expenses	9.7	9.5	4.1	14.8	11.3	11.4	-1.7	10.3	20.4	-21.7
Operating expenses, annualised, % of AUM	0.07	0.06	0.06	0.07	0.07	0.08	0.07	0.08	0.10	0.09
Commission expenses, annualised, % of AUM	0.07	0.09	0.11	0.10	0.07	0.06	0.05	0.05	0.06	0.07
Return after expenses	9.6	9.3	4.0	14.6	11.2	11.3	-1.9	10.2	20.2	-21.9
Net investment income and expenses in total portfolio, SEK bn										
Net investment income before expenses	29.8	27.4	11.8	36.9	26.0	24.5	-4.0	20.8	34.9	-47.7
Total administrative expenses, SEK bn	0.4	-0.5	-0.5	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Exposure, %										
Equities	37.9	34.1	34.7	48.9	49.2	47.4	49.2	60.3	58.6	54.6
Sweden	12.9	12.3	12.3	11.6	12.0	11.4	12.6	15.7	13.8	11.2
Developed markets	10.7	12.5	14.4	27.1	27.5	25.0	25.3			
Emerging markets	14.2	9.2	8.0	10.1	9.7	11.0	11.4			
Fixed-income securities ⁽¹⁾	31.7	29.8	30.2	30.9	31.2	36.4	40.9	32.5	34.7	40.1
- of which fixed-income securities in other assets	0.5	2.5	2.3	3.3	1.5					
Cash	-2.4	-1.1	-0.1	-1.1	-0.7					
Real estate	12.8	12.6	11.5	8.8	8.8	7.7	5.6	5.0	3.4	4.0
Infrastructure	3.4	3.0	2.9							
Hedge funds	4.0	5.0	4.8	5.9	4.9	4.3	0.2	0.3	-	-
Private equity funds	4.6	4.7	5.0	4.4	3.3	3.2	2.8	2.0	1.7	1.4
High yield	4.5	4.5	2.9							
Alternative strategies	1.0	5.0	4.4							
Systematic strategies	3.0	4.5	5.2	5.6	4.8	0.7	0.6	0.7		
Special investments ⁽²⁾		0.5	0.7							
Foreign exchange	25.3	22.1	31.3	35.1	29.2	27.4	21.3	24.0	21.6	22.2
Risk										
Risk ⁽³⁾	3.6	6.4	8.1	5.4	5.0	5.9	8.9	7.4	9.7	16.6
Sharpe ratio	2.9	1.5	0.5	2.6	2.1	1.9	neg.	1.1	2.0	neg.
External management, %										
Share of total portfolio at 31 December ⁽⁴⁾	32.5	31.8	31.0	34.6	37.1	39.3	41.4	43.7	42.4	39.7

⁽¹⁾ Investment grade bonds (fixed income incl. cash funds in accounts = 32.54% for 2017)

⁽²⁾ As of 2017, Special investments are reported under Equities.

⁽³⁾ Standard deviation calculated on daily return in 2017.

⁽⁴⁾ In accordance with a joint decision, the AP Funds report wholly or partially owned real estate companies as being internally managed.

Income Statement

SEK m	Note	31/12/2017	31/12/2016
Operating income			
Net interest income	1	186	504
Dividends received		4,897	6,086
Net gains/losses, listed shares and participations	2	16,632	5,762
Net gains/losses, unlisted shares and participations	3	7,457	6,900
Net gains/losses, fixed-income assets		278	2,347
Net gains/losses, derivative instruments		2,830	-979
Net gains/losses, foreign exchange movements		-2,486	6,803
Commission expenses	4	-236	-271
Total operating income		29,558	27,152
Operating expenses			
Personnel costs	5	-131	-118
Other administrative expenses	6	-78	-69
Total operating expenses		-209	-187
Net investment income		29,349	26,965

Balance Sheet

SEK m	Note	31/12/2017	31/12/2016
Assets			
Shares and participations, listed	7	138,328	126,433
Shares and participations, unlisted	8	71,568	76,440
Bonds and other fixed-income assets	9	114,226	96,438
Derivatives	10	2,753	2,960
Cash and bank balances		5,085	5,222
Other assets	11	989	4,455
Prepaid expenses and accrued income	12	912	868
Total assets		333,861	312,816
Liabilities			
Derivatives	10	645	478
Other liabilities	13	666	1,762
Deferred income and accrued expenses	14	41	41
Total liabilities		1,352	2,281
Net assets	15		
Opening net assets		310,535	290,207
Net payments to/from the pension system		-7,375	-6,637
Net investment income for the year		29,349	26,965
Total net assets		332,509	310,535
Total net assets and liabilities		333,861	312,816
Memorandum items	16	33,433	36,502

Notes

Första AP-fonden, corporate identity number 802005-7538, domiciled in Stockholm, is one of the buffer funds in the Swedish pension system. This annual report for the 2017 financial year was approved by the Board of Directors on 22 February 2018. The income statement and balance sheet are subject to adoption by the Swedish Government.

Accounting and valuation policies

The National Pension Insurance Funds Act (2000:192) sets out that the annual report shall be prepared in accordance with generally accepted accounting principles, whereby the assets in which the Fund invests shall be entered at market value. In light thereof, the First to Fourth AP Funds (AP1, AP2, AP3, AP4) have developed joint accounting and valuation policies which have been applied and are summarised below.

The Funds' accounting and valuation policies are being gradually adapted to International Financial Reporting Standards, IFRS. Because IFRS is undergoing extensive revisions, the adaptations so far have been focused on meeting the disclosure requirements in IFRS 7 and IFRS 13. Complete adaptation to IFRS would have no material impact on the reported net investment income and net assets. The AP Fund meets the requirements to be defined as an investment entity under IFRS 10. Compared to the currently applicable IFRS, the only major difference is that a cash flow statement has not been prepared.

Trade date accounting

Transactions in securities and derivative instruments in the money, bond, equity and foreign exchange markets are recognised in the balance sheet at the trade date, i.e. the time at which material rights and hence risks are transferred between the parties. The receivable from or liability to the counterparty between the trade date and settlement date is recognised in other assets or other liabilities. Other transactions, primarily those relating to unlisted equities, are recognised in the balance sheet at the settlement date, which is consistent with market practice.

Net accounting

Financial assets and liabilities are recognised net in the balance sheet when there is a legal right to net transactions and there is an intention to pay net proceeds or realise the asset and simultaneously settle the liability.

Translation of foreign currencies

Transactions in foreign currencies are translated to SEK at the exchange rate on the transaction date. In the balance sheet, assets and liabilities in foreign currencies are translated to SEK at the exchange rate on the balance sheet date. Changes in the value of assets and liabilities denominated in foreign currencies are broken down into the part attributable to the change in the value of the asset or liability in the local currency and the part caused by fluctuations in the exchange rate. Foreign exchange gains/losses arising from changes in foreign exchange rates are recognised in the income statement in the line Net gains/losses, foreign exchange movements.

Shares in subsidiaries/associated companies

In accordance with the National Pension Insurance Funds Act, shares in subsidiaries/associated companies are stated at fair value. Fair value is determined using the same methods that apply for unlisted shares and participations. There is no requirement to prepare consolidated accounts.

Valuation of financial instruments

All of the Fund's investments are measured at fair value, and both realised and unrealised changes in value are recognised in the income statement. Consequently, the lines for net gains/losses per asset class include both realised and unrealised gains/losses. A description of how the fair values of the Fund's various investments are determined is provided below.

Listed shares and participations

For shares and participations that are admitted to trade on a regulated

market or trading venue, fair value is determined based on official quoted market prices on the balance sheet date according to the Fund's designated index supplier (MSCI, SIX, Russell), usually the average price. Holdings that are not part of an index are valued at quoted prices observable in an active market. Paid brokerage commissions are recognised in net gains/losses on listed shares.

Unlisted shares and participations

For shares and participations that are not admitted to trade on a regulated market or trading venue, fair value is determined based on the valuation provided by the counterparty or other external party. This valuation is updated when a new valuation has been obtained and is adjusted for any cash flows up to the close of accounts. In cases where the Fund has reasonable grounds to consider the valuation incorrect, the valuation received is adjusted.

This valuation complies with International Private Equity and Venture Capital Valuation Guidelines (IPEV) or similar valuation principles and should be primarily based on arm's length transactions, although other valuation methods can be used.

Unlisted real estate shares are valued based on the net worth method to the extent that the share has not been subject to transactions in a secondary market. Holdings in unlisted real estate companies are measured taking into consideration deferred tax liabilities at a value that is used in real estate transactions, which differs from the valuation performed in the annual accounts of the real estate companies.

Bonds and other fixed-income assets

For bonds and other fixed-income assets, fair value is determined based on the official quoted market prices on the balance sheet date (usually the bid price) according to the Fund's designated index supplier (Barclays, SHB). Holdings that are not part of an index are valued at quoted prices observable in an active market. For an instrument that is not traded on an active market and for which no reliable market prices are available, the instrument is valued using generally accepted valuation models in which cash flows are discounted to the applicable valuation curve.

Interest income is recognised as interest calculated according to the effective interest rate method based on amortised cost. Amortised cost is the discounted present value of future payments, in which the discount rate is the effective rate of interest on the acquisition date. This means that acquired premiums and discounts are apportioned to periods over the remaining maturity or until the next interest adjustment date and are included in recognised interest income. Changes in value resulting from interest rate movements are recognised under net gains/losses for fixed-income assets, while changes in value resulting from foreign exchange movements are recognised under net gains/losses on foreign exchange movements.

