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# Instructions for ethical and sustainable investment for the Church of Sweden's asset management at the national level

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## 1 Instructions for ethical and sustainable investment - background

In the Financial policy for the church's national level, decided on by the Central Board of the Church of Sweden 22 April 2010 and updated latest on 27 Feb 2020, it is stipulated that the Asset Management Council shall establish investment instructions for asset management. This document contains the ethical and sustainable aspects of this management. Other governing documents prepared by the Asset Management Council are "Financial investment instructions for the Church of Sweden's asset management at the national level" and "Working methods and reporting for the Church of Sweden's asset management at the national level".

The Asset Management Council regularly, normally once a year, examines whether changes need to be made to these investment instructions.

The financial policy does not go into detail on how, for example, controversial activities should be interpreted (see section 6.3 in the financial policy) or what the restrictions on fossil energy based on climate considerations mean (section 6.3.1). Nor is it described in more detail what the Church of Sweden means by responsible and sustainable companies. This is why we have developed these investment instructions which clarify how we view responsible and sustainable companies and certain industries. These instructions are thus a clarification of the financial policy and provide the necessary guidance for asset managers.

The asset managers who have questions about the policy and investment instructions are welcome to contact the Finance Unit at the Church of Sweden's national level via the switchboard, 018-169500.

## 2 Responsible and sustainable companies – overall purpose of the investments

In section 6.2.2 it states that the Church of Sweden shall contribute to solutions for sustainable development in our world. Managers of the Church of Sweden's capital are therefore expected to choose companies based on societal benefits, where the global development goals provide guidance. This means that, e.g. companies through their goods and services contribute to sustainable development or work systematically and purposefully with issues related to the environment, working conditions, human rights and poverty reduction, where it has a bearing on their businesses. This also regards issues that regard corporate governance, i.e. corruption, remuneration system and transparency.

The asset managers we secure the services of must be able to justify holdings based on the wording in the financial policy above. Extra demands are placed on companies operating in regions or industries where the risk of corruption or lack of respect for human rights and the environment is high.

By "company" we also mean financial activities in other forms, such as projects or consortia.

### 2.1 Screening and company dialogues

The policy states (section 6.2.2) that selected companies must comply with international regulations (*international norms*) that aim to protect people and the environment. For this reason, the holdings list must undergo an annual screening (deep analysis) based on international norms. The companies that are in breach of any international norm must be followed up, as there is a great risk that they are not in compliance with the policy. Depending on what measures the companies take, how serious the violations are and how well the sustainability work as a whole is integrated, it is then decided whether these companies should be retained or divested.

The manager must also have knowledge of the strengths and weaknesses in the companies' sustainability work. In the examples below, we describe how the Church of Sweden at the national level views different factors before making a decision.

### **Example 1 Deficiencies in a company with well-developed sustainability work**

Even companies that have come a long way can prove to have serious shortcomings in some portion of the business and risk not being in compliance with the policy. The asset manager must then have a dialogue with the company in question, or with several companies in the same industry, in order to improve the company or companies' working methods. Once again, the companies' response, action plan and how serious the shortcomings are, are absolutely decisive for whether they are possible to invest in.

### **Example 2 Company that has begun late**

Some companies and industries have come further in their sustainability work than others. The companies that started late or for other reasons have not integrated sustainability issues into their business operations must at least have reached an acceptable level or be able to demonstrate clear and ambitious change work in order for an investment to be compatible with the Church of Sweden's financial policy.

### **Example 3 Small and middle-sized companies**

Large companies often have an environmental staff or a sustainability department that communicates with investors. Smaller companies seldom have such resources. Their impact on the environment and surrounding communities can still be significant. For this reason, we place equally high demands on risk analysis, a well-thought-out sustainability strategy and the introduction and follow-up of activities at all companies, regardless of size. On the other hand, we believe that the requirements for how extensive the work should be, ought to be set in relation to the company's size and actual impact.

