CORPORATE GOVERNANCE REPORT FOR 2008-2009

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The Third Swedish National Pension Fund (AP3) aims to generate maximum returns on fund capital at a low level of risk, and we use our influence as an investor to help us achieve that goal. The legislation that regulates our operations requires us to disregard economic and business policy considerations in our investment decisions. We are, however, required to take environmental and social considerations in our investment activities, without compromising the goal of securing high returns. Our mandate gives us a unique opportunity to exercise influence as an independent institutional shareholder on Sweden's equity market. As part of the national pension system, we are independent of other investors and business interests. This autonomy makes us well placed to earn respect for our role as a shareholder and underpins our credibility and ability to gain support for our views on key issues.

The AP3 corporate governance policy is approved by the Board of Directors and communicates our positions on corporate governance and related issues. The policy is updated regularly and published on the AP3 website at www.ap3.se. It is not always practicable to provide detailed reports of our discussions with other investors, nomination committees, corporate managements and boards. This is primarily because we believe confidential dialogue is often the most effective way to communicate our views. We aim to exert influence at an early stage in the process, usually ahead of the AGM season. Only if we feel that a company board or nomination committee has not responded to our comments do we consider raising the issue at the AGM or voting against a resolution.

AP3 believes that active governance makes a positive contribution over the longer term to our primary goal of obtaining high investment returns. We also believe that active governance helps build trust and confidence in AP3 – an important factor, especially in times of instability on financial markets. Our aim is to report, as openly as possible, our governance engagements and main focus areas during the year. To that end, we are pleased to present our annual governance report for the 12 months ended 30 June 2009.

Corporate governance at AP3

We aim at all times to adjust our governance activities to the conditions dictated by our overall strategy. AP3 has a diversified global portfolio of around SEK 95 billion invested in 2,500 companies worldwide. Our foreign equity holdings are small and we rarely control more than 0.05 percent of the voting rights in any one company.

We have also gradually altered the management structure of the Swedish equity portfolio, which formerly included small cap and mid cap equities. The portfolio now includes only the larger companies listed on the Stockholm Stock Exchange. Although the overall impact of the change has been to reduce the size of individual equity interests in the Swedish portfolio, the holdings are considerably larger than in the foreign equity portfolio. In the Swedish equity portfolio, we hold more than 0.5 percent of the voting rights in over 50 companies. In half of these, our share of ownership exceeds 1 percent. Only in five companies does our share of the voting rights exceed 3 percent. We are a mid-sized Swedish institutional investor whose Swedish equity portfolio had a market value of approximately SEK 18 billion at the start of 2009.

AP3 prioritises active governance in companies where we have relatively large equity holdings, which at present relates mainly to Swedish stocks. We also prioritise taking an active role in the debate on corporate governance guidelines in the Swedish equity market.

AP3's main governance tools are:

- **Nomination committees** are arguably best placed to influence governance because they nominate directors. Nomination committees in Sweden are usually composed of representatives of the three to five largest shareholders. However, because most of AP3's portfolio holdings are relatively small, we generally exercise governance through other channels. At the start of this year's AGM season AP3 had seats on five nomination committees – Enea, BioInvent, Karo Bio, Bergvik Skog and Karolinska Development – compared to two in 2008, one in 2007, five in 2006, eight in 2005 and ten in 2004.

- **Dialogue with corporate managements and boards** is an excellent way to communicate our views on corporate governance. Companies often contact institutional investors like AP3 before the AGM to discuss proposed resolutions, particularly in respect of remuneration schemes. On occasion, we also initiate dialogue with the companies themselves when there are important issues to discuss.
- We seek to exercise our **right to vote at the AGM** in such a way as to generate higher portfolio returns. Going into this year's AGM season, we chose to focus our governance activities on a group of 50 companies. We also voted at the AGMs of around 300 companies in the foreign equity portfolio.
- **Raising issues at AGMs** is an important governance mechanism. We are always prepared to speak at AGMs to explain our position on specific issues, ask questions and – where appropriate – express criticism.
- **Contacts with foreign shareholders** are becoming increasingly important as these investors become more active in exercising their voting rights at Swedish AGMs. Alongside other institutional investors, AP3 seeks to promote understanding of the Swedish governance model abroad.
- **Environmental and social responsibility** is a key focus area for AP3 in a corporate governance context and we engage actively in dialogue with Swedish companies on this level. We also hold discussions with foreign companies with regard to breaches of international conventions. Our dialogues with foreign companies are conducted jointly with AP1, AP2 and AP4 via the Ethical Council.
- Playing an **active role in developing the self-regulatory system** for the Swedish equity market is natural for AP3 as both Chief Executive Officer Kerstin Hessius and Deputy Chairman Lars Otterbeck are members of the Council for Swedish Corporate Governance. As a member of the Institutional Owners Association for Regulatory Issues in the Stock Market, AP3 had for a long time sought a review of the Swedish Industry and Commerce Stock Exchange Committee's takeover rules. The review took place during the year. The resulting changes are extensive, but we would like to highlight the particular importance of tighter regulations relating to offer prices for different share classes. The new principle is that class A and class B shares should receive equal treatment in takeover contexts. This is crucial for creating a fair regulatory framework for the Swedish equity market and ensuring international confidence in the Swedish market.

AP3 also supports a range of initiatives to make it easier for investors to make their voice heard abroad. We also endorse investor initiatives to increase corporate transparency, improve environmental reporting and promote corporate social and environmental responsibility. Support for most of these initiatives is provided via the Ethical Council.