Derivative instruments

For derivative instruments, fair value is determined based on quoted market prices at year-end. For an instrument that is not traded on an active market and for which no reliable market prices are available, the value of the instrument is established using generally accepted valuation models in which input data consists of observable market data.

Derivative contracts with a positive fair value on the balance sheet date are recognised as assets, while contracts with a negative fair value are recognised as liabilities. Changes in value resulting from foreign exchange movements are recognised in the income statement under net gains/losses on foreign exchange movements, while other changes in value are recognised under net gains/losses on derivative instruments. The difference between the

forward and spot rates for futures contracts is apportioned to periods on a straight-line basis over the maturity period and is recognised as interest.

Repurchase transactions

In a true repo (repurchase) transaction, the sold asset remains in the balance sheet and the proceeds received are recognised as a liability. The divested security is recognised in the balance sheet as a pledged asset under memorandum items. The difference between proceeds in the spot and forward legs is apportioned to periods over the maturity of the security and recognised as interest.

Securities lending

Securities on loan are recognised in the balance sheet at fair value, while compensation received for securities on loan is recognised as interest income in the income statement. Collateral received for securities on loan may consist of securities and/or cash. In cases where AP1 has a right of disposal over the received cash collateral, this is recognised in the balance sheet as an asset and a corresponding liability. In cases where the Fund does not have a right of disposal over the collateral, the collateral received is not recognised in the balance sheet but is stated separately under the heading 'Pledged assets, contingent liabilities and obligations'. The value of securities on loan, as well as collateral for these, are also recognised under this heading.

Items recognised directly in net assets

Incoming payments to and outgoing payments from the national pension system are recognised directly in the Fund's net assets.

Commission expenses

Commission expenses are recognised in the income statement as a deduction from operating income. These consist of external costs for management services, such as custodian bank fees and fixed fees for external managers, as well as fixed fees for listed funds. Performance-based fees, which are payable if the manager achieves a return over a predetermined level at which profit-sharing applies, are recognised as a deductible item from net investment income for the relevant asset class in the income statement.

Management fees for unlisted shares and participations, for which a refund is permitted before profit-sharing and in which a refund is deemed probable, are recognised at cost and are therefore included in unrealised gains/losses. In other cases, they are recognised as commission expenses.

Operating expenses

All administrative expenses, excluding brokerage fees, fees for external managers and custodian bank fees, are recognised in operating expenses. Investments in equipment and software developed or acquired by the Fund are normally expensed as incurred.

Taxes

AP1 is exempt from all income tax on domestic investments in Sweden. The dividend and coupon taxes imposed in certain countries are recognised net in the income statement under the relevant income item.

With effect from 2012 the Fund is registered for value added tax and is therefore liable for VAT on acquisitions from outside Sweden. The Fund does not have the right to recover paid VAT. Expensed VAT is included in the relevant expense item.

Note 1 Net interest income

SEK m	2017	2016
Interest income		
Bonds and other fixed-income securities	1,930	1,939
Derivatives	581	194
Other interest income	43	44
Total interest income	2,554	2,177
Interest expenses		
Derivatives	-2,336	-1,660
Other interest expenses	-32	-13
Total interest expenses	-2,368	-1,673
Total net interest income	186	504

Note 2 Net gains/losses, listed shares and participations

SEK m	2017	2016
Net gains/losses	16,704	5,838
Less brokerage commissions	-72	-76
Net gains/losses, listed shares and participations	16,632	5,762

Note 3 Net gains/losses, unlisted shares and participations

SEK m	2017	2016
Capital gains/losses	3,084	4,832
Unrealised value changes	4,373	2,068
Net gains/losses, unlisted shares and participations	7,457	6,900

External management fees for unlisted assets are recognised in accordance with two different principles depending on whether or not underlying management agreements permit a refund before profit-sharing in connection with future profit-generating divestments. In cases where the agreements permit such a refund, fees paid are recognised as part of the cost of the asset and therefore burden the unrealised net gains/losses for unlisted assets. Refunded management fees accordingly have a positive effect on unrealised gains/losses. In cases where the agreements do not permit a refund, fees paid are expensed directly under commission expenses.

During the year, a total of SEK 164 million (192) was paid in management fees for unlisted assets, of which SEK 87 million (79) permit refunds in accordance with the above-mentioned principle. SEK 0 million (89) was repaid during the year and the unrealised net gains/losses for unlisted shares and participations were therefore negatively affected by SEK 87 million net.

Note 4 Commission expenses

SEK m	2017	2016
External management fees, listed assets	-140	-142
External management fees, unlisted assets	-77	-113
Other commission expenses, incl. custodian bank expenses	-19	-16
Commission expenses	-236	-271

Commission expenses do not include performance-based expenses. During the year these amounted to SEK 65 million (37) and reduce net investment income for the asset under management.

External management fees for unlisted assets are recognised as commission expenses to the extent that the agreements do not permit a refund before profit-sharing in connection with future profit-generating divestments.

Note 5 Employees

	2017			2016		
	Total	Men	Women	Total	Men	Women
Number of employees						
Average number of employees	61	38	23	59	38	21
Closing no. of employees ⁽¹⁾	61	38	23	61	39	22
No. of executive management members at year-end	8	3	5	8	3	5

⁽¹⁾ At year-end 2017, 0 (2) individuals were employed on a project basis.

Personnel costs 2017, SEK thousands	Salaries and remuneration	Pension costs	Of which salary exchange ⁽²⁾	Payroll overheads ⁽¹⁾	Total
Board Chairman	113			36	149
Other Board members (8 people)	511			161	672
Chief Executive Officer	4,058	1,185		1,562	6,805
Executive management team, excl. CEO					
Chief Investment Officer	3,047	463		1,070	4,579
Chief Active Ownership Officer	1,657	755		704	3,116
Head of Communications	1,363	418		530	2,311
Head of Business Support	1,170	979		605	2,755
Head of Middle Office & Risk	1,401	340		522	2,263
Head of Legal & Compliance	1,087	259		404	1,751
Head of HR	1,369	776		618	2,763
Other employees	57,639	19,552		22,147	99,338
Total	73,415	24,726		28,359	126,500
Other personnel costs					4,001
Total personnel costs					130,501

Personnel costs 2016, SEK thousands	Salaries and remuneration	Pension costs	Of which salary exchange	Payroll overheads ⁽¹⁾	Total
Board Chairman	113			36	149
Other Board members (8 people)	503			158	661
Chief Executive Officer	3,501	1,800	630	1,537	6,838
Executive management team, excl. CEO					
Chief Investment Officer	2,883	470		1,020	4,373
Chief Active Ownership Officer	1,621	679	13	674	2,974
Head of Communications Aug-Dec 2016	542	137	5	203	882
Head of Business Support Jan-May 2016	643	174		244	1,061
Head of Business Support Jun-Dec 2016	664	466		322	1,452
Head of Middle Office & Risk Jun-Dec 2016	781	188		291	1,260
Head of Legal & Compliance Nov-Dec 2016	138	29		50	217
Head of HR	1,344	723	126	598	2,665
Other employees	52,668	19,131	3,142	21,112	92,911
Total	65,401	23,797	3,916	26,245	115,443
Other personnel costs					2,906
Total personnel costs					118,349

⁽¹⁾ Payroll overheads also include the cost of payroll tax.

⁽²⁾ All employees are given an opportunity to exchange their salary for pension premiums. The total amount of salary exchanged in 2017 was SEK 3,149,000.

AP1's remuneration policy for senior executives is based on the Government's guidelines for remuneration to senior executives and other employees. There were no deviations from the policy or guidelines in 2017.

Salaries and other benefits

Board fees are determined by the Government. The Fund governance report provides information about fees and attendance for each Board member. The Board of Directors determines the terms of employment for the CEO, following preparation in the remuneration committee. All employees have individual employment contracts. Since 1 January 2010, AP1 has no variable remuneration. In the event of termination on the part of the employer, the notice period for the CEO is 18 months. For members of the executive management team and other employees it is between 2 and 6 months. A few agreements entered before April 2009 contain divergences. For cost-related reasons, these agreements are not being renegotiated.

In the event of the Fund issuing notice of termination of employment, severance pay can equal a maximum of 18 months' salary. The severance pay shall only consist of the fixed salary, without the addition of benefits. Both salary during the notice period and severance pay shall be reduced by an amount equal to any income from new employment or business activity during the pay-out period. Severance pay is never paid out beyond 65 years of age.

Pensions and similar benefits

The CEO's employment contract includes an obligation for the Fund to pay pension premiums equal to 30 per cent of salary. For the portion of salary granting entitlement under the national pension, the pension premium is reduced to 11.5 per cent.

As of 1 February 2013, AP1 has switched to a defined contribution pension plan, BTP1, for newly hired employees. The pension agreement has been signed and agreed on between the parties. This means that the Fund has two occupational pension plans – BTP1, which is a defined contribution plan, and BTP2, which is a defined benefit plan.

All employees have the option of participating in a salary exchange scheme in which gross salary is exchanged for pension premiums. The pension premium is then increased by 5 per cent, which corresponds to the difference between payroll tax and social security fees. The premium exchange is therefore cost-neutral for the Fund. Other benefits are taxable and amount to smaller amounts.

