

# Stewardship Report 2020

INVESTEE AGMS 1 JULY 2019 – 30 JUNE 2020



**AP3** Third Swedish National Pension Fund

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 of how AP3 engages and acts as an institutional investor.

# ACTIVE GOVERNANCE AMID THE CORONAVIRUS PANDEMIC

Corporate stewardship is a cornerstone of AP3's commitment to sustainability. The Fund believes that well-managed companies which adopt a responsible approach to climate challenges and social issues deliver superior risk-adjusted returns over time. In 2020 the coronavirus pandemic strongly impacted AP3's stewardship engagements. Nevertheless, the AGM season proceeded according to plan, in spite of the limitations on interactions between investee companies and their shareholders that were imposed in response to the pandemic.

It is crucial that AP3 manages Sweden's pension assets responsibly and meets the public's expectations that the Fund acts as an active owner and discloses its governance activities publicly. AP3 has published an annual stewardship report since 2003. This report discloses how we exercised governance during the 12 months ended 30 June 2020.

AP3 is a committed owner that engages proactively with the companies in which we invest in order to drive positive change. Being a dedicated and responsible owner means engaging with investee companies and other investors and stakeholders and participating in national and international initiatives in support of good corporate stewardship and sustainable development.

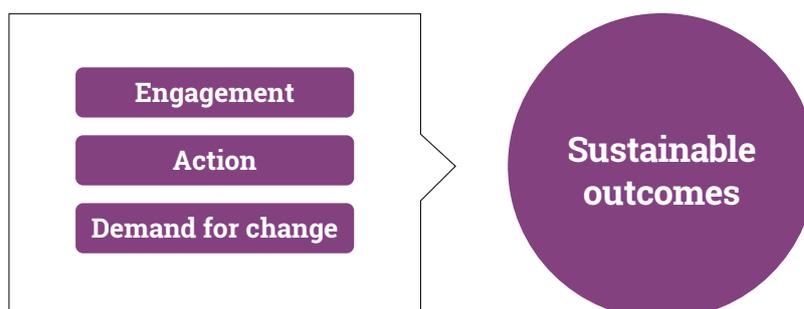
## Stewardship policy – AP3's governance framework

The AP3 stewardship policy is the cornerstone 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](http://www.ap3.se). The stewardship policy sets out various 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. The CEO is in charge of overseeing compliance with the policy. Day-to-day stewardship activities are coordinated by the CIO Office, a team supporting the Head of Asset Management. Key stewardship issues are discussed in consultation with the board of directors.

In addition to the stewardship policy, the Fund uses other tools such as national codes of corporate governance. These play a key role in establishing trust in the equity market and in individual investees and also help to highlight best practice in local markets.

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Active stewardship is AP3's tool for encouraging investees to embrace long-term sustainability



### Shareholding size determines chosen strategy

AP3 has a broadly based investment portfolio but does not pursue an extreme level of diversification. Rather, the Fund makes informed choices between different markets and investment types. A significant proportion of capital assets are held in Sweden, mainly as investments in directly owned companies but also as listed equities. Local proximity to our Swedish investments allows us to exercise effective and direct governance.

This centre of gravity has been beneficial over the course of many years and has enabled the Fund to deploy a Swedish perspective at global level. A highly experienced team of fund managers and an extensive contact network have enabled AP3 to develop far-reaching expertise in Swedish market conditions. This is why we hold most of our investments directly and in Sweden. Hence, our stewardship focuses on Swedish investees. The comparatively large size of our Swedish equity holdings increases our ability to engage actively with these investees. Also, the Fund's prominence in the Swedish capital market gives our views greater weight with local investees.

The AP3 portfolio is comprised of around 1,600 companies with a combined market value of SEK 142 billion as at 30 June 2020. Individual holdings vary in size. A group of around 20 large Swedish multinationals, including Volvo, Ericsson, Investor and several banks, and holdings in large US technology companies such as Apple, Microsoft, Alphabet and Amazon together account for more than a fifth of total portfolio exposure. At the same time, the Fund owns smaller holdings in close to 750 small cap companies. The value of each of these investments is less than SEK 30 million.

