

# **RESPONSIBLE INVESTMENT**

**REPORT 2015**

# CONTENTS

2015 Summary	3
New investments with concrete societal benefits	4
Financial performance	6
The Church of Sweden's efforts for a more sustainable financial sector	9
Our engagement in climate issues	10
Corporate engagement	11

This is the fifth year in a row that we have published the Responsible Investment Report. As of this year we are publishing the report in a different format. The information about new investments, financial performance and ongoing corporate engagement are found in this report where you will also find a number of links to further information on the Internet. Documentation of a more permanent nature, i.e. our method of investment, partners and governance, that we have previously published in each annual report, will shortly be found together with other more in-depth information on our website. Here you will also find, as previously, information about our holdings, financial policy and more. We will update the English version during the fall. Go to: [www.svenskakyrkan.se/economyandfinance](http://www.svenskakyrkan.se/economyandfinance) or [www.svenskakyrkan.se/responsibleinvestment](http://www.svenskakyrkan.se/responsibleinvestment).

# 2015 SUMMARY

## CONTINUED STABLE FINANCIAL RETURNS

Performance during 2015 shows that returns for the Church of Sweden's asset management for the national level exceed the long-term return target for both the year 2015 and a ten-year period. Returns during the period 2006–2015 were 70.4%, which corresponds to 5.5% per annum. The annual real returns, i.e. above inflation, during this period were 4.4% on average. Since 2010, the return target in real terms has been 3.0% and previous to this, 4.0% per annum.

In 2015, performance including bank and administrative fees was SEK 326.3 million (SEK 885.2 million the previous year). The total return amounted to 5.1% (16.0% the previous year). This is two (2.0) percentage points higher than the real return target and 2.5 percentage points better than our benchmark index. This is the fourth year in a row that returns have exceeded the weighted benchmark index for assets under management.

At year's end, assets under management amounted to SEK 6,759.5 million (SEK 6,432.6 million the previous year).

## NEW INVESTMENTS WITH CONCRETE SOCIETAL BENEFITS

During 2015, we continued to pursue investments that have concrete societal benefits. We made investments in a green bond fund for the efficient use of energy in south-east Europe, a fund for sustainable small banks, an old-school micro-financing fund and a real property fund with a green profile.

## OUR ENGAGEMENT IN CLIMATE CHANGE ISSUES

2015 was an important year for the climate and climate change policy. A historic agreement was signed in Paris in which most of the countries in the world committed to curb climate change. The Church of Sweden is very involved in climate change on a variety of fronts, including asset management. We have a long history of making investments in methods for counteracting climate change while at the same time also refraining from making investments in oil and gas.

## AWARDS

On 1 January 2015, the CFA Society Sweden's ESG Award was conferred upon the Church of Sweden along with SPP and the fourth AP fund (AP4). The jury's motivation reads:

"These institutions have demonstrated leadership and commitment to this challenge, each in their own way, as it relates to their fiduciary duty and clients. All three have incorporated their views on fossil fuels to implement investment strategies to capitalize and generate higher investment returns. They have demonstrated that you do not need to sacrifice short-term goals in order to achieve long-term objectives. Through their leadership they have invited to an industry dialogue and initiated the development of toolkits for a sustainable approach."

# NEW INVESTMENTS WITH CONCRETE SOCIETAL BENEFITS

## GREEN BONDS

During 2015 we invested in a new green bond fund. This fund invests in bonds that finance projects such as renewable energy, energy efficiency and infrastructure for water (supply) and sewage. The interest in green bonds has grown at an enormous rate throughout the world in recent years. It is a straight forward way to obtain green returns from fixed-income investments. To ensure that the money actually goes to the intended projects and that these wouldn't have been realised in any case, there is a process for getting a second opinion, i.e. that an independent organisation, often a non-profit organisation, takes a closer look at the bonds. Currently, there is no standard for this, but there is a voluntary green bond framework called Green Bond Principles. The fund that we have chosen is managed by SPP/Storebrand and invests in green and sustainable bonds around the world, including Sweden, that lead to sizeable improvements, primarily in the areas of climate and water. Information in Swedish about the fund can be found here [here](#) and about Green Bond Principles [here](#).

