

Annual Report 2020

AP3

AP3 Tredje AP-fonden

ASSET MANAGEMENT ACROSS GENERATIONS

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Third Swedish National Pension Fund Annual Report 2020

This annual report describes AP3's operating activities in 2020. The Fund publishes a separate Stewardship Report each autumn in conjunction with the interim report.

AP3's reporting conforms to the GRI Standards of the Global Reporting Initiative. Under the GRI, the Fund reports at "core" level and in conformity with "financial services" sector requirements. The GRI Index is presented on pages 87-88. See also [etikradet.se](#), the website of the Council on Ethics of the Swedish AP Funds.

Financial information

Information about AP3 and our operating activities and investments is available at [ap3.se](#), along with all annual and interim reports.

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About AP3

AP3 is an investor tasked with contributing to the stability of the Swedish income pension system on behalf of current and future pensioners.

The Fund's capital is invested to obtain high returns over time. Our mandate includes promoting a sustainable development through responsible ownership and investment.

37.2

SEK bn
Net result
for 2020

9.7

percent
Total return after
expenses

423.0

SEK bn
Fund capital at 31 Dec

8.7

percent
Annual average return
after expenses in
last 10 years

Key financial data

	2020	2019	2018	2017	2016
Fund capital at 31 Dec, SEK bn	423.0	393.7	340.7	345.2	324.4
Net payments to pension system, SEK bn	7.9	6.5	6.8	7.4	6.6
Net result, SEK bn	37.2	59.5	2.2	28.2	28.0
Return before expenses, %	9.8	17.7	0.7	8.9	9.5
Return after expenses, %	9.7	17.6	0.6	8.8	9.4
Operating expense ratio, %	0.09	0.09	0.09	0.10	0.12
Operating expense ratio excluding commission costs, %	0.06	0.06	0.06	0.06	0.06



KERSTIN HESSIUS:

High returns strengthen the pension system in challenging times

“

A net result of SEK 37.2 billion represented a return of 9.7% after expenses. This was a strong performance in challenging circumstances.

The Swedish pension system is in good shape today. The balance figure that governs the state income pension system is the strongest since the pension system launched 20 years ago. In 2021 this means that pension credits and pensions will be indexed upwards by 2.2% minus interest for paid out pensions in advance. The pandemic has put some pressure on the income pension system, but the AP funds' strong financial results have reduced the adverse impact.

AP3's fund capital, which stood at SEK 423 billion at year-end, gives us a solid base to fulfil our mission going forward. In the last decade, pension contributions have been insufficient to cover the cost of paid-out pensions. As a result, AP3 in 2020 made net-payments to the income pension system of SEK 7.9 billion. AP3 together with AP1, AP2 and AP4, financed the total deficit of SEK 31.6 billion. The deficit is projected to rise to SEK 9.1 billion per fund in 2021, which equates to about 2% of the fund capital. According to the Swedish Pensions Agency, the deficit is likely to remain at this level for the next five years before gradually decreasing until the end of the 2030s.

1) Read more about the LSP on page 48

From high uncertainty to gradual adjustment

“Future uncertainty is something we confront every day when managing pension assets. Financial markets seek constantly to put a price on this uncertainty, but when it becomes too great the markets cease to function effectively. This happened in mid-March 2020, when successive countries entered lockdown without anyone knowing for how long. Had national governments and central banks not acted to implement vast financial support packages, incalculable amounts of money – and many people's livelihoods – would have been lost. Though neither the virus nor the economic uncertainty is yet behind us, we are probably past the worst in terms of financial market turbulence.”

I wrote these words in our interim report last July. Six months on, it is necessary to add a postscript. The virus surged during the autumn and the financial markets reacted differently than they did during the spring when Covid-19 first hit. This time, more was known about the pandemic and how to manage it. Governments and central banks had demonstrated their determination to avoid certain outcomes. And all of us had begun to adapt to prevailing con-

ditions. Hope rose late in the year as vaccines approached and a long-term sustainable solution began to feel within reach.

Rapid recovery

The financial markets showed their strength in the second half of the year despite the worsening of the pandemic and market concern over the outcome of the US presidential election. Each fall in the market was followed by a larger rebound, and the year ended on an all-time high. So did AP3. Our net result of SEK 37.2 billion represented a return of 9.7% after expenses – a strong performance in challenging circumstances. We started the year robustly, achieving a return of more than 3% by mid-February. But a month or so later, we were down almost 13%. Nevertheless, the drop in the AP3 portfolio was comparatively limited given that the stock market as a whole fell more than 30%.

Adding risk – a crucial part of risk management

My mission as CEO has been to build an asset management structure and portfolio capable of withstanding a serious financial crisis without sustaining losses of a magnitude that would directly impact the pension system. This demands a diversified portfolio and a skilful management model that constantly evaluates portfolio risk. Then, when crisis hits, it requires effective control. The next step in the process is discussed less often. It involves resuming the search for opportunities and being bold enough to take on greater risk in the portfolio. This is perhaps the biggest challenge of all. It demands discipline and courage – and is critical to a successful recovery.

AP3 has outperformed the LSP¹, our reference portfolio, by a growing margin as the Covid-19 crisis has progressed, regardless of whether the market has moved up or down. This highlights the ability of our diversification strategy and active asset management to create a much more robust portfolio than an automated index portfolio. In 2020 our returns exceeded the LSP by almost 3 percentage points.

Collaboration and trust essential in crisis management

AP3's crisis management strategy was effective. All employees did their utmost to manage risk, establish productive conditions for remote working, exploit opportunities and manage our assets responsibly in an extremely challenging situation. Extensive experience, strong collaboration and mutual trust were key factors in this endeavour. It is essential not to panic during a crisis and to remain calm and act responsibly while keeping a long-term perspective. We did exactly that.

We also managed to implement a new asset management organisation focused on allocating capital and risk more effectively across the portfolio. This change will make our asset management easier to track and monitor too, which is a major plus in an ever more complex world.

Active stewardship is required

During the year we kept a close focus on active corporate stewardship. The difficult and uncertain conditions created by the pandemic make it even more important for long-term institutional owners like AP3 to act responsibly. AP3 engaged actively with investee companies to discuss their challenges. We also participated in share issues when needed and continued to exercise active governance by voting at 1,100 general meetings, 71 of which were held in Sweden. We engaged with companies on a range of issues, including the need for well-balanced boards and the importance of having a climate change strategy. The government's annual review of the AP funds' performance and sustainability engagement through the Swedish National Pension Funds' Council on Ethics identified the funds as leaders among institutional investors in this field.

AP3 has several climate-based goals that include halving the Fund's carbon footprint by 2025 and expanding our holdings of green bonds, which today have a market value of SEK 18.7 billion and represent 15% of our fixed income portfolio. AP3 has also launched a drive to further strengthen the integration of sustainability in our asset management. A comprehensive and long-term sustainability strategy will be even more important in the future.