Stewardship strategies are tailored to the size of each holding and address the areas where we see maximum scope for achieving influence and impact.

- In investees where the Fund owns a **majority stake**, such as the unlisted real estate companies Vasakronan, Hemsö, Trophi, Regio and Trenum and infrastructure companies Ellevio and Polhem Infra, we influence decision-making through board membership.

- In the case of **foreign listed investees**, AP3 often works closely with other institutional investors, primarily via the AP funds' Council on Ethics.
- In **Swedish listed companies**, active engagement is through dialogue with boards and management, voting at company meetings and nomination committee membership.

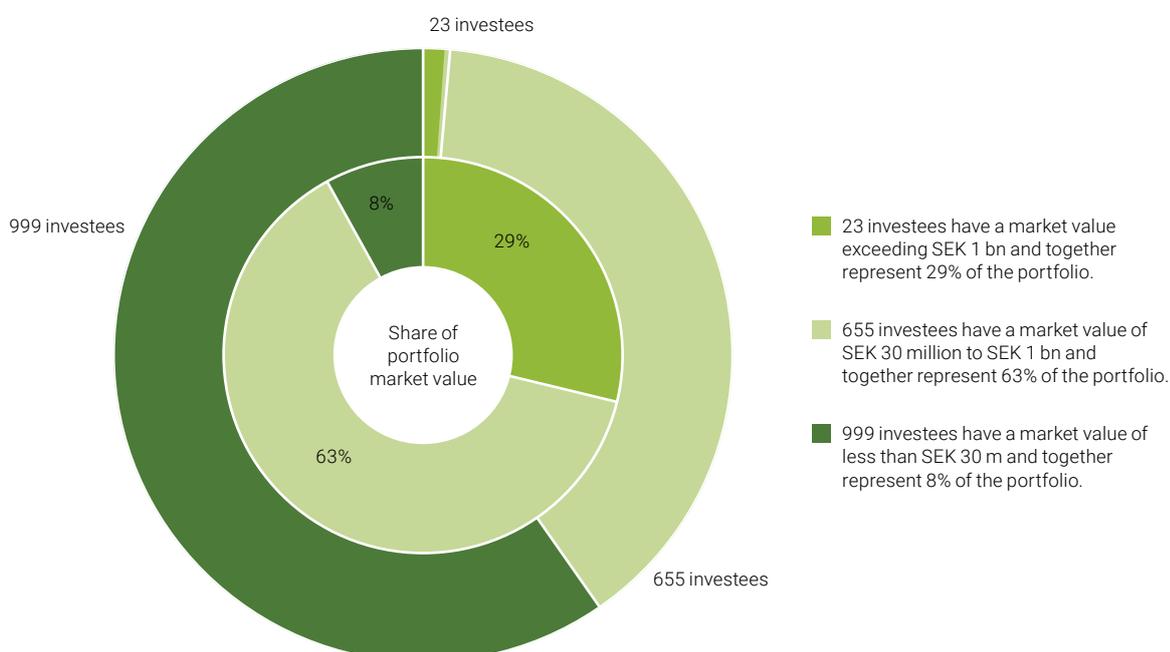
### Engagement across multiple issues

AP3 engages with investee companies by entering into dialogue with directors, management and other investors, through participation in nomination processes and by voting at company meetings. Sometimes engagement has a direct impact, for instance when an investee company listens to what we have to say and changes its AGM resolutions accordingly. But active stewardship is typically a longer process, as is the case when engaging with companies on climate-related issues. AP3 engages with investees on a wide range of issues centred on several areas of strategic importance to the Fund:

- Influencing the structure of **executive remuneration programmes** – share-based incentive schemes should be clearly and measurably linked to performance.
- Influencing **board structure** – improving diversity and separating the positions of chairman and CEO.
- Ensuring companies maintain their **capital structures** – curbing overly generous mandates.
- Promoting healthy **working conditions** – opposing any abuse of power.
- Combating **financial crime** – focusing on anti-corruption and money laundering.
- Encouraging investees to adopt a **climate strategy** – they should measure and report carbon footprint and modify their business operations to reduce climate impacts.

