

Responsible Investment 2013



Church of Sweden 

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ABOUT THE REPORT

The Church of Sweden is Sweden's largest religious community and the country's largest membership organisation. At the end of 2013, we had about 6.4 million members, equivalent to 66 percent of the population. The organisation consists of independent local and regional units (parishes and dioceses) and a national level (the General Synod, the Central Board and the Central Church Office in Uppsala).

In 2012, the national level of the Church of Sweden published its first annual report describing how we integrate sustainability aspects in our investment decisions. The present report reviews our efforts in 2013. It is primarily intended for parishes, dioceses and investors with whom we cooperate, but also for a broader public.

For further information about the Church of Sweden's other efforts towards sustainable development, please visit the following website:

www.svenskakyrkan.se/international

Message from the Chair and the Chief Investment Officer

Investors – whether small-scale savers, large pension funds or asset owners like us – can be a force for positive change in the world simply by thinking carefully about where they invest their money. The Church of Sweden has been working for several years with what is now called responsible investment, a general term that covers a variety of methods and strategies. We are proud of our focus on solutions; the mandate we give to asset managers we select is to think long-term and emphasise companies that are interesting from the sustainability perspective. In addition to this, we refrain from investing in businesses we do not want to support.

In this year's report, we are delighted to announce that once again we achieved our long-term return target. Set by the Central Board of the Church of Sweden, the annual return requirement is 3% above inflation over a rolling ten-year period. This corresponds to a 60% return target since 2004, or 4.8% per year. Actual return during the period was 82% (corresponding to 6.2% on average per year. Performance was also very good for the past year alone with a profit of SEK 610 million, corresponding to a return of 12.4% (index based on our reference portfolio: 10.0%).

In partnership with our selected external asset managers, the Church of Sweden has started and further developed several sustainability funds over the years. The asset managers we engage are leaders in the industry. This demands the ability to see beyond the next quarter and consider long-term needs and global challenges, while expanding the perspective on both risks and opportunities. Consequently, there are many companies in our equity portfolios that are for example adept at saving energy and that are good stewards of human capital. There are also several companies whose goods and services are helping overcome the great challenges of our time, such as climate change and water scarcity.

Nevertheless, there is no such thing as a perfect company and the challenges can be daunting in certain sectors and high-risk markets. In response, we have intensified our efforts over the last three years to engage with the companies in which we invest. We believe in a model in which companies, in close dialogue with stakeholders including investors, discuss how they can act to support values such as human rights, environmental preservation and business ethics, regardless of where in the world they do business.

We chose to invest in a couple of new funds in 2013 that we consider particularly interesting from the sustainability perspective. One is a microfinance fund that is making a difference in for instance sub-Saharan Africa. The other fund focuses on protecting forests and facilitating sustainable agriculture. Each is a reflection of how quickly the availability of interesting funds is developing. During the year, we continued to find alternatives to traditional fixed-income investments, where anticipated returns are very low at present. We expanded our investments in the rental housing fund already in our portfolio and invested in a corporate bond fund.


By selecting funds with a distinct sustainability orientation, it is possible to contribute to a more resilient society while generating good returns. Research shows a clear correlation; companies that perform well on ESG (Environmental, Social and Governance) matters tend to outperform companies that do not¹. The high-performing companies, as an example, benefit from a lower cost of capital because the credit market recognises that they are associated with lower risk. Our investment strategy is thus motivated by both ethical and financial reasons.

In this annual report, we describe our work with responsible investment during the past year. We hope that it will be of interest to you.




Bertil Persson
Chair Central Board Asset
Management Council




Anders Thorendal
Treasurer and Chief
Investment Officer

¹ DB Climate Change Advisors, 2012, *Sustainable Investing: Establishing Long-Term Value and Performance*.



Our method of working

Committed efforts are ongoing at various levels within the Church of Sweden towards ensuring respect for the equal value of all human beings and the limits of nature. Asset management at the national level abides by the same principles. We strive to invest in companies that are contributing to sustainable development through their conduct, goods, or services. We are active shareholders working to achieve sustainable value creation by engaging with companies and cooperating with other investors.

Assets at the national level of the Church of Sweden, which are maintained as a buffer against future needs, totalled approximately SEK 5.5 billion at year-end 2013. The internal regulations of the Church of Sweden (the Church Order) state that asset management must take a long-term perspective, with an annual return requirement of 3% above inflation over a rolling ten-year period. These returns make additional initiatives in parishes and dioceses possible. The General Synod, the supreme governing body of the Church of Sweden, has since 2008 regularly decided to withdraw funds from assets at the national level, which has led to total withdrawals of SEK 573 million from assets under management.

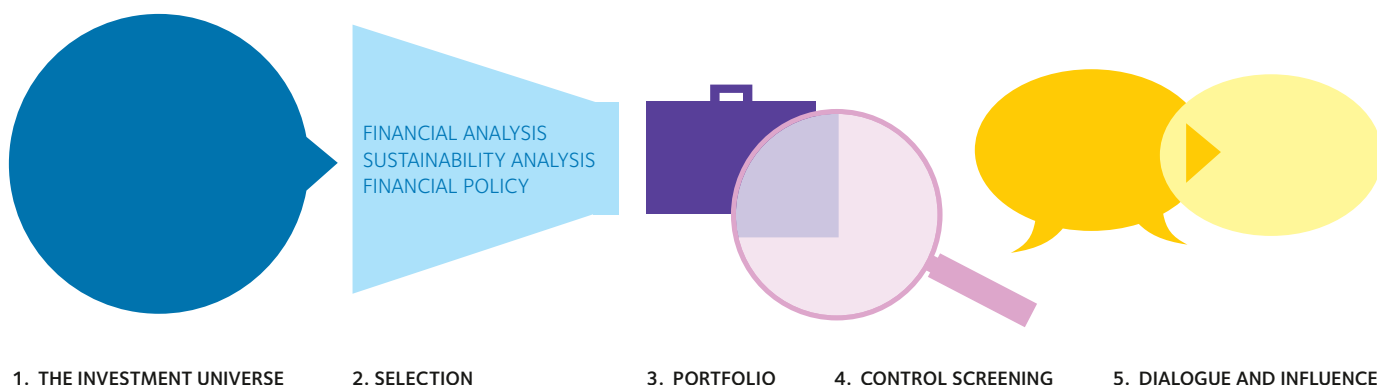
The segment referred to as 'responsible' or 'sustainable' investment is expressed in a variety of ways. The objective of the Church of Sweden is to be a responsible owner in the broad sense. Accordingly, we are long-term, active owners and we take advantage of our opportunity to influence business and industry in a sustainable direction, independently and in partnership with other investors. Our strategy can be summarised in four points:

- We invest our capital in funds whose managers have strong expertise in integrating factors that relate to the environment, social issues and corporate governance² in their investment decisions.
- We emphasise well-managed companies engaged in sustainability issues that are material to business and society. We are restrictive about investing in controversial industries that are problematic in relation to the fundamental values of the Church.
- We contribute to developing investment products that have a distinct focus on sustainability.
- We take advantage of our opportunity as asset owners to influence individual companies, sectors and the financial industry as a whole.

◀ Significant investments in renewable energy and energy efficiency are needed to tackle climate change. Read more about the Church of Sweden's work on pg.19.

² Corporate governance refers to standards and decisions concerning how companies should be managed, regulated and audited to meet the expectations of owners and other stakeholders. The Swedish Corporate Governance Code addresses issues including the role and responsibilities of the board of directors, auditing and reporting.

THE INVESTMENT PROCESS



We publish our holdings on our website: www.svenskakyrkan.se/ekonomiandfinance

GUIDED BY THE FINANCIAL POLICY

The Church of Sweden's work with responsible investment has been ongoing for many years and is under constant development. Asset management is based on the financial policy adopted by the Central Board in 2010. The policy is based upon two fundamental values: the principle of human dignity and the concept of stewardship as reflected in international environmental and human rights conventions and existing frameworks for responsible business. Based upon these two principles, asset management complements other efforts towards sustainable development within the Church of Sweden, at home and abroad. The policy stresses that the Church of Sweden's asset managers must actively seek out companies that are contributing to sustainable development through their conduct, goods, or services. These may include companies that are working systematically and in a goal-oriented manner with issues such as

the environment, working conditions, human rights, corporate governance, poverty reduction and corruption. They may also be companies that develop products and services that are advancing solutions to some of the most pressing needs of society today. We also refrain from investing in certain businesses, such as manufacturing of tobacco and weapons (see also page 11).



Download the financial policy at
www.svenskakyrkan.se/responsibleinvestment

FROM POLICY TO ACTION

Assets are managed externally by Swedish and foreign asset managers with varied investment strategies and methods of ensuring compliance with our financial policy. Since the managers put emphasis on companies that have an established and systematic



PHOTO: ISTOCKPHOTO

World population is increasing and resources must be used more wisely. Many of the companies we invest in have reduced their environmental impact and costs through recycling and the reuse of what would otherwise have become waste.

sustainability programme, many companies are eliminated in the initial research process.

In addition to the research and screening conducted by the asset managers, we engage independent consultancy firms to perform a control screening at least once a year. The screening checks that no company is in breach of the exclusionary criteria for controversial businesses (see page 11) and that the companies are generally given good sustainability scores. The screening also investigates whether any of the companies have acted in contravention of corporate responsibility frameworks and international conventions intended to protect human rights and the environment. If such is the case, the manager investigates the allegations, sometimes jointly with the Church of Sweden. Depending on which measures the companies take and the gravity of the allegations, a decision is later taken as to whether the holdings will be retained or sold.