Experience makes us wiser

2020 will long have a special place in history. Many issues rose to the surface when the pandemic struck. As the world locked down, our eyes opened to what is most important for society to protect. Priorities change dramatically when public health is threatened. We saw democracy, free trade, freedom of speech, security, welfare and other issues through a more existential lens. The speed with which we had to adapt as reality changed will further accelerate the structural shift that is already under way. Our experience of this pandemic has been highly informative, even if it remains too early to draw solid conclusions about the long-term global economic impact. Ultimately, experience makes us wiser. For that reason, I am optimistic that we will all be slightly more capable of making informed, long-term decisions after Covid-19 than we were before it.

During the year our organisation, with a strong support from the board, did a remarkable job in enabling staff to work remotely while simultaneously managing the portfolio responsibly and productively in extremely challenging circumstances. I have been deeply impressed by everyone's ability to adapt quickly to change and have observed what agility means in practice. Our experience will serve us well in the future as we continue our mission to make a positive contribution to a strong and sustainable pension system. With warmest thanks.

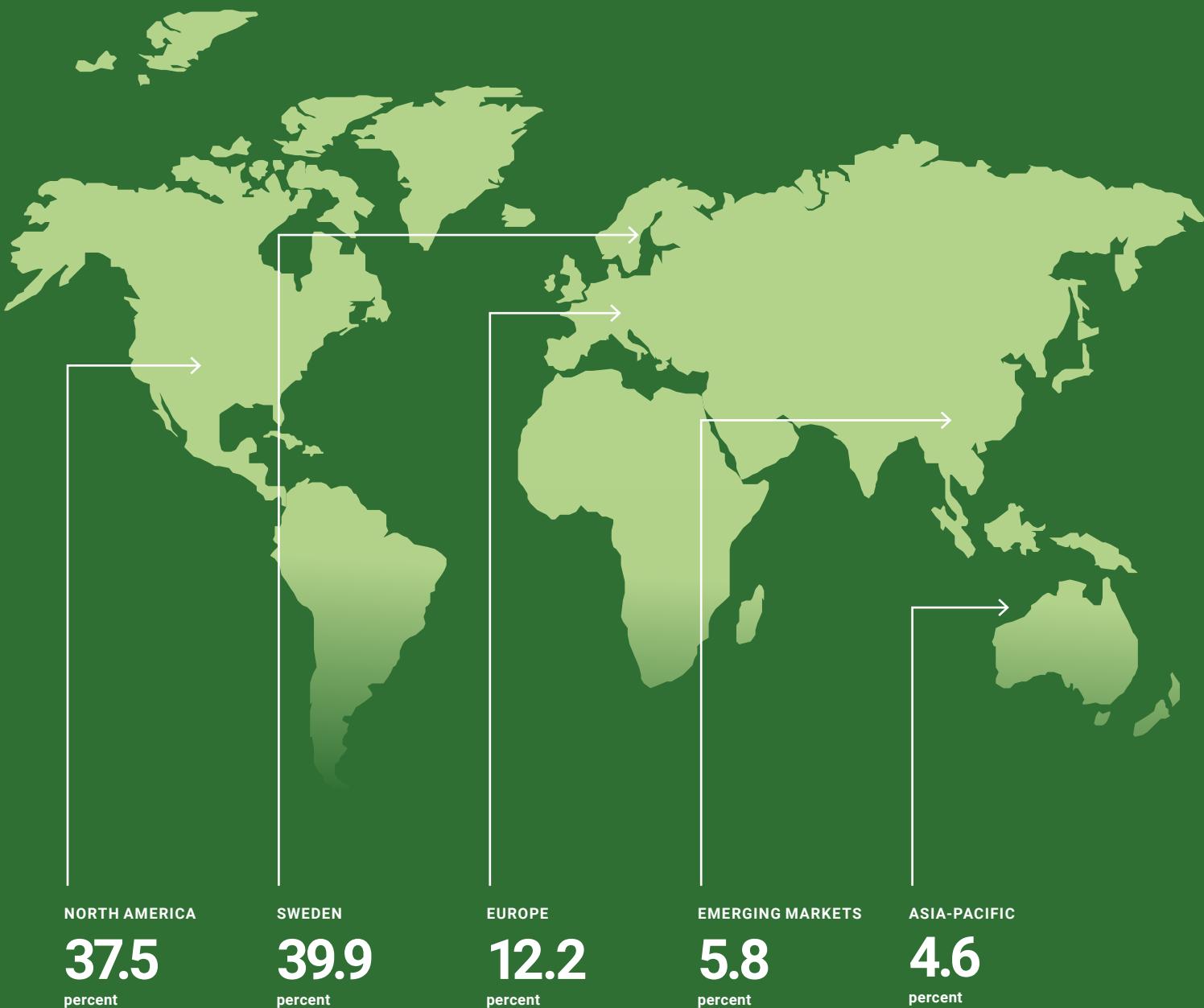
Kerstin Hessius
CEO



2020 will long have a special place in history. Many issues rose to the surface when the pandemic struck. As the world locked down, our eyes opened to what is most important for society to protect.

Investments of more than SEK 400 billion in a limited number of markets

From a risk perspective, it is essential for AP3 to avoid putting all our eggs in one basket. However, we have also chosen to limit the geographical diversification of our investments. As a result, a considerable portion of our fund capital is invested in Sweden, which is home to many attractive companies that enjoy success at both domestic and global level. Swedish companies are often leaders in sustainability, a priority area for AP3. North America is another important investment market. Our holdings are in listed equities, fixed income and alternative investments. AP3's alternative investments consist of private equity funds, real estate, infrastructure assets, timberland and insurance risk.

