

Annual Report 2018



We invest pension assets
to make them grow.

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Highlights of the Year

The Fund reports a strong ten-year result, but with a slight decline in 2018. The value of net assets decreased to SEK 324 billion.

Comments from the CEO

CEO Johan Magnusson looks back on a year when many markets grew weaker. The Fund made changes to its portfolio.

Our Mandate

AP1 shall contribute to a stable pension system and create a real return of at least 4 per cent in the long term. Six 'investment beliefs' guide the Fund's work.

Our Investments

In order to achieve our goal, we invest in equities and fixed-income securities, and also make alternative investments. The fund allocation spreads the risk and allows long-term return opportunities.

Results

We exceeded our ten-year income target by a good margin. The risk level of investments was reduced, which entailed a reduction in the proportion of equities. The excess return was positive also in 2018. AP1 maintains a long-term approach. Changes in the AP Funds Act entail new investment opportunities and demands on exemplary asset management.

Our Employees

A high level of education and cutting-edge expertise characterises AP1 employees. During the year there were several internal projects to strengthen the Fund's role as a modern, attractive workplace.

Looking ahead

Several key ratios and political uncertainty indicate a weak development for the financial markets.

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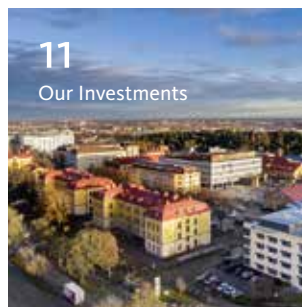
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We invest pension assets to make them grow

FÖRSTA AP-FONDEN (AP1) IS firmly based in Sweden, but executes its mandate around the world. This means that Norwegian fjords, American technical innovations and Japanese basic industry are all part of our day.

We manage part of the capital in Sweden's national income pension system. Our assets of more than SEK 320 billion are distributed across equities, fixed-income securities, real estate, infrastructure, private equity funds and hedge funds. We invest sustainably and long-term, and practise responsible ownership.



AP1's investment in the private equity fund behind Hurtigruten is one of many examples of how the Fund manages pension assets.

Highlights of the Year

Net investment income for 2018 means that AP1's return exceeds the long-term target of an annual real return of 4.0 per cent after expenses over rolling ten-year periods.

- Net investment income after expenses for 2018 was SEK -2,074 million (29,349). This equals a return of -0.7 per cent (9.6).
- The average annual real return after expenses for the past ten-year period is 7.4 per cent, which is higher than the target of 4.0 per cent.
- Management generated an excess return of SEK 5.5 billion (3.5) above the Fund's strategic asset allocation, which equates to 1.7 per cent (see pages 8 and 24). The main contributions in absolute terms came from real estate and private equity funds.
- AP1's total portfolio value on 31 December 2018 was SEK 324 billion.
- Since 2009 AP1 has disbursed SEK 51 billion, of which SEK 6.8 billion in 2018, to cover the contribution deficit in the income pension system.
- The Fund's administrative expenses totalled SEK 451 million (445), equalling 0.14 per cent (0.14) of average assets under management.
- During the ten-year period 2009–2018, the Fund's return exceeded the income index by 5.9 per cent a year on average.
- The risk level in the portfolio was reduced in line with market developments.
- A decision was made to stop investing in companies that produce tobacco, nuclear weapons, thermal coal and oil sands.
- Seven of the UN's Sustainable Development Goals were selected as being of particular relevance to the Fund's operations.

Return after expenses



-0.7%

Net assets



SEK 324 bn

Into the pension system



SEK 6.8 bn

| Five-year overview – summary | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|-------|-------|-------|-------|-------|
| Return before expenses, % | -0.6 | 9.7 | 9.5 | 4.1 | 14.8 |
| Expense ratio, % | 0.14 | 0.14 | 0.15 | 0.17 | 0.17 |
| Return after expenses, % | -0.7 | 9.6 | 9.3 | 4.0 | 14.6 |
| Net investment income after expenses, SEK bn | -2.1 | 29.3 | 27.0 | 11.3 | 36.4 |
| Net flows, SEK bn | -6.8 | -7.4 | -6.6 | -4.9 | -5.1 |
| Closing net assets, SEK bn | 323.7 | 332.5 | 310.5 | 290.2 | 283.8 |
| Exposure, % | | | | | |
| Equities | 34.1 | 37.9 | 34.1 | 34.7 | 48.9 |
| of which Swedish equities | 11.2 | 12.9 | 12.3 | 12.3 | 11.6 |
| Fixed-income securities ⁽¹⁾ | 33.3 | 31.7 | 29.8 | 30.2 | 30.9 |
| of which fixed-income securities in other assets | 0.0 | 0.5 | 2.5 | 2.3 | 3.3 |
| Real estate | 14.3 | 12.8 | 12.6 | 11.5 | 8.8 |
| Infrastructure | 3.7 | 3.4 | 3.0 | 2.9 | |
| Hedge funds | 4.6 | 4.0 | 5.0 | 4.8 | 5.9 |
| Private equity funds | 5.5 | 4.6 | 4.7 | 5.0 | 4.4 |
| High yield | 2.8 | 4.5 | 4.5 | 2.9 | |
| Alternative strategies | 0.9 | 1.0 | 5.0 | 4.4 | 5.6 |
| Systematic strategies | 3.2 | 3.0 | 4.5 | 5.2 | |
| Special investments ⁽²⁾ | | | 0.5 | 0.7 | |
| Foreign exchange | 26.0 | 25.3 | 22.1 | 31.3 | 35.1 |
| Share of external management, % | 33.5 | 32.5 | 31.8 | 31.0 | 34.6 |

⁽¹⁾ Investment grade bonds (fixed income incl. cash funds in accounts = 32.14% for 2018)

⁽²⁾ As of 2017, special investments are reported under equities



The number of employees was 60, including Malin Johansson.

Prepared to face harder times

We can look back on a ten-year period during which we exceeded our long-term target, but the long-awaited slowdown on the market finally happened in 2018. To adapt to the commercial environment, we reduced the risk level in our investments.

AP1's net investment income for the ten-year period 2009–2018 was a real return of 7.4 per cent after expenses. This means that we are exceeding our target by a good margin. For the individual year 2018 the result was in line with our expectations. Following a long period of very positive development, it was clear that the foundation for continued growth was not present. The return for the year finished at -0.7 per cent. The Fund's asset management has however created surplus value of just over SEK 5 billion, the largest contributors being private equity funds and real estate. Our net assets total SEK 324 billion, and during the year we transferred SEK 6.8 billion to the Swedish Pensions Agency to cover the deficit in pension disbursements.

“The risk level is lower than normal”

For several years now we have been saying that the extremely favourable conditions on the financial markets are not sustainable in the long term. We have enjoyed very high returns on our assets ever since the economy began to recover from the latest financial crisis. We can now see signs that conditions are changing. We therefore anticipate a growing challenge in terms of achieving our real return target of 4 per cent, and the Board will be reviewing the Fund's long-term targets.

In order to adapt to the developments on the market, in 2017 we began to reduce the risk level in our portfolio, and this process continued in 2018. This means that should the market develop weakly, the Fund will be in a more

favourable position than had we retained a higher level of risk.

There is much to indicate that we have passed the economic peak in the current cycle.

Meanwhile, monetary policy continues to tend towards austerity around the world. The majority of 2018 was characterised by high asset values, high indebtedness in many places and strong optimism on the financial markets. Company investment decisions continued to be made on the assumption that interest rates would remain low and demand high. There was concern towards the end of the year, however, and we saw for instance that developments in the US led the way when the stock markets fell in large parts of the world. The situation remains vulnerable. Individual incidents risk triggering dramatic reactions on the market.

We consider it wise to maintain a lower risk level. We do however realise that the markets will grow again in the future, and AP1 needs to be prepared to make the most of new opportunities. We are able to have this preparedness thanks to our position as a long-term player within the framework of a stable pension system. We know from experience that preparations for action in turbulent markets are important if we are to make rational decisions to secure a good return in the long term.

So as regards to our various asset classes, real estate and private equity funds developed positively. Real estate companies Willhem and Vasakronan posted returns of just over 20 per cent each. Equities generally performed poorly, including on emerging markets and in our quantitative portfolio management.

We uphold our positive view of equities in emerging markets and of the Swedish krona, where we have relatively significant positions. Apart from

that, for the past few years we have been focusing on increasing our holdings in infrastructure, which is an important complement to our other asset classes. We are working to develop new solutions for cooperation in this area.

“We say no to tobacco, nuclear weapons, thermal coal and oil sands”

Changes in the National Pension Insurance Funds (AP Funds) Act brings us more flexible investment rules from 1 January 2019. The basis for achieving our return target improves, for instance in the reduction of the minimum limit for fixed-income securities from 30 to 20 per cent of the portfolio.

We look forward to the next stage of modernisation in the investment rules, as this will improve opportunities for making unlisted investments.

The new regulations also entail higher demands on the AP Funds to act in an exemplary way from a sustainability perspective. We have worked closely with the other AP Funds to formulate a joint approach to core values, guidelines for sustainability reporting, and which assets the funds should avoid investing in. The well-established, successful collaboration in the AP Funds' Council on Ethics has served us well in this respect.

The joint guidelines on which assets funds should not be invested in are primarily related to international conventions. AP1 also chooses not to invest in 100 or so companies that produce tobacco, nuclear weapons, thermal coal and oil sands; these companies do not



"We are taking goal-conscious action to integrate sustainability aspects into our entire portfolio," says Johan Magnusson.

directly violate the conventions, but their business conflicts with the spirit of them.

We are taking goal-conscious action to integrate sustainability aspects into our entire portfolio. During 2018 we have drawn up specific sustainability beliefs to increase the stringency around how these issues are dealt with. We are now better equipped to communicate our broad initiative in a cohesive way.

In 2018 we took part in 37 Swedish shareholders general meetings and voted in 570 foreign ones. AP1 is represented in 11 nomination committees in Swedish companies ahead of the 2019 shareholders general meetings; as one of the major players we are involved, for instance, in nominating board members.

The fact that work on ownership issues is demanding is occasionally very apparent. During the year were represented on the nomination committee of Swedish gaming company Starbreeze, and endeavoured to raise the level of board expertise. This work intensified

at the end of the year when the company filed for reconstruction. This example shows how resource-intensive it can sometimes be to own equities in small companies. Having said that, we consider investments in small companies to be essential in order to achieve a good return over time. Moreover, our portfolio of Swedish small companies has performed well overall.

The Swedish government's latest assessment, published during the summer, shows that AP1 and the other Swedish National Pension (AP) Funds have all contributed to the strength of the income pension system. We recently heard the pleasing news that the estimated deficit between contributions to and disbursements from the pension system is shrinking, which relieves the pressure on the system. AP1 still has the vital task of safeguarding Swedish pensions, and we approach this mission with great respect.

As I look back on 2018, there are

many positives to highlight and take with us into the year ahead. One important internal project during the year was our work on operational risks. We have mapped and are developing many of our business processes. We continue to work on self-leadership, a process that gives our personnel greater opportunities to make decisions independently. This means that we have improved our toolbox in various ways during the year and are continuing to build an even more modern, attractive workplace.

We are developing at a good pace and several exciting initiatives are under way. This in turn has created positive development for the organisation. We have refined our processes and our expertise, and I would like to take this opportunity to thank all employees who have given of their knowledge and dedication.

Stockholm, February 2019
Johan Magnusson

Our mandate and how we carry it out

AP1 has to manage the assets to the greatest possible benefit of current and future Swedish pensioners. Good performance by the Fund helps to create pension stability across generations.

The Swedish income pension system is a pay-as-you-go system. This means that the money being paid into the pension system today is paid out to today's pensioners. Similarly, the people who are now working and paying into the system have the right to receive a pension in future.

In the long term, the size of pensions that can be paid out will be determined by the overall payroll amount in Sweden. The more of us there are working and the longer we work, the higher the pensions can be.

The pension system in itself is stable. It is structured in such a way that it cannot make a loss over time. It does, however, happen that pension contributions paid in are not sufficient in the short term to pay out disbursements. This is when the difference is balanced out by withdrawing funds from the First, Second, Third and Fourth AP Funds (AP1-4).

It is the task of the AP Funds to manage a part of the pension assets as well as possible, so as to balance any gap between contributions and disbursements and help to keep the system stable in the long term.

AP1-4 jointly manage around 15 per cent of the assets in Sweden's national pension system, some SEK 1,400 billion in total. At present assets in the system are approximately 4 per cent larger than liabilities.

It is therefore the task of AP1 to contribute to secure income pensions by creating the highest possible return on the assets for which we are responsible. We strive to be a world-class pension manager, and to perform on the same level as leading global asset managers.

Target: real return of 4 per cent

Our asset management should result in the return on net assets developing better than average pay. Expressed specifically, our target is for the real, i.e. inflation-adjusted, return to be higher than 4.0 per cent after expenses, measured on a rolling ten-year basis. This target will be reviewed by the Board of Directors during 2019.

Control and mandate

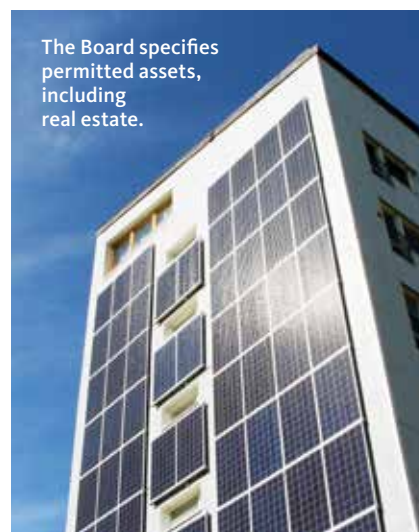
The AP1 Board of Directors establishes the return target and decides the level of financial risk the Fund should take. The Board specifies on a general level how much capital should be invested in equities and fixed-income securities respectively. It also establishes which deviations from the goals and which asset classes are permitted. The starting point is the National Pension Insurance Funds (AP Funds) Act.

The Board's guidelines are broken

Why funds with different numbers?

The four Funds all serve the same purpose. The assets are divided between four funds so as to spread the risks. The Board of each Fund decides on the focus of investments, within the framework of the AP Funds Act. This is why there are some differences in terms of allocation into asset classes.

The Board specifies permitted assets, including real estate.



down into several levels at AP1. The Fund's CEO specifies the goals for asset management over ten years. The CIO sets the strategic portfolio for three to five years ahead. This is then executed by the investment organisation and formulated as a set of reference values, a benchmark, for each individual asset manager.

AP1's operation is continuously monitored via internal control and internal auditing. The Fund is also scrutinised annually by external auditors, and by the Swedish Government.

Our investment beliefs

To guide its work towards achieving 4 per cent return, the Fund has six investment beliefs: long-term approach, risk premiums, diversification, cost efficiency, sustainable value creation and inefficient markets. These are described in more detail further on in the report.

The investment in electricity distribution company Ellevio is one example of how AP1 benefits from its long-term approach.



Long-term approach

Taking a long-term approach creates opportunities for taking risks. This in turn creates returns, since the risks are balanced over time.



The long-term investment approach gives AP1 benefits over other investors. It allows more opportunities and reduces the financial risks over time.

The ability to invest in assets that are not liquid is one way of deploying the

long-term approach; this is an ability that many other investors do not have.

The least liquid assets include infrastructure, in which ownership is generally very long term. Infrastructure is often publicly regulated and a natural monopoly, which provides stable cash flows. In the long term, income follows growth in society. The Fund's investments in infrastructure provide a high return in relation to the risks and also contribute to sustainable value creation.

Risk premiums

Risk-taking on the financial markets is assumed to yield a positive return over time.



The risk premium is the additional return obtained in relation to the risk-free interest for the investor that takes a market risk. AP1's potential to benefit from risk premiums is closely linked to the Fund's long-term approach. There is no guarantee that the Fund will receive payment for its risk premiums every year; over the long term, the Fund counts on receiving that much higher payment on average. Not utilising risk premiums would entail passivity on the Fund's part and thus limit the potential for returns.

Diversification


We invest worldwide and in many types of assets. The aim is to spread the risks while creating several options for generating returns.



The portfolio includes equities and fixed-income securities, as well as alternative investments such as real estate, infrastructure, private equity funds, hedge funds and foreign exchange. The asset classes are affected in varying ways by changes in the market and economic environment. The liquidity of the assets – i.e. the ability to sell them quickly to allow new investment opportunities or make disbursements into the pension system – also varies.

Cost efficiency

AP1 should act on a commercial basis and have low costs in relation to the profit it makes.

 The Fund's return level should not be burdened by inefficient cost utilisation. It is, however, crucial that costs be measured in relation to returns in the portfolio.

Since 2014, cost efficiency has been

measured annually by CEM Benchmarking of Canada. All the measurements have shown that AP1 is cost efficient by international comparison.

Comparison is made with 18 asset managers with a similar distribution of assets. The aim is to consider differences that may be attributable to asset classes having different levels of cost demand.



Investments on emerging markets, such as India, present good opportunities.



Vasakronan owns many properties with a strong sustainability profile.

Inefficient markets

An information advantage and meticulous analysis provide opportunities for higher returns on less well-analysed markets.


 On an efficient market, the price of an asset reflects all the available information and the collective analysis of all investors. Financial markets rarely work in this way, although many parts of them are well analysed. By considering less well-analysed markets, AP1 can exploit an information advantage, particularly through active asset management. We always seek out investments that are underpriced.

One clear example is the world's less developed economies. The companies there are less subject to due diligence and the social structures do not always work the same way as in more developed economies. AP1's fundamental approach is therefore that it is worth being active on these markets.

Success requires in-depth local knowledge, which is resource-demanding. The Fund therefore works with external asset managers on emerging markets.

Sustainable value creation

Focus on sustainable value creation makes it possible to increase returns and reduce financial risk in the long term.

 One of AP1's fundamental principles with regard to sustainability is that it should be an integral aspect of investments. Considering sustainability issues enhances due diligence about the investment objects. We believe that well-managed companies have great potential to generate a good, risk-adjusted return over time.

