

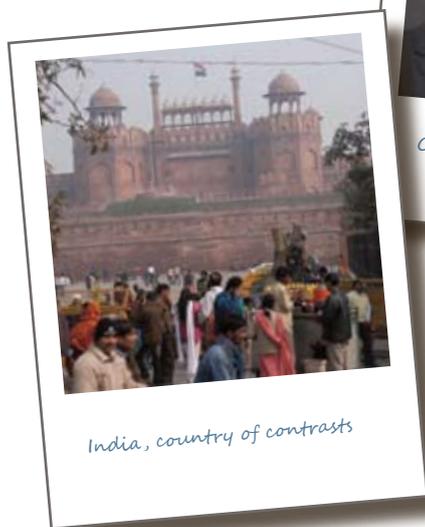
Annual Report 2009

 **The Ethical Council
sets an example
to others.**

*– Nordic pension and investment magazine
NRPN gives the Ethical Council the award
for Best strategy for responsible and
sustainable investment*

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The Ethical Council on a field trip to India.
Read about it on pages 22-23.



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Members of the Ethical Council



Nadine Viel Lamare
AP1 (www.ap1.se)



Ulrika Danielson¹
AP2 (www.ap2.se)

AP3 Tredje AP-fonden



Christina Kusoffsky Hillesöy
AP3 (www.ap3.se)



Annika Andersson
AP4 (www.ap4.se)
Chair and spokesperson during 2010

1. Carl Rosén left his post as Head of Corporate Governance at AP2 and the Ethical Council in August 2009.



Chair 2009
Christina Kusoffsky Hillesöy

Our objective is to influence companies to assume their corporate social responsibilities

2009 began with an uncertain financial market. Many participants were forced to rein in their ambitions regarding ethical and environmental work. The work of the Ethical Council, however, has not been affected by cutbacks. We remain convinced that well-run companies that actively tackle environmental and social issues constitute better long-term investments. As long-term investors, we therefore see our involvement in these issues as a key part of our role in the pension system.

Our aim is to influence companies to address environmental and social issues through active dialogue with management, often together with other investors. Our experience to date shows that dialogue is an effective tool that produces results. During 2009 we concluded four dialogues as a consequence of the companies meeting our demands.

Dialogues can be time-consuming and demand great patience, but as long as we believe that we can influence a company and we see progress, we are willing to invest both time and resources in these dialogues. Our primary objective is to bring about change and we feel that the best way of achieving that is by remaining an owner of the company and trying to exert influence through dialogue. We also see this as our way of taking responsibility as shareholders. If we sell our shares in a company, the problem is seldom resolved – the violation continues, which is why exclusion should be the action of last resort.

VOTING RIGHTS ARE AN EFFECTIVE TOOL

As shareholders, we also have the opportunity to exercise our right to vote at AGMs, which is an effective tool in influencing companies. During 2009, we voted, through the respective AP Funds, on 30 or so resolutions concerning environmental and social responsibility. We also joined forces with the Dutch ABP and New York City Pension Fund to file a resolution at the AGM of the US mining company Freeport-McMoran. The resolution attracted strong support, with 32 percent voting for our resolution that the board should appoint an environmental expert.

COOPERATION BRINGS GREATER WEIGHT

The First, Second, Third and Fourth AP Funds (AP1, AP2, AP3 and AP4) were quick to sign up to the UN Principles for Responsible Investment (PRI). The principles urge investors and fund managers to incorporate environmental, social and corporate governance (ESG) issues into their investment analysis and decision-making processes. Investors are also urged to work together and to apply an active ownership policy. These are principles that the Ethical Council has championed since the start. As more and more investors and service partners sign up to these principles – 662 signatories as of 31 December 2009 – several international initiatives have been launched. Encouraging investors to band together around a common issue, with the aim of influencing a company or an industry, is an effective way of coordinating stakeholders and increasing the scope to bring about change.

The Ethical Council is active in supporting investor initiatives aimed at encouraging companies to improve transparency, act more responsibly and address crucial ESG issues.



If we sell our shares in a company, the problem is seldom resolved – the violation continues, which is why exclusion should be the action of last resort.

In 2009 we supported a climate initiative together with 177 other investors, where we challenged the delegates at the Climate Conference in Copenhagen to take robust action to tackle climate change. Oil sand extraction in Canada and its environmental and social risks are another area of focus for the Ethical Council. A Council representative visited Canada with other investors to gain a deeper understanding of the challenges facing the oil industry. The Ethical Council is also involved in an initiative to increase the transparency and reporting concerning oil sand extraction in Canada. In Sweden, the Ethical Council supported a move to pressure the country's one hundred largest listed companies to strive for value creation that is responsible and sustainable in the long term. You can read more about these and other initiatives in which we have been involved later on in the report.

WE ARE EXPANDING OUR RESOURCES

It is gratifying to see the work of the Ethical Council recognised. 2009 saw us win an award for best SRI strategy since, according to the jury, we have “the most well-developed process and a level of transparency that is necessary to achieve change” and “the Ethical Council stands as a role model to others”.

With our work on environmental and ethical considerations becoming ever more wide-ranging, we have decided to strengthen our resources by appointing a Secretary-General. The key task of the Secretary-General will be to coordinate our company dialogues and the investor initiatives supported by the Council, as well as helping to develop our strategies. The purpose of this appointment is to make us even more effective and focused in our strategy, and to develop our preventive and proactive work. We look forward to continuing our active ownership work in 2010.

Stockholm, March 2010



Christina Kusoffsky Hillesöy
Chair of the Ethical Council, 2009



The Ethical Council
strengthens its
resources by
appointing a
Secretary-General.



John Howchin
Secretary-General

Three questions for the Ethical Council's new Secretary-General

On 1 March 2010, the Ethical Council is strengthening its resources by employing John Howchin as Secretary-General.

WHAT IS YOUR BACKGROUND?

I have been working on environmental and sustainability issues practically all my life. I was born and grew up in Västerås, Sweden, and this is where my interest in corporate risk management and shareholder influence comes from. ABB is a key feature of the business landscape in Västerås and the company's fortunes in the 1990s, which included pay disputes, the Bakun Dam in Malaysia and ill-advised investments such as Combustion Engineering, whose asbestos problems almost broke ABB, stimulated my interest in how companies are managed and also what role shareholders play, or at least should play. Bakun, an enormous dam project in Malaysia, is also an example of the inherent contradictions of globalisation, with a nation in growth and its ensuing energy needs on the one hand, and on the other hand the native population and the enormous areas of pristine rainforest. These are the kinds of contradiction that many companies and their shareholders now have to pick their way through and it is by no means easy.

Over the past ten years, I have been working both as a consultant and directly with investors on how they reasonably can and should take responsibility for their investments. My last position was with Norges Bank Investment Management (NBIM), which manages the Norwegian Government Pension Fund. There I held the position of senior analyst for the corporate governance team, with responsibility for environmental analyses, company dialogues and strategy development. Before that, I worked as Deputy Chief Executive and Research Director at GES Investment Services, a research company for responsible investments.

WHAT ATTRACTED YOU TO THE JOB OF SECRETARY-GENERAL OF THE ETHICAL COUNCIL?