Focus issues in 2008-2009

AP3's corporate governance strategy prioritises initiatives most likely to contribute to our primary goal of achieving high investment returns and our secondary goal of ensuring public confidence in us and our operations. For the 2009 AGM season we focused on the following four areas:

Remuneration

Executive pay and benefits take up a major part of AP3's corporate governance work. We share the same interests as the companies in which we invest: namely, creating conditions for optimal returns over time on our investments. Remuneration plans for senior executives should therefore be structured as a cost-effective reward for long-term value creation. AP3 believes corporate boards should be responsible for setting executive pay levels and guidelines. As an investor, it is always important to base our approach on the company's best interests as this is the optimum way to create long-term value for shareholders. We believe dialogue with company representatives and other shareholders is the best route to make our voice heard. Ahead of the 2009 AGM season, we wrote to the boards of the largest listed companies to clarify our views on executive pay. We also raised our view on executive pay in direct dialogue with companies.

Board diversity

AP3 promotes board diversity at listed companies. We believe that boards should possess a broad spectrum of experience and that directorships should be offered to candidates from beyond the established networks. We also wish to see directors being chosen from a wide range of potential candidates. Securing greater representation of female directors is a primary objective in this context.

Environment and social responsibility

AP3 believes there is a connection between corporate ethics and the capacity to deliver long-term shareholder value. We apply standards of environmental and socially responsible investment by screening companies to ensure they are not in breach of international conventions. We also engage companies in dialogue and support joint investor initiatives.

Governance in the foreign equity portfolio

Most of AP3's foreign equity portfolio is managed by external managers, to whom we delegate our voting rights. However, we are expanding our direct voting in the global equity portfolio as part of our extended commitment to corporate governance. This undertaking builds trust in AP3's governance and will help us in the long run to achieve higher returns in the equity portfolio. AP3 will vote at approximately AGMs of 300 foreign companies during 2009.

AGMS in 2009

Going into this year's AGM season, we maintained our strategy of focusing on a manageable number of companies based on a few key criteria:

Our 20 largest portfolio holdings.

- Companies with market capitalisation above SEK 100 million and where our equity interest exceeds 1 percent
- Life science companies with market capitalisation above SEK 10 million and where our equity interest exceeds 2 percent
- Companies with a contentious agenda item or with which AP3 held discussions on an important governance issue prior to the AGM.
- Investment companies

AP3 attended and voted at 44 AGMs during spring 2009 and voted remotely at a further two AGMs. We also attended six extraordinary general meetings during the first half of 2009.

At the start of the AGM season we put strong emphasis on the capital procurement needs of many listed companies. Many corporations cut or withheld their dividends for 2008, while some moved swiftly to strengthen their balance sheets by issuing new shares. Swedbank raised more than SEK 12 billion kronor prior to the start of the year, and the start of the AGM season in early March coincided with rights issues by SEB, Nordea and Husqvarna that together raised SEK 47 billion. Capital procurement was mainly in the spotlight during the early part of the AGM season, but it is possible that this issue may return to take a prominent place on the agenda later on in the year.

Executive pay was another issue in the spotlight at AGMs. On 20 April 2009 the Swedish government approved new guidelines for employment conditions and benefits to senior executives in state-owned companies. The guidelines remove the right to receive variable pay. It was difficult at short notice to establish the impact of the new guidelines on the AP3 governance policy so we decided to abstain from all votes on executive pay for the remainder of the Swedish AGM season. In a few individual cases, however, we set this principle aside and voted in favour of share-based incentive plans. These related to bonus schemes in small and medium sized growth companies which had yet to establish sustainable positive cash flow and where the incentive plans in question were intended to incentivise staff without depleting the companies' limited cash reserves by paying high fixed salaries.

There were relatively few changes in terms of board composition and directors' remuneration. The financial crisis was doubtless the main reason why nomination committees and investors sought few changes at board level. Many listed companies have publicly acknowledged that they are facing difficult times, and in such conditions it may be prudent to maintain board continuity and avoid major alterations. The financial crisis was also reflected in moderate pay awards to directors. Virtually all nomination committees proposed unchanged remuneration levels for directors, and some boards even took voluntary pay cuts.

Some AGM resolutions are shown below, along with AP3's views on the issues involved and an explanation for why we voted one way or the other on share-based incentive schemes.

A planned rights issue led **SEB** to bring forward its AGM. The issue raised SEK 15 billion, which together with the bank's decision to withhold its 2008 dividend substantially strengthened SEB's balance sheet. The AGM adopted a board proposal to cut directors' basic pay by 25 percent and also approved a revised remuneration policy that abolished short-term bonuses for the chief executive officer and senior management. The Swedish government had demanded this as a qualifying condition for its state loan guarantee programme. As a result, fixed salaries for senior management were increased, though the company later withdrew the proposed increase for the chief executive officer. The proposed long-term incentive programme was to all intents and purposes identical to the previous year's plan and contained three elements. The scheme is based on a share savings plan open to all employees and requires a personal investment of up to 5 percent of fixed gross salary, thus giving rise to a financial risk for beneficiaries. If the shares are held for three years and the beneficiary still works for SEB, he or she receives one new share for every share saved. The plan also includes a performance share scheme for 325 senior executives and key individuals. The element of subsidy is quite high because the share price is fixed at a low level. On the other hand, it runs for a long time – seven years – and contains a strong link between performance and reward. The scheme also included a share matching programme for senior management and key individuals (70 people in total), which allocates 25 percent of short-term variable pay for 2008 being paid into a pool with various share entitlements. After three years, each participant receives one share for each share matching entitlement and a number of "matching shares", depending on the extent to which performance targets have been met. SEB informed AP3 about the resolution in advance of the AGM and we voted in favour, as we did the year before.

An extraordinary general meeting at **Husqvarna** approved a preferential rights issue of SEK 3 billion. Investor, LE Lundbergföretagen, Alecta, AFA Försäkring, Investment AB Öresund and AP4 gave their backing to the rights issue and undertook to subscribe for shares on a pro rata equity basis. Investor guaranteed one third of the issue, more than its pro rata share, after the Swedish Securities Council allowed it an exemption from mandatory bid rules in the event that its holding were to exceed 30 percent of the voting rights. A consortium of SEB, SHB and Nordea guaranteed the remainder of the issue. AP3 voted in favour of the rights issue.