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

The size of AP3's shareholding affects our ability to exert influence. The larger the holding, the easier it is to be heard.





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. However, 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, AP3 has 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 investee companies' climate impact and communicates 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.

#### Coronavirus impacted stewardship in 2020

The coronavirus outbreak significantly affected the 2020 AGM season. Companies sought a balance between the requirements of the Companies Act entitling shareholders to attend AGMs in person and the restrictions on public gatherings mandated by the Public Health Agency of Sweden. The Covid-19 emergency caused the postponement of many AGMs, with many not being held until mid-year.

On 15 April legislation was passed giving Swedish companies a legal exemption that entitled them to allow shareholders to vote in advance of the AGM. This led to AGMs being quick, simple events with few attendees and which dealt exclusively with procedural matters. AP3 hopes to see a return to the previous status quo, when Swedish AGMs gave shareholders and company representatives the opportunity to meet and for investors to ask relevant questions about the company's business activities.

Dividends came under the spotlight in 2020 amid the impact of the pandemic. AP3 contacted most of our Swedish investees to advise restraint and prudence in the light of the exceptional conditions. Boards should understand that there is a risk that companies which pay dividends will receive less support or less



Stewardship strategies are tailored to the size of each holding and address the areas where the Fund sees maximum scope for achieving influence and impact.

preferential treatment in the event that the government offers financial support. Restraint and prudence should also take centre stage when it comes to the remuneration of senior executives and directors.

After the Swedish government and the Financial Supervisory Authority stressed the importance of restraint, many companies postponed, reduced or cancelled their dividends. Many nomination committees also revised their proposals on executive pay, leaving them unchanged from the prior year.

From AP3's perspective, the AGM season worked out very well notwithstanding the fact that the limitations on public gatherings reduced the interaction between companies and their shareholders. AP3 relied heavily on advance voting when it became legally possible on 15 April. The Fund voted in advance at more than 90% of the AGMs of our Swedish investees. Only in isolated cases, such as when we held a nomination committee seat and were part of the nomination process, did AP3 vote physically.



# Stewardship in the swedish equity portfolio in 2020

A large proportion of the AP3 listed equity portfolio – about 30% – is invested in the Swedish stock market. For this reason, Swedish equities have a significantly higher weight in the Fund’s portfolio than Sweden’s market weight in a global share index. The portfolio contains around 140 companies. Percentage holdings are larger than in foreign investees, averaging 1.4% of the equity and a slightly lower percentage of the votes. However, the size of our holding varies from company to company. In one in five investees, AP3 holds an equity stake of less than 0.3%; in one in five investees the Fund’s equity holding exceeds 2%; and in around 10 investees our equity holdings are significantly larger, ranging from 5% to 10%.