The formation of the Ethical Council has represented a major advance in the scope to influence companies and to become a more active owner. Being given the opportunity to advance this work feels exciting and challenging. The Ethical Council has an excellent reputation among global investors and I aim to protect that reputation. The challenge lies in developing the role, identifying a profile that sits well with the AP Funds and drawing up a long-term strategy. We are only in the early stages of the process, but focus on these issues has grown both in Sweden and abroad.

WHAT DO YOU HOPE TO CONTRIBUTE TO THE WORK OF THE ETHICAL COUNCIL?

The main thrust of the Ethical Council has been to conduct dialogues with companies that can be associated with violation of international conventions. We will retain and build on this method, but I also hope that we will be able to take a more preventive approach, for example by going into high-risk sectors and identifying companies that are poorly equipped to manage ESG issues – and achieve improvements before serious incidents occur. The Ethical Council has taken part in a number of such initiatives, but I hope we will be able to take our proactive work further.

About the Ethical Council

AP1, AP2, AP3 and AP4 are buffer funds in the Swedish national pension system, managing the pension capital accrued by everyone who has ever worked in Sweden. In 2001, the four competing funds were given a common mission: to invest their pension capital in order to achieve the greatest possible benefit for the pension system and generate high long-term returns with a low level of risk. In so doing, the funds should take ethical and environmental consideration, but without compromising the overall objective of attaining high returns.²

TOGETHER WE ARE STRONGER

Since 2007, AP1, AP2, AP3 and AP4 have been coordinating their work on environmental and ethical issues through the joint Ethical Council. The purpose of the Council is to join forces to work for positive change in companies outside Sweden associated with violations of international conventions on the environment and human rights.

The Ethical Council consists of an ordinary member from each Fund. The Chair, which alternates between the Funds, was held by AP3 in 2009 and has now transferred to AP4 for 2010.

The core values of the Ethical Council

As part of the Swedish pension system and in their capacity as a Swedish public agency, it is only natural for AP1-AP4, and in turn the Ethical Council, to apply the same values as the state of Sweden, where democracy and the equal value of all people are key components. These values manifest themselves in the international conventions signed by the state of Sweden, including conventions on human rights, labour law, corruption and inhumane weapons, and through the Swedish support of initiatives such as the UN Global Compact and the OECD's guidelines for multinational companies. In its work, the Ethical Council maintains that all the conventions to which Sweden is a signatory are of equal value and thus must be complied with. This point of departure is also supported in decisions and declarations from various UN bodies stating that human rights are universal, inseparable, interdependent, interrelated and all of equal importance.

THE WORK BASED ON THESE VALUES COMPRISES TWO PARTS

- Reactive work that involves identifying companies which can be associated with breaches of a convention. Through dialogue and other means, the Ethical Council works to influence companies to address the violations and to implement preventive systems and measures to avoid similar breaches in the future.
- Proactive work where, through various industry and investor initiatives, the Ethical Council works to influence companies to improve their policies and processes, their transparency and to address crucial ESG issues in general.

By basing the work of the Ethical Council on conventions signed by the state of Sweden our work is grounded in a clear set of values that are increasingly accepted among international investors and companies. Underpinned by these values, the actions taken by the Ethical Council can have greater impact due to other investors and companies sharing the same views. This generates real power to achieve change.

Key advantages of the Ethical Council

- The combined assets of the four Funds, at over SEK 800 billion, increase the leverage to influence a company compared to individual action.
- The Ethical Council is an attractive partner for other international investors with a similar environmental and ethical agenda, which further increases the scope to exert an influence.
- Cooperation within the Ethical Council leads to greater efficiency in the work of the Funds, as expressed in an increased number of company dialogues, an increased number of international investor initiatives and more conferences at which the Council is represented.

² See the preamble to the National Pension Insurance Funds (AP Funds) Act 2000:192, which governs the work of the Funds.

The work of the Ethical Council

The four AP Funds that are members of the Ethical Council invest globally in diversified portfolios of several thousand companies. A large proportion of the assets of the Funds are passively managed, which means that the Funds have a wide spread of ownership, with relatively small stakes in a range of companies. Obviously, the Ethical Council does not have the resources for active management in all of the holdings. The Council therefore applies a systematic process for identifying where active management will reap the greatest benefit. The process helps us to ensure a good spread of issues, geographical locations and assets, so that not all of our work is derived from the same industry or relate to the same issues.

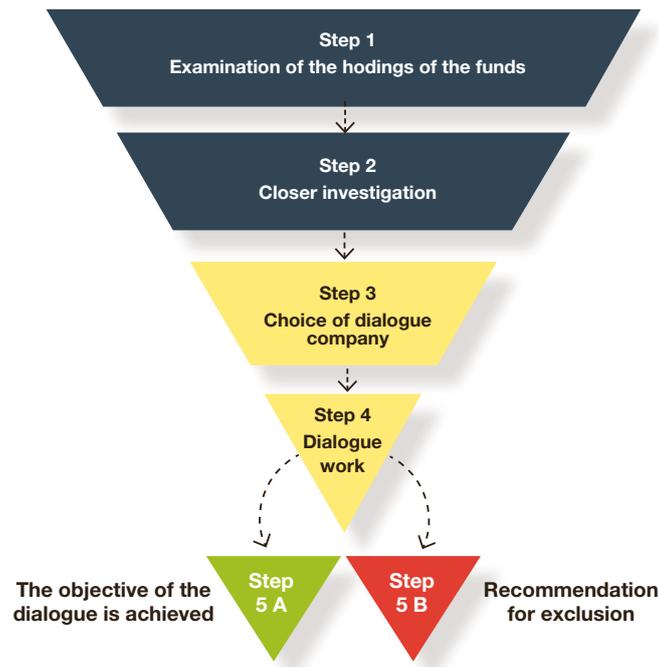
A SYSTEMATIC PROCESS IN FIVE STEPS

The working method of the Ethical Council is based on a monitoring of the portfolios of the four AP Funds for violations of international conventions. The goal of the Ethical Council is to conduct an active dialogue with companies that breach conventions, with a view to driving them to take action. The examination is carried out with the help of an external consultant who, on a daily basis, seeks out and gathers in relevant information from a large number of sources, including various UN sources, the media and reports from a range of voluntary and stakeholder organisations. The shareholdings of the AP Funds are matched against this database and in cases of reported incidents involving violations of international conventions, these companies are investigated further. The task of the consultant is to verify the sources and make contact with the company for their comments on the reported violations.

Of the companies with verified violations, a number are chosen by the Ethical Council and become the subject of a dialogue. A dialogue may last for several years, but as long as it continues to move forward and the Ethical Council believes in the possibility of influencing the company in a positive direction, the Council is willing to devote time and resources to the dialogue.

On behalf of the Ethical Council and other clients, the consultant maintains a dialogue with the companies with which the Ethical Council has chosen not to enter into direct dialogue, but where suspected or confirmed violations have been reported. When the Ethical Council removes companies from its dialogue list as a result of the objective of the dialogue being achieved or the company being excluded, the Council then opens a direct dialogue with new companies. The Ethical Council receives ongoing information on new incidents and monitors the progress of all company dialogues and incidents.

