

Stewardship Report 2019



AP3 Third Swedish National Pension Fund

LONG-TERM ASSET MANAGEMENT ACROSS GENERATIONS

AP3 Third Swedish National Pension Fund

About the AP3 Stewardship Report

The AP3 Stewardship Report is published annually and provides an overview of the Fund's corporate governance activities during the year. The report aims to increase understanding for how AP3 engages and acts as an institutional investor.

Better value growth through active stewardship

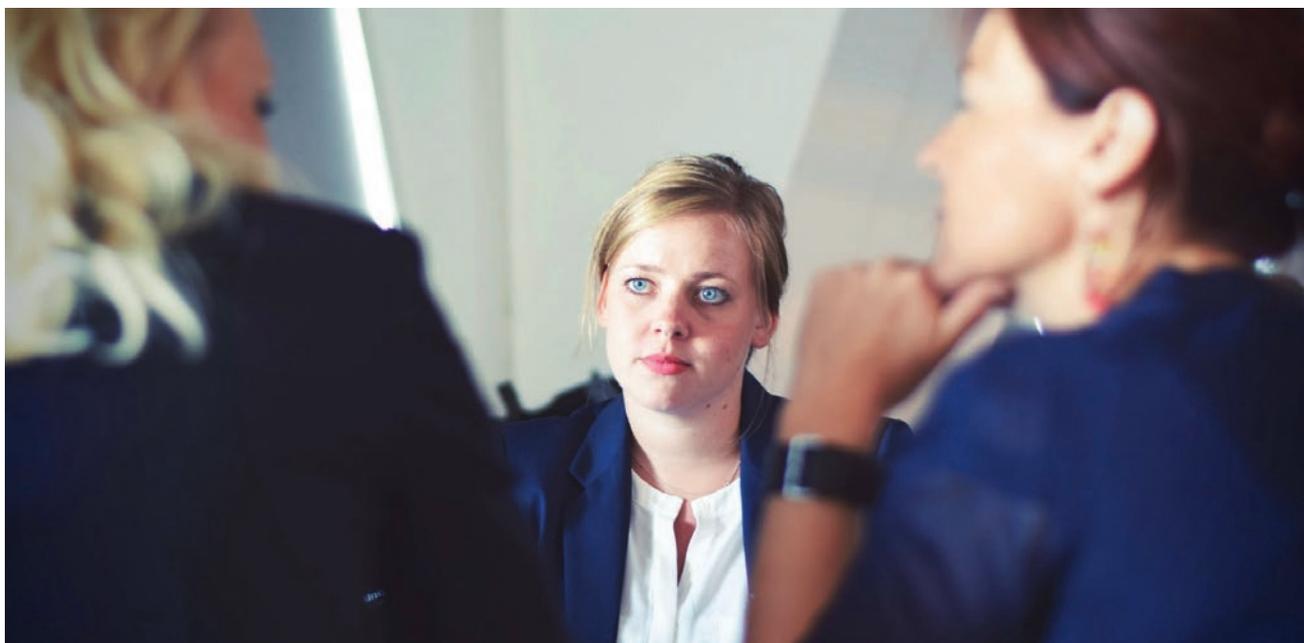
Corporate stewardship is a cornerstone of AP3's commitment to sustainability. We believe that well-managed companies which adopt a responsible approach to climate challenges and social issues deliver superior risk-adjusted returns over time.

Our stewardship focuses on the Swedish equity market as this is where the Fund is best able to exert a positive influence. At international level, the Fund works closely with the other AP funds via the Joint Council on Ethics of the Swedish AP Funds and also partners with other large institutional investors to achieve maximum impact.

For AP3, our guiding principles are engagement, action and calling for change. We firmly believe that investors with a strong position in the capital markets are well placed to exert a positive influence and to place demands on investee companies.

Stewardship policy – AP3's corporate governance framework

The AP3 board of directors has responsibility for the direction of the Fund's corporate governance and its stewardship policies. Some stewardship issues are considered passively on a need-to-know basis, while in others the board takes active decisions. The AP3 stewardship policy is the foundation of our corporate governance engagements. The policy is approved by the board of directors and updated when necessary. It is available on the AP3 website at www.ap3.se. The stewardship policy sets out various core principles in areas such as shareholder rights and responsibilities, investee capital structure, board structure, audit and internal control, executive remuneration and information disclosure. The policy also defines the Fund's views on investees' social and environmental responsibilities.