## CLEAN ENERGY IN SOUTH-EAST EUROPE

In late winter of 2016, we invested in a fixed-income security fund with immense benefits to the climate, the Green for Growth Fund. The fund lends money to companies, agricultural actors, households and municipalities who want to conserve energy or convert from fossil fuels to renewable energy sources in countries such as Albania and Bosnia as well as other new markets. The lending is done via local banks who also receive training in how to promote the efficient use of energy among lenders. This fund is unique in that it provides a substantial and measurable benefit to society at a low financial risk.

Since its inception in 2009, on average, the emissions of carbon-dioxide have been cut in half in the projects that have thus far been financed. Many operations have also been modernised, lowered their energy

costs and led to positive health and environmental effects. Large and important actors such as the European Investment Bank and the World Bank Group's International Finance Corporation stand behind the fund. Read more [here](#).

## MICRO-FINANCING 2.0

During 2015, the Church of Sweden invested in two innovative micro-financing funds that offer concrete societal benefits. The first is Sapphire, a new fund that we invested in as seed financiers. Its purpose is to strengthen the real economy and furnish small banks that want to act with greater sustainability, with assets to be used in the long-term, so that small and middle-sized companies can borrow money, grow and build stable, local economies in their communities. These companies focus on the environment, health, education and other important societal services. The small banks in the fund lend the greater portion of their assets, almost twice as much as many larger banks, to individuals and local companies. They are also not involved to the same extent in trading with different types of financial instruments and the risks that they imply. In light of the financial crises, one could say that the fund contributes to reduced risks and strengthens the global, financial system. Read more [here](#).

In many ways, Sapphire represents an innovative approach to micro-financing in which both the lender and borrower have benefitted. The micro-financing institutes whose objectives are to become regular banks, i.e. being entitled, for example, to receive deposits, benefit from this fund by receiving access to long-term capital that they can lend out to local, middle-sized companies that have different needs of financial services than those they had when they were small companies (micro-enterprises). This fund has been developed based upon the initiative of a global network of sustainable banks. Read more [here](#) and [here](#).

For a great many years, micro-financing has been a part of the Church of Sweden's international work,

conducted primarily through Oikocredit, one of the world's leading micro-financing actors that the Church of Sweden participated in instituting over 40 years ago. We invested as seed-financers in Sweden's first micro-financing fund for institutional investors that was launched by SEB 2013 (SEB Microfinance Fund) and reinvested in their third, follow-up fund in May 2015. The fund invests in institutes that lend smaller amounts of money, often just a few thousand kronor, to micro-companies that consist of perhaps just one person who may need to invest, for example, in a new sewing machine.

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Examples of companies active in micro-financing: One of our holdings is in the micro-financing fund M-KOPA Solar who currently supply over 300,000 households in Kenya, Tanzania and Uganda with electricity from solar cells that is sufficient to charge five mobile telephones, a radio and three LED lamps on a daily basis. For an equivalent amount, about \$ 0.50, which is what it costs a household without access to electricity to buy their daily supply of kerosene for lighting, they can instead buy a package on an instalment plan with solar cells, a battery and several lamps. After a year, when all payments have been made, they can keep the equipment. Instalment payments are made via the very same mobile telephones that the solar cells charge. M-KOPA Solar can monitor the equipment remotely and step-in if it doesn't operate properly or if the customer is not making payments. When the initial purchase has been completed, the customers can continue the agreement and take a step up to a larger battery that will supply a digital TV – a move that is very popular. The company is growing at a rate of 500 new customers per day and has over 750 full-time employees and 1,200 representatives working in the field.

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## **REAL PROPERTY WITH A GREEN PROFILE**

During 2015, we invested in another real property fund, Thule Real Estate, which is managed by Skandia Fastigheter. To a great extent, environmental work in buildings concerns reducing energy consumption using a variety of methods, e.g. sun-screening, more efficient ventilation, presence detection LED lighting, and offering occupants green, rental agreements in which both parties commit to reducing environmental impact in different ways.

The district, Masthusen in Malmö is the first district of its kind in the Nordic countries to be sustainability certified in line with the BREEAM Communities concept. In addition, the district, which also belongs to Thule, has received the rating, "Excellent" which is the highest rating possible (for a Swedish property). The district generates almost all of its own energy needs locally via geothermal heating and solar cells. The roofs and a building wall are covered in plants which contribute to biological diversity. The district shall also provide a better quality of life for those who use offices and occupy residences, including adjoining areas, by providing a useful selection of services, public transport and verdant public places such as parks etc.

A completely renovated property at Sveavägen 44 in Stockholm has also been certified according to BREEAM standards and has also received the highest rating possible (in Sweden). This property was also the first in Sweden to receive such a rating.