The Fund prioritises selected areas to achieve the greatest impact from its sustainability work. The overriding aspect is not to violate any international

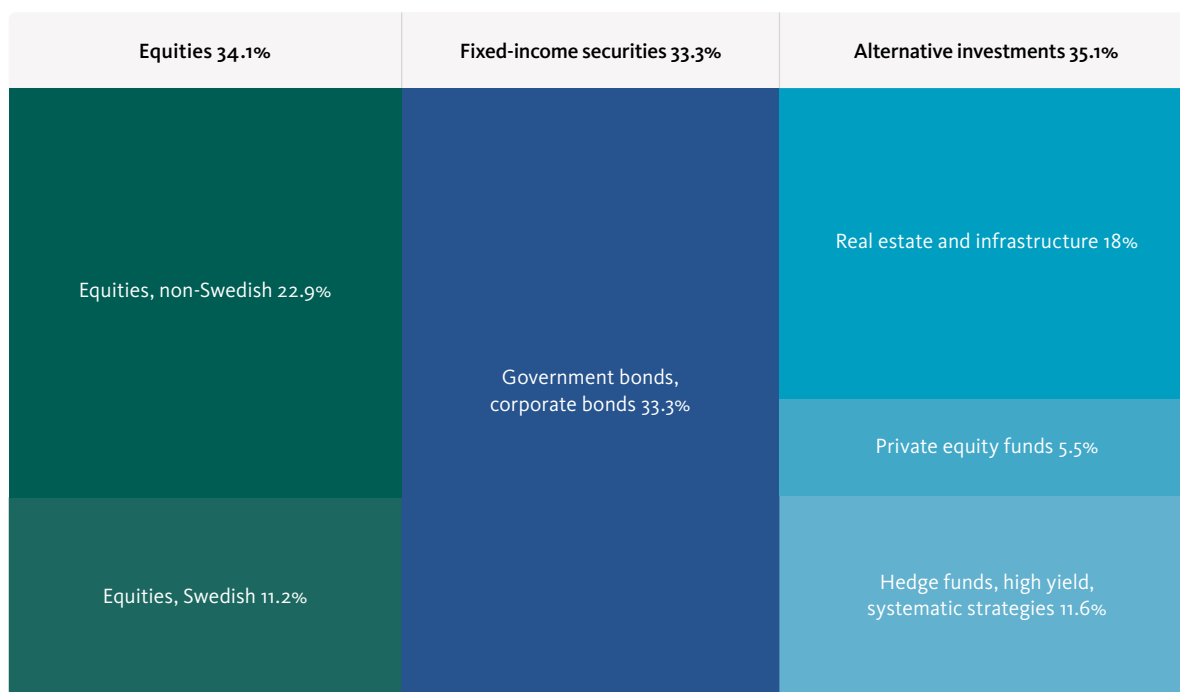
laws or conventions. Other important considerations include the risk and potential return, as well as sustainability.

We take a holistic view of companies' value chains, exercise our ability to influence them in a desirable direction, and strive towards greater transparency. Our efforts to influence the companies are based on a selection of the UN's Sustainable Development Goals.

AP1 also seeks out active investments that can contribute to sustainable development. Here too the UN goals guide us, including Goal 11, which relates to sustainable cities and communities. Existing holdings include Vasakronan, for instance, a large real estate company with good results in the area of sustainability.

Spreading assets to achieve the target

Return on the pension assets is created through the Fund's investments, which are spread across a range of different asset classes around the world.



AP1's assets are spread across the main categories of equities, fixed-income securities and alternative investments. The chart above shows the Fund's exposure to different classes of asset. Due to investments in derivative instruments, the sum does not total 100 per cent.

In AP1's asset management, different investment aspects are compared to achieve the target of at least 4 per cent real return on the pension assets in the long term.

Our asset managers strive actively to achieve a better result than would be possible by simply following the Board's general investment allocation between different asset classes. In our day-to-day asset management we therefore work with a wide range of asset types of different character and on different markets.

Equities entail taking a risk

The development of the equities portfolio is influenced both by general social factors and economic fluctuations. Investing in equities entails a risk, but it also enables high returns over the long term.

The Fund's equities portfolio includes a selection of companies in Sweden and developed foreign markets, primarily the US and Europe, but also some in Asia. We also invest in equities on emerging markets. All Swedish equities and the majority in Europe and

the US are managed internally. Other non-Swedish equities are managed by external partners.

We also have an extensive operation focusing on systematic, more technically focused portfolio management for equities, based on mathematical models.

Fixed income reduces the risk

Fixed-income assets are not subject to quite as large fluctuations as equities, which makes the risk level lower. These assets are also liquid, i.e. they can be sold quickly. The long-term return is gener-

Vasakronan is a significant holding in the real estate portfolio.



ally far lower than with equities.

The foundation of AP1's fixed-interest securities are government bonds with a high credit rating, supplemented by corporate bonds with a limited risk level. The vast majority of AP1's fixed-income assets are foreign.

Alternative investments

As well as equities and fixed-income securities, the Fund also spreads its assets across alternative investments; primarily real estate, infrastructure, private equity funds, hedge funds and foreign exchange.

Real estate often provides good protection against inflation in the longer term. In Sweden, AP1 invests directly in property-owning companies. International real estate investments are mainly pursued through unlisted real estate companies and funds.

Infrastructure also differs from equities in various respects. Infrastructure is often a natural monopoly, which provides stable cash flows. The income develops in relation to inflation, and in the long term returns reflect the state of growth in society. As with the Fund's real estate investments, infrastructure

investments are direct in Sweden and are often made with the support of external asset managers abroad.

When it comes to private equity, AP1 invests in private equity funds, which in turn invest in unlisted companies.

The aim of investing in hedge funds is to mitigate the effect of dramatic price fluctuations, primarily in equities.

Foreign exchange management does not tie up any capital, however it can generate returns in the short term and also spreads the risk. The rate of inflation and short interest rates affect the overall value development.

New construction in Paris and London

The Fund's real estate investments comprise stable objects supplemented by innovative development projects focusing on the environment and social factors.

At AP1 real estate is counted as an alternative investment, an asset class which complements equities and fixed-income securities.

Real estate company CityHold is owned by AP1 along with AP2 and American fund TIAA. The focus is on commercial properties in European hubs.

"This allows a constant influx of tenants and low risk, which is well suited to long-term owners," says Johan Temse, who works in real estate investments at AP1.

The focus has now been expanded to create opportunities for higher returns by taking a limited development risk.

"We have invested in the development of a property in central London, founded on a faith in offices with a sustainability focus. Our expectations have come to fruition."



The iron-shaped building is one example of CityHold's sustainable buildings in London.

Another innovative project can be found in Paris.

"It's an exciting one from both a commercial and an urban planning perspective. When the city put out land on the banks of the Seine to tender, bidders were asked to suggest how the site could be developed with regards to social and

cultural aspects, for example."

Offices, homes, a youth hostel and art studios are now being created on the site, all based on the original 1960s building.

"CityHold was selected among other bidders for its expertise and fast investment process," Temse explains.

Human rights integrated in investments

AP1 is a pioneer in highlighting human rights in its investment analyses.

The Fund has begun working with American asset management firm Arabesque, which is a leader in data for sustainability analysis of investments, and particularly social aspects.

Arabesque will provide AP1 with daily sustainability data using its S-Ray system. The aim is to develop a unique parameter for how well companies work on human rights.

The point of departure is the UN Global Compact, which specifies minimum requirements for sustainable enterprise, and the human rights guidelines being developed in the United Nations Guiding Principles, UNGP.

"This is a welcome complement to



Professor John Ruggie.

the other sustainability data we currently use. Having the latest rating on any given day is of tremendous value," says Ossian Ekdahl, Chief Active Ownership Officer at AP1.

The unique parameter will help AP1 to assess companies' performance in relation to UN principles, and identify

companies with high human rights risks. Professor John Ruggie, who formulated the UNGPs, is involved in the development process; they are in fact known as the Ruggie principles, named after him.

"This joint initiative with AP1 is the first of its kind on the investor side. Almost all of the social aspects covered by the 'S' in ESG relate to human rights, but few people in the financial industry recognise this," says Professor Ruggie, alluding to ESG as in Environmental, Social and Governance.

S-Ray is based on machine learning and big data. The company processes data from 7,000 companies, 200 ESG parameters and 50,000 sources in 15 different languages.



Consumer habits and preferences have an impact on the Fund's returns.

Consumer analysis steers investments

Market intelligence is key when investing in the consumer sector as consumer tastes change quickly.

AP1's asset management in the equities class is divided into regions and sectors. Philip Mitchell works with the consumer sector in Sweden and on developed foreign markets.

"Out of thousands of publicly listed companies we focus on around a dozen, a quarter of which are in Sweden. We have owned some of them for over five years."

"We look at long-term trends, both for the market and the company. We

have to balance profitability with valuation. A highly profitable company that's highly valued is of no interest to AP1, regardless of the sector."

AP1 uses a system for filtering out companies based on aspects such as investment earnings, the share's valuation and sustainability factors, ESG.

"We avoid companies that are dubious from a sustainability point of view, but also look at their willingness to improve."

There are challenges in purely commercial terms.

"Consumer tastes change quickly,

and companies have to be innovative."

In order to monitor consumer trends, Philip Mitchell meets with companies and covers conferences. Some of the factors the industry needs to consider are an increase in online buying, altered media behaviour and a growth in organic food.

"The established companies have been slow in understanding the impact of the internet," says Mitchell.

Understanding geographical differences is important.

"The drivers behind success vary and influence the level of return."

Collaboration on emerging markets

An innovative collaboration facilitates considering sustainability when making investments on emerging markets.

In 2018, AP1 and asset management firm BlackRock started a special fund for developing the ability to combine financial metrics and sustainability data on markets where the companies

themselves often have a lack of reporting on sustainability issues.

In the new fund information is structured, filtered and validated using data-driven information processing. Decisions can then be based on more up-to-date sustainability data than the companies' own reporting.

"It is an innovative fund. Data and

technology can improve both the investments themselves and the insights surrounding sustainability. Considering sustainability aspects is no longer an obstacle when investing in emerging markets," says Tina Rönnholm, Portfolio Coordinator for investments managed by external asset managers.

"Ten-year periods are always more important than returns in a single year," says Mikael Angberg, Chief Investment Officer at AP1.

RESULTS

Portfolio positioned for a weaker market

The long-term return is always in focus at AP1. Over a ten-year perspective, the investment income is above target. AP1's investment decisions in 2018 were based on the fundamental view that the market is at the end of an economic cycle.

In 2018, the Fund exceeded the ten-year income target for its asset management. Real return after expenses for the period 2009–2018 was 7.4 per cent, compared to the target of 4.0 per cent.

"We have enjoyed several consecutive very strong years. We realised in the run-up to 2018, however, that it would be difficult to continue generating the same kind of results. For several years, various market factors have been indicating that we are at the end of an economic upswing. In late 2017, we therefore began reposition-

ing the portfolio in order to reduce the level of risk," says Mikael Angberg, Chief Investment Officer at AP1.

The reallocation continued in 2018 and has primarily entailed a reduction in the proportion of equities and an increase in fixed-income securities, actions which are deemed to increase the potential for positive returns in the long term. The Fund has consciously opted for a lower proportion of equities than normal.

Actual economic developments during

the year tallied with the Fund's expectations, albeit with some delay. AP1's return for 2018 as a whole amounted to -0.7 per cent.

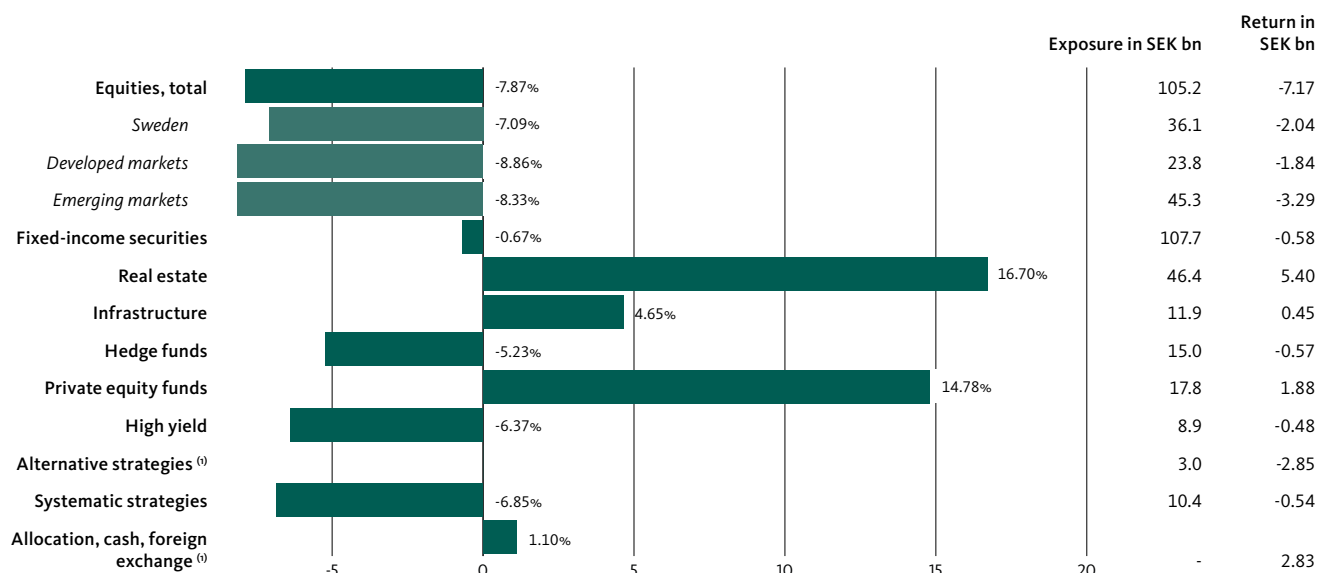
"AP1 is a long-term investor. We are assessed for our performance over ten-year periods, which is always more important than returns in a single year," says Angberg.

Downswing in many areas

The equity market was driven by an upswing in the US early on in the year,

RESULTS

Return by asset class in 2018



⁽¹⁾ The great majority of the underlying strategies do not tie up capital, which is why the return in relation to funded capital is not relevant.

The largest contributors to the returns came from private equity funds and real estate.

primarily in the technology sector. The US economy developed strongly and was positively affected by tax reductions, for example. At the end of the year, the stock markets then declined on developed markets worldwide.

“I am pleased that we reduced the risk in our portfolio. Along with other measures, it meant that we generated an excess return of SEK 5.5 billion in 2018, which is even better than the year before.”

On emerging markets, the situation developed slightly differently.

“A stronger dollar was a factor and initially slowed developments. Towards the end of the year things improved once again in relation to more well-established markets. AP1 has a positive long-term view of emerging markets and plans to continue having relatively high exposure there,” says Angberg.

Interest rates increased during the year, although less than anticipated. As interest rates rise the Fund invests more in financial instruments of longer duration, which brings a relatively higher return.

Alternative investments

In AP1’s alternative investments, which include real estate, infrastructure, hedge funds, private equity funds and foreign exchange, for example, there have been only minor changes during 2018.

Value growth in the real estate and infrastructure markets, which has been very positive for several years, continued in 2018.

Generally speaking, the market for hedge funds developed negatively during the year. The downswing was mitigated for AP1, the Fund has been conducting management in-house since 2017, thus increasing cost efficiency.

“Our assets in private equity funds generated excellent returns,” says Mikael Angberg.

In foreign exchange the Fund assumed a more offensive stance than for other asset classes.

“We have opted for a long-term holding in Swedish kronor, based on the assessment that the krona is undervalued. This view has not yet been fulfilled, but does remain.”

A stable strategy

Accordingly, AP1’s asset allocation was adjusted during the year to prepare for less favourable market conditions. The investment perspective is long-term.

“Reducing the risk in the portfolio is being planned in several small steps. At the same time though, we need to prepare for a future strengthening of the markets, when it will be necessary to increase our exposure to risk premiums if we are to build good returns,” says Angberg.

“It is important to stick to our strategy over time. We are continuously developing systematic decision support to facilitate this approach.”

Changes in the AP Funds Act will allow the Fund to take a higher market risk from 2019.

“In the long term higher risk-taking will be the best path to high returns. In the short term, however, the market situation suggests that this is not the right time to change the risk profile,” Mikael Angberg concludes.

Carbon footprint

Carbon footprint reporting is part of the Fund's annual performance reporting.

Every year, AP1 reports on the carbon footprint in its investments using four indicators. Three of them are calculated based on the Funds' holding percentage in the companies. The fourth indicator is a weighted average, reported in accordance with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD).

The carbon footprint calculations are carried out using data for direct emissions, Scope 1, and indirect emissions from energy, Scope 2.

The basic unit for reporting is the number of tonnes of carbon dioxide equivalents (tCO₂e). The same indicators are used for the other three AP Funds. The results of the various Funds are,

however, not fully comparable. AP1 is a driver in developing metrics for carbon footprint, which is still in its early stages as a process and does have limitations.

During 2018, AP1 has changed its supplier of data and calculations from Trucost® to MSCI. Consequently, the figures for 2018 are not fully comparable with previous years.

| | Absolute carbon footprint (tCO ₂ e) | | Carbon intensity in relation to market value (tCO ₂ e/SEK m) | | Carbon intensity in relation to turnover (tCO ₂ e/SEK m) | | Carbon intensity, weighted average relative to turnover is multiplied by the company's percentage of the portfolio (tCO ₂ e/SEK m) | |
|-------------------|--|-------------------------|---|-------------------------|---|-------------------------|---|-------------------------|
| | Absolute | Relative ⁽¹⁾ | Absolute | Relative ⁽¹⁾ | Absolute | Relative ⁽¹⁾ | Absolute | Relative ⁽¹⁾ |
| Sweden | 106,000 | -31% | 3.1 | -31% | 4.4 | -38% | 4.3 | -14% |
| Developed markets | 705,000 | 37% | 20,3 | 37% | 38,2 | 67% | 41,2 | 88% |
| Emerging markets | 982,000 | -32% | 24.5 | -32% | 36.2 | -26% | 29.5 | -26% |
| Total | 1,756,000 | -12% | 16.1 | -12% | 24.8 | -9% | 25.2 | 14% |

| Year-on-year comparison | 2018 | 2017 ⁽²⁾ | 2016 |
|--|------|---------------------|------|
| Absolute carbon footprint equating to the owned share of the companies' aggregate emissions (millions of tCO ₂ e) | 1.8 | 1.6 | 1.7 |
| Carbon intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' market value(3) (tCO ₂ e/SEK m) | 16.1 | 12.8 | 14.2 |
| Carbon dioxide intensity, in which the absolute carbon footprint is related to the share of ownership of the companies' turnover (tCO ₂ e/SEK m) | 24.8 | 20.6 | 24.7 |
| Carbon intensity, weighted average, where the companies' carbon intensity relative to turnover is multiplied by the company's percentage of the portfolio based on market value (tCO ₂ e/SEK m) | 25.2 | 24.2 | N/A |
| Charted market value as a percentage of total net assets | 34% | 39% | 39% |

⁽¹⁾ The 'Relative' columns show the extent of the portfolios' carbon footprint in relation to that of the benchmark portfolios. Negative figures mean that the Fund's portfolio has a footprint lower than that of the benchmark portfolios.

⁽²⁾ The 2017 figures published in the AP1 Annual Report 2017 have been adjusted.