An extraordinary general meeting at **Nordea** also approved a rights issue. Around half of the €2.5 billion issue was guaranteed by the Swedish government, Sampo OY and Nordea-fonden. Investment banks Merrill Lynch and J.P. Morgan guaranteed the remainder. The Swedish government used funds from its new stability fund to underwrite the issue, which raised Nordea's core primary capital ratio to 10 percent, making Nordea one of the best capitalised banks in Europe. AP3 voted in favour of the rights issue, which was unanimously approved. An AGM decision to cut the dividend to 19 percent of net profit from the usual level of 40 percent provided a further capital strengthening.

Our sister pension fund, AP2, represented us at the AGM of real estate management company **Castellum**. The meeting approved a dividend of SEK 3.15 per share, roughly three-quarters of net income. This might seem high, especially as the dividend policy is based on net income and takes no account of non-cash decreases in the value of group property holdings. However, it should be noted that non-cash gains or losses have played no part in Castellum's dividend policy in prior years. Castellum's 2007 AGM approved an employee incentive plan that was basically an extension of previous plans. It consists of an annual profit-based bonus for 2008, 20009 and 2010 and a three-year share-based bonus for June 2011 to May 2011. The maximum payout of annual profit-based bonus is six months' salary, representing a cost to Castellum of SEK 10 million. The maximum three-year share-based bonus payable for June 2008 to May 2011 is 18 months' salary, representing a cost to Castellum of SEK 29 million. AP3 voted in favour of the resolution.

As last year, AP3 held a seat on the **Enea** nomination committee. Prior to the AGM, chairman Staffan Ahlberg informed shareholders he would not be seeking reelection. The nomination committee proposed Anders Lidbeck as new chairman. Lidbeck has spent the last ten years as chief executive officer of software manufacturer Telelogic. The nomination committee said his knowledge of the software industry made him an excellent person to lead the board.

The board of **Investor** carried out research to analyse the company's incentive plan. The review showed the plan was popular with participants and acceptable to Swedish and foreign shareholders. Respondents highlighted the benefits of an investment by the beneficiary and the presence of a lock-in period. They also noted potential for improvement in the plan's design and the desirability of a stronger focus on the target group through improved gearing. Based on the review, the board proposed a revised plan to the AGM, details of which were made available to AP3 in advance of the meeting. The plan was fundamentally on the lines of previous years, with a share savings scheme for all employees and a performance-based share scheme for the CEO and senior management. The plan incorporated personal investments by beneficiaries and a lock-in period of adequate length. It contained a clear performance link for senior managers and a payout ceiling, and also offered shareholders a limited cost known in advance. The proposed changes this year involved limiting the plan to a single target variable (absolute total return in excess of the risk-free interest rate) and increasing entitlements from 50 percent to 100 percent of the share price. AP3 voted in favour of the resolution. Prior to the AGM we informed Investor that we were positive to the changes but wished to see future performance criteria based on benchmarking against competitors, as well as adoption of a total return target.

Electrolux also polled employees to ascertain their attitudes to the company's remuneration model, especially its long-term incentive component. This review formed the basis for the long-term incentive plan presented by the board to the AGM. Some aspects of the plan fell short of AP3's requirements. The plan included a performance link in the form of an average annual increase in earnings per share in the three-year period 2009-2011, but the incentive element was limited. Earnings per share have fluctuated heavily in recent years and hit a historic low in 2008, the start date for the performance period. The proposed plan included a qualification criterion based on a minimum 5 percent increase in earnings per share for the next three years. This was positive, but we felt the qualification barrier ought to have been higher. A further positive element was the inclusion of an allocation ceiling, both in absolute terms and for individual beneficiaries. However, shares would be allocated free after the end of the three-year period, meaning an absence of personal financial risk. AP3 feels it is important for participants to make a personal financial commitment to ensure that shareholders and beneficiaries share the same long-term goals and risks. At the AGM the board presented two changes to the original proposal: an upper dilution limit of 1 percent (which was positive) and a recommendation to group management members to invest 12 months' salary in Electrolux shares (meaning that management would be subject to the same risk as shareholders). AP3 voted in favour of the proposed incentive programme but expressed the view that future proposals should include a greater element of personal risk. Other large institutional shareholders share our opinion and we hope future proposals will reflect our wishes in this context.

The AGM of **LE Lundbergföretagen** made major changes to the board with the re-election of Carl Bennet as non-executive director and Katarina Lundberg as alternate director and the election of Mats Guldbrand as chairman. The meeting also approved unchanged guidelines for remuneration of executive management that allow for payment of bonuses based on earnings and profitability targets or activity-related goals. The guidelines make no provision for remuneration by way of options or other share-based incentive schemes. AP3 voted in favour of the board's resolution.

The **SSAB** AGM approved a dividend of SEK 4 per share and the re-election of director John Tulloch, a former senior executive at IPSCO Inc., which SSAB acquired in 2007. SSAB does not have an incentive plan and has a clear and straightforward remuneration policy for senior management and other key individuals. However, at the last moment the board presented an amendment to the remuneration policy that involved structuring variable pay plans to give the board discretion to limit or withhold bonuses in exceptional financial circumstances, in cases where the board deems such action to be reasonable and compatible with the company's obligations to shareholders, employees and other stakeholders. The revision empowered the board to withhold variable pay and was welcomed by AP3. We voted in favour of the board's resolution.