# FINANCIAL PERFORMANCE

## SUSTAINABILITY IN FOCUS

In the task given to the Asset Management Council by the Central Board of the Church of Sweden, it is clearly stated that asset management shall focus on long-term performance. The target return is 3% per annum over inflation measured in rolling ten-year periods. To meet this demand, we have created a balanced portfolio containing equities, fixed-income securities, real property and alternative types of investments. We have chosen to invest in real property and alternative investments because we want to limit the risks in our overall portfolio by supplementing it with asset classes whose returns are not expected to follow the equities and fixed-income markets particularly closely. Making alternative investments, often in unlisted holdings, also provide the opportunity to make investments of a more focused character where the Church of Sweden can make a difference and provide benefits to society.

During 2015, we increased our investments somewhat in real property and in alternative investments. In the currently extremely low interest environment, can expect a higher return as compared to traditional fixed-income investments over time.

For the ten-year period 2006–2015, our returns were 70.4% corresponding to 5.5% per annum. The return target for the same period was 55.2%. The graph on pg. 7 illustrates this. The annual real return during this period, i.e. above inflation, was 4.4% on average. Since 2010, the return target in real terms has been 3.0% and previous to this, 4.0% per annum.

## PERFORMANCE 2015

Performance in 2015, including bank and administrative fees amounted to SEK 326.3 million (SEK 885.2 million the previous year). Returns in the overall portfolio amounted to 5.1% (16.0%). This is two (2.0)

percentage points higher than the real return target and 2.5 percentage points better than our benchmark index. This is fourth year in a row that returns have exceeded the weighted reference portfolio's<sup>1</sup> return. During 2015, this was due solely to asset managers of primarily global equities, and to a certain extent equities in Emerging Markets, significantly outperforming their respective markets (benchmark index). This so called, tactical asset allocation had however, very little importance during 2015.

Among the different asset classes, global equities yielded the highest returns at 11.2% followed by real property at 8.8%. The Swedish equities market was strong during the year; SIXRX increased by 10.4%. Unfortunately, our Swedish equity portfolio only achieved half of this return (5.2%), primarily due to our only having limited holdings in smaller companies, who performed excellently on the stock market during the year. This was more than compensated for however, as previously mentioned, by the asset managers, for both global equities and emerging markets, achieving significantly better results than their respective markets.

As expected, in light of the low interest levels, returns from fixed-income securities were low during the year, but in any case positive.

Alternative investments contributed to performance in 2015 to a much lesser extent than the previous year. The primary reason for the negative return (-1.9%) was the hedge fund (Excalibur) which is a part of the portfolio (and constitutes the single largest investment in the asset class). Moreover, 2014's performance was strengthened by the micro-financing fund having an unusually high return due to a positive currency effect.

Several of the investments within the real property and alternative investments asset classes are long-term commitments in which the investment periods stretch over several years and we have only made initial invest-

<sup>1</sup> Our weighted benchmark index is based upon long-term strategic allocation. Our allocation among asset classes for 2015 in the reference portfolio was as follows: global equities 20%, Swedish equities 20%, Emerging Market equities 10%, fixed-income securities 30%, corporate bonds 5%, real property 5% and alternative investments 10%. The table on pg 7 shows the benchmark index we use for each asset class.

ments in a couple of cases. In addition to the reported invested assets within these portfolios, at year's end there were outstanding commitments of SEK 300 million that will be invested during the coming years.

The tables below show more information on performance for 2015 and our historical returns five and ten years back in time. We consider the ten-year performance to be an important benchmark.



\* The graph shows only returns for each respective full year, with one measurement point per year. The real return target was 4 % during the period of 2005–2009 and was adjusted to 3 % in 2010.