Although a large number of sources are monitored, there is naturally always a risk that something might be missed. If the Ethical Council receives information about a violation by some other means, this is integrated into the same systematic process as the other information.



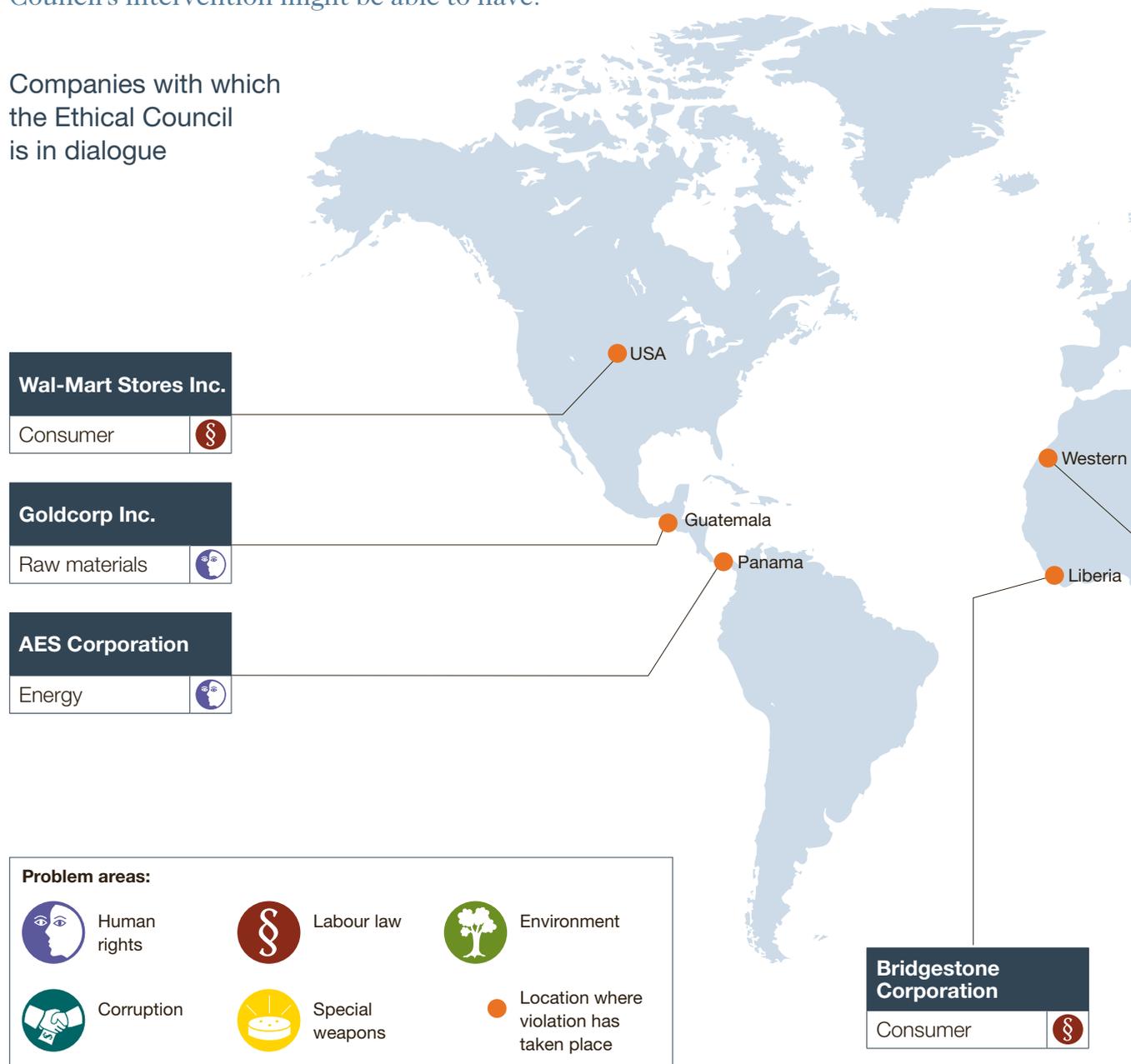
	The consultant ³	The Ethical Council
Step 1 Examination of the holdings of the funds	Systematic monitoring of information on approx. 4,200 companies. Sources include media, stakeholder organisations and UN bodies.	The Ethical Council becomes aware that an incident has occurred in one of its portfolio companies.
Step 2 Closer investigation	Around 100 companies are investigated more closely, based on reports of alleged violations of international conventions.	
Step 3 Choice of dialogue company	A list of companies with documented links to violations of international conventions is published twice a year. A dialogue is also maintained with the companies (under steps 2 and 3) with which the Ethical Council has chosen not to enter into direct dialogue, but where suspected or confirmed violations of international conventions exist. The dialogue with these companies is carried out by the consultant, on behalf of the Ethical Council and other clients.	The Ethical Council takes the initiative to start a direct dialogue. From the list, the Ethical Council chooses 10–15 companies where problems are evident and well documented. The Ethical Council targets these companies with active corporate governance work.
Step 4 Dialogue work		Additional pressure is applied. This includes cooperation with other investors, plus filing resolutions and voting at AGMs.
Step 5 A The objective of the dialogue is achieved	Special monitoring of the company for 5 years.	If the first four steps achieve the desired result, the company is removed from the Ethical Council's dialogue list.
Step 5 B Recommendation for exclusion		If the first four steps do not produce the desired results, each individual Fund makes a decision on the possible sale of its holding based on a recommendation from the Ethical Council. The Ethical Council then contacts the above companies once a year to check whether the situation has changed and to urge the company to operate in line with international conventions.