We also contribute to bringing new financial products to the market either by stepping in as a seed investor or by establishing our own funds. The Ethos Funds are one example, created in cooperation with two asset managers who we work closely with: SEB (Swedish equity and fixed-income funds) and Robeco SAM (a global equity fund). The Ethos funds are based on the Church of Sweden's financial policy and are marketed primarily towards dioceses and parishes. At the end of the year, various units within the Church of Sweden, including the national level, had invested approximately SEK 5.1 billion in the Ethos Funds. Please see page 18 for a complete list of the asset managers we engaged in 2013.



Read more about the Church of Sweden's other efforts towards sustainable development:

www.svenskakyrkan.se/international

Companies we select...

We asked three asset managers we engage to describe a company that illustrates the sustainability orientation of their funds.³

CHINA SUNTIEN

Air pollution in China has become severe. According to some reports, the health care costs of various types of respiratory conditions equal one percent of China's GDP. Consequently, China must act quickly to reduce emissions and improve air quality. The road to improvement is via renewable energy and natural gas. Natural gas is still a fossil fuel, of course, but gas is cleaner than coal with much lower levels of harmful particles.

The Chinese government is under considerable pressure. In many areas of the country people are protesting against various types of environmental problems that are having serious impact on their lives. China is currently the largest consumer of coal in the world. Coal is still the source of more than three quarters of the country's electricity usage. The government targets, however, are for wind power production of 100 GW to be installed by 2015 and for gas consumption to be markedly higher by 2020 relative to current levels.

In this context, conditions are favourable for China Suntien. The company focuses on the northern province of Hebei,

the most polluted in China, where steel production and other industries foul the air. On some days, the smog is so thick that it is difficult for planes to take off from Beijing (which is in Hebei).

Suntien owns and maintains wind power production facilities, pipelines for long-distance gas transmission, a network for distribution to households and filling stations for vehicle gas. Natural conditions in Hebei are suitable for energy extraction and the province is a net exporter of electricity. The company is also playing a central role in helping the local government meet its environmental objectives. For these reasons, I expect the company to deliver good returns, above the average, for several years.

Jon Sigurdson, Portfolio Manager DNB Miljøinvest



Factories and households that burn coal in combination with congested road traffic contribute to the brown cloud of pollution that covers large portions of South-East Asia today.

³ This information should not be regarded as a basis for investment decisions. The companies are included in diversified portfolios and the asset managers give no recommendations as to possible positions.



OCADO

Ocado is a British food retailer in the UK whose customers order products online rather than going to the supermarket. We are of the opinion that this presents a disruptive challenge to both traditional, “off-line” supermarkets as well as the incumbents’ “store-pick” approach to online sales. We believe Ocado’s business model, together with a strong culture and aligned management team, allow it to address a number of sustainability challenges that make it a highly attractive business for us. While the company has yet to turn a profit, we believe that it continues to prove itself in the UK and we envision it going on to have international application.

From an environmental perspective, our analysis shows the warehouse model to be significantly less carbon intensive than traditional approaches. Even though Ocado does not yet benefit from the scale advantages of its larger counterparts, it is already a less carbon intensive way to shop than even walking to a supermarket. As the company continues to develop its systems and build scale, emissions savings versus conventional supermarkets will only grow.

Furthermore, Ocado has pioneered “green delivery” by encouraging customers to request delivery slots when a van is already scheduled to be in the same neighbourhood. In addition, Ocado is committed to choosing sustainable fuel options and their logistics efficiencies lead to significantly lower food waste than conventional supermarkets (less than 0.7% of sales to compare with 3% for traditional supermarkets), generating further upstream climate and environmental benefits.

Given growing concerns around use of plastic shopping bags, Ocado was the first UK grocery retailer to operate fully closed-loop bag recycling, taking delivered bags back and recycling them at a dedicated UK facility. In terms of Ocado’s product offering, they have one of the largest organic ranges in the UK. They have also developed exclusive relationships with a number of small organic suppliers, allowing these suppliers to reach customers they otherwise wouldn’t have been able to.

Duncan Austin, Partner, Generation IM



Ocado’s online sales have led to both a reduction in the emissions of carbon dioxide as well as reduced food-waste as compared to sales in traditional grocery shops.



OECD estimates that by 2030 approximately half the world's population will be living in areas suffering from water shortages. New infrastructure is needed to manage this situation. To the right, the water metres used by Manila Water in an area where the payment schemes have been adapted to low income earners.



MANILA WATER COMPANY

Here at First State Stewart, sustainability means questioning how companies respond to sustainable development challenges and how well positioned they are to benefit from, and contribute to, sustainable development. Manila Water provides water, wastewater and other environmental services to homes and businesses in the Philippines and Vietnam. The company also has a strong track record of improving the quality of water provision in an emerging market city like Manila without unduly raising prices. By engaging with customers the company has cut water leakage far more successfully than they could have done from the executive floor. The company's commitment to sustainable development and social responsibility has enhanced its license to operate and supported its convincing financial performance. Today it is one of the most profitable water companies in the world.

When analyzing companies we look closely at how they are governed. Manila Water is controlled by the Ayala family who has a strong approach to corporate governance. All Ayala companies report on sustainability (which is still not common on emerging markets) and they incorporate it clearly into their business strategy. Moreover, the Ayala family has a history of treating minority shareholders fairly.

Manila Water's primary operation and revenue stream is the Metro Manila East Zone concession. The zone incorporates 40% of the capital city with over 6 million inhabitants. In 1997 only 65% of houses were connected to the mains, only one forth had water 24/7 and water losses, through leakages etc, was 63%. Moreover, with only 3% of homes connected to sewers, the environmental impact of wastewater was immense. Now water availability is 99.6%, 23% of homes are connected to sewers and water lost 12.2%, saving approximately 700 million litres of water per day, which would cost approximately 580 million USD to produce per year.

Connecting each customer to the Manila Water pipeline is to connect them to health, well-being, and productivity, all of which are vital in creating economic stability and self-sufficiency. The company continues to prove that its inclusive vision is compatible with strong business performance. For example, 303,288 low income families (equivalent to 1.7 million people) are connected to water through various designs of deferred payment schemes.

David Gait, manager of First State Global Emerging Markets Sustainability Fund

... and businesses we avoid

The principle of human dignity and the stewardship concept have also led to the following principles in our asset management. Asset managers we select must be able to defend all holdings on the basis of the public good.



WEAPONS. We refrain from investing in companies whose production can be linked to weapons or munitions that are essential to waging war. For products that are not essential to waging war, the permitted turnover limit is about 1%. In addition to this, we perform a qualitative assessment in each individual case.

TOBACCO. We do not invest in tobacco manufacturers. Sellers of tobacco must be able to demonstrate that they conform to an internal code of conduct or an industry code based on the WHO Convention on Tobacco Control.

ALCOHOL AND GAMING. Here as well, we set standards for responsible marketing in order to minimise negative impact on society and the lives of individuals.

PORNOGRAPHY. Companies that produce pornography are excluded. With respect to distribution, assessments of media companies are carried out to determine whether or not income

derived from distribution is marginal and whether the companies actively market pornographic material.

OIL AND NATURAL GAS. We are very restrictive as regards investments in companies that extract fossil energy sources. In this sector, we only invest in companies in which natural gas constitutes the majority of production.

OIL SAND. We do not invest in companies involved in oil sand exploration or extraction. Shale oil, shale gas and deep-sea drilling are avoided if the consequences of extraction may be equated to those for oil sand.

COAL. Only companies whose income from coal is less than 5% of turnover are permitted.

ENERGY COMPANIES. The companies we select must be industry leaders in sustainability.



The year in review

The economic upturn in many markets in 2013 contributed to a strong financial year for our asset management, which generated profit of SEK 610 million, corresponding to a return of 12.4%. We expanded our holdings in the alternative investments asset class during the year as a complement to our traditional fixed-income and equity management. We continued our corporate engagement processes and, for the first time, we measured the climate footprint of our Swedish equity portfolio.

Expansive monetary policy set the tone for 2013 and the economy gradually improved in many areas, especially in the United States, while inflation remained low. The picture was more mixed in Europe, although minor improvements could also be seen here. The immediate risk of a major systemic crisis has subsided and economic growth is positive. Deficit and unemployment levels remain very high and despite massive support from the European Central Bank, investments are not rising to any appreciable extent. Development is highly fragmented among European countries and there is rising opinion that free movement of persons should be restricted.

World stock exchanges developed strongly in 2013 with the exception of emerging markets. Our Swedish equity index (SIX RX) rose by a full 28.0% and the world equity markets by 25.2% (MSCI World) and 20.8% (DJSI), respectively. In both cases, growth was essentially double that of the preceding year. The trend in emerging markets went in the opposite direction: on the heels of relatively strong performance in 2012, MSCI Emerging Markets fell by 3.6%.

On the aggregate level, our own performance developed in a very positive direction. We achieved a profit of SEK 610 million (compared with SEK 412 million in 2012), corresponding to a total return on assets under management at the national level of 12.4% (index: 10,0%).

We increased our holdings in 'Alternative Investments' in 2013. Investments in this asset class are aimed at reducing risk in total assets under management over time, in that returns are not expected to track the trend in the equity and fixed-income markets to the same high extent. It also gives us the opportunity to support businesses and projects with clear and positive impact on the environment and society. The first investment was made in SEB's new microfinance fund, which provides loans to microfinance institutions, which then lend money to individuals in developing countries who lack access to financial services. Microloans give more people the opportunity to develop small businesses and create better lives for themselves and their families. The second investment was made in the Althelia Climate Fund, which aims to mitigate climate change by creating the conditions to protect forests and pursue more sustainable agri-

◀ During 2013, we invested in Althelia's Climate Fund which protects forests and supports sustainable forestry. The picture shows the re-planting of trees in Kenya.

culture. Please turn to page 23 for more information.