Different ways to achieve impact

AP3 has a diversified portfolio that spans multiple asset types and listed and unlisted investments. The Fund diversifies extensively in each asset category: the equity portfolio, for example, consists of shares in 1,600 companies with a combined market value of SEK 142 billion as at 30 June 2019.

Individual holdings vary considerably in size. A small number of investments in large Swedish multinationals, including Volvo, Ericsson, Investor and leading Swedish banks, and in large US technology companies such as Apple, Microsoft, Alphabet and Amazon together account for more than a fifth of our total portfolio exposure. At the same time, the Fund has numerous holdings in close to 900 small cap companies in which the value of each investment is less than SEK 30 million.

Approximately 30 percent of the market value of the listed equity portfolio relates to Swedish companies. As at 30 June 2019, AP3's Swedish equity portfolio was worth SEK 43 billion. The Swedish equity portfolio is highly diversified, comprising holdings in almost 140 different companies. The total equity portfolio has a so-called home bias owing to the fact that the weight of Swedish equities exceeds Sweden's market weight in a global equity index. As a result, the portfolio's percentage holdings in Swedish investee companies far exceed those in foreign investees, averaging around 1.4%

of the equity and a slightly lower percentage of the voting rights. These figures vary considerably from case to case, however. In one in five companies, AP3's equity holding is less than 0.3%; in one in five companies the equity holding exceeds 2%; and in around 10 companies our equity holdings are significantly larger, ranging from 5% to 10%.

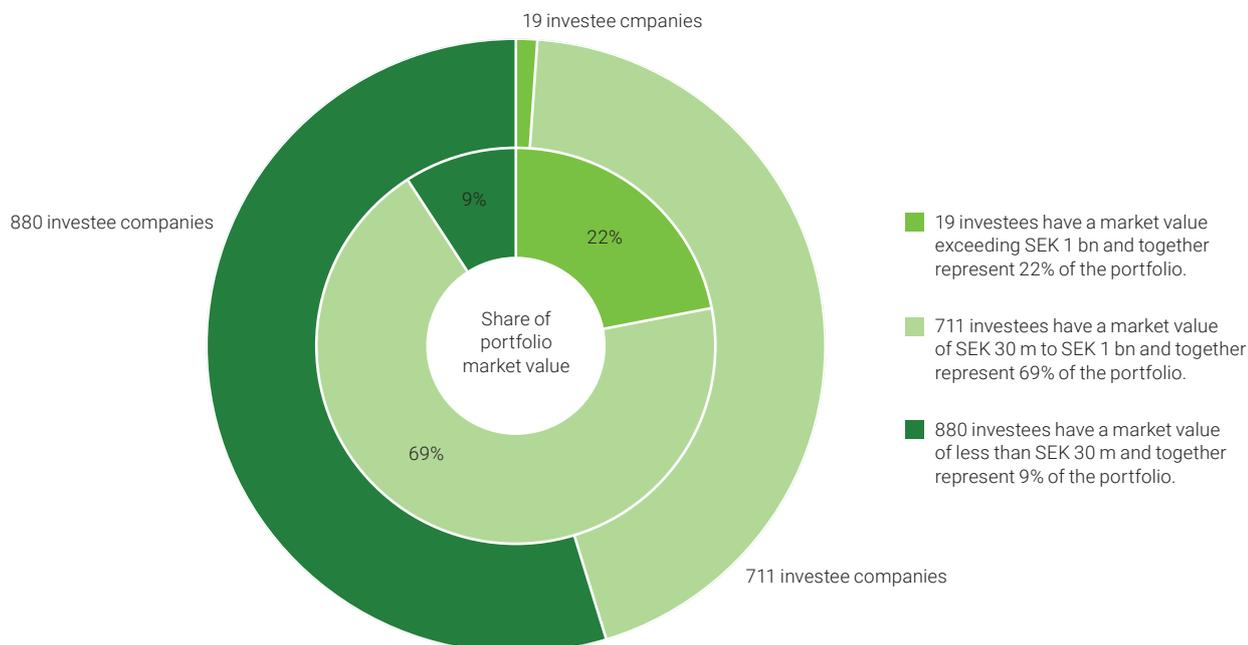
AP3 tailors its stewardship strategies to the size of each holding and targets contexts where we believe we can achieve maximum influence and impact.

