



IMPACT THROUGH DIALOGUE

THE ETHICAL COUNCIL
ANNUAL REPORT 2013

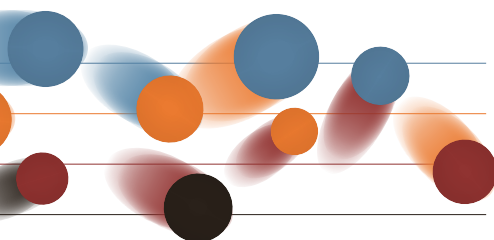
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A WORD FROM THE CHAIRWOMAN

When I look back in the rear-view mirror, I am proud of the accomplishments that the Ethical Council has achieved by means of dialogue and collaboration.



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COMPANY DIALOGUES

As of 2014, reactive dialogues will be subject to time limits.



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PREVENTIVE DIALOGUE

Ever since 2011, the Ethical Council has focused on the mining industry and the sustainability challenges it faces.



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REPORT FROM SOUTH AFRICA

While attending the annual conference of Principles for Responsible Investment, the Ethical Council visited a number of companies.

THE WORKING PROCESS OF THE ETHICAL COUNCIL

 **ethical council**
A COLLABORATION BETWEEN
FIRST-FOURTH AP-FUNDS

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THE WORKING PROCESS OF THE ETHICAL COUNCIL

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THE YEAR IN BRIEF

The Ethical Council carried on both preventive and reactive dialogues in 2013 covering human rights, corruption, the environment and other sustainability issues with more than 230 companies that do business in various international industries.

2013

MORE THAN 230 COMPANIES

The Council pursued preventive and reactive dialogue with 133 companies around the world. The dialogue often addressed more than one area of sustainable development. Additionally, the Council's service providers held dialogues with 101 companies on behalf of the AP Funds and other clients.

FOUR COMPANIES WHERE DIALOGUE OBJECTIVES WERE ACHIEVED

Four companies that had been implicated in violations of international conventions – AES (United States), Toyota (Japan), Alstom (France) and Veolia Environment (France) took action in line with the demands of the Ethical Council. After concluding the dialogues, the Council continues to monitor the companies. All four dialogues lasted for a number of years. The persistence of the Council and other investors when it came to pursuing the dialogues was decisive to the ultimate improvements adopted by the companies.

PREVENTIVE INITIATIVES AND COLLABORATION

Preventive initiatives, often in collaboration with other international investors, are integral to the Council's commitment to persuade companies to assume greater social responsibility. The Council's mining project illustrates the potential of such an approach. The Council also took a closer look at the telecom and pharmaceutical industries in 2013.

RECOMMENDING DIVESTMENT

Acting on recommendations of the Council, the AP Funds divested four companies – Walmart, Freeport McMoRan, Incitec Pivot and Potash – in 2013. These companies had been implicated in violations of international conventions and the Council had determined that continuing the dialogue with the companies would not be meaningful.

IMPROVED WORKING PROCESS

The Council overhauled its working process during the year. The result was a more dynamic model for engaging in preventive and reactive dialogue. The new methods have been implemented step-by-step during 2013.

ANNUAL REPORTING

The efforts of the Council are presented in its annual report, as well as at www.ethicalcouncil.com and the shareholder and annual reports of the AP Funds.

ENGAGEMENT

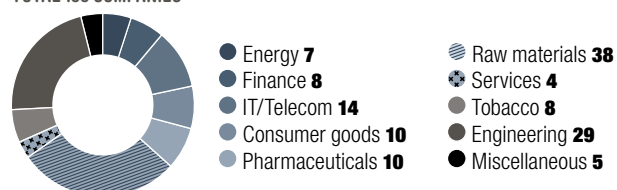
ENGAGEMENT BY AREA OF SUSTAINABILITY

TOTAL 276



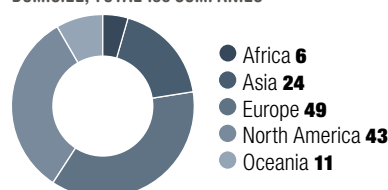
ENGAGEMENT BY INDUSTRY

TOTAL 133 COMPANIES



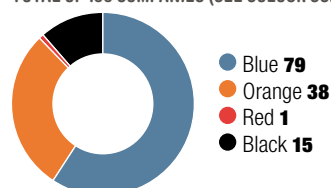
ENGAGEMENT BY REGION

DOMICILE, TOTAL 133 COMPANIES



STATUS OF 2013 DIALOGUE AT YEAR-END

TOTAL OF 133 COMPANIES (SEE COLOUR SCHEME ON PAGE 6)



ENGAGEMENT OF THE ETHICAL COUNCIL THROUGH SERVICE PROVIDERS

111 INCIDENTS, 101 COMPANIES



A WORD FROM THE CHAIRWOMAN

The Ethical Council has never placed any time limits on its reactive dialogues, since its inception in 2007. However, as of 2014, no reactive dialogue will last longer than four years. The Council is also adopting a more flexible description of objectives in order to deal with companies where the problems discussed can be seen as a grey zone.

The reason for the new working method is that a number of dialogues have lasted for many years without resolution. The situation has not only demanded extensive resources but been the target of external criticism. For example, we engaged in a resource-intensive dialogue with Walmart for seven years but brought it to a conclusion in 2013 and recommended that the AP Funds divest it. We had failed to achieve our objective and concluded that the probability of succeeding was not great enough to justify using additional resources.

UPGRADING THE DIALOGUE PROCESS

The Ethical Council had established strict objectives for our reactive dialogues and been more than willing to pursue them as long as we felt that we could make a difference and exert a positive influence.

Nevertheless, we have realized that it is difficult to stick to strict targets for a dialogue, because the reality is rarely a matter of black or white. The ethical problems that companies face are often in a grey zone. New issues may emerge while the dialogue is under way as others are resolved. A more flexible model that captures changes as time goes on was clearly needed.

In line with requests by non-governmental organisations and other stakeholders, the ambition is that the new dialogue process will make both our preventive and reactive dialogues more transparent. This annual report recounts a number of dialogues that we pursued in 2013 on the basis of a blue/orange/red/black colour scheme. Dialogues with companies whose violations of a convention have been verified are coded red and will be limited to four years. We concluded a number of red-coded dialogues during the year and had only a few left on 31 December. The Ethical Council continually pursues dialogues and launches new ones. This annual report offers a snapshot of their status at the end of 2013. Refer to page 6 for a detailed description of the new dialogue process and colour scheme.

CONCLUDING EIGHT REACTIVE DIALOGUES

The Ethical Council concluded, among other things, eight reactive dialogues in 2013 that had lasted for a number of years. The objectives for the dialogues with AES, Toyota, Alstom and Veolia had been achieved. In the cases of Walmart, Freeport McMoRan, Incitec Pivot and Potash, the Council deemed further dialogue to be meaningless and recommended divestment by the AP Funds, which acted accordingly.

When launched by the AP Funds in 2007, the Ethical Council focused on companies with problems that could be linked to violations of conventions to which Sweden is a signatory. But it wasn't long before we realized that a company is seldom alone in lacking effective policies and procedures to deal with the problem area (human rights, corruption or the environment) in question. Their

competitors are likely to face similar challenges. As a result, the Council has increasingly turned its attention to preventive dialogues with large groups of companies in the same industry. A company that assumes greater responsibility often creates a ripple effect and others follow suit.

Preventive dialogues have turned out to be a successful concept that makes a difference. We are pleased by all the companies that have taken the Council's viewpoints seriously and improved their sustainability effort. The Council launched a number of preventive initiatives in 2013 that addressed various industries and problem areas.

As companies increasingly outsource production and do their purchasing in low-cost countries, managing the supply chain is more important than ever. The Council has launched a preventive effort that addresses the pharmaceutical industry and its discharges into water of chemically active substances that can spawn resistant bacteria.

The Council also turned its attention to the telecom sector, which faces major challenges, in 2013. While it is important that telecom operators do business in countries under dictatorial rule, they must also deal with freedom of expression, privacy and corruption in a satisfactory manner. We pursued dialogues about these issues with a number of operators.

Reports of frightful industrial accidents in Bangladesh caused by the collapse of poorly built factories and killing thousands of workers emerged once again during the year. Also many workers were burned to death because emergency exits had been locked and fire protection procedures were lacking. The Council has thrown its support behind an initiative demanding that purchasers and manufacturers of Bangladesh garments collaborate to improve safety procedures in the factories.