Through corporate engagement, we dialogue with a selection of the companies in which we invest in each year. In the aftermath of news reports about TeliaSonera in 2012, in response to which we divested our shares early in the year, we engaged with several ICT and telecommunications companies. Every company has an individual responsibility to uphold high standards of business ethics and conduct, and we have followed TeliaSonera's change process in 2013 with great interest. In order to fight corruption and oppression, we also need powerful coalitions of businesses and other actors that can pursue the issues on a broad front. Our involvement in the multi-stakeholder Global Network Initiative (GNI) is one example. GNI brings together ICT companies, human rights organisations, academics and investors in the effort to protect freedom of expression and the right to privacy. Please turn to page 29 to read more about our partnerships.

In what might be the most positive news of the year, H&M decided in late 2013 to implement living wages⁴ for the majority of its suppliers before 2018. The H&M initiative will affect a total of 850,000 workers. The textile workers who sew our clothes often struggle to support themselves and their families on the minimum wages they earn. The Church of Sweden therefore welcomes H&M's decision to accede to our wishes and those of other stakeholders concerning this issue.

More than two decades have passed since the initial reports on the working conditions of textile workers in low-wage countries were released. Many improvements have been made in the intervening years, but the situation is still unacceptable in some areas. The collapse of the Rana Plaza production centre in Bangladesh, in which more than 1,000 people lost their lives, became the symbol of this problem in 2013. During the year, the Church of Sweden joined an investor initiative that put

pressure on clothing companies to make sure that textile factories in the country are safe. Please turn to page 24 to read more about our corporate engagement processes.

The role of the financial market in sustainable development was discussed during the year in various contexts. At the annual political convention in Almedalen, the Church of Sweden contributed by inviting representatives of the government and the financial sector to discuss how to counteract short-termism in the industry. Many companies are currently choosing not to make investments that are important for the future. The financial sector is often the driver of these short-term perspectives and decisions, even though a long-term strategy is essential to ensuring good returns over time.

The importance of the financial sector may be especially clear when it comes to staving off climate change. A major redistribution of capital from fossil energy sources and outmoded technology to investments in renewable energy and novel resource-efficient technology will be essential to meeting the two-degree target.⁵ Despite this, fossil fuels are still heavily subsidised while new technologies often lack established forms of financing and support. Companies in the fossil energy business still weigh heavily in many equity indices.

We 'climate-adjusted' our asset management in 2009. In 2013, we had the 'climate footprint' of our Swedish equity portfolio analysed for the first time. The purpose was twofold: to gain a picture of how well our selected asset managers are integrating climate factors into their investment decisions, and to give us and them information about the companies that need to step up their efforts in relation to this issue. The study shows that the funds we have selected are clearly better equipped for the future than Swedish index funds. Please turn to page 19 for more information.

⁴ A living wage covers the basic cost of living for the worker and his or her family.

⁵ The two-degree target indicates a limit for how much the mean global temperature is permitted to rise (a maximum of two degrees by 2050 compared with the pre-industrial level). The target has been adopted as a policy objective by both the EU and Sweden.

Financial performance

Sustainability and a long-term value creation are two important underlying components for asset management at the national level of the Church. This is reflected in the long-term return target set by the Central Board (3% annually above inflation over a rolling ten-year period) and in our selection of asset managers. Our investments are mainly in the equity markets, which are widely characterised by short-termism and rapid turnover. We have therefore chosen asset managers who share our ambition to be long-term owners. This approach is also reflected in our entry into the alternative investments asset class, where for certain investments we make a commitment for several years, in part due to lack of liquidity. In line with our long-term focus, this report is not limited only to last year's performance but also covers the five-year and ten-year perspectives, the later based on our mandate from the Central Board.

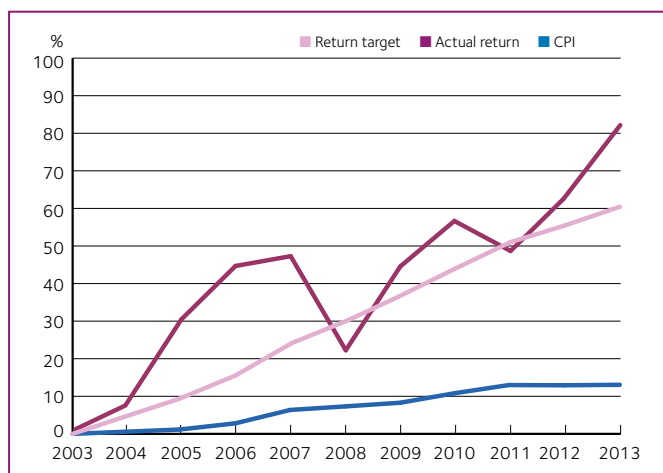
In order to attain the long-term target without risking excessive fluctuations in year-on-year performance, we have created a reference portfolio that indicates our strategic allocation. The general allocation in 2013 was 50% equities, 40% fixed-income securities and 10% alternative investments. As last year, we can conclude that we have achieved the ten-year return target and thus exceeded the expectations of the Central Board for our asset

management. Returns since 2004 amount to 82% (corresponding to annual average return of 6.2%), which may be compared with the return target of 60% for the same period (4.8% annually). This is illustrated in the chart below.

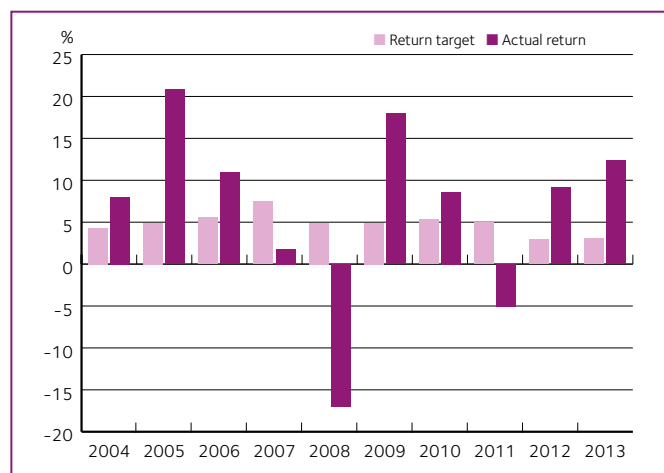
Looking at 2013, net profit was SEK 610 million, corresponding to return of 12.4% (index: 10.0%). Assets under management totalled SEK 5.5 billion at year-end. For the second consecutive year, return on the total portfolio outperformed return on the reference portfolio, this year by a full 2.4 percentage points. A contribution analysis shows that this outperformance was equally distributed between the asset managers' stock picks and our own tactical allocation among asset classes. In 2013, we were overweight, compared with the reference portfolio, in the asset classes that performed strongly (primarily global equities) and underweight in fixed income securities, which delivered relatively low returns. All of this contributed to the positive result.

As in 2012, most of our asset managers outperformed their respective benchmark indices. This trend was strengthened in 2013, particularly in the asset classes of global and emerging markets equities. The asset managers who delivered outstanding performance in global equities were RobecoSAM (Ethos Global Fund) with a return of 26.6%, and the Generation Global Fund,

CUMULATIVE ACTUAL RETURN, RETURN TARGET AND INFLATION ⁶



RETURN TARGET AND ACTUAL RETURN



⁶ The chart shows only returns for each respective full year, with one measurement point per year. The real return target was 4% during the period of 2004–2009 and was adjusted to 3% in 2010.

which delivered 25.1%. Returns for these funds outperformed the Dow Jones Sustainability Index (DJSI), the benchmark we apply to the global equity mandate, by 5.8 and 4.3 percentage points respectively. MSCI World, the benchmark index more familiar in investment circles, rose by 25.2% in 2013 and our global asset managers thus also performed well against this benchmark. The return on our total global portfolio was 25.7% during the year.

The very strong performance of the emerging markets funds managers continued, as evident in the five-year review presented in the table below. During this period, the asset class has outperformed the benchmark (MSCI EM) by 7.4 percentage points per year on average. The Generation IM Asia fund delivered 6.3% in 2013 and First State Global Emerging Markets Sustainability Fund 4.1%, while the trend was negative for the market as a whole (MSCI EM), with a downturn of 3.8%.

Unfortunately, none of the Swedish equity managers were able to match the market's performance of 28.0%, but from an historical perspective, the Swedish equity portfolio delivered

good returns in absolute terms of 23.3%. Returns from fixed-income management were limited to 0.3% for the full year. Traditional fixed income securities are expected to generate limited returns in the next few years. In response to this, we decided to invest in Nordea Institutional Cross Over Fund. This corporate bond fund achieved a return of 4.6% during the period of June to December 2013. We have now invested in a total of six funds in the alternative investments asset class (see table on page 18). The SEB Credit Opportunity Fund III delivered the highest return in this asset class at 9.3%. Several of the investments in the asset class are characterised by an investment horizon of several years. We have thus far made only the initial investments in a couple of these funds.

In common with our managers of emerging markets funds, the global equity portfolio and fixed-income managers have also outperformed their benchmarks over the last five years, as shown in the table below. While Swedish equity management has not matched the superb relative return outcomes, it still delivered the best return in absolute terms at 16.4% on average since 2009.

2013 RESULTS AND HISTORICAL RETURNS (5 YEARS)

Asset class	Profit 2013 SEKm	Return full year 2013		Return full year 2012		Average annual return 2009–2013		Benchmark
		Portfolio	Index	Portfolio	Index	Portfolio	Index	
Swedish Equities	225.9	23.3%	28.0%	17.7%	16.5%	16.4%	20.0%	SIX RX
Global Equities *	340.8	25.7%	20.8%	8.9%	9.2%	9.9%	9.1%	DJSI World
Emerging Markets **	19.8	4.7%	–3.8%	22.6%	11.7%	14.3%	6.9%	MSCI EM
Fixed-Income Securities	1.4	0.3%	0.3%	3.9%	3.3%	3.6%	3.4%	OMRX Bond
Corporate Bonds ***	11.5	4.6%	1.7%	N/A	N/A			Merrill Lynch EMU
Alternative Investments ****	10.7	3.2%	3.1%	10.8%	3.0%			CPI + 3 %
Total	610.1	12.4%	10.0%	9.1%	8.5%	8.3%	9.4%	

* The asset class, which is measured as a whole against DJSI, includes DNB Miljöinvest (return 37.2%, benchmark Wilderhill New Energy Index, 53.7% for 2013).