Ahead of the **Volvo** AGM, the company's remuneration committee proposed substantial increases in remuneration to senior management. The resolution, which was supported by the company's largest shareholders – representing more than 50 percent of the voting rights – aimed to raise the ceiling for management's performance -based variable remuneration from 50 percent to 60 percent of fixed salary, though it did not apply to the chief executive officer, for whom a 65 percent ceiling was already in place. Also, the proposal envisaged a 50 percent increase in the maximum number of distributable shares. After attracting strong criticism from employees and other shareholders, the proposal was withdrawn and the board reverted to a proposal in line with the previous year's incentive plan for senior management. AP3 voted in favour of last year's plan while informing the company that we wished future programmes to be of longer duration and contain more challenging performance requirements. This year's plan was both of a short-term nature and lacked a personal investment component so we voted against it.

Prior to **TeliaSonera's** AGM, the board withdrew a resolution authorising it to approve acquisitions of the company's own shares, noting that the resolution might be open to misinterpretation by shareholders. AP3, which would otherwise have voted against the resolution, welcomed this decision. The TeliaSonera board's resolution on executive management remuneration included an entitlement to annual variable pay linked to financial and non-financial targets. According to the proposal, variable pay would not exceed 50 percent of annual fixed salary. At the meeting, the Swedish government presented a counter resolution proposing a new remuneration policy that would remove all entitlement to variable salary for executive management. The Finnish government and a number of institutional investors spoke in favour of the board's resolution but the Swedish government nevertheless won the day thanks to its majority shareholding of 52 percent of the voting rights. AP3 joined all other institutional investors in voting in favour of the board's resolution.

Nordea's remuneration policy allows variable pay but limits it to 35 percent of fixed salary and makes it contingent on stated financial, customer-based and personal targets for beneficiaries. The board proposed a long-term incentive programme offering 400 senior managers and other key personnel the opportunity to acquire shares worth up to 10 percent of salary. After two years, a matching clause would kick in enabling beneficiaries to acquire new shares at a subsidised price. In addition, a share options scheme would give participants who have purchased shares the opportunity to purchase shares at a subsidised rate. For every purchased share, the holder would gain three entitlements to purchase reduced-rate shares. This part of the plan was linked to fulfilment of three performance targets. AP3 received information about the resolution at an investors' briefing and we responded that the programme met our criteria despite being relatively complex. This was because it contained a financial downside for beneficiaries, included a clear link to performance, was sufficiently long term in nature and gave rise to a limited cost to shareholders. Nordea's chief executive officer and senior management undertook to forego variable pay in 2009. The Swedish government submitted an alternative remuneration policy resolution proscribing variable pay at Nordea. However, this was rejected by 63 percent of shareholders – a clear majority. AP3 voted in favour of the board's resolution.

As in 2007, the board of **Ratos** proposed two share options plans for 30 key people. The plans consisted of call options for Ratos shares and synthetic options based on the performance of the Ratos portfolio. The call options plan contained no link to performance but had a strong lock-in period of three years plus a two-year redemption period. The performance link in the synthetic options plan was also relatively strong, with beneficiaries qualifying for allocations only if the company records an annual return of 15 percent. Participants were also to pay a market premium for the share options, creating an element of financial risk. The main question mark concerned the absence of a ceiling as this raises a risk of exorbitant payouts that could damage public confidence in the company. However, the combination of a strong lock-in period and link to company performance led AP3 to vote in favour of the resolution.

Though **SCA** has no incentive plans for employees, executive management can qualify for variable pay. In AP3's view, the variable pay component to senior managers was well structured as it included a ceiling, was based on fixed salary and performance against set targets and was also tied, in so far as possible, to the performance of the SCA share. In addition, variable pay was not included in pension-entitled income. The board also presented an amendment to the company's remuneration principles that would allow it to withhold variable pay if necessary. AP3 voted in favour of the board's resolution.

Construction company **Skanska** presented no additions or changes to its share savings plan for all 47,000 employees. The plan had no impact on Skanska's financial position in 2008 because the share allocation targets were not met. The board informed the AGM that it would freeze executive management salaries in 2009 and announced a change in remuneration principles that would give the board responsibility to review variable pay and empower it to stop all payments if necessary. AP3 voted in favour of the board's resolution.

Investment bank **D Carnegie & Co** was delisted in late 2008**.** April saw publication of the special report on events at the company. The report's findings led the AGM to decide not to discharge the former chief executive officer and board from liability for Carnegie's financial reporting. It should also be noted that the board asked an appeal tribunal to value the company's assets.

Alfa Laval in 2008 approved a long-term share-based incentive plan for up to 75 top managers. This year's AGM adopted a similar scheme comprising a three-year cash-based plan linked to performance and the company's earnings growth. Annual variable pay can be up to 60 percent of basic salary and the incentive plan can generate up to 17 percent of beneficiaries' annual variable pay, provided that the company meets the board's earnings per share target. Payments are after three years, assuming that participants remain with the company during that period. The proposal met AP3's requirements for this type of plan and we voted in favour. It is worth noting that Alfa Laval in 2006 converted its defined benefit pension plans to defined contribution plans, setting an example that other enterprises with defined benefit pension plans would be well advised to follow.

SKF's remuneration guidelines entitle senior managers to variable pay under a performance-based plan which operates a ceiling based on a certain percentage of fixed salary. In 2005 the company introduced a performance-based remuneration plan with a short-term component and a long-term component. Last year, the AGM approved the replacement of the long-term component with a performance-based share savings plan for up to 310 senior managers and key personnel. The board proposed the same type of scheme to this year's AGM. AP3 abstained in the vote on remuneration guidelines to executive management and the performance-based share savings plan. The board also sought approval for a buyback of class A and class B shares. AP3 saw this as a useful way to adjust the capital structure to the company's needs, thus adding value for shareholders, though we said the company should always buy back the cheapest shares. SKF's chairman said the company shared this view.