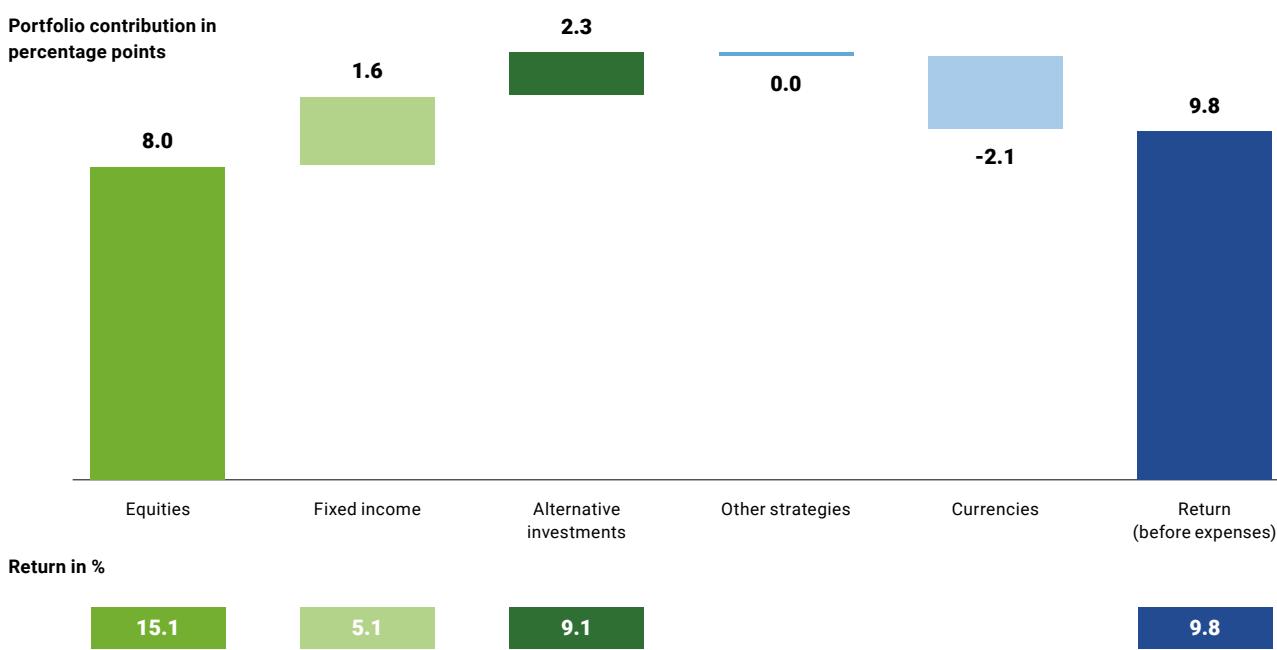


High portfolio return of 9.8% in 2020 driven by equity market gains

In 2020 the AP3's investments in listed equities again made a vital contribution to total return. Returns on the fixed income and alternative investment portfolios were also positive, while the appreciation of the Swedish krona negatively affected the AP3's open currency exposure.

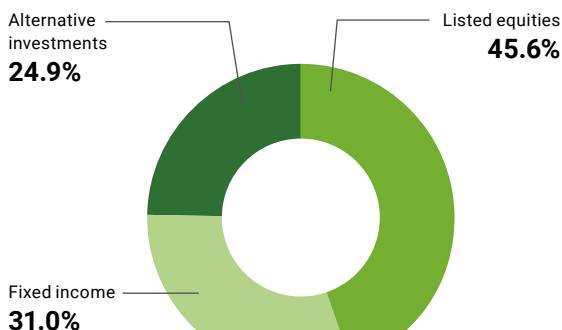
Return and contribution to total portfolio per asset class

(Currencies include currency hedges and exchange rate effects. Only the contribution to total portfolio return is shown for currencies and other strategies.)

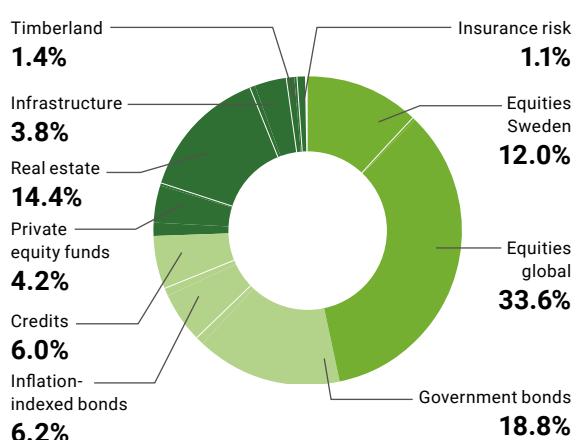


AP3's portfolio comprises three types of investments: listed equities, fixed income and alternative investments. These sub-divide into different asset classes (see the chart, below right).

Exposure, investments



Exposure, asset classes



Mission – contributing to the stability of the income pension system

Sweden operates a public pension system that covers everyone who works and pays tax. The system is funded by pension contributions paid in by employers and employees. The public pension system consists of an income pension system which AP3 helps to finance and a premium pension system.

The public pension system's assets account for more than 75% of Sweden's combined pension capital, which also includes occupational pensions and private pensions. This figure underlines the importance of public pensions as a source of pension income. AP1, AP2, AP3 and AP4 act as a capital buffer for the income pension system. A difference arises every year between paid-in contributions and paid-out pensions. The role of the AP funds is to manage this gap. The AP funds also invest their assets in a way that contributes to the financial stability of the income pension system over time.

How pensions are financed

The income pension system is funded primarily by pension contributions. Sixteen percent of an individual's pensionable income is registered by the Swedish Pensions Agency as a pension credit in the individual's personal income pension account. Hence, the individual "saves" towards his or her own pension. The total value of all the credits in the income pension system's personal accounts is referred to as the system's pension liabilities. Due to demographic factors, Swedish pension contributions have been insufficient to cover paid-out pensions since 2009. This deficit is projected to persist until around 2040, and financing it is one of the main reasons for the AP funds' existence. The funds use their combined capital to meet the deficit. In 2020, the AP funds paid SEK 31 billion to help finance total pension payments of SEK 326 billion.

Financial health of the income pension system

As of today, the income pension system is in robust financial health. The system's assets exceed its liabilities, giving a "balance figure" of 1.08. This solid position is largely due to the strong returns generated by the AP funds in recent years. Indeed, the funds' share of total income pension assets now stands at 16% (up from 10% when the pension system launched in 2001). The remaining 84% is comprised of future pension contributions.

Growth in pension capital

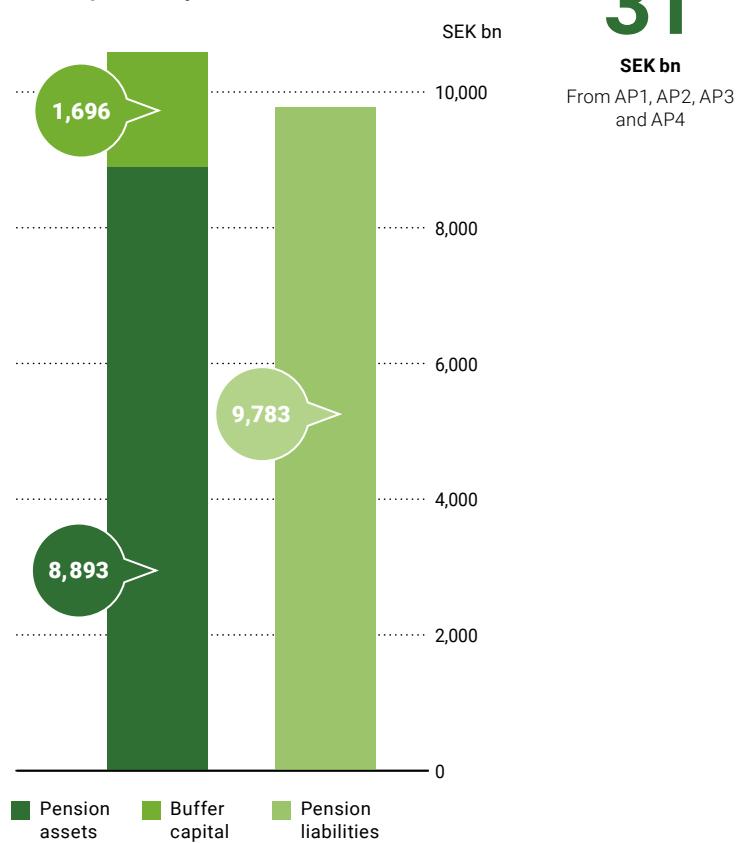
Provided that the income pension system is not in a "balancing" phase, the value of pension credits and

pensions increases in step with the income index so that pensions keep pace with wage growth. When the income pension system's assets fall below its liabilities and the balance figure drops below 1.0, the system enters a phase of balancing to regain financial equilibrium. During such periods, pensions and pension credits increase in step with the balance index. This rate of increase is below that of the income index and remains so until the balance figure returns to 1.0.