The Council is also backing a project that encourages companies to produce and purchase certified palm oil, an ingredient of cosmetics, food and other products. Rainforests around the world are cleared to make room for palm oil plantations, ravaging the environment and potentially violating the rights of the indigenous population.

IS THERE A UNIVERSAL ETHICAL STANDARD?

The holdings of the AP Funds are compared from time to time with other fund managers and investors, often using lists of divested companies as an ethical standard. The question is whether there is any such thing as a universal standard. If so, who sets the standard? Weighing the ethical rules of various funds against each other is far from a simple proposition, more a futile attempt to compare apples and oranges. Investors proceed from differing values and methods when dealing with ethical issues. The initiatives that the Ethical Council takes are based on the conventions to which Sweden is a signatory. Unlike a number of other managers, for

“A COMPANY THAT ASSUMES GREATER RESPONSIBILITY OFTEN CREATES A RIPPLE EFFECT AND OTHERS FOLLOW SUIT.”

example, the AP Funds have not divested tobacco companies given that they do not operate in contravention of international conventions. Nevertheless, the Council carries on preventive dialogue with these companies to address child labour, the environment and other important issues that call for social awareness and responsibility. It follows that the Council may recommend that the AP Funds divest a tobacco company that violates international conventions on human rights or another area if dialogue has failed to resolve the problem. But the very nature of the business activities that a tobacco company conducts does not constitute sufficient grounds for divestment.

CONCLUDING REMARKS

A number of Danish investors dropped out of the UN Principles for Responsible Investment (PRI) initiative¹ in 2013 due to dissatisfaction with the organisation’s evolution since starting in 2006. Their view was that both public control and corporate governance left much to be desired. While the Ethical Council shares some of the concern, the advantages of supporting the PRI currently outweigh the disadvantages. In the view of the Council, collaborating and sharing experience with other PRI members is a valuable process, while the organisation itself plays a key role in promoting responsible investment practices in the financial industry.

My year as Chairwoman of the Council have been very intense and I would like to take this opportunity to express my gratitude to all of my colleagues. Our strength is that everyone contributes with their own experience, devoting their time and resources to taking the next step with our dialogues and initiatives. I also want to thank everyone at Swedish and international pension funds with whom we collaborate. Finally I want to extend a personal note of gratitude. After seven years with the Council and two years as Chairwoman, I will be pursuing new challenges outside the sphere of the AP Funds and passing the baton on to the Fourth AP Fund. When I look back in the rear-view mirror, I am proud of the accomplishments that the Council has achieved up by means of dialogue and collaboration. The Ethical Council makes a difference.

Stockholm, January 2014

Christina Kusoffsky Hillesøy



Christina Kusoffsky Hillesøy
Chairwoman, Ethical Council, 2013

¹ PRI, Principles for Responsible Investment – a UN-initiative. All four AP funds are signatories.

THE ETHICAL COUNCIL AT A GLANCE

The First, Second, Third, and Fourth AP Funds are competing buffer funds in the Swedish national pension system. The Government assigned them the joint mission in 2001 of investing the country's buffer capital in a way that serves the pension system best while generating high long-term returns at low risk. The Funds must take ethical and environmental into consideration without sacrificing the overall objective of generating high returns.

Since 2007, the first four AP Funds have coordinated their efforts when it comes to environmental and ethical issues through the Ethical Council. The Council views its mission as encouraging companies to proceed from the activities they conduct to address relevant sustainability considerations and adopt appropriate guidelines, along with management and monitoring systems that enable them to do business as responsibly as possible. The approach of the Council is to promote and participate in preventive initiatives, as well as advocating for positive change at a number of companies that have been implicated in violations of international conventions on human rights and the environment.

EACH AP FUND MAKES ITS OWN INVESTMENT DECISIONS

Each AP Fund is fully responsible for the investment decisions made. Given that they are competitors, the AP Funds do not discuss investment decisions. Each fund has shareholdings in somewhere between 1,500 and 4,000 companies, largely by means of passive management.

Passive management is frequently used to ensure cost-effective exposure to various stock markets, thereby holding shares of all companies in a particular share index.

CORE VALUES AND COLLABORATION

The Funds have proceeded from their joint mission to articulate a set of core values: "Acting in accordance with the principles of commitment, action and the need for change in order to make a difference." Because the Funds are part of the national pension system, these principles are based on the core values of the Swedish state. Central to these values are the tenets of democracy, human equality, the freedom and dignity of the individual, and sustainable growth. The Swedish Constitution reflects these values and tenets. Along with the core values of the state, the international conventions to which Sweden is a signatory and its particular positions on matters of international law are key tools in the efforts of the Ethical Council.

WORKING TOGETHER TO EXERT GREATER INFLUENCE ON COMPANIES

The Ethical Council collaborates on engagement with companies, mostly foreign holdings, in the listed equity portfolios of the AP Funds. Given that the funds are relatively small shareholders in international companies, these holdings represent the greatest need for collaboration with others.

GLOBAL COLLABORATION IS IMPORTANT

The Council collaborates with major international investors in other countries, primarily pension funds, for the purpose of sharing experience and conducting joint efforts to exert greater influence as shareholders and more readily ensure improvements by the companies.

RETROSPECTIVE

Since its inception in 2007 the Ethical Councils efforts have evolved from a focus on reactive dialogue to a growing emphasis on preventive dialogue as part of industry-wide initiatives. The Council steadily adopted a more flexible process in 2013 in tandem with a project aimed at lending greater transparency to the dialogues it conducts.

EVOLUTION OF THE ACTIVITIES OF THE ETHICAL COUNCIL

<p>2007 →</p>	<p>COUNCIL established.</p>	<p>FOCUS ON REACTIVE DIALOGUES and scrutiny of companies for violations of international conventions.</p>		
<p>2008 →</p>	<p>PUBLICATION of first annual report.</p>	<p>FIRST ROUNDTABLE DISCUSSIONS with non-governmental organisations. Focus on the need to identify a clearer purpose for dialogues.</p>	<p>THE GOVERNMENT APPOINTS a commission (SOU 2008 “Ethics, environment and pensions”) to review the efforts of the AP Funds. Among the recommendations of the commission are that the AP Funds proceed from more transparent core values, become less dependant on a single ethical consulting firm and cultivate more of its own analytical support to quality assure information obtained from external consultants.</p>	<p>COLLABORATION LAUNCHED with a number of European pension funds for the purpose of sharing experience and exerting joint influence.</p>
<p>2009 →</p>	<p>THE FOUR AP FUNDS draw up new core principles via the Ethical Council.</p>	<p>THE ANNUAL REPORT expands to include the objectives of the dialogues and their accomplishments during the year.</p>	<p>GREATER FOCUS on preventive dialogue.</p>	
<p>2010 →</p>	<p>THE COUNCIL APPOINTS a secretary-general to assume responsibility for day-to-day activities, quality assurance of analyses, dialogue and collaboration with other investors.</p>	<p>THE COUNCIL PROCURES additional service providers to minimise its dependence on a single consulting agency.</p>	<p>THE COUNCIL DEVELOPS a website for greater transparency and dissemination of information.</p>	
<p>2011 2012 →</p>	<p>GREATER FOCUS on preventive industry initiatives.</p>	<p>AS PART OF ONE such initiative, the Council analyses the extent to which a number of mining companies are complying with the sustainability principles established by the industry.</p>		
<p>2013 →</p>	<p>OVERHAUL OF THE COUNCIL'S working process, followed by development of its working model and adoption of more dynamic classification of processes for carrying on reactive and preventive dialogue.</p>	<p>TIME LIMIT IMPOSED on reactive dialogues as of 2014.</p>		

STEADY FLOW OF DIALOGUES

In 2013, the Ethical Council conducted dialogues with 133 companies, often addressing several different areas of sustainability. This classification offers a snapshot of their status at the end of 2013.

→ BLUE-CODED DIALOGUE

A preventive dialogue that the Council carried on with a company or that concerned an incident that the company sufficiently explained and/or addressed during the year. A total of 79 companies at the end of 2013.