** The average return figures refer to the period we have been invested in the asset class; that is, since April 2009.

*** Held for a total of 6 months; therefore, no long-term average return is reported.

**** Held for a total of 26 months; therefore, no long-term average return is reported.

OUR LARGEST EQUITY HOLDINGS AS OF 31 DEC 2013

SWEDISH EQUITIES

Hennes & Mauritz
SEB
Volvo
Nordea
Atlas Copco
Swedbank
ABB
Sandvik
Millicom Int. Cellular
Alfa Laval

GLOBAL EQUITIES

Unilever
QUALCOMM
Waters Corp
Intuit
MSCI
Novo-Nordisk
C R Bard
Becton Dickinson
Varian Medical
Roche Holding

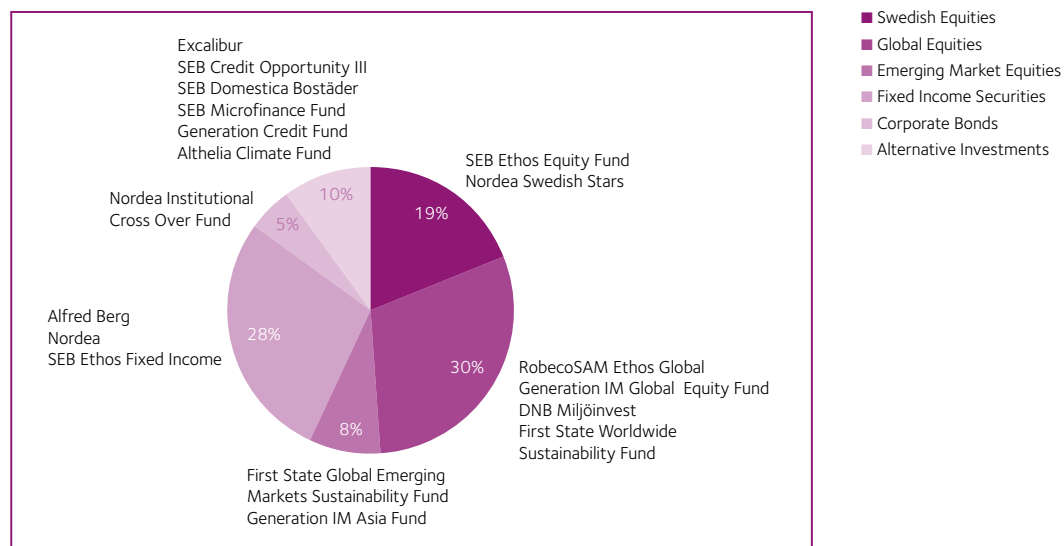
EMERGING MARKETS

Tech Mahindra
Unilever
Marico
Delta Electronics
QUALCOMM
Taiwan Semiconductor
Guaranty Trust Bank
Public Bank
Kasikornbank
Standard Food Corp

Distributed by asset class. For a complete list of holdings, please refer to:

www.svenskakyrkan.se/economyandfinance

DISTRIBUTION AMONG ASSET CLASSES AS OF 31 DEC 2013



PORTFOLIO ALLOCATION PER ASSET MANAGEMENT AND ASSET CLASS

Amounts stated in SEK millions	Market value 2013	Portfolio share 2013	Market value 2012	Portfolio share 2012	Reference portfolio
SEB Ethos Equity Fund	631	11%	403	8%	
Nordea Swedish Stars	421	8%	237	5%	
<i>DNB, discretionary mandate ended in 2013</i>	–	–	338	7%	
Swedish Equities	1 052	19%	978	20%	20%
RobecoSAM Ethos Global	615	11%	486	10%	
Generation IM Global Equity Fund	719	13%	574	12%	
DNB Miljøinvest (renewable energy/cleantech)	99	2%	72	1%	
First State Worldwide Sustainability Fund	236	4%	196	4%	
Global Equities	1 669	30%	1 328	27%	20%
First State Global Emerging Markets Sustainability Fund	327	6%	314	7%	
Generation IM Asia Fund	115	2%	108	2%	
Emerging Markets	442	8%	422	9%	10%
Total equity portfolio	3 163	57%	2 728	55%	50%
Alfred Berg, discretionary mandate	636	11%	634	13%	
Nordea, discretionary mandate	424	8%	671	14%	
SEB Ethos Fixed Income Fund	483	9%	635	13%	
Fixed Income Securities	1 543	28%	1 940	40%	35%
Nordea Institutional Cross Over Fund	262	5%	–	–	
Corporate Bonds	262	5%	–	–	5%
Total fixed income portfolio	1 805	33%	1 940	40%	40%
Excalibur (hedge fund)	213	4%	110	2%	
SEB Credit Opportunity III	121	2%	110	2%	
Domestica Bostäder (real estate fund)	136	2%	46	1%	
SEB Microfinance Fund	99	2%	–	–	
Generation Credit Fund	7	0%	–	–	
Althelia Climate Fund	2	0%	–	–	
Alternative Investments	578	10%	266	5%	10%
TOTAL PORTFOLIO	5 546	100%	4 934	100%	100%



Analysing our carbon footprint

The Church of Sweden takes a clear stand on climate change. Global warming is in many ways an issue of global fairness. It is the poorest people of the world who contribute least to the emissions of greenhouse gases while at the same time it is they who suffer most from the effects of climate change. The global community needs to make the conversion from a fossil fuel driven economy to long-term, sustainable solutions if we are going to be able to meet the increased need of resources and energy. Changes in the climate are a fact. At the same time 1.3 billion people still do not have access to electricity.

During the autumn of 2013, the UN's Intergovernmental Panel on Climate Change (IPCC) released an update on research findings.⁷ Effects of climate change are noticeable on all of the world's continents in a variety of forms, for example, extreme weather and increasing sea-levels. According to the IPCC, it is still possible to meet the two-degree target, but we have to act quickly and vigorously.

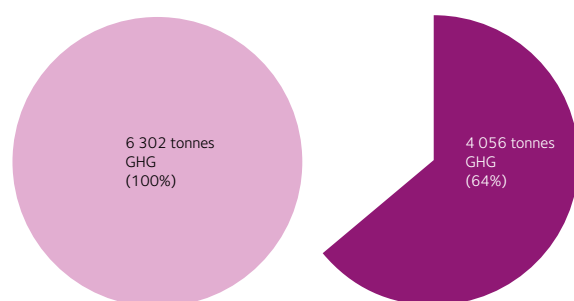
The asset management of the national level of the Church of Sweden has a restrictive policy in regard to investing in companies that extract fossil energy sources. This reflects both the Church's position on this issue as well as our management of the

financial risks that are linked to it. In line with this, we invest in several companies that focus on renewable energy and energy-efficient solutions. We have not invested in any oil or coal-mining company since 2009. In 2013, we had holdings in four gas companies.⁸

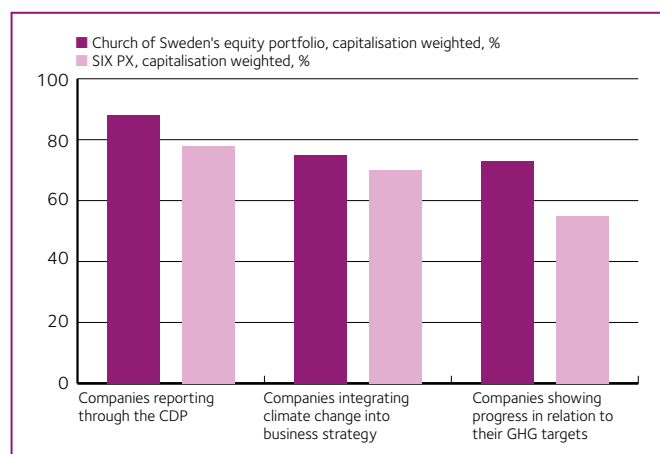
In 2013, the Church of Sweden commissioned the organisation CDP and climate consultant South Pole Carbon⁹ to measure the carbon footprint of the Church's investments in two Swedish equity funds (Ethos Swedish Equity Fund and Nordea Swedish Stars) and the benchmark, SIX PX, which reflects the Stockholm Stock Exchange.¹⁰ CDP and South Pole Carbon first processed the climate data for the companies in the funds and then the index. They then compared the Church's carbon footprint in the funds with the corresponding amounts invested in the Stockholm Stock Exchange. The analysis showed that investments in companies encompassed by the Swedish funds, when calculating the emissions coming from direct operations and from purchased electrical power, district heating and cooling, resulted in the emission of a third less greenhouse gases than what would have resulted if corresponding investments had been made in the benchmark. The companies' emissions

EMISSIONS FROM OUR PORTFOLIO COMPARED TO BENCHMARK

■ Benchmark (SIX PX)
■ Church of Sweden's investment in Swedish equities



FURTHER COMPARISONS



⁷ The report is summarised by The European Climate Foundation och Cambridges universitet in *Climate Change: Action, Trends and Implications for Business – The IPCC's Fifth Assessment Report Working Group*.

⁸ On 31 Dec 2013 we had holdings in Woodside Petroleum, BG Group and Hongkong China Gas. In addition, MOL Hungarian was included in a corporate bond fund in which we have invested.

⁹ www.cdp.net, www.southpolecarbon.com

¹⁰ The overall carbon footprint of the Stockholm Stock Exchange is several times lower than the MSCI UK since few companies with coal-mining and oil & gas production are traded on the former.

throughout their entire supply chains and usage phase were not included in the analysis due to a lack of data.

