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## The AP Funds' sustainability work

– investments and corporate governance

### Summary and recommendations

The Swedish National Audit Office (Swedish NAO) has audited whether the national Swedish pension funds' (AP Funds) sustainability work is appropriate, i.e. if they integrate sustainability into investments and ownership without compromising the overall objective of long-term high returns with the greatest benefit for the pension system.

The audit shows that the AP Funds' sustainability work is appropriate in relation to their respective overall objective. Sustainability aspects are integrated in the AP Funds' policy documents and have been integrated into the funds' asset management and corporate governance. The extent of this integration is reasonable based on the overall objectives of the AP Funds. However, measures should be taken in order for the AP funds assets' to further promote the Riksdag's goals and intentions for sustainable development.

### **Sustainability objectives could be clearer for some of the AP Funds**

The fact that the AP Funds should take into account the environment and ethics is shown in the legislative history of the laws that have governed the AP Funds for twenty years. Since 2019 the first four AP Funds are also legally required to promote sustainable development. The Government has been proposed that the Seventh AP Fund should also be covered by the same statutory requirement, but there is no corresponding proposal for the Sixth AP Fund. According to Swedish NAO, a statutory sustainability objective strengthens the legitimacy of sustainability work, which would promote the Riksdag's goals of sustainable development.

The AP Funds' sustainability goals are primarily focused on environment and climate aspects, as well as corporate governance. Few goals concern social sustainability, which means that it is not always clear what the AP Funds want to achieve in this area.

## **Established processes for integrating sustainability into investments**

The AP Funds have established processes to monitor and analyse their holdings to detect sustainability risks and opportunities, as well as to evaluate industries' and companies' environmental, social and governance sustainability. Few companies are excluded from the AP funds' ownership due to violations of international conventions. Instead, the AP funds prioritise dialogue with the companies in order to achieve change. An increasing number of investments in industries and companies have been sold due to financial climate risks. The First and Second AP Funds have decided to divest from fossil fuels. The Third and Fourth AP Funds have also reduced their holdings. As climate-related financial risks increasingly can be priced, they can also be considered in financial analyses and decisions.

Most of the AP Funds aim to increase their share of sustainable investments, for example in companies that contribute to climate adaptation. The definitions of sustainable investments vary between the funds. This makes it difficult to assess the proportion of the assets that can be classified as sustainable investments.

## **Sustainability is integrated into corporate governance, but follow-up is difficult**

All AP funds have increased their activity as owners over the past five years, including increased voting at shareholders' general meetings and participation in nomination committees. At shareholders' general meetings, voting is largely about traditional company issues, such as board appointments and remuneration systems. The work on environmental and social sustainability aspects is conducted primarily through dialogue with companies, individually and together with other investors in various international sustainability initiatives. However, it is difficult to follow up and evaluate both the scope and results of these dialogues. It is also a challenge for the AP Funds to identify and prioritise areas and companies where they have the greatest opportunity to exert influence.

## **Sustainability reporting has improved, but needs to be developed**

The AP Funds report their sustainability work according to several globally established frameworks, such as how they contribute to the UN's sustainable development goals. However, there are major differences in how the frameworks are used in the reporting. This makes it difficult to get a comprehensive and clear picture of the sustainability work. Lack of standardised definitions and inadequate sustainability data is common for the entire financial sector, but international work is under way for increased harmonisation.

The Government's reporting of the AP Funds' sustainability work has given the Riksdag an increased opportunity to examine the sustainability work in the respective AP Funds. Nevertheless, it is difficult to get an overall picture of the sustainability work carried out by the Funds.

## **Recommendations**

The Swedish NAO makes the following recommendations to the AP Funds:

- The AP Funds should clarify their goals in social sustainability so that they reflect the Funds' long-term ambitions in the area.
- The first four AP Funds and the Seventh AP Fund should continue to develop their environmental and social sustainability work in their corporate governance to ensure that the work is focused on areas where the Fund has the greatest opportunity to exert influence and be of the greatest benefit.
- The first four AP Funds and the Seventh AP Fund should develop how reporting on stewardship strategies and dialogues can be made clearer, both in terms of scope and if possible, results achieved.
- The first four AP Funds should identify common key indicators for investments and corporate governance that can make the sustainability reporting more easily accessible and result-oriented. When possible, the Sixth AP Fund and the Seventh AP Fund should also use the same key indicators so that the Government can provide as comprehensive a picture as possible in its reporting to the Riksdag.
- The Sixth AP Fund should report how the Fund can contribute to the UN Sustainable Development Goals.

The Swedish NAO makes the following recommendations to the Government:

- Take the initiative to clarify the Sixth AP Fund's objective in relation to exemplary management.
- Develop the annual communication to the Riksdag so that it clearly answers the question whether the first four AP Funds fulfil the statutory requirements for the management of assets through responsible investments and responsible ownership.
- Develop the communication so that the overall outcome of the AP Funds' sustainability work is clearer.