Other roles for AP6 and AP7

AP6 also forms part of the capital buffer but plays no role in managing annual deficits. AP7 is part of the premium pension system and is a fund that pension savers can choose to invest in. The premium pension system is part of the public pension system and allows savers to choose which funds to invest in. A total of 2.5% of each individual's pensionable income is assigned to the premium pension system. The growth of these fund savings depends on the investment choices made by the individual over time.

Income pension system balance sheet



326

SEK bn

Paid-out income pensions
(including administrative costs)

295

SEK bn

Paid-in pension contributions

31

SEK bn

From AP1, AP2, AP3 and AP4

The value of the income pension to increase by 2.2% in 2021

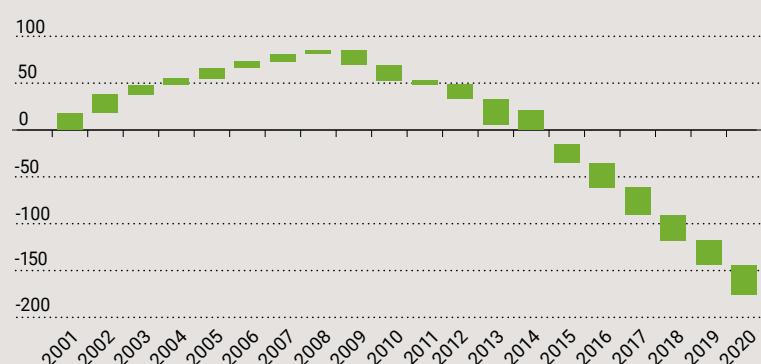
Since the assets of the income pension system exceed pension commitments, the value of these assets will rise in line with the income index in 2021. The investment returns generated by the AP funds have strengthened the financial status of the income pension system. The AP funds' capital buffer is used when a deficit arises between paid-in pension contributions and pension commitments. A deficit has existed since 2009 and is expected to persist until about 2040.

AP funds smooth generational differences

The current Swedish pension model was developed in the 1990s to confront future demographic challenges. From 2001 to 2008 the system enjoyed a surplus of pension contributions over paid-out pensions and was able to build up a capital buffer that has been deployed since 2009, when growth in the number of people entering retirement pushed the system into annual deficit. During this period, strong investment returns strengthened the system as a whole. However, the deficits are projected to persist for another two decades.

The AP funds finance the income pension system deficit. Over time, the AP funds have contributed SEK 176 billion to offset the deficit.

SEK bn



Financial strength vital to keep pensions in line with income development

The income pension system is self-financing and falls outside the government budget. Its financial health is measured annually by comparing assets to liabilities. If the ratio between them (the balance figure) falls below 1.0 the system enters a phase of balancing to regain financial equilibrium. This occurred for the first time after 2008, prompting the start of a rebalancing period in 2010 that continued until 2018. The AP funds' high returns in the last decade have strengthened the pension system financially. In 2019 the balance figure was 1.08.

Balance figure (total assets/liabilities) 2002–2019



Pensions and pension credits indexing via income index and balance index 2001–2021



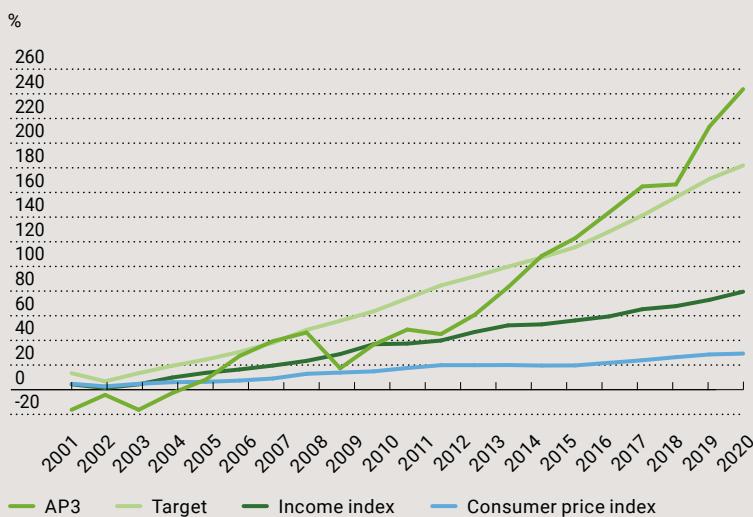
Impact of wage growth on pensions

The income index has risen by an annual average of 3.0% since 2001. The fact that pension system assets currently exceed pension commitments and the system is not in a balancing phase means that pension capital can increase in line with the income index. When an individual retires, he or she receives an advance on their saved pension capital in the form of a pension that exceeds the value of the capital. This sum is repaid by paying out pensions whose value is 1.6% below the increase in the income index. In 2021 the value of the income pension system's capital will rise by 2.2% because the income index rose 2.2% in 2019.

AP3's performance over time

The income pension system is currently in a long phase of deficit between pension contributions and paid-out pensions that the AP funds are helping to finance. AP3 has nevertheless continued to grow fund capital thanks to strong investment returns.

Aggregate percentage growth of portfolio and benchmarks, 2001–2020

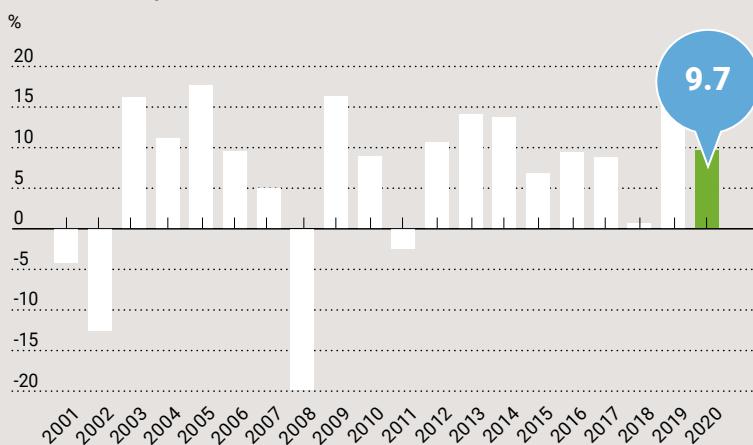


Performance since 2001

During its first two decades as a fund tasked with financing the income pension system's capital buffer, AP3 outperformed its ambitious target of an average annual real return of 4%. As of 2020, the target was lowered to 3.5% (see Annual Report 2019, page 16).

The Fund's average annual return stands at 6.4% since inception, corresponding to a return of 5.0% after inflation. This is substantially higher than the income index, which rose by an annual average of 3.0% during the period. AP3's portfolio management has thus made a strong contribution to the financial health of the income pension system. During the period, annual inflation remained low at 1.3% and well below the Riksbank's target level of 2%.