The table above shows AP1's carbon footprint according to the above metrics for the listed part of the equity portfolio. That portfolio makes up 34 per cent of the Fund's total portfolio. For 2018, 71 per cent of the carbon footprint in the total portfolio is based on reported emissions. For 23 per cent of the portfolio, the calculations are based on estimated data. A summary of the calculations is published on www.ap1.se. The calculations are performed by MSCI. The carbon footprint from AP1's office operation and its employees' travel has been offset since 2015.

The Fund's carbon footprint has worsened between the 2017 and 2018 year-ends. This is partly due to the fact that the Fund sold its holdings in companies that produce tobacco, coal and oil sands, and companies involved in the modernisation of nuclear weapons. Many of these companies have a stable share price development (low volatility). Some of the Fund's systematic strategies replaced these shares with other equities with low volatility, which proved to have a higher carbon footprint.

Sustainability in focus

Sustainability aspects remain central to AP1. A new AP Funds Act brings with it more stringent requirements. More companies will be excluded from investments.



"AP1 chooses not to invest in companies that produce tobacco, nuclear weapons, thermal coal or oil sands," says Ossian Ekdahl.

At the beginning of 2019, the National Pension Insurance Funds (AP Funds) Act changed. The new investment rules it introduced allow the AP Funds greater freedom to choose in which classes of asset they invest.

The revised law also includes a section stating that funds should be invested in an exemplary way through responsible investment and responsible conduct.

"The act's previous formulation told us to consider the environment and ethics. The change imposes higher demands on us as regards to sustainability

issues, but still with the basic premise that we should not compromise the overarching goal regarding risk level and returns," says Ossian Ekdahl, Chief Active Ownership Officer at AP1.

"AP1 has long been working to integrate sustainability into its investments. The exemplary asset management requirement puts more focus on improvement, which tallies well with our own ambitions."

The act's new wording does not go into detail about exactly what exemplary management entails.

"Swedish parliament has left it to the four AP Funds to jointly interpret this for themselves. We therefore worked together intensively during 2018 on preparing for the change in law. A follow-up of our work will be part of the government's scrutiny of the Funds in 2019," Ekdahl explains.

Three joint documents

Cooperation between the Funds encompasses common core values for asset management, common guidelines for reporting on how the Funds'

work on the sustainability objective has been achieved, and common guidelines on which assets funds should not be invested in. The three documents were approved by the Fund's Board of Directors and can be found on its website, www.ap1.se.

Exemplary management entails integrating sustainability factors such as the environment, social aspects, corporate governance and business ethics in the various operations. It relates both to the own organisation and to the management of the net assets.

"Examples of goals and principles we observe include the Global Compact, the UN's global Sustainable Development Goals, and the Swedish parliament's generational goal, which is the overarching goal for environmental policy in Sweden," says Ekdahl.

Decisions made in each Fund

The shared core values for the AP Funds are based on the constitutional values of the Swedish state: democracy, legality, objectivity, freedom of opinion, respect, and efficiency and service.

"We have set out the meanings of these principles with the aim of clarifying the relevance to our respective operations," says Ekdahl.

When it comes to which assets funds should not be invested in, the Funds have produced common guidelines. They are primarily based on international conventions endorsed by Sweden.

A Fund may remain an owner in a company even though it does not meet the set requirements, with the aim of trying to influence the company in a desirable direction. In the same way, a Fund may decide to exclude invest-

ments on other grounds.

"AP1 will continue to choose not to invest in 100 or so companies that produce tobacco, nuclear weapons, coal and oil sands. We do not believe we should be owners in these companies since their production is in conflict with the spirit of the conventions. Moreover, we have no possibility to influence them in a desirable direction." The convention on tobacco control aims to dramatically reduce tobacco consumption, so as to reduce the harmful effects of tobacco smoking.

"On a related note, since autumn 2018 AP1 also excludes companies that produce cannabis for non-medical use."

As for nuclear weapons, AP1's exclusion relates to companies with operations that do not tally with the spirit of the Non-Proliferation Treaty, the aim of which is eventually to rid the world of nuclear weapons. AP1 also includes the modernisation and upgrading of existing nuclear weapons in this category.

In the field of energy, companies are excluded which produce coal for energy as well as oil sands, since these energy

forms have the worst climate footprints and are therefore not in line with the Paris Agreement.

Reporting leads to development

Reporting on how the sustainability goals are being achieved is a pivotal aspect on the endeavour towards exemplary conduct.

"Anything that is measured can be studied and followed up," says Ossian Ekdahl.

Each AP Fund publishes an annual and a half-yearly report, as well as a sustainability report. Reporting and valuation have gradually been adapted to International Financial Reporting Standards (IFRS). The reporting strives to follow the Global Reporting Initiative (GRI) international standard.

The Funds also report annually on the UN-supported Principles for Responsible Investment (PRI), the Task Force on Climate-related Financial Disclosures (TCFD), their own carbon footprint co-operation, and the UN global Sustainable Development Goals (SDGs).

The AP Funds' Council on Ethics

Eleven years ago, the Council on Ethics of the AP Funds was formed. In it, AP1-4 collaborate on matters relating to foreign companies that do not live up to the Funds' expectations. These are mainly companies that violate international conventions which Sweden has endorsed. The fundamental principle of the Council on Ethics is primarily to influence companies in the right direction, and as a last resort to recommend that they be excluded from the Funds' investments. Each AP Fund considers the recommendations and makes its own decision on exclusion.

The Council also runs a number of proactive projects in an effort to influence companies to act more responsibly in areas such as water efficiency and human rights, including workers' rights. Another important area is fighting corruption. The Council on Ethics publishes a yearly report on current and completed projects.

Increasingly important to influence

As a major owner we can influence companies to develop in the right direction.

In Swedish companies, we are often offered a place on the nomination committee, which puts forward board

members for the next general meeting of shareholders. Since the boards decide on strategy and appoint the CEO, it is very important to have the right board in place. AP1 votes at all shareholders general meetings in Swedish companies.

"In non-Swedish companies, where our holding is smaller, we exert an influence through cooperation with other owners, primarily through the AP Funds' Council on Ethics," Ossian Ekdahl explains.

Developmental projects for internal collaboration

A rejuvenation is under way among AP1's employees. There has also been modernisation during the year with development projects in areas such as self-leadership and risk management.

AP1 is a small, cost-effective organisation in which each employee plays a key role. During 2018, new recruitment has lowered the average age at the Fund. There is continued growth in IT and systems development.

Several important projects took place to develop personnel and the organisation. One of the aims is to clarify goals and processes, and also to strengthen the Fund as an attractive employer for well-educated specialists.

One development programme is looking at self-leadership, the point of departure being the driving forces of the individual. The aim is to promote employee creativity, productivity and well-being, as well as a culture in which all employees feel a shared responsibility for the whole. Each person maps their own values, and these are then linked to the Fund's working method. Work on self-leadership will continue in 2019.

Concerted efforts were made in 2018 to develop systematic management of operational risks, a process that will continue in 2019. This project is part of AP1's work on continuous improvement which, among other things, is of importance to inter-unit collaboration within the organisation.

Implementation of a new system for monitoring the results of asset management was completed in 2018. The project was run in close cooperation between different units at AP1, in order to harmonise approaches in the process and lay the foundation for more efficient management.

The 2018 employee survey was pub-



Internal communication contributes to greater clarity and a stronger corporate culture. Pictured: Mats Enebrink.



Of AP1's employees, 63 per cent are men and 37 per cent women.

lished in November and showed a high level of commitment among the personnel. The results also provided guidance for the ongoing development of working methods and leadership.

During the year, the Fund offered two paid internships, and one of the interns was later given a permanent position. AP1 worked with the other AP Funds on activities to recruit students. By working together, the Funds can draw benefit from their shared brand and save resources.

Internal communication initiatives have continued, and have become established parts of the operation which contribute to greater clarity and a stronger corporate culture.

Dialogue for mapping risks



Malin Johansson and Dmytro Sheludchenko work together to prevent risks.

During the year, AP1 personnel have made concerted efforts to streamline risk management in the day-to-day operation, i.e. operational risks relating to processes, IT systems and corporate culture.

“We do of course work continuously in improvements, but this project on our operational risks is a more systematic initiative. It helps us to do our jobs better,” says Dmytro Sheludchenko, analyst at the asset allocation unit.

“Better control over operational risks also lays a better foundation for preventing market risks. We share feed-

back with colleagues and review details that could be problematic.”

The aim is to limit the number of incidents or detect them at an early stage.

“We have mapped the processes and now have a good overview of where there is scope for systematic initiatives, for example when it comes to reducing manual operations,” says Malin Johansson, who works in business support at AP1.

“Doing this alongside other units is of great value. We control the risks by working across unit boundaries to clarify responsibilities and evaluate new solutions,” says Johansson.

Consensus through digitisation

A new results monitoring system provides AP1 with better decision data for investments, while also improving coordination between asset management and the group for risk and return analysis.

“The system has been developed across unit boundaries and has involved many employees,” says project coordinator Fredrik Nylund at the group for risk and return analysis.

The main aim has been to replace the existing system with a more modern solution where the results can be broken down in various ways.

“In our team the key is to be able to divide returns into smaller components, such as different connections between interest rates and durations, so that we can see what contribution each investment decision has made,” says Angelica Diehn, who works in fixed-income and foreign exchange management.

“During the project we’ve worked alongside the risk and analysis team, as well as other units. We’ve looked at how our processes work today and where we



Creating consensus has been important in the IT project, in which Angelica Diehn and Fredrik Nylund have participated.

want to develop using the new system. It has been both enjoyable and educational.”

Other teams have also had a chance to submit system requirements.

“We have been able to compare our working methods within the framework of the project. Being able to assure consensus from the very beginning has been invaluable,” says Fredrik Nylund.

Flow becomes ebb

Return on risky assets is predicted to be poor in the years to come.
Creating good results will be a challenge, but AP1 has its
long-term approach to benefit from.

Economic links and political events affect developments on the financial market, and thereby also AP1's ability to deliver returns to the Swedish income pension system.

The financial crisis of 2008 is still making itself felt on the financial landscape.

"In conjunction with the crisis, the central banks stepped in to save the global economy. They started to buy large amounts of securities. The fact that the central banks collectively bought risky assets, and without being sensitive to pricing, led to a very favourable risk climate and thereby falling risk premiums. Interest rates were pushed down to record lows, which raised the value of virtually every kind of asset," says Magnus Lomakka, strategist at AP1.

These asset values are now high and the central banks are reducing their previous incentives.

"The European Central Bank has recently stopped buying assets, while the US Federal Reserve has started to reduce its holding of bonds. This means that someone else has to buy them and also fund their purchase. Less and less money is being invested in risky assets.

Declining values

Returns on assets generally – equities, credits, real estate and so on – are expected to face a challenging period following ten good years. Generating a satisfactory level of return will be difficult.

"For the first time in a very long time, the financial markets will have to get by without assistance from the central banks. The flow of liquidity is slowly but surely changing into an ebb," says Magnus Lomakka.

AP1 is of the opinion that the global economy is in the late stages of an economic cycle.

"Growth is slowing. The US did have a very strong year driven by tax reliefs, but the effects of this are now dissipating and 2019 will probably be considerably weaker."

Political events complicate the work of analysing and predicting economic links.

"In Europe for instance we're seeing a political situation in Italy that could cause severe problems for the EMU," Lomakka explains.

Since Donald Trump was elected President of the US, political developments are also being tensely monitored by the financial markets.

"The Trump effect is a hard one to define. The president's expansive politics, with tax relief and other incentives, has apparently had a positive effect. Having said that the US economy is generally strong, and may have developed well regardless of who the president is," Lomakka explains.

"One thing that remains a challenge,

though, is trying to predict what President Trump will do, and that creates uncertainty."

An escalating trade war between the US and China adds to the threat scenario. Restrictions in international trade could contribute to higher prices and weaker growth. China itself is a tremendously important market, and one that's hard to define and predict.

In addition Brexit has also been cause for concern for several years, although as yet with no palpable effects on the markets outside of the UK.

Adapting the risk level

Generally speaking, it is becoming increasingly difficult to create returns.

"Our long-term approach enables us to see beyond short-term turbulence, but it is important to realise that any fall in asset prices does present opportunities for better returns in the long term," says Magnus Lomakka.

"Less and less money is being invested in risky assets," says strategist Magnus Lomakka.



The central banks, including ECB, are reducing their emergency liquidity assistance.



Directors' Report

The Board of Directors and the CEO of Första AP-fonden hereby submit their Directors' Report for 2018. The Directors' Report, together with the annual accounts and notes, has been reviewed by the auditors of the Fund. The review covers pages 24 to 44.

Första AP-fonden's (AP1's) net investment income for 2018 was SEK -2,074 million (29,349), which means a return after expenses of -0.7 per cent (9.6). Measured over the last ten-year period, the return was 8.6 per cent. This equates to an average real return of 7.4 per cent a year, exceeding the long-term target of a real return after expenses of 4.0 per cent over rolling ten-year periods.

Transfer to the Swedish Pensions Agency

In 2018, the Fund transferred SEK 6.8 billion (7.4) to the pension system to cover the deficit in pension contributions in relation to pension disbursements. Since 2009, the Fund has paid SEK 51 billion net to the Swedish Pensions Agency to cover the deficit in pension disbursements.

Control and mandate

The Board of Directors of AP1 bears full responsibility for the operations of the Fund and is responsible for the Fund's organisation and management of Fund assets. The Board's work is regulated by the AP Funds Act (the National Pension Insurance Funds Act (2000:192)). The Board has delegated a management mandate to the CEO, who establishes the asset management framework. The mandate is expressed in a risk tolerance. This is manifested in an overarching asset allocation and limitations as to how much the asset allocation can be deviated from. The limitations are expressed both as exposure limits and limitations in terms of forecast tracking error.

Asset allocation and results of the Fund's management

Within the framework of the management mandate, the CEO of AP1 decides on the management orientation and asset allocation in the form of a strategic asset allocation. The CEO's strategic asset allocation forms the basis of the management organisation's work on allocation and management. In 2018, the Fund's management generated an excess return in relation to the strategic asset allocation of 1.7 percentage points (1.2), which equates to SEK 5.5 billion (3.5).

Cost efficiency through cooperation with other AP Funds

Smoothly functioning, healthy competition has been made possible through four independent buffer funds. This competition has resulted in cost-effective management. In areas that do not jeopardise competition between the funds, the AP Funds can cooperate to achieve cost savings, synergies and efficient use of resources. There is also value in securing a relevant exchange of experiences, knowledge and working methods between the organisations.

Cooperation between the AP Funds takes place in different established forums in nine areas, with a varying composition of representatives from the various AP Funds. Some of the groups also include the Sixth and Seventh AP Funds. The common denominator in these collaborations is that they are run based on the added value created by the collaboration, both for each individual Fund and for the Funds together. The various coordination groups are Communications, Legal & Compliance, Accounting, Administration, Risk & Performance, HR, IT and Back Office. There is also the AP Funds' Council on Ethics, which mainly focuses on screening and dialogue with foreign listed companies to influence the companies on sustainability issues. The Funds also make some joint investments in, for example, infrastructure and real estate. This way each Fund's resources are maximised in the individual investment.

Sustainable value creation

AP1's ambition in the field of sustainability is high. The Fund is convinced that investments in sustainable companies entail a lower risk and probably generate a higher return in the long run. Sustainability aspects are integrated into investment decisions and the Fund's work as an engaged owner. AP1's entire asset management is steeped in its ambition to generate long-term sustainable value growth.

Net investment income for 2018 before expenses in local currency

| | Contribution, SEK bn | Contribution, percentage points | Portfolio return, % |
|------------------------------------|----------------------|---------------------------------|---------------------|
| Equities | -7.2 | -2.7 | -7.9 |
| Sweden | -2.0 | -0.8 | -7.1 |
| Developed markets | -1.8 | -0.7 | -8.9 |
| Emerging markets | -3.3 | -1.3 | -8.3 |
| Fixed-income securities | -0.6 | -0.2 | -0.7 |
| Real estate | 5.4 | 2.1 | 16.7 |
| Infrastructure | 0.4 | 0.2 | 4.6 |
| Hedge funds | -0.6 | -0.2 | -5.2 |
| Private equity funds | 1.9 | 0.7 | 14.8 |
| High yield | -0.5 | -0.2 | -6.4 |
| Alternative strategies | -2.9 | -1.1 | |
| Systematic strategies | -0.5 | -0.2 | -6.8 |
| Allocation, cash, foreign exchange | 2.8 | 1.1 | 1.1 |
| Total | -1.6 | -0.6 | -0.6 |

Asset class

Equities

AP1's listed equity portfolio was valued at SEK 105.2 billion at year-end, equating to 32.5 per cent of the total portfolio. The equity portfolio comprises SEK 36.1 billion in Sweden, SEK 23.8 billion in foreign developed markets and SEK 45.3 billion in emerging markets. Swedish equities and equities in foreign developed markets are managed internally, while emerging markets are handled by external managers. Investments in listed equities also include the systematic strategies sub-portfolio in the amount of SEK 10.4 billion. The return on the equity portfolio for 2018 was -7.9 per cent, which equates to SEK -7.2 billion.

Fixed-income securities

AP1's fixed-income portfolio was valued at SEK 107.7 billion at year-end, equalling 33.3 per cent of net assets. The majority comprises investments in foreign securities. AP1 also has fixed-income securities through Fund holdings within the alternative strategies sub-portfolio. The return on the Fund's fixed-income portfolio in 2018 was -0.7 per cent, equalling SEK -0.6 billion.

Bonds with a lower credit rating

AP1's investments in bonds with a lower credit rating (high-yield investments) amounted to SEK 8.9 billion or 2.8 per cent of the total portfolio on 31 December 2018. The return on the high-yield portfolio for 2018 was -6.4 per cent, which equates to SEK -0.5 billion.

Alternative investments

Real estate

AP1's real estate holding was valued at SEK 46.4 billion at year-end, equalling 14.3 per cent of net assets. The main long-term focus of the Fund's real estate investments is running return from rent payments, and to some extent expected value appreciation. The return on the real estate portfolio in 2018 totalled 16.7 per cent, equalling SEK 5.4 billion.

Infrastructure

The Fund's investments in infrastructure amounted to SEK 11.9 billion at year-end, equalling 3.7 per cent of net assets. The return on the infrastructure portfolio was 4.6 per cent, which equates to SEK 0.4 billion.

Hedge funds

AP1's hedge fund portfolio was valued at SEK 15.0 billion at year-end, equalling 4.6 per cent of net assets. Investments in hedge funds are designed to generate a more diversified, robust portfolio, which tones down the effects of sharp price volatility in the rest of the portfolio. The return on the hedge fund portfolio in 2018 was -5.2 per cent, equalling SEK -0.6 billion.