The analysis also showed that 75% of assets in the funds were invested in companies which report that they have integrated the climate issue into their business strategy, while the benchmark figure was 70%. The funds were invested to a level of 73% in companies able to report results compared with their emissions targets for greenhouse gases. Only 55% of total market capitalisation was able to do so. Finally, the review showed that 88% of companies in the funds, in terms of market capitalisation, have elected to report their greenhouse gas emissions. The corresponding figure in the benchmark index was 78%.

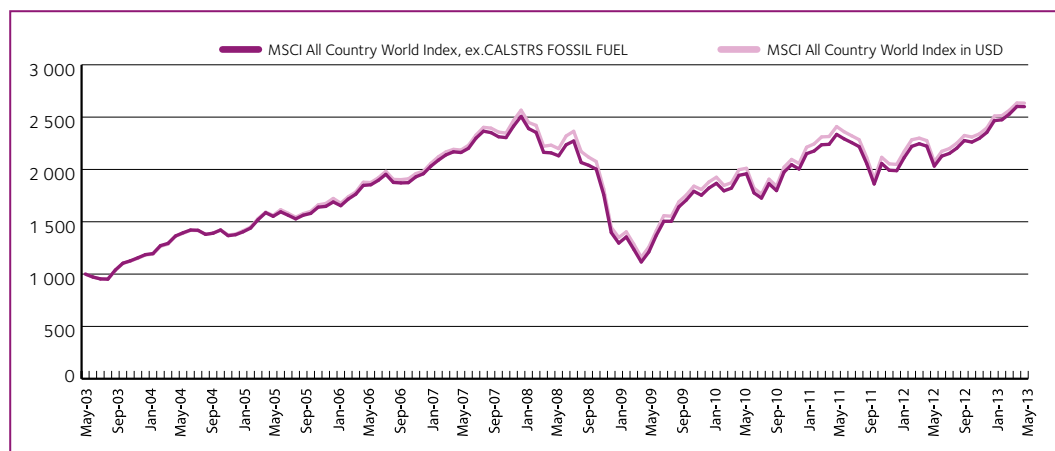
Two of the foreign asset managers we have selected have conducted similar analyses. The carbon footprints of Generation IM and First State Stewart's global funds were less than half as large as they would have been had the corresponding amounts of money been invested in their benchmarks (MSCI World and MSCI All Country World). Their analyses included direct impacts and impacts of first-tier suppliers. The differences in the carbon footprint were due in part to how the asset managers chose to invest in different sectors and in part to their stock-picking.

These types of analyses provide snapshots of particular points in time. They are based upon public data and estimates of emissions in cases when data is not available. During 2014, the Church of Sweden will discuss the results with the Swedish asset managers and look into whether certain companies should be re-evaluated or contacted to initiate a dialogue for the purpose of improving results and reducing the risk profile of the funds further.

STRANDED ASSETS

The decision to be restrictive in regard to fossil fuels within the national level's asset management was taken for ethical reasons by the Asset Management Council in 2009. Our evaluation was then, and continues to be, that climate change will continue to affect our society to a greater extent and will lead to increased pressure on both politicians and the business community. It is probable that we will see further regulation and increased costs in the form of taxes, carbon credits or other types of economic instruments. For this reason, from a financial perspective, we believe less in companies that emit large amounts of greenhouse gases than companies that reduce their use of energy and convert to renewable energy. MSCI recently showed that

RETURNS WITH AND WITHOUT FOSSIL ENERGY STOCKS



¹¹ Studies have compared the MSCI All Country World Index with a simulated index in which coal-mining, oil & gas and electrical power companies have been removed. The differences one, three and five years back in time favoured the modified portfolio. Between 2003 and 2013 the returns on investment were somewhat lower in the modified portfolio but the difference was marginal (-0.16% annually on average). The exclusions were based upon the work of the organisation Carbon Tracker (www.carbontracker.org). According to Carbon Tracker, the 200 largest fossil-fuel companies spent up to \$674bn last year on prospecting and extracting new reserves. The study is available here: http://www.msci.com/resources/factsheets/MSCI_ESG_Research_FAQ_on_Fossil-Free_Investing.pdf

an investment in their global index during the last ten years would, in principle, have yielded unchanged returns even if the companies within fossil energy had been excluded (see chart on previous page).¹¹

According to the International Energy Agency (IEA) only a third of the world's fossil reserves can be extracted if it is going to be possible to meet the two-degree target. This means that two-thirds must remain underground if it is going to be possible to avoid devastating effects of climate change. During the autumn of 2013, one of our asset managers, Generation IM, published an article on what are called stranded carbon assets, that is, assets at risk of never being realised. Generation IM was founded in 2004 by the former U.S. Vice-President Al Gore together with David Blood, former managing director of Goldman Sachs Asset Management. The Church of Sweden invests in three Generation IM funds. These funds do not invest in fossil energy sources but instead focus on companies that contribute to solutions to several of the great challenges to the world. Generation's Global Equity Fund has since we invested in the fund in October 2008 yielded on the average an annual return of 9.8% as compared with 5.7% in annual return for the fund's benchmark (Dow Jones Sustainability Index). The average annual return for MSCI World during the same period was 7.6%.

Incorporating climate change into analyses regarding other asset classes is also important. It is not just fossil energy reserves that can decline in value due to changes in the climate but also agricultural land and infrastructure when, for example, there is

drought and intense storm weather. The value of certain types of properties can also decline due to the risk of flooding. According to the re-insurance company Munich Re, the number of weather events that have caused great damage has doubled in Europe during the last three decades and in Asia it has quadrupled. In North America, it has increased fivefold at a cost of over \$1,000bn during the same period.¹² An increasing number of companies identify climate change as a risk to their business activities, but all too many have not established goals and concrete strategies.

In October 2013, the Church of Sweden, WWF and the communication agency Prime arranged a seminar on how the financial sector can contribute to a more rapid conversion to a low-carbon economy. A narrow view of risk contributes to many investors not removing their significant investments from companies with large fossil energy reserves. These companies are included in traditional index funds since they make up a considerable part of the stock market. At the same time, awareness of climate risks is increasing. Actors such as the Norwegian Storebrand and the Dutch Rabobank chose to divest some high-carbon companies during 2013. The demand for green bonds that are linked for example to climate-smart infrastructure is also increasing.



Read more about how other parts of the Church of Sweden are working with climate change at : www.svenskakyrkan.se/omoss/why-the-climate-issue-is-a-question-of-global-fairness-and-justice

QUICK FACTS

- Today, 80% of all energy in the world used comes from fossil energy sources.
- Despite investments in renewable energy, it is estimated that carbon emissions will increase by 20% by 2035.
- Fossil fuel energy was subsidised in total with more than \$500bn in 2011 which was six times the amount of subsidies for renewable energy.
- There are 1.3 billion people in the world who still do not have access to electricity.

Source: IEA, *World Energy Outlook 2013*.

¹² Munich Re, *North America Most Affected by Increase in Weather-Related Natural Catastrophes*, 17 October 2012.

A loan that requires good stewardship



Life exists only as a changeable existence. Humanity's time on Earth is finite. No future generations are going to live as we do now. Whether their lives will be better or worse remains to be seen. Life has

evolved both from relatively stable conditions and from sudden, often disastrous, changes. Most changes have occurred slowly. The weather has varied, but annual mean temperatures have not changed rapidly. The changes emanated from circumstances beyond our control, one of the conditions of life.

And yet we have now changed the conditions of life, on our own terms. We are fuelling climate change, through the vast shift of carbon atoms from below the surface of the earth, in coal, oil and gas, to the atmosphere, bound with oxygen atoms into carbon dioxide. We have increased our risk appetite. There is of course elasticity in this huge ecosystem. Some call it redundancy. Others call it buffer capacity. One might also call it mercy. As a result, a long time often passes between impact and outcome.

The climate footprint analysis presented on the preceding page shows that it is possible to take climate action within the framework of asset management. Do we leave ownership of companies that have great impact on the climate to others simply to keep our own hands clean? No, we do not. Several of the companies in which we invest can also improve their work, and several of them are making serious attempts to reduce their climate impact and can, by virtue of the power of good example, be role models for others. We want to show that alternatives exist in order to create hope in a time of rising storms.

Our ethics are largely and fundamentally universal. 'Do unto others as you would have them do unto you.' But the focus varies. How far into the future do we want to see? Is it meaningful to include our great-grandchildren's rights too? And 'the people', how far away in the world are they? Only in my own country, or also among environmental refugees and island populations that cannot seek shelter from the next typhoon? People who have recently experienced disasters and war often see things differently and have different priorities than those who have only heard stories about these things from the past. People who are used to scarcity in their daily lives think and act differently to those who are used to having more than they need. For some, life is a gift, for others it is a battle.

These discrete perspectives are apparent in the international climate negotiations, in which the parties find it extremely diffi-



PHOTO: MAGNUS ARONSON/NOI

cult to agree, even though time is of the essence. The Church of Sweden does not believe that we have all the answers. There are many roads to a better world. The Christian tradition helps us in our internal discussions of priorities and important choices of direction. It moves the boundaries for who can be considered my neighbour beyond those who live next door. Jesus surprises us by naming a Samaritan, whom most of his followers considered an enemy, as a good example of who is our neighbour.

In 2008, I gathered representatives of the major religions to a meeting about climate change. Jewish, Christian and Muslim traditions, along with many other religious traditions, bridge eras and epochs and thus often adopt a long-term perspective. They also share the view that nature and the environment do not exist for humankind alone. They are a sacred gift to humanity and our shared responsibility.

Faith in God gives us good reasons to act prudently and strive for sustainability. In the Christian tradition, we often speak of stewardship. Part of that is realising that the diversity of Creation is not something we are permitted to limit based on what we believe – at this moment in time – is useful or not. It is a divine loan. And loans require good stewardship and transparent reporting. The climate analysis presented in this report is the Church of Sweden's contribution to the debate.'