Note 6 Other administrative expenses

SEK th	2017	2016
Costs for premises	-13,273	-12,262
Purchased services	-24,697	-18,579
Information and data expenses	-34,686	-30,996
Other administration expenses	-5,531	-7,409
Other administrative expenses	-78,187	-69,246
The amount for purchased services includes remuneration for the Fund's auditor, PwC, broken down into the following assignments:		
Audit services	-802	-712

Note 7 Listed shares and participations

Fair value, SEK m	31/12/2017	31/12/2016
Equities, Swedish	42,776	34,565
Equities, non-Swedish	87,116	81,135
Participations in Swedish funds	-	-
Participations in non-Swedish funds	8,436	10,733
Total fair value	138,328	126,433

At 31/12/2017, AP1 had shares on loan to a value of SEK 1.4 billion (1.2). As collateral, government bonds to a value of SEK 1.5 billion were received. The market value of the loaned position and collateral is calculated daily. The collateral shall amount to a minimum of 102 per cent.

Five largest Swedish equity holdings	Number	Fair value
Volvo B	30,204,737	4,612
Nordea Bank	40,255,187	3,997
Autoliv INC-Swed Dep Receipt	3,051,751	3,195
Ericsson (LM) B	58,318,943	3,140
Essity B	12,205,690	2,844
Total fair value		17,788

Five largest non-Swedish equity holdings	Number	Fair value
Samsung Electronics	100,393	1,720
Tencent Holdings Ltd	4,024,881	1,711
Taiwan Semiconductor Ltd	17,652,492	1,449
Alibaba Group Holding Ltd	777,459	1,098
Pershing Square Holdings	7,500,000	839
Total fair value		6,817

A complete list of all listed holdings at 30 June and 31 December is available on Första AP-fonden's website www.ap1.se.

Note 8 Unlisted shares and participations

Fair value, SEK m	31/12/2017	31/12/2016
Swedish unlisted shares and participations: Subsidiaries and associated companies	30,092	25,256
Non-Swedish unlisted shares and participations: Subsidiaries and associated companies	2,465	2,666
Other unlisted shares and participations	39,011	48,518
Total	71,568	76,440

Subsidiaries and associated companies	Domicile	Corp. ID No.	Number	Holding, %	Net investment income	Equity	Fair value
Swedish shares and participations, subsidiaries and associated companies							
Aros Bostad IV AB	Stockholm	559032-9503	14,747	29	0.6 ⁽¹⁾	175 ⁽¹⁾	140
Ellevio AB	Stockholm	559005-2444	6,250	12.5	-239 ⁽¹⁾	5,923 ⁽¹⁾	1,181
Secore Fastigheter AB	Stockholm	559018-9451	25,000	50	1.8 ⁽¹⁾	60 ⁽¹⁾	507
Vasakronan Holding AB	Stockholm	556650-4196	1,000,000	25	10,916 ⁽¹⁾	46,117 ⁽¹⁾	15,218
Willhem AB	Gothenburg	556797-1295	769,880,846	100	1,692 ⁽¹⁾	9,078 ⁽¹⁾	13,046
Total							30,092
Non-Swedish shares and participations, associated companies and subsidiaries							
First Australian Farmland Pty Ltd	Australia	155,718,013		100	-26 ⁽²⁾	297 ⁽²⁾	230
Chapone S.à.r.l	Luxembourg	B 200297		100	-74 ⁽²⁾	2,083 ⁽²⁾	1,870
ASE Holdings S.à.r.l	Luxembourg	B 169327		38	113 ⁽²⁾	804 ⁽²⁾	222
ASE Holdings III S.à.r.l	Luxembourg	B 207618		32	-0.1 ⁽²⁾	0 ⁽²⁾	44
Agore Kiinteistö KY	Finland	2834365-4		50	-	-	99
Total							2,465

⁽¹⁾Pertains to figures released 31/12/2016

⁽²⁾Refers to 31/12/2016 translated at the exchange rate on 31/12/2016

Five largest holdings, unlisted shares and participations	Domicile	Holding, %	Cost
LGT, First Hedge Fund Investments L.P	Guernsey	100	10,976
Hamilton Lane, Private Equity	US	99	8,732
Bridgewater Tailored All Weather Fund L.P.	Cayman Islands	100	2,104
FIRST Private Equity Investments, L.P.	Guernsey	100	2,358
Triangular Fund L.P	Cayman Islands	100	996

A complete list of all unlisted holdings at 30 June and 31 December is available on Första AP-fonden's website www.ap1.se.

Note 9 Bonds and other fixed-income assets

Fair value, SEK m	31/12/2017	31/12/2016
Breakdown by type of issuer		
Swedish state	15,393	5,952
Swedish municipalities	2,291	2,274
Swedish mortgage institutions	5,786	9,219
Other Swedish companies		
Financial companies	2,750	5,102
Non-financial companies	6,801	9,780
Foreign states	46,545	38,014
Other foreign issuers	34,660	26,097
Total	114,226	96,438
Breakdown by type of instrument		
Inflation-indexed bonds	27,050	22,056
Other bonds	77,496	59,812
Treasury bills		454
Commercial papers		
Other instruments	9,680	14,116
Total	114,226	96,438

Note 10 Derivatives

	31/12/2017		31/12/2016	
	Derivative instruments with:			
SEK m	Positive fair value	Negative fair value	Positive fair value	Negative fair value
Equity-linked instruments				
Options				
Held	50		71	
Issued		-73		-61
Swaps	141	-5	203	-14
Futures	8	-7		-6
Total	199	-85	274	-81
Interest-linked instruments				
Swaps	481	-175	307	-148
Futures				
Total	481	-175	307	-148
Currency-linked instruments				
Swaps	2,073	-382	2,379	-249
Futures		-3		
Total	2,073	-385	2,379	-249
Total derivative instruments				
	2,753	-645	2,960	-478

Derivative positions with a negative value amounting to SEK -159 million have a maturity exceeding 12 months. For maturity analysis thereof, see Note 18.

Note 11 Other assets

SEK m	31/12/2017	31/12/2016
Incoming payments, unsettled transactions	483	3,465
Receivables from foreign tax authorities	84	128
Reinvested cash collateral for derivative positions	284	854
Other assets	138	8
Total other assets	989	4,455

Note 12 Prepaid expenses and accrued income

SEK m	31/12/2017	31/12/2016
Accrued interest income	741	691
Accrued dividends	156	166
Other prepaid expenses and accrued income	15	11
Prepaid expenses and accrued income	912	868

Note 13 Other liabilities

SEK m	31/12/2017	31/12/2016
Outgoing payments, unsettled transactions	364	896
Received cash collateral for derivative positions	284	854
Other	18	12
Other liabilities	666	1,762

Note 14 Deferred income and accrued expenses

SEK m	31/12/2017	31/12/2016
Accrued management fees	24	28
Other accrued expenses	17	13
Deferred income and accrued expenses	41	41

Note 15 Net assets

SEK m	2017	2016
Opening net assets	310,535	290,207
Net flow to/from the pension system		
Incoming pension contributions	66,850	64,174
Outgoing pension disbursements	-73,999	-70,595
Transfer of pension rights to the EC	-2	-1
Settlement of pension rights	2	1
Outgoing administrative contribution to the Swedish Pensions Agency	-226	-216
Total net outflow to the pension system	-7,375	-6,637
Net investment income after expenses for the year	29,349	26,965
Closing net assets	332,509	310,535

Note 16 Memorandum items

SEK m	2017	2016
Pledged assets and equivalent collateral for own liability	none	none
Securities on loan against other collateral ⁽¹⁾	1,429	1,104
Collateral provided for futures transactions	2,454	3,253
Collateral provided for OTC transactions ⁽²⁾	158	93
Other pledged assets and equivalent collateral	4,041	4,450
Investment commitments, unlisted holdings	29,392	32,052
Undertakings	29,392	32,052
Total memorandum items	33,433	36,502
⁽¹⁾ Collateral received for securities on loan	1,515	1,173
⁽²⁾ Collateral received for OTC transactions	1,217	1,396

Note 17 Financial instruments, price and valuation hierarchy

This Note provides disclosures about how fair value is determined for the financial instruments used by AP Funds. The Funds' accounting and valuation policies are in accordance with the international reporting standard. The objective is to present information about the fair values of financial assets and liabilities and to ensure transparency and comparability between different companies. This means that the disclosures about valuation of assets and liabilities in the balance sheet take account of whether trade occurs on an active or inactive market and whether quoted prices are available at the time of valuation.

Valuation of the Fund's net assets – market-listed assets

The majority of the Fund's assets are market listed, which means that they are traded on an active market at prices that represent actual and regularly occurring market transactions. Most of the Fund's market listed assets are valued daily at their quoted market prices and consist of equities, bonds, derivatives, funds and foreign exchange. Some Fund holdings with listed holdings in underlying securities are valued less frequently than daily, e.g. weekly or every other week. A handful of Fund holdings with listed holdings in underlying securities are valued only once a month.

For OTC derivatives the valuation is based on either theoretical modelling or on a valuation from an external party. For the Fund's holdings of currency futures the valuation is based on theoretical modelling, whereby the model's subjective feature at present consists exclusively of the choice of yield curve and methodology for calculating and forecasting future value (interpolation and extrapolation). The same methodology is applied for deposits, short-dated commercial papers and similar instruments. For other OTC derivatives, valuation is performed exclusively by an external party as a comparison to the Fund's own valuations. In periods when the market lacks liquidity for market listed securities, a higher degree of subjectivity is required in the valuation process. At such times, the market features sharply increased spreads between bid and ask prices, which can also differ substantially between market participants. At such times, funds have used a conservative approach to valuation.