→ ORANGE-CODED DIALOGUE

A dialogue that the Council pursued during the year due to an incident or the participation of the company in a preventive project that requires it to take additional measures. Thus, the Council will continue to dialogue with the company. A total of 38 companies at the end of 2013.

→ RED-CODED DIALOGUE

Dialogue with a company whose violation of a convention has been verified. This dialogue is subject to a time limit of four years. Unless the dialogue has generated improvements by that time, the Council will recommend that the AP Funds divest the company. One company at the end of 2013.

→ BLACK-CODED COMPANY

A company that the Council has recommended that the AP Funds divest. Each year, the Council determines whether the violation of international conventions that occasioned the divestment has been corrected. The Council has recommended that the AP Funds divest a total of 15 companies since 2007. The Funds have followed each recommendation.

A FEW DIALOGUES AND THEIR STATUS AT THE END OF 2013

Alstom

Dialogue about sales of trams used on the Jerusalem-West Bank line. After Alstom divested its holdings in the project, the Ethical Council concluded the dialogue, which had lasted for several years.

AES

Once the company had put together human rights policies and divested its holdings in the project, the Ethical Council concluded the dialogue, which had lasted for several years.

Veolia

Contract to maintain trams on the Jerusalem-West Bank line. Veolia is aiming at divesting its holdings but the local authorities are dragging their feet. The dialogue has been concluded.

Toyota Motor Corporation

The Ethical Council initiated a dialogue about union busting in 2007. Most of the objectives have been achieved. The dialogue has been concluded.

Wesfarmers

The company had been buying phosphates from Western Sahara. The practice stopped in 2012. The dialogue has been concluded.

Total

Total has signed agreements with Morocco to conduct geological surveys (reconnaissance) off the West Saharan coast. If the project expands to include oil prospecting and extraction, violations of international law may result.

Barrick Gold

A dialogue between the Ethical Council and the company about a policy to address discharges of mine waste into river systems has proven unsatisfactory.

Motorola Solutions

Supplying West Bank settlements with surveillance equipment is a violation of international law. The dialogue continues.

Walmart Stores, Inc.

Systematic violations of workers rights. The company had exhibited scant interest in changing its behaviour despite several years of dialogue.

Freeport McMoRan Copper & Gold Inc.

Divested due to the risk of serious environmental damage.

Incitec Pivot Ltd.

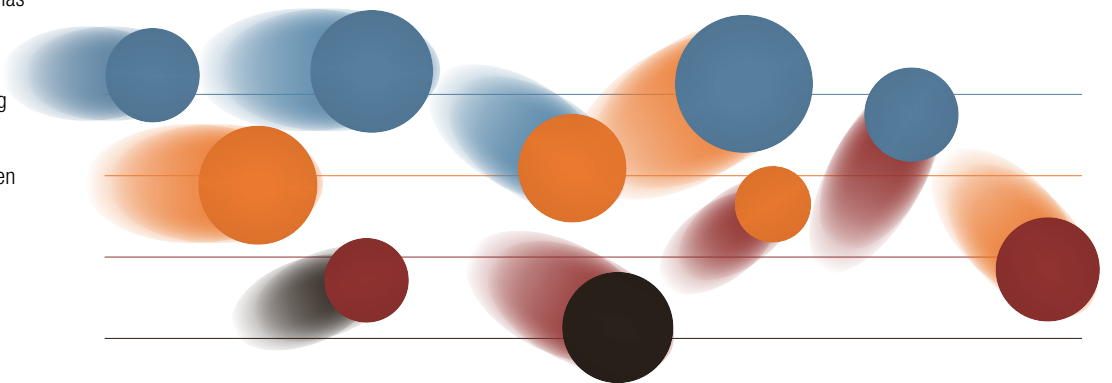
The company purchases phosphates from Western Sahara and is unable to demonstrate that it does so in the best interests of the population.

Potash Corp.

The company purchases phosphates from Western Sahara and is unable to demonstrate that it does so in the best interests of the population.

The Council's working process manages a steady flow of dialogues with various companies. Dialogues can unfold in any number of ways.

The Council recommended in 2013 that the AP Funds divest all of the above companies. The funds followed the recommendation and had fully divested their holdings by the end of 2013.



SOME EXAMPLES OF DIALOGUES DURING THE YEAR

The Ethical Council expanded its reporting model in 2013 in order to improve transparency with respect to its various dialogues. Given that the dialogues are confidential, they cannot always be reported to the general public. But the Council embraces transparency and attempts to release as much information about its activities as possible without jeopardizing achievement of its dialogue objectives.

VIOLATION OF INTERNATIONAL HUMANITARIAN LAW

Ever since 2010, the Ethical Council has been in dialogue with **MOTOROLA SOLUTIONS** about its provision of customised surveillance equipment to West Bank settlements in contravention of international humanitarian law. The main objective of the dialogue is to persuade the company to stop supplying settlements in occupied territories with surveillance systems and associated services. An additional objective is for the company to adopt a corporate policy that prohibits violations of international humanitarian law. In collaboration with an American investor, the Ethical Council has filed a resolution to the 2014 annual general meeting of Motorola Solutions. The resolution urges the company to overhaul its human rights policy, as well as its approach to compliance with the Geneva Convention relative to the Protection of Civilian Persons in Time of War (Fourth Geneva Convention) and other international agreements.

Since 2010, the Council has been pursuing a dialogue with **ALSTOM, S.A.** about its sales of trams to Jerusalem Light Rail, which connects West Jerusalem with West Bank settlements, in violation of the Fourth Geneva Convention. After Alstom sold its holdings in the project during the course of 2013, the Council concluded the dialogue. However, the company still has an agreement to maintain the trams. The Council has also carried on a dialogue with **VEOLIA ENVIRONMENT** since 2010 about the same project and problem. Veolia has tried to divest its holdings but encountered delays because local authorities have lodged objections and subjected the purchaser to various demands. Although concluding the dialogue in 2013, the Council will continue to monitor the problem.

VIOLATION OF THE RIGHTS OF INDIGENOUS PEOPLES

The Council has been carrying on a dialogue for several years with **AES CORPORATION** about construction of the Chan 75 hydroelectric dam in Panama. The project has been implicated in violation of the ILO Indigenous and Tribal Peoples Convention (No. 169). The dam was filled in 2011 under the supervision of the national ombudsman, public authorities responsible for natural resources and the environment, and municipalities. AES had been drawing up human rights policies based on the legal structure of each country in which it does business. Given the challenges that many countries face when it comes to incorporating ILO 169 into their laws, the Council was able to approve the decision by AES to address the problem at the national level as opposed to adopting a group-wide policy. Thus, the dialogue was concluded in 2013.

UNION ISSUES

Since 2007, the Council had been pursuing a dialogue with **TOYOTA MOTOR CORPORATION** about the union issues by a Philippine subsidiary in violation of the ILO Freedom of Association and Protection of the Right to Organise Convention. The objective of the dialogue was to persuade the company to ensure that independent trade unions are able to act freely and to adopt a group policy protecting freedom of association among its employees. As a result of the dialogue, the subsidiary now respects freedom of association and the right to organise. The objective of persuading the company to adopt a group policy on freedom of association has not been achieved. However, the company is engaged in a systematic effort to address such questions within the framework of the Toyota Way principles and no similar cases have been reported. Thus, the Council has coded Toyota blue and concluded the dialogue.

PRODUCTS USED FOR ANOTHER PURPOSE

It came to the attention of the Ethical Council during the year that preparations by **HOSPIRA**, which sells anaesthetics and other medicinal products, had been used by American prisons as an ingredient in lethal injections for death row inmates. The Ethical Council determined that they were standard preparations normally used by healthcare professionals as a lifesaving measure, but the products were used for a purpose other than their intended purpose. A European partner of the Council was already conducting a dialogue with Hospira, which had begun to act on it. The Council also contacted Hospira, which replied that it had opposed the use of its preparations in lethal injections at American prisons. The company had changed its distribution system to pharmacies and other retailers such that the preparations were no longer available to the prisons.

SERIOUS ENVIRONMENTAL DAMAGE

The Council recommended in 2013 that the AP Funds divest **FREEMPORT MCMORAN COPPER & GOLD** after its mining operations had been implicated in serious environmental damage in contravention of the UN Convention on Biological Diversity. The Grasberg mine, Indonesia, discharges large quantities of waste into a nearby river. The Council had pursued a dialogue with the company in 2007 with the objective of persuading it to take action to prevent future violations. The company made it clear that they reserved the right to discharge waste into rivers. The Council concluded that ongoing dialogue was meaningless, given the risk of recurring violations in view of the company's refusal to rule out use of the controversial waste disposal method.