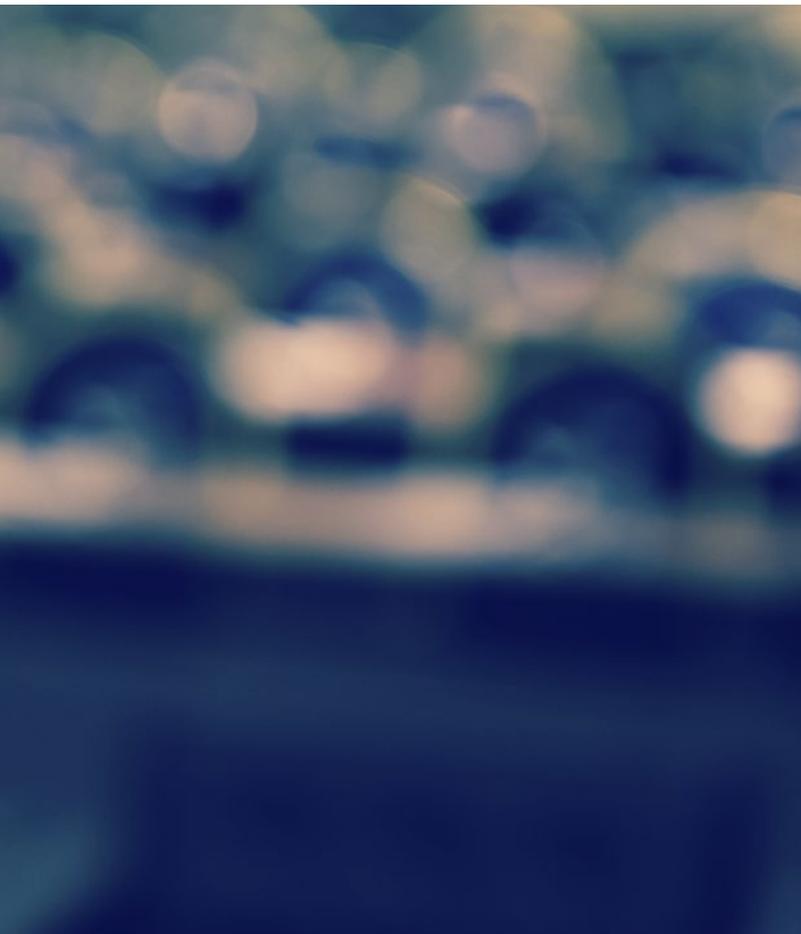
Stewardship is closely integrated in the day-to-day asset management process and is a tool for achieving the Fund’s objective of maximum investment returns. Effective governance involves prioritising resources, and for this reason AP3 focuses on voting at selected investees that are either major companies in which we

hold a large stake or smaller investees in which our capital investment may not be especially large but where our equity holding is more significant.

In total, AP3 voted at 71 AGMs, which was a slightly lower figure compared to 2019 but a good outcome in the circumstances. AP3 also participated in several extraordinary general meetings. These stewardship responsibilities are usually shared among members of the asset management team, but in 2020 we elected to vote by proxy in most cases. The 71 investee companies at which AP3 exercised its voting rights had a combined market value of SEK 41 billion. The Swedish equity portfolio had a combined market value of SEK 43 billion at 30 June. Hence, our stewardship engagements covered some 95% of the portfolio.

The equity portfolio has holdings in numerous companies that are leaders both in Sweden and globally in their specific sectors. Many Swedish corporations have been successful in integrating

|                                                  | 2020  | 2019  | 2018  | 2017  | 2016  |
|--------------------------------------------------|-------|-------|-------|-------|-------|
| Number of AGMs                                   | 71    | 75    | 70    | 62    | 53    |
| Percentage of portfolio companies at which voted | 51%   | 55%   | 40%   | 39%   | 35%   |
| Number of agenda items                           | 1,900 | 2,000 | 1,800 | 1,600 | 1,300 |
| Number of nomination committees                  | 5     | 7     | 5     | 5     | 4     |



In total, AP3 voted at 71 AGMs, which was a slightly lower figure compared to 2019 but a good outcome in the circumstances. Physical attendance at AGMs was low.

sustainability into their operations as a way to drive their businesses forward. This makes them more competitive and equips them to make a positive contribution to society worldwide. As a large institutional investor in Sweden, AP3 has an opportunity – and a responsibility – to participate in this trend.

### **Climate change high on the agenda**

Climate-related issues have gained greater prominence on the agendas of companies and their owners. Today, climate change is a core consideration for most investees. Transparency is crucial, both for companies and their shareholders. Disclosure and reporting of climate impacts is considerably more open than it was a few years ago. New European Union regulations on sustainable financing, which include a taxonomical classification of business activities deemed to be sustainable, have spurred further progress in this area.

AP3's strategy is to limit the negative impacts of climate change on our portfolio investments and society. To achieve this, the Fund has a set of sustainability goals to be achieved by 2025 (read more at [www.ap3.se](http://www.ap3.se)). AP3 has chosen not to invest in industries that negatively impact the climate, such as coal mining and oil shale production. Generally speaking, our approach is not to withdraw from

responsibility by divesting companies that face climate-related challenges but to drive positive change through proactive stewardship. It is about convincing companies to measure their carbon footprint and to adapt their operating activities to reduce it.