Valuation of net assets – alternative investments

For assets that are not valued in an active market, different valuation methodologies are applied to determine fair value. Fair value equals the price that would have been received or paid in an orderly transaction between two independent parties. AP1's unlisted investments consist of investments in

hedge funds, risk parity funds, private equity funds, real estate companies and real estate funds. Investments in unlisted hedge funds and risk parity funds are normally valued with a one-month lag. These funds invest primarily in market listed securities. Valuation of fund participations is based on the same principles as for market listed assets. Investments in private equity funds are valued according to International Private Equity and Venture Capital Guidelines (IPEV) or similar principles. According to IPEV, the valuation can be based on completed transactions, market multiples in valuation, the net asset value or discounting of future cash flows. Valuation of the Fund's investments in private equity funds is based on the most recent available reporting. Since reporting from private equity funds is received with a lag, the Fund's annual accounts are generally based on reports at 30 September adjusted for cash flows for the subsequent period and up to the closing date. In a situation with rising returns in the equity markets, this means that the Fund has a lower valuation in the annual accounts than that which is later reported by private equity fund managers.

Investments in real estate companies are valued in accordance with IFRS and industry practice as established in IPD's recommendations. The valuation is based on discounting of future rental income, operating expenses and sales prices by market-based return requirements. With regard to valuation of deferred tax in a real estate company, this is measured at fair value, i.e. a discounting of future tax effects by an interest rate that is relevant for the individual company. Investments in real estate funds are valued according to recommendations from industry organisations such as INREV.

Fair value

The fair value of a financial instrument is defined as the amount for which an asset could be transferred or a liability settled between knowledgeable and willing parties in an arm's length transaction. Depending on which market data is available for valuation of the financial instruments, these are broken down into three levels:

- **Level 1:** Financial instruments traded in an active market. The market is deemed active if there are quoted prices that are regularly updated with a greater frequency than once a week and if the prices are used unaltered to settle trades in the market.
- **Level 2:** Financial instruments⁽¹⁾ traded on a market that is not considered active but for which there are quoted prices that are used unaltered to settle trades, or observable input data that is regularly updated for indirect valuation using generally accepted models.
- **Level 3:** Instruments belong to level 3 if they cannot be included in level 1 or level 2. In such cases, no observable market data can be used for

⁽¹⁾ In classification to an appropriate level in the valuation hierarchy, financial instruments shall be assessed without screening.

valuation. Valuations are based on information with consideration to the circumstances, and may require a significant element of estimation from the Fund's management.

Active market

An active market is one in which quoted prices are readily and regularly available from an exchange, a trader or similar and where transactions are priced on commercial terms. It is virtually only equities for listed companies, currencies and fixed-income securities issued by governments, municipalities, banks or major corporations that are traded on an active market and can thus be included in level 1. For example, currency derivatives are traded on very active markets, but are classified at level 2 since the value must be derived from prices of other instruments.

Inactive market

An inactive market features a low trading volume and a much lower level of trading activity than on an active market. Available prices vary sharply over time or between market participants. In most cases, the prices are not current.

Financial instruments, price and valuation hierarchy

Financial assets and liabilities, closing balance 31/12/2017	Level 1, SEK m	Level 2, SEK m	Level 3, SEK m	Total
Financial assets				
Shares and participations, listed	136,269	-	2,060	138,329
Shares and participations, unlisted	-	-	71,568	71,568
Bonds and other fixed-income assets	109,471	319	4,436	114,226
Derivatives	-	2,753	-	2,753
Total assets valued at	245,740	3,072	78,064	326,876
Financial liabilities				
Derivatives	-	-645	-	-645
Total liabilities valued at	0	-645	0	-645
Financial assets and liabilities	245,740	2,427	78,064	326,231

Financial assets and liabilities, closing balance 31/12/2016	Level 1, SEK m	Level 2, SEK m	Level 3, SEK m	Total
Financial assets				
Shares and participations, listed	124,189	-	2,244	126,433
Shares and participations, unlisted	-	-	76,503	76,503
Bonds and other fixed-income assets	90,840	332	5,266	96,438
Derivatives	-	2,960	-	2,960
Total assets valued at	215,029	3,292	84,013	302,334
Financial liabilities				
Derivatives	-	-478	-	-478
Total liabilities valued at	0	-478	0	-478
Financial assets and liabilities	215,029	2,814	84,013	301,856

Change, level 3	2017	2016
Shares and participations, listed, opening balance	2,244	2,174
Reclassification from level 2, opening balance 2017	-	-
Buy	494	0
Sell	-1,015	-163
Change in value	337	233
Change in shares and participations, listed	-184	70
Shares and participations, listed, closing balance	2,060	2,244
Shares and participations, unlisted, opening balance	76,503	67,788
Reclassification from level 1, opening balance 2017	-	-
Buy	11,330	9,657
Sell	-20,226	-12,182
Change in value	3,961	11,240
Change in shares and participations, unlisted	-4,935	8,715
Shares and participations, unlisted, closing balance	71,568	76,503
Bonds and other fixed-income assets, opening balance	5,266	6,188
Buy	657	2,424
Sell	-1,442	-3,464
Change in value	-45	118
Change in bonds and other fixed-income assets	-830	-922
Bonds and other fixed-income assets, closing balance	4,436	5,266
Total change, level 3	-5,949	7,863

Of the change in value reported above, -73 per cent (48) was unrealised on the balance sheet date. The Fund has the majority of its investments at level 1 where the valuations are obtained from independent and reputed valuation sources. Level 3 listed equities refer to listed fund participations, for which prices are updated less frequently than every seventh day.

Note 18 Financial risks

All investments in the financial markets are associated with risk. The most significant risks can be divided into three groups – investment risks, administrative risks and operational risks. Investment risks can be further divided into market risk, liquidity risk and credit risk. The Fund's most significant investment risk is market risk, which is the risk of changes in the value of an asset. Market risk is quantifiable and is typically measured in terms of standard deviation of return (volatility), value at risk and expected shortfall.

Liquidity risk is the risk of a low volume of trading in an instrument, which can lead to substantial differences between bid and ask prices and therefore high transaction costs, or make it impossible to sell an instrument at the desired time. The Fund's equity investments take place in listed markets and are in most cases highly liquid. However, alternative investments have low liquidity. The table below shows the maturity structure of the Fund's bond portfolio. Credit risk arises in bond investments and the risk that an issuer will be unable to meet its obligations or, in the worst case, will suspend payments. Credit risk is estimated by a credit rating agency. To limit this risk the Fund only invests to a minor extent in bonds with a rating below BBB.

Credit risk also arises when there is a risk that a counterparty will not meet its obligations with respect to the Fund. Counterparty risk arises in trading in securities and OTC contracts. To minimise this risk, such trading is limited and diversified. For counterparties trading in OTC contracts, high creditworthiness from credit rating agencies and signed netting agreements (ISDA agreements) are required.

Forecast risk

The assets' expected market risk is presented in the sensitivity analysis according to the table below. The calculations are based on the Fund's portfolio composition at 29 December 2017 and historical market returns.

The sensitivity analysis is carried out through simulation of return outcomes for the Fund's assets. By using the historical return breakdown in the simulation, any extreme outcomes are taken into account. Hence, no assumptions about normal distribution are necessary. The simulations shown

in the table are created for a short-term risk perspective. The simulation uses a one-year data history and risk is presented for a horizon of a one-day change in value. The simulation is based on a joint standard that has been agreed on by the First, Second, Third and Fourth AP Funds.

The simulation is shown with two different but related risk measures. Value at Risk shows the outcome exceeded by the Fund with 95 per cent probability. The Expected Shortfall measure estimates the extent of the loss that may occur with 5 per cent probability. Expected Shortfall shows the expected loss given that the loss is greater than the Value at Risk measure.

The Fund's risk measured as forecast volatility amounted to 3.8 per cent annualised for the Fund's total portfolio at 31 December. The foreign exchange asset class shows the Fund's total currency risk, while the other assets in the table are hedged for currency risk. The table shows the diversification gain achieved through the Fund's investment in different assets, which together reduce the Fund's risk of loss compared to the risks specific to each individual asset.

Realised risk

Average realised risk is calculated based on a joint standard that has been agreed on by the First, Second, Third and Fourth AP Funds and which is founded on the principle that calculation of risk shall reflect the market valuation of the Fund's total assets. The valuation frequency is established as quarterly and the period for calculation is established at ten years. Consequently, for the total portfolio the realised standard deviation for the past ten years has been expressed at an annual rate based on quarterly data.

AP1's average realised risk for the past ten-year period was 8.6 per cent based on this calculation methodology.

The First, Second, Third and Fourth AP Funds have also agreed to report average realised risk for the past year both for the total portfolio and for the assets for which a market value is obtained daily. For this calculation of standard deviation, daily data is used. The average realised risk during the year was 3.6 per cent for the total portfolio and 4.2 per cent for the part of the portfolio for which a market value is obtained daily. The share of the portfolio for which a market value is obtained daily was 77 per cent at the end of the year.