Anders Wejryd, Archbishop 2006–2014

New investments

The national level of the Church of Sweden invests primarily in listed equities and fixed income securities, but also in other less liquid assets which we categorise as alternative investments. We acquired holdings in two new funds in 2013 that are in a favourable position to have positive impact on society and the environment.

The first is the Althelia Climate Fund, whose objective is to give people better opportunities to make a living at sustainable agriculture while preventing the clearing of valuable forests. Deforestation accounts for almost one fifth of global carbon emissions. Much of the clearing is done to make way for agricultural land.

The projects selected by Althelia are included in the United Nations REDD+ programme (*Reducing Emissions from Deforestation and Forest Degradation*). Local forest-dependent communities are paid, via carbon credits that the fund sells, in exchange for the villages allowing the forests to remain standing. Communities are also given financial support to improve their farms using sustainable and more efficient methods as part of the effort to prevent deforestation and increase their income.

The other new investment was made in the SEB Microfinance Fund, which lends money to microfinance institutes worldwide. Through its international activities and in partnership with churches all over the world, the Church of Sweden

has been involved in microfinance for several decades as one of the founders of Oikocredit. As Oikocredit does not have any funds suitable for institutional investors, we have searched for other alternatives. The new SEB fund meets the standards of the national level and its approach is similar to that taken by Oikocredit. Microenterprises are the fund's primary target group, along with medium-size enterprises and cooperatives. In its allocations among countries, the fund makes an effort to overweight sub-Saharan Africa and underweight South America compared with global market allocations. SEB has partnered with Symbiotics, an investment boutique with long experience in microfinance, for the purpose of selecting microfinance institutions.



Read more about UN REDD+: www.un-redd.org

Read more about Symbiotics: www.symbioticsgroup.com

QUICK FACTS

- More than half the world's adult population do not use or lack access to formal financial services.
- Deforestation accounts for almost one fifth of global carbon emissions.

Source: UN REDD and Global Trends.

PHOTO: SYMBIOTICS



Ouch Srey and her husband in Cambodia have been able to expand their production of noodles with the help of a micro-loan from one of the fund's lending institutions.



PHOTO: LISA KRISTINE

One of Althelia's local partners, Wildlife Works Carbon, guards a forest area in Kenya and reports poachers and illegal logging activities.

Corporate engagement in 2013

All companies are affected by sustainability issues in one way or another. Some companies are working with sustainability in a systematic, goal oriented way to constantly improve. Others have made a late start or lack adequate support from the board and senior management. Research shows that companies that are actively engaged in sustainability work also tend to deliver better financial performance.¹³ The national level of the Church engages each year with a selection of our investee companies. These engagement processes are usually conducted jointly with our asset

managers or with other investors with whom we have established cooperation over the years. We differentiate between reactive and proactive dialogue. The former is initiated when we become aware of criticism via public reports and screening. We also initiate proactive dialogue to forestall and resolve problems. On the following pages, we provide examples of corporate engagement themes that we have worked with since 2011. It should be noted however that it is difficult to separate the effects of our advocacy efforts from the impact of the work of others.

PHOTO: ISTOCKPHOTO



Approximately 4.6 billion people lack access to the Internet. ICT companies increasing access are contributing to bridging the so-called "digital divide". At the same time some of the world's governments are using the same technology to step up their efforts to monitor their citizens. Read more on the next page.

¹³ DB Climate Change Advisors, 2012, Sustainable Investing: Establishing Long-Term Value and Performance. Some analysts argue that companies that are dealing effectively with sustainability issues are often better-managed than those that are not, and that it can be difficult to determine cause and effect.

Conflict, oppression and corruption

Conflict and corruption hinder respect for and establishment of human rights in several countries. Many companies in which we hold an equity stake do business in these markets. During our engagement processes, we recommend that companies perform thorough due diligence and risk assessments, establish robust governance systems and cooperate with other companies to contribute to change in the countries where they do business.

TELIASONERA

Early in 2013, the national level of the Church sold its holding in TeliaSonera due to lack of confidence in the company's board and management. TeliaSonera has been accused of having paid bribes to acquire a license in Uzbekistan. An external investigation was performed early in the year, which confirmed serious deficiencies in the company's risk management and corporate governance. A preliminary police inquiry is in progress in Sweden and is expected to be completed in 2014. The company's CEO and board of directors were replaced in 2013. Four executives were dismissed after an investigation ordered by the new board of directors revealed failures in business ethics in other countries in addition to Uzbekistan.

The Church of Sweden welcomes the steps taken in 2013 by the new board of directors and management of TeliaSonera. These actions are consistent with the recommendations that we communicated to the company when the holding was divested and we will continue to monitor the company's implementation of the plans presented during the year. In parallel, we are advocating joint initiatives in the sector. The risk of corruption is rife in the ICT sector. Last spring, the Church of Sweden in partnership with Transparency International invited industry representatives to a discussion of how companies can work together to prevent corruption and share lessons learnt from successful initiatives in various markets. Companies often cooperate in areas related to the environment and working conditions, but joint efforts to eliminate corruption are equally important.

THE GLOBAL NETWORK INITIATIVE (GNI)

The criticism of TeliaSonera does not apply only to corruption; there are also allegations that the technology is being abused in countries whose citizens are being monitored and oppressed. Last autumn, TeliaSonera presented a new policy that lays the foundation for how the company should manage the risk of violations of their customers' rights to privacy and freedom of expression going forward. This particular issue moved higher on corporate agendas in 2013 as a result of Edward Snowden's revelations and the deficiencies that have emerged in the laws and supervision of many countries. The Church of Sweden is engaged in the issue through the multi-stakeholder Global Network Initiative (GNI), in which companies, investors, academics and human rights organisations are working to protect the rights to freedom of expression and privacy. Our fundamental premise is that ICT can make significant contributions to development and sustainability, but companies – along with human rights organisations and other experts – need to devise strategies for responsibly managing risks in high-risk markets while increasing their positive impact on human rights. Corporate members of the GNI are assessed by an independent party to ensure compliance with GNI principles. We hope to see TeliaSonera as a member in the future.

A collaboration began in 2013 between GNI and eight telecommunications companies, including TeliaSonera, aimed at determining how these issues can be jointly pursued going forward. The Telecommunications Industry Dialogue¹⁴ has thus far not committed to allowing independent assessment of how they are managing these issues. During 2013, GNI has also engaged in dialogue with the governments of several countries to emphasise the importance of strengthening laws and legal oversight to ensure protection of personal privacy. Edward Snowden's disclosures have shown that there is great need for this in democracies as well. GNI has also encouraged countries around the world to allow companies to report what they actually do at the request of various governments. In several countries, this option is restricted by law.



Read more about GNI at: www.globalnetworkinitiative.org

¹⁴ Eight telecommunications companies established the Telecommunications Industry Dialogue in early 2013 to collaborate around freedom of expression and the right to privacy. The companies were Alcatel-Lucent, Millicom, NSN, Orange, Telefónica, Telenor, TeliaSonera and Vodafone. AT&T joined the initiative in autumn 2013.



The collapsed Rana Plaza production centre in Dhaka, Bangladesh's capital city.

The impact of a company reaches far beyond its own business activities. We urge companies to analyse sustainability risks and opportunities across the entire product lifecycle and explore business opportunities linked to an ecocycle approach, such as finding new applications for obsolete products. Some companies are lowering their costs and gaining competitive advantage by reusing materials. Others are building resilient supply chains and strengthening their brands by contributing to good working conditions at their supplier factories.

BUILDING COLLAPSES AND FIRES IN THE GARMENT FACTORIES OF BANGLADESH

More than 1,000 textile workers died when the Rana Plaza production centre collapsed on the 24th of April, 2013 in Dhaka, the capital city of Bangladesh. Supervisors had pushed workers to enter despite clear indications that the building was unsafe. Nearly two decades have passed since the garment industry began to work to improve working conditions at factories in

low-wage countries like Bangladesh but the textile workers, mainly women, still often live under deprived conditions. This time, for many, enough was enough. The collapse led to a groundswell as several clothing companies joined forces with suppliers and the Bangladeshi government to make the factories safe and share the costs. The International Labour Organisation (a specialised UN agency) is coordinating the work. During 2013, the Church of Sweden collaborated with a large group of investors to gather support for this initiative from as many garment companies as possible. In a joint appeal, we urged major companies to take action to ensure safe working conditions, living wages and the right to form unions. Towards the end of the year, more than a hundred clothing companies had joined the fire and building safety initiative, including Puma, Adidas and H&M, in which we own shares.

INITIATIVES TO PREVENT RESISTANT BACTERIA

In recent years, many pharmaceutical companies have begun to rapidly outsource production of active ingredients used in drugs (APIs) to low-cost countries. A few years ago, scientists in Gothenburg showed that this had led to serious water pollution in an industrial area outside Hyderabad, India. Water samples taken from a municipal treatment plant showed that high concentrations of antibiotics and other APIs were being discharged directly into the ecosystem. The levels in the water were sometimes higher than those found in the blood of people being treated for the conditions. Studies from other countries have also shown that water treatment is ineffective, even as the WHO has assessed antibiotic resistance as one of the most serious threats to human health today. During 2014, the Church of Sweden will be joining two major pension funds in the continued effort to address this issue in dialogue with pharmaceutical companies in which we invest. Among else, we will be asking for effective water treatment and sufficient inspections of manufacturing facilities.

Eradication of poverty

The proportion of people who live in extreme poverty (on less than \$1.25 per day) has been more than halved since the 1980s. In terms of absolute numbers, this is a reduction by about 30 percent, but about 1.2 billion people are still living at this level. The reduction of the number of people who live on less than two dollars a day is clearly lower. More than two and a half billion people are still living at this level.