BioInvent is a relatively small and research-intensive company with few employees. AP3 is one of the main institutional shareholders and has previously held a seat on the nomination committee. The pay and benefit guidelines for senior management include scope for variable pay. The board of directors proposed an add-on to the previous year's staff share options scheme to allow people who joined the company after the 2009 AGM and before the 2010 AGM to participate in a virtually identical incentive plan. It said the add-on would not give rise to further costs, share distributions or dilution. Nor would it have any impact on key financials over and above what the company has already disclosed in respect of the existing staff options scheme. The share options, given to all new employees using a special allocation key, would be free of charge and entitle the beneficiary to acquire new shares at a relatively favourable rate. The plan imposed requirements on employees before they can redeem their share options. Combined with a long duration, this offered staff a strong incentive to stay with the company. As beneficiaries were not required to pay for the share options there was no financial downside. However, the programme did include a performance link. AP3 felt the programme was vital to the company's ability to recruit and retain skilled staff and for this reason we voted in favour of the board's resolution.

Ericsson's board proposed that the AGM approve a one-year extension to its three-step incentive scheme, consisting of a share savings plan for all staff, a plan for key individuals, and an earnings-based plan for senior management. In the past AP3 has raised a number of concerns with the scheme: it is financially expensive (but acceptable in terms of earnings per share); large allocations of free shares mean the subsidy factor is high; the performance link is not particularly strong; and the entry level is set at a generous level. We voted in favour of the board's proposal in previous years because the programme was tied to continued employment, was of satisfactory duration and required beneficiaries to make a personal investment. This year, however, we abstained.

The board of real estate company **Kungsleden** withdrew an AGM resolution seeking approval for a share options plan motivated by the company's desire to include in the 2008 accounts the sale of a 50 percent equity stake in Hemsö Fastigheter to AP3. The deal saw Kungsleden complete the sale of 50 percent of its holdings in a large number of public buildings, used primarily for elderly care, welfare services and schooling. The sale price was based on a property value of SEK 14.6 billion and is forecast to have an effect of SEK 800 million on distributable income in 2009. The board proposed that the transaction be considered a 2008 event for the purposes of the company's performance-based share options scheme, even though the sale was not finalised until spring 2009. The Swedish Competition Authority had yet to approve the transaction by the end of 2008 and financing was not fully in place. AP3 welcomed the board's decision to withdraw the resolution.

Assa Abloy's remuneration guidelines for executive management allow variable pay, which should be based on outcome in relation to earnings targets in the beneficiary's specific area of responsibility. The maximum ceiling for variable pay to the chief executive officer and other senior executives is 75 percent of basic salary. AP3 abstained on the remuneration issue.

Prior to **Medivir's** AGM, five members of the board of the medical technology company had requested re-election. For this reason, the nomination committee proposed that the board be reduced in size from ten directors to five. In 2007 the company adopted a share options scheme for staff. Under the remuneration policy, an individual bonus of up to 50 percent of fixed salary may be payable at the company's discretion. AP3 abstained from voting on remuneration issues.

The nomination committee of medical technology company **Karo Bio** (which was chaired by an AP3 representative) proposed the re-election of three board members – Bo Håkansson, Johan Kördel and Jon Risfelt. The company's remuneration policy includes a stay bonus to retain key individuals in the event that a major change in the company's ownership structure occurs or is proposed. The stay bonus is up to 50 percent of fixed salary for the chief executive officer and other senior executives. This might seem unusual, but such a measure is vital in a company like Karo Bio and AP3 voted in favour of the resolution.

Swedbank has relatively high exposure to the Baltic states and during autumn 2008 raised SEK 12 billion in a rights issue to strengthen its balance sheet. As a natural response to market uncertainty, the board proposed the payment of no dividend for the 2008 financial year. The board gained a new look at the AGM after the nomination committee proposed the election of Anders Igel, Pia Rudengren, Anders Sundström and Karl-Henrik Sundström as new directors. AP3 abstained from voting on the remuneration policy because it allowed senior managers to qualify for short-term and long-term incentive plans despite the bank not having a long-term incentive plan in place. The short-term programme was in line with the bank's general policy for incentive schemes and contained a ceiling. Outcomes were tied to earnings targets and involved cash payment. The bank operates a unique approach that imposes a cost ceiling on remuneration to senior management. For 2009, the cost is 400 so-called income base amounts for the chief executive officer and 350 income base amounts for other senior executives.

The board of **Atlas Copco** presented a performance-based share options plan for 280 key employees. The plan, which was based on previous years' principles, did not require beneficiaries to pay for the options. AP3 has in the past criticised plans of this type for lacking personal financial risk. On the plus side, allocations are performance-based and related to the shareholder value the company generates in 2009. The plan runs from five years from the issue date and allows beneficiaries to redeem one third of their options allocations in each of the three following years (creating a lock-in effect of between one and three years). AP3 has in the past also criticised the fact that share options entitlements have not required the employee to remain with the company. We were therefore delighted that this year's resolution contained a clause stating that employees who leave the company can only redeem options earned up to that point. We abstained from voting on remuneration issues at the AGM.

Vitrolife's remuneration guidelines entitle the chief executive officer to receive a bonus of up to six months' salary and other senior executives to receive up to one to three months' salary. The board is responsible for making an annual decision on whether to recommend that the AGM approves a share-based incentive plan. At present, Vitrolife has no such plan. AP3 abstained from voting on these issues. The board asked the AGM for authorisation to undertake a rights issue, with or without shareholders' preferential rights, for business acquisition purposes. If fully utilised, the authorisation would represent dilution of around 10 percent of both the equity and voting rights. AP3 normally recommends that share issues extend preferential rights to existing shareholders. However, we supported the resolution in this case.

AP3 is a relatively large shareholder of **Bergvik Skog** and has held a seat on the unlisted forestry company's nomination committee. The AGM adopted a proposal by a large group of shareholders to enlarge the board by one director to 11 (including the two directors nominated by Stora Enso and the one director nominated by

Korsnäs).