SHELL'S COMPLIANCE WITH A UNITED NATIONS ENVIRONMENT PROGRAMME REPORT

In autumn 2012², the Council paid a visit to **SHELL** Petroleum Development Company of Nigeria (SPDC) and the refineries in the Niger Delta in which Shell holds a 30 percent interest to monitor the company's compliance with a report by the United Nations Environment Programme (UNEP) and the measures it had proposed. The Council continued the dialogue with Shell about the Niger Delta in 2013. Shell is planning to move the pipeline that goes through the area because it cannot be cleaned due to constant sabotage and theft, thereby contaminating the surrounding soil and water. However, the new pipeline may also be the target of sabotage and theft. SPDC divested some minor assets in the Niger Delta in 2013. The Council will continue to pursue its dialogue with Shell about compliance with the UNEP report.

SYSTEMATIC VIOLATIONS OF WORKERS RIGHTS

The Council recommended in 2013 that the AP Funds divest **WALMART STORES** after the company in its American operation had been implicated in systematic violations of workers rights in contravention of the ILO Freedom of Association and Protection of the Right to Organise Convention. The Council had initiated the dialogue back in 2007 with the objective of persuading Walmart to adopt group-wide policies and guidelines for the protection of workers rights in line with international guidelines on collective bargaining and the right to organise. A secondary objective was that the company adopt a credible system to monitor compliance. The Council concluded in 2013 that the dialogue was no longer meaningful given that the improvements adopted by the company were inadequate to address the violations.

WESTERN SAHARA – NON-SELF-GOVERNING TERRITORY TO BE DECOLONISED

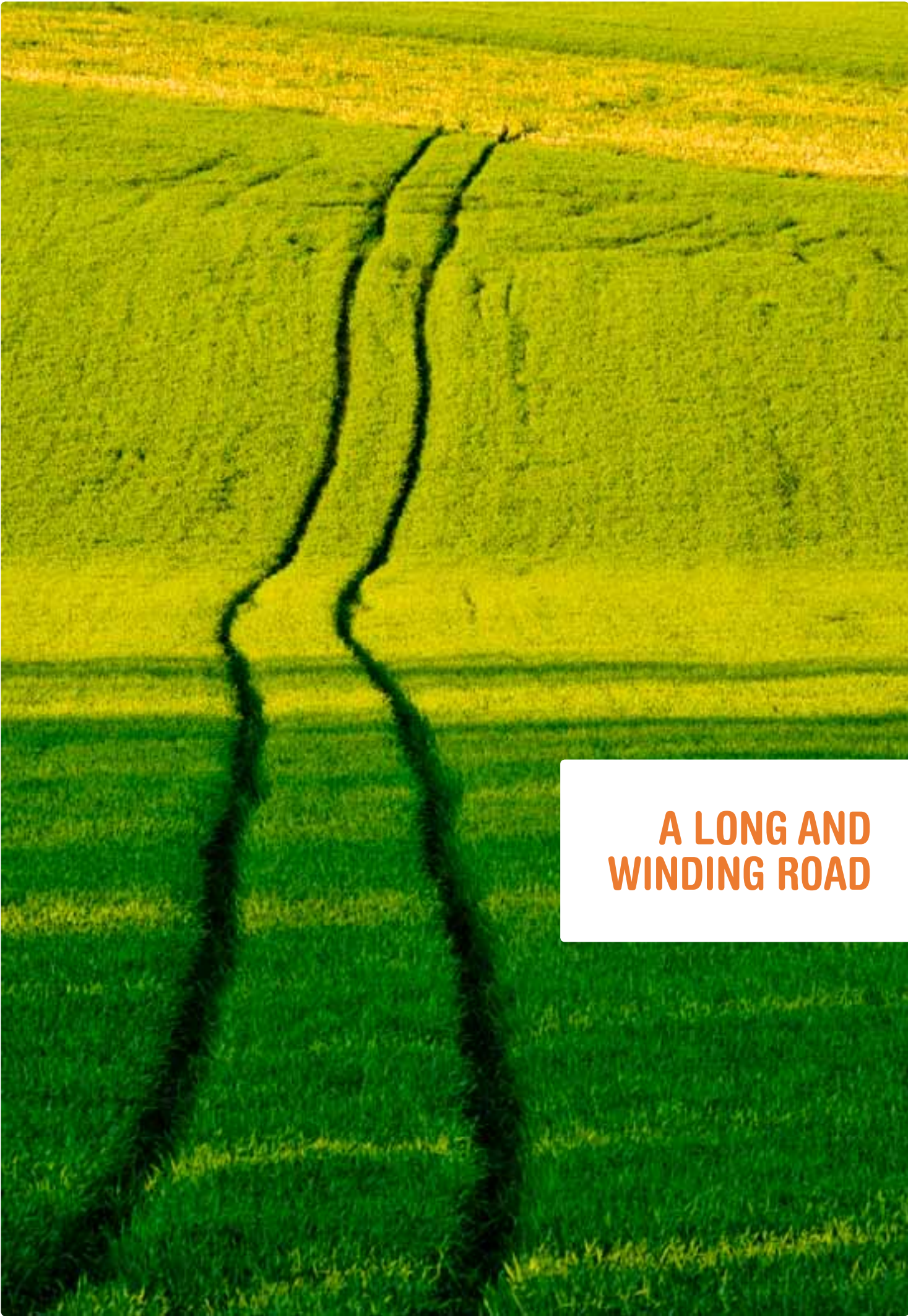
Western Sahara, which has been occupied by Morocco since 1975, is on the UN List of Non-Self-Governing Territories to be decolonised. The UN Legal Counsel stated in January 2002 that exploration of mineral resources in Western Sahara without local consent would be in breach of the UN Covenant on Civil and Political Rights and the UN Covenant on Economic, Social and Cultural Rights³. The Council has carried on a dialogue since 2009 with a number of companies that buy phosphates from a Moroccan mining company. The objective of the dialogue is to persuade the companies to stop purchasing the phosphates or demonstrate that the extraction is consistent with the interests and wishes of the West Saharan population in accordance with the legal counsel's statement. The Council's ethical consultant monitored the issue prior to the commencement of the dialogue. **FMC CORP** stopped buying phosphates from Western Sahara in 2010. **WESFARMERS** developed a new technology that enabled them to stop buying phosphates from Western Sahara in 2012. The Council recommended in 2013 that the AP Funds divest **INCITEC PIVOT LTD** and **POTASH CORP.**, both of which had announced that they had no plans to stop buying phosphates from Western Sahara in the foreseeable future. Nor had they been able to demonstrate that the extraction of phosphates was consistent with the interests or wishes of the West Saharan population.

The Ethical Council has pursued a dialogue with the **TOTAL** oil company, which has an agreement with the Moroccan government for geological surveys (reconnaissance) off the coast of Western Sahara. The UN Security Council voted in 2002 that contracts for exploration and evaluation do not constitute exploitation or physical removal of mineral resources.⁴ The conclusion is that reconnaissance does not violate international law but would do so if exploration or extraction were inconsistent with the interests and wishes of the Western Saharan population. The Ethical Council will continue the dialogue with Total. If the company embarks on exploratory drilling, the Council will make the same demands as it did with the phosphate purchasers.

² See Ethical Council Annual Report 2012.

³ UN S 2002 161 Letter dated 29 January 2002 from the Under-Secretary-General for Legal Affairs, the Legal Counsel, addressed to the President of the Security Council.

⁴ UN S 2002 161 Letter dated 29 January 2002 from the Under-Secretary-General for Legal Affairs, the Legal Counsel, addressed to the President of the Security Council.



**A LONG AND
WINDING ROAD**

ONGOING ANTI-CORRUPTION EFFORT

Anti-corruption is one of the Ethical Council's focus areas.
Corruption distorts competition and can deplete a company's assets.