Private equity funds

AP1's investments in private equity funds amounted to SEK 17.8 billion at year-end, equalling 5.5 per cent of net assets. The investments therefore exceed the limit of 5.0 per cent, but as new regulations came into effect on 1 January no action has been taken. The Fund invests globally in private equity funds. The return on this asset class is expected to be higher than for listed equities over time. The return on the private equity portfolio for the year was 14.8 per cent, equalling SEK 1.9 billion.

Alternative strategies

AP1's alternative strategies portfolio amounted to SEK 3.0 billion at year-end, equalling 0.9 per cent of net assets. Alternative strategies include a risk parity portfolio with the purpose of limiting macroeconomic risks without renouncing return opportunities and a portfolio consisting of alternative beta strategies designed to systematically obtain risk premiums. The return on the alternative strategies portfolio for 2018 was SEK -2.9 billion. (The great majority of the underlying strategies do not tie up capital, which is why the return in relation to funded capital is not relevant.)

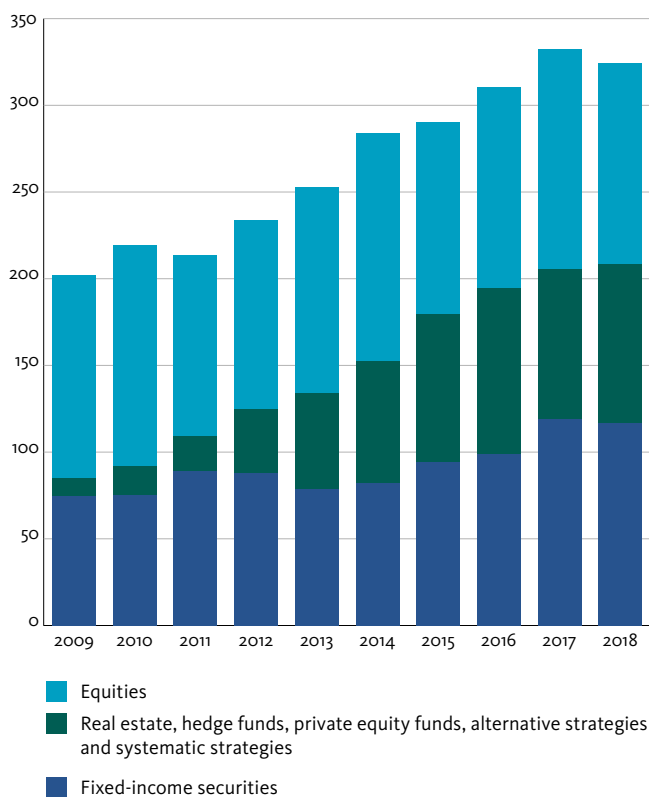
Systematic strategies

AP1's systematic strategies portfolio amounted to SEK 10.4 billion at year-end, equalling 3.2 per cent of net assets. Systematic strategies include investments in equities with low volatility in developed countries. The return on this portfolio was -6.8 per cent, which equates to SEK -0.5 billion during the year.

Foreign exchange

AP1 owns assets in different currencies. Currency is treated as a separate asset that is managed according to special foreign exchange strategies. The value of all foreign assets is translated into Swedish kronor. The majority of the Fund's foreign assets are protected, in terms of exchange rate fluctuations, using currency hedges. The return contribution from these currency hedges amounted to -3.0 per cent in 2018, which equates to SEK -10.0 billion.

Net asset performance 2009–2018, SEK bn



Expenses and expense ratio

| | 2018 | | 2017 | |
|--------------------------|-----------------|------------------|-----------------|------------------|
| | Expenses, SEK m | Expense level, % | Expenses, SEK m | Expense level, % |
| Personnel costs | 135 | 0.04 | 131 | 0.04 |
| Other admin. expenses | 88 | 0.03 | 78 | 0.03 |
| Operating expense | 223 | 0.07 | 209 | 0.07 |
| Commission expenses | 228 | 0.07 | 236 | 0.07 |
| Total expenses | 451 | 0.14 | 445 | 0.14 |

Portfolio composition

| Asset class | Portfolio value SEK m, 31/12/2018 | Holding, % | Exposure, % | Portfolio value SEK m, 31/12/2017 | Holding, % | Exposure, % |
|---------------------------------|---|--------------|--------------|---|--------------|--------------|
| | | | | | | |
| Equities | 105,181.2 | 32.5 | 34.1 | 117,446.5 | 35.3 | 37.9 |
| Sweden | 36,077.0 | 11.1 | 11.2 | 42,922.3 | 12.9 | 12.9 |
| Developed markets | 23,790.6 | 7.3 | 8.8 | 27,436.6 | 8.3 | 10.7 |
| Emerging markets | 45,313.5 | 14.0 | 14.1 | 47,087.6 | 14.2 | 14.2 |
| Fixed-income securities | 107,724.0 | 33.3 | 33.3 | 103,721.8 | 31.2 | 31.2 |
| Nominal, government | 43,849.6 | 13.5 | 13.5 | 44,147.6 | 13.3 | 13.3 |
| Nominal, credit | 31,356.0 | 9.7 | 9.7 | 36,404.1 | 10.9 | 10.9 |
| Real interest rates | 32,518.4 | 10.0 | 10.0 | 23,170.1 | 7.0 | 7.0 |
| Cash | -2,740.5 | -0.8 | -2.5 | 334.1 | 0.1 | -2.4 |
| Total listed investments | 210,164.6 | 64.9 | 64.9 | 221,502.4 | 66.6 | 66.6 |
| Real estate | 46,401.9 | 14.3 | 14.3 | 42,581.0 | 12.8 | 12.8 |
| Infrastructure | 11,912.2 | 3.7 | 3.7 | 11,380.6 | 3.4 | 3.4 |
| Hedge funds | 14,996.8 | 4.6 | 4.6 | 13,407.3 | 4.0 | 4.0 |
| Private equity funds | 17,843.9 | 5.5 | 5.5 | 15,412.8 | 4.6 | 4.6 |
| High yield | 8,930.3 | 2.8 | 2.8 | 14,942.3 | 4.5 | 4.5 |
| Alternative strategies | 2,992.7 | 0.9 | 0.9 | 3,469.4 | 1.0 | 1.0 |
| Systematic strategies | 10,426.2 | 3.2 | 3.2 | 9,813.1 | 3.0 | 3.0 |
| Total portfolio | 323,668.6 | 100.0 | 102.5 | 332,508.9 | 100.0 | 102.4 |
| Foreign exchange exposure | 84,194.0 | | 26.0% | 84,008.0 | | 25.3% |

⁽⁴⁾ As of 2018, special investments are reported under equities

Currency exposure, 31/12/2018

| SEK m | USD | GBP | EUR | JPY | Others | Total |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Shares and participations | 81,281 | 5,534 | 12,565 | 2,854 | 33,869 | 136,102 |
| Fixed-income securities | 39,743 | 5,280 | 21,824 | 1,508 | 1,297 | 69,652 |
| Other assets | 4,033 | 81 | 190 | 14 | 128 | 4,447 |
| Derivatives | -102,708 | -12,351 | -38,268 | 27,675 | -355 | -126,007 |
| Total | 22,349 | -1,456 | -3,689 | 32,051 | 34,939 | 84,194 |
| Currency exposure, 31/12/2017 | 32,198 | 6,406 | 7,057 | 8,103 | 30,244 | 84,008 |
| Currency exposure, 31/12/2016 | 46,638 | -5,362 | -503 | 6,735 | 21,030 | 68,538 |

Ten-Year Overview

| Net investment income and inflow, SEK bn | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Net assets at 31 December | 323.7 | 332.5 | 310.5 | 290.2 | 283.8 | 252.5 | 233.7 | 213.3 | 218.8 | 202.3 |
| Net flows from the pension system | -6.8 | -7.4 | -6.6 | -4.9 | -5.1 | -6.9 | -3.8 | -1.2 | -4.0 | -3.9 |
| Net investment income for the year | -2.1 | 29.3 | 27.0 | 11.3 | 36.4 | 25.7 | 24.2 | -4.2 | 20.5 | 34.6 |
| Return, expenses and risk, % | | | | | | | | | | |
| Return before expenses | -0.6 | 9.7 | 9.5 | 4.1 | 14.8 | 11.3 | 11.4 | -1.7 | 10.3 | 20.4 |
| Operating expenses, annualised, % of AUM | 0.06 | 0.07 | 0.06 | 0.06 | 0.07 | 0.07 | 0.08 | 0.07 | 0.08 | 0.10 |
| Commission expenses, annualised, % of AUM | 0.07 | 0.07 | 0.09 | 0.11 | 0.10 | 0.07 | 0.06 | 0.05 | 0.05 | 0.06 |
| Return after expenses | -0.7 | 9.6 | 9.3 | 4.0 | 14.6 | 11.2 | 11.3 | -1.9 | 10.2 | 20.2 |
| Net investment income and expenses in total portfolio, SEK bn | | | | | | | | | | |
| Net investment income before expenses | -1.6 | 29.8 | 27.4 | 11.8 | 36.9 | 26.0 | 24.5 | -4.0 | 20.8 | 34.9 |
| Total administrative expenses, SEK bn | -0.5 | -0.4 | -0.5 | -0.5 | -0.5 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| Exposure, % | | | | | | | | | | |
| Equities | 34.1 | 37.9 | 34.1 | 34.7 | 48.9 | 49.2 | 47.4 | 49.2 | 60.3 | 58.6 |
| Sweden | 11.2 | 12.9 | 12.3 | 12.3 | 11.6 | 12.0 | 11.4 | 12.6 | 15.7 | 13.8 |
| Developed markets | 8.8 | 10.7 | 12.5 | 14.4 | 27.1 | 27.5 | 25.0 | 25.3 | | |
| Emerging markets | 14.1 | 14.2 | 9.2 | 8.0 | 10.1 | 9.7 | 11.0 | 11.4 | | |
| Fixed-income securities ⁽¹⁾ | 33.3 | 31.7 | 29.8 | 30.2 | 30.9 | 31.2 | 36.4 | 40.9 | 32.5 | 34.7 |
| - of which fixed-income securities in other assets | 0.0 | 0.5 | 2.5 | 2.3 | 3.3 | 1.5 | | | | |
| Cash | -2.5 | -2.4 | -1.1 | -0.1 | -1.1 | -0.7 | | | | |
| Real estate | 14.3 | 12.8 | 12.6 | 11.5 | 8.8 | 8.8 | 7.7 | 5.6 | 5.0 | 3.4 |
| Infrastructure | 3.7 | 3.4 | 3.0 | 2.9 | | | | | | |
| Hedge funds | 4.6 | 4.0 | 5.0 | 4.8 | 5.9 | 4.9 | 4.3 | 0.2 | 0.3 | - |
| Private equity funds | 5.5 | 4.6 | 4.7 | 5.0 | 4.4 | 3.3 | 3.2 | 2.8 | 2.0 | 1.7 |
| High yield | 2.8 | 4.5 | 4.5 | 2.9 | | | | | | |
| Alternative strategies | 0.9 | 1.0 | 5.0 | 4.4 | | | | | | |
| Systematic strategies | 3.2 | 3.0 | 4.5 | 5.2 | 5.6 | 4.8 | 0.7 | 0.6 | 0.7 | |
| Special investments | | | 0.5 | 0.7 | | | | | | |
| Foreign exchange | 26.0 | 25.3 | 22.1 | 31.3 | 35.1 | 29.2 | 27.4 | 21.3 | 24.0 | 21.6 |
| Risk | | | | | | | | | | |
| Risk ⁽²⁾ | 4.9 | 3.6 | 6.4 | 8.1 | 5.4 | 5.0 | 5.9 | 8.9 | 7.4 | 9.7 |
| Sharpe ratio | 0.0 | 2.9 | 1.5 | 0.5 | 2.6 | 2.1 | 1.9 | neg. | 1.1 | 2.0 |
| External management, % | | | | | | | | | | |
| Share of total portfolio at 31 December ⁽³⁾ | 33.5 | 32.5 | 31.8 | 31.0 | 34.6 | 37.1 | 39.3 | 41.4 | 43.7 | 42.4 |

⁽¹⁾ Investment grade bonds (fixed income incl. cash funds in accounts = 32.14% for 2018).

⁽²⁾ Standard deviation calculated on daily return in 2018.

⁽³⁾ In accordance with a joint decision, the AP Funds report wholly or partially owned real estate companies as being internally managed.

Income Statement

| SEK m | Note | 31/12/2018 | 31/12/2017 |
|--|------|---------------|---------------|
| Operating income | | | |
| Net interest income | 1 | 2,462 | 1,941 |
| Dividends received | | 5,330 | 4,897 |
| Net gains/losses, listed shares and participations | 2 | -12,548 | 16,632 |
| Net gains/losses, unlisted shares and participations | 3 | 8,200 | 7,457 |
| Net gains/losses, fixed-income assets | | -1,660 | 278 |
| Net gains/losses, derivative instruments | | -7,820 | 1,075 |
| Net gains/losses, foreign exchange movements | | 4,413 | -2,486 |
| Commission expenses | 4 | -228 | -236 |
| Total operating income | | -1,851 | 29,558 |
| Operating expenses | | | |
| Personnel costs | 5 | -135 | -131 |
| Other administrative expenses | 6 | -88 | -78 |
| Total operating expenses | | -223 | -209 |
| Net investment income | | -2,074 | 29,349 |

Balance Sheet

| SEK m | Note | 31/12/2018 | 31/12/2017 |
|---|------|----------------|----------------|
| Assets | | | |
| Shares and participations, listed | 7 | 118,183 | 138,328 |
| Shares and participations, unlisted | 8 | 83,537 | 71,568 |
| Bonds and other fixed-income assets | 9 | 110,515 | 114,226 |
| Derivatives | 10 | 3,735 | 2,753 |
| Cash and bank balances | | 6,570 | 5,085 |
| Other assets | 11 | 2,835 | 989 |
| Prepaid expenses and accrued income | 12 | 811 | 912 |
| Total assets | | 326,186 | 333,861 |
| Liabilities | | | |
| Derivatives | 10 | 1,450 | 645 |
| Other liabilities | 13 | 1,011 | 666 |
| Deferred income and accrued expenses | 14 | 63 | 41 |
| Total liabilities | | 2,524 | 1,352 |
| Net assets | 15 | | |
| Opening net assets | | 332,509 | 310,535 |
| Net payments to/from the pension system | | -6,773 | -7,375 |
| Net investment income for the year | | -2,074 | 29,349 |
| Total net assets | | 323,662 | 332,509 |
| Total net assets and liabilities | | 326,186 | 333,861 |
| Memorandum items | 16 | 25,317 | 33,433 |

Notes

Första AP-fonden (AP1), corporate identity number 802005-7538, domiciled in Stockholm, is one of the buffer funds in the Swedish pension system. This annual report for the 2018 financial year was approved by the Board of Directors on 21 February 2019. The income statement and balance sheet are subject to adoption by the Swedish Government.

Accounting and valuation policies

The National Pension Insurance Funds Act (2000:192) sets out that the annual report shall be prepared in accordance with generally accepted accounting principles, whereby the assets in which the Fund invests shall be entered at market value. In light thereof, the First to Fourth AP Funds (AP1, AP2, AP3 and AP4) have developed joint accounting and valuation policies which have been applied and are summarised below. The Funds' accounting and valuation policies are being gradually adapted to International Financial Reporting Standards, IFRS. Because IFRS is undergoing revisions, the adaptations so far have been focused on meeting the disclosure requirements in IFRS 7 and IFRS 13. Complete adaptation to IFRS would have no material impact on the reported net investment income and net assets. AP1 meets the requirements to be defined as an investment entity under IFRS 10. Compared to the currently applicable IFRS, the only major difference is that a cash flow statement has not been prepared.

Trade date accounting

Transactions in securities and derivative instruments in the money, bond, equity and foreign exchange markets are recognised in the balance sheet at the trade date, i.e. the time at which material rights and hence risks are transferred between the parties. The receivable from or liability to the counterparty between the trade date and settlement date is recognised in other assets or other liabilities. Other transactions, primarily those relating to unlisted equities, are recognised in the balance sheet at the settlement date, which is consistent with market practice.

Netting

Financial assets and liabilities are recognised net in the balance sheet when there is a legal right to net transactions and there is an intention to pay net proceeds or realise the asset and simultaneously settle the liability.

Translation of foreign currency

Transactions in foreign currencies are translated to SEK at the exchange rate on the transaction date. In the balance sheet, assets and liabilities in foreign currencies are translated to SEK at the exchange rates on the balance sheet date. Changes in the value of assets and liabilities denominated in foreign currencies are broken down into the part attributable to the change in the value of the asset or liability in local currency and the part caused by fluctuations in the exchange rate. Foreign exchange gains/losses arising from changes in foreign exchange rates are recognised in the income statement in the line net gains/losses, foreign exchange movements.

Shares in subsidiaries/associated companies

In accordance with the National Pension Insurance Funds Act, shares in and loans to subsidiaries/associated companies are both stated at fair value. Fair value is determined using the same methods that apply for unlisted shares and participations. There is no requirement to prepare consolidated accounts.

Loans to subsidiaries and associated companies that are intended to be held until their maturity are measured at fair value via the fair value option in IFRS 9. However, the total change in value is recognised as part of the shareholding in the line net gains/losses, unlisted shares and participations.

Valuation of financial instruments

All of the Fund's investments are measured at fair value, and both realised and unrealised changes in value are recognised in the income statement. Consequently, the lines for net gains/losses per asset class include both realised and

unrealised gains/losses. Equity instruments are held for trading and therefore measured at fair value through profit or loss. Debt instruments are held for trading and therefore measured at fair value through profit or loss. Loans to subsidiaries and associated companies are intended to be held until their maturity, but the fair value option is applied here so that the National Pension Insurance Funds Act's requirement on measurement at fair value is met. The AP Funds monitor all of their assets based on fair value. A description of how the fair values of the Fund's various investments are determined is provided below.

Listed shares and participations

For shares and participations that are admitted to trade on a regulated market or trading venue, fair value is determined based on official quoted market prices on the balance sheet date according to the Fund's designated index supplier, most often the average price. Holdings that are not part of an index are valued at quoted prices observable in an active market. Paid brokerage commissions are recognised in net gains/losses on listed shares.

Unlisted shares and participations

For shares and participations that are not admitted to trade on a regulated market or trading venue, fair value is determined based on the valuation provided by the counterparty or other external party. This valuation is updated when a new valuation has been obtained and is adjusted for any cash flows up to the close of accounts. In cases where the Fund has reasonable grounds to consider the valuation to be incorrect, the valuation received is adjusted. Valuations of unlisted participations comply with International Private Equity and Venture (IPEV) Capital Valuation Guidelines or similar valuation policies and should be primarily based on arm's length transactions, although other valuation methods can be used. Unlisted real estate shares are valued based on the net worth method to the extent that the share has not been subject to transactions in a secondary market. Holdings in unlisted real estate companies are measured taking into consideration deferred tax liabilities at a value that is used in real estate transactions, which differs from the valuation performed in the annual accounts of the real estate companies.