- In **investees where we own all or a large share of the equity** – notably in the unlisted real estate companies Vasakronan, Hemsö, Trophi, Regio and Trenum – we can exert direct influence over corporate strategy through board membership.
- In **foreign investees**, our smaller size limits our ability to exert influence through active governance. For this reason we often join forces with other institutional investors, working primarily via the Council on Ethics of the Swedish AP Funds.
- Our voting rights are larger in listed **Swedish companies** and here we engage investees in direct dialogue and exercise governance by voting at AGMs and serving on nomination committees. AP3's strong position in the Swedish capital market means our views tend to carry greater weight with Swedish investee companies.



AP3 tailors its stewardship strategies to the size of each holding and targets contexts where we believe we can achieve maximum influence and impact.

The variable size of AP3's shareholdings results in different stewardship strategies





Broad-based engagement

AP3 exerts influence by engaging in dialogue with directors, management and investors, by serving on nomination committees and by voting at company meetings. Sometimes stewardship has immediate effects, but more often it is a gradual process that takes time. AP3 engages in a diverse range of stewardship issues and advocates on a range of topics of strategic importance to the Fund. Regardless of individual investee companies or their location, we apply a fixed set of principles in our stewardship:

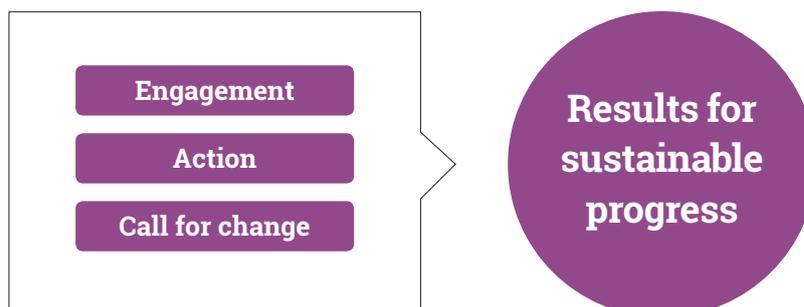
- Influence the structure of remuneration programmes by requiring, for instance, that share-based incentive schemes include a clear and measurable link to performance.
- Influence board structure by improving diversity and by separating the positions of chairman and CEO.
- Protect the capital structure of investee companies, for instance by opposing excessive share issues that substantially dilute investors' holdings.
- Promote healthy working conditions in investee companies at all times.
- Oppose all forms of corruption and financial wrongdoing.
- Encourage investee companies to adopt a climate strategy to ensure that they measure and report their carbon footprint and take steps to reduce their climate impacts.

Trust depends on transparency and clarity

The European Union is introducing new regulations in 2019 and 2020 that treat institutional investors as active owners which exercise their votes at investee company meetings and report annually on their stewardship. AP3 aims to report as openly as possible on corporate governance activities and since 2003 we have published an annual report detailing our work in this arena. It is not always practicable to disclose the details of discussions with other investors, nomination committees and corporate managements and boards because confidential dialogue is often the best way to achieve results. Nevertheless, transparency and clarity are important and are our motivation for publishing this stewardship report and disclosing how we exercised governance during the 12 months ended 30 June 2019.

It is important that we provide feedback to investees and explain our views on stewardship-related issues. Our close geographic proximity to Swedish investee companies makes this undertaking relatively simple, while equivalent dialogues with foreign companies require more time and effort. Our policy is to provide feedback to selected foreign investees explaining how and why we voted on different AGM resolutions. In the past, we have targeted key areas including board structure, major rights issues, and remuneration programmes that fall short of our standards. These areas remain our core focus today. AP3 also addresses the climate impact of investee companies and we communicate the importance of having a climate strategy that measures and reports on carbon footprint and guides the organisation towards reducing climate impacts. Our aim is to engage in dialogue that develops and grows, leading the investee to gain a broader understanding of the issues that we see as crucial to progressive social development.