Return after expenses 2001–2020



Balancing risk and return – neutrality across generations

AP3 is required to observe neutrality across generations, meaning that the needs of all age cohorts must be observed equally. This requires striking a balance between investing in high-risk assets to achieve strong returns over time while on the other hand limiting significant drops in value in the short run. At the same time, the Fund must be able to weather the natural variations in annual returns. The value of the AP3 portfolio fell sharply in 2008 in the wake of the financial crisis, but since then returns have been high and relatively stable. Indeed, 2020 was the ninth consecutive year in which the Fund saw positive portfolio growth.

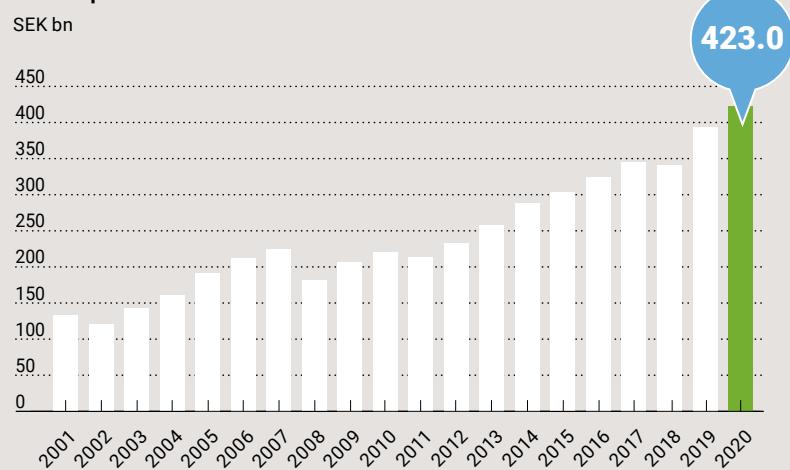
5.0
percent

AP3 has generated an average annual return since inception of 5.0% in real terms, meaning after allowing for inflation. Prior to 2020, the target was an average annual real return of 4%. This figure was lowered to 3.5% in 2020.

Fund capital at record high

AP3's positive return in 2020 lifted fund capital to an all-time high of SEK 423.0 billion. The AP funds' capital buffer now accounts for 16% of the income pension system's asset base. However, fund capital can decrease even if investment returns are positive. This happened in 2018 and was because returns were insufficient to cover AP3's payments to the pension system.

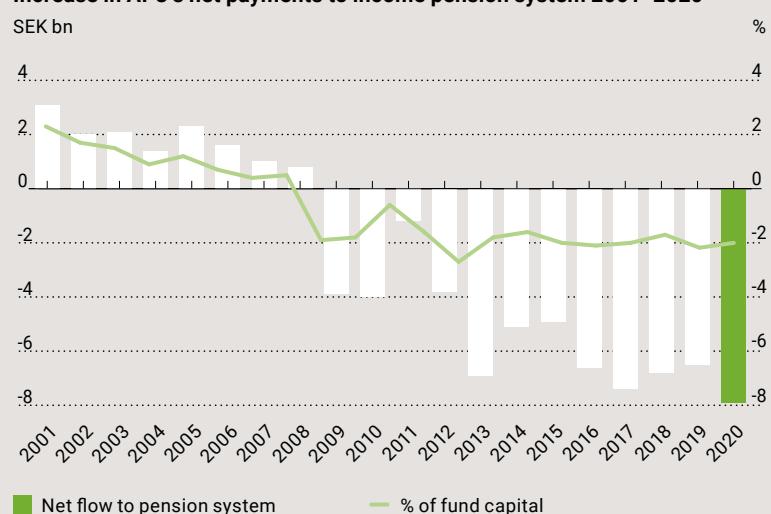
Fund capital 2001-2020



AP3's investment capital helps to fund deficits in the income pension system

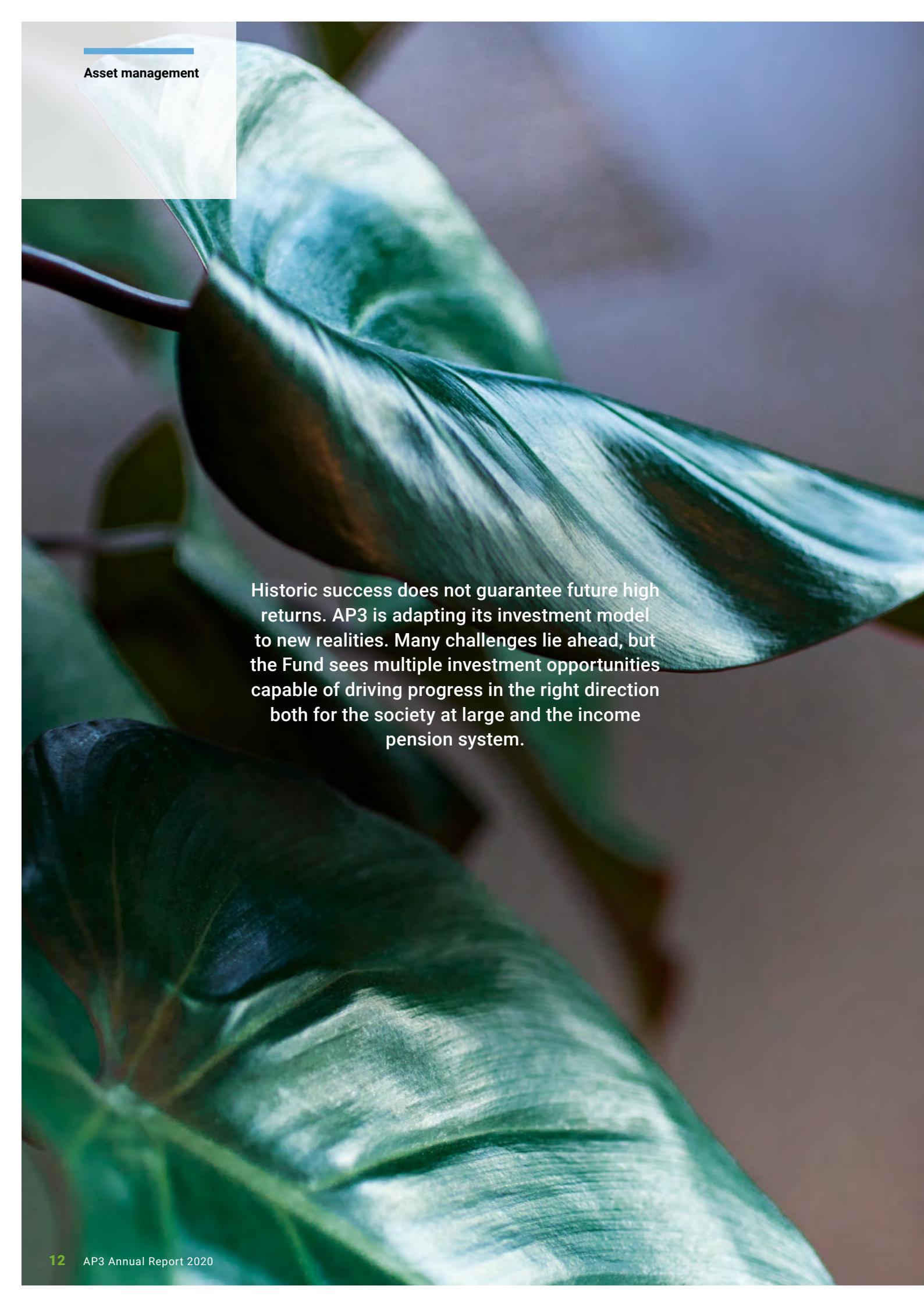
In 2020 AP3 paid out SEK 7.9 billion to the income pension system. Since 2009, the Fund has contributed SEK 65.0 billion to help finance the system's deficit. AP3 projects annual deficit of between 2% and 2.5% in the coming decade, which is of the same magnitude as the deficit that arose during the 2010s. The combination of a structural deficit and lower projected investment returns means that AP3 expects the capital buffer to grow more slowly in the next decade than in the last 10 years.