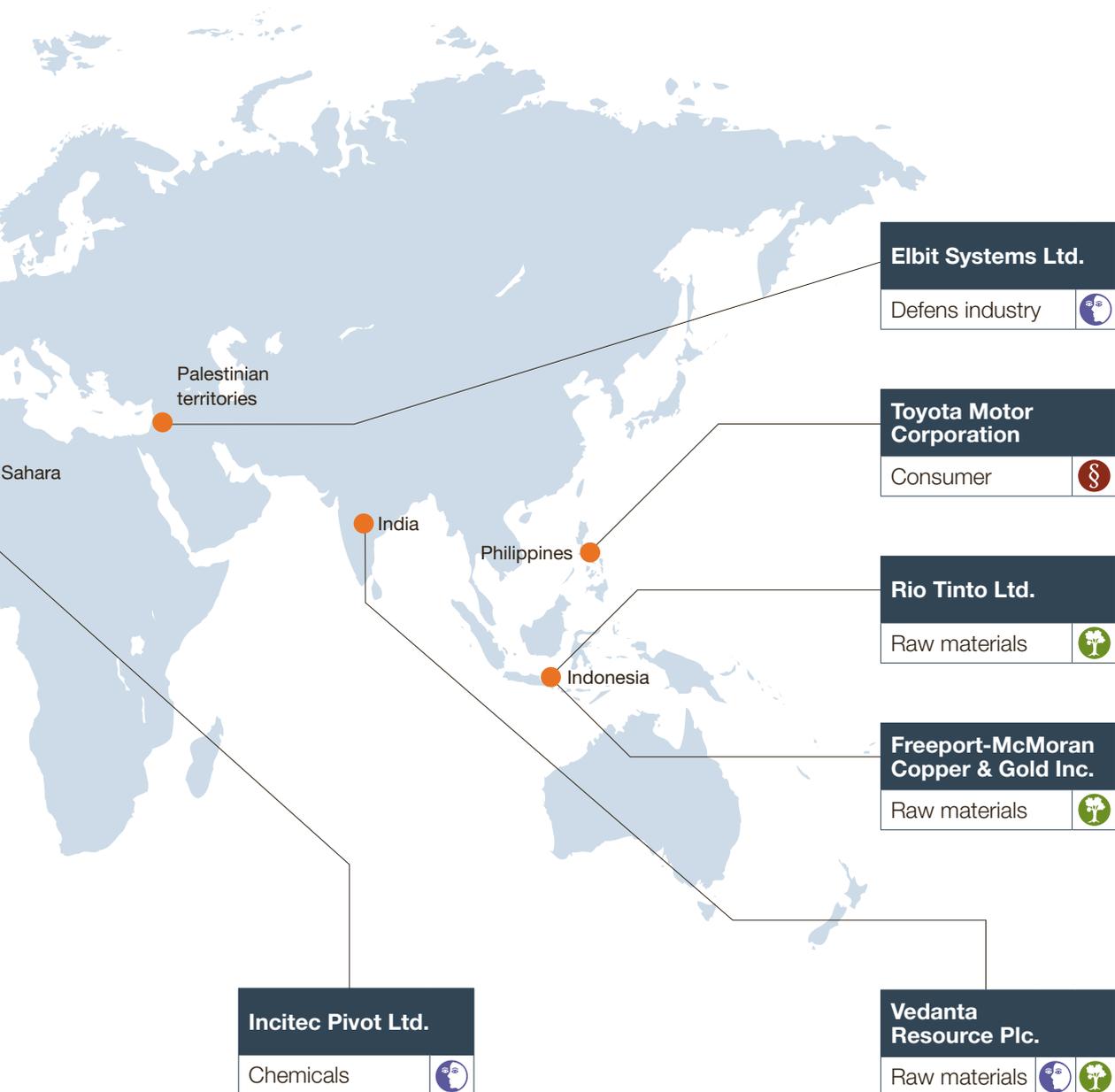
A global focus

The Ethical Council is monitoring a number of cases where companies have been associated with violation of international conventions and principles. The Ethical Council is conducting an active dialogue with around ten of these companies, with a view to driving them to take action.

AP1, AP2, AP3 and AP4 that make up the Ethical Council invest in globally diversified portfolios of several thousand companies. The Ethical Council does not have sufficient resources to adopt active corporate governance measures for all of these, but chooses instead to focus on a selection of companies. The choice of companies depends on the type of violation, where it took place and what impact the Council's intervention might be able to have.

Companies with which the Ethical Council is in dialogue





Companies where the objectives of the dialogue were met in 2009

A company is removed from the Ethical Council's dialogue list when the objectives set by the Council when the dialogue was started have been met. The company is then subject to special monitoring for five years.

Problem areas:

-  Human rights
-  Labour law
-  Environment
-  Corruption
-  Special weapons

Development is rated according to the objectives set in each individual case.

-  No positive development
-  Signs of development
-  Weak positive development
-  Positive development
-  Very positive development

The status of the dialogues refers to development as of 31 December 2009.

Grupo Ferrovial S.A.

Domicile	Sector	Location	Area	Development
Spain	Construction	Poland		 2008 2009

Incident: The company is associated with a road project that infringes on a nature reserve in Poland, contrary to the UN Convention on Biological Diversity.

Objective: For Grupo Ferrovial to strengthen its own guidelines and risk analyses for assessment of environmental risks in connection with similar projects.

Comment: Road building was halted in December 2007 and Grupo Ferrovial has since improved its sustainability policy and its risk analyses for assessment of environmental risks in connection with infrastructure projects. The Ethical Council and other investors have held a constructive dialogue with the company and have expressed support for the improved sustainability work and risk management that Grupo Ferrovial has implemented.

PetroChina Company Limited

Domicile	Sector	Location	Area	Development
China	Energy	China		 2008 2009

Incident: The company is associated with deficient safety procedures and emissions of chemicals into the Songhua River in China, contrary to the Basel Convention on Hazardous Waste.

Objective: For PetroChina to strengthen its guidelines and procedures for safety and environmental work and to pay the fines imposed on it to deal with the consequences caused by the discharge of chemicals.

Comment: In recent years, PetroChina has improved the transparency surrounding its sustainability work. The company has strengthened its procedures for safety and environmental work and now reports on environmental and social issues in its sustainability report. PetroChina has also paid the fines imposed on it to clean the Songhua River.

Thales SA

Domicile	Sector	Location	Area	Development
France	Defence industry	South Africa		 2008 2009

Incident: Thales has been associated with bribery of officials in South Africa, contrary to the UN Convention against Corruption.

Objective: For Thales to increase its transparency with regard to an anti-corruption policy and guidelines for transactions.

Comment: Thales has centralised its sales organisation, developed a robust anti-corruption programme and drawn up a handbook to help staff tackle the problem of corruption. Thales has also taken a leading role in the European defence industry's anti-corruption initiative.

Yahoo! Inc.

Domicile	Sector	Location	Area	Development
USA	IT	China		 2008 2009

Incident: Yahoo has been associated with violations of freedom of expression in China through a joint venture in China disclosing user information about several journalists that later led to their imprisonment. This conduct by the company is contrary to the UN Universal Declaration of Human Rights, which includes the right to freedom of opinion and expression.

Objective: For Yahoo to formulate and implement a policy for human rights and freedom of expression as well as procedures that specifically address how the company will avoid forced complicity in such violations.

Comment: Yahoo has joined forces with other stakeholders to draw up the Global Network Initiative, a code of ethics whose principles and guidelines are designed to reduce the risk of being compelled to assist in violations of freedom of expression and user confidentiality. These principles include analysing country-specific risks before commencing operations in new markets. The initiative is still being implemented and from 2012 will involve external auditing of and reporting on compliance with the principles. Yahoo has also launched its internal Yahoo Business & Human Rights Program to raise staff awareness of the risks concerning human rights for the company.

Companies where the objectives of the dialogue were met pre-2009

2008



BHP Billiton Plc

Incident: Associated with violations of the right to sign collective agreements in Australia, contrary to the ILO Right to Organize and Collective Bargaining Convention.

Objective: For BHP Billiton to alter its employment procedures so that the signing of individual agreements is not a decisive condition for employment and that the employees instead have the right to sign collective agreements.

Comment: With the change of government in 2007 came the introduction of new legislation prohibiting the requirement of individual agreements. The company has confirmed in writing that all individual agreements will be phased out by 1 January 2010.

2008



Chevron Corporation

Incident: Violations of human rights in Nigeria, contrary to the UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials.

