



CORPORATE GOVERNANCE PLAN

Active, committed and
responsible owner

Contents

2 Introduction

3 Governance

3 Strategy

4 Advocacy and the expectations AP3 has of companies

7 Targets and metrics

7 Reporting and monitoring



Third AP Fund
Stockholm, August 2023

Staffan Hansén
Chief Executive Officer

Third AP Fund | Box 1176, SE-111 91 Stockholm | info@ap3.se | +46 (0)8 555 17 100 | www.ap3.se

Introduction

The Third AP Fund (AP3) is an investor with a mission to promote the stable development of the state income pension system for current and future pensioners. The capital is invested in order to generate a high return over time. AP3's mission includes promoting sustainable social development by being a role model as a responsible owner and investor. Through active stewardship, AP3 will work to ensure that the companies in which it invests are well managed and well governed. The action plan aims to describe how AP3 will work to fulfil the basic principles set out in the Responsible Investment Policy adopted by the Board.

The AP Funds' core values are based on the values of the Swedish state, in which democracy, fundamental freedoms and rights, the equal value of all people and the freedom and dignity of the individual are key elements in accordance with the wording of the Instrument of Government. The international UN conventions that Sweden has ratified, including conventions on the environment, human rights, labour law, corruption and inhumane weapons, also form essential parts of the framework on which the Fund's values and work are based. The framework is also expressed through Sweden's support for initiatives such as the UN Global Compact, the ILO and the OECD Guidelines for Multinational Enterprises, and through Sweden's positions on issues of international law.

About AP3's corporate governance plan

AP3 is an active owner that makes a difference by engaging, taking action and demanding positive change. At the heart of this is a belief that well-run companies must operate in a sustainable manner in order to yield high returns with low risk over time.

AP3 has put its signature to the [UN Principles for Responsible Investment \(PRI\)](#). These guidelines encompass environmental and social issues, as well as corporate governance. These principles are wide-ranging and apply to all companies in which the Fund has ownership, whether such holdings are in Swedish or foreign companies. AP3 focuses its stewardship work in those areas where the Fund believes it can achieve the greatest benefit and where it has the greatest opportunity to exert influence. The principles may therefore be applied differently depending on the geographical location of the company and the size of the Fund's holding.

AP3's action plan for corporate governance describes the targets and plan that AP3 has for corporate governance. The status of each target is presented based on the latest full-year data.

Governance

The Swedish Government appoints AP3's Board members, who adopt a Responsible Investment Policy with general guidelines for the Fund's sustainability work and corporate governance.

Corporate governance is one of AP3's focus areas within sustainability. Through active stewardship, AP3 will work to ensure that the companies in which it invests are well managed and well governed.

The Board of Directors must be informed on an ongoing basis about how work on sustainability and stewardship is being conducted and developed. The Chief Executive Officer bears overall responsibility for ensuring compliance with the Responsible Investment Policy and the Corporate Governance Action Plan and that these are operationalised.

AP3's Investment Committee (IC) makes decisions on sustainability issues of a material nature, and the work to integrate corporate governance takes place in the fund management. The Head of Sustainability and Stewardship will report on sustainability risk issues to the Fund's Risk Management Committee (RMC) on a quarterly basis. The Sustainability and Stewardship Team is responsible for this work and supports the fund management in evaluating corporate governance risks and monitoring targets on an ongoing basis.

Strategy

AP3's corporate stewardship is based on being an active, responsible shareholder that demands change where necessary to achieve healthy corporate governance.

Being an engaged, responsible shareholder means voting at general meetings, engaging in dialogue with companies and

participating with other shareholders and stakeholders in various national and international initiatives and contexts that promote good corporate governance and sustainable development. The diagram below provides an illustration of the Fund's general work on stewardship issues.



Figure 1. AP3's general work on stewardship issues.

AP3 requires those companies in which the Fund invests to comply with national legislation in those countries in which they operate. It is the responsibility of the Board of Directors of each company to ensure they have adequate processes and controls in place to guarantee this.

Many countries employ codes of corporate governance and these are important in terms of confidence for both the stock market and the companies, but they also provide a tool for the stewardship work of the Fund. Although there are many benefits of codes that

promote best practice in local markets, the basis of stewardship work must always be what is best for the individual company.

AP3 makes a positive difference by working actively with companies to achieve sustainable development, by engaging with companies where serious and systematic problems have been identified and by engaging with companies where breaches of international conventions have been identified, deemed to be significant and are well documented.

Advocacy and the expectations AP3 has of companies

AP3 has put its signature to the UN Principles for Responsible Investment (PRI). These guidelines contain a number of basic principles on corporate governance and on the Fund's approach to the social and environmental responsibilities of companies.