The board of medical technology company **Aerocrine** submitted an AGM resolution on the introduction of a share options plan for 40 staff under which a total of 1 million options vest when the company's share price passes certain target levels. The share options entitle beneficiaries to purchase shares at a fixed price. Half of the options are allocated to the chief executive officer, who in return undertakes to reduce his monthly salary by SEK 85,000. Full exercise of the options would dilute earnings per share by close to 2 percent. Along with previously approved options programmes, the total maximum dilution would be just over 7 percent. Such a high level of dilution is not unusual in a research-intensive small company like Aerocrine. AP3 was positive to the board's resolution.

Sandvik operates no share-based incentive plan, though its chief executive officer and executive management may receive variable pay of up to 50-75 percent of fixed salary and a long-term variable bonus of up to 45-50 percent of fixed salary. The bonus payment is related to fulfilment of three-year targets. AP1 represented AP3 at the AGM and AP3 abstained on this issue.

In compliance with its executive remuneration guidelines, **Swedish Match** stated that the maximum cost for variable pay in 2009 would be SEK 14.3 million. All employees participate in a profit-sharing scheme that in 2008 generated a payout of about SEK 32,000 per individual. The board asked the AGM to approve a share options scheme for up to 74 staff. This plan has been in existence since 1999 and has, in AP3's view, certain shortcomings because the options are not tied to the employee remaining with the company and can be freely transferred to third parties. On the other hand, it contains a clear link between performance and reward, which is an important plus, and distributions are based on the same independent criteria as the 2008 plan. AP3 voted yes to last year's proposal but abstained this time round.

Handelsbanken has no share-based incentive schemes. Since 1973 it has relied exclusively on a profit-sharing system called the Octagon Fund to reward employees for good performance. This fund is not subject to AGM decisions, however. Because senior executives at Handelsbanken only have fixed salary, AP3 voted in favour of the remuneration policy.

The nomination committee of medical technology company **Q-Med** proposed that the committee henceforth comprise five members, with three being appointed by the AGM (chief executive officer and principal shareholder Bengt Ågerup, chairman Anders Milton and nomination committee chairman Robert Wikholm) and the other two appointed from among the major shareholders. The company has no incentive plan but does offer variable pay by way of a bonus or profit-sharing distribution with a ceiling tied to the beneficiary's fixed salary. AP3 voted in favour of the board's resolution.

AstraZeneca is domiciled in the UK and is therefore not subject to the same rules as companies listed in Stockholm. For example, allocations of shares or share options under incentive plans are approved by a remuneration committee rather than by the AGM. As last year, AstraZeneca sought authorisation to make limited party-political contributions. Such contributions are not unusual among foreign companies and are used for lobbying purposes. The company's 2008 annual report disclosed contributions last year to local and national party-political committees and local campaign committees for candidates of the major political parties. AP3 is obliged as a government agency to refrain from political partisanship, and for this reason we voted against the resolution.

Hennes & Mauritz's AGM approved a reduction in the size of the board from nine to seven directors. This followed director Fred Andersson's decision not to seek re-election and Karl-Johan Persson's decision to leave the board after being appointed chief executive officer from 1 July 2009. We note that H&M, one of the world's largest clothing companies, has a relatively modest remuneration policy, certainly when it comes to variable pay. Bonuses can be paid, but only to members of group management and country managers. They are limited to a net maximum of SEK 300,000 after tax for members of group management and SEK 900,000 for the chief executive officer. The remuneration policy also requires all bonuses to be invested in H&M shares, which must be held for a minimum of five years. The company has no share-based incentive schemes. AP3 voted in favour of the proposed remuneration policy.

The incentive scheme presented at the **Scania** AGM was divided into two parts consisting of cash payments based on percentages of annual fixed salary. The percentages related to the beneficiary's position at the company, were set by the remuneration committee and were dependent on the size and change in Scania's net profit adjusted for the cost of capital. Payments for each of the two parts were set at between 35 percent and 150 percent of fixed salary. Half of the variable pay was to be in cash and the balance invested in shares that vested over three years, with one third of the shares accruing each year. Payments and distributions were conditional on the beneficiary being employed at the end of the relevant financial year or having agreed retirement terms. AP3 abstained from voting on the remuneration issue.

Securitas's AGM passed without major incident as there were no remuneration-related or other contentious issues on the agenda. As a result, the meeting concluded in less than an hour. At an extraordinary general meeting in December 2008 approved the distribution to Securitas shareholders of all shares in the wholly owned subsidiary Loomis. Shareholders received one class A share in Loomis for every five class A shares held and one class B share for every five class B shares held. Various institutional investors, including AP3, made the point both before and during the EGM that the proposal discriminated between shareholders. We expressed the view that all distributed shares should be of equal market value. We wrote to the board noting our dissatisfaction at how they had handled the matter.

The AGM of **Industrivärden** elected SSAB chief executive officer Olof Faxander as a new director. Unlike last year, no incentive plan was proposed. It is notable that Industrivärden has proposed that most of its portfolio companies adopt an amended remuneration policy allowing the board to limit or withhold all variable pay where deemed reasonable and compatible with the company's responsibilities to shareholders, employees and other stakeholders. AP3 voted in favour of the board's resolution.

The board of **Kinnevik** asked the AGM to approve a performance-based incentive plan for 22 senior executives. The proposed model included a clear link to performance, a lock-in clause and a requirement that beneficiaries invest their own money in Kinnevik shares. It also came at a reasonable cost to shareholders. The company informed AP3 and other investors before the AGM that it proposed to extend the programme to include the new chief executive officer of Korsnäs. The company also proposed an increase in the number of shares in issue because the share price had fallen and the board wanted to keep the beneficiary's personal investment level at 8-10 percent of salary. AP3 asked the board to structure the programme to avoid excessive payouts in the event of a sharp rise in the company's share price. The board listened and opted not to expand the programme as originally planned. Due to the fact that dialogue with the company was successful, we voted in favour of the board's proposal.