Bonds and other fixed-income assets

For bonds and other fixed income assets, fair value is determined based on the official quoted market prices on the balance sheet date (most often the bid price) according to the Fund's designated index supplier. Holdings that are not part of an index are valued at quoted prices observable in an active market. For an instrument that is not traded on an active market and for which no reliable market prices are available, the instrument is valued using generally accepted valuation models in which cash flows are discounted to the applicable valuation curve. Interest income is recognised as interest calculated according to the effective interest rate method based on amortised cost. Amortised cost is the discounted present value of future payments, in which the discount rate is the effective rate of interest on the acquisition date. This means that acquired premiums and discounts are apportioned to periods over the remaining maturity or until the next interest adjustment date and are included in recognised interest income. Changes in value resulting from interest rate movements are recognised under net gains/losses for fixed-income assets, while changes in value resulting from foreign exchange movements are recognised under net gains/losses on foreign exchange movements.

Derivative instruments

For derivative instruments, fair value is determined based on quoted market

prices at year-end. For an instrument that is not traded on an active market and for which no reliable market prices are available, the value of the instrument is established using generally accepted valuation models in which input data consists of observable market data. Derivative contracts with a positive fair value on the balance sheet date are recognised as assets, while contracts with a negative fair value are recognised as liabilities. Changes in value resulting from foreign exchange movements are recognised in the income statement under net gains/losses on foreign exchange movements, while other changes in value are recognised under net gains/losses on derivative instruments.

Repurchase transactions

In a true repo (repurchase) transaction, the sold asset remains in the balance sheet and the proceeds received are recognised as a liability. The divested security is recognised in the balance sheet as a pledged asset under memorandum items. The difference between proceeds in the spot and forward legs is apportioned to periods over the maturity of the security and recognised as interest.

Securities lending

Securities on loan are recognised in the balance sheet at fair value, while compensation received for securities on loan is recognised as interest income in the income statement. Collateral received for securities on loan may consist of securities and/or cash. In cases where AP1 has a right of disposal over the received cash collateral, this is recognised in the balance sheet as an asset and a corresponding liability. In cases where the Fund does not have a right of disposal over the collateral, the collateral received is not recognised in the balance sheet but is stated separately in a note under the heading 'Pledged assets, contingent liabilities and obligations'. The value of securities on loan, as well as collateral for these, are also recognised under this heading.

Items recognised directly in net assets

Payments to and from the national pension system are recognised directly in the Fund's net assets.

Commission expenses

Commission expenses are recognised in the income statement as a deduction under operating income. These consist of external costs for management services, such as custodian bank fees and fixed fees for external managers, as well as fixed fees for listed funds. Performance-based fees, which are payable if the manager achieves a return over a predetermined level at which profit-sharing applies, are recognised as a deductible item from net investment income for the relevant asset class in the income statement. Management fees for unlisted shares and participations, for which a refund is permitted before profit-sharing and in which a refund is deemed probable, are recognised at cost and are therefore included in unrealised gains/losses. In other cases, they are recognised as commission expenses.

Operating expenses

All administrative expenses, excluding brokerage fees, fees for external managers and custodian bank fees, are recognised in operating expenses. Investments in equipment and software developed or acquired by the Fund are normally expensed as incurred.

Taxes

AP1 is exempt from all income tax on domestic investments in Sweden. The dividend and coupon taxes imposed in certain countries are recognised net in the income statement under the relevant income type. With effect from 2012 the Fund is registered for value added tax and is therefore liable for VAT on acquisitions from outside Sweden. The Fund does not have the right to recover paid VAT. Expensed VAT is included in the relevant expense item. Amounts are in SEK million (SEK m), unless otherwise stated.

Note 1 Net interest income

| SEK m | 2018 | 2017 |
|---|--------------|--------------|
| Interest income | | |
| Bonds and other fixed-income securities | 2,378 | 1,930 |
| Other interest income | 112 | 43 |
| Total interest income | 2,490 | 1,973 |
| Interest expenses | | |
| Other interest expenses | -28 | -32 |
| Total interest expenses | -28 | -32 |
| Total net interest income | 2,462 | 1,941 |

Owing to the introduction of IFRS 9 and changes to IAS 1, the interest components of all derivative instruments are recognised in the line net gains/losses, derivatives instead of the line net interest income. Comparison figures have been adjusted in a corresponding way.

Note 2 Net gains/losses, listed shares and participations

| SEK m | 2018 | 2017 |
|---|----------------|---------------|
| Net gains/losses | -12,483 | 16,704 |
| Less brokerage commissions | -65 | -72 |
| Net gains/losses, listed shares and participations | -12,548 | 16,632 |

Note 3 Net gains/losses, unlisted shares and participations

| SEK m | 2018 | 2017 |
|---|--------------|--------------|
| Capital gains/losses | 1,358 | 3,084 |
| Unrealised value changes | 6,842 | 4,373 |
| Net gains/losses, unlisted shares and participations | 8,200 | 7,457 |

External management fees for unlisted assets are recognised in accordance with two different policies depending on whether or not underlying management agreements permit a refund before profit-sharing in connection with future profit-generating divestments. In cases where the agreements permit such a refund, fees paid are recognised as part of the cost of the asset and therefore burden the unrealised net gains/losses for unlisted assets. Refunded management fees accordingly have a positive effect on unrealised gains/losses. In cases where the agreements do not permit a refund, fees paid are expensed directly under commission expenses. During the year, a total of SEK 152 million (164) was paid in management fees for unlisted assets, of which SEK 109 million (87) permit refunds in accordance with the above-mentioned policy. SEK 0 million (0) was repaid during the year and the unrealised net gains/losses for unlisted shares and participations were therefore negatively affected by SEK 109 million net.

Note 4 Commission expenses

| SEK m | 2018 | 2017 |
|--|-------------|-------------|
| External management fees, listed assets | -161 | -140 |
| External management fees, unlisted assets | -44 | -77 |
| Other commission expenses, incl. custodian bank expenses | -23 | -19 |
| Commission expenses | -228 | -236 |

Commission expenses do not include performance-based expenses. During the year these amounted to SEK 90 million (65) and reduce net investment income for the asset under management.

External management fees for unlisted assets are recognised as commission expenses to the extent that the agreements do not permit a refund before profit-sharing in connection with future profit-generating divestments.

Note 5 Employees

| Number of employees | 2018 | | | 2017 | | |
|---|-------|-----|-------|-------|-----|-------|
| | Total | Men | Women | Total | Men | Women |
| Average number of employees | 61 | 38 | 23 | 61 | 38 | 23 |
| Closing no. of employees ⁽ⁱ⁾ | 60 | 38 | 22 | 61 | 38 | 23 |
| No. of executive management members at year-end | 7 | 3 | 4 | 8 | 3 | 5 |

⁽ⁱ⁾ At year-end 2018, 0 (0) individuals were employed on a project basis.

| Personnel costs 2018, SEK thousands | Salaries and remuneration | Pension costs | Payroll overheads ⁽¹⁾ | Total |
|---|---------------------------|---------------|----------------------------------|----------------|
| Board Chairman | 113 | | 36 | 149 |
| Other Board members (8 people) | 511 | | 161 | 672 |
| Chief Executive Officer | 4,267 | 1,212 | 1,343 | 6,822 |
| Executive management team, excl. CEO | | | | |
| Chief Investment Officer | 3,154 | 1,128 | 1,266 | 5,548 |
| Chief Active Ownership Officer (Jan-Sep) | 1,252 | 571 | 533 | 2,356 |
| Head of Communications (Jan-Oct) | 1,128 | 355 | 441 | 1,924 |
| Head of Business Support | 1,212 | 902 | 601 | 2,715 |
| Head of IT (May-Dec) | 1,106 | 205 | 268 | 1,579 |
| Head of Middle Office & Risk | 1,431 | 361 | 538 | 2,330 |
| General Counsel | 1,157 | 196 | 316 | 1,669 |
| Head of HR | 1,391 | 831 | 640 | 2,862 |
| Other employees | 58,118 | 19,028 | 23,106 | 100,252 |
| Total | 74,840 | 24,789 | 29,249 | 128,878 |
| Other personnel costs | | | | 6,221 |
| Total personnel costs | | | | 135,099 |

| Personnel costs 2017, SEK thousands | Salaries and remuneration | Pension costs | Payroll overheads ⁽¹⁾ | Total |
|---|---------------------------|---------------|----------------------------------|----------------|
| Board Chairman | 113 | | 36 | 149 |
| Other Board members (8 people) | 511 | | 161 | 672 |
| Chief Executive Officer | 4,058 | 1,185 | 1,562 | 6,805 |
| Executive management team, excl. CEO | | | | |
| Chief Investment Officer | 3,047 | 463 | 1,070 | 4,579 |
| Chief Active Ownership Officer | 1,657 | 755 | 704 | 3,116 |
| Head of Communications | 1,363 | 418 | 530 | 2,311 |
| Head of Business Support | 1,170 | 979 | 605 | 2,755 |
| Head of Middle Office & Risk | 1,401 | 340 | 522 | 2,263 |
| General Counsel & Compliance | 1,087 | 259 | 404 | 1,751 |
| Head of HR | 1,369 | 776 | 618 | 2,763 |
| Other employees | 57,639 | 19,552 | 22,147 | 99,338 |
| Total | 73,415 | 24,726 | 28,359 | 126,500 |
| Other personnel costs | | | | 4,001 |
| Total personnel costs | | | | 130,501 |

⁽ⁱ⁾ Payroll overheads also include the cost of payroll tax.

AP1's remuneration policy for senior executives is based on the Government's guidelines for remuneration to senior executives and other employees. There were no deviations from the policy or guidelines in 2018. There were no deviations from the policy or guidelines in 2018.

Salaries and other benefits

Board fees are determined by the Government. The Fund governance report provides information about fees and attendance for each Board member. The Board of Directors determines the terms of employment for the CEO, following preparation in the remuneration committee. All employees have individual employment contracts. Since 1 January 2010, AP1 has no variable remuneration. In the event of termination on the part of the employer, the notice period for the CEO is 18 months. For members of the executive management team and other employees it is between 2 and 6 months. A few agreements entered before April 2009 contain divergences. For cost-related reasons, these agreements are not being renegotiated.

In the event of the Fund issuing notice of termination of employment, severance pay can equal a maximum of 18 months' salary. The severance pay shall only consist of the fixed monthly salary, without the addition of benefits. Both salary during the notice period and severance pay shall be reduced by

an amount equal to any income from new employment or business activity during the pay-out period. Severance pay is never paid out beyond 65 years of age.

Pensions and similar benefits

The employment contract of the CEO includes an obligation for the Fund to pay pension premiums equal to 30 per cent of salary. For the portion of salary granting entitlement under the national pension, the pension premium is reduced to 11.5 per cent.

As of 1 February 2013, AP1 has switched to a defined contribution pension plan, BTP1, for newly hired employees. The pension agreement has been signed and agreed on between the parties. This means that the Fund has two occupational pension plans – BTP1, which is a defined contribution plan, and BTP2, which is a defined benefit plan.

All employees have the option of participating in a salary exchange scheme in which gross salary is exchanged for pension premiums. The pension premium is then increased by 5 per cent, which corresponds to the difference between payroll tax and social security fees. The premium exchange is therefore cost-neutral for the Fund. Other benefits are taxable and amount to smaller amounts.

Note 6 Other administrative expenses

| SEK th | 2018 | 2017 |
|--|----------------|----------------|
| Costs for premises | -12,892 | -13,273 |
| Purchased services | -25,867 | -24,697 |
| Information and data expenses | -44,694 | -34,686 |
| Other administration expenses | -2,995 | -5,531 |
| Other administrative expenses | -86,448 | -78,187 |
| The amount for purchased services includes remuneration for the Fund's auditor, PwC, broken down into the following assignments: | | |
| Audit services | -687 | -802 |

Note 7 Listed shares and participations

| Fair value, SEK m | 31/12/2018 | 31/12/2017 |
|-------------------------------------|----------------|----------------|
| Equities, Swedish | 24,706 | 42,776 |
| Equities, non-Swedish | 77,936 | 87,116 |
| Participations in Swedish funds | - | - |
| Participations in non-Swedish funds | 15,541 | 8,436 |
| Total fair value | 118,183 | 138,328 |

At 31/12/2017, AP1 had shares on loan to a value of SEK 1.4 billion (1.2). As collateral, government bonds to a value of SEK 1.5 billion were received. The market value of the loaned position and collateral is calculated daily. The collateral shall amount to a minimum of 102 per cent.

| Five largest Swedish equity holdings | Number | Fair value |
|--------------------------------------|------------|---------------|
| Volvo B | 35,506,522 | 4,117 |
| Ericsson (LM) B | 45,349,721 | 3,534 |
| Essity B | 13,070,505 | 2,844 |
| Skand. Enskilda Banken A | 21,662,731 | 1,865 |
| Hexagon B | 3,760,274 | 1,534 |
| Total fair value | | 13,894 |

| Five largest non-Swedish equity holdings | Number | Fair value |
|--|------------|--------------|
| Nordea Bank | 38,291,428 | 2,856 |
| AstraZeneca Plc | 2,729,740 | 1,839 |
| Autoliv Inc-Swed Dep Receipt | 2,523,661 | 1,589 |
| Kindred Group Sdr | 19,373,664 | 1,581 |
| Tencent Holdings Ltd | 4,363,681 | 1,551 |
| Total fair value | | 9,416 |

A complete list of all listed holdings at 30 June and 31 December is available on AP1's website www.ap1.se.

Note 8 Unlisted shares and participations

| Fair value, SEK m | 31/12/2018 | 31/12/2017 |
|---|---------------|---------------|
| Swedish unlisted shares and participations: Subsidiaries and associated companies | 35,281 | 30,092 |
| Non-Swedish unlisted shares and participations: Subsidiaries and associated companies | 5,398 | 2,465 |
| Other unlisted shares and participations | 42,858 | 39,011 |
| Total | 83,537 | 71,568 |

| Subsidiaries and associated companies | Domicile | Corp. ID No. | Number | Holding, % | Net invest- ment income | Equity | Fair value |
|---|-------------|--------------|-------------|------------|----------------------------|-----------------------|---------------|
| Swedish shares and participations, subsidiaries and associated companies | | | | | | | |
| Aros Bostad IV AB | Stockholm | 559032-9503 | 14,747 | 28 | -0.6 ⁽¹⁾ | 397 ⁽¹⁾ | 245 |
| Ellevio AB | Stockholm | 559005-2444 | 6,250 | 12.5 | 288 ⁽¹⁾ | 6,201 ⁽¹⁾ | 1,438 |
| Secore Fastigheter AB | Stockholm | 559018-9451 | 25,000 | 50 | 22 ⁽¹⁾ | 800 ⁽¹⁾ | 543 |
| Vasakronan Holding AB | Stockholm | 556650-4196 | 1,000,000 | 25 | 9,269 ⁽¹⁾ | 51,377 ⁽¹⁾ | 17,704 |
| Willhem AB | Gothenburg | 556797-1295 | 769,880,846 | 100 | 2,152 ⁽¹⁾ | 11,221 ⁽¹⁾ | 15,351 |
| Total | | | | | | | 35,281 |
| Non-Swedish shares and participations, associated companies and subsidiaries | | | | | | | |
| First Australian Farmland Pty Ltd | Australia | 155,718,013 | | 100 | -20 ⁽²⁾ | 283 ⁽²⁾ | 251 |
| Chapone S.à.r.l | Luxembourg | B 200297 | | 100 | 150 ⁽²⁾ | 1,887 ⁽²⁾ | 2,051 |
| OMERS Farmoor 3 Holdings B.V. | Netherlands | | | 100 | - | - | 2,549 |
| Jutas Invest Finland OY | Finland | 2793175-3 | | 100 | -13 | 87 ⁽²⁾ | 283 |
| ASE Holdings S.à.r.l | Luxembourg | B 169327 | | 38 | 108 ⁽²⁾ | 591 ⁽²⁾ | 83 |
| ASE Holdings III S.à.r.l | Luxembourg | B 207618 | | 35 | -25 ⁽²⁾ | 135 ⁽²⁾ | 181 |
| Total | | | | | | | 5,398 |

⁽¹⁾Pertains to figures released 31/12/2017

⁽²⁾Refers to 31/12/2017 translated at the exchange rate on 31/12/2017

| Five largest holdings, unlisted shares and participations | Domicile | Holding, % | Cost |
|---|----------------|------------|--------|
| Hamilton Lane, Private Equity | US | 99 | 11,340 |
| Idiosyncratic AI L P | Cayman Islands | 100 | 10,480 |
| Bridgewater Tailored All Weather Fund L.P. | Cayman Islands | 100 | 2,103 |
| LGT, First Hedge Fund Investments L.P. | Guernsey | 100 | 1,683 |
| FIRST Private Equity Investments, L.P. | Guernsey | 100 | 1,169 |

Note 9 Bonds and other fixed-income assets

| Fair value, SEK m | 31/12/2018 | 31/12/2017 |
|--|----------------|----------------|
| Breakdown by type of issuer | | |
| Swedish state | 17,857 | 15,393 |
| Swedish municipalities | 2,317 | 2,291 |
| Swedish mortgage institutions | 3,386 | 5,786 |
| Other Swedish companies | | |
| Financial companies | 2,454 | 2,750 |
| Non-financial companies | 9,083 | 6,801 |
| Foreign states | 48,844 | 46,545 |
| Other foreign issuers | 26,574 | 34,660 |
| Total | 110,515 | 114,226 |
| Breakdown by type of instrument | | |
| Inflation-indexed bonds | 35,019 | 27,050 |
| Other bonds | 66,344 | 77,496 |
| Treasury bills | | |
| Commercial papers | | |
| Other instruments | 9,152 | 9,680 |
| Total | 110,515 | 114,226 |

Note 10 Derivatives

| | 31/12/2018 | | 31/12/2017 | |
|------------------------------|------------------------------|------------------------|------------------------|------------------------|
| | Derivative instruments with: | | | |
| SEK m | Positive fair value | Negative fair value | Positive fair value | Negative fair value |
| Equity-linked instruments | | | | |
| Options | | | | |
| Held | 16 | | 50 | |
| Issued | | -198 | | -73 |
| Swaps | 16 | -721 | 141 | -5 |
| Futures | | | 8 | -7 |
| Total | 32 | -919 | 199 | -85 |
| Interest-linked instruments | | | | |
| Swaps | 50 | -203 | 481 | -175 |
| Futures | 1 | -16 | | |
| Total | 51 | -219 | 481 | -175 |
| Currency-linked instruments | | | | |
| Swaps | 3,446 | -106 | 2,073 | -382 |
| Futures | | | | |
| Options | 206 | -206 | | -3 |
| Total | 3,652 | -312 | 2,073 | -385 |
| Total derivative instruments | 3,735 | -1,450 | 2,753 | -645 |

Derivative positions with a negative value amounting to SEK -891 million have a maturity exceeding 12 months. For maturity analysis thereof, see Note 18.