Objective: Chevron has adopted a framework, the Voluntary Principles on Security and Human Rights, to safeguard human rights in connection with the work of security personnel. The objective is therefore for the company to report how it has implemented this policy in practice to secure compliance.

Comment: Information from the company confirms that it has integrated the aforementioned industry initiative into its operations in Nigeria.

2007



Halliburton Corporation

Incident: Shortcomings in their corporate governance and bribery in Iraq and Nigeria, contrary to the UN Convention against Corruption.

Objective: For Halliburton to strengthen and implement policies and guidelines on how agents and brokers are used in a business context and to act responsibly with regard to the incidents reported.

Comment: The company has clarified its policy on this issue and strengthened responsibility within the organisation for acting in accordance with the guidelines. The company has also, in conjunction with the sale of the subsidiary which has been at the centre of the investigations, accepted official responsibility for any legal and/or financial consequences of the former subsidiary's actions.

2008



Sodexo

Incident: Inhumane conditions at an immigration removal centre in the UK, contrary to the UN Universal Declaration of Human Rights and the UN Convention relating to the Status of Refugees.

Objective: For the company to formulate and implement a clear human rights policy that addresses particularly sensitive issues such as deprivation of liberty.

Comment: An official report from 2008 confirmed a considerable improvement in the immigration removal centre. The company has also drawn up a human rights policy that has been implemented globally within its operations.

Ongoing dialogues

AES Corporation

Domicile	Sector	Location	Area	Development
USA	Energy	Panama		 2008 2009

Incident: AES has been associated with violations against the rights of the Charco la Pava community in connection with construction of the Chan 75 hydroelectric dam in Panama. The violations have been condemned by the UN special rapporteur on human rights and fundamental freedoms of indigenous peoples and are contrary to ILO Convention 169 concerning Indigenous and Tribal Peoples.

Objective: To suspend construction of Chan 75 until a transparent and inclusive evaluation process has been carried out in accordance with the principle of free prior and informed consent as stated in ILO Convention 169 and in the UN Declaration on the Rights of Indigenous Peoples, or until the company can otherwise show that the rights of Charco la Pava are being respected.

Bridgestone Corporation

Domicile	Sector	Location	Area	Development
Japan	Consumer non-durables	Liberia		 2008 2009

Incident: The company has been associated with child labour at its rubber plantation in Liberia, contrary to the UN Convention on the Rights of the Child.

Objective: For Bridgestone to take concrete measures to prevent the occurrence of child labour and to implement a scrutiny mechanism to secure compliance with this. As a preventive measure, the company should adopt a policy on child labour for all of its operations.

Comment: In 2008, the company signed a collective agreement with the unions to improve the working conditions of employees.

Elbit Systems Ltd. (New)

Domicile	Sector	Location	Area	Development
Israel	Defence industry	Palestinian territories		 2009

Incident: Elbit Systems supplies a surveillance system for the northern and southern sections of the West Bank barrier wall. The sections of the barrier wall that lie on occupied Palestinian territory contravene international humanitarian law (e.g. the Fourth Geneva Convention), as confirmed by the International Court of Justice (ICJ) in the Hague.

Objective: For the company to desist in supplying the surveillance system and associated services for the sections of the barrier wall that lie in occupied territory. The company must also adopt a corporate policy that prevents it from contributing to contraventions of international humanitarian law.

Comment: In the first quarter of 2010, the Ethical Council recommended the four AP Funds to exclude Elbit Systems Ltd since, despite repeated requests by the Ethical Council, the company has refused to comment on the incident.

Freeport-McMoran Copper & Gold Inc.

Domicile	Sector	Location	Area	Development
USA	Raw materials	Indonesia		 2008 2009

Incident: Freeport is associated with serious negative environmental impact through its mining operations in Indonesia, contrary to the UN Convention on Biological Diversity, and with accusations of corruption.

Objective: For the company to report on how it is working to minimise its impact on the environment and to draw up a plan for reinstating the area once mining operations have ceased.

Comment: The Ethical Council and two other investors, the Dutch ABP and the American New York City Pension Funds, filed a resolution at the 2009 AGM demanding the appointment of an environmental expert to the board. The resolution gained 32.5 percent of the votes at the AGM.

Goldcorp Inc.

Domicile	Sector	Location	Area	Development
Canada	Raw materials	Guatemala		 2008 2009

Incident: The Mayan people in communities around the Marlin Mine have accused the company of failing to respect their human rights and rights as an indigenous people, and of polluting the water and contributing to rising tensions, threats and harassment within the communities.

Objective: For Goldcorp to examine its policies, programme for and impact on the local population and to take action to ensure respect for the rights of the indigenous people in current and future projects in Guatemala.

Comment: The Ethical Council visited the Marlin Mine in February 2008 along with some Canadian investors. On the recommendation of this team of investors, an independent assessment of the human rights situation in the area was initiated. During 2010, the company is expected to respond to the conclusions and recommendations arising from the assessment.

Incitec Pivot Ltd. (New)

Domicile	Sector	Location	Area	Development
Australia	Chemicals	Western Sahara		 2009

Incident: Incitec Pivot purchases phosphate from a Moroccan company that is involved in mining phosphate in Western Sahara. Western Sahara, a former Spanish colony, has been occupied by Morocco since 1975 and is on the UN list of Non-Self-Governing Territories which must be decolonised. The exploitation of the natural resources of Western Sahara, against the will of the Sahrawi population, was declared illegal in an opinion issued in 2002 by the UN Under-Secretary General for Legal Affairs. Doing so would be a contravention of the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights.

Objective: For Incitec Pivot to cease its purchases of phosphate from Western Sahara, or to prove that extraction is carried out in accordance with the interests and wishes of the Sahrawi population, in line with the UN legal opinion from 2002. The company must also adopt a corporate policy that prevents it from contributing to breaches of international humanitarian law.

Rio Tinto Ltd.

Domicile	Sector	Location	Area	Development
Australia	Raw materials	Indonesia		 2008 2009

Incident: Through cooperation with Freeport-McMoran Copper & Gold Inc. and its mining operations in Indonesia, Rio Tinto has been associated with serious negative environmental impact, contrary to the UN Convention on Biological Diversity.

Objective: For Rio Tinto to proactively ensure that the necessary measures are implemented so that operations at the Grasberg Mine are in compliance with internationally accepted levels for mining waste management.

Toyota Motor Corporation

Domicile	Sector	Location	Area	Development
Japan	Consumer non-durables	Philippines		  2008 2009

Incident: Toyota Motor has been associated with anti-union activity in a subsidiary in the Philippines, contrary to the ILO Convention on Freedom of Association and the Right to Organise.

Objective: For the company to address the situation in the Philippines and ensure that an independent trade union is able to act freely, and for the company to adopt a group policy for employees on freedom of association.

Vedanta Resources Plc.

Domicile	Sector	Location	Area	Development
Great Britain	Raw materials	India	 	  2008 2009

Incident: Vedanta has been associated with serious negative environmental impact and human rights violations in connection with the establishment of an aluminium mine in India, contrary to ILO Convention 169 concerning Indigenous and Tribal Peoples.