The board of **Tele2** also proposed a performance-based incentive plan. The scheme, for 80 top managers and key people, resembled Kinnevik's, containing a clear link to performance, a lock-in clause and a requirement that beneficiaries invest their own money in Tele2 shares. It also came at a reasonable cost to shareholders. Kinnevik also provided AP3 with advance information about the scheme and gave us the opportunity to comment on it. We voted in favour of the board's proposal.

At the AGM of **Lundin Petroleum** the board of directors presented a resolution proposing a long-term bonus plan. As last year, the board came under fire from shareholders for a total lack of consultation and prior disclosure. The plan included share-based remuneration, which meant it should have been treated as an incentive scheme and should, in compliance with the Swedish Code of Corporate Governance, have been a separate agenda item. Following criticism from shareholders, the company agreed to divide the decision into separate items. However, the board's long-term remuneration plan contained no link to performance or element of personal risk. AP3 criticised the proposal at the AGM and voted against the proposed plan.

Alpcot Agro is a Swedish limited company that acquires and farms agricultural land in Russia and Ukraine. Its AGM authorised the board to approve an issue of shares, convertibles and/or warrants with or without preferential rights for existing shareholders. AP3 normally recommends preference issues, and a fully subscribed issue might in this case lead to substantial dilution of the company's share capital and voting rights. However, an issue of this sort can be necessary to facilitate business acquisitions, to accelerate growth, to strengthen the company's financial position or to enable a share listing, and AP3 therefore voted in favour of the board's resolution. Alpcot Agro was also one of only a handful of Swedish companies to ask the AGM for authorisation to reduce directors' remuneration by 10 percent as a cost-cutting measure.

Oriflame, domiciled in Luxembourg, gave shareholders the option of voting remotely at its AGM. The board asked the AGM for approval to allocate 6.5 percent of any increase in annual operating profit to a profit-sharing scheme for senior managers, with individuals entitled to receive distributions of up to 12 months' salary. The company also has a share-based incentive plan that offers its 200 top managers an annual opportunity to purchase shares at market rates, with participants receiving up to four free shares over a three-year period, depending on growth in group operating profit. AP3 abstained from voting on remuneration issues.

Ray Search Labs' remuneration principles entitle the chief executive officer to variable pay of 2 percent of pre-tax profit up to a maximum six months' salary. Contrary to past practice, other members of group management are no longer entitled to variable pay. The company currently has no incentive plans for members of group management and no such plan was proposed at this year's AGM. However, the AGM did authorise the participation of all employees, including senior executives (but not the chief executive officer) in the company's share options plan and profit-sharing scheme. AP3 voted in favour of the board's resolutions.

Karolinska Development is an investment company that finances, develops and commercialises new and promising life science innovations. As one of the major shareholders, AP3 has held a seat on the nomination committee and has a representative on the board of directors. The proposed remuneration policy contained two variable pay plans: a combined share options and profit-sharing scheme for members of group management that was adopted by an EGM last year; and a profit-sharing programme for other staff. AP3 voted in favour of the resolution on pay guidelines for senior managers.

Governance in the global equity portfolio

AP3 has a global corporate governance policy and a global voting policy alongside its corporate governance policy for Swedish companies. Most of our foreign equity portfolio is managed by external managers, to whom we delegate our voting rights. We talk regularly to managers to find out how they handle governance issues.

As part of our extended commitment to corporate governance we last year began expanding our direct voting in the global equity portfolio. This extended commitment builds trust in AP3's governance and will help us over time to achieve higher returns in our equity portfolio. We initially limited this undertaking to the 90 largest companies in the European equity portfolio, a small part of the total global portfolio. Together with AP1, AP2 and AP4, we have during 2009 so far voted at the shareholder meetings of around 200 foreign companies. However, each fund made its own decisions in each individual company. Nordic Investor Services, a Swedish corporate governance consultancy, administrated the votes and Manifest, a UK consultancy, provided the electronic voting platform.

Equity selection was based primarily on each company's weight in the global MSCI share index. We also used several other selection criteria: for example, we voted at foreign AGMs on matters relating to international initiatives that we support and at AGMs where we submitted a resolution. We voted on environmental and social responsibility-related resolutions raised by other investors at the AGMs of various North American corporations.

We have also drawn up a global voting policy to facilitate our voting procedures and engagements. The policy is based on internationally accepted corporate governance principles, namely the OECD's Principles of Corporate Governance and Multinational Enterprises and the United Nations Global Compact (which is also the foundation for the Ethical Council, of which AP3 is a member along with other AP funds). The global voting policy is similar to the policy of Norwegian pension fund NBIM. It is general in scope and it is important to bear in mind that small deviations may be necessary due to local codes and regulations, industrial standards and market-specific conditions. A fundamental principle for voting is that AP3 cannot take a definitive stance on AGM resolutions unless the material provided by the company is sufficient to enable us to make an informed decision. Where such information has been insufficient we have abstained from voting.

Environmental and social responsibility

AP3 believes there is a connection between corporate ethics and the capacity to deliver long-term shareholder value. We believe companies that are well run are a better long-term investment. We screen companies to make sure they are not violating international conventions, we engage in active dialogue to encourage firms to act responsibly and we support various investor initiatives in these areas.

AP3's parliamentary mandate is to practise environmentally and socially responsible investment without compromising our overriding goal of high investment returns. Environmental and social responsibility is part of our governance policy, and our approach is based on international conventions and agreements ratified by Sweden, such as the ILO's core conventions[1] the United Nations Declaration on Human Rights and the OECD's guidelines for multinational corporations.[2]

Proactive dialogues on environmental and social responsibility with Swedish companies

AP3 focuses its proactive initiatives on social and environmental responsibility primarily on Swedish companies with substantial production or purchasing in countries governed by undemocratic regimes or with weak labour and environmental laws (the latter applies primarily to developing countries and newly industrialised nations).