Note 11 Other assets

| SEK m | 31/12/2018 | 31/12/2017 |
|---|--------------|------------|
| Incoming payments, unsettled transactions | 1,961 | 483 |
| Receivables from foreign tax authorities | 123 | 84 |
| Reinvested cash collateral for derivative positions | 622 | 284 |
| Other assets | 129 | 138 |
| Total other assets | 2,835 | 989 |

Note 12 Prepaid expenses and accrued income

| SEK m | 31/12/2018 | 31/12/2017 |
|--|------------|------------|
| Accrued interest income | 646 | 741 |
| Accrued dividends | 147 | 156 |
| Other prepaid expenses and accrued income | 18 | 15 |
| Prepaid expenses and accrued income | 811 | 912 |

Note 13 Other liabilities

| SEK m | 31/12/2018 | 31/12/2017 |
|---|--------------|------------|
| Outgoing payments, unsettled transactions | 367 | 364 |
| Received cash collateral for derivative positions | 622 | 284 |
| Other | 22 | 18 |
| Other liabilities | 1,011 | 666 |

Note 14 Deferred income and accrued expenses

| SEK m | 31/12/2018 | 31/12/2017 |
|---|------------|------------|
| Accrued management fees | 40 | 24 |
| Other accrued expenses | 23 | 17 |
| Deferred income and accrued expenses | 63 | 41 |

Note 15 Net assets

| SEK m | 2018 | 2017 |
|---|----------------|----------------|
| Opening net assets | 332,509 | 310,535 |
| Net flow to/from the pension system | | |
| Incoming pension contributions | 69,552 | 66,850 |
| Outgoing pension disbursements | -76,110 | -73,999 |
| Transfer of pension rights to the EC | -1 | -2 |
| Settlement of pension rights | 2 | 2 |
| Outgoing administrative contribution to the Swedish Pensions Agency | -216 | -226 |
| Total net outflow to the pension system | -6,773 | -7,375 |
| Net investment income after expenses for the year | -2,074 | 29,349 |
| Closing net assets | 323,662 | 332,509 |

Note 16 Memorandum items

| SEK m | 2018 | 2017 |
|---|---------------|---------------|
| Pledged assets and equivalent collateral for own liability | none | none |
| Securities on loan against other collateral ⁽¹⁾ | - | 1,429 |
| Collateral provided for futures transactions | 293 | 2,454 |
| Collateral provided for OTC transactions ⁽²⁾ | 732 | 158 |
| Other pledged assets and equivalent collateral | 1,025 | 4,041 |
| Investment commitments, unlisted holdings | 24,387 | 29,392 |
| Undertakings | 24,387 | 29,392 |
| Total memorandum items | 25,412 | 33,433 |
| ⁽¹⁾ Collateral received for securities on loan | - | 1,515 |
| ⁽²⁾ Collateral received for OTC transactions | 929 | 1,217 |

Note 17 Financial instruments, price and valuation hierarchy

This Note provides disclosures about how fair value is determined for the financial instruments used by the AP Funds. The Funds' accounting and valuation policies are in accordance with the international reporting standard. The objective is to present information about the fair values of financial assets and liabilities and to ensure transparency and comparability between different companies. This means that the disclosures about valuation of assets and liabilities in the balance sheet take account of whether trade occurs on an active or inactive market and whether quoted prices are available at the time of valuation.

Valuation of the Fund's net assets – market-listed assets

The majority of the Fund's assets are market listed, which means that they are traded on an active market at prices that represent actual and regularly occurring market transactions. The majority of the Fund's market listed assets are valued daily at their quoted market prices and consist of equities, bonds, derivatives, funds and foreign exchange. Some Fund holdings with listed holdings in underlying securities are valued less frequently than daily, e.g. weekly or every other week. A handful of Fund holdings with listed holdings in underlying securities are valued only once a month.

For OTC derivatives the valuation is based on either theoretical modelling or on a valuation from an external party. For the Fund's holdings of currency futures the valuation is based on theoretical modelling, whereby the model's subjective feature at present consists exclusively of the choice of yield curve and methodology for calculating and forecasting future value (interpolation and extrapolation). The same methodology is applied for deposits, short-dated commercial papers and similar instruments. For other OTC derivatives, valuation is performed exclusively by an external party as a comparison to the Fund's own valuations. In periods when the market lacks liquidity for market listed securities, a higher degree of subjectivity is required in the valuation process. At such times, the market features sharply increased spreads between bid and ask prices, which can also differ substantially between market participants. At such times, Funds have used a conservative approach to valuation.

Valuation of net assets – alternative investments

For assets that are not valued in an active market, different valuation methodologies are applied to determine fair value. Fair value equals the price that would have been received or paid in an orderly transaction between two independent parties. AP1's unlisted investments consist of investments in hedge funds, risk parity funds, private equity funds, real estate companies and real estate funds. Investments in unlisted hedge funds and risk parity funds

are normally valued with a one-month lag. These funds invest primarily in market listed securities. Valuation of fund participations is based on the same policies as for market listed assets. Investments in private equity funds are valued according to the International Private Equity and Venture Capital Valuation (IPEV) Guidelines or similar policies. According to IPEV, the valuation can be based on completed transactions, market multiples in valuation, the net asset value or discounting of future cash flows. Valuation of the Fund's investments in private equity funds is based on the most recent available reporting. Since reporting from private equity funds is received with a lag, the Fund's annual accounts are generally based on reports at 30 September adjusted for cash flows for the subsequent period and up to the closing date. In a situation with rising returns in the equity markets, this means that the Fund has a lower valuation in the annual accounts than that which is later reported by private equity fund managers and vice versa.

Investments in real estate companies are valued in accordance with IFRS and industry practice as established in IPD's recommendations. The valuation is based on discounting of future rental income, operating expenses and sales prices by market-based return requirements. With regard to valuation of deferred tax in a real estate company, this is measured at fair value, i.e. a discounting of future tax effects by an interest rate that is relevant for the individual company. Investments in real estate funds are valued according to recommendations from industry organisations such as INREV.

Fair value

The fair value of a financial instrument is defined as the amount for which an asset could be transferred or a liability settled between knowledgeable and willing parties in an arm's length transaction. Depending on which market data is available for valuation of the financial instruments, these are broken down into three levels:

- **Level 1:** Financial instruments traded in an active market. The market is deemed active if there are quoted prices that are regularly updated with a greater frequency than once a week and if the prices are used unaltered to settle trades in the market.
- **Level 2:** Financial instruments⁽¹⁾ traded on a market that is not considered active but for which there are quoted prices that are used unaltered to settle trades, or observable input data that is regularly updated for indirect valuation using generally accepted models.
- **Level 3:** Instruments belong to level 3 if they cannot be included in level 1 or level 2. In such cases, no observable market data can be used for valuation. Valuations are based on information with consideration to the circumstances, and may require a significant element of estimation from the Fund's management.

⁽¹⁾ In classification to an appropriate level in the valuation hierarchy, financial instruments shall be assessed without screening.

Active market

An active market is one in which quoted prices are readily and regularly available from an exchange, a trader or similar and where transactions are priced on commercial terms. It is virtually only equities for listed companies, currencies and fixed-income securities issued by governments, municipalities, banks or major corporations that are traded on an active market and can thus be included in level 1. For example, currency derivatives are traded on very active markets, but are classified at level 2 since the value must be derived from prices of other instruments.

Inactive market

An inactive market features a low trading volume and a much lower level of trading activity than on an active market. Available prices vary sharply over time or between market participants. In most cases, the prices are not current.

Financial instruments, price and valuation hierarchy

| Financial assets and liabilities, closing balance 31/12/2018 | Level 1, SEK m | Level 2, SEK m | Level 3, SEK m | Total |
|--|----------------|----------------|----------------|----------------|
| Financial assets | | | | |
| Shares and participations, listed | 115,990 | | 2,293 | 118,283 |
| Shares and participations, unlisted | | | 83,537 | 83,537 |
| Bonds and other fixed-income assets | 96,814 | 9,059 | 4,642 | 110,515 |
| Derivatives | | 3,735 | | 3,735 |
| Total assets valued at | 212,804 | 12,794 | 90,472 | 316,070 |
| Financial liabilities | | | | |
| Derivatives | | -1,450 | | -1,450 |
| Total liabilities valued at | 0 | -1,450 | 0 | -1,450 |
| Financial assets and liabilities | 212,804 | 11,344 | 90,472 | 314,620 |

| Financial assets and liabilities, closing balance 31/12/2017 | Level 1, SEK m | Level 2, SEK m | Level 3, SEK m | Total |
|--|----------------|----------------|----------------|----------------|
| Financial assets | | | | |
| Shares and participations, listed | 136,269 | - | 2,060 | 138,329 |
| Shares and participations, unlisted | - | - | 71,568 | 71,568 |
| Bonds and other fixed-income assets | 109,471 | 319 | 4,436 | 114,226 |
| Derivatives | - | 2,753 | - | 2,753 |
| Total assets valued at | 245,740 | 3,072 | 78,064 | 326,876 |
| Financial liabilities | | | | |
| Derivatives | - | -645 | - | -645 |
| Total liabilities valued at | 0 | -645 | 0 | -645 |
| Financial assets and liabilities | 245,740 | 2,427 | 78,064 | 326 231 |

| Change, level 3 | 2018 | 2017 |
|---|---------------|---------------|
| Shares and participations, listed, opening balance | 2,060 | 2,244 |
| Reclassification from level 2, opening balance 2017 | - | - |
| Buy | 443 | 494 |
| Sell | 0 | -1,015 |
| Change in value | -210 | 337 |
| Change in shares and participations, listed | 233 | -184 |
| Shares and participations, listed, closing balance | 2,293 | 2,060 |
| Shares and participations, unlisted, opening balance | 71,568 | 76,503 |
| Reclassification from level 1, opening balance 2017 | - | - |
| Buy | 15,810 | 11,330 |
| Sell | -14,382 | -20,226 |
| Change in value | 10,541 | 3,961 |
| Change in shares and participations, unlisted | 11,969 | -4,935 |
| Shares and participations, unlisted, closing balance | 83,537 | 71,568 |
| Bonds and other fixed-income assets, opening balance | 4,436 | 5,266 |
| Buy | 543 | 657 |
| Sell | -411 | -1,442 |
| Change in value | 75 | -45 |
| Change in bonds and other fixed-income assets | 207 | -830 |
| Bonds and other fixed-income assets, closing balance | 4,643 | 4,436 |
| Total change, level 3 | 12,409 | -5,949 |

Of the change in value reported above, 79 per cent (73) was unrealised on the balance sheet date. The Fund has the majority of its investments at level 1 where the valuations are obtained from independent and reputed valuation sources. Level 3 listed equities refer to listed fund participations, for which prices are updated less frequently than every seventh day.

Note 18 Financial risks

All investments in the financial markets are associated with risk. The most significant risks can be divided into three groups – investment risks, administrative risks and operational risks. Investment risks can be further divided into market risk, liquidity risk and credit risk. The Fund's most significant investment risk is market risk, which is the risk of changes in the value of an asset. Market risk is quantifiable and is typically measured in terms of standard deviation of return (volatility), value at risk and expected shortfall.

Liquidity risk is the risk of a low volume of trading in an instrument, which can lead to substantial differences between bid and ask prices and therefore high transaction costs, or make it impossible to sell an instrument at the desired time. The Fund's equity investments take place in listed markets and are in most cases highly liquid. However, alternative investments have low liquidity. The table below shows the maturity structure of the Fund's bond portfolio. Credit risk arises in bond investment and the risk that an issuer will be unable to meet its obligations or, in the worst case, will suspend payments. Credit risk is estimated by a credit rating agency. To limit this risk the Fund only invests to a minor extent in bonds with a rating below BBB.

Credit risk also arises when there is a risk that a counterparty will not meet its obligations with respect to the Fund. Counterparty risk arises in trading in securities and OTC contracts. To minimise this risk, such trading is limited and diversified. For counterparties trading in OTC contracts, high creditworthiness from credit rating agencies and signed netting agreements (ISDA agreements) are required.

Forecast risk

The assets' expected market risk is presented in the sensitivity analysis according to the table below. The calculations are based on the Fund's portfolio composition at 31 December 2018 and historical market returns.

The sensitivity analysis is carried out through simulation of return outcomes for the Fund's assets. By using the historical return breakdown in the simulation, any extreme outcomes are taken into account. Hence, no assumptions about normal distribution are necessary. The simulations

shown in the table are created for a short-term risk perspective. The simulation uses a one-year data history and risk is presented for a horizon of a one-day change in value. The simulation is based on a joint standard that has been agreed on by the First, Second, Third and Fourth AP Funds.

The simulation is shown with two different but related risk measures. Value at risk shows the outcome exceeded by the Fund with 95 per cent probability. The expected shortfall measure estimates the extent of the loss that may occur with 5 per cent probability. Expected shortfall shows the expected loss given that the loss is greater than the value at risk measure.

The Fund's risk measured as forecast volatility amounted to 6.8 per cent annualised for the Fund's total portfolio at 31 December. The foreign exchange asset class shows the Fund's total currency risk, while the other assets in the table are hedged for currency risk. The table shows the diversification gain achieved through the Fund's investment in different assets, which together reduce the Fund's risk of loss compared to the risks specific to each individual asset.

Realised risk

Average realised risk is calculated based on a joint standard that has been agreed on by the First, Second, Third and Fourth AP Funds and which is founded on the principle that calculation of risk shall reflect the market valuation of the Fund's total assets. The valuation frequency is established as quarterly and the period for calculation is established at ten years. Consequently, for the total portfolio the realised standard deviation for the past ten years has been expressed at an annual rate based on quarterly data.

AP1's average realised risk for the past ten-year period was 7.0 per cent based on this calculation methodology.

The First, Second, Third and Fourth AP Funds have also agreed to report average realised risk for the past year both for the total portfolio and for the assets for which a market value is obtained daily. For this calculation of standard deviation, daily data is used. The average realised risk during the year was 4.9 per cent for the total portfolio and 6.0 per cent for the part of the portfolio for which a market value is obtained daily. The share of the portfolio for which a market value is obtained daily was 73 per cent at the end of the year.

Financial risks

| | Volatility annualised % | | Value at risk annualised, SEK m | | Expected shortfall annualised, SEK m | | Value at risk one day, SEK m | | Expected shortfall one day, SEK m | |
|--|-------------------------|------|---------------------------------|---------|--------------------------------------|---------|------------------------------|--------|-----------------------------------|--------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Sensitivity analysis, market risk, at 31 Dec | | | | | | | | | | |
| Equities | 12.8 | 6.8 | -24,576 | -14,425 | -32,696 | -19,353 | -1,524 | -895 | -2,028 | -1,200 |
| Fixed income | 1.3 | 1.1 | -2,460 | -2,203 | -3,014 | -2,987 | -153 | -137 | -187 | -185 |
| Alternative investments | 10.9 | 6.6 | -16,551 | -9,336 | -24,641 | -11,761 | -1,026 | -579 | -1,528 | -729 |
| Foreign exchange | 8.7 | 7.0 | -5,319 | -3,931 | -6,725 | -5,252 | -330 | -244 | -417 | -326 |
| Contribution from Diversification | -2.4 | -1.6 | 12,808 | 8,984 | 14,252 | 8,333 | 794 | 557 | 884 | 517 |
| Liquid portfolio | 6.1 | 4.0 | -25,237 | -17,188 | -34,809 | -24,113 | -1,565 | -1,066 | -2,159 | -1,495 |
| Total portfolio | 6.8 | 3.8 | -36,098 | -20,911 | -52,825 | -31,019 | -2,239 | -1,297 | -3,276 | -1,924 |

Liquidity risk, at 31 Dec

| Maturity structure, Maturity in years, SEK m | < 1 | | 1–3 | | 3–5 | | 5–10 | | > 10 | | Total balance, SEK m | |
|--|--------|-------|--------|--------|--------|--------|--------|--------|--------|--------|----------------------|---------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Nominal, government | 13,868 | 4,332 | 6,674 | 13,362 | 7,469 | 5,068 | 11,548 | 17,040 | 4,290 | 5,246 | 43,850 | 45,048 |
| Nominal, credit | 4,025 | 4,649 | 11,726 | 12,164 | 7,474 | 12,043 | 11,821 | 14,151 | 5,240 | 7,440 | 40,286 | 50,446 |
| Inflation-indexed | 2,432 | 572 | 11,373 | 6,854 | 6,318 | 7,366 | 6,572 | 4,274 | 5,823 | 4,105 | 32,518 | 23,170 |
| Total portfolio | 20,325 | 9,553 | 29,773 | 32,380 | 21,262 | 24,476 | 29,941 | 35,465 | 15,353 | 16,790 | 116,654 | 118,664 |

Derivative positions with a negative fair value, maturity exceeding 12 months, at 31 Dec

| Maturity structure, Maturity in years, SEK m | 1–3 | | 3–5 | | 5–10 | | > 10 | | Total balance, SEK m | |
|--|------|------|------|------|------|------|------|------|----------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Equity-linked instruments | -683 | 0 | 0 | 0 | 0 | 0 | | 0 | -683 | 0 |
| Interest-linked instruments | -69 | 0 | -132 | 0 | -3 | -119 | | 0 | -204 | -119 |
| Currency-linked instruments | | 0 | | -35 | | 0 | | 0 | -0 | -35 |
| Total | | | | | | | | | -887 | -154 |

Reporting of maturity structure

The maturity structure for bonds is presented in the liquidity risk table. According to the current maturity structure, AP1's fixed-income assets generate inflows to the Fund that exceed forecast payments to the pension system. The Fund is thus able to meet the forecast requirements for payments to the pension system.

Reporting of credit risk

Credit risk for bonds is estimated through grading into different rating classes. AP1 uses the credit rating agency Standard & Poor's®. The agency issues an assessment that assigns a bond's credit rating, with a highest possible rating of AAA. The Fund has limited holdings of bonds with a rating of BBB, SEK 10,259 million, and holdings with a lower rating than investment grade, <BBB, in high-yield investments, SEK 10,773 million. See the table below. The overall assessment is that the Fund has low exposure to credit risk in its bond holdings.