## **2.2 Exclusion of certain industries**

Asset managers must thus focus on finding responsible and sustainable companies. Then there are other aspects of responsibility that concern certain controversial products and industries that the Church of Sweden does not want to invest in (see section 6.3 in the financial policy). The Church of Sweden has therefore formulated specific requirements for industries related to fossil energy, weapons, pornography, tobacco, alcohol and gambling for money. In some cases, a qualitative assessment needs to be made to determine whether a company constitutes a possible investment or not. How these assessments shall be made is described in the following section.

### **2.2.1 Less focus on benchmark**

Because the Church of Sweden's policy excludes industries with controversial activities as described above, about half of the investment universe in the MSCI World Index, calculated in capital value, is not eligible.

In such active management, it is difficult to obtain a low Tracking Error (the standard deviation between the fund's return and the benchmark's return) against an index such as MSCI World. This is because the industries and companies that are excluded make up a significant part of these indices. We therefore allow (and expect) a Tracking Error that is higher compared to more conventional management, which is based on mimicking its benchmark index in terms of exposure to different industries.

The manager should be able to show in an analysis how the deviations from the benchmark index have affected the return. It is not in itself unusual for the Tracking Error to differ quite a lot between different active asset management types with the same benchmark index.

### 3 Climate strategy – a guide based upon sector

Since 2008, the Church of Sweden has had a consistent climate strategy in the entire portfolio at the national level, as stated in section 6.3.1 of the fiscal policy as follows:

The Church of Sweden perceives climate change as a serious threat to creation and the basic living conditions on our planet and therefore does not invest in companies engaged in the extraction of fossil energy sources such as coal, oil and gas, or energy production that largely consists of fossil fuels. Thus, we do not invest in, e.g. oil sands or shale gas. Asset managers of the Church of Sweden's capital are instead expected to invest in companies that in a constructive manner contribute to solving climate issues.

#### Increased focus on selection of individual shares

Climate strategy has two components. In one component, the Church of Sweden actively looks for companies that offer sustainable or "climate-smart" goods and services, energy from sustainable energy sources or have energy-efficient processes in place. We also do not invest in companies that extract fossil energy from the earth's crust. We are also restrictive in regard to producers of electricity, heating and cooling (electricity producers) who use fossil energy sources in their production. The focus of all investment decisions is to choose shares that managers believe are financially, socially and environmentally sustainable in the long term, while at the same time providing a good financial return. The Paris Agreement is indicative and we assess the climate performance in the companies' entire value chain, both upstream and downstream. We believe that the information can be misleading if you do not include the carbon footprints in the entire value chain in communication material about funds, as these measurements often omit about 80% of emissions. For example, a manufacturer of vehicles using fossil fuels can have significantly lower emissions than a manufacturer of solar panels. There are other ways to report a fund's climate performance, such as how well the companies in the fund adhere to the Paris Agreement or Science-based targets (<https://sciencebasedtargets.org>), what their emissions targets and investments in climate measures will look like in the next few years, and so on.

#### 3.1 Sectors that require special screening

The other component in the climate strategy regards certain industries and thus shares that do not match the Church of Sweden's overall climate goals or the intentions of the fiscal policy and are therefore excluded. Although the world is dependent on fossil energy today, it also needs to switch to a sustainable energy supply. We believe that it is easier for power plants to use renewable energy sources to a greater extent to produce heat, cooling and electricity, than for oil, coal and gas extraction companies to drop their core business and increase the supply of renewable energy. So far, we do not know of a single company in oil, coal and gas that can show figures that they are changing their business model from extracting fossil energy to something else. However, there are several such electricity producers. For this reason, we make a distinction in the climate adjustment between companies that extract and electricity producers.

Below are the results of this approach. The guidelines must be applied by all asset managers who state that they follow the financial policy.

### 3.1.1 Industry-specific interpretation (based mainly on the division in GICS)<sup>1</sup>

Some companies are in industries that should be completely excluded. Other companies exist in different types of industries and are therefore covered by other parameters. Companies with significant fossil reserves<sup>2</sup> are not investable.