### **Board diversity – a recurring issue for investors**

The Swedish corporate governance code recommends that Swedish companies aim for an equal gender balance among directors. According to the code, this corresponds to a minimum of 40% of directors being male or female. Data from the Swedish Corporate Governance Board shows that female representation did not increase from 2019 to 2020. The percentage of female directors was unchanged at 35.6% (excluding CEOs who also serve as directors). Female board representation at large companies was 40.2%, a decrease of 0.8 percentage points from 2019. At small and medium-sized companies the figure was 33.5%, an increase of 0.4 percentage points. The board's data also revealed a decline in the percentage of newly elected female directors, from 36.7% to 35.4%. Hence, a good deal of work remains to be done, especially by small and medium-sized companies, to achieve the 40% target.

All investors have an interest in greater board equality. Here the primary burden falls on nomination committees, which are responsible for nominating directors. AP3 works to achieve increased female board representation at investee companies where we serve on the nomination committee. The Fund served on five nomination committees in 2020. In several cases, the company in question faces challenges in terms of achieving greater board diversity:

- Wind power company Arise has the smallest board of directors of any Swedish listed company, with four directors. Female board representation of 25% is too low, though this figure should be seen in the context of the board having only four directors.
- Changes at medical technology company Karolinska Development in recent years have also had an effect at boardroom level. Only one of the company's five directors is female. The nomination committee has launched a long-term effort to overhaul the board's structure.
- The board of safety helmet specialist MIPS decreased in size from six to five directors. Two of these are female, which means that the percentage of women directors rose from 33% to 40%.
- At biopharma company BioArctic, the departure of a female director during the year resulted in the company having just one woman on its board. Female representation fell from 25% to 13%.
- At bus transport group Nobina, a female director left the board shortly before the AGM and the nomination committee had insufficient time to find a replacement. Only one of the company's directors is female, corresponding to a gender balance of 20%.

Most investors share the view that corporate boards and managements should reflect the diversity of society at large. AP3 believes that greater equality at board level makes companies more attractive as employers and leads to better decision-making and higher value creation over time. There can be no ambivalence about our desire to ensure greater diversity on corporate boards. Our opportunities to achieve this goal are greatest in the investees where we own a majority of the shares – and it is in these companies where

the Fund's efforts have met with most success. Female representation on the boards of AP3's unlisted real estate companies varies from 33% to 67% and averages 46%. Six out of Vasakronan's nine directors are female and the company also has a female CEO as well as a female chairman.

AP3 notes that far from all companies have proportionate gender representation on their boards when they make their stock market debut. During the spring AP3 joined other institutional investors in authoring an opinion article urging advisers to focus more on board structure when preparing a company for an IPO. The article also called on NASDAQ to demand proportionate gender representation as part of the IPO process.

### **Culmination of money laundering scandal at Swedish banks**

In 2019, parts of the Baltic and Nordic banking sector were hit hard by money laundering allegations. Banks including Danske Bank and Swedbank were accused of widespread and systematic laundering activity. The investigations were probed by the authorities in Sweden and Estonia, leading to a storm of criticism against the banks. Just before its AGM, Swedbank was fined SEK 4 billion for failures in its financial management. At the meeting, AP3 voted against discharging the prior CEO from liability. The money laundering issue is still not over for Swedbank pending the completion of a US investigation by the relevant authorities there. SEB received a fine of SEK 1 billion for inadequate internal control leading to its failure to identify the risk of money laundering in its Baltic operations.

AP3 takes any type of financial crime very seriously, regardless of whether the cause is compliance failures or systematic wrongdoing. AP3 expects bank managements and boards to act strongly to ensure effective control mechanisms are in place to minimise the risk of banks being used for money laundering or to finance terrorism.