Active stewardship is AP3's tool for encouraging investee companies to adopt practices that are sustainable over time





Stewardship in the Swedish equity portfolio in 2019

When AP3 in the early 2000s began actively participating and voting at Swedish company meetings, our ambition was to do likewise at all our investee companies. This was a reasonable aim given that the Swedish equity portfolio invested in only the largest listed companies. However, our investment strategy has evolved over time and the Swedish equity portfolio has since diversified significantly. Today, it has investments in many more companies than in the past. The size of the portfolio also varies over time in line with equity market movements and how we allocate our investment capital. Today, it comprises shares in approximately 140 companies. Most of AP3's equity holdings track a broad market index, which means that most of the major holdings in kronor terms are in the largest corporations listed on the Stockholm stock exchange. The Fund also own shares in small cap companies. The Fund's ownership may not exceed 10% and our largest percentage holdings are in the wind power operator Arise and medical technology company Karolinska Development, in which we hold equity stakes of 9-10%. We also have holdings of 5-8% in real estate company Sagax, medical technology company Boule Diagnostics and helmet safety specialist MIPS.

AP3 at all times seeks to maximise return on investment – and this also applies in corporate governance. Stewardship is closely integrated in our day-to-day asset management and is a means to help achieve our goal of maximum investment returns. As a result, large parts of the asset management organisation are actively involved in corporate governance in one way or another.

In 2019, 13 Fund representatives attended and voted at investee company meetings. AP3's highly diversified equity portfolio means it is not practicable to be physically present at the meetings of all the companies in the Swedish equity portfolio. It is also not cost-effective to prioritise heavy stewardship engagements in investees where we own a minor equity stake. For this reason, we target selected investees that are either major companies in which we hold a large stake or smaller firms in which our capital investment may not be especially large but where our equity holding is more significant.

AP3 has been increasingly active at Swedish company meetings in recent years. In 2019 we voted at 75 AGMs – 63 in person and 12 by proxy. The Fund also attended one extraordinary general meeting. We have also been attending a higher proportion of AGMs in the Swedish equity portfolio. In 2019 the Fund attended and voted at more than half of investee AGMs. This positive trend not only reflects the fact that AP3 now attends more AGMs than in the past, but also the reduced breadth of the Swedish equity portfolio. The higher number of AGMs attended resulted in the total number of agenda items on which the Fund voted increasing in 2019 from 1,800 to 2,000.

The 75 companies at which AP3 voted had a total market value of SEK 41 billion. The Swedish equity portfolio had a market value of SEK 43 billion at 30 June. Hence, our stewardship engagements covered some 95% of the portfolio.

| | 2019 | 2018 | 2017 | 2016 |
|---|-------|-------|-------|-------|
| No. of AGMs | 75 | 70 | 62 | 53 |
| Percentage of portfolio company AGMs at which voted | 55% | 40% | 39% | 35% |
| No. of agenda items | 2,000 | 1,800 | 1,600 | 1,300 |
| No. of nomination committees | 7 | 5 | 5 | 4 |



In 2019 we voted at 75 AGMs – 63 in person and 12 by proxy.



Money laundering in focus at Swedish banks

AP3 is often given the opportunity in advance of the AGM season to meet the managements, boards and nomination committees of many investee companies, either privately or in company with other institutional investors. AP3 attended around 40 such meetings prior to the 2019 season. These events allowed AP3 to communicate the Fund's stance on various stewardship issues and to raise our profile as a transparent and professional owner.

The 2019 AGM season was relatively quiet overall. Companies and investors largely succeeded in focusing on the core issues of business activities and results of operations. In most years, however, there are always one or two controversies that dominate the AGMs of the companies concerned, and 2019 was no different. The first press stories about suspected money laundering at Danske Bank emerged in the spring of 2017. Media scrutiny resulted in a major investigation in 2018 that led the bank to replace its CEO and shut all operations in Estonia. Following on from this scandal, the Organised Crime and Corruption Reporting Project, an international media and journalism consortium, in late 2018 uncovered links between Nordea and extensive money laundering. The bank was accused of involvement in funnelling more than SEK 7 billion to various shell companies between 2005 and 2017. When the Swedish broadcaster SVT in the spring of 2019 uncovered similar suspicions relating to Swedbank, the bank sacked its CEO on the eve of the AGM and replaced multiple directors at an emergency general meeting in the summer. AP3 takes any case of suspected money laundering and other wrongdoing by Swedish banks very seriously and expects managements and boards to act to ensure effective control mechanisms are in place to identify any risk that the banks may be used for money laundering or to finance terrorism.