Financial risks

	Volatility annualised, %		Value at Risk annualised, SEK m		Expected Shortfall annualised, SEK m		Value at Risk one day, SEK m		Expected Shortfall one day, SEK m	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Sensitivity analysis, market risk, at 31 Dec										
Equities	6.8	13.0	-14,425	-26,308	-19,353	-41,281	-895	-1,632	-1,200	-2,560
Fixed income	1.1	1.3	-2,203	-2,119	-2,987	-3,034	-137	-131	-185	-188
Alternative investments	6.6	9.6	-9,336	-16,759	-11,761	-23,454	-579	-1,039	-729	-1,455
Foreign exchange	7.0	9.4	-3,931	-5,501	-5,252	-7,388	-244	-341	-326	-458
Contribution from Diversification	-1.6	-2.2	8,984	11,354	8,333	17,406	557	704	517	1,080
Liquid portfolio	4.0	7.4	-17,188	-28,142	-24,113	-39,995	-1,066	-1,745	-1,495	-2,480
Total portfolio	3.8	7.7	-20,911	-39,334	-31,019	-57,752	-1,297	-2,439	-1,924	-3,582

Liquidity risk, at 31 Dec

	<1		1-3		3-5		5-10		>10		Total balance, SEK m	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Maturity structure, Maturity in years, SEK m												
Nominal, government	4,332	0	13,362	2,738	5,068	6,457	17,040	9,056	5,246	5,594	45,048	23,845
Nominal, credit	4,649	242	12,164	6,767	12,043	12,498	14,151	21,044	7,440	4,773	50,446	45,324
Inflation-indexed	572	0	6,854	2,471	7,366	7,450	4,274	8,826	4,105	3,400	23,170	22,147
Total portfolio	9,553	242	32,380	11,976	24,476	26,405	35,465	38,926	16,790	13,767	118,664	91,317

Derivative positions with a negative fair value, maturity exceeding 12 months, at 31 Dec

Maturity structure, Maturity in years, SEK m	1-3		3-5		5-10		>10		Total balance, SEK m	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Equity-linked instruments	0	0	0	0	0	0	0	0	0	0
Interest-linked instruments	0	-5	0	0	-119	-143	0	0	-119	-148
Currency-linked instruments	0	0	-35	0	0	0	0	0	-35	0
Total									-154	-148

Reporting of maturity structure

The maturity structure for bonds is presented in the table above. According to the current maturity structure, AP1's fixed-income assets generate inflows to the Fund that exceed forecast payments to the pension system. The Fund is thus able to meet the forecast requirements for payments to the pension system.

Reporting of credit risk

Credit risk for bonds is estimated through grading into different rating classes. AP1 uses the credit rating agency Standard & Poor's®.

The agency issues an assessment that assigns a bond's credit rating, with a highest possible rating of AAA. The Fund has limited holdings of bonds with a rating of BBB, SEK 21,951 million, and holdings with a lower rating than investment grade, <BBB, in high-yield investments, SEK 15,369 million. See the table below. The overall assessment is that the Fund has low exposure to credit risk in its bond holdings.

Credit risk, at 31 Dec

Rating SEK m ⁽¹⁾	AAA		AA		A		BBB		<BBB		Total balance, SEK m	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Nominal, government	14,434	17,411	20,817	538	378	0	9,419	5,897		0	45,048	23,845
Nominal, credit	11,629	15,997	6,002	3,464	8,168	10,649	9,278	6,362	15,369	8,852	50,446	45,324
Inflation-indexed	9,902	16,026	9,662	3,462	352	0	3,254	2,660		0	23,170	22,147
Total	35,964	49,433	36,481	7,464	8,898	10,649	21,951	14,918	15,369	8,852	118,664	91,317

⁽¹⁾ Reporting of credit risk for fixed-income securities based on ratings issued by reputed rating agencies.

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Note 19 Financial assets and liabilities that are netted or governed by netting agreements

SEK m, 31/12/2017	Gross amount	Netted amount in the balance sheet	Net amount in the balance sheet	Related amounts that cannot be netted			Other ⁽¹⁾	Total in the balance sheet
				Framework agreement on netting	Collateral received	Net amount		
Unsettled assets	22	22	0	-	-	-	483	483
Derivatives	-	-	2,753	638	1,217	898	-	2,753
Total assets	22	22	2,753	638	1,217	898	483	3,236
Liabilities								
Unsettled liabilities	22	22	0	0	0	0	896	896
Derivatives	-	-	638	638	0	0	7	645
Total liabilities	22	22	638	638	0	0	903	1,541

SEK m, 31/12/2016	Gross amount	Netted amount in the balance sheet	Net amount in the balance sheet	Related amounts that cannot be netted			Other ⁽¹⁾	Total in the balance sheet
				Framework agreement on netting	Collateral received	Net amount		
Unsettled assets	46	46	0	-	-	-	3,465	3,465
Derivatives	-	-	2,960	472	1,396	1,092	-	2,960
Total assets	46	46	2,960	472	1,396	1,092	3,465	6,425
Liabilities								
Unsettled liabilities	46	46	0	-	-	-	896	896
Derivatives	-	-	472	472	0	0	6	478
Total liabilities	46	46	472	472	0	0	902	1,374

⁽¹⁾ Other instruments in the balance sheet that are not governed by netting agreements.

The table above shows the financial assets and liabilities that are presented net in the balance sheet, or that carry rights associated with legally binding framework agreements regarding netting or similar agreements. Financial assets and liabilities are recognised net in the balance sheet when the Fund has a legal right to perform netting in normal business conditions and in the event of insolvency, and if there is an intention to pay net proceeds or realise the asset and simultaneously settle the liability. Financial assets and liabilities that are governed by legally binding framework agreements regarding netting or similar agreements that are not presented net in the balance sheet are arrangements that commonly come into legal effect in the event of insolvency, but not in normal business conditions, or arrangements in which the Fund does not intend to settle the positions simultaneously.

Note 20 Related parties

The table shows AP1's transactions, outstanding dealings and obligations with related parties in accordance with definitions in IAS 24.

Related parties to AP1 are considered to be subsidiaries and associates in which the Fund's ownership is a minimum of 20 per cent, and the Fund's Board members and executive management team.

See Note 5 for information regarding salaries and remuneration for Board members and the executive management team.

Counterparty and ownership	31/12/2017	31/12/2016
AROS Bostadsutveckling, 29%		
Interest income	-	-
Proprietary loans	-	-
Shareholder contribution during the year	78	61
Investment commitments	400	400
Chapone S.à.r.l, 100%		
Interest income	57	18
Proprietary loans	1,066	1,104
Shareholder contribution during the year	-	92
Investment commitments	2,458	2,875

Counterparty and ownership	31/12/2017	31/12/2016
Secore AB, 50%		
Interest income	-	8
Proprietary loans	-	205
Shareholder contribution during the year	364	-
Investment commitments	636	1,000
Vasakronan Holding AB, 25%		
Rent for premises ⁽ⁱ⁾	11	11
Interest income	9	147
Proprietary loans	-	-
Shareholder contribution during the year	-	3,000
Undertaking, on the request of Vasakronan, to purchase commercial papers in the company, up to the highest total settlement amount at any time of:	4,500	4,500
Willhem AB, 100%		
Interest income	16	16
Proprietary loans	-	-
Shareholder contribution during the year	-	-
Undertaking, on the request of Willhem, to purchase commercial papers in the company, up to the highest total settlement amount at any time of:	5,500	5,500
ASE Holdings Ltd, 38%		
Interest income	27	27
Proprietary loans	222	224
Shareholder contribution during the year	-	-
ASE Holdings III S.à.r.l, 32%		
Interest income	3	
Proprietary loans	57	
Shareholder contribution during the year	57	
Agoré Kiinteistöt KY, 50%		
Interest income	12	
Proprietary loans	289	
Shareholder contribution during the year	99	
First Australian Farmland Pty Ltd, 100%		
Interest income	32	30
Proprietary loans	435	415
Shareholder contribution during the year	-	104

⁽ⁱ⁾AP1 rents office premises from Vasakronan on market terms

The Board of Directors' Statement of Assurance

We hereby give our assurance that, to the best of our knowledge, the annual accounts have been prepared in conformity with generally accepted accounting principles in Sweden and with the joint accounting and valuation principles developed by the AP Funds, that the information therein gives a true and fair presentation of the actual conditions, and that nothing of material significance has been omitted that could affect the presentation of the Fund created by this annual report.

Stockholm, 22 February 2018

Urban Karlström
Chairman

Annika Sundén
Deputy Chairman

Göran Arrius

Kent Eriksson

Urban Hansson Brusewitz

Anna Hesselman

Åsa-Pia Järliden Bergström

Åsa Kullgren

Eva Redhe

Our auditors' report was submitted on 22 February 2018

Peter Nilsson
Authorised Public Accountant
Appointed by the Swedish
Government

Helena Kaiser de Carolis
Authorised Public Accountant
Appointed by the Swedish
Government

Auditors' Report

For Första AP-fonden, Corp. ID No. 8020057538

Report on the annual accounts

Opinion

We have audited the annual accounts of Första AP-fonden for the year 2017. The Fund's annual accounts are on pages 28–49 of this document.

In our opinion the annual accounts have been prepared in accordance with the National Pension Insurance Funds Act (2000:192) and present fairly, in all material aspects, the financial position of Första AP-fonden as of 31 December 2017 and its financial performance for the year then ended in accordance with the National Pension Insurance Funds Act.

The statutory administration report is consistent with the other parts of the annual accounts.

We therefore recommend that the income statement and balance sheet be adopted.

Basis for our opinion

We conducted our audit in accordance with International Standards on Auditing (ISA) and generally accepted auditing standards in Sweden. Our responsibility as set out in these standards is described in more detail in the section on "The auditor's responsibility". We are independent of Första AP-fonden in accordance with generally accepted auditing standards in Sweden and we have otherwise fulfilled our professional ethical responsibility in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information other than the annual accounts

This document also contains information other than the annual accounts, and this can be found on pages 1–27 and 52–60. The Board of Directors and the CEO are responsible for this other information.

Our opinion regarding the annual accounts does not extend to this information, and we do not provide any opinion with assurance regarding this other information.

In connection with our audit of the annual accounts, it is our responsibility to read the information identified above and to consider whether or not the information is, to a material extent, inconsistent with the annual accounts. During this review, we also take into consideration the knowledge we have otherwise gained during the audit and assess whether the information otherwise seems to contain material misstatement.