The appendix to this report contains a more detailed presentation of AGM resolutions and how AP3 voted on them.



# Stewardship in the foreign equity portfolio in 2020



The diversification of AP3's listed equity investments at global level helps to spread portfolio risk and also enables the Fund to invest in companies and sectors that play a key role in world economic development. 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.

AP3 gradually become more active in exercising active governance and today the Fund participates in many more global investor initiatives and engages in dialogue with many more investee companies than in the past. The Fund has also become more active in exercising its voting rights at company meetings. When we commenced active governance in the global portfolio in 2008, we voted at 70 AGMs of non-Swedish investees. Since then, this figure has risen steadily. In 2020 we voted at 1,070 AGMs, of which 71 were held by Swedish companies. Last year the Fund virtually halved the number of companies in the global equity portfolio, from 3,000 to 1,600. This means we now cover a much larger percentage – around 60% – of our investee AGMs.

The geographic spread of the Fund's global portfolio holdings makes it impracticable to attend and vote at the AGMs of foreign investees. Instead, we vote by proxy using an electronic voting system provided by Institutional Shareholder Services (ISS), a global corporate governance consultancy. Nordic Investor Services, a Swedish corporate governance consultancy, monitors company meetings, analyses relevant paperwork and administers the voting process. At all times, however, AP3 draws its own conclusions and decides independently how to vote.

Investees are selected primarily on the basis of their relative weights in the global MSCI share index. The Fund voted at the AGMs of our largest investees in Australia, Bermuda, Canada, France, Germany, Hong Kong, Ireland, Japan, the Netherlands, Singapore, Switzerland, the UK and the US. We also voted at a number of companies registered in Belgium, the Cayman Islands, Denmark, Italy, Jersey, Liberia, Luxembourg, New Zealand, Norway, Papua New Guinea and Spain.

|                                                           | 2020   | 2019   | 2018  | 2017   | 2016  |
|-----------------------------------------------------------|--------|--------|-------|--------|-------|
| Number of non-Swedish AGMs                                | 999    | 972    | 780   | 837    | 670   |
| Percentage of portfolio company AGMs at which voted       | 61%    | 60%    | 28%   | 28%    | 22%   |
| Number of agenda items                                    | 12,680 | 11,565 | 9,766 | 10,371 | 8,657 |
| Percentage of votes in support of board proposal          | 72%    | 72%    | 70%   | 71%    | 75%   |
| Percentage of abstentions or votes against board proposal | 28%    | 28%    | 30%   | 29%    | 25%   |



### Challenging executive pay structures at foreign investees

In the 12 months ended 30 June 2020 AP3 voted on 12,700 resolutions at close to 1,000 foreign company meetings. Three times out of ten we voted against the board's recommendation. This high level of "no" votes shows how many foreign investees find it more difficult than their Swedish counterparts to meet AP3's governance requirements. It also indicates that foreign companies are less successful than Swedish corporations in winning shareholder support for their AGM resolutions.

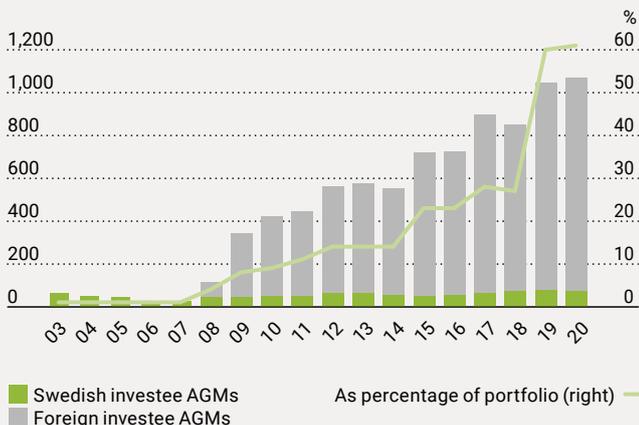
Executive remuneration is an area where major differences exist between Swedish and non-Swedish investees. During the period we voted against more than half of the resolutions on executive remuneration proposed by non-Swedish investees. Foreign companies clearly find it harder to meet our requirements 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, while shareholders have only an advisory role. Nevertheless, less than unanimous support for AGM resolutions may help to produce change over time.