The Church of Sweden welcomes that some companies in which we invest are adjusting their products and pricing structures to the needs of less affluent markets and groups. This may for example involve microloans, lower prices for medicines, or cheap mobile phones. Living wages and contributions to social security systems are other important factors that are contributing to mitigating poverty and deprivation.

H&M INTRODUCES LIVING WAGES AT SUPPLIER FACTORIES

H&M has been one of our largest Swedish equity holdings for a long time. In recent years, we and our asset managers have engaged with the company concerning the needs for textile workers to be paid a living wage. The minimum wage, which the workers often earn for full-time work, is rarely enough to cover their basic needs. We therefore welcome H&M's decision to implement a living wage standard at all strategically important supplier factories by 2018 – a decision that will make a difference in the lives of 850,000 textile workers.

The H&M strategy is based on recognition of their own responsibility and that of their suppliers and the governments of the countries involved. H&M will be reviewing its purchasing practices, contributing to skills development for the workers and continuing to encourage governments to set minimum wages at living-wage levels. Facilitating social dialogue and securing union rights are central components of the strategy, since over the long term changes should be driven by the negotiating parties in the labour market. We hope that the model will spread within the industry.



PHOTO: GUNNELA HAHN

During a visit to India in 2012, the Church of Sweden met textile workers who were proud of their jobs but had to manage on very low wages.



Read more about the working conditions of textile workers in Swedwatch report:
www.swedwatch.org/sv/rapporter/en-forlorad-revolution

Extreme weather events are rising in number and placing an increasing burden on the public purse. As the effects of climate change become increasingly tangible, we believe we are going to see more regulations. As previously mentioned, we believe companies that reduce emissions or develop energy efficient products and services are going to be well-positioned in this reality. Likewise, the global shortage of clean water is creating both risks and potential competitive advantages for companies that act in time. The OECD estimates that about half the world's population will be living in areas of severe water stress by 2030.

Climate and water are recurring themes in our corporate engagement processes. We support the non-for-profit organisation CDP, which on behalf of investors has created a system in which companies report how they are working with climate and water issues (read more on the next page). The initiative makes it possible for investors to take more well-informed decisions. In 2013, we asked about 1,000 companies, through CDP, to report how they are managing the water issue. Their responses show that progress is being made, but that most companies have yet to formulate a strategy. The majority of the respondents reported that water scarcity is going to affect their operations within the next five years. In 2014, we and our asset managers will engage with a selection of companies on these themes.

CDP is also working with the issue of deforestation. Deforestation presently accounts for almost one fifth of global carbon emissions. We invest in companies that use palm oil in their production. The most frequently used vegetable oil in the world today, palm oil is used to make everything from margarine and cosmetics to biofuels. However, palm oil plantations have led to

the destruction of vast areas of forest in Southeast Asia, which has led to sharply accelerated emissions of greenhouse gases and rapid declines in biodiversity. During the year, we and some of the asset managers we work with have been engaged in initiatives to influence the industry to improve its standards and set timeframes and strategies for ensuring that palm oil becomes traceable and is sourced from certified plantations. Towards the end of the year, one of the world's largest palm oil companies, Wilmar, promised not to grow or purchase palm oil that has contributed to deforestation. The company also promised to respect the rights of workers and indigenous peoples. Wilmar's decision came after several years of pressure from the company's customers, private organisations and investors.



PHOTO: ISTOCKPHOTO

Deforestation accounts for 17% of the global emissions of greenhouse gases. This is more than what combined, world transport accounts for.

THE INTERNATIONAL WORK OF THE CHURCH OF SWEDEN

Asset management at the national level supplements the work that takes place within other parts of the Church. The international work of the Church of Sweden is one example. The focus of this work is long-term development, rapid-response humanitarian aid, advocacy work and cooperation with other churches and organisations throughout the world. *Sustainable Development* and *Democracy, Peace and Security* were two important themes for our work in 2013. The work relates to about 100 partner organisations, more than 300 projects in 38 countries and about 5,000 international representatives in dioceses and parishes. The inter-

national work of the Church of Sweden is part of the ACT Alliance, Action by Churches Together, a global coalition of churches and organisations engaged in humanitarian aid, development assistance and advocacy. The ACT Alliance has 132 member churches and affiliated organisations and a total of about 30,000 staff working in 140 countries. The international work of the Church of Sweden is also promoting sustainable business conduct by companies with ties to Sweden through the involvement in Swedwatch.

Read more: www.svenskakyrkan.se/internationalwork

Our partnerships

We participated in several forums and initiatives in 2013 that are working to promote long-term value creation and sustainable development.

UN PRINCIPLES OF RESPONSIBLE INVESTMENT (PRI)

PRI's membership has grown strongly in recent years to encompass more than 1,200 asset owners and investment managers who represent combined capital of \$32,000 billion. The Church of Sweden became a signatory in 2007, thereby making a commitment to integrate environmental, social and governance factors in its research and investment decisions.

www.unpri.org



THE INSTITUTIONAL INVESTORS GROUP ON CLIMATE CHANGE (IIGCC)

The IIGCC brings together 80 European investors whose aim is a low-carbon economy. The IIGCC encourages public policy that can facilitate such a transition. The issue was pursued in preparation for the climate talks in Warsaw. In total, members of the initiative represent around €7,500 billion in assets.

www.iigcc.org



CDP

CDP is an organisation that aims to disclose corporate emissions of greenhouse gases and report on water strategies. The fundamental precept is that greater access to information will facilitate responsible investment decisions. At present, several thousand companies report to CDP, which works on behalf of about 720 institutional investors that represent combined assets under management of \$87,000 billion.

www.cdp.net



THE SWEDISH FORUM FOR SUSTAINABLE INVESTMENT (SWESIF)

SWESIF is an independent network of organisations working with sustainable investment in Sweden. The purpose of the forum is to increase knowledge and interest in sustainable investment among institutional asset owners and managers. At the end of 2013, Swesif had some 35 member organisations.

www.swesif.org



SUSTAINABLE VALUE CREATION INITIATIVE

The Sustainable Value Creation Initiative is a cooperative project conceived in 2009 by 14 influential Swedish institutional investors. The group reaches out to board chairs and CEOs of the 100 largest public companies in Sweden with the message that working in a structured manner with sustainability is essential to securing long-term value. Combined, the investors included in the initiative represent almost one-fifth of the capital traded on the Stockholm Stock Exchange.

www.hallbartvardeskapande.se



THE GLOBAL NETWORK INITIATIVE (GNI)

GNI is a multi-stakeholder initiative in which companies, civil society organisations, academics and investors are working to protect the rights to freedom of expression and privacy. Shared learning, advocacy, public reporting and independent assessment of ICT companies are key components of the initiative.

www.globalnetworkinitiative.org



Focus on the financial sector – where do we go from here?

The climate crisis and the economic crisis must be handled together. So said Lord Nicholas Stern, one of the most prominent economists in the world, at the very outset of the economic crisis in 2008. Three years earlier, he had been appointed by the British government to head a comprehensive inquiry tasked with determining how the global economy could respond to climate change and cast off dependence on fossil energy. His message was crystal clear: the longer we put off dealing with climate change, the costlier it will be for the global economy and the worse will be the damage. The report had strong impact worldwide.¹⁵

Today, five years later, we must concede that neither crisis has been resolved (although the economic crisis has been ameliorated by robust stimulus packages from several of the world's leading central banks). Meanwhile, companies are increasingly acting on the conclusions of the Stern review and reports by other researchers on the consequences of climate change. Visionaries speak of a nascent paradigm shift, away from fossil energy sources and constantly increasing extraction of natural resources to an economy, still capitalist, that becomes circular or even regenerative.¹⁶ In a regenerative economy, companies look at natural resources, waste, consumption and ownership in a new way. It is not only about recycling and reusing, but also fundamentally changing production and usage patterns.

Our present economic system proceeds from the notion that many natural services are free. These 'ecosystem services' help

the world through everything from insect pollination of crops to forests that, in addition to supplying us with fibres, regulate the conditions for wind, water, topsoil and air temperature. These services are essential to our access to food, clean water and much more, and are thus the backbone of our economy. In line with this, the latest World Economic Forum (WEF) survey of how leaders and decision-makers view risk showed that four out of ten of the greatest threats to the global economy are linked to ecosystem services (see box below). In agreement with Nicholas Stern, the WEF report concludes that environmental issues and social issues cannot be separated from economic development.

THE TEN GLOBAL RISKS OF GREATEST CONCERN IN 2014, ACCORDING TO THE WEF SURVEY ¹⁷

1. Fiscal crises in key economies.
 2. Structurally high unemployment/underemployment.
 3. Water crises.
 4. Severe income disparity.
 5. Failure of climate change mitigation and adaptation.
 6. Greater incidence of extreme weather events (e.g. floods, storms, fires).
 7. Global governance failure.
 8. Food crises.
 9. Failure of a major financial mechanism/institution.
 10. Profound political and social instability.
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¹⁵ The full report may be accessed here: http://mudancasclimaticas.cptec.inpe.br/~rmclima/pdfs/destaques/sternreview_report_complete.pdf

¹⁶ www.capitalinstitute.org/blog/beyond-sustainability-road-regenerative-capitalism#.UupR8PI5Ov8

¹⁷ www3.weforum.org/docs/WEF_GlobalRisks_Report_2014.pdf

People and natural resources are the core of the public economy. Sustainable and viable long-term economic development can only be achieved when these resources are in harmony with the economic system and not over-exploited. During 2013, the Church of Sweden began to illustrate how the financial sector could become more sustainable, with a particular focus on the role of asset owners and asset managers. We wanted to widen the focus from individual companies and funds to the sector as a whole. During meetings and seminars with sector representatives, the following barriers for change were identified, along with paths forward to enable the industry to contribute more to sustainable development, particularly within asset management.