These principles are wide-ranging and apply to all companies in which the Fund has ownership, whether such holdings are in Swedish or foreign companies. The Fund's holdings usually represent a much greater share of ownership in Swedish companies than in foreign ones and it therefore has greater opportunities to exert influence over Swedish companies.

There follows a description of seven fundamental principles of corporate governance. These principles apply to both foreign and Swedish holdings. The principles concern corporate governance at listed companies and to the relevant extent at unlisted companies. The work of nomination committees is also covered by these principles.

Principle 1: Rights and obligations of shareholders

AP3 strives to achieve a good balance of power between the owners, Board of Directors and company management.

1.1 Equal treatment of shareholders

The principle of equal treatment is a cornerstone of corporate law.

AP3 strives to ensure that shares which have the same economic rights in a company are always treated equally from an economic perspective. It is important that the interests of non-controlling shareholders are protected and that shareholders are not unfairly treated financially in relation to dividends or on the liquidation of a company or the acquisition of all the shares in a company. Derogations from this are only permitted if effected in accordance with the articles of association of the company.

1.2 Voting rights and the right to submit proposals at general meetings

The general meeting is the highest body of a company. It is also the most important, and often only, opportunity for shareholders to express their opinions and submit their own proposals to the company. The right to vote at general meetings is the most important way in which shareholders are able to exercise ownership influence.

AP3 works to safeguard voting rights and the right to submit proposals at general meetings. AP3 seeks to attend and vote at the general meetings of all companies in which the Fund has shareholdings.

1.3 Nomination committees

Nomination committees act on behalf of the shareholders and their most important task is nominating the Chair and other members of the Board of Directors for the approval of the Annual General Meeting. The members of a nomination committee may be elected at the Annual General Meeting or they can be appointed subsequently from among the largest shareholders.

AP3 takes an active part in the work to nominate Board members and is usually a member of the nomination committee at those companies where the Fund's shareholding allows.

1.4 Dialogues and processes

Holding confidential dialogues is often an excellent way of influencing companies and other shareholders.

AP3 is often involved in preparatory work ahead of Annual General Meetings and submits its views on the companies' proposals and

those of other shareholders, as well as submitting its own proposals. The Fund will initiate dialogue with representatives of the companies or other shareholders where it believes there are grounds to do so.

Principle 2: Capital structure

Companies must have a well-balanced long-term capital structure that is aligned with their strategic goals and financial targets. Decisions regarding dividends, new issues, repurchase of own shares and any redemption of these shares must be made by the shareholders.

AP3 believes that the Boards of the companies should justify the various methods they employ to adjust the capital structure.

2.1 Dividends

Companies must regularly communicate their views on their capital structure and clearly describe the company's dividend policy.

AP3 believes that any capital which cannot be used effectively for securing or developing the company's business should be distributed to shareholders.

2.2 Share issues

Companies that need to strengthen their capital base should be able to issue new shares quickly and at low cost. At the same time, it is important that new issues do not jeopardise the interests of current shareholders.

Generally speaking, AP3 believes that new issues should take place with preferential rights granted to existing shareholders. Private placements can favour those who are invited to take part in the issue at the expense of those shareholders who are not given the opportunity to participate. In those exceptional cases where private placements are proposed, very high standards should therefore be applied to the procedure and transparency in term of rationale and pricing.

The need of the companies to perform a new share issue quickly and at low cost must be balanced against the interests of the shareholders in not being diluted or otherwise disadvantaged. In the case of non-cash issues, a clear and thorough valuation must be published to enable the shareholders to assess the terms of the issue in relation to the assets acquired.

2.3 Repurchases

Redeeming repurchased own shares is one of several ways in which a company can return capital to its shareholders.

AP3 believes that proposals to repurchase shares must be properly grounded and that the conditions stipulating when the Board is permitted to use any authorisation granted must be made clear to shareholders. The sale of repurchased shares on the stock exchange should be prohibited, except in order to secure a company's share-based incentive programme. If the company has different classes of shares, repurchases should be made only of the cheapest class of share at any given time.

Principle 3: Company Boards

The role of the Board of Directors is to represent all of the shareholders in the governance of the company. One of the most important tasks for shareholders, in particular institutional investors such as AP3, is to influence the selection of Board members.

AP3 believes that the work of the nomination committee requires a systematic evaluation of the Board's work and of the performance of the individual Board members, as well as information about the Board's collective expertise and experience. In order to ensure independence, it is sometimes desirable for such evaluation to be performed by an external party.

The composition of a Board of Directors must be based on the needs of the individual company. The skills, experience and background of the Board members are key factors for the success of the Board's work. It is also important that the Board members are able to devote sufficient time to their task. Effective Board work requires diversity in the composition of the Board.

AP3 is therefore striving to broaden the recruitment base for Boards of Directors. Among other things, the Fund works to ensure a more even gender balance on company Boards.