THE ANTI-CORRUPTION EFFORT OF THE ETHICAL COUNCIL IS PROCEEDING APACE

The Council decided in 2013 to participate in the second phase of the Principles for Responsible Investment project on anti-corruption in the private sector. The first phase, which lasted from 2010 to 2012, involved some 20 companies at the global level. A third party analysed their preventive efforts to prevent corruption. A larger group of investors subsequently contacted the companies to discuss the analysis and propose improvements. The companies responded well to the project and incorporated many of the proposals into their policies and reporting structures. Some **30 COMPANIES** were contacted when phase two of the anti-corruption project got off the ground in the autumn of 2013. Approximately 20 investors, some of which are in charge of several dialogues, are collaborating on the project. The Ethical Council, which is responsible for dialogues with four Asian companies, also participates in progress meetings about the other company dialogues.

SUSTAINABLE VALUE CREATION

The Sustainable Value Creation initiative, in which all four AP Funds participate, emphasised anti-corruption at its annual seminar, to which the board chairmen, managing directors and other representatives of the 100 largest listed companies had been invited. The seminar was followed by small roundtable discussions for the purpose of sharing experiences and learning from one another.



TRANSPARENCY IN THE MINING INDUSTRY

Many countries that are rich in natural resources are wrestling with corruption at high levels. Corruption is a major obstacle to democratic development and economic growth. Given the power of transparency as a tool for combating corruption, the Ethical Council has been supporting the Extractive Industries Transparency Initiative (EITI) for the past several years.

The goal of EITI is to persuade governments – along with oil, gas and mining companies – to report payments from the companies to the governments. That way the EITI will be able to verify the payments and determine whether or not they end up in the right hands. The ultimate objective is to ensure that a country's natural resources benefit the population as a whole. Twenty-five countries are reporting in accordance with the EITI standard and another 15 are preparing to do so. Virtually every public oil, gas and mining company is supporting the initiative, not to mention the backing of many voluntary organisations. More than 70 investors have lent their formal support to EITI, sending an unmistakable signal to governments and companies with mining operations that shareholders value transparent reporting.

A representative of the Council sat in on the February EITI board meeting in Oslo to better understand the activities of the

initiative. A great many other observers from various stakeholders (governments, companies, investors and voluntary organisations) were there as well. The board is made up of representatives of the various stakeholders. While the board members disagreed on a number of issues, they all exhibited a strong desire to promote greater transparency. The EITI is indisputably a vital mechanism for putting together reporting standards, as well as a venue for discussing these issues.

The Council and other investors that back the EITI teleconference regularly to exchange information and talk about the activities of the initiative. The forum serves as a foundation for investor collaboration on transparency matters. Some 30 investors, along with the AP Funds that make up the Ethical Council, wrote letters to Natural Resources Canada and the American Securities and Exchange Commission (SEC) demanding the adoption of a uniform global standard for tax revenues and royalty income from mining companies.



CLIMATE CHANGE – A THORNY ISSUE IN THE ABSENCE OF GLOBAL REGULATION

Although world leaders set a target at the 2009 United Nations Climate Change Conference in Copenhagen that the average temperature on earth should not rise more than two degrees centigrade above pre-industrial levels, policy measures for meeting the target are conspicuous by their absence. Both investors and companies need clear long-term ground rules in order to evaluate and plan their investment decisions.

GLOBAL WARMING – NO LONGER IN DOUBT

The UN Intergovernmental Panel on Climate Change (IPCC) published its fifth evaluation in 2013 of the current state of knowledge in the field. The first report was released seven years ago – the new one makes it eminently clear that global warming is now an undeniable fact. For example, the Greenland ice sheet and glaciers around the world are continuing to shrink, while the oceans are getting warmer at deeper and deeper levels. Ecosystems increasingly exhibit the effects of climate change.

The report was followed by the 19th Climate Change Conference in Warsaw in November to discuss the United Nations Framework Convention on Climate Change and negotiations for a successor to the Kyoto Protocol. The focus was on preparing for the 2015 conference in Paris to draw up a new protocol. While expectations are high, many thorny issues demand resolution if the 2015 conference is to succeed.

COLLABORATION WITH OTHER INVESTORS

The Ethical Council is continuing to support the Institutional Investors Group on Climate Change (IIGCC).

The goal of the IIGCC is to cobble together clear, long-term regulations that make it easier for institutions to invest in conversion to a low-fossil-fuel economy.

The history of the EU Emission Trading Scheme and the difficulties the UN has faced in trying to hammer out an effective treaty after the Kyoto Protocol are causing problems for both companies and institutional investors. They need clear ground rules in order to determine whether or not potential investments will be financially sustainable.

The IIGCC published a report in 2013 addressing expectations of investors for the next EU Climate Change Plan for 2030. Among the requests are a pan-European price signal to replace the fragmented national systems that currently call the shots. The EU emission trading scheme has the potential to send that kind of signal but only if the current surplus of emission allowances is eliminated and some type of mechanism is adopted to minimise volatility. The report also stresses the risks associated with both Basel 3 and Solvency 2, as well as prospects for investing in low-fossil-fuel infrastructure.

THE ETHICAL COUNCIL ARRANGES A CLIMATE CHANGE SEMINAR

The Council arranged a seminar in autumn 2013 about financing the transition to a low-fossil-fuel economy.

Policymakers, trade associations and investors were invited to listen to Michael Liebreich of Bloomberg New Energy Finance, a leading international expert on investment in renewable energy. He argued that the combination of declining long-term production costs and more efficient wind power, solar energy and batteries are paving the way for cost-effective conversion to a low-fossil-fuel economy. The challenge is to decide what kind of investments will both benefit from and contribute to the transition. Industries associated with renewable energy have been consolidating rapidly and experiencing volatile share price performance. Mr Liebreich identified infrastructure investments as offering the greatest potential going forward.

HUMAN RIGHTS AND THE ENVIRONMENT

Faulty processes for stakeholder dialogue hurt workers, local populations and the environment. Improving these processes is a key component of the Ethical Council's preventive dialogues.

PALM OIL – COLLABORATION FOR SUSTAINABLE PRODUCTION

Palm trees produce the most popular vegetable oil in the world. Not only is it used for cooking, but it is an ingredient of foods, cosmetics, soaps, detergents, biodiesel fuels and many other products. Nevertheless, palm oil production poses many environmental and social challenges. The Council joined a collaborative Principles for Responsible Investment initiative with other investors in the autumn of 2013.

The members of the PRI working group on palm oil are working together to raise investor awareness and reach a consensus on developing a sustainable product. The group is supporting the Roundtable on Sustainable Palm Oil (RSPO), an industry initiative, whose guidelines they consider to be best practice in the area. The investors will pursue dialogue with palm oil manufacturers in 2014 to encourage more sustainable approaches.

In 2013 the Council participated in an international investor initiative for the purpose of persuading companies to produce and purchase certified palm oil. The Council will continue to be involved in this area, primarily via the PRI Working Group, in 2014.

FORCED LABOUR IN THE COTTON FIELDS

A significant percentage of the world's cotton is grown in Uzbekistan and sold on the international market with poor traceability. Much of Uzbek society grinds to a halt during harvest. The government demands the participation of teenagers, as well as employees of the public and private sectors. Both forced labour and unacceptable working conditions have led to involvement by the Ethical Council.

Uzbekistan is a world-leading cotton producer. Meanwhile, the country demonstrates very little respect for human rights. Freedom of association and expression is limited and the authorities are unfavourably disposed to international organisations. Both ILO and voluntary organisations report that child and forced labour are common during the government-directed cotton harvest. Every autumn the authorities close schools around the country and send students out to pick cotton. The 2013 season was no exception. Upper secondary school students, not to mention public employees and many workers from the private sector, were mobilised for two months. While fewer children under 15 participated, they suffer as well since some of their teachers are out in the fields.

Since 2012, the Ethical Council has carried on dialogues with **OLAM INTERNATIONAL** and **DAEWOO INTERNATIONAL**, both of which buy cotton from Uzbekistan. The Council is asking that the companies

exert their influence to persuade the government to stop child and forced labour, as well as to allow the ILO to conduct independent inspections during the harvest season. Through its participation in the Association of Cotton Merchants in Europe (ACME), Olam proactively encouraged the Uzbek government to take the first step of outlawing child labour. Once ACME had achieved that objective after several years of trying, it turned its attention to obtaining permission for ILO to send in inspectors. By virtue of the garment factories that Daewoo operates in Uzbekistan, it has been able to bring up these issues directly with government representatives. As a result of the collective effort, ILO observers were permitted to inspect the 2013 harvest though the delegation could not move about freely.