#### **A. Oil and gas**

1. Excludes companies within GICS industry code 1010 Energy:

- 10101010 Oil & Gas Drilling
- 10101020 Oil & Gas Equipment & Services
- 10102010 Integrated Oil & Gas
- 10102020 Oil & Gas Exploration & Production
- 10102030 Oil & Gas Refining & Marketing
- 10102040 Oil & Gas Storage & Transportation as well as Pipelines
- Coal & Consumable Fuels

2. Excludes exploration and extraction of oil sands, shale oil and shale gas, regardless of industry and scope.

#### **B. Coal**

1. Excludes sector: Coal
2. Other sectors: Excludes companies with revenues >5% of sales from exploration and extraction of coal, such as certain mining companies.

#### **C. Service companies and other sectors**

Excludes a) service companies (including oil and gas distribution companies) with revenues >25% from activities within A. and B. above; b) companies with revenues >25% from similar activities as in A. and B. but belonging to another industry; c) majority owners of companies within a) and b) above (i.e. within C.).

#### **D. Electricity producers and electricity distributors**

1. Companies that produce or distribute electricity from nuclear power  
Electricity producers and electricity distributors with large exposures to nuclear power can be selected if they are leaders in sustainability in their industry, especially in terms of safety and the environment. The companies are investable if less than a quarter (<25%) of the electricity comes from nuclear power. However, the precautionary principle must apply.
2. Companies that produce or distribute electricity from coal, oil or gas  
Electricity producers are investable if less than a quarter (<25%) of installed production capacity is intended for fossil energy sources and there is a clear plan to reduce that portion. Electricity distributors are investable if less than a quarter (<25%) of the distribution consists of electricity from fossil energy sources and there is a clear plan to reduce that portion.

#### **E. Energy-intensive companies**

Companies in certain energy-intensive industries such as cement, steel and paper can be selected if they are leaders in sustainability in their industry, primarily in regard to the issue of climate. They

<sup>1</sup> Global Industry Classification Standard, <https://www.msci.com/our-solutions/indexes/gics>

<sup>2</sup> See text <https://www.ffisolutions.com/research-analytics-index-solutions/research-screening/>

may, for example, have adopted targets for net-zero emissions or "science-based targets" which show that they have a plan to be aligned with the Paris Agreement.

## 4 Alcohol, tobacco and gambling for money

The Church of Sweden applies restrictions on how large a share of sales, i.e. the turnover that a company can have from a certain type of product that they manufacture. We have decided that income from production may not exceed 5% for alcohol, 0% for tobacco and 5% for gambling. (See section 6.3.3 in the policy) Companies whose products are necessary for the design or development of software or platforms specific to the gaming industry are also not investable.

In regard to the distribution of these goods, however, we have not set any absolute restrictions, because it can sometimes be difficult to collect and secure this type of data, and to set parameters that lead to a fair and meaningful assessment.

This does not mean "carte blanche" for companies that distribute alcohol, tobacco and gambling. If such companies are selected, the asset manager must also be able to justify the choices of companies on the basis of the requirements for accountability in section 6.2.2 of the finance policy.

## 5 The Church of Sweden's weapons criterion - a guide

Section 6.3.2 of the financial policy describes the weapons criterion:

The Church of Sweden excludes investments in companies that to a not insignificant extent manufacture or sell weapons or munitions. The Church of Sweden also excludes investments in companies that are actively involved in the development and production of particularly inhumane weapons or their special components. What is meant by actively involved is the provision of products and services that are specifically tailored to weapons.

### Definition of weapons and weapons-related munitions

Weapons refer to products intended to kill, mutilate or destroy and which are sold for military purposes. Munitions refers to products or sub-components that are specially developed to be included in weapons or weapon systems. Products and services covered by the Church of Sweden's policy are based on the appendix to Ordinance 2019: 314 on munitions, which can be downloaded from the website of the Swedish Inspectorate for Strategic Products (ISP). Products covered are all munitions for combat systems as well as the products and services under the category, Other Munitions, that have been significantly modified to be used in combat systems. Other products in the appendix are not covered in cases where they are deemed to have dual uses (military/civilian) and/or lack a clear connection to the combat function.<sup>3</sup>

### 5.1 Assessment based on relevance

#### 5.1.1 One percent (1%) – a grey area for analysis

For companies whose turnover from weapons or munitions are central to the combat function, a zero limit (0%) applies. In the case of companies whose turnover from other military products (e.g. test instruments) exceeds 1%, they are in principle not investable, while if they are below 1%, they are

<sup>3</sup> <https://isp.se/media/1313/sfs2019-314.pdf>



approved for investment. However, the 1% limit is only a benchmark. Companies whose turnover is close to this limit are not excluded or approved automatically but are assessed individually.