If, based on the work carried out regarding this information, we conclude that the other information contains a material misstatement, we are obliged to report it. We have nothing to report in this respect.

The Board of Directors' and the CEO's responsibility

The Board of Directors and the CEO are responsible for the preparation of the annual accounts and for ensuring that they provide a true and fair presentation in accordance with the National Pension Insurance Funds Act. The Board of Directors and CEO are also responsible for such internal control as the Board of Directors and the CEO deem necessary for the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

While preparing the annual accounts, the Board of Directors and the CEO are responsible for assessing the Fund's ability to continue its operation. They disclose, where applicable, conditions that could affect the Fund's ability to continue its operation and to apply the going concern assumption. The going concern assumption, however, is not applied if the Board of Directors and the CEO intend to liquidate the Fund, close down the operation or do not have a realistic alternative to one of these options.

The auditor's responsibility

Our goals are to express an opinion with reasonable assurance on whether the

annual accounts as a whole contain any material misstatements, whether due to fraud or error, and to provide an auditors' report containing our opinions. Reasonable assurance is a high degree of certainty, but it is no guarantee that an audit performed in accordance with ISA and generally accepted auditing standards in Sweden will always discover a material misstatement should one exist. Misstatements can occur due to fraud or error, and are deemed to be material if individually or jointly they can reasonably be expected to affect the financial decisions made by users based on the annual accounts.

As part of an audit performed in accordance with ISA, we use professional judgement and we take a professionally sceptical approach during the entire audit. We also carry out the following stages:

- We identify and assess the risks of material misstatement in the annual accounts, whether due to fraud or error, we design and perform audit procedures, partly based on these risks, and we obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. There is a higher risk of not discovering a material misstatement due to fraud than one due to error as fraud may entail acting in collusion, falsification, intentional omissions, incorrect information or disregarding internal control.
- We acquire an understanding of the part of the Fund's internal control that is important to our audit in order to design audit procedures that are appropriate taking into account the circumstances, but not in order to express an opinion on the efficacy of the internal control.
- We evaluate the appropriateness of the accounting policies used and the reasonableness of the accounting estimates and pertaining disclosures made by the Board of Directors and the CEO.
- We test the appropriateness of the Board of Directors and the CEO applying the going concern assumption when preparing the annual accounts. Based on the audit evidence obtained, we test whether there are any material uncertainties relating to any events or conditions that could result in significant doubt about the Fund's ability to continue the operation. If we conclude that there is a material uncertainty, we must draw attention in the auditors' report to the disclosures in the annual accounts about the material uncertainty, or, if such disclosures are insufficient, we must modify our opinion of the annual accounts. Our conclusions are based on the audit evidence obtained up until the date of the auditors' report. Future events or conditions may, however, mean that the Fund is no longer able to continue its operations.
- We evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts render the underlying transactions and events in a way that provides a true and fair presentation.

We must inform the Board of Directors of the planned scope and direction of the audit, as well as the timing of the audit, for example. We must also provide information about significant observations during the audit, including any significant shortcomings we identify in the internal control.

Report on other legal and regulatory requirements

Opinion

In addition to our audit of the annual accounts, we have examined the inventory of the assets managed by Första AP-fonden. We have also examined whether there are any qualifications in general concerning the Board of Directors' and the CEO's administration of Första AP-fonden for 2017.

Our audit has not resulted in any qualifications concerning the inventory of assets or in general regarding the administration of the Fund.

Basis for our opinion

We have conducted our audit in accordance with generally accepted auditing

standards in Sweden. Our responsibility as set out in these standards is described in more detail in the section on "The auditor's responsibility". We are independent of Första AP-fonden in accordance with generally accepted auditing standards in Sweden and we have otherwise fulfilled our professional ethical responsibility in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The Board of Directors' and the CEO's responsibility

The Board of Directors and the CEO are responsible for the preparation of the accounting documents and for the management of the Fund's assets in accordance with the National Pension Insurance Funds Act.

The Board of Directors is responsible for Första AP-fonden's organisation and for the management of Första AP-fonden's affairs. This includes, for example, continuously assessing Första AP-fonden's financial situation and ensuring that Första AP-fonden's organisation is designed so that accounting, asset management and Första AP-fonden's financial affairs are otherwise controlled in an adequate manner. The CEO shall manage the ongoing administration in accordance with the Board of Directors' guidelines and instructions and, for example, take the necessary measures to ensure that Första AP-fonden's accounting is fulfilled in conformity with legislation and to ensure that asset management is handled in an adequate manner.

The auditor's responsibility

Our goal regarding the audit of the administration, and thereby our opinion on the administration, is to obtain audit evidence in order to assess with reasonable assurance whether or not there is any qualification concerning the Board of Directors' and the CEO's administration of Första AP-fonden for the 2017 financial year.

Reasonable assurance is a high degree of certainty, but it is no guarantee that an audit performed in accordance with generally accepted auditing standards in Sweden will always discover measures or omissions that can result in qualifications.

As part of an audit performed in accordance with generally accepted auditing standards in Sweden we use professional judgement and we take a professionally sceptical approach during the entire audit. The review of the administration is primarily based on the audit of the annual accounts. Decisions regarding additional audit procedures carried out are based on our professional judgement with the starting points of risk and material aspects. This means that we focus the review on such procedures, areas and conditions that are material to the operation and where deviations and non-compliance would have particular significance for Första AP-fonden's situation. We review and test the decisions made, bases for decisions, measures taken and other conditions that are relevant to our opinion of the administration.

Stockholm, 22 February 2018

Peter Nilsson

Authorised Public Accountant
Appointed by the Swedish Government

Helena Kaiser de Carolis

Authorised Public Accountant
Appointed by the Swedish Government

Första AP-fonden's Fund Governance Report 2017

The Board of Directors of AP1 has chosen to publish a Fund Governance Report to provide information on the work of the Board and Fund on governance and risk management. AP1's principles – professionalism, engagement, a long-term approach and sustainability – are at the heart of its corporate culture.

The Fund Governance Report, including the Board of Directors' report on risk management, has not been reviewed by the auditors.

Första AP-fonden is a Government authority (for details see the Fund's website, www.ap1.se) commissioned to manage assets in the Swedish income pension system. The AP Funds are more independent than most Swedish authorities because their operations are only regulated in the National Pension Insurance Funds (AP Funds) Act and not by regulations or appropriation directions. As a Government authority, AP1 is also affected by other laws.

Each year, the operations of all AP Funds are evaluated by order of the

Swedish Government and the results are presented in a communication to the Swedish Parliament, presented in May of the year following the review period. Government communication 2016/17:130 describes the evaluation through 2016. The communications are available at www.ap1.se.

AP1 voluntarily complies with the Swedish Code of Corporate Governance where it is possible. Publication of this Fund Governance Report is part of this compliance. However, not all rules in the Code are applicable to all parts, since AP1 is a Government authority. In the table, the rules which the Fund does not follow are set out, and the reasons for this. All other rules of the Code are followed.

Rule	Divergence	Reason
Section 1	AP1 does not hold an AGM	The Board members of the Fund are appointed by the Swedish Government. Therefore, the Fund has neither an AGM nor a nomination committee.
Section 2	AP1 does not have a nomination committee	The Board members of the Fund are appointed by the Swedish Government. Therefore, the Fund has neither an AGM nor a nomination committee.
7.6	The Fund's six-month interim report is not reviewed by the auditors	AP Funds report full-year and six-month results. The six-month report, which does not affect the pension system, is not reviewed for cost reasons.
10.2 p1	The Fund does not report the composition of the nomination committee	The Fund's Board members are appointed by the Government and consequently there is no nomination committee.

⁽¹⁾The National Pension Insurance Funds Act (2000:192) (the AP Funds Act)

⁽²⁾For example, the Public Procurement Act (2007:1091), the Public Access to Information and Secrecy Act (2009:400), the Financial Instruments Trading (Market Abuse Penalties) Act (2005:377) and Anti-Bribery legislation in Chapter 10 of the Criminal Code. The Retirement Pension (Income-Based) Act (1998:674) also affects the Fund's operations

Board of Directors

The Board of Directors of AP1 bears full responsibility for the operations of the Fund and is responsible for the Fund's organisation and management of Fund assets. The work of the Board is regulated in the National Pension Insurance Funds (AP Funds) Act.

AP1's Board of Directors consists of nine members, all of whom are appointed by the Swedish Government. Two of the members are appointed on the proposal of organisations representing employee interests, and two are appointed on the proposal of organisations representing employer interests. Since 2007, the Confederation of Swedish Enterprise has abstained from proposing members. The Government also appoints the Chairman and Deputy Chairman from among the members not proposed by labour market parties. The Fund's CEO is not a member of the Board. The Government also appoints the Fund's external auditors.

The members' term of office is one year, i.e. it extends until the Fund's income statement and balance sheet for 2017 have been adopted.

Fees and other remuneration for members of the Board are determined by the Government. Remuneration for the full year amounts to SEK 100,000 for the Chairman, SEK 75,000 for the Deputy Chairman and SEK 50,000 each for the other Board members. In addition, there is scope to pay total fees of SEK 100,000 for work on the Board's committees. The Board has resolved to

pay fees of SEK 20,000 per year to each member of the audit committee and SEK 13,000 per year to each member of the remuneration committee. For more information about fees for Board members, see Note 5. A more detailed presentation of the members of the Board of Directors is provided on page 56.