AP3 voted for over half of the resolutions submitted by other investors, reflecting the fact that many shareholders of foreign investees move their own AGM resolutions and these are often of a high standard. For example, AP3 voted for resolutions to improve the disclosure of political donations and to separate the role of chairman and CEO. The Fund also voted for a majority of resolutions relating to climate change.

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](http://www.ap3.se).

### Steady increase in AP3's engagement in investee AGMs



### Data on AP3's global voting in 2019/2020

Geographic breakdown of AGMs 2019/2020, %

|           |    |                 |   |
|-----------|----|-----------------|---|
| USA       | 40 | Singapore       | 2 |
| Japan     | 27 | Hong Kong       | 2 |
| Canada    | 6  | New Zealand     | 1 |
| Australia | 6  | Ireland         | 1 |
| UK        | 4  | Switzerland     | 1 |
| France    | 3  | Netherlands     | 1 |
| Germany   | 2  | Other countries | 4 |



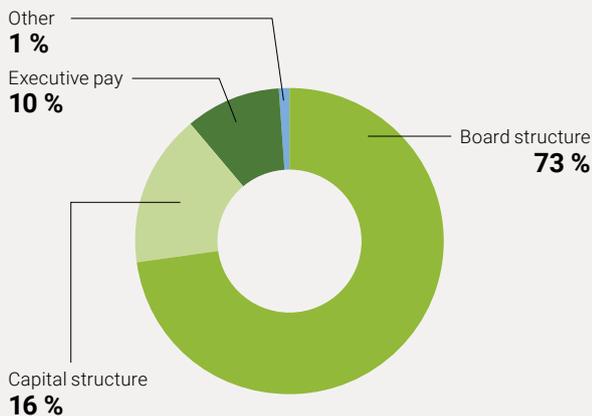
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|                                                  | 2020          | 2019          | 2018         | 2017          | 2016         |
|--------------------------------------------------|---------------|---------------|--------------|---------------|--------------|
| Number of board resolutions                      | 12,251        | 11,242        | 9,366        | 9,949         | 8,239        |
| Number of shareholder resolutions                | 429           | 323           | 400          | 422           | 418          |
| <b>Total number of agenda items</b>              | <b>12,680</b> | <b>11,565</b> | <b>9,766</b> | <b>10,371</b> | <b>8,657</b> |
| Number of votes for board resolutions            | 9,170         | 8,347         | 7,100        | 7,216         | 6,714        |
| Number of votes against board resolutions        | 2,517         | 2,473         | 2,167        | 2,648         | 972          |
| Number of abstentions                            | 993           | 745           | 499          | 507           | 971          |
| <b>Total number of agenda items</b>              | <b>12,680</b> | <b>11,565</b> | <b>9,766</b> | <b>10,371</b> | <b>8,657</b> |
| Number of votes for board's recommendation       | 9,177         | 8,252         | 6,974        | 7,419         | 6,580        |
| Number of votes against board's recommendation   | 3,503         | 3,313         | 2,792        | 2,952         | 2,077        |
| <b>Total number of agenda items</b>              | <b>12,680</b> | <b>11,565</b> | <b>9,766</b> | <b>10,371</b> | <b>8,657</b> |
| Number of votes for shareholder resolutions      | 232           | 171           | 223          | 235           | 230          |
| Number of votes against shareholder resolutions  | 196           | 152           | 177          | 187           | 185          |
| Number of abstentions on shareholder resolutions | 1             | 0             | 0            | 0             | 3            |
| <b>Number of shareholder resolutions</b>         | <b>429</b>    | <b>323</b>    | <b>400</b>   | <b>422</b>    | <b>418</b>   |

#### Data on AP3's global voting in 2019/2020

Breakdown of board resolutions 2019/2020, %



Breakdown of shareholder resolutions 2019/2020, %