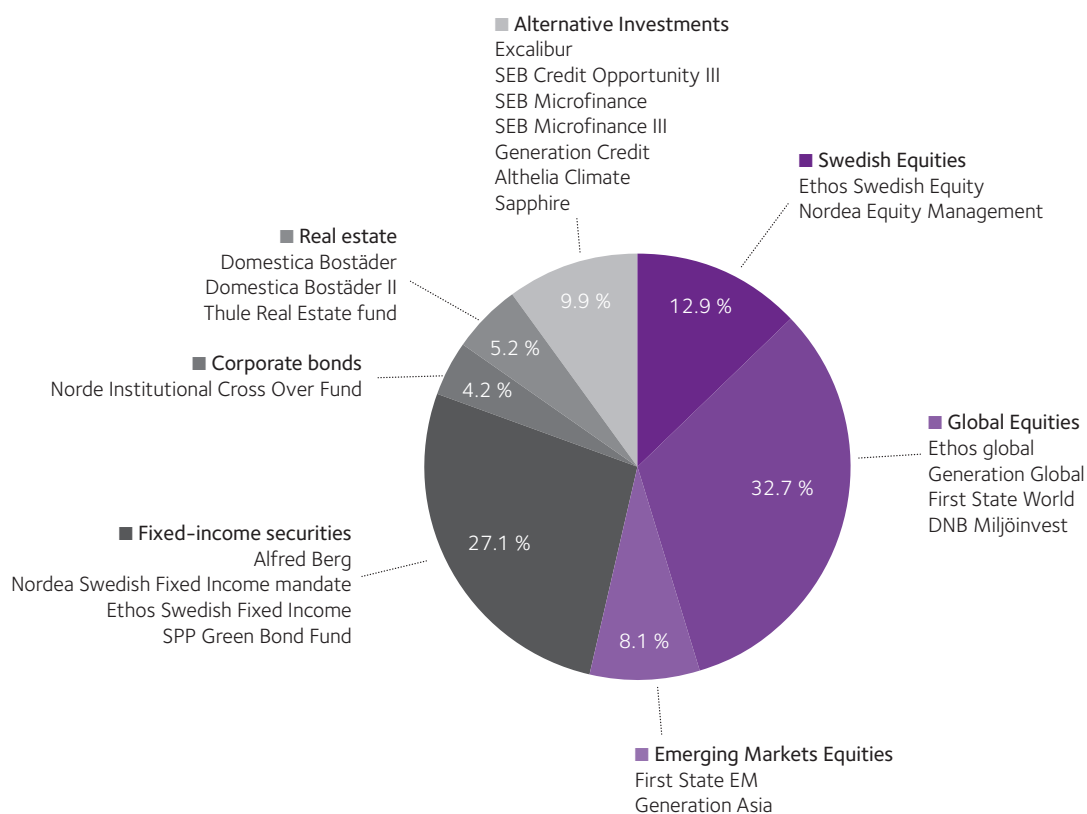
Tillgångsslag	Profit 2015 mnkr	Return full year 2015		Return full year 2014		Average annual return 2011–2015		Benchmark
		Portfolio	Index	Portfolio	Index	Portfolio	Index	
Swedish Equities	69.1	5.2 %	10.4 %	15.5 %	15.8 %	6.9 %	10.5 %	SIX RX
Global Equities *	234.0	11.2 %	3.6 %	26.3 %	22.7 %	11.9 %	9.6 %	DJSI World
Emerging Markets	-15.6	-2.8 %	-7.8 %	27.0 %	18.7 %	6.6 %	-0.4 %	MSCI EM
Fixed-income securities	4.6	0.2 %	0.5 %	7.2 %	7.1 %	3.9 %	3.9 %	OMRX Bond
Corporate bonds **	3.3	1.2 %	-0.5 %	7.0 %	8.8 %			Merrill Lynch EMU
Real estate ***	24.5	8.8 %	3.1 %	7.1 %	2.7 %			KPI + 3 %
Alternative investments	6.4	1.2 %	3.1 %	8.8 %	2.7 %	5.8 %	2.9 %	KPI + 3 %
<b>Total</b>	<b>326.3</b>	<b>5.1 %</b>	<b>2.6 %</b>	<b>16.0 %</b>	<b>12.5 %</b>	<b>7.2 %</b>	<b>6.0 %</b>	

\* In this asset class, that is in total compared to DJSI, the DNB Miljöinvest is included (return 11,7 %, benchmark Wilderhill New Energy index 9,4 % for 2015).

\*\* Holdings total over 30 months, which is why there is no long-term average return.

\*\*\* Holdings total over 36 months, which is why there is no long-term average return.