It is both natural and desirable for representatives of the principal owners to be members of the Board of Directors. However, the proportion of Board members associated with the company's principal shareholders must be in reasonable proportion to the share of capital of the shareholder in question. The Fund believes that the Chair of the Board and the Chief Executive Officer should not be the same person.

The remuneration of the Board of Directors must be on market terms and reflect the responsibilities and performance of the Board. The Fund believes it to be in the interests of the shareholders that the Board members are also shareholders in the company. The design of share-based incentives for the Board of Directors should take into account, however, the fact that the Board performs a supervisory function in relation to the management of the company.

AP3 therefore favours a model where a specific portion of the Board fee is allocated to the acquisition of shares in the company.

Principle 4: Audit and internal control

The quality of the external audit and internal control is of the utmost importance to the shareholders. Auditors are appointed by the company's shareholders and are the scrutinising body of the shareholders. It is therefore important that the audit is continuously evaluated from a shareholder perspective.

AP3 believes that the process of evaluating and procuring audit services should be handled by the nomination committee.

In the evaluation and procurement process, the independence of the auditors in relation to the company, its management and its Board of Directors is vital for the shareholders to have confidence in their audit of the management of the company. To ensure this independence, the principal task of the audit firm must be auditing. Other consultancy services should be limited and a report on such ancillary services must be submitted to the shareholders at the general meeting and in the annual report. To further ensure the independence of the auditor, the company must change both the auditor and the audit firm at regular intervals.

Principle 5: Remuneration for senior executives

The remuneration scheme for a company's management should be designed in a cost-effective manner that rewards efforts to generate long-term shareholder value and enables companies to attract and retain key personnel.

AP3 believes it is important to base this on what is best for the individual company. This means that the company's Board Of Directors

is responsible for designing, explaining and defending the management remuneration scheme. The Board must also ensure that its remuneration schemes are evaluated.

The remuneration scheme for senior executives must be clearly described in the company's remuneration policy, which is adopted by the shareholders at the company's Annual General Meeting. It is vital that all the elements of the total remuneration package are described: fixed salary, any variable remuneration, including share-based or share-price-related incentive schemes, pension provisions and other financial benefits.

AP3 believes that the entirety of the company's total remuneration package and the overall remuneration levels must be reasonable and on market terms.

5.1 Variable remuneration

Variable remuneration for senior executives that involves cash remuneration in addition to their fixed salary must be aligned with the long-term interests of the shareholders. This means that exceptional performance can result in positive outcomes, with the opposite true if the desired performance is not achieved.

AP3 sets high standards for the design, evaluation and transparency of remuneration schemes. The following points in particular must be taken into consideration:

- *Variable remuneration must be linked to predefined, measurable performance criteria, including non-financial criteria, which the relevant persons must be able to influence.*
- *Variable remuneration must be of limited scope and caps must be set that are linked to the fixed salary. This is particularly important if the variable remuneration is related to the company's profits. If no cap is set, unreasonably large payments can be detrimental to the company, its employees and its shareholders.*
- *When structuring variable remuneration, the Board of Directors should consider whether to delay payment of a set portion of the remuneration after it has been earned. The main purpose of this is to ensure that the performance for which the remuneration is earned is sustainable over time. Having a remuneration structure of this kind is likely to discourage excessively risky short-term behaviour, while also providing positive lock-in effects.*
- *A company's remuneration policy must include the option for the Board of Directors to limit or cancel the payment of variable remuneration where it considers this to be justified and consistent with the company's responsibility to its shareholders, employees and other stakeholders. It may be difficult to justify the payment of variable remuneration, for example, if the company has not generated a profit. The company must also ensure that it is able to recover variable remuneration that has been paid on a clearly erroneous basis.*

5.2 Share-based remuneration schemes

When they are properly structured, share-based or share-price-related remuneration schemes are a good way of connecting the interests of management with those of the company's shareholders. Companies have different needs and circumstances and a company's Board of Directors is best placed to perform the task incumbent upon it of drawing up proposals for incentives that foster value creation at the individual company. The Board is also required to clarify the connection between the objectives to be achieved and the structure of the scheme and to evaluate how the scheme has helped to achieve these objectives.

AP3 has drawn up a few simple basic requirements for this kind of remuneration scheme:

- *Share-based schemes are preferable to share option schemes, particularly where the share option schemes are based on the allocation of options free of charge and without any required performance in return.*
- *The performance requirements should be linked to the company's financial targets but also ideally based on benchmarking with competitors.*
- *There should also be a link between the performance requirements and the sustainability work of the companies.*
- *The personal risk-taking of participants by being invested in the company's shares is recommended.*
- *The schemes should have caps or soundness clauses to protect the company from unreasonable outcomes.*
- *The schemes must be evaluated and it is the responsibility of the Board of Directors to ensure that such evaluation is performed and reported to the shareholders.*

Share-based remuneration schemes that require personal risk-taking through personal investment in the company's shares often have elements of share matching. Matching is normally designed to compensate the participants for their investment after a set period of time by providing them with shares free of charge or by allowing them to buy shares at a subsidised price. The size of the subsidy can significantly reduce or even eliminate personal risk-taking.