In addition, it is important to look at whether the company's connection to weapons adds up to a significant amount. If the company is on lists of the 100 largest contracts for leading military customers but still has less than 1% connection, it must be included in the analysis.

### 5.1.2 Look at the whole company

If a company has products with a connection to weapons of about 1% but the products are not central to the combat function, the manager should also make an overall assessment of how responsible the company is. The less open a company is, the more careful the valuation of the weapons connection must be. A slightly larger share of sales than 1% can only be accepted if the company is transparent and conducts good sustainability work. The asset manager should be able to justify such a holding. This small amount of flexibility, therefore, only applies if the company's products with a weapon connection are not central to a combat function.

### 5.1.3 Influence the company to sell its operation

If a company has a weapon-related production below 1% of sales but is central to the combat function, it is not investable. In these cases, the company shall be divested as quickly as possible. In some cases, however, there may be an opportunity to influence the company in question to sell its weapons-related operations. This is especially true if the operations are extremely marginal and stand in the way of the company's sustainability profile. There are several examples of companies that are excluded from different sustainability indices due to a marginal connection to weapons, despite the fact that they receive high sustainability ratings. There are also examples of companies with a sustainability profile having divested their military operations. The asset manager and the Church of Sweden should therefore investigate the possibility of urging the company in question to sell its operations that are linked to weapons. If the company is open to such a discussion, the Church of Sweden - together with the asset manager and preferably with other capital owners and asset managers - can begin a dialogue process. If the commitment does not yield results within a reasonable time, the holding is divested in a discretionary mandate. In open-end funds, the asset manager decides on the sale. If the asset manager is not responsive to our reasoning, we must consider divesting the fund. In this manner, we exercise our responsibility as owners to influence companies to take a more sustainable and responsible direction. Each such case, however, must be examined individually by the Church of Sweden (which is ultimately responsible for how the weapons criterion is to be interpreted) based on how we view the company, the weapons-related product and the possibilities of achieving the desired result of the dialogue.

### 5.1.4 List of weapons and munitions

The Military Equipment Act is part of Swedish legislation, while products that are used both militarily and for civilian purposes are covered by EU legislation. In 2012, the list of weapons and munitions was revised and is now adapted to the EU Military List (ML). It is divided into 22 different areas. For companies that provide services to military customers, the asset manager should assess whether the services are part of the core business and whether they are used for offensive purposes.

Read the entire list in Swedish [here](#)<sup>[4]</sup> and in English [here](#)<sup>[5]</sup>. They both have the same content as the Swedish regulation we mentioned above.



## 5.2 How should the criterion be interpreted?

### 5.2.1 Examples of types of companies that are investable

#### Company A

The company owns 20% of a company that belongs to Other Munitions according to ISP's division. The turnover from the production that can be linked to weapons is only 0.3% and is not central to the combat function.

#### Company B

Sales from the part of the business that can be linked to weapons are marginal, 0.3%. The content is not central to combat functions.

#### Company C

Company C owns 20% of company E, see below. Otherwise, there is no link to weapons.

#### Company D

The company makes test instruments, which are important (but not central) to combat functions. Approximately 1% of the turnover is weapon related. They are a leader in sustainability issues. An overall determination leads to the company being investable.

**Companies that manufacture semiconductors** - can be compared with manufacturers of nuts and bolts, i.e. semiconductors are not central to combat functions. The companies are investable as long as the products are also sold to civilian customers, but not if they are only sold to the military.

We consider companies that manufacture **certain other munitions** to be investable. Examples are protective equipment and ammunition for hunting or sport shooting.

### 5.2.2 Examples of companies that are not investable

#### Company E

Three (3%) percent is weapons related. The company owns 49% of a company that manufactures combat vehicles, which are categorised as being central to combat. It is thus excluded both in terms of scope and type of product.

#### Company F

Although the turnover is below 1%, it is excluded due to the contents of the product. The company has advanced pilot training programs for attack aircraft that are used on a large scale.