Credit risk, at 31 Dec

| Rating SEK m ⁽ⁱ⁾ | AAA | | AA | | A | | BBB | | <BBB | | Total balance, SEK m | |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|--------------|---------------|---------------|---------------|---------------|----------------------|----------------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Nominal, government | 18,372 | 14,434 | 17,394 | 20,817 | 5,602 | 378 | 2,482 | 9,419 | 0 | 0 | 43,850 | 45,048 |
| Nominal, credit | 9,656 | 11,629 | 5,246 | 6,002 | 6,834 | 8,168 | 7,777 | 9,278 | 10,773 | 15,369 | 40,286 | 50,446 |
| Inflation-indexed | 15,434 | 9,902 | 16,702 | 9,662 | 383 | 352 | 0 | 3,254 | 0 | 0 | 32,518 | 23,170 |
| Total | 43,461 | 35,965 | 39,341 | 36,481 | 12,820 | 8,898 | 10,259 | 21,951 | 10,773 | 15,369 | 116,654 | 118,664 |

⁽ⁱ⁾ Reporting of credit risk for fixed-income securities based on ratings issued by reputed rating agencies.

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Note 19 Financial assets and liabilities that are netted or governed by netting agreements

| SEK m, 31/12/2018 | Gross amount | Netted amount in the balance sheet | Net amount in the balance sheet | Related amounts that cannot be netted | | | Other ⁽¹⁾ | Total in the balance sheet |
|--------------------------|--------------|--|---------------------------------------|---------------------------------------|------------------------|--------------|----------------------|----------------------------------|
| | | | | Framework agreement on netting | Collateral received | Net amount | | |
| Unsettled assets | 1 | | 1 | | | | 1,961 | 1,961 |
| Derivatives | | | 3,733 | 1,434 | 929 | 1,371 | 2 | 3,735 |
| Total assets | 1 | 0 | 3,734 | 1,434 | 929 | 1,371 | 1,963 | 5,696 |
| Liabilities | | | | | | | | |
| Unsettled liabilities | 1 | | 1 | | | | 367 | 367 |
| Derivatives | | | 1,434 | 1434 | | 16 | 16 | 1,450 |
| Total liabilities | 1 | 0 | 1,435 | 1434 | 0 | 16 | 383 | 1,817 |

| SEK m, 31/12/2017 | Gross amount | Netted amount in the balance sheet | Net amount in the balance sheet | Related amounts that cannot be netted | | | Other ⁽¹⁾ | Total in the balance sheet |
|--------------------------|--------------|--|---------------------------------------|---------------------------------------|------------------------|------------|----------------------|----------------------------------|
| | | | | Framework agreement on netting | Collateral received | Net amount | | |
| Unsettled assets | 22 | 22 | 0 | - | - | - | 483 | 483 |
| Derivatives | - | - | 2,753 | 638 | 1,217 | 898 | - | 2,753 |
| Total assets | 22 | 22 | 2,753 | 638 | 1,217 | 898 | 483 | 3,236 |
| Liabilities | | | | | | | | |
| Unsettled liabilities | 22 | 22 | 0 | 0 | 0 | 0 | 896 | 896 |
| Derivatives | - | - | 638 | 638 | 0 | 0 | 7 | 645 |
| Total liabilities | 22 | 22 | 638 | 638 | 0 | 0 | 903 | 1,541 |

⁽¹⁾ Other instruments in the balance sheet that are not governed by netting agreements.

The table above shows the financial assets and liabilities that are presented net in the balance sheet, or that carry rights associated with legally binding framework agreements regarding netting or similar agreements. Financial assets and liabilities are recognised net in the balance sheet when the Fund has a legal right to perform netting in normal business conditions and in the event of insolvency, and if there is an intention to pay net proceeds or realise the asset and simultaneously settle the liability. Financial assets and liabilities that are governed by legally binding framework agreements regarding netting or similar agreements that are not presented net in the balance sheet are arrangements that commonly come into legal effect in the event of insolvency, but not in normal business conditions, or arrangements in which the Fund does not intend to settle the positions simultaneously.

Note 20 Related parties

The table shows AP1's transactions, outstanding dealings and obligations with related parties in accordance with definitions in IAS 24. Related parties to AP1 are considered to be subsidiaries and associated companies in which the Fund's ownership is a minimum of 20 per cent, and the Fund's Board members and executive management team.

See Note 5 for information regarding salaries and remuneration for Board members and the executive management team.

| Counterparty and ownership | 31/12/18 | 31/12/17 |
|--|----------|----------|
| AROS Bostadsutveckling, 29% | | |
| Interest income | - | - |
| Proprietary loans | - | - |
| Shareholder contribution during the year | 106 | 78 |
| Investment commitments | 400 | 400 |
| Chapone S.à.r.l, 100% | | |
| Interest income | 39 | 57 |
| Proprietary loans | 1,022 | 1,066 |
| Shareholder contribution during the year/repaid | -168 | - |
| Investment commitments | 2,771 | 2,458 |
| Secore AB, 50% | | |
| Interest income | | - |
| Proprietary loans | | - |
| Shareholder contribution during the year | 28 | 364 |
| Investment commitments | 608 | 636 |
| Vasakronan Holding AB, 25% | | |
| Rent for premises ⁽ⁱ⁾ | 11 | 11 |
| Interest income | - | 9 |
| Proprietary loans | - | - |
| Shareholder contribution during the year | - | - |
| Undertaking, on the request of Vasakronan, to purchase commercial papers in the company, up to the highest total settlement amount at any time of: | 4,500 | 4,500 |
| Willhem AB, 100% | | |
| Interest income | - | 16 |
| Proprietary loans | - | - |
| Shareholder contribution during the year | -1 | - |
| Undertaking, on the request of Willhem, to purchase commercial paper in the company, up to the highest total settlement amount at any time of: | 6,000 | 5,500 |
| ASE Holdings Ltd, 38% | | |
| Interest income | 22 | 27 |
| Proprietary loans | 226 | 222 |
| Shareholder contribution during the year/repaid | -219 | 0 |
| ASE Holdings III S.à.r.l, 32% | | |
| Interest income | 7 | 3 |
| Proprietary loans | 112 | 57 |
| Shareholder contribution during the year | 56 | 57 |

| Counterparty and ownership | 31/12/18 | 31/12/17 |
|--|----------|----------|
| Jutas Invest Finland OY, 100% | | |
| Interest income | 22 | 12 |
| Proprietary loans | 321 | 289 |
| Shareholder contribution during the year | 164 | 99 |
| First Australian Farmland Pty Ltd, 100% | | |
| Interest income | 34 | 32 |
| Proprietary loans | 458 | 435 |
| Shareholder contribution during the year | - | - |
| OMERS Farmoor 3 Holdings B.V., 100% | | |
| Interest income | - | - |
| Proprietary loans | - | - |
| Shareholder contribution during the year | 1,313 | 1,272 |

⁽⁴⁾ AP1 rents office premises from Vasakronan on market terms.

The Board of Directors' Statement of Assurance

We hereby give our assurance that, to the best of our knowledge, the annual accounts have been prepared in conformity with generally accepted accounting principles in Sweden and with the joint accounting and valuation policies developed by the AP Funds, that the information therein gives a true and fair presentation of the actual conditions, and that nothing of material significance has been omitted that could affect the presentation of the Fund created by this annual report.

Stockholm, 21 February 2019

Urban Karlström
Chairman

Annika Sundén
Deputy Chairman

Göran Arrius

Kent Eriksson

Urban Hansson Brusewitz

Anna Hesselman

Åsa-Pia Järliden Bergström

Anders Henriksson

Eva Redhe

Our auditors' report was submitted on 21 February 2019

Peter Nilsson
Authorised Public Accountant
Appointed by the Swedish
Government

Helena Kaiser de Carolis
Authorised Public Accountant
Appointed by the Swedish
Government

Auditors' Report

For Första AP-fonden, Corp. ID No. 8020057538

Report on the annual accounts

Opinion

We have audited the annual accounts of Första AP-fonden for the year 2018. The Fund's annual accounts are on pages 24–44 of this document.

In our opinion the annual accounts have been prepared in accordance with the National Pension Insurance Funds Act (2000:192) and present fairly, in all material aspects, the financial position of Första AP-fonden as of 31 December 2018 and its financial performance for the year then ended in accordance with the National Pension Insurance Funds Act.

The statutory administration report is consistent with the other parts of the annual accounts.

We therefore recommend that the income statement and balance sheet be adopted.

Basis for our opinion

We conducted our audit in accordance with International Standards on Auditing (ISA) and generally accepted auditing standards in Sweden. Our responsibility as set out in these standards is described in more detail in the section on "The auditor's responsibility". We are independent of Första AP-fonden in accordance with generally accepted auditing standards in Sweden and we have otherwise fulfilled our professional ethical responsibility in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information other than the annual accounts

This document also contains information other than the annual accounts, and this can be found on pages 2–23 and 48–53. The Board of Directors and the CEO are responsible for this other information.

Our opinion regarding the annual accounts does not extend to this information, and we do not provide any opinion with assurance regarding this other information.

In connection with our audit of the annual accounts, it is our responsibility to read the information identified above and to consider whether or not the information is, to a material extent, inconsistent with the annual accounts. During this review, we also take into consideration the knowledge we have otherwise gained during the audit and assess whether the information otherwise seems to contain material misstatement.

If, based on the work carried out regarding this information, we conclude that the other information contains a material misstatement, we are obliged to report it. We have nothing to report in this respect.

The Board of Directors' and the CEO's responsibility

The Board of Directors and the CEO are responsible for the preparation of the annual accounts and for ensuring that they provide a true and fair presentation in accordance with the National Pension Insurance Funds Act. The Board of Directors and CEO are also responsible for such internal control as the Board of Directors and the CEO deem necessary for the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

While preparing the annual accounts, the Board of Directors and the CEO are responsible for assessing the Fund's ability to continue its operation. They disclose, where applicable, conditions that could affect the Fund's ability to continue its operation and to apply the going concern assumption. The going concern assumption, however, is not applied if the Board of Directors and the CEO intend to liquidate the Fund, close down the operation or do not have a realistic alternative to one of these options.

The auditor's responsibility

Our goals are to express an opinion with reasonable assurance on whether the annual accounts as a whole contain any material misstatements, whether due to fraud or error, and to provide an auditors' report containing our opinions. Reasonable assurance is a high degree of certainty, but it is no guarantee that an audit performed in accordance with ISA and generally accepted auditing standards in Sweden will always discover a material misstatement should one exist. Misstatements can occur due to fraud or error, and are deemed to be material if individually or jointly they can reasonably be expected to affect the financial decisions made by users based on the annual accounts.

As part of an audit performed in accordance with ISA, we use professional judgement and we take a professionally sceptical approach during the entire audit. We also carry out the following stages:

- We identify and assess the risks of material misstatement in the annual accounts, whether due to fraud or error, we design and perform audit procedures, partly based on these risks, and we obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. There is a higher risk of not discovering a material misstatement due to fraud than one due to error as fraud may entail acting in collusion, falsification, intentional omissions, incorrect information or disregarding internal control.
- We acquire an understanding of the part of the Fund's internal control that is important to our audit in order to design audit procedures that are appropriate taking into account the circumstances, but not in order to express an opinion on the efficacy of the internal control.
- We evaluate the appropriateness of the accounting policies used and the reasonableness of the accounting estimates and pertaining disclosures made by the Board of Directors and the CEO.
- We test the appropriateness of the Board of Directors and the CEO applying the going concern assumption when preparing the annual accounts. Based on the audit evidence obtained, we test whether there are any material uncertainties relating to any events or conditions that could result in significant doubt about the Fund's ability to continue the operation. If we conclude that there is a material uncertainty, we must draw attention in the auditors' report to the disclosures in the annual accounts about the material uncertainty, or, if such disclosures are insufficient, we must modify our opinion of the annual accounts. Our conclusions are based on the audit evidence obtained up until the date of the auditors' report. Future events or conditions may, however, mean that the Fund is no longer able to continue its operations.
- We evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts render the underlying transactions and events in a way that provides a true and fair presentation.

We must inform the Board of Directors of the planned scope and direction of the audit, as well as the timing of the audit, for example. We must also provide information about significant observations during the audit, including any significant shortcomings we identify in the internal control.

Report on other legal and regulatory requirements

Opinion

In addition to our audit of the annual accounts, we have examined the inventory of the assets managed by Första AP-fonden. We have also examined whether there are any qualifications in general concerning the Board of Directors' and the CEO's administration of Första AP-fonden for 2018.

Our audit has not resulted in any qualifications concerning the inventory of assets or in general regarding the administration of the Fund.

Basis for our opinion

We have conducted our audit in accordance with generally accepted auditing standards in Sweden. Our responsibility as set out in these standards is described in more detail in the section on "The auditor's responsibility". We are independent of Första AP-fonden in accordance with generally accepted auditing standards in Sweden and we have otherwise fulfilled our professional ethical responsibility in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The Board of Directors' and the CEO's responsibility

The Board of Directors and the CEO are responsible for the preparation of the accounting documents and for the management of the Fund's assets in accordance with the National Pension Insurance Funds Act.

The Board of Directors is responsible for Första AP-fonden's organisation and for the management of Första AP-fonden's affairs. This includes, for example, continuously assessing Första AP-fonden's financial situation and ensuring that Första AP-fonden's organisation is designed so that accounting, asset management and Första AP-fonden's financial affairs are otherwise controlled in an adequate manner. The CEO shall manage the ongoing administration in accordance with the Board of Directors' guidelines and instructions and, for example, take the necessary measures to ensure that Första AP-fonden's accounting is fulfilled in conformity with legislation and to ensure that asset management is handled in an adequate manner.

The auditor's responsibility

Our goal regarding the audit of the administration, and thereby our opinion on the administration, is to obtain audit evidence in order to assess with reasonable assurance whether or not there is any qualification concerning the Board of Directors' and the CEO's administration of Första AP-fonden for the 2018 financial year.

Reasonable assurance is a high degree of certainty, but it is no guarantee that an audit performed in accordance with generally accepted auditing standards in Sweden will always discover measures or omissions that can result in qualifications.

As part of an audit performed in accordance with generally accepted auditing standards in Sweden we use professional judgement and we take a professionally sceptical approach during the entire audit. The review of the administration is primarily based on the audit of the annual accounts. Decisions regarding additional audit procedures carried out are based on our professional judgement with the starting points of risk and material aspects. This means that we focus the review on such procedures, areas and conditions that are material to the operation and where deviations and non-compliance would have particular significance for Första AP-fonden's situation. We review and test the decisions made, bases for decisions, measures taken and other conditions that are relevant to our opinion of the administration.

Stockholm, 21 February 2019

Peter Nilsson

Authorised Public Accountant
Appointed by the Swedish Government

Helena Kaiser de Carolis

Authorised Public Accountant
Appointed by the Swedish Government

Första AP-fonden's Fund Governance Report 2018

The Board of Directors of AP1 has chosen to publish a Fund Governance Report to provide information on the work of the Board and Fund on governance and risk management. AP1's principles and core values – professionalism, engagement, a long-term approach and sustainability – are at the heart of its corporate culture.

The Fund Governance Report, including the Board of Directors' report on risk management, has not been reviewed by the auditors.

Första AP-fonden (AP1) is a Government authority (for details see the Fund's website, www.ap1.se) commissioned to manage assets in the Swedish income pension system. The AP Funds are more independent than most Swedish authorities because their operations are only regulated in the Swedish National Pension Funds Act⁽¹⁾ (the AP Funds Act) and not by regulations or appropriation directions. As a Government authority, AP1 is also affected by other laws⁽²⁾.

Each year, the operations of all AP Funds are evaluated by order of the

Swedish Government. The results of the evaluation are presented in a communication to the Swedish Parliament, presented in May of the year following the review period. Government communication 2017/18:130 describes the evaluation through 2017. The communications are available at www.ap1.se.

AP1 voluntarily complies with the Swedish Code of Corporate Governance where it is possible. Publication of this Fund Governance Report is part of this compliance. However, not all rules in the Code are applicable to all parts, since AP1 is a Government authority. In the table, the rules which the Fund does not follow are set out, and the reasons for this. All other rules of the Code are followed.

| Rule | Divergence | Reason |
|-----------|--|--|
| Section 1 | AP1 does not hold an AGM | The Board members of the Fund are appointed by the Swedish Government. Therefore, the Fund has neither an AGM nor a nomination committee. |
| Section 2 | AP1 does not have a nomination committee | The Board members of the Fund are appointed by the Swedish Government. Therefore, the Fund has neither an AGM nor a nomination committee. |
| 7.6 | The Fund's six-month interim report is not reviewed by the auditors | AP Funds report full-year and six-month results. The six-month report, which does not affect the pension system, is not reviewed for cost reasons. |
| 10.2 p1 | The Fund does not report the composition of the nomination committee | The Fund's Board members are appointed by the Government and consequently there is no nomination committee. |

⁽¹⁾ The National Pension Insurance Funds Act (2000:192) (the AP Funds Act).

⁽²⁾ For example, the Public Procurement Act (2007:1091), the Public Access to Information and Secrecy Act (2009:400), the Financial Instruments Trading (Market Abuse Penalties) Act (2005:377) and Anti-Bribery legislation in Chapter 10 of the Criminal Code. The Retirement Pension (Income-Based) Act (1998:674) also affects the Fund's operations.

Board of Directors

The Board of Directors of AP1 bears full responsibility for the operations of the Fund and is responsible for the Fund's organisation and management of Fund assets. The work of the Board is regulated in the National Pension Insurance Funds (AP Funds) Act.

AP1's Board of Directors consists of nine members, all of whom are appointed by the Swedish Government. Two of the members are appointed on the proposal of organisations representing employee interests, and two are appointed on the proposal of organisations representing employer interests. Since 2007, the Confederation of Swedish Enterprise has abstained from proposing members. The Government also appoints the Chairman and Deputy Chairman from among the members not proposed by labour market parties. The Fund's CEO is not a member of the Board. The Government also appoints the Fund's external auditors.

The members' term of office is one year, i.e. it extends until the Fund's income statement and balance sheet for 2018 have been adopted.

Fees and other remuneration for members of the Board are determined by the Government. Remuneration for the full year amounts to SEK 100,000 for the Chairman, SEK 75,000 for the Deputy Chairman and SEK 50,000 each for the other Board members. In addition, there is scope to pay total fees of SEK 100,000 for work on the Board's committees. The Board has resolved to pay fees of SEK 20,000 per year to each member of the audit committee and SEK 13,000 per year to each member of the remuneration committee. For more

information about fees for Board members see Note 5. A more detailed presentation of the members of the Board of Directors is provided on page 52.

Work of the Board of Directors

Each year, in compliance with the requirements imposed by the National Pension Insurance Funds (AP Funds) Act, the Board of Directors establishes targets and guidelines for the investing activities, the Fund's risk management plan, ownership policy, business plan and budget. In addition, the Board resolves to operationalise the Fund's mandate in its strategy and a number of governance documents, the most important being its principles and ethical policy, policy for gifts, hospitality and other benefits, remuneration policy for senior executives and rules governing employees' trade in financial instruments.