Our primary approach is dialogue with companies as we believe this provides the best opportunity to exert influence. As a long-term investor we realise that change can take time and we therefore work systematically to monitor company responses to our views and requirements until we have achieved our objectives in each specific dialogue.

We carry out an annual review with the help of our responsible-investment adviser, GES, to identify which Swedish companies are least prepared for social and environmental risks in their businesses. This review is in addition to our own analyses whereby we select a group of 5-10 companies every year for closer scrutiny and dialogue. The dialogues aim to ensure that companies have risk management systems and codes of conduct in place and that they have managers in charge of environmental and social responsibility to reduce the risk of the organisation breaching international conventions.

In our dialogues we make the following demands:

- **Risk analysis and systems**

Companies should work systematically to identify the social and environmental risks to which their businesses are exposed. They should also have risk management systems in place.

- **Code of conduct**

Companies should have group-wide codes of conduct covering human rights, working conditions and environmental protection. Codes should be based on the UN Declaration on Human Rights and the ILO's core conventions. They should be publicly available and subject to compliance monitoring.

- **Reporting**

Companies should publish external social and environmental reports either in their annual report or in a separate sustainability report and make them available on their websites. The guidelines of the Global Reporting Initiative (GRI), a United Nations initiative to create a global standard for corporate sustainability reporting, are an appropriate framework for such reports.

During the past 12 months we held discussions on social and environmental responsibility with five Swedish corporations. Our impression is that these issues are often raised at group level and are increasingly reflected in operating and strategic risk analyses. Environmental issues are a focus area for many companies, with many businesses realising this area presents both business risks and opportunities.

The Ethical Council

As of 2007, AP1, AP2, AP3 and AP4 coordinate their screening and dialogue processes via a joint Ethical Council. By pooling resources and voting rights, the funds are better able to influence foreign companies in which they invest and encourage them to avoid breaches of international conventions ratified by Sweden. The position of chairman is held on a rotating basis and during the 2009 financial year is held by AP3's communications manager.

An external expert screens the funds' equity holdings to determine whether any company in the portfolio is acting in violation of international treaties. If a company is accused of a breach the Council investigates the facts, contacts the company concerned and encourages it to take action to address the breach and prevent any recurrence.

Infringements of the funds' investment guidelines often arise because companies have not addressed their responsibility for such incidents or failed to take a sufficiently proactive approach to environmental and social responsibility.

During 2008 the Council held dialogues with 14 companies worldwide. A number of companies were removed from the dialogue list in 2008 and during the first half of 2009 after the dialogue process produced the desired

[1] ILO – The International Labour Organisation is the United Nations body that monitors working conditions and labour issues. Its eight core conventions concern freedom of association, forced labour, discrimination and child labour.

[2] The OECDs guidelines for multinational corporations are joint recommendations to business from 40 governments, including Swe-

den's. They cover human rights, corruption, employment, competition, taxation and disclosure.

results. Three new dialogues were begun in 2009. Acting on the Council's advice, AP3 removed nine companies from its portfolio in 2008. All the companies were involved in marketing cluster bombs and were therefore acting in contravention of the anti-cluster bomb treaty signed by Sweden that same year.

In April each year the Council publishes a report on its operations, including company dialogues and investor actions. The report is available for download from www.ethicalcouncil.com.

International initiatives for social and environmental development

As of 2006, AP3 is a signatory to the **Principles for Responsible Investment (PRI),** a United Nations initiative to encourage investors to incorporate environmental, social and governance considerations in financial analysis and management processes. By signing the principles we signalled our support for the initiative and our intention to comply with it in our business activities.

AP3 has also participated via the Ethical Council in investor actions initiated by other PRI members. These included an emerging markets initiative that encourages domestic companies to improve their reporting on corporate governance and social and environmental issues.

The Ethical Council is also involved with other investors in promoting the **UN Global Compact**.[3] by writing to companies, that are members of the Global Compact, urging them to be proactive in integrating Global Compact principles in their operations. Letters were also sent to enterprises that have signed the Global Compact, encouraging them to comply with its principles.

The Council also helped to found the Seoul initiative to encourage 9,000 corporations listed on the MSCI World, FTSE-All-World and IFC Emerging Market equity indices to join the Global Compact.

AP3 has since 2006 supported the Fund **Carbon Disclosure Project (CDP)**, which aims to encourage increased corporate awareness of climate change. It seeks to persuade companies to adopt greater transparency in reporting their climate change strategies and developing key metrics to measure improvements. The CDP aims to make the data collection process more effective through a joint request for data and emissions reporting signed by a large number of investors. The sixth edition of this document, from 358 investors with combined capital of US$57 trillion, was sent to more than 3,000 enterprises in 2008. Responses are published on an investors' website. The response rate has been 80-90 percent in recent years.

AP3 has worked to increase response frequency among Swedish companies by getting in touch with them in person to underline the importance of providing answers. The Ethical Council has supported an initiative with a group of around 40 investors to write to foreign companies that did not reply to the CDP questions and to companies that in 2008 sent in an unsatisfactory environmental report.

The Council also supports the **Extractive Industries Transparency Initiative**, which promotes increased transparency in how countries report income from extractive industries and how mining companies report their payments to host countries. Transparency in these areas is particularly important in countries that are rich in minerals but have weak governments.

In 2009 the Council provided support to a variety of new initiatives. One challenges fund **managers to sign the PRI** and to integrate environmental and social responsibility in their financial analysis. Another involves urging the ILO to **intensify its scrutiny and engagement on child labour in Uzbekistan's cotton fields**. A third aims to **improve transparency in the reporting by oil companies of oil sand extraction in Canada** and urges the companies to undertake environmental impact assessments and provides recommendations on how to reduce environmental impacts.

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[3] A voluntary UN initiative to help companies operate in conformity with ten universal principles. The principles are based on UN conventions on human rights, labour standards, the environment and corruption.