Clear trends in corporate governance

Visible trends in the corporate governance field include long-term thinking, sustainability and diversity. These trends also influence corporate AGMs. It is clear that sustainability has climbed up the agenda of companies and their investors. Climate change has evolved into an issue that is now a standard fixture at all AGMs. Transparency is increasingly important for companies and their shareholders, with disclosure and reporting now being considerably more open than a few years ago.

Another trend is that executive remuneration no longer attracts the level of scrutiny it did in the past. New incentive-based remuneration programmes are more or less as common as they used to be, but the resolutions proposing them are far less controversial than in the past. Today it is unusual for a proposed scheme to fall short of the standards expected by AP3 and other institutional investors. Such programmes are almost always performance-based and the cost to shareholders is invariably known and limited. They typically comprise a ceiling and include an element of risk in the form of a personal investment by the beneficiary. Also, proposals are normally well-structured and include an analysis of prior schemes where applicable.

Another trend is the growing pressure on company boards and managements to embrace diversity and be more reflective of society at large by striking a more equal balance between males and females and between people from different backgrounds and areas of experience. It is in investors' interest for directors to have different profiles as this ensures a higher level of expertise at board level. Diversity is not merely an issue of gender; it is a wider concept that extends to age and ethnic and cultural background. AP3 believes that greater diversity at board level makes companies

more attractive as employers and enhances decision-making, resulting in higher value creation over time. AP3 has for many years campaigned for Swedish listed companies to appoint more female directors. Companies with a low level of female representation at board and senior management level may be failing adequately to utilise the full range of available skills and expertise both internally and in the wider business sector.

The Swedish Corporate Governance Code mandates Swedish companies to aim for an equal gender balance among directors. In May 2014 the Council for Swedish Corporate Governance introduced phased guidelines for board gender representation: a minimum of 40% of all directors to be of either sex by the end of the 2020 AGM season and a minimum of 35% of all directors of large companies – and 30% of small companies – to be of either sex by the end of the 2017 AGM season. In its latest report, the council noted a continued, but marginal, increase in female board representation in 2019, with the overall number of women elected as directors rising by 0.2 percentage points to 34.5%. Female board representation at large companies was 39.2%, an increase of 0.2 percentage points from 2018. At small and medium-sized companies the figure was 32.3%, an increase of 0.4 percentage points. Although the figures show that representation of newly elected female directors rose in 2019 from 34.8% to 36.7%, nomination committees have a considerable amount of work ahead of them to ensure that the 40% target is achieved by 2020. In 2019, the Council for Swedish Corporate Governance examined the gender balance among directors classed as related parties to major shareholders. The council found female representation in this group to be much lower, at only 18.6%, than across the business sector as a whole. The low ratio of women in this group will make it difficult for some companies to re-elect male directors and still achieve the 40% target.

All investors have a responsibility to ensure greater boardroom equality, but the primary responsibility falls on nomination committees. AP3 seeks to achieve an increased number of female directors in investee companies where this is feasible and where we hold a nomination committee seat. AP3 served on seven nomination committees during the year. Of these, our involvement in gaming company MRG ceased when the company was acquired by William Hill at the end of 2018.

Although female board representation has increased, many companies still have very few women directors. Eleven out of 300 listed Swedish companies have no female directors at all and 65 have a sole female director. This was one of the reasons why AP3, along with AP1 and AP2, contacted the nomination committees of companies with one or no female directors and urged them to do their utmost to improve board diversity, to explain their decision-making in the light of the Swedish Code of Corporate Governance's guidelines, and to report to the AGM on their efforts to achieve numerical parity between male and female directors. It must be noted that AP3 and other investors have work to do before our goals are met.

AP3'S NOMINATION COMMITTEE ENGAGEMENTS

- Arise has the smallest board of directors of any Swedish listed company. The wind power generator further reduced its director headcount, from four to three, in 2019. Female board representation of 33% is below the Council for Swedish Corporate Governance's target, but this figure should be seen in the context of the board's small size.
- Major changes at medical technology company Karolinska Development in recent years have also had an effect at boardroom level. Only one of the company's six directors is a woman. Excluding the CEO, this equates to female board representation of just 20%. The nomination committee has discussed a future transition and initiated a long-term strategy to change the board's structure.
- Property developer SSM Holding has six male directors and one female director. Its nomination committee has expressed an intention to increase female representation in the future.
- Bengt Baron stepped down as chairman of MIPS at the helmet safety company's AGM. The nomination committee proposed Magnus Welander as his successor. Two of the board's six directors are female. At 33%, female board representation was unchanged from 2018.
- BioArctic's nomination committee proposed Ewa Björling, a former Swedish trade minister, as a new director in 2019. Her appointment, in addition to chairwoman Wenche Rolfsen, lifted female representation on the biopharma company's board to 25%.
- The board of NCAB Group remained unchanged after the nomination committee proposed the re-election of all directors, including the chairman, Christian Salamon. Only two non-executive directors are women and female board representation is 28%.