A group of investors in which the Council was part has learned that getting Uzbek authorities to engage in dialogue is no easy task. Despite valiant attempts, the team was denied entry permits in autumn 2013. A few steps have been taken in the right direction. One is the presence of ILO observers. There are indications that the cotton harvest has begun to be mechanised but that the process will take some years. The Council will continue to promote forward movement.

TOBACCO – GROWING FOCUS ON COMBATING CHILD LABOUR

Tobacco companies purchase most of their raw materials from growers in Africa, Central Asia, Southeast Asia and the United States. Corruption and environmental devastation, as well as violations of human and workers rights, are everyday occurrences in many of these countries. Child labour is also a problem, particularly in Africa. Cultivation, harvesting and processing of tobacco leaves is hazardous to the health if improperly performed.

Shortly after embarking on a preventive initiative in early 2012, the Ethical Council discovered that only half of the suppliers had adopted any kind of monitoring or action programme to address these issues. Pressure by purchasers of tobacco leaves for elimination of child labour was woefully inadequate.

The Council has been able to establish that essentially all **EIGHT COMPANIES** with which it was in contact in 2013 have reinforced their processes, subjecting their suppliers to stricter requirements. The companies and suppliers are collaborating to improve both working conditions and environmental protection.

Under new management that includes Save the Children, the Eliminating Child Labour in Tobacco Growing Foundation (ECLT), an industry initiative, has turned up the heat. For

example, ECLT, ILO and the Malawi government co-organised a child labour conference in 2012 that produced concrete results. The foundation is also conducting projects in Tanzania, Kyrgyzstan and Uganda. In the wake of informational campaigns, 80 percent of Ugandans have the kind of insight into the problem of child labour that is needed if any changes are to occur.

While the potential for minimising child labour among tobacco growers has taken an important step forward, the problem is far from resolved. The impression of the Council is that active dialogue has not targeted these growers to the same extent as other industries. One reason may be that many investors avoid holdings in tobacco companies. That makes it all the more important that the AP Funds and other investors who have not divested the industry per se demand that tobacco companies continue to pursue their sustainability efforts.

CHILD LABOUR AMONG COCOA GROWERS

Ivory Coast grows more than 35 percent⁵ of the world's supply of cocoa. Cocoa is often grown at small family plantations that use children to cultivate, harvest and process the beans.

For the past two years, the Council has been backing a project to ensure that child labour is abolished at cocoa plantations. Dialogues have been conducted with a number of cocoa purchasers. For example, the dialogue with Singapore-based **OLAM INTERNATIONAL**, addresses purchases of both cotton from Uzbekistan (see page 12) and of cocoa from Ivory Coast. Olam purchases cocoa beans both directly from growers and on the open market. Whenever the company has a relationship with individual growers, it can influence cultivation methods. Olam includes clauses prohibiting hazardous child labour in its agreements and trains growers. The company's revised supplier code of conduct also prohibits child labour. Olam's collaboration with the Fair Labour Association is another key component of its proactive effort to combat child labour. The Council will continue to monitor developments and support the project.

DEPLORABLE WORKING CONDITIONS AT BANGLADESH GARMENT FACTORIES

The Ethical Council has long conducted dialogues with companies that purchase goods from low-cost countries. The dialogues address working conditions, as well as health and safety both for both preventive purposes and for handling incidents that have already occurred. The companies are responsible for their suppliers acting in a socially responsible manner. The task is not always so easy given that there can be any number of sub-chains.

The working conditions of garment workers in low-cost countries are frequently unacceptable, including wages that cannot feed a family, unpaid overtime, unhealthy work environments and lack of basic human rights. As the slew of tragic accidents at Bangladesh garment factories over the past few years attest to, the work environments can be deadly. Mass fatalities due to inadequate fire protection measures and collapsing roofs are common occurrences. The frequency of such accidents is alarming. Another tragedy took place in April 2013 when Rana Plaza, an entire building, caved in due to construction fraud and more than 1,000 workers lost their lives.

Many garment manufacturers are working on improving working conditions at the factories by inspecting their suppliers. They check a supplier's fire procedures and fire protection equipment while ensuring that fire exits are not locked and evacuation routes are not blocked. Knowledge sharing by means of comprehensive training programmes, often in collaboration with other purchasers and trade associations, are more common nowadays.

Along with many other Swedish and international institutions, the Ethical Council signed an investor initiative in 2013 urging more than a hundred companies to assume greater responsibility by affixing their names to the Accord on Fire and Building Safety in Bangladesh. As of April 2013, Hennes & Mauritz, though few American companies, was among the signatories. Those who sign the agreement pledge to collaborate on improving safety procedures at Bangladesh factories.

⁵ICCO Quarterly Bulletin of Cocoa Statistics, Vol. XXXIX, No. 3, Cocoa year 2012/13.

PHARMACEUTICAL INDUSTRY

Many pharmaceutical manufacturers these days are making fewer active ingredients and purchasing them instead from China, India and other countries. The local water purification systems in these countries are frequently incapable of preventing hazardous and unhealthy substances from being discharged into rivers and lakes. One consequence is that bacteria spread throughout the ecosystem and give rise to resistant strains, a perilous course of events.

The Ethical Council began collaborating in 2013 with the Church of Sweden asset management team and PGGM, a Dutch pension manager, to address the pharmaceutical industry and discharges of active ingredients. The Church visited Hyderabad, India in 2012 and concluded that water pollution was a major problem.

The initial focus is on a handful of manufacturers with production in emerging economies in order to more fully identify reasonable requirements for effective water purification by their suppliers and regular inspection of waste water discharged from factories.





**SUSTAINABILITY
EFFORTS BEAR
FRUIT**

TELECOM INDUSTRY

The telecom industry is a positive force in promoting democratic development and freedom of expression. Nevertheless, governments can employ censorship and surveillance to misuse technology, violating the right to privacy and freedom of expression. What should an operator do when a country's security apparatus requests information about its users? How can the operator make sure that the person issuing the request is legally entitled to do so and will not misuse the information? The Ethical Council has long pursued dialogue with a number of telecom operators about managing potential violations of privacy and human rights.

A number of surveillance scandals and violations of freedom of expression in the telecom industry have been reported through the years. The issue took centre stage in 2013 when Edward Snowden blew the whistle on the global mass surveillance system operated by the American National Security Agency (NSA).

The Council has been involved in the telecom industry ever since its inception in 2007. Telecom operators must be encouraged to do business in countries under dictatorial rule as an incentive to democratic development. Meanwhile, they need to manage the risks associated with potential violations of privacy and freedom of expression in a socially responsible manner. Corruption, particularly in connection with the sale of network licences, is very common in many countries. Various telecom operators often face similar challenges. With that in mind, the Council believes that the operators should collaborate to articulate joint principles for managing the risks they encounter.

SURVEILLANCE MAY CONSTITUTE A VIOLATION OF HUMAN RIGHTS

How can operators make sure that the person issuing the request is legally entitled to do so and will not misuse the information? How can they make sure that customer data are not misused? How should customers be informed that a network is going to be shut down? How do operators assess risks regarding human rights before starting up in a new country and how are the risks subsequently managed? What do operators do to combat corruption? These are only some of the questions that the Council has explored in depth in order to be more familiar with the procedures that telecom operators have adopted and the risks that they manage.

PREVENTIVE DIALOGUES WITH TELECOM OPERATORS

The Ethical Council analysed [NINE TELECOM OPERATORS](#) in 2013 on the basis of their efforts in the areas of anti-corruption, human rights, freedom of expression and privacy. The purpose was to bring strengths and vulnerabilities to light as reflected in external policies, sustainability reports and other information intended for the general public. The Council concluded that the operators need to look more closely at the ways that they influence the level of human rights in a country. Policies covering freedom of expression, privacy and whistleblowing exhibited a number of flaws. Most companies were furthest along when it came to anti-corruption matters. The Council followed up on the inadequacies identified at the various operators by means of e-mails, phone calls or face-to-face meetings.

