A4S
ASSET OWNERS
NETWORK

SECURING LONG-TERM VALUE THROUGH STEWARDSHIP

Practical example: Alecta

THE PRINCE OF WALES'S
CHARITABLE FUND

alecta

WHAT?

Alecta is a Swedish mutually owned occupational pension company with 35,000 corporate customers and 2.6 million private customers. We have assets under management of more than SEK 960 billion (approximately US$ 100 billion), of which more than 40% are equity shareholdings distributed across just over 100 investee companies.

Our strategy is to be an active investor, and we do all of our work in-house. As an active investor that cares about social and environmental issues, we have a corporate governance policy that guides how we engage with our investee companies on sustainability and other areas. For us, stewardship consists of having regular dialogue with companies, voting in shareholder meetings and collaborating with other owners.

This active approach to stewardship helps us to meet our own sustainability objectives and policy: we are committed to building a portfolio that aligns with the Paris Agreement 1.5°C ambition and we aim to achieve net zero by 2050. One of the activities we undertake to make sure that we are operating in line with our sustainability objectives is to carry out an annual stress test exercise. Our findings feed back into the conversations that we have with the companies in our portfolio.

WHY?

Our main goal is to ensure that we generate as much value as possible for our customers. Actively considering how companies manage social and environmental risks and opportunities is something we think is essential to fulfilling that fiduciary duty. Companies that are both well managed and well equipped to manage the transition to a net-zero emissions economy offer more value, stability and resilience.

As a pension company we need to be able to deliver returns to our customers many years into the future. We think that investee companies best placed to grow in value, and survive shocks, are those that have built environmental, social and governance (ESG) factors into their strategies and business models. So for us, sustainability is not at odds with delivering strong financial returns – it safeguards returns over the long term.

To achieve those sustainable returns, we have to understand the companies that we invest in at a deeper level. Our ongoing dialogue with companies gives us better information about our investments, better data and more opportunities to influence companies' direction and practices. This helps the companies in our portfolio to create value, which ultimately creates value for our customers.

HOW?

Our corporate governance policy reflects our view that stewardship is a critical part of being an active investor. We developed the document internally – with the Swedish Corporate Governance Code as a useful reference – and our board of directors approved it. The value of this policy is twofold: it makes it easier to show stakeholders how they can expect us to behave in the market and it steers our stewardship work. The policy is supported by more specific guidelines and goals.

Stewardship can operate in different ways. For us, in line with our active investor strategy, stewardship is primarily about our engagement and dialogue with investee companies rather than divestment. We want to understand a company's potential and then support it on its path to net zero – so long as the company has a trustworthy plan, clear milestones that they are meeting and engaged leadership. Beyond this, we exercise our voting rights and collaborate with other organizations that share our goals.

Through these activities we work towards our own sustainability objectives. To get a sense of where we are on our net zero target, we stress test our portfolio against climate scenarios. We build up our portfolio-level analysis from information about the carbon emissions of each investee company. This means we can use the stress test at a more granular level, to guide our assessment of whether a company is on track. Where we have concerns, we take our analysis and questions directly to the company.

BEING AN ACTIVE INVESTOR

DIALOGUE

The most important stewardship strategy for us is our ongoing dialogue with the companies we invest in. We talk to companies about their approach to key business areas such as strategy, risk and governance – and how they integrate ESG issues into these areas. Our net zero target is an explicit part of these conversations.

Approaching stewardship in this way means we can influence the companies in our portfolio to enhance their disclosures and KPIs. Over time this will support us to get better data to monitor progress against our own sustainability objectives. Building up this in-depth knowledge of our investments also helps us to create strong returns for our customers.

VOTING

We find that we get more impact with other types of engagement but voting is still an important platform for exercising our corporate governance policy. Our goal is to vote in all of the shareholder meetings for our investee companies, and we disclose this in our annual report. For the 2019 financial year, we voted in all but one of these meetings.

Internally, we review all of the agenda items and suggestions for AGMs to take a view on them, with their ESG impact being a major consideration. At meetings we vote, and we also ask questions about social and environmental issues. When we need to, we vote against motions that are not in line with our objectives and ambitions, including net zero.