Stewardship in the foreign equity portfolio in 2019



The foreign equity portfolio is managed both in-house by the Fund's own managers and by external managers. AP3's stewardship at foreign investee companies includes supporting investor-led initiatives and voting at company meetings. Our voting approach in the global equity portfolio has developed over time – from delegating our voting rights to external managers, to voting via our custodian bank, and to taking on full first-hand responsibility for voting.

AP3 has gradually become more active in exercising the Fund's voting rights, especially in the global equity portfolio. When we commenced active governance in this portfolio in 2008, we voted at 70 AGMs of non-Swedish investees. Since then, this figure has risen steadily. In 2019 we voted at 1,050 AGMs, of which 75 were held by Swedish companies. In 2019 the Fund reduced by almost half the number of companies in the global equity portfolio, from 3,000 to 1,600. This means we now cover a much larger percentage of our investee AGMs – around 60%.

AP3 has a diversified equity portfolio with relatively small holdings in a wide range of companies, so the extent to which we vote at company meetings involves striking a balance between the costs involved and the value that our interventions generate. The geographic spread of these holdings makes it impracticable to attend and vote at all foreign investee AGMs. Instead, we vote by proxy using an electronic voting system provided by Institu-

tional Shareholder Services (ISS), a global corporate governance consultancy. Nordic Investor Services, a Swedish consultancy, monitors company meetings, analyses relevant paperwork and administers the voting process. However, AP3 at all times comes to its own conclusions and decides independently how to vote. Indeed, the Fund deviates fairly often from ISS's recommendations. In 27% of cases – more than one in four – in which ISS has issued a voting recommendation based on its analysis, AP3 has opted not to follow the ISS guidance. On such occasions this is often because the ISS recommendations conflict with our corporate governance policy.

Outside Sweden, AP3's voting engagements cover 25 countries and include investees in Australia, Bermuda, Canada, France, Germany, Ireland, Jersey, Japan, the Netherlands, Singapore, Switzerland, the UK and the US. We also voted at a number of companies registered in Belgium, the Cayman Islands, Curaçao, Denmark, Liberia, Luxembourg, New Zealand, Norway, Panama, Papua New Guinea, Spain and South Korea. Selections are based on a company's relative weight in the MSCI ACWI global share index, which means we vote at the meetings of our largest investee companies in the markets concerned. On occasion, we also vote at AGMs in which the AP funds support specific resolutions or on which the Council on Ethics of the Swedish AP Funds has a special focus.

| | 2019 | 2018 | 2017 | 2016 |
|---|--------|-------|--------|-------|
| No. of non-Swedish AGMs | 972 | 780 | 837 | 670 |
| Percentage of portfolio company AGMs at which voted | 60% | 28% | 28% | 22% |
| No. of agenda items | 11,565 | 9,766 | 10,371 | 8,657 |
| Percentage of votes in support of board proposal | 72% | 70% | 71% | 75% |
| Percentage of abstentions or votes against board proposal | 28% | 30% | 29% | 25% |



Companies struggling to meet AP3's high standards

In the 12 months ended 30 June 2019 AP3 voted on 11,600 resolutions at 970 foreign company meetings. Three times out of ten we voted against the board's recommendation. This high level of "no" votes shows the extent to which many foreign investees find it more difficult than their Swedish counterparts to meet AP3's governance requirements. It also indicates that foreign company boards and managements are less successful in winning over shareholders to their resolutions. Typically, Swedish companies inform institutional investors about proposed resolutions in good time before the AGM. Swedish resolutions also tend to enjoy broader consensus backing from shareholders by the time the meeting is held. Executive remuneration is another area where major differences exist between Swedish and

non-Swedish investees. In 2019 we voted against more than half of the executive remuneration resolutions proposed by non-Swedish investees. Foreign companies clearly find it harder to meet our requirements in this area than Swedish companies do. It is difficult as an investor to exert influence in this field because remuneration is often approved directly by the board and shareholders have only an advisory role.