Increase in AP3's net payments to income pension system 2001–2020



Since 2009, AP3 has paid out a total of SEK 65.0 billion to help finance the system's deficit. The annual deficit is projected to be around 2 – 2.5% of the value of the capital buffer in the coming decade.

65.0
SEK bn



Historic success does not guarantee future high returns. AP3 is adapting its investment model to new realities. Many challenges lie ahead, but the Fund sees multiple investment opportunities capable of driving progress in the right direction both for the society at large and the income pension system.

AP3's unique attributes are at the heart of our mission

The rules governing the management of the income pension system's capital buffer are designed in consideration of how to create good conditions for successful investment management.

AP3's asset management model has developed over the course of 20 years. The model reflects our specifics as an investor and is our cornerstone for conducting sustainable and successful asset management.

The National Pension Insurance Funds Act's focus on sustainability underscores the importance of strong engagement in sustainability for achieving high investment returns over time.

The following pages describes AP3's approach to sustainability, our asset management model, our investment choices and the pivotal role played by both collaboration and our employees.



Mission and investment strategy – a long-term approach

AP3 has a long-term mission on behalf of the Swedish pension system that allows us to operate beyond the short and medium term with a focus on sustainability. The long-term nature of this mission enables the Fund to invest in unlisted companies where value creation takes place over long periods of time. Returns can be high compared to many market-listed investments because these types of investment are not available to all types of investor and come with a liquidity premium.

Optimal asset base and organisation size

The size of the AP3 asset base and organisation are attuned to delivering on the Fund's mandate. The portfolio is large enough to enjoy advantages of scale and to enable the Fund to build its own companies. This is one reason why AP3's costs are very low by international standards. The small size of the organisation facilitates short decision-making processes and a professional culture in which employees take a large degree of personal responsibility.

AAA counterpart

AP3's status as a government body, its Swedish domicile and its investment approach together make AP3 a valued partner and asset owner, facilitating access to attractive long-term investments worldwide. This can be especially useful in times of market uncertainty and may open up for attractive investment opportunities.

Based in Sweden

Though a global investor, AP3 is based in Sweden and has a natural focus on domestic investments. These holdings have performed well over time by international standards and have also enabled the Fund to share a Swedish perspective with global investors. Swedish expertise is an increasing asset in a world where sustainability is steadily gaining prominence.

Independent government body

AP3 is regulated by the National Pension Insurance Funds ("AP funds") Act, which sets the framework for the Fund's portfolio management. The act empowers AP3 to invest flexibly and with a long-term perspective, giving it an advantage over other institutions.

The next pages describe the Fund's asset management results, its different asset classes, its sustainability engagements and what it is like to work at AP3. Figures for return are SEK-hedged.



The mission shapes AP3's approach to sustainability

AP1, AP2, AP3 and AP4 share the same parliamentary mandate: to generate high returns for the income pension system at a low level of risk. The funds are required to manage their assets in an exemplary way through responsible investments and practices. As AP funds, we must focus especially on how to operate sustainably without compromising their goal of securing high investment returns. We are not allowed to include economic policy considerations in investment decisions.

Focus shaped by international frameworks

Sustainability covers a wide range of issues and factors surrounding human impact on the environment and the viability of life on Earth. Within these environmental, social and economic parameters, AP3 makes priorities based on where the Fund's impact is likely to be greatest in relation to its mandate and investments.

The Fund's sustainability work are based on:

- **The National Pension Insurance Funds Act.** A strong focus on sustainability in the National Pension Insurance Funds Act underscores the importance of strong engagement in sustainability as a precondition for achieving high investment returns over time.
- **UN conventions signed by Sweden and international agreements supported by Sweden.** Since inception, the AP funds have worked to promote global compliance with UN conventions ratified by Sweden. The conventions cover areas including the environment, human and labour rights, anti-corruption and inhumane weapons.
- **Policies and recommendations of the Council on Ethics of the Swedish AP Funds.** Since 2007, the AP funds have both proactively and in reaction

to incidents in the above areas through the Council on Ethics of the Swedish AP Funds.

- **The Paris Agreement and the UN Sustainable Development Goals.** These framework have a major impact on Sweden's sustainability policies and, by extension, on AP3's actions.

Paris Agreement – a global climate treaty

The Paris Agreement is a global climate pact that took effect in 2016 and that has been signed by Sweden and most of the world's countries. It commits signatories to work to keep global temperature rise to 2°C below pre-industrial levels, and if possible limit it to 1.5°C, by reducing greenhouse gas emissions in line with scientific advice and by managing and limiting the negative impacts of climate change.

Two of the core tenets are that the countries with the best preconditions should lead the way, and that rich nations should support developing countries. Living up to the Paris Agreement involves a continuing effort to reach targets that are evaluated every five years and against levels of ambition that increase over time. The next evaluation will be the 26th Climate Change Conference (COP26), to be held in Glasgow late in 2021.

EU taxonomy drives financial sector's climate transition inputs

The European Union is rapidly developing its rules and regulations within the Paris Agreement framework. The EU is preparing a taxonomy aimed at making it easier for capital flows to support investments that help EU states to meet the Paris Agreement's objectives. Firms and fund managers are required to start reporting under the EU taxonomy in 2022. The taxonomy is designed to support sustainable development by directing financial flows to activities classed as economically sustainable under the taxonomy framework.

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The Paris Agreement and the UN Sustainable Development Goals have a major impact on Sweden's sustainability policies and, by extension, on AP3's actions.



PARIS 2015
UN CLIMATE CHANGE CONFERENCE
COP21·CMP11

AP3 bases its sustainability reporting on the AP funds' joint practices on the disclosure of responsible investment performance. AP3 seeks to follow the Annual Accounts Act's guidelines on sustainability reporting and the GRI Standards. The Fund's sustainability disclosures are on pages 14-48, a TCFD table is shown on page 42 and the GRI Index can be found on pages 87-88.