COLLABORATION

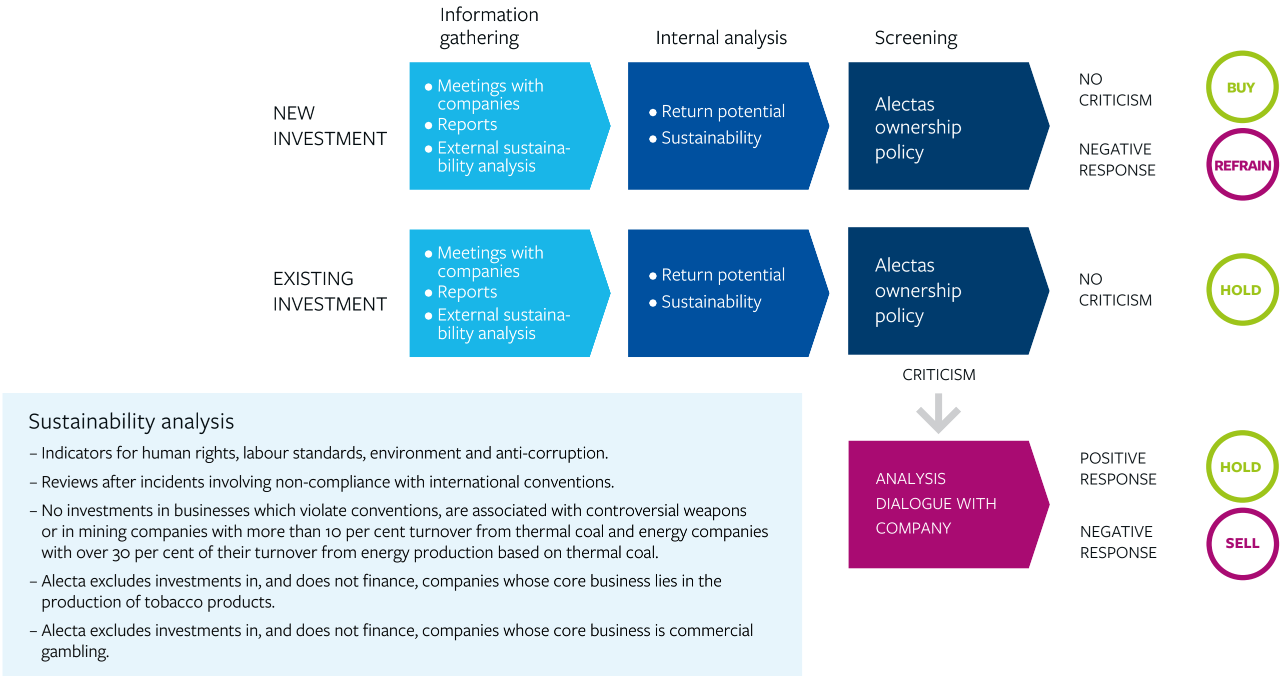
Although we generally act independently, our corporate governance policy permits us to collaborate with other shareholders. Working with alliances is particularly useful for increasing our impact when we engage with larger investee companies in which we hold a smaller share.

To support this element of our stewardship, we are a signatory to Climate Action 100+. We are also founding members of the UN-convened Net-Zero Asset Owner Alliance. The goal of this alliance is to work together with other investors to accelerate the transition to a net-zero emissions economy. There are a range of other initiatives and partnerships that we actively take part in too.

OTHER METHODS

We used whatever reasonable means are at our disposal to pursue our net zero objective. For Swedish companies, we often are part of the nomination committee. This is one way that we can ensure that the board of directors has capacity and interest in taking social and environmental issues seriously as part of the company's strategy.

ALECTA'S INVESTMENT PROCESS



Source: Alecta's Annual Report 2019

USING STRESS TESTING

THE APPROACH

The goal of our stress test was to test our portfolio against a 1.5°C warming scenario.

To develop our analysis, we first analysed current carbon emissions for each company in our portfolio. Our data on scope 1, 2 and 3 carbon emissions came from a third-party provider that approximates emissions. For scope 3, we also used company-reported data from Bloomberg, and used this instead of the approximated data where possible.

Once we had the emissions data, we calculated our share of those emissions based on the proportion of company shares that we held.

Then we turned to a carbon price. We looked at a range of sources to identify a carbon price that aligned with our 1.5°C target. We discounted that carbon price from 2040 to today and multiplied it by our share of emissions.

Finally, we had a result that we could compare to market value, and we could see the discrepancy between market value and the carbon-adjusted value that we had calculated. The difference is because the market value undervalues the – current and future – price of carbon.

THE CHALLENGES

We experienced three main challenges with stress testing our portfolio:

1. **Carbon price**: The range of carbon prices we found in available external research was very large, so the price we select makes a big difference to our results. We chose to use estimates from the Intergovernmental Panel on Climate Change and the International Energy Agency.
2. **Disclosures**: We had to rely heavily on approximated data. In our portfolio, about 80% of companies disclose scope 1 and 2 emissions, and fewer companies report scope 3 emissions.
3. **Data quality**: Where scope 3 emissions data does exist, that data isn't always reliable. We discovered significant differences between company-reported scope 3 emissions and the approximated data from our third-party provider, with the company-reported data generally being higher.

THE APPLICATION

The stress testing exercise gave us useful information that we could take to companies, talking to them about our results and analysis. This provided a framework for asking about how they planned to bring their emissions in line with a 1.5°C target and ultimately get to net zero. When the companies have identified a way forward, we will get the details of that plan and monitor their progress.

Our data challenges also prompted us to encourage companies to report scope 1, 2 and 3 emissions data.

NEXT STEPS AND TOP TIPS

NEXT STEPS

We see this as an area where it is in the interest of investors to cooperate: strengthened engagement and data around climate change will help the whole institutional community to improve the data, improve the reporting and meet our net zero goals. So we will continue to collaborate with other institutional investors and organizations such as A4S, working to put us all in a better position.

TOP TIPS

START FROM YOUR FIDUCIARY DUTY

Our starting point has to be fiduciary duty – and clarifying what that means. Increasingly, our end customer wants both robust returns and a strong performance on social and environmental issues. But it all ties back to fiduciary duty.

ENGAGE WITH YOUR INVESTEE COMPANIES

Having a meaningful engagement with companies is a way to drive real and lasting change. As shareholders, we can use our influence to steer companies towards net zero and better targets, metrics and disclosures.

TARGET YOUR APPROACH

For our approach to stewardship, we have identified the most effective ways to engage with the companies in our portfolio given our structure, business model and investments. You may have other options open to you. Focus your activities where you can have the most influence.

COLLABORATE

There are many initiatives working on ways to help institutional investors by strengthening data, improving reporting and supporting engagement with investee companies. Participating in these initiatives can increase the number of tools you have access to and your potential impact.

GET IN TOUCH OR FIND OUT MORE

@PrincesA4S

The Prince's Accounting for Sustainability Project (A4S)

ThePrincesA4S

info@a4s.org

www.accountingforsustainability.org

A4S ASSET OWNERS NETWORK

The A4S Asset Owners Network is a grouping of pension fund chairs and trustees to discuss integrating sustainability into investment decision making. Click here to find out more.