COLLABORATION AMONG TELECOM OPERATORS

Given that these problems pervade the entire industry, individual operators may have trouble acting alone. The Telecom Industry Dialogue was formed in 2011 to jointly manage risks associated with

violations of privacy and freedom of expression. The group began collaborating in 2013 with the Global Network Initiative (GNI) for the purpose of sharing best practice, learning and joint tools. GNI consists of human rights organisations, companies, academicians and investors. The initiative supports human rights, as well as efforts by the Information and Communication Technology industry to protect privacy and freedom of expression. The Council was member of GNI in 2013.

The group has drawn up principles for handling the above risks on the basis of the UN Guiding Principles on Business and Human Rights. Collaboration through the Industry Dialogue will permit telecom operators to draw up joint ground rules. The group includes Alcatel-Lucent, AT&T, Orange France Telecom, Millicom, Nokia Solutions & Networks, Telefonica, Telenor, TeliaSonera and Vodafone. Tele2, Deutsche Telecom and British Telecom collaborate through the Global and European Studies Institute (GESI), which includes a couple of Industry Dialogue members as well.

SURVEILLANCE TO COMBAT CRIME

Public authorities typically engage in surveillance of telecommunication networks to prevent crime or track down offenders. Both the police and security apparatus can legally demand virtually any data they want from an operator, assuming that certain criteria have been met and a court judgement has been obtained. Many countries provide the security services with direct access to a telecommunication network and authorisation to obtain whatever data they are looking for without special permission or assistance from the operator. Even in such cases, surveillance is not always justified – privacy and freedom of expression may be violated.

TRANSPARENCY IS VITAL

Transparency when it comes to official inquiries about data integrity and closure of networks is vital to ensuring that public authorities respect human rights. The particular content and procedures for reporting are open to discussion. GNI and the Industry Dialogue are discussing a possible standard – for example, if an authority submits an inquiry about 50 users, should it be regarded as one inquiry or 50?

Governments need to ensure transparency as well. The Swedish Government's annual report describes the application of regulations about secret wiretapping and surveillance of telecommunication networks in the Code of Judicial Procedure. The report lists the number of such inquiries that Swedish courts have granted, the number that they have denied and the types of suspected offences involved. Because the report does not include inquiries by the security service, an overview of surveillance operations is not possible. All EU Member States are required to file a similar report.

MINING INDUSTRY

The mining industry faces major challenges when it comes to human rights, corruption, health, safety and the environment. Thus, making sure that mining companies establish effective preventive procedures for managing sustainability risks is of the utmost importance. Since 2011, the Council has focused on the mining industry and the tools it has developed to operate in a socially responsible manner.

In collaboration with the Seventh AP Fund and PGGM, a Dutch pension manager, the Ethical Council has followed some 30 mining companies since 2011. The focus is on preventive sustainability efforts by the companies.

The project is based on public corporate policies and strategies as analysed on the basis of the ten sustainability principles of the International Council on Mining and Metals (ICMM). After analysing the strengths and vulnerabilities of the various companies, the Council has dialogued with them about the results. The great majority of the companies have made improvements, while a couple of them have not been open to constructive dialogue. The mining project is preventive in nature. The analysis has generated proposals for improvements, as well as food for discussion rather than rigid demands. The Council has decided to examine two of the companies in greater detail. The first one is **ZIJIN MINING GROUP CO.** (China), which scored poorest in the original analysis. The company, which has experienced recurring problems for a number of years, reported incidents involving the environment and violations of human rights. The second company is **BARRICK GOLD** (Canada), whose dialogue with the Council about a policy on discharges of mine waste into river systems has proven unsatisfactory.

The Council will continue dialoguing with the mining industry, which faces many challenges. The magnitude of the changes that have been adopted in terms of preventive efforts by the companies will not be evaluated until late 2014 or early 2015 so that they have a reasonable amount of time to report on what they have accomplished since the dialogue began.



SOUTH AFRICA – A LAND OF OPPORTUNITIES AND CHALLENGES

South Africa is rich in mineral resources. The mining companies have a series of challenges to consider, particularly major income gaps, high unemployment and the social tensions arising from the legacy of apartheid. Meanwhile, the heavy environmental impact of mining operations must be addressed in a socially responsible manner. The purpose of the Council's trip to South Africa was to attend the annual Principles for Responsible Investment conference and visit companies.



SOUTH AFRICA

POPULATION: Approximately 53 million people.

UNEMPLOYMENT: Approximately 25 percent, around 40 percent among young people.

APARTHEID: Abolished in 1994. Major social tensions remain.

WIDESPREAD POVERTY: More than 25 percent of the population lives at or below the poverty line for access to food, which is R305 per month.

AIDS/HIV: An estimated 12 percent of the population has been exposed to the HIV virus.

ENVIRONMENT: Many areas suffer from water shortages and compromised biodiversity due to plantations, mining and urbanisation.

Source: MSCI ESG Research

Mining companies encounter social tensions in connection with major income gaps, high unemployment, and large numbers of unskilled or low-skilled immigrant workers from neighbouring countries. The situation calls for a socially responsible approach. Mining operations affect communities, as well as human and animal habitats. Strikes and labour disputes over wages and working conditions are far from uncommon in mining and other industries. An additional challenge comes from the environmental impact of mining, particularly in terms of biodiversity and access to water, exacerbating social tensions in nearby communities. Mining, particularly extraction of platinum, is a water-intensive activity. Many areas suffer from water shortages, sometimes so severe that the authorities impose restrictions on mining companies to ensure that the local population has enough.⁵

SOCIAL CHALLENGES

The mines attract many job seekers, and the shanty towns that spring up around them are overcrowded – housing standards are poor and residents are frequently consigned to rudimentary hovels. High indebtedness among the poor is a growing social problem. Many of them are at the mercy of loan sharks who charge exorbitant interest rates, leading to debt traps that are hard to get out of, further exacerbating social tensions.

FREQUENT ACCIDENTS AT THE WORKPLACE

An estimated 500,000 people work for mining companies. The frequency of accidents is alarmingly high. The mining industry reported 3,105 accidents and 112 deaths in 2012⁶. By way of

contrast, Australia has approximately 245,000 mine workers (the world's largest mining country) only five of whom died in 2012.⁷ South African mining is more labour-intensive than its Australian counterpart, including a large percentage of low-skilled workers and less use of sophisticated equipment. The mines are often deep, adding stress to the work environment.

TRADE UNIONS ARE POWERFUL

South African trade unions have had a key political and social role to play throughout the nation's history. In recent years the traditional National Union of Mineworkers (NUM), which has ties to the African National Congress, has experienced competition from the Association of Mineworkers and Construction Union (AMCU), some of whose members have left the NUM. The unions demand wage increases far greater than inflation while both commodity prices and the earning power of mining companies have declined in recent years. A number of companies have resorted to layoffs and adopted new technologies that automate some of the tasks performed by low-skilled workers in particular. Many unions use strikes to press their demands. Conflicts in 2012 between the two unions and the mining companies over wage increases and improved working conditions led to violence and wildcat strikes. A strike by 3,000 workers at the Marikana mine, which is operated by Lonmin, ended tragically when the police intervened and 46 workers were killed. Collective bargaining in 2013 went relatively smoothly at both the gold and platinum companies.

PREVENTIVE DIALOGUE WITH SOUTH AFRICAN MINING COMPANIES

The Ethical Council visited five mining companies (**GOLD FIELDS**, **ANGLO AMERICAN PLATINUM**, **LONMIN**, **ANGLOGOLD ASHANTI** and **IMPLATS**) to discuss health, safety, environmental impact and workers rights. Collective bargaining was under way at the time. The Council brought up the issue of handling 2013 negotiations in a way that would avert the kind of tragic violence that had occurred the previous year. The relationship of the companies to employee housing, personal debt and other conditions were also on the agenda. Many of the companies provide preventive information and training to help employees and nearby residents avoid debt traps.

The Council also met with **EXXARO RESOURCES**, which is devoted primarily to coal mining but plans to invest in renewable energy as well. The government has targeted reduction of coal dependency from 95 percent to 65 percent by transitioning to alternative sources such as wind power, solar energy and nuclear energy. The Council's discussion with Exxaro focused largely on renewable energy.



South Africa is dependent on coal and releases more greenhouse gases than any other country on the continent. It ranks 20th on an international scale. The country is likely to adopt a carbon tax in 2015⁵ – most industries, including mining, will feel the impact. At this point nobody knows exactly how the tax will be designed or what kind of practical consequences it will have.