#### Company G

Through its wholly owned subsidiary, the company manufactures advanced combat vehicles, which are central to combat functions. Therefore, they are excluded. However, sales are below 1% from this business.

## 6 Church of Sweden's pornography criterion

The criterion can be found in section 6.3.5 of the fiscal policy and has the following wording:

### *Production and distribution of pornography*

The Church of Sweden does not invest in the production or active distribution of pornography that in an open and challenging way depicts sexual situations or events, where human value and dignity are violated.

## Definitions and considerations

Active distribution refers to marketing or sales that are a result of the company's own active measures.

According to the National Encyclopaedia, pornography is a "term for very different, entertaining and pleasurable descriptions of the erotic life of man." Swedish legislation today has restrictions on depictions of "sexual violence or coercion" and against "children in pornographic contexts". However, even legal pornography can in many cases be linked to human value and dignity being violated. Nevertheless, there is also erotic or pornographic literature and films that affirms a healthy sexuality in both men and women.

However, it is difficult to draw a sharp line between the healthy and the offensive. What is taboo and shameful has also changed over time and looks different in different cultures. As far as we know, there are no listed companies that produce what we, in everyday speech, consider to be pornography. Nevertheless, we have a zero limit for the production of pornography.

Distribution of pornography, on the other hand, is a more complicated issue. Companies that distribute pornography do not report their revenues from this segment. In other words, it is difficult to assess the content and scope of the programme offering at, for example, a film distributor. What can nevertheless be assessed is whether the company in question actively markets pornography. Therefore, the Church of Sweden refrains from investing in companies whose income comes from the company's own active measures in marketing and distribution of pornography.

From a purely technical point of view, it is therefore impossible to guarantee a zero limit for distribution, as there is insufficient or reliable data. For technical screening reasons, we therefore set the limit slightly above zero percent, 0-1%. In practice, this means that the media companies that are investable for the Church of Sweden do not show any tangible and received income from pornographic films or other pornographic material where human dignity is violated.

## **6.1 Interpretation key for active distribution**

Production of pornography occurs only in a few isolated cases among the world's listed companies. These companies are excluded immediately due to the criterion. The distribution of pornographic materials regards the following sectors:

- Trade
- Telecom operator
- Media
- Hotel

The different industries are involved to varying degrees and have different driving forces for their involvement. There is a clear and distinct line in the level of activity between companies that receive a significant part of their income from pornography and those companies that only to a small extent make money from the distribution of pornographic material. The companies that are active in their marketing of pornographic material also make the most money from it. These companies are in the media industry.

On the other hand, revenues from the distribution of pornography are marginal for the hotels, trade and telecommunications operators. The companies in these industries are also passive in their distribution. Pornographic material may be available to those who are interested, but customers must look for it themselves and make an active and conscious choice to get access to it. It can be compared to libraries that provide pornographic material.

The hub of distribution is thus the media companies. They own and operate channels for cable TV and satellite TV. They also sell movies over the Internet. It is these companies' activities that occur in the three other industries, which mainly function as distribution channels to the media companies. In the future, it is possible that telecom operators will be more proactive, and then we will have to make a new assessment.

Screening should therefore only be done by the media industry, with GICS code 25401025.

The media companies that have a clear connection to pornography are not investable. With regard to the other industries (trade, telecommunications operators and hotels), it can be stated that the distribution of pornography that occurs can be characterised as passive. The business is also very limited in scope.

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<sup>[1]</sup> Global Industry Classification Standard, <https://www.msci.com/our-solutions/indexes/gics>

<sup>[2]</sup> See, e.g. <https://www.ffisolutions.com/research-analytics-index-solutions/research-screening/>  
<https://isp.se/media/1313/sfs2019-314.pdf>

<sup>[3]</sup> [https://eur-lex.europa.eu/legal-content/SV/TXT/PDF/?uri=CELEX:52019XG0312\(01\)](https://eur-lex.europa.eu/legal-content/SV/TXT/PDF/?uri=CELEX:52019XG0312(01))

<sup>[5]</sup> [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XG0328\(01\)&qid=1498749371326&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XG0328(01)&qid=1498749371326&from=EN)