Objective: For construction of the Niyamgiri Mine to be suspended until a transparent and inclusive evaluation process has been carried out in accordance with human rights conventions, or until the company can otherwise demonstrate that the rights of indigenous peoples are being respected.

Comment: During 2009, Vedanta has been criticised by the UK National Contact Point within the framework of the OECD's guidelines for multinational companies for not consulting the indigenous people in advance when planning the aluminium mine in Orissa. The Ethical Council visited Vedanta in India in January 2010.

Wal-Mart Stores, Inc.

Domicile	Sector	Location	Area	Development
USA	Consumer durables	USA		  2008 2009

Incident: Wal-Mart has been associated with systematic violation of workers' rights, contrary to the ILO Core Conventions on labour standards both in its own operations and among its suppliers.

Objective: For Wal-Mart to strengthen its policies and guidelines so that these are aligned with the international guidelines, and to show a credible monitoring system that secures compliance with the guidelines.

Companies where the dialogue has been terminated pending the outcome of ongoing legal proceedings

Chevron Corporation

Domicile	Sector	Location	Area	Development
USA	Energy	Ecuador		  2008 2009

Incident: The company has been associated with environmental destruction in Amazonas, Ecuador, contrary to the UN Convention on Biological Diversity.

Objective: For Chevron to take preventive action by strengthening its guidelines on the environment and undertaking to use the best available technology for recycling across all the company's operations, and to address the specific pollution problems that have arisen out of the company's activities in Ecuador.

Comment: The case is the subject of legal proceedings in Ecuador. The judge in the case has been replaced due to charges of bribery, which has further delayed a verdict. The company denies responsibility for the pollution in Amazonas and claims that it took sufficient pollution control measures before it withdrew from the project. The Ethical Council believes that it has come as far as it can in its active dialogue with Chevron and is now awaiting a verdict in the ongoing legal case.

Duke Energy Corporation

Domicile	Sector	Location	Area	Development
USA	Energy	USA		  2008 2009

Incident: Duke Energy has been associated with serious air pollutants through failure to modernise a number of coal-fired power plants in the USA, contrary to the Convention on Long-range Transboundary Air Pollution.

Objective: For the company to report how the affected power plants will be made more efficient through modernisation and the implementation of technology to measure and reduce emissions of nitrogen oxides and sulphur dioxide, in accordance with the requirements of the US Environmental Protection Agency.

Comment: The company now has flue gas purification technology in place for nitrogen oxides at the eight power stations concerned. Regarding sulphur dioxide, the company has installed flue gas desulphurisation technology at three of the power stations and, according to the company's plans, modern purification technology will be installed at another power station in 2010–11. Two of the power stations are in the process of being decommissioned and will be closed within three to seven years. For the two remaining power stations, there are no plans for closure or to introduce flue gas desulphurisation technology, since these facilities are smaller and only operate for parts of the year. Since 1990, the USA has had a trading system for sulphur dioxide emissions that all the power stations concerned are involved in. Within this system, the company meets all the requirements set by the US authorities.

The Ethical Council believes that it has come as far as it can in its active dialogue with Duke Energy and is now awaiting the outcome of the ongoing legal case between the company and the US Environmental Protection Agency (EPA) regarding this incident.

Companies that have been excluded from all Funds

Below is a list of the companies recommended by the Ethical Council for exclusion by the Fund in question. The recommendation has been followed by all Funds. All of these companies are domiciled in countries that have not signed the international weapons conventions regarding cluster munitions or anti-personnel mines, and are therefore not bound by the provisions of these conventions under national law. This means that there is little scope for the Ethical Council to exert an influence, since the companies are expected to follow national security policy directives.

The Ethical Council has the annual routine of urging these excluded companies to act in compliance with the international weapon conventions.

A more detailed report on these companies is available on the Ethical Council's website: www.ethicalcouncil.com

Excluded 2008

Alliant Techsystems Inc.

Breaching the Convention on Cluster Munitions

GenCorp Inc.

Breaching the Convention on Cluster Munitions

General Dynamics Corporation

Breaching the Convention on Cluster Munitions

Hanwha Corporation

Breaching the Convention on Cluster Munitions

L-3 Communications Holdings, Inc.

Breaching the Convention on Cluster Munitions

Lockheed Martin Corporation

Breaching the Convention on Cluster Munitions

Poongsan Corporation (plus Poongsan Holdings Corporation)

Breaching the Convention on Cluster Munitions

Raytheon Company

Breaching the Convention on Cluster Munitions

Textron Inc.

Breaching the Convention on Cluster Munitions

Excluded before the formation of the Ethical Council in 2007

Singapore Technologies Engineering

Breaching the Ottawa Convention on anti-personnel mines

In the first quarter of 2010, the Ethical Council recommended the four AP Funds to exclude Elbit Systems Ltd, a recommendation that was followed by all the Funds.

Oil sands in Canada

The functioning of our society is dependent on metals, minerals and fossil fuels. Extracting these materials from the crust of the earth always has an impact on people and the environment. At the same time, they are also the raw materials for a large number of other industries. On the one hand, the mining and extraction industry often has a negative impact on the environment, but on the other hand metals are a necessary input for many businesses in our society.

The Ethical Council has been maintaining dialogues with mining and oil companies since early 2007. It is important for the companies to be transparent and for extraction to be carried out in a manner that does not breach international conventions.

To gain a better understanding of the environmental impacts of the mining industry, in 2008 the Ethical Council drew up a report on and visited a mine in Guatemala (the report can be downloaded from www.ethicalcouncil.com). The Ethical Council works with other institutional investors to address individual companies and entire sectors.

GREATER FOCUS ON OIL SAND EXTRACTION

2009 has seen an increased focus on oil sand extraction. Extracting oil from oil sand has been severely criticised by many environmental organisations, since it is more carbon intensive than extraction of conventional oil. The oil sands in Canada is of interest to international oil companies because the supply of conventional oil reserves is falling, while demand for oil is expected to rise. Canada has the second largest oil reserves in the world after Saudi Arabia, thanks to its 173 billion barrels of oil sand.

The Ethical Council is working with other investors through the PRI oil sand initiative to secure improved reporting from all companies with investments in the oil sands in Canada, with regard to their carbon emissions, environmental impact and responsibility towards the indigenous population. The aim is to increase transparency in order to better assess the risks and opportunities that exist. To gain a better understanding of the environmental and social challenges relating to the oil sand, a representative of the Ethical Council travelled to Alberta, Canada in November 2009 on a field trip together with other European and Canadian institutional investors.

FIELD TRIP TO ALBERTA

The field trip included a visit to two oil sand mines operated by Shell, Muskeg River Mine, and Jackpine Mine, which will come on line in 2010. As part of the trip there were also meetings with the Canadian Association for Petroleum Producers (CAPP), a number of oil companies involved in either oil sand mines or *insitu* projects, an environmental organisation and representatives of the Government of Alberta.