Auditor's opinion regarding the statutory sustainability report

To the board of the Third Swedish National Pension Fund, corporate identity number 802014-4120

Engagement and responsibility

The board of directors is responsible for the statutory sustainability report for the year 2020 and that it is prepared in accordance with the Third Swedish National Pension Fund's policies for sustainability reporting.

Scope of the examination

Our examination was conducted in accordance with FAR auditing standard RevR 12 "Auditor's opinion on the statutory sustainability report". This means that our examination of the sustainability report is substantially different and less in scope than an audit conducted in

accordance with International Standards on Auditing and generally accepted auditing standards in Sweden. We believe that the examination has provided us with sufficient basis for our statement.

Statement

A sustainability report has been prepared.

Stockholm, 18 February 2021

Peter Nilsson

Authorised public accountant

Appointed by the government

Helena Kaiser de Carolis

Authorised public accountant

Appointed by the government

Foto: SSAB



Sustainability – a business and investment strategy to create value

Sustainability is today a natural consideration for most long-term investors. AP3 has strong reasons for promoting sustainable development because it is a prerequisite for achieving high investment returns over time. For AP3, sustainability means operating within the terms of our mandate to create value through our investments and for society as a whole. The Fund focuses on areas where we as an investor can achieve most impact.

Sustainability covers a wide range of concepts that are sometimes described as environmental, social and governance, or ESG for short. ESG relates to how businesses and their value chain impact the natural and social environment. It covers how businesses are governed, and how this affects them and their stakeholders. From an investor perspective, ESG is also relevant in terms of how it impacts on businesses' competitive situation, customer preferences, regulations and other sustainability-related aspects.

Supporting a sustainable transition and value creation

As an active and long-term investor, AP3 can influence businesses and encourage them to take a more long-term approach. The Fund believes that the most effective and value-enhancing way to engage in sustainability is by influencing the companies and sectors that face the great, serious challenges in this arena. By remaining as a shareholder, the Fund can push the company to develop in a sustainable direction. Along with other responsible asset owners, AP3 works proactively in support of a sustainable paradigm shift.

The real estate industry is one of the largest global energy consumers, using large amounts of electricity for property construction, maintenance and operation. Real estate also has a key role to play in enabling people to survive and thrive in tomorrow's sustainable society. By owning real estate

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The Fund believes that the most effective and value-enhancing way to engage in sustainability is to also hold investments in companies and sectors facing challenges.

companies that have incorporated sustainability into their business strategies, AP3 contributes to more efficient energy use and helps spur the transition to renewable energy. These companies' properties become more attractive to tenants, making the businesses a good investment for the Fund.

The steel industry is another key sector that is transitioning. AP3 is a shareholder of SSAB, a company that processes iron ore into steel and generates the highest carbon dioxide emissions in Sweden. Major investments are being made in revolutionary steel manufacturing technologies that will enable SSAB to replace coal and coke, the traditional staple fuel in steel production, with fossil-free electricity and hydrogen gas. SSAB aims to deliver zero-carbon steel to the market by 2026 and become the world's first fossil-free steel producer. To get there, SSAB will require access to large quantities of renewable energy – something that Ellevio, an infrastructure company part-owned by AP3, can deliver.

Creating impact as an asset owner and investor

The AP3 sustainability strategy is based on pushing for positive change where we see that the investee company is in a sustainable direction. We exercise our role as a shareholder and investor in different ways depending on context. In investee companies where the Fund is sole or part-owner, influence can be exerted directly by appointing the board of directors and executive management. Vasakronan, Hemsö and Ellevio are three companies where this is the case. AP3 is a well known investor in listed Swedish companies with a track record of engaging directly with management and participating in nomination committees. Outside Sweden, the Fund seeks to influence listed investees primarily via the Council on Ethics of the Swedish AP Funds and by working closely with other large investors. As a fixed income investor, AP3 can create impact through involvement in discussions on credit terms and by promoting transparency and sustainable frameworks through green bonds.



Read more about AP3's corporate stewardship on page 40

Focusing where AP3 can create value for investments and society

In sustainability, AP3 concentrates on areas where the Fund can make the biggest difference in terms of investment value and impact on the society. Achieving this means having a clear focus, good analysis and adequate resources. AP3 has several focus areas and frequently works in partnership with other large investors.

Environment and human rights

The environment and human rights have played a central role in the AP funds' sustainability engagement ever since inception. These two focus areas give investors like the AP funds a licence to operate. For this reason we invest a relatively large amount of time and attention in these areas. Several important initiatives in recent years in relation to mining practices have led to a new global standard for tailings dams. In human rights, AP3 is through the Council on Ethics in dialogue with technology companies in areas including their responsibility in relation to data integrity. These efforts are receiving increasing attention over time.

Ethical standards

AP3's corporate stewardship policy directly addresses issue relating to business ethics. The best example is the Fund's work on anti-corruption and our insistence that investee companies act responsibly. AP3 has worked with other investors, regulators and banks to combat money laundering.

Climate action

Engagement in climate change is the focus area with the strongest impact on AP3's investments. The Fund has since 2014 applied targets to portfolio investments, investee companies and the AP3 organisation to reduce climate impacts.

AP3 works closely with other large investors through the Climate Action 100+ initiative, the Task Force on Climate-Related Financial Disclosures (TCFD), the Transition Pathway Initiative (TPI) and the Institutional investor Group on Climate Change (IIGCC) – see fact boxes below.



The environment and human rights have played a central role in the AP funds' sustainability engagement since inception. These two focus areas give investors like the AP funds a licence to operate.



Read more about the Council on Ethics of the Swedish AP Funds' prizewinning work with the mining industry on page 41

International partnerships for greater impact

IIGCC
Institutional Investors Group on Climate Change

Institutional Investor Group on Climate Change (IIGCC) – member since 2010

An investor partnership on climate-related policy. It aims to communicate investor perspectives on climate change and to engage companies, government authorities and other asset owners in addressing the long-term risks and opportunities arising from climate change.

Transition Pathway Initiative (TPI)
– member since 2016

Global initiative to assess companies' preparedness for the transition to sustainable, low carbon economic activity. The TPI has developed a tool to track companies' progress towards the Paris Agreement's 1.5°C target. AP3 has committed to use the tool in evaluating portfolio investees where possible.

Climate Action 100+

Climate Action 100+ – member since 2017

The goal is to engage with more than 160 companies with the largest greenhouse gas emissions globally. These companies have a great role to play in the transition to sustainable energy production and reaching the targets of the Paris Agreement. Companies are urged to take the necessary steps to bring their climate gas emissions into line with the Paris Agreement. Brings together 450 investors with more than USD 39,000 billion of assets under management.

Task Force on Climate-related Financial Disclosures (TCFD) – member since 2017

The TCFD is an initiative of the Financial Stability Board (FSB) that was established during the financial crisis in 2009 to provide coordinated monitoring of financial risks among regulators and supervisory agencies. Climate change risks have been identified as among those that require better tracking through improved transparency and disclosure. The TCFD works to achieve this. Read more about AP3's involvement in the TCFD on page 42.

Climate strategy with transition focus

As a long-term investor, AP3 has good opportunities to participate in the transition to a low-carbon economy that is needed if we are to reduce emissions and limit the impact of climate change. The Fund seeks to influence the decisions of investee companies and to allocate capital to investments that can facilitate the transition.