THE NEED FOR LONG-TERM OWNERSHIP

One of the fundamental tasks of the financial sector is to allocate resources among various parts of society by correctly pricing financial risk. Allocation refers to a combination of distributing, transferring and appropriating resources. Meanwhile, many studies have shown that short-termism in the financial sector has increased, which makes it harder to meet the long-term needs of society. It emerged in one study, for example, that a full 80% of the CEOs who responded to the survey would refrain from a profitable investment if it would have adverse impact on the quarterly report.¹⁸

In 2011, the British government requested a study of how the financial sector could become more long-term and better at

creating value for society. The resulting Kay Review¹⁹ called for a new perspective on risk and ownership in the sector. Companies need to be given scope to invest in the future so that they can continue generating value for both shareholders and society as a whole. The Kay Review stresses that investors must see themselves as owners of the companies in which they invest, rather than traders in securities. Today, investors hold a share for only seven months on average. From the 1940s until the mid 1970s, shares were held for an average of seven years.²⁰

INCENTIVE SYSTEMS THAT PROMOTE SUSTAINABILITY

There is risk that today's demands for quick profits will inhibit long-term corporate behaviour. Short-termism in equity investments is worsened through short-term incentive systems in effect at asset managers and investee companies alike. Performance in the financial sector is still most commonly rewarded on an annual basis. Some of the asset managers engaged by the Church of Sweden have chosen to swim against the tide. They have developed internal incentive systems that promote long-term behaviour. One asset manager also applies a fee structure that benefits long-term clients, which is another important component in the context. It is not unusual for clients, especially institutional asset owners, to replace asset managers who do not perform well in the short term, which constrains the asset manager from acting from a long-term perspective.

¹⁸ Graham, J, Harvey, C, & Rajgopal, S 2005, *The Economic Implications of Corporate Financial Reporting*, *Journal Of Accounting And Economics*, 40, 1–3, pp. 3–73.

¹⁹ The Kay Review, <http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf>

²⁰ Dominic Barton, 'Capitalism for the Long Term', *The Harvard Business Review*, March 2011.

NEW TOOLS AND TRAINING

Market actors are increasingly seeing a need for new research tools and investment models to facilitate the analysis of long-term risks and opportunities. Bloomberg, a provider of business and financial information whose company data and analyses are used by much of the financial sector, launched a new climate analysis model called the Carbon Risk Valuation Tool in 2013. It shows how carbon prices affect the valuation of companies in the oil, gas and coal industries. The leading index provider, MSCI, recently introduced a new emerging markets index, developed for a Swedish client, from which companies with substantial fossil energy reserves or carbon footprints have been excluded. The purpose was to offer the client a benchmark that is less sensitive to stranded assets.

The Church of Sweden welcomes the emergence of new analytical tools. We also recommend that fund companies reinforce their internal expertise in these areas so that they can evaluate the information and ask the right questions of their investee companies.

THE VIEW ON RISK

In somewhat simplified terms, sustainable investment involves expanding the view on risks and opportunities and thinking long-term. We are of the opinion that the most common risk definition in fund investments is too narrow, since it focuses on how the daily return on the fund in question deviates from its benchmark. The greater the deviation, the higher the risk. This view on risk has gradually led to widespread ‘herd behaviour’. Companies and sectors are selected for the equity portfolio based on the mix found in an index, rather than selecting companies the asset manager believes in and has the capacity to track and analyse in greater detail. Nowadays, many investors are satisfied, even if they have lost money, as long as their fund has declined less than the index.

The Church of Sweden is attempting to add nuance to this logic. In our view, risk is primarily a matter of how our asset management outcomes stand up to our long-term return target. Our focus lies on this rather than monthly or quarterly deviations from the benchmark. Benchmark comparison may,

PHOTO: ISTOCKPHOTO



The turnover rate on stock markets has increased markedly. Today, investors keep an equity for seven months on average. From the 1940s up to the 1970s, investors held on to equities for about seven years.

however, be useful in evaluating isolated management performance. The asset managers we engage base their decisions on individual companies and particularly their potential to deliver good returns from a long-term perspective. The composition of the benchmark index (in terms of sectors, countries, currencies, etc) thus becomes secondary. The mandate also becomes rather concentrated, with comparatively fewer companies, around 30 to 60. Despite this explicit strategy, the risk level expressed in terms of active risk, or ‘tracking error’ (the deviation from the index) need not be markedly higher compared with other comparable investments.

THE NEED FOR BETTER DATA

Investors are dependent upon corporate information in order to take sustainability factors into account in their investment decisions. Thus far in Sweden, only state-owned companies have been required to issue sustainability reports. Denmark has chosen to go further: all large companies, including those in the financial sector, have been required since 2009 to publicly report how they are working with issues such as the en-

vironment, social responsibility and corporate governance. In the United Kingdom, it became required by law in 2013 for all large listed companies to report carbon emissions or explain why they do not do so.

During 2013, the Church of Sweden voiced its support of the European Commission’s proposal that all large companies within the EU must begin reporting material sustainability information. The final decision is scheduled for 2014. Looking forward, we hope that the quality of corporate sustainability reporting increases and that companies start linking sustainability aspects to their overall financial information. This practice, known as integrated reporting, is still in its infancy, but a global framework has been established since late 2013 and several companies, including some Swedish ones, are moving in this direction²¹.

In forthcoming years, the Church of Sweden will continue its efforts to bring about a more sustainable financial sector by highlighting best practices and inviting stakeholders to discuss these issues. We welcome your comments, thoughts or suggestions on this or other matters addressed in this report.

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PHOTO: FREDRIK SANDIN CARLSON

²¹ www.theiirc.org

Gunnela Hahn, Anders Thorendal and Sara Nordbrand.

Governance – The Asset Management Council

The Central Board of the Church of Sweden has delegated responsibility for asset management at the national level to the Asset Management Council. The Council works continuously to develop and improve asset management and the financial policy.

THE TASKS OF THE ASSET MANAGEMENT COUNCIL INCLUDE:

- Initiating and proposing changes to the financial policy
- Monitoring compliance with the financial policy
- Deciding the reference portfolio; that is, allocation among asset classes
- Selecting benchmarks for each asset class
- Selecting asset managers
- Deciding on matters related to corporate governance
- Regular reporting to the Central Board concerning financial performance and sustainability work

The Council had six members in 2013: three elected internally by the Central Board and three external experts. The primary role of the external experts is to provide skills and experience in asset management. All expert members are appointed by the Central Board.

HOW OUR WORK IS GOVERNED

THE GENERAL SYNOD

This is the Church of Sweden's supreme governing body, which appoints the Central Board of the Church of Sweden.

THE CENTRAL BOARD OF THE CHURCH OF SWEDEN

Leads and coordinates assignments at the national level. The Central Board has general strategic responsibility for asset management. The Board also decides on matters such as return targets and risk levels and sets the financial policy.

THE ASSET MANAGEMENT COUNCIL

Has operational responsibility, which includes decisions regarding asset managers, allocation between asset classes and exclusion of companies. The Council, which is appointed by the Central Board of the Church of Sweden, consists of representatives from the Central Board and external experts. The board members in 2013 are presented on the next page.

THE NATIONAL LEVEL

Executes decisions made by the Asset Management Council. Evaluates and follows up present and potential asset managers on the basis of a financial and ethical perspective. Works for active ownership through corporate engagement and cooperation with other investors.

EXTERNAL ASSET MANAGERS WE SELECT

Our external asset managers invest in securities on the basis of the mandate given them by the Church of Sweden. A few assignments are in the form of separate accounts and the rest are mutual funds.

MEMBERS OF THE ASSET MANAGEMENT COUNCIL IN 2013

BERTIL PERSSON

Chair; alternate member of the Central Board of the Church of Sweden.
Born 1940. Elected to the Council 2007.

Previous assignments

Director of Sweden's central bank and adviser to the IMF;
chair of the board of the Church Fund, 1999–2006.

BIRGITTA HALVARSSON

Member of the Central Board of the Church of Sweden.
Born 1957. Elected to the Council 2007.

Present profession

Vicar.

Previous assignments

Various board assignments with companies and public authorities.
Municipal commissioner of Torsby Municipality.

HANS WALLMARK

Member of the General Synod of the Church of Sweden.
Born 1965. Elected to the Council 2007.

Present profession

Member of Parliament and member of the party board of the Moderate Party.

Previous assignments

Municipal commissioner of Ängelholm Municipality.
Political editor of publications including Nordvästra Skånes Tidningar.

ÅKE GUSTAFSON

External expert.
Born 1958. Elected to the Council december 2012.

Present profession

CEO of Försäkringsbranschens Pensionskassa, FPK.

Other assignments

Director of Movestic Kapitalförvaltning AB.
Chair of the board of Stiftelsen De Blindas Bokfond.

Previous professional positions and assignments include:

CEO of Länsförsäkringar Fonder.
Director of the PSA/PSF pension funds.

KAJSA LINDSTÅHL

External expert.
Born 1943. Elected to the Council 2007.

Other assignments

Chair of the board of Södersjukhuset AB and the foundation Timba Bruk.
Director of PRI Pensionsgaranti, Thulestiftelsen (the Skandia Group) and the Institute for Financial Research (SIFR); member of the Investment Council of the Church of Sweden Pension Fund.

Previous professional positions and assignments include:

CEO and later chair of the board of Banco Fonder.
Chair of the Amnesty Business Group.

ÅSA OHLSTRÖM

External expert.
Born 1955. Elected to the Council 2007.

Present profession

Business owner.

Previous positions and assignments

CFO of Riksbyggen.
CEO of BoSpar.
Directorships for property companies.



From left: Hans Wallmark, Bertil Persson, Åsa Ohlström, Åke Gustafson and Kajsa Lindståhl (absent Birigitta Halvarsson).

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