The Council also visited **MTN GROUP**, a telecom operator that does business in many African and Middle Eastern countries. Among the topics that came up were the company's policies in the areas of human rights, anti-corruption, protection of user privacy and freedom of expression.

⁵ The Times, 4 October 2013, Department of Water Affairs.

⁶ <http://sheqafrika.com/mining-safety-statistics/>.

⁷ www.safeworkaustralia.gov.au/sites/swa/statistics/work-related-fatalities/pages/worker-fatalities.

⁸ The carbon tax policy was circulated for comment in May 2013 and is expected to be adopted as of 1 January 2015.

CODE FOR CORPORATE GOVERNANCE

CLEAR SUSTAINABILITY REQUIREMENTS FOR THE JOHANNESBURG STOCK EXCHANGE

The King Report on Corporate Governance contains recommendations for listed companies concerning the composition of boards, the majority of whose members should be independent. Companies are obliged to comply or explain any divergence from the code.

The code also recommends that sustainability reporting be incorporated into financial reports and that the Global Reporting Initiative (GRI) be followed. Because the code is part of the listing agreement for the Johannesburg Stock Exchange, the companies are more transparent when it comes to sustainability issues than their counterparts in many other parts of the world.

THE WORKING PROCESS OF THE ETHICAL COUNCIL

The activities of the Ethical Council help reduce the risks and increase the long-term returns on the investments of the AP Funds. The activities proceed from the principles of engagement, action and the need for change with the goal of being a long-term, responsible and committed shareholder. As active, responsible shareholders, the AP Funds help companies around the world operate in a long-term, sustainable manner.

DIALOGUE IS OUR MOST IMPORTANT TOOL

Dialogue is the Council's most important tool for promoting change and persuading companies to act in a more socially responsible manner. The Council supports the AP Funds in exercising active corporate governance by persuading companies to both correct documented violations and engage in preventive efforts.

The Council uses direct dialogue to influence the actions of companies. The Council also participates in a series of international initiatives for the purpose of taking positions as an investor, influencing legislation and self-regulation, and bolstering corporate responsibility.

All four AP Fund that participate in the Ethical Council are signatories to the UN Principles for Responsible Investment (PRI), thereby drawing the attention of investors to environmental and social issues.

The PRI also represent an important platform for creating the conditions under which international investors can collaborate. Working with other, primarily international, investors, the Council uses letters and public support of various initiatives to demonstrate that environmental and ethical efforts are important for shareholders and that the AP Funds monitor corporate developments in these areas.

REACTIVE EFFORTS IN CONNECTION WITH VIOLATIONS OF INTERNATIONAL CONVENTIONS

The Council's reactive working process is based on a biannual review of the share portfolios of the AP Funds to detect violations of international conventions. Reported incidents are monitored on a continual basis between the reviews. The Council pursues dialogue with the companies for which a violation is suspected or has been verified. The purpose of dialogue is to persuade the company to stop engaging in the violation and to adopt preventive measures that will avert future violations. Dialogue is conducted directly by the Council, as well as by its service providers.

DIALOGUE FOR NO MORE THAN FOUR YEARS

The problems at the companies with which a direct dialogue is carried out are deemed to be evident, well documented and amenable to the involvement of the Council. As long as the dialogue is progressing and the Council feels that the company can be positively influenced, time and resources continue to be devoted. Generally speaking, a dialogue is concluded when its objective has been achieved. As of 2014, the Council imposes a time limit of four years on dialogues that concern violations of international conventions. Unless the Council has achieved its dialogue objectives by that time, it will recommend that the AP Funds to divest the company.

DIVESTING A COMPANY RARELY SOLVES ANY PROBLEMS

The Council regards divestment as a last recourse, knowing well that the problem is unlikely to go away. The improprieties will probably continue without pressure from active shareholders that demand improvements.

INFORMATION FROM A NUMBER OF DIFFERENT SOURCES

To monitor the occurrence of incidents, the AP Funds and Council use a large number of sources, including the media, trade association and UN bodies. Nevertheless, there is always the risk that individual incidents will be overlooked. Any information that comes to the attention of the Council about such an incident or violation is incorporated into its systematic process.

PREVENTIVE INITIATIVES

The commitment of the Council is not limited to persuading companies to deal with problems that have already arisen.

Equally or more important are the Council's preventive initiatives, which strive to avert serious incidents and reinforce the sustainability efforts of the companies. In recent years, the Council has placed increasing emphasis on preventive initiatives as a demonstrably effective way of persuading companies to act in a more socially responsible manner.

The dialogues encourage companies to focus more on management of the risks associated with various environmental and social issues, improve their internal processes and make their activities more transparent. The Council analyses a company's strengths and vulnerabilities on the basis of existing corporate disclosures and best practice in the particular industry. In addition to meeting with individual companies for preventive purposes, the Council carries on this type of dialogue with a focus on the particular industry or problem area involved. For example, the Council engages in preventive initiatives that target the mining, tobacco and telecom industries. The Council also conducts preventive dialogue through a number of investor initiatives in which it participates.

Because the dialogues are conducted on a confidential basis, they cannot always be reported to the general public. But the Council embraces transparency and attempts to release as much information about its activities as possible without jeopardizing achievement of its dialogue objectives.

ETHICAL COUNCIL'S WORK PROCESS

STEP IN THE WORK PROCESS	PREVENTIVE DIALOGUE	REACTIVE DIALOGUE (FOR SUSPECTED VIOLATION OF CONVENTIONS)
1. → REVIEW OF THE CORPORATE HOLDINGS OF THE AP FUNDS	The Council receives systematic business intelligence covering approximately 4,000 companies. Among the sources are media, other investors, trade associations, UN bodies and non-governmental organisations.	
2. → IN-DEPTH EXAMINATION	The Council performs a review and overall analysis of companies, industries, problem areas and investor initiatives.	Approximately 100–200 companies every year are reviewed further for suspected implication in violation of international conventions. The review is performed by the Council, other investors and various service providers.
3. → CHOICE OF COMPANIES AND DIALOGUE OBJECTIVES	The Council chooses companies and preventive projects. The choice of focus areas does not represent a statement that some areas are more important than others but is simply a deliberate strategy to devote the resources of the Council to issues that are most likely to benefit from them.	The Council pursues direct dialogue with a number of companies whose violations of international conventions are evident and well documented. In addition, the Council collaborates with various service providers to dialogue with another hundred companies in response to alleged violations of international conventions.
4. → DIALOGUE EFFORTS	In-depth corporate analyses and possible comparisons with minimum requirements and best practice for the industry in question.	Additional pressure, such as collaboration with other investors, submitting proposals to general meetings and voting at general meetings.
5A. → THE OBJECTIVE OF THE DIALOGUE HAS BEEN ACHIEVED	The dialogue has been concluded.	The dialogue has been concluded. The company is closely monitored for five years.
5B. → THE OBJECTIVE OF THE DIALOGUE HAS NOT BEEN ACHIEVED	The dialogue continues.	Unless a dialogue has produced the desired results after four years, the Council recommends that the AP Funds to divest the company. Each AP Fund makes its own divestment decisions. The Council checks once a year to see whether the situation has changed and the company is now operating in compliance with international conventions.

THE ETHICAL COUNCIL – MEMBERS

The Ethical Council consists of one representative from each Fund. The Chair, which alternates between the Funds, was held by the Third AP Fund in 2013 and has now been handed over to the Fourth AP Fund for 2014.



LEFT TO RIGHT: (standing) Christina Kusoffsky Hillesøy (member through January 2014), John Howchin, Ulrika Danielson, Ossian Ekdahl (deputy), Pia Axelsson (deputy), (sitting) Arne Lööv, Nadine Viel Lamare and Christina Olivecrona (deputy). Peter Lundkvist (deputy) is not shown.

NADINE VIEL LAMARE

First AP Fund
www.ap1.se

ULRIKA DANIELSON

Second AP Fund
www.ap2.se

PETER LUNDKVIST (Acting)

Third AP Fund
www.ap3.se

ARNE LÖÖV

Fourth AP Fund
Chairman and spokesperson 2014
www.ap4.se

JOHN HOWCHIN

Secretary-General, Ethical Council
www.etikradetapfonderna.se

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