## DISTRIBUTION AMONG ASSET CLASSES 31 DEC 2015



## THE TEN LARGEST HOLDINGS

### Swedish Equities

Hennes & Mauritz  
Nordea  
Atlas Copco  
Autoliv  
Swedbank  
SEB  
ABB  
Volvo  
Ericsson  
Millicom Int. Cellular

### Global Equities

Linear Technology Corp  
Unilever  
Nielsen Holdings Plc  
MSCI Inc  
Tencent Holdings Limited  
Naver Corporation  
Mediatek Inc  
Sirona Dental Systems Inc  
Legrand SA  
Microsoft Corp

### Emerging Markets

Unilever  
Marico  
Taiwan Semiconductor Manufacturing Company Ltd  
Tech Mahindra Limited  
Standard Foods Corp  
Natura Cosmeticos SA  
Manila Water Company  
Tencent Holdings Limited  
Dr. Reddy's Laboratories Ltd.  
Samsonite International



# THE CHURCH OF SWEDEN'S EFFORTS FOR A MORE SUSTAINABLE FINANCIAL SECTOR

For many years, in a variety of contexts, we have emphasised the need for financial sector to redefine its role in society and the economy. Changes in the climate need to be addressed with new forms of investment and a changed view of risk in the short and long-term. We see signs of this occurring in many areas. Several large asset managers in Europe have this issue on their agenda and the UN has a programme, Inquiry into the Design of a Sustainable Financial System, which highlights the good examples that already exist and provides concrete proposals for the way forward in an effort to align the financial sector with the objectives for sustainable development.

But the financial sector cannot resolve larger societal problems on its own or invest in the solutions that we all understand are necessary. As is often the case, politicians must provide the framework, policies and regulations that make it possible for market forces to act for the common good. In Sweden, these questions are the responsibility of Per Bolund, the Minister of Finance. As an example of this, the Government has

commissioned the Financial Supervisory Authority to conduct an investigation into the need to stress-test the Swedish financial system in relation to climate change risks. The report was issued in March and stated that Sweden is at lower risk than other countries since we are not equally as dependent upon fossil-fuel energy sources. Despite this, the Financial Supervisory Authority is still encouraging Swedish banks to stress-test their lending and assets based upon more stringent climate control and a changed climate.

For many years, in a variety of contexts, the Church of Sweden has also communicated its views on these questions directly to the minister. On one such occasion at our Almadalen, Visby seminar, we invited Per Bolund, Sarah McPhee who has been the MD for SPP for many years, Mats Andersson, MD for AP4 as well as Svenne Junker, researcher for the Stockholm School of Economics to participate in a panel discussion. The question posed was whether or not the financial sector was ready to tackle the climate challenge. View the panel discussion [here](#).

# OUR ENGAGEMENT IN CLIMATE ISSUES

During the year, we have been invited by other organisations, for example, churches, municipalities and investors both in Sweden and internationally to explain how, since 2008, we have conducted our strategic work regarding climate change issues in our asset management. Many organisations are considering how they can manage their assets in a more environmentally compatible manner.

Interest in the financial sector was especially great in 2015 as a result of a comprehensive campaign against investments in the fossil-fuel industry, i.e. companies that extract, coal, oil and natural gas. This campaign was initiated by students in the USA and spread throughout the world. In combination with the 2015 United Nations Climate Change Conference held in Paris in December 2015, pressure was extra strong on investors to show responsibility in regard to this issue.

Read the agreement [here](#).

## INCREASED FOCUS ON INVESTORS' ROLES IN CLIMATE ADAPTATION

After the Paris Agreement we can expect more stringent climate control measures around the world and more focus on the financial sector's role in directing the flow of finances in a manner that will reduce the carbon footprint which is a specifically expressed objective in the agreement. To achieve the two-degree objective, i.e. that the planet's average temperature increase at most 20 C compared to the pre-industrial age, at least two-thirds of the earth's fossil-fuel reserves must remain in the ground. These assets are today valued highly on the balance sheets of fossil-fuel companies and risk becoming "stranded", i.e. and losing their future value. That risk does not exist in our portfolio since we divested the major part of our holdings in these companies as early as 2008. Another objective in the Paris Agreement is to strive for a maximum temperature increase of 1.50 C as this would significantly reduce the risks and effects of climate change.

The greatest risks to the climate are found in energy-intensive companies such as those active in the steel,

cement and power-generating industries as well as the automotive industry. We only have holdings in a few such companies. We are in any case committed to our companies working actively with climate change issues since developing more efficient energy use can be achieved in most businesses thus promoting positive future development. We also attempt to continuously find new investments that offer solutions to the climate crises such as renewable energy, energy efficiency and the protection of tropical forests. For example, we are proud of the benefits for people, biological diversity and the climate that our investments in Althelia Climate Fund make. This fund was awarded a prize by the UN for being one of the foremost agents for change, a "game changer", in the climate change issue. Read more [here](#) and [here](#).