The Board also appoints a CEO to whom it delegates responsibility for the Fund's day-to-day activities. The Board has resolved on rules of procedure for its own work. In 2018 the Board met on seven occasions.

During the year, the Board addressed the outcome of management, expenses, ownership matters, the business plan and budget, etc. In addition to the ordinary meetings, the Board of Directors also discussed the Fund's mandate, strategy and targets ahead of forthcoming decisions at a seminar. AP1's comments on the proposed change in investment rules were raised at an extraordinary Board meeting in October.

Average attendance at Board meetings was 94 per cent (see table).

Reporting of day-to-day asset management and risk reporting have been standing items on the agenda. At Board meetings, in addition to Board members, the CEO of the Fund attends as well as the secretary to the Board. The secretary to the Board is the Fund's General Counsel. Other staff of the Fund also participate as experts or reporting persons. External speakers are also invited to Board meetings when needed. The Fund's external auditors report to the Board at least once a year. On these occasions, there is time for discussions between the Board and auditors without the presence of employees of the Fund.

Each year, the Board conducts an evaluation of its own work. The evaluation is then used to improve the work of the Board and its committees, as well as the preparatory work of management ahead of Board meetings. The Chairman of the Board reports the main results to the Government.

From among its own members the Board has appointed two committees: an audit committee and a remuneration committee. Both committees are preparatory organs and the Board retains the right to make decisions in all matters addressed in the committees. The audit committee assists the Board

in matters related to internal control, operational risks, financial reporting and auditing. In 2018 Annika Sundén was chair and Anna Hesselman and Urban Hansson Brusewitz were members of the audit committee. The committee convened four times. Attendance at meetings of the audit committee was 92 per cent. The Fund's auditors take part in the meetings of the audit committee on two occasions. The Fund's General Counsel, the Head of Middle Office & Risk and the Head of Business Support are co-opted into the audit committee meetings.

The remuneration committee assists the Board in matters related to remuneration. In 2018 the committee consisted of Board Chairman Urban Karlström (chairman of the committee), Göran Arrius and Åsa Kullgren (until April), and Anders Henriksson (from May). The committee convened twice during the year. Attendance at meetings of the remuneration committee was 100 per cent. The CEO of the Fund is co-opted into the remuneration committee's meetings, apart from when his remuneration is discussed. The Head of Human Resources is co-opted into remuneration committee meetings.

| Appointed on the proposal of | Attendance Board meetings | Audit committee (attendance) | Remuneration committee (attendance) |
|------------------------------|------------------------------|---------------------------------|--|
| Urban Karlström, Chair | 7/7 | | Chairman 2/2 |
| Annika Sundén, Deputy Chair | 5/7 | Chair 3/4 | |
| Göran Arrius | 7/7 | | Board member 2/2 |
| Urban Hansson Brusewitz | 7/7 | Board member 4/4 | |
| Kent Eriksson | 6/7 | | |
| Anna Hesselman | 7/7 | Board member 4/4 | |
| Åsa-Pia Järliden Bergström | 7/7 | | |
| Åsa Kullgren | 2/2 | | Board member 1/1 |
| Eva Redhe | 7/7 | | |
| Anders Henriksson | 4/5 | | Board member 1/1 |
| Total | 59/63 | 11/12 | 6/6 |

Management of the Fund

The Board of AP1 has delegated responsibility for operating activities to the Fund's CEO. The Board decides on the long-term risk preference of the Fund, which is manifested in overarching asset allocation. In order to implement the Fund's investment philosophy, the CEO is given a mandate to diverge from the overarching asset allocation within specified bounds.

In support of the CEO in decisions pertaining to operating activities, the CEO has decided to appoint an executive management team that includes the Chief Investment Officer and the General Counsel, and the Heads of Middle Office & Risk, Business Support, IT, Communication and HR.

Remuneration

AP1's Board of Directors annually adopts a policy for remuneration for senior executives (published on www.ap1.se). The Fund's policy is based on the guidelines resolved by the Government on 20 April 2009. The policy sets out that the total amount of remuneration for each person should be fair and reasonable, balanced and characterised by moderation. Furthermore, remuneration should be market-based and competitive with respect to the labour market in which the executive works, but without being higher than the norm for comparable positions. No variable remuneration is available to the Fund's employees. AP1, together with the Second, Third, Fourth, Sixth and Seventh AP funds, also has a joint policy for remuneration, employee benefits, hospitality and business travel. It is published on www.ap1.se.

Remuneration to the CEO is determined by the Board of Directors and consists of fixed salary and payment of defined contribution pension premiums equal to 30 per cent of basic salary. For the portion of remuneration granting rights under the national pension scheme, the pension premium is reduced to 11.5 per cent. Remuneration for senior executives of AP1 is determined by the CEO according to a well-defined process that involves the Board of Directors and its remuneration committee. AP1 complies with all

points (9.1–9.8) relating to remuneration to senior executives in the Swedish Code of Corporate Governance.

In each of the past four years, the Fund's average salary increases have been low. They have averaged at 2.2 per cent, which is lower than the corresponding increase for the comparable market. See Note 5 for further information regarding remuneration for the executive management team paid in 2018.

Every year, the Fund commissions a comparison of remuneration levels with relevant parts of the labour market as a basis for monitoring remuneration for the Fund's employees, and this also occurred in 2018. In the Board's opinion, salary levels are market-based, competitive, reasonable and appropriate without being higher than the norm with regard to the CEO, senior executives and other employees. The Board has found that the Fund is in compliance with both the remuneration policy established by the Board and the Swedish Government's 'Guidelines for terms of employment of senior executives in the AP Funds. A small number of old employment contracts have a notice period exceeding six months. However, the Board has decided not to renegotiate these contracts since this would result in higher costs for the Fund without achieving any significant improvement in the contracts.

Compared to the other entities in the study, remuneration for the Fund's employees is in some individual cases above the median for each position. Furthermore, the Board of Directors' analysis shows that there are two reasons why the Fund's remuneration is higher than that in the comparison groups:

- **Employees with cutting-edge expertise:** AP1 is a small and knowledge-intensive organisation that has an explicit strategy to hire and retain employees with cutting-edge expertise in specific areas.

- **No variable salary:** The Fund's employees are offered only fixed remuneration. Many of the areas of expertise sought by the Fund are offered variable salary by other employers. To attract and retain employees, the Fund

therefore offers higher fixed salaries. The fact that AP1 does not pay variable salary when other entities in the study do causes difficulties in interpreting the comparative statistics. At times when performance-based variable salary is lower, AP1's remuneration can therefore be higher than the average for comparable areas of expertise. At times of high returns in the financial industry, the Fund's remuneration will instead be lower than the average for comparable areas of expertise.

Hence, the Fund's remuneration is within a range that can be regarded as market-based.

The auditors perform a review to ensure compliance with the Fund's remuneration policy for senior executives, the Swedish Government's guidelines for terms of employment of senior executives in the AP funds and the joint policy with other AP funds. No divergences from the above were noted.

AP1 invests in various real estate markets via companies in which the Fund has a significant voting share. This currently includes Vasakronan, Cityhold and Willhem. The Fund has issued ownership directives that affect remuneration matters for these companies. The directives are published on www.ap1.se.

Conflicts of interest

AP1 uses a three-step process to handle any conflicts of interest. The first stage is to identify potential conflicts of interest in advance. In the second stage, transpired conflicts of interest are addressed by means of the CEO deciding on the Fund's action in the individual case. For conflicts of interest of particular importance, the Chairman of the Board is consulted. Any conflicts of interest are reported to the Board and published on the Fund's website as they arise. No conflicts of interest arose in 2018. The Board has, however, decided in consultation with the CEO to instruct KPMG to review a potential conflict of interest from 2016.

Internal control

The Board of Directors is responsible for the governance and risk management of the Fund. In the Fund's risk management plan, the Board has adopted guidelines and frameworks for the Fund's overarching allocation of responsibilities, risks, risk limits and procedures for monitoring and control of compliance with rules and guidelines. The Board's report on risk management is provided on page 51.

Independent review

In 2018 the Board decided to commission an advisory review of the Fund's sustainability projects as part of its internal auditing. The review focused on the Fund's vision and convictions regarding sustainability together with implementation to achieve the Fund's targets. The results were reported back to the audit committee in November and to the Board in December.

External audit

AP1's auditors are appointed by the Swedish Government. The current assignment, shared by Peter Nilsson and Helena Kaiser de Carolis, both from PwC, commenced on 14 September 2017 and extends until the adoption of the Fund's income statement and balance sheet for 2018.

Peter Nilsson has been appointed by the Government to coordinate the auditing procedures of all AP Funds. The auditors have also been appointed as auditors of the Second, Third, Fourth and Seventh AP funds. The auditors report directly to the Board in the form of a written audit report and a verbal presentation. The auditors participate in at least one Board meeting per year. In addition, regular meetings with the audit committee are held. The auditors present an auditors' report of their findings. The auditors also submit a yearly verbal report to the Swedish Ministry of Finance. The auditors' duties include examining the Fund's operating activities, the administration of the Fund, the year-end accounts and the annual report, and expressing an opinion on the Fund's accounting documents and administration based on their audit. Their duties also include assessment of AP1's application of the accounting and valuation policies established by the AP Funds and whether the accounting records prepared provide a true and fair presentation of the operations. In addition to a regular audit, the AP Funds' auditors must append a written, signed statement to the auditors' report to express their opinion on whether or not the guidelines for remuneration to senior executives as established for the financial year have been complied with.

The Board of Directors' Report on Risk Management

Since 2015, AP1 works according to a new investment process, which is an enhancement of the investment process implemented in 2014. This report describes risk management in 2018. The Swedish Government commissions external auditors to review the Fund's financial statements and risk control. An internal audit is also conducted annually, as commissioned by the Board.

According to the National Pension Insurance Funds Act (2000:192), the Board of Directors of AP1 is responsible for the Fund's organisation and management of the Fund's assets. Part of this responsibility is to ensure the high quality of the Fund's internal control. From among its members, the Board appoints an audit committee to prepare matters pertaining to internal control, for example. The Board submits this report on risk management annually. However, this report is not part of the formal annual report and is therefore not examined by the Fund's auditors.

As a participant in financial markets, the Fund distinguishes between three risk categories that are addressed in different ways.

- Financial risks – market risks and issuer risks – enable the Fund, when employed correctly, to increase its return on invested capital. Financial risks shall thus be optimised within the risk mandate delegated to the CEO by the Board, and the risk mandate further delegated by the CEO within the management organisation.
- Counterparty and delivery risks shall be minimised. Counterparties are evaluated and approved in a set process in which account is taken of, for example, their official rating.
- Operational risks shall be minimised by means of e.g. incident follow-up, preparing relevant policy documents, staff training and investment in IT systems.

Control environment – Fund governance

The Board of Directors annually adopts a risk management plan that sets out guidelines and limitations for the risk mandate delegated by the Board to the CEO. This document serves as a basis for internal control and monitoring of the Fund's investing activities. Therein, limitations are specified for the Fund's financial risk-taking, as are well-defined decision-making structures for the operating activities. The approach leads to sound internal risk control.

Although AP1 does not formally come under the regulations of Finansinspektionen (the Swedish financial supervisory authority), the Fund's risk management rests on Finansinspektionen's Regulations and General Guidelines regarding governance, risk management and control at credit institutions (FFFS 2014:1) in terms of the three lines of defence, (i) responsibility for risk management and control in the business operations, (ii) internal control and regulatory compliance and (iii) independent review. For the third line of defence, independent review through internal audit, the Board of Directors has resolved to conduct independent reviews with the support of an external consultant.

Managing financial risks is fundamental to the ability of the Fund to deliver on its mandate in the pension system. Risk management in the Fund is thus proactive, with financial risk forecast for each asset individually and for the portfolio as a whole. For this reason, there is a well-established risk culture at the Fund. Important elements of this culture are transparent reporting of the Fund's investments and a principle of duality for executing business transactions. This means that everyone in the organisation can monitor investing activities via an enterprise-wide system and that each business transaction requires the approval of at least two people – one from the Fund's Back Office and one from the relevant investment unit.

The second line of defence comprises the internal risk control function and compliance function. Middle Office focuses on financial risks and counterpar-

ty and delivery risks. The Compliance Officer works primarily with verifying compliance with external regulations.

Risk assessment

To ensure effective financial reporting and identification of operational risks, a yearly review of the Fund's processes and documentation thereof is conducted by order of the Board. The results of this review are reported to the Board's audit committee and the Board. A key component of this review is the account-closing process, which serves as a basis for the external financial reporting. The account-closing process encompasses valuation, reconciliation and controls of securities in connection with the closing of accounts. Aside from a general review of the processes, the Chief Risk Officer, after consultation with the CEO, establishes on a yearly basis the areas to be prioritised and subjected to special review. The units within the organisation that are affected by the review participate actively in the analysis, which is based on a self-assessment method. This work results in an evaluation of identified risks and a prioritisation of measures. The Fund's Chief Risk Officer oversees the analysis process and ensures that the prioritised measures are implemented.

Control structure and activities

The financial information is analysed and verified by the Fund's Back Office and Middle Office. The systems in Back Office and Middle Office also produce source materials for various risk analyses that are used as support for control activities.

AP1's accounting and valuation policies are being gradually adapted to International Financial Reporting Standards, IFRS. Complete adaptation to IFRS would have no material impact on the reported net investment income and assets. Compared to the currently applicable IFRSs, the only major difference is that consolidated financial statements and cash flow statements are not prepared.

To read more about this, see the Fund's accounting and valuation policies.

The portfolio is managed according to forecast financial risk within the given mandates. The forecast risk is analysed retrospectively in relation to the actual risk outcome. In this way, the model for portfolio management can be developed.

Communication and reporting

All guidelines and instructions with relevance for internal control are communicated clearly and are available to all employees on the Fund's intranet. This transparency also applies to the daily internal performance reports, which are also available on the Fund's intranet.

The Board is regularly informed about the Fund's financial position and performance. Each month, the Board is provided with an income, return and risk report. An income statement and balance sheet report is presented to the Board on a quarterly basis. The Fund's financial position and risk-taking are also reported at each ordinary Board meeting. Risk reporting is a standing item on the agenda of all of the Fund's ordinary Board meetings. These procedures are deemed to secure the Fund's external financial reporting. External reports of the Fund's financial position are published in connection with the annual and semi-annual accounts. Middle Office reports to the audit committee in connection with its meetings. The auditors report continuously to the audit committee and to the Board in connection with the annual closing of accounts.

Board of Directors



Urban Karlström
Chairman, chair of the remuneration committee

Ph.D. Econ., Director-General of the Swedish Fortifications Agency.
Born 1953. Elected to the Board in 2011.

Other assignments: Chairman of Arcato AB, board member of Caterva AB and board member of AB ATG.



Annika Sundén
Deputy Chairman, chair of the audit committee

Associate Professor, Analysis Director at Sweden's Public Employment Agency.
Born 1964. Elected to the Board in 2011.

Other assignments: Member of the Institute for Future Studies, the Delegation for Migration Studies, the Scientific Council of IFAU and of the Swedish Social Insurance Inspectorate's transparency council. Board member of the National Government Employee Pensions Board.



Göran Arrius
Member of the remuneration committee

Appointed on the proposal of employee organisation (Saco – the Swedish Confederation of Professional Associations), Chairman of Saco.
Born 1959. Elected to the Board in 2011.

Other assignments: Chairman of Folk och Försvar and AEA. Chairman of LO, TCO and Saco's office in Brussels. Member of the Swedish Defence Intelligence Court, Folksam Liv, the National Committee for the National Day and of The Royal Society of Naval Sciences.



Kent Eriksson

Professor at the Royal Institute of Technology.
Born 1964. Elected to the Board in 2015.



Urban Hansson Brusewitz
Member of the audit committee

PhD in Economics, Director-General of the National Institute of Economic Research. Born 1958.
Elected to the Board in 2016.

Other assignments: Member of the Swedish National Financial Management Authority's transparency council.



Anna Hesselman
Member of the audit committee

Licentiate Degree in Economics. Consulting business in accounting and finance.
Born 1954. Elected to the Board in 2015.



Anders Henriksson

Appointed on the proposal of employer organisation (Swedish Association of Local Authorities and Regions – SALAR).
Born 1961. Elected to the Board in 2018.

Other assignments: Chairman of Kalmar County's Regional Board. Board member of KPA Pension, Deputy chairman of SALAR.



Åsa-Pia Järliden Bergström

Appointed on the proposal of employee organisation (LO). M. Sc. in Economics, LO economist.
Born 1969. Elected to the Board in 2015.

Other assignments: Chairman of Bantorget finans AB, board member of Bio-ech R&D AB.



Eva Redhe

MBA. Born 1962. Elected to the Board in 2013.

Other assignments: Chairman of the board of Ftrack AB. Board member of Axel Christiernsson International AB and Nordkinn Asset Management AB.

Executive Management Team



Johan Magnusson
Chief Executive Officer

Education: Economist.
Born 1959. Employed since 2008.

Previous experience: Senior positions at SEB Wealth Management and ABB Investment Management.



Mikael Angberg
Chief Investment Officer

Education: Master of Engineering.
Born 1973. Employed since 2013.

Previous experience: PIMCO, BNP Paribas, Goldman Sachs, AXA Investment Managers and CERN.



Katarina Höller
Head of Middle Office & Head of Risk

Education: B. Sc. in Statistics.
Born 1966. Employed since 2016.

Previous experience: SEB Wealth Management, Finansinspektionen (the Swedish financial supervisory authority), DnB NOR, Skandia Asset Management.



Mats Enebrink
Head of IT and Systems Development

Education: Master of Engineering, CFA.
Born 1976. Employed since 2008.

Previous experience: AFA Försäkring, VPD Financial Software Consulting.



Gun Hammarlund
Head of Business Support

Education: MBA.
Born 1958. Employed since 1987.

Previous experience: Various positions within AP1.



Teresa Isele
General Counsel

Education: Swedish Bachelor of Laws & Master of Laws at Stockholm University, German Bachelor of Laws at Humboldt-Universität, Berlin, Diploma in English Law at King's College London.
Born 1982. Employed since 2015.

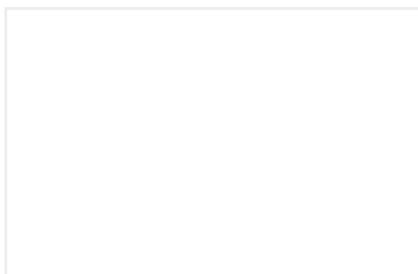
Previous experience: EQT, Vinge.



Marina Westman
Head of Human Resources

Education: Human Resources.
Born 1960. Employed since 2008.

Previous experience: HR positions in the SEB group.



Head of Communications

From March 2019.



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