As full share matching means that participants in the scheme only have a connection with the shareholders in an upward-trending market, AP3 recommends other solutions.

In addition to the basic requirements stated above, there are other elements that AP3 considers when assessing a proposed incentive scheme. The scope of the scheme and the cost to shareholders are obvious factors that always form part of the assessment. In addition, the proposals should naturally be presented well in advance of the notice convening the general meeting to enable the shareholders to evaluate and consider their position on the information.

It is important to note that the conditions relating to share-based remuneration vary at different companies. Share-based remuneration is a way of connecting the interests of shareholders with those of management but, most importantly, these schemes represent tools for motivating and recruiting employees. For companies which have not yet achieved sustained positive cash flows, such schemes can be an important way of further motivating employees without burdening the company's cash flow.

In specific cases, therefore, AP3 may deviate from its basic view of how share-based remuneration should be structured.

5.3 Management pensions

With defined benefit pension schemes, there is a risk of large, and highly uncertain, pension costs and these should therefore be avoided.

Where such pension agreements nevertheless exist, the Fund believes that the companies should make active efforts to renegotiate the pension agreements and convert them to defined contribution pension schemes. The cost involved in converting pension agreements from defined benefit to defined contribution schemes should always be taken into consideration of course. Pensions should be based on the employee's fixed salary. Variable remuneration or long-term share-based schemes must not be pensionable.

5.4 Severance pay for management

It is important to ensure that the sole purpose of severance pay is to provide a safety net in the event of the early termination of an employment contract.

AP3 believes that severance pay should therefore be limited to a specific amount or period of time, which should generally not exceed an amount equivalent to two years' fixed remuneration. Severance pay must not be paid if an executive resigns of their own accord.

Principle 6: Sustainability and business ethics

AP3 strives to ensure that the companies in which the Fund invests take a systematic and structured approach to sustainability and that they run their businesses in a responsible manner.

Among other things, the companies must manage relevant aspects of sustainability, have appropriate policies and procedures in place and ensure compliance with these, as well as employ relevant management and monitoring systems.

ESG criteria form part of the Fund's ongoing dialogue with companies. AP3 has adopted the positions described in its Responsible Investment Policy.



Principle 7: Providing information

Companies must seek to maintain an open and continuous dialogue with their shareholders. Information provided by the companies must be accurate, clear, factual and credible. The information that the companies provide must enable a qualified assessment to be made of the company's future development and the factors that create value for their shareholders. Companies must endeavour to be clear about their objectives and the financial and strategic implications of those objectives.

The companies should publish a code of conduct and other relevant policies, such as an anti-corruption policy. Companies should also be transparent on tax issues, by publishing a tax policy for example. The companies should also describe in a transparent manner how their policies and guidelines are implemented, monitored and evaluated.

AP3 strives to ensure that the companies develop appropriate environmental policies, report their carbon footprint, draw up plans for reducing their own climate impact and analyse how they themselves are affected by the climate transition.

Targets and metrics

	Key figures – target	Activities	Status
 Percentage of the underrepresented gender on the Board (for Swedish companies)	All large Swedish companies in the portfolio should have at least 40% of the underrepresented gender on the Board by 2026	Contacted the nomination committees of the 20 companies in the portfolio that are below the target	<p>The proportion of female Board members at the companies contacted has increased from an average of 20% to 30%</p> <p>On average, the proportion of female Board members at large companies is 41%</p>
 Sustainability criteria in incentive schemes	The percentage of Swedish companies with sustainability criteria in incentive schemes must be doubled from 20% to 40% no later than 2025	Communicated the target to the companies through a joint position within IÄF	The proportion of portfolio companies with sustainability criteria has increased from 20% to 25%

Reporting and monitoring

Once a year, AP3 publishes a sustainability report detailing its corporate governance work during the year. The work conducted via the Council on Ethics of the Swedish AP Funds is reported in the Council's annual report.

Once a year, the Fund also publishes a corporate governance report containing information such as how AP3 voted at annual general meetings. AP3 also regularly meets representatives of various stakeholder organisations.

The purpose of these meetings and dialogues is to keep the Fund informed of key sustainability issues and to obtain new information and knowledge that can form the basis for further development of the Fund's work.

The Board of Directors must be informed on an ongoing basis about how work on sustainability and stewardship is being conducted and developed. The Head of Sustainability and Stewardship will report on sustainability risk issues to the Fund's Risk Management Committee (RMC) on a quarterly basis.