Around 20 percent of the oil sand is so close to the surface that it is possible to mine it in open pits. To extract the remaining 80 percent, *insitu* techniques are required to make oil sand in the ground fluid so that it can be pumped up to the surface for refining. Since it takes more steps to extract oil from oil sand than from oil fields, the refining process requires more energy, which means that oil sand is more carbon intensive. The environment is also affected locally and regionally by emissions of acidifying substances to air, leakage into watercourses and changes to the landscape. The degree of environmental impact depends on the techniques used for extraction. The mines use large quantities of water from a nearby river in their processes, while the *insitu* processes use groundwater.

A major issue for the mines is reinstatement of the land, particularly with regard to the large oil sand tailing deposits that are a waste product of the mining. The *insitu* project has less of a visual impact on the surroundings, but still affects land use due to the infrastructure required. The environmental impact is also a vital issue for the indigenous people of Canada who live in this area and have a legal right to lead a traditional life. All the companies must consult the indigenous people as part of their projects.

In 2010, the Ethical Council will continue to engage in the mining and extraction industry, through both its own dialogue work and joint initiatives with other investors.



Oil sand (the top image) is a type of sand with voids that contain oil of so called bitumen quality.

The oil sand is excavated by giant excavators (the bottom image) and loaded onto the largest trucks in the world which are able to carry a load of 400 tons.



The demands on suppliers made by Swedish companies lead to positive change.

India - country of contrasts and opportunities

India is a country of contrasts: Extreme wealth rubbing shoulders with extreme poverty. A country with respected universities and poor or no schooling for many children. The country also has a burgeoning middle class. As the second largest democracy in the world, India is a land of many challenges and fantastic opportunities.

In January 2010, the Ethical Council made a field trip to India to gain an insight into the risks and opportunities that companies operating in India face in terms of both the environment and human rights. We wanted to increase our knowledge of child labour, environmental work and the way Swedish and Indian companies work with their suppliers on issues such as working conditions and the environment. We met Indian, Swedish and international companies, as well as stakeholder organisations.

DIFFERENT WAYS OF IMPROVING CONDITIONS FOR CHILDREN

We discussed child labour and conditions for children with UNICEF. They explained how complex the problem is in practice. There is widespread social acceptance of putting children to work in India, and it will take a great deal of effort to change attitudes. Around 80 percent of all child labour in India occurs in agriculture. Going to school must be seen as a better alternative than work by both parents and children, which is not always the case at the moment. There may not even be a school in the village, or the teacher fails to turn up. The teacher not turning up is a common problem because he/she sometimes has a long distance to travel and little motivation to work in a village school in a rural area. If there is a school, it usually comprises a class of 100 pupils of various ages, and there is a widespread shortage of school books.

In order to improve education, UNICEF has drawn up teaching material designed to work for small self-study groups. UNICEF is also working to improve the health of women and children. In order to disseminate facts about HIV/Aids, the UN body has turned to the power of the soap opera, as well as passing on information at service stations in order to reach lorry drivers, who are an important target group.

UNICEF is also working with companies to improve the situation of children. They emphasise the importance of companies leading the way in showing that it is possible to combine good working conditions and environmental awareness with business success. IKEA and H&M are two of the Swedish companies supporting UNICEF's projects in India.

The Ethical Council visited several companies and their suppliers in India. This photo is from a textile factory.



THE MINING INDUSTRY OFTEN CAUSES CONFLICT

In our conversations with two Indian environmental organisations (the Centre for Science and Environment and Navdanya), we discussed Indian industry in general and the mining and agricultural industries in particular. Many states have considerable natural resources and extraction of these often creates conflict between mining companies and the local population. It is important for mines to be established in agreement with the local communities and in an environmentally responsible way. The Ethical Council also met a mining company to discuss these issues.

GENETICALLY MODIFIED SEEDS IN AGRICULTURE

Around 70 percent of the population of India live in rural areas and they are often dependent on the land and/or forests for their livelihood. There is currently an ongoing debate in India about whether the need of the country for food will best be met via organic agriculture using traditional seeds or agriculture using hybrid and genetically modified seeds. We met environmental organisation Navdanya, which is a strong advocate of organic agriculture, and also one of the companies that produces and sells genetically modified seeds. As is so often the case in discussions about the environment and development, companies and stakeholder organisations have opposing views. Greater openness and transparency is important in reducing the information gap between companies, investors and other stakeholders, which was something we commented on during our meetings.

ENVIRONMENTAL AND SOCIAL DEMANDS MADE OF SUPPLIERS

India is a key market for many Swedish multinational companies. Many have long had production and sales operations in India, since India had high import tariffs up until the mid-1990s. The Swedish manufacturing companies that we visited continue to sell primarily to the Indian market. For other industries, such as the textile industry, India is an important country of purchase.

One area that we focused on was how companies work with their suppliers on working conditions, safety at work, human rights and the environment. We saw many examples of demands made by Swedish companies in these areas leading to positive change. These may be simple but important changes such as workers having access to clean drinking water, clean toilets and subsidised nutritious food. It may also be a case of Indian labour law being followed with regard to pay and overtime, and the use of personal protective equipment.

One of the suppliers proudly showed off three audits by its Swedish customer showing clear improvements. This work has also helped the supplier to attract new customers. Many suppliers stated that, thanks to their customers, they have now started making social and environmental demands of their own suppliers.

We are conscious that we have visited “good” suppliers and that there are of course factories where conditions and the working environment are much worse. However, it is inspiring to see that change is possible and that it leads to good business along many links in the value chain.



The Ethical Council visiting a supplier.



It is inspiring to see that change is possible and that it leads to good business along many links in the value chain.



There are huge contrasts in India.





Swedish institutions in unique investor cooperation for a sustainable future

In addition to the Ethical Council's core task of influencing the actions of companies through dialogue, the Council takes part in a number of international initiatives intended to demonstrate its position as an investor and to promote corporate social responsibility.

In 2009, 15 Swedish institutional investors, which together manage assets of SEK 4 000 billion, joined forces in a unique partnership aimed at steering Swedish listed companies towards value creation that is both responsible and sustainable in the long term. These institutions include the four AP Funds behind the Ethical Council. The other organisations committed to the Sustainable Value Creation project are DnB NOR, Folksam, Handelsbanken, the Knowledge Foundation, Meta Asset Management, Nordea, SEB, Skandia Liv, SPP, Swedbank Robur and the Church of Sweden.

Together, these institutions have over SEK 550 billion invested in the Swedish stock market, which corresponds to 20 percent of the capital on the Stockholm Stock Exchange. In September, the top 100 companies on the Stockholm Stock Exchange were urged to take part in a survey with questions on responsible and sustainable enterprise. The results of the survey were published in a report in January 2010. For more information, visit www.hallbartvardeskapande.se.

WHY IS THE ETHICAL COUNCIL SUPPORTING THIS INITIATIVE?

The Ethical Council believes that, by actively tackling environmental and social aspects of their activities, companies can help to reduce risks and costs while also exploiting business opportunities. This promotes sustainable value creation and allows investors to ensure that essential conditions are in place for a financial return for current and future pensioners in Sweden that is sustainable in the long term.

The objective of the project is to emphasise the importance of Swedish listed companies taking a structural approach to sustainability issues and long-term value creation. Reliable and relevant information from the companies about how environmental and social aspects are integrated into their business creates better transparency, which in turn establishes a sounder basis on which investors can make their decisions.