## PROACTIVE INVESTORS

The Church of Sweden has been a member of the Portfolio Decarbonisation Coalition (PDC) since 2014. We saw this as an opportunity to share our knowledge and experience with other investors on how to combine good returns with a climate strategy as well as to learn from others. PDC gathers together about 25 asset owners and managers who work proactively to reduce climate risks in their investments. Collectively, they have carried out climate change adjustments in their portfolios amounting to over \$600 billion.

The initiative was launched to send a clear signal to politicians during the 2015 United Nations Climate Change Conference held in Paris in December 2015 that investors are already working with climate adaptation in their portfolios that they need additional help from policy decisions. Previous to the Paris conference, the objective was to mobilise \$100 billion. During the Paris conference several large insurance companies and pension managers announced that they were participants in the group thus making it possible to exceed our target by 600%! Read more [here](#).

# CORPORATE ENGAGEMENT

Overall, the Church of Sweden's portfolio contains holdings in companies who have extensively incorporated sustainability work into their operations. At the same time, many difficult challenges remain, so there is always much room for improvement even in those companies who have come relatively far in this work. We review our holdings regularly with the help of the consultancy firm GES Investment Services who search for news and databases around the world. If a company has drawn attention to itself because they have breached an international convention, GES initiates an analysis and dialogue with the company. If the accusations are true and indicate serious faults in the company's governance, a process is begun, that we sometimes take part in, to influence the company to correct its actions. There were no such cases in 2015. We have, however, carried out dialogues on themes that we consider to be of importance. We often work in conjunction with other investors to garner greater attention.

One such issue has regarded banks. Together with other investors, we have inquired into how banks align their operations with the risks and opportunities that climate change creates. Previous to the Paris Climate Change Conference, a report was published that summarised the current state of this work and presented a number of good examples of actions taken in this area. However, the report also shows both that the banking sector is missing an opportunity to be a clear force in the conversion from fossil-fuels to renewable energy and also that the lack of clear climate change strategies creates a great many financial risks. Follow-up discussions are planned for 2016.

Another issue regards taxation. For a society to function properly it needs tax revenues. Companies that are all too ingenious in their tax avoidance are not acting in the best interests of society. Several large companies that are active in Europe have drawn attention to themselves due to the fact that they pay almost no taxes. This has already led to consequences, for example, in the form of strengthened legislation in the EU that require multi-national corporations to provide

accounts of how much tax they pay in each individual country beginning in 2016. For this reason, we have conducted discussions during the past year with a number of Swedish and foreign companies in an effort to have them report what principles characterise their deliberations on these issues and how they are governed and followed up. We have also given our views to two pharmaceutical companies who we invest in since the pharmaceutical industry is one of the industries that will most likely be greatly affected by the new tax legislation in the coming years. The Church of Sweden also supports a working group within the UN initiative, UNPRI (Principles for Responsible Investment) in this issue.

Three years have passed since over 1100 workers were lost when a large factory, Rana Plaza, collapsed in Bangladesh. These people, mostly female textile workers, were forced to work in buildings that were flimsy and very dangerous. As a result of the catastrophe, the industry promised to take measures to increase safety and reduce the risk of fire in factories around India. Much has been done, however, much more needs to be done to adhere to the established schedule of corrective and safety measures. At the beginning of 2016, in an effort to draw attention to the plight of the textile workers three years subsequent to the tragedy at Rana Plaza, the Church of Sweden signed an appeal addressed to the textile industry together with 139 other institutional investors with collective assets of over \$3000 billion. It encourages the textile industry to meet its obligations regarding building safety and ensuring that independent safety committees at the factory are formed.

## FREEDOM OF EXPRESSION AND INTEGRITY

The Global Network Initiative (GNI) is a multi-party initiative established in 2008 for the purpose of strengthening the freedom of expression and integrity on the Internet and telephone. Members are investors,

academic institutions, human rights organisations and corporations. The Church of Sweden has been a board member since 2013. Over a longer period of time, there have been attempts to broaden membership beyond Internet companies such as Google and Microsoft. During 2015, an agreement was reached with seven

telecom companies who after a longer period of co-operation with GNI have decided to become observers (which precedes full membership in 2017). The companies are TeliaSonera, Millicom, Vodafone, Nokia, Telenor, Spanish Telefónica and French Orange.