AP3 voted for over half of the resolutions submitted by other investors, reflecting the fact that many institutions move their own resolutions at foreign AGMs and these are often of a high standard. Examples include resolutions for improved reporting of political donations and for separating the role of chairman and CEO.

A list of all the foreign AGMs at which AP3 voted and how we voted is available on the Fund's website at www.ap3.se.

Steady increase in AP3's engagement in investee AGMs



Data on AP3's global voting in 2018/19

Geographic breakdown of company meetings 2018/2019, %

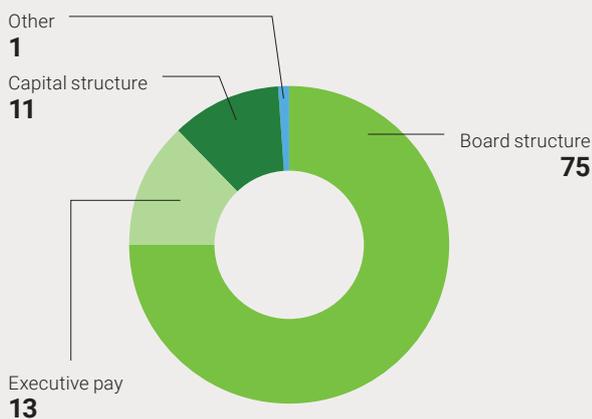
| | | | |
|-----------|----|-------------|---|
| USA | 48 | Ireland | 1 |
| Japan | 30 | Bermuda | 1 |
| Australia | 5 | France | 1 |
| Canada | 5 | Netherlands | 1 |
| UK | 2 | Switzerland | 1 |
| Singapore | 1 | Jersey | 1 |
| Germany | 1 | Others | 2 |



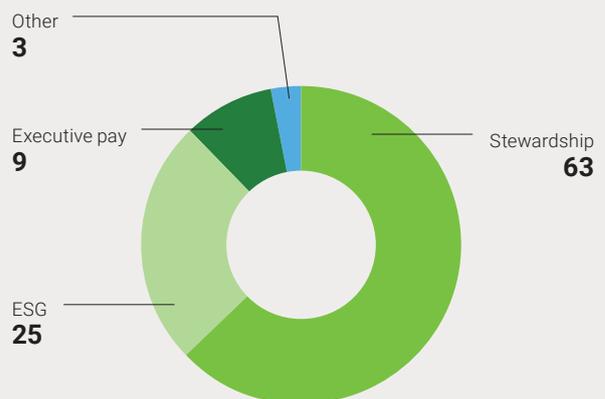
In 2019 we voted against more than half of the executive remuneration resolutions proposed by non-Swedish investees.

| | 2019 | 2018 | 2017 | 2016 |
|---|---------------|--------------|---------------|--------------|
| No. of board resolutions | 11,242 | 9,366 | 9,949 | 8,239 |
| No. of shareholder resolutions | 323 | 400 | 422 | 418 |
| Total no. of agenda items | 11,565 | 9,766 | 10,371 | 8,657 |
| No. of votes for board resolutions | 8,347 | 7,100 | 7,216 | 6,714 |
| No. of votes against board resolutions | 2,473 | 2,167 | 2,648 | 972 |
| No. of abstentions | 745 | 499 | 507 | 971 |
| Total no. of agenda items | 11,565 | 9,766 | 10,371 | 8,657 |
| No. of votes for board's recommendation | 8,252 | 6,974 | 7,419 | 6,580 |
| No. of votes against board's recommendation | 3,313 | 2,792 | 2,952 | 2,077 |
| Total no. of agenda items | 11,565 | 9,766 | 10,371 | 8,657 |
| No. of votes for shareholder resolutions | 171 | 223 | 235 | 230 |
| No. of votes against shareholder resolutions | 152 | 177 | 187 | 185 |
| No. of abstentions on shareholder resolutions | 0 | 0 | 0 | 3 |
| No. of shareholder resolutions | 323 | 400 | 422 | 418 |

Breakdown of board resolutions 2018/2019, %



Breakdown of shareholder resolutions 2018/2019, %



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