International cooperation and initiatives

DEMANDS FOR GREATER TRANSPARENCY

As members of the UN Principles for Responsible Investment (PRI) initiative, the four member Funds of the Ethical Council support the idea that investors should take the social and environmental aspects of their operations into account. PRI is also an important forum that creates the conditions for cooperation between international investors.

Together with other investors, the Ethical Council is showing, through letters and through public support for various initiatives, that shareholders value ESG work, and that we as owners are monitoring companies' progress on these issues.

During 2009, the Ethical Council took part in a number of PRI initiatives along with other investors and organisations. Along with 60 other investors, the Ethical Council has put its name to an appeal against forced labour and child labour in the cotton industry in Uzbekistan.

Within the framework of another initiative, each member Fund of the Ethical Council has voted on around 30 resolutions with a climate focus, including urging US companies to report on their work to cut carbon emissions.

In both 2008 and 2009, the Ethical Council took part in the Seoul Initiative, where major corporations listed on world indices (MSCI World, FTSE-All-World and the IFC Emerging Markets Index) who have not yet signed up to the Global Compact were encouraged to do so. A total of around 9,000 companies were contacted.

The Ethical Council has also supported a range of initiatives aimed at improving the scope for shareholders to influence corporate remuneration structures in Switzerland and the USA.

FOCUS ON CLIMATE CHANGE

All the Funds on the Ethical Council support the Carbon Disclosure Project (CDP), an international collaboration aimed at increasing corporate awareness of climate change. Through the project, institutional investors drive companies to report more transparently on their climate strategies and to better document key performance indicators that might indicate improvements. The purpose of the CDP is to improve the efficiency of the data gathering process through a large number of investors collectively signing a joint demand regarding data on and reporting of greenhouse gas emissions.

Within the framework of the PRI, the Ethical Council and 181 other investors supported an initiative challenging the delegates at the Climate Conference in Copenhagen in December 2009 to take robust action to tackle climate change.

The Ethical Council and a group of investors have also written to companies that have not completed the annual CDP questionnaire or whose responses were unsatisfactory in 2008.

TRANSPARENCY IN THE OIL INDUSTRY

The Ethical Council has taken part in an initiative, together with 44 other investors, involving writing to 19 companies involved in oil sand extraction in Canada.

Another international initiative supported by the Ethical Council is the Extractive Industries Transparency Initiative (EITI), which primarily targets oil companies. Transparency and good governance are particularly important in countries with abundant natural resources but with weak governments. Full disclosure of company payments and government revenues increases transparency in society and helps to create better conditions for financial control. Together with some 70 other investors, the Ethical Council has formally declared its support of the EITI, signalling to countries and companies with extraction activities that shareholders value clear and transparent reporting of revenues.

PRI – Principles for Responsible Investment – a UN initiative to increase collaboration and the exchange of knowledge between responsible investors across the globe. (www.unpri.org)

Global Compact – is a voluntary UN initiative to encourage businesses to align their operations with ten universally accepted principles. The ten principles are based on UN conventions in the areas of human rights, labour law, the environment and anti-corruption. (www.unglobalcompact.org)

ILO – International Labour Organization – is the UN agency for labour law issues and working conditions. The ILO embraces representatives from both sides of the employer/employee divide. The ILO has produced a number of conventions on labour rights, of which the best known are the eight ILO Core Conventions dealing with freedom of association and the right to organise, forced labour, discrimination and child labour. (www.ilo.org)



CARBON DISCLOSURE PROJECT



The Ethical Council receives an award for best SRI strategy

In 2009 the Ethical Council received the NRPN's⁴ award for "Best strategy for responsible and sustainable investment". The jury explained its choice as follows: "The Ethical Council has the most developed process, clarity and a transparency that is necessary to achieve changes. The winner can be regarded as a role model for others, not least through cooperation both within and across Sweden's borders."

The Ethical Council places great emphasis on having a systematic process, being transparent and striving to increase the capacity to influence companies by combining forces with other investors. The comments of the jury can therefore be seen as recognition that the Ethical Council has chosen the right strategy for its active ownership work.

The approach of the Ethical Council has attracted a great deal of attention, with an increasing number of investors getting in touch to discuss common projects. Cooperation with other investors adds greater weight to individual company dialogues and various industry initiatives, and is therefore something that the Ethical Council prioritises.



The Ethical Council received an award in 2009 for its transparency, process and cooperation with other investors.

4. NRPN stands for Nordic Region Pensions and Investment News and is a publication within the Financial Times Group.

Stakeholder dialogue

In April 2009, the Ethical Council invited a number of stakeholder organisations to a presentation of its Annual Report 2008. Many of the questions in the discussion that followed were related to company dialogues, transparency and the objectives of these dialogues. 2009 also saw the Council hold individual meetings with several stakeholder organisations to discuss a range of issues.

Conferences and forums 2009

Over the year, the Ethical Council has taken part in a number of conferences and forums, presenting its work and exchanging experience on environmental and ethical issues. The Council also regularly meets investors and other stakeholders to explain its work. By exchanging experience and presenting its work, the Ethical Council is contributing to the debate on and awareness of corporate responsibility.

Swedish Parliamentary Committee on Finance, Stockholm 21 April

Presentation of the work of the Ethical Council

Chair Christina Kusoffsky Hillesöy, AP3 and Nadine Viel Lamare, AP1

Shareholder Activism in Europe on Workplace Issues, Madrid 13 May

Presentation of tools that investors can use to influence companies

Chair Christina Kusoffsky Hillesöy, AP3

Best of SRI European Forum 2009, Paris 14 May

Presentation of the work of the Ethical Council and how investors can influence companies through dialogue

Chair Christina Kusoffsky Hillesöy, AP3

SWESIF, Corporate governance – does it have any impact?, Stockholm 27 May

Presentation of the work of the Ethical Council

Chair Christina Kusoffsky Hillesöy, AP3 and Nadine Viel Lamare, AP1

Responsible Investor, Integrating ESG into Portfolios, New York 25 June

Trends among European investors for active ownership

Chair Christina Kusoffsky Hillesöy, AP3

ICGN Annual Conference, Sydney 13-15 July

Presentation of the work of the Ethical Council

Carl Rosén, AP2

UN PRI, Sydney 16-17 July

Panel debate on responsible investment and unlisted shares

Carl Rosén, AP2. AP1 also took part in the conference

UN PRI, From Principles to Practice, Stockholm 22 September

The Ethical Council presented how it applies the Principles of Responsible Investment to its work

Nadine Viel Lamare, AP1

Eurosif och Responsible Investor - The Future of ESG Integration, Amsterdam 11 November

Panel debate on dialogues with companies and cooperation with other investors

Chair Christina Kusoffsky Hillesöy, AP3

Novethics - ESG Strategies for Responsible Investors, Paris 27 November

Panel debate on ESG issues in pension funds

Nadine Viel Lamare, AP1

Questions about the Ethical Council?

Contact Annika Andersson,
Chair of the Ethical Council in 2010.
E-mail: info@ethicalcouncil.com
Tel: +46 8 787 75 69