Work of the Board of Directors

Each year, in compliance with the requirements imposed by the National Pension Insurance Funds (AP Funds) Act, the Board of Directors establishes targets and guidelines for the investing activities, the Fund's risk management plan, ownership policy, business plan and budget. In addition, the Board resolves to operationalise the Fund's mandate in its strategy and a number of governance documents, the most important being its principles and ethical policy, policy for gifts, hospitality and other benefits, remuneration policy for senior executives and rules governing employees' trade in financial instruments.

The Board also appoints a CEO to whom it delegates responsibility for the Fund's day-to-day activities. The Board has resolved on rules of procedure for its own work. In 2017 the Board met on eight occasions.

During the year, the Board addressed the outcome of management, expenses, ownership matters, the business plan and budget, etc. In addition to the ordinary meetings, the Board of Directors also discussed the Fund's

mandate, strategy and targets ahead of forthcoming decisions at a seminar. AP1's comments on the proposed change in investment rules were raised at an extraordinary Board meeting in October.

Average attendance at Board meetings was 94 per cent (see table). Reporting of day-to-day asset management and risk reporting have been standing items on the agenda. At Board meetings, in addition to Board members, the CEO of the Fund attends as well as the secretary to the Board. The secretary to the Board is the Fund's Head of Legal. Other staff of the Fund also participate as experts or reporting persons. External speakers are also invited to Board meetings when needed. The Fund's external auditors report to the Board at least once a year. On these occasions, there is time for discussions between the Board and auditors without the presence of employees of the Fund.

Each year, the Board conducts an evaluation of its own work. The evaluation is then used to improve the work of the Board and its committees, as well as the preparatory work of management ahead of Board meetings. The Chairman of the Board reports the main results to the Government.

From among its own members the Board has appointed two committees, an audit committee and a remuneration committee. Both committees are

preparatory organs and the Board retains the right to make decisions in all matters addressed in the committees. The audit committee assists the Board in matters related to internal control, operational risks, financial reporting and auditing. In 2017 Annika Sundén was chair and Anna Hesselman and Urban Brusewitz were members of the audit committee. The committee convened five times. Attendance at meetings of the audit committee was 89 per cent. The Fund's auditors take part in the meetings of the audit committee on two occasions. The Fund's Head of Legal, the Head of Middle Office & Risk, and the Head of Business Support are co-opted into the audit committee meetings.

The remuneration committee assists the Board in matters related to remuneration. In 2017 the committee consisted of Board Chairman Urban Karlström (chairman of the committee), Göran Arrius and Åsa Kullgren. The committee convened twice during the year. Attendance at meetings of the remuneration committee was 100 per cent. The CEO of the Fund is co-opted into the remuneration committee's meetings, apart from when his remuneration is discussed. The Head of Human Resources is co-opted into remuneration committee meetings.

	Appointed on the proposal of	Attendance Board meetings	Audit committee (attendance)	Remuneration committee (attendance)
Urban Karlström, Chair		7/8		Chairman 2/2
Annika Sundén, Deputy Chair		7/8	Chairman 2/3	
Göran Arrius	Employee organisation (Saco)	7/8		Board member 2/2
Urban Hansson Brusewitz		8/8	Board member 3/3	
Kent Eriksson		7/8		
Anna Hesselman		8/8	Board member 3/3	
Åsa-Pia Järliden Bergström	Employee organisation (LO)	8/8		
Åsa Kullgren		8/8		Board member 2/2
Eva Redhe		8/8		
Total		68/72	8/9	6/6

Management of the Fund

The Board of AP1 has delegated responsibility for operating activities to the Fund's CEO. The Board decides on the long-term risk preference of the Fund, which is manifested in overarching asset allocation. In order to implement the Fund's investment philosophy, the CEO is given a mandate to diverge from the overarching asset allocation within specified bounds.

In support of the CEO in decisions pertaining to operating activities, the CEO has decided to appoint an executive management team that includes the Chief Investment Officer, Chief Active Ownership Officer and the Heads of Middle Office & Risk, Business Support, Legal & Compliance, Communications and HR.

Remuneration

AP1's Board of Directors annually adopts a policy for remuneration for senior executives (published on www.ap1.se). The Fund's policy is based on the guidelines resolved by the Government on 20 April 2009. The policy sets out that the total amount of remuneration for each person should be fair and reasonable, balanced and characterised by moderation. Furthermore, remuneration should be market-based and competitive with respect to the labour market in which the executive works, but without being higher than the norm for comparable positions. No variable remuneration is available to the Fund's employees. AP1, together with the Second, Third, Fourth, Sixth and Seventh AP Funds, also has a joint policy for remuneration, employee benefits, hospitality and business travel. It is published on www.ap1.se.

Remuneration to the CEO is determined by the Board of Directors and consists of fixed salary and payment of defined contribution pension premiums equal to 30 per cent of basic salary. For the portion of remuneration granting rights under the national pension scheme, the pension premium is reduced to 11.5 per cent. Remuneration for senior executives of AP1 is determined by the CEO according to a well-defined process that involves the Board of Directors and its remuneration committee. AP1 complies with all points (9.1-9.8) relating to remuneration to senior executives in the Swedish

Code of Corporate Governance.

In each of the past four years, the Fund's average salary increases have been low. They have averaged at 1.9 per cent, which is lower than the corresponding increase for the comparable market and within the public administration sector. See Note 5 for further information regarding remuneration for the executive management team paid in 2017. Every year, the Fund commissions a comparison of remuneration levels with relevant parts of the labour market as a basis for monitoring remuneration for the Fund's employees, and this also occurred in 2017. In the Board's opinion, salary levels are market-based, competitive, reasonable and appropriate without being higher than the norm with regard to the CEO, senior executives and other employees. The Board has found that the Fund is in compliance with both the remuneration policy established by the Board and the Swedish Government's "Guidelines for terms of employment of senior executives in the AP funds". A small number of old employment contracts have a notice period exceeding six months. However, the Board has decided not to renegotiate these contracts since this would result in higher costs for the Fund without achieving any significant improvement in the contracts.

Compared to the other entities in the study, remuneration for the Fund's employees is in some individual cases above the median for each position. Furthermore, the Board of Directors' analysis shows that there are two reasons why the Fund's remuneration is higher than that in the comparison groups:

- **Employees with cutting-edge expertise:** AP1 is a small and knowledge-intensive organisation that has an explicit strategy to hire and retain employees with cutting-edge expertise in specific areas.

- **No variable salary:** The Fund's employees are offered only fixed remuneration. Many of the areas of expertise sought by the Fund are offered variable salary by other employers. To attract and retain employees, the Fund therefore

offers higher fixed salaries. The fact that AP1 does not pay variable salary when other entities in the study do causes difficulties in interpreting the comparative statistics. At times when performance-based variable salary is lower, AP1's remuneration can therefore be higher than the average for comparable areas of expertise. At times of high returns in the financial industry, the Fund's remuneration will instead be lower than the average for comparable areas of expertise.

Hence, the Fund's remuneration is within a range that can be regarded as market-based.

The auditors perform a review to ensure compliance with the Fund's remuneration policy for senior executives, the Swedish Government's guidelines for terms of employment of senior executives in the AP Funds and the joint policy with other AP Funds. No divergences from the above were noted.

AP1 invests in various real estate markets via companies in which the Fund has a significant voting share. This currently includes Vasakronan, Cityhold and Willhem. The Fund has issued ownership directives that affect remuneration matters for these companies. The directives are published on www.ap1.se.

Conflicts of interest

AP1 uses a three-stage process to handle any conflicts of interest. The first stage is to identify potential conflicts of interest in advance. In the second stage, transpired conflicts of interest are addressed by means of the CEO deciding on the Fund's action in the individual case. For conflicts of interest of particular importance, the Chairman of the Board is consulted. Existing conflicts of interest are reported to the Board and subsequently published on the Fund's website. No conflicts of interest arose in 2017.

Internal control

The Board of Directors is responsible for the governance and risk management of the Fund. In the Fund's risk management plan, the Board has adopted guidelines and frameworks for the Fund's overarching allocation of responsibilities, risks, risk limits and procedures for monitoring and control of compliance with rules and guidelines. The Board's risk report is provided on page 55.

Independent review

In 2017, the Board commissioned an external consultant to review specific areas. The area "processes within alternative investments" was chosen following discussions in the audit committee. The results were reported back to the audit committee in September and to the Board in December.

External audit

AP1's auditors are appointed by the Swedish Government. The current assignment, shared by Peter Nilsson and Helena Kaiser de Carolis, both from PwC, commenced on 14 September 2017 and extends until the adoption of the Fund's income statement and balance sheet for 2017.

Peter Nilsson has been appointed by the Government to coordinate the auditing procedures of all AP Funds. The auditors have also been appointed as auditors of the Second, Third, Fourth and Seventh AP funds. The auditors report directly to the Board in the form of a written audit report and a verbal presentation. The auditors participate in at least one Board meeting per year. In addition, regular meetings with the audit committee are held. The auditors present an auditors' report of their findings. The auditors also submit a yearly verbal report to the Swedish Ministry of Finance. The auditors' duties include examining the Fund's operating activities, the administration of the Fund, the year-end accounts and the annual report, and expressing an opinion on the Fund's accounting documents and administration based on their audit. Their duties also include assessment of AP1's application of the accounting and valuation policies established by the AP Funds and whether the accounting records prepared provide a true and fair presentation of the operations. In addition to a regular audit, the AP Funds' auditors must append a written, signed statement to the auditors' report to express their opinion on whether or not the guidelines for remuneration to senior executives as established for the financial year have been complied with.

The Board of Directors' Report on Risk Management

Since 2015, Första AP-fonden has been working according to a new investment process. This report describes risk management in 2017. The Swedish Government commissions external auditors to review the Fund's financial statements and risk control. An internal audit is also conducted, as commissioned by the Board.

According to the National Pension Insurance Funds Act (2000:192), the Board of Directors of AP1 is responsible for the Fund's organisation and management of the Fund's assets. Part of this responsibility is to ensure the high quality of the Fund's internal control. From among its members, the Board appoints an audit committee to prepare matters pertaining to internal control, for example. The Board submits this report on risk management annually. However, this report is not part of the formal annual report and is therefore not examined by the Fund's auditors.

As a participant in financial markets, the Fund distinguishes between three risk categories that are addressed in different ways.

- Financial risks – market risks and issuer risks – enable the Fund, when employed correctly, to increase its return on invested capital. Financial risks shall thus be optimised within the risk mandate delegated to the CEO by the Board, and the risk mandate further delegated by the CEO within the management organisation.
- Counterparty and delivery risks shall be minimised. Counterparties are evaluated and approved in a set process in which account is taken of, for example, their official rating.
- Operational risks shall be minimised by means of e.g. incident follow-up, preparing relevant policy documents, staff training and investment in IT systems.

Control environment – Fund governance

The Board of Directors annually adopts a risk management plan that sets out guidelines and limitations for the risk mandate delegated by the Board to the CEO. This document serves as a basis for internal control and monitoring of the Fund's investing activities. Therein, limitations are specified for the Fund's financial risk-taking, as are well-defined decision-making structures for the operating activities. The approach leads to sound internal risk control.

The Fund's risk management is based on Finansinspektionen's (the Swedish financial supervisory authority's) Regulations and General Guidelines regarding governance, risk management and control at credit institutions (FFFS 2014:1) in terms of the three lines of defence, (i) responsibility for risk management and control in the business operations, (ii) internal control and compliance and (iii) independent review. For the third line of defence, independent review through internal audit, the Board of Directors has resolved to conduct independent reviews with the support of an external consultant.

Managing financial risks is fundamental to the ability of the Fund to deliver on its mandate in the pension system. Risk management in the Fund is thus proactive, with financial risk forecast for each asset individually and for the portfolio as a whole. For this reason, there is a well-established risk culture at the Fund. Important elements of this culture are transparent reporting of the Fund's investments and a principle of duality for executing business transactions. This means that everyone in the organisation can monitor investing activities via an enterprise-wide system and that each business transaction requires the approval of at least two people – one from the Fund's Back Office and one from the relevant investment unit.

The second line of defence comprises the internal risk control function, finance function and compliance function. Middle Office focuses on financial risks and counterparty and delivery risks. The Compliance Officer works primarily on verifying compliance with external regulations. The finance function ensures the financial reporting. Middle Office and the finance function jointly control operational risk.

Risk assessment

To ensure effective financial reporting and identification of operational risks, a yearly review of the Fund's processes and documentation thereof is conducted by order of the Board. The results of this review are reported to the Board's audit committee. A key component of this review is the account-closing process, which serves as a basis for the external financial reporting. The account-closing process encompasses valuation, reconciliation and controls of assets and liabilities in connection with the closing of accounts. Aside from a general review of the processes, the Chief Risk Officer, after consultation with the CEO, establishes on a yearly basis the areas to be prioritised and subjected to special review. The units within the organisation that are affected by the review participate actively in the analysis, which is based on a self-assessment method. This work results in an evaluation of identified risks and a prioritisation of measures. The Fund's Chief Risk Officer oversees the analysis process and ensures that the prioritised measures are implemented.

Control structure and activities

The financial information is analysed and verified by the Fund's Back Office and Middle Office. The systems in Back Office and Middle Office also produce source materials for various risk analyses that are used as support for control activities.

AP1's accounting and valuation policies are being gradually adapted to International Financial Reporting Standards, IFRS. Complete adaptation to IFRS would have no material impact on the reported net investment income and net assets. Compared to the currently applicable IFRS, the only major difference is that consolidated accounts and cash flow statements are not prepared.

To read more about this, see the Fund's accounting and valuation policies.

The portfolio is managed according to forecast financial risk within the given mandates. The forecast risk is analysed retrospectively in relation to the actual risk outcome. In this way, the model for portfolio management can be developed.

Communication and reporting

All guidelines and instructions with relevance for internal control are communicated clearly and are available to all employees on the Fund's intranet. This transparency also applies to the daily internal performance reports, which are also available on the Fund's intranet.

The Board is regularly informed about the Fund's financial position and performance. Each month, the Board is provided with an income, return and risk report. An income statement and balance sheet report is presented to the Board on a quarterly basis. The Fund's financial position and risk-taking are also reported at each ordinary Board meeting. Risk reporting is a standing item on the agenda of all of the Fund's ordinary Board meetings. These procedures are deemed to secure the Fund's external financial reporting. External reports of the Fund's financial position are published in connection with the annual and semi-annual accounts. Middle Office reports to the audit committee in connection with its meetings. The auditors report continuously to the audit committee and to the Board in connection with the annual closing of accounts.

Board of Directors



Urban Karlström
Chairman, chair of the remuneration committee

Ph.D. Econ., Director-General of the Swedish Fortifications Agency.
Born 1953. Elected to the Board in 2011.

Other assignments: Chairman of Forum for Innovation in the Transport Sector, chairman of Arcato AB, board member of Caterva AB, board member of Drive Sweden.



Annika Sundén
Deputy Chairman, chair of the audit committee

Associate Professor, Analysis Director at Sweden's Public Employment Agency.
Born 1964. Elected to the Board in 2011.

Other assignments: Member of the Institute for Future Studies, member of the Delegation for Migration Studies, member of the Scientific Council of IFAU, member of the Swedish Social Insurance Inspectorate's transparency council, board member of the National Government Employee Pensions Board, member of Mälardalen University Sweden.



Göran Arrius
Member of the remuneration committee.

Appointed on the proposal of employee organisation (Saco – the Swedish Confederation of Professional Associations), Chairman of Saco.
Born 1959. Elected to the Board in 2011.

Other assignments: Chairman of AEA, member of the Swedish Defence Intelligence Court, chairman of Folk och Försvar, chairman of LO, TCO and Saco's office in Brussels, member of Folksam Liv, member of the National Committee for Sweden's National Day, member of The Royal Society of Naval Sciences.



Kent Eriksson
Professor at the Royal Institute of Technology.
Born 1964. Elected to the Board in 2015.



Urban Hansson Brusewitz
Member of the audit committee

PhD in Economics, Director-General of the National Institute of Economic Research. Born 1958.
Elected to the Board in 2016.

Other assignments: Member of the Swedish National Financial Management Authority's transparency council.



Anna Hesselman
Member of the audit committee

Licentiate Degree in Economics. Consulting business in accounting and finance.
Born 1954. Elected to the Board in 2015.



Åsa-Pia Järliden Bergström
Appointed on the proposal of employee organisation (LO). M. Sc. in Economics, LO economist.
Born 1969. Elected to the Board in 2015.

Other assignments: Chairman of Bantorget finans AB, board member of Bio-ech R&D AB.



Åsa Kullgren
Member of the remuneration committee.

Appointed on the proposal of employer organisation (Swedish Association of Local Authorities and Regions). Bachelor of Laws, prosecutor.
Born 1971. Elected to the Board in 2015.

Other assignments: Special investigator in the new pharmacy market inquiry.



Eva Redhe
MBA. Born 1962. Elected to the Board in 2013.

Other assignments: Chairman of Spago Nanomedical AB and Ftrack AB, board member of Starbreeze AB, and Axel Christiernsson International AB.

Executive Management Team



Johan Magnusson
Chief Executive Officer

Education: Economist.
Born 1959. Employed since 2008.

Previous experience: Senior positions at SEB Wealth Management and ABB Investment Management.



Mikael Angberg
Chief Investment Officer

Education: Master of Engineering.
Born 1973. Employed since 2013.

Previous experience: PIMCO, BNP Paribas, Goldman Sachs, AXA Investment Managers and CERN.



Ossian Ekdahl
Chief Active Ownership Officer

Education: MBA, Licentiate Degree in Economics.
Born 1961. Employed since 1999.

Previous experience: Stockholm School of Economics, University of Karlstad, the Ministry of Finance and the Central Bank of Sweden.



Anna Fall
Head of Communications

Education: BSc in Political Science, Communication Studies and Business Economics.
Born 1969. Employed since 2016.

Previous experience: Royal Bank of Scotland, Nordisk Renting, NCC.



Gun Hammarlund
Head of Business Support

Education: MBA.
Born 1958. Employed since 1987.

Previous experience: Various positions within AP1.



Katarina Höller
Head of Middle Office @ Risk

Education: B. Sc. in Statistics.
Born 1966. Employed since 2016.

Previous experience: SEB Wealth Management, Finansinspektionen (the Swedish financial supervisory authority), DnB NOR, Skandia.



Teresa Isele
Head of Legal @ Compliance

Education: Swedish Bachelor of Laws & Master of Laws at Stockholm University, German Bachelor of Laws at Humboldt-Universität, Berlin, Diploma in English Law at King's College London.
Born 1982. Employed since 2015.

Previous experience: EQT, Vinge.



Marina Westman
Head of Human Resources

Education: Human Resources.
Born 1960. Employed since 2008.

Previous experience: HR positions in the SEB group.

Innovations for the future are the focus as
Första AP-fonden integrates sustainability
into its investments.

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MILJÖMÄRKT Trycksak 3041 0065



Första AP-fonden

Box 16294, SE-103 25 Stockholm, Sweden

Street address: Regeringsgatan 28, Stockholm, Sweden

Phone: +46 (0)8-566 202 00

www.ap1.se