Paris Agreement is part of AP3's strategy ...

The Paris Agreement and the Sustainable Development Goals directly and indirectly address the threat of climate change. It is imperative for AP3 to understand where investment opportunities are located and how the Fund's assets can guide progress in the right direction. The Fund's climate strategy addresses key areas where we have chosen to cooperate with other global investors and also sets concrete targets for AP3's investments. The targets apply to asset classes that clearly help reduce climate-related risk and promote sustainable development. These asset classes include green bonds and other strategic sustainable investments, particularly those classed as alternative investments.

... and the strategies of directly owned investees

A key part of the climate strategy involves incorporating sustainability in the business strategies and operations of AP3's real estate investees. Buildings are high consumers of resources in terms of energy, materials and waste. It is of great importance to AP3 that the Fund's directly owned real estate companies are sector leaders in sustainability.

In the listed equity portfolio, AP3 engages with investee companies to encourage them to minimise their climate footprint and transition to sustainable practices.

The Fund also works to limit sustainability-related risks that can adversely impact on investment returns. Influencing investees to embrace change is the primary route, but the Fund also seeks to reduce the portfolio's carbon footprint by limiting or avoiding exposure to companies and sectors where the prospects for transitioning to a sustainable model are small.

As of 2014, AP3 applies specific climate goals. These have helped to spur internal sustainability engagement and to build stakeholder trust. In 2019 the Fund adopted new sustainability goals that are due to be reached by 2025. Read more below about AP3's climate goals and what happened in 2020.



See page 42 for
AP3's policy on TCFD
disclosures.

Climate goals due to be reached by 2025.

Progress towards the goals in 2020	
1. The AP3 portfolio will contribute to reducing the risk of global warming	CO₂ <ul style="list-style-type: none"> – The AP funds' efforts to engage with investee companies to reduce carbon dioxide emissions continued both via direct dialogue and global collaborations. – AP3 continued to reduce the portfolio's exposure to companies with high carbon intensity. – AP3 continued to make progress with the help of the scenario-based analysis performed in 2019. – AP3 participated in a project with Sweden's largest institutional investors to evaluate the compliance of a group of 100 companies with the TCFD recommendations.
2. AP3 will double its strategic sustainable investments by 2025	<ul style="list-style-type: none"> – Polhem Infra, a company jointly owned by AP1, AP3 and AP4, completed several large investments, including in Sweden's largest wind power plant, in the province of Härjedalen, and the acquisition of Telia Carrier. – AP3 increased its timberland investments in the US in partnership with Oregon company Lone Rock Resources.
3. AP3's directly owned unlisted investee companies will be sector leaders in sustainability	<ul style="list-style-type: none"> – AP3's wholly and partly owned real estate and infrastructure companies continued to lead the way in sustainability and drive the agenda with a focus on energy efficiency, smart material selection, resource efficiency, green tenancies and green finance. – Vasakronan continued its path towards becoming climate-neutral by 2030, in line with the plan the company adopted in 2019. See also page 31.

Adapting the organisation to new realities

AP3 has a board-approved target of an annual real return of 3.5% over time. In current conditions, this is a demanding goal for AP3's investment organisation. In 2020, organisational changes were made to ensure the Fund is well-positioned to achieve its investment and sustainability targets.

It is now more than 10 years since AP3 demerged its active and passive asset management operations and transitioned to an investment structure based on risk categories. This approach has worked well, delivered favourable returns and helped to diversify the portfolio. It was achieved with a portfolio containing a relatively high ratio of unlisted investments. These have made a strong contribution to the Fund's returns.

In 2020 AP3 implemented its first major reorganisation. The process was part of the ongoing effort to simplify the Fund's organisation, its structure and processes. The changes included developing and updating the investment model's core pillars: integrated sustainability, cost-effective asset management and effective corporate stewardship.

Adapting to new opportunities

The investment organisation has been adjusted to improve the integration of sustainability, to make best use of the Fund's excellence in asset management and to create the best possible conditions for active management. Investment management is now divided into four asset classes: listed equities, fixed income, currencies and alternative investments. A new team, the CIO Office, has been established to work on overarching investment management issues.

Clear lines of responsibility

The new organisation is designed to achieve AP3's mission and to create the best conditions possible to reach the targets for return and sustainability set by the board.

Strategic positions are taken within the scope of the National Pension Funds Insurance Act to achieve the long-term return target. These positions comprise the AP3 portfolio and encompass listed equities, fixed income instruments and alternative investments, as well as some open currency exposure.

The Fund's investment management teams are tasked with generating returns over and above those of the strategic portfolio. AP3 sees returns from active management as a necessity because



The investment organisation has been adjusted to improve the integration of sustainability, to optimise the Fund's excellence in asset management and to create the best possible conditions for active management.

Pablo Bernengo,
CIO



the projected return on the different asset classes is traditionally low. The Chief Investment Officer and CIO Office are also involved in active allocations at strategic and tactical level. AP3 now has an organisation and portfolio structure that are designed to fit together and where roles and responsibilities are clear throughout the organisation.

Active management for more effective governance

The reorganisation resulted in an increase in the ratio of actively managed assets. It is not feasible for AP3 to engage with all investee companies across all the sectors and regions in the Fund's investment universe. Instead, the goal is to concentrate resources where they can achieve maximum impact. This is why we have decided to increase the ratio of actively managed assets. It is a trend that we expect to continue.

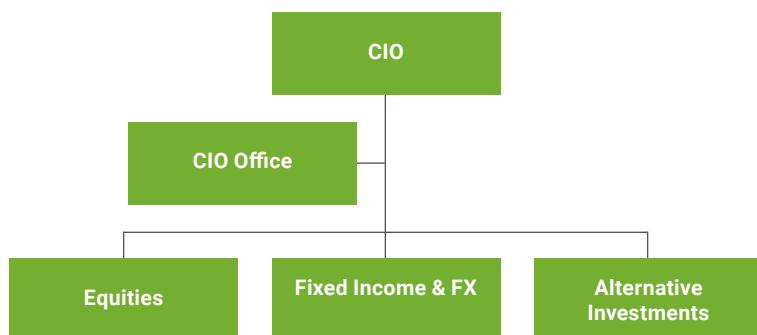
CIO Office

The CIO Office is responsible for analysing the portfolio's strategic focus in asset allocation, sustainability and corporate governance. It also has responsibility for the Fund's external investments, including in hedge funds. The CIO Office also manages tactical allocation mandates.

Other strategies

"Other strategies" relate to internal and external absolute return strategies, meaning hedge funds. AP3's hedge fund investments consist of trend-tracking strategies, macro, credit and emerging market strategies and volatility trading.

Investment management organisation





AP3 as a global investor

AP3 has elected not to pursue an extreme level of diversification but rather to make informed choices between different markets and investment types. Hence, the Fund looks internationally for opportunities that do not exist in Sweden or to achieve geographic diversification. One example is the United States, where the Fund has a significant portion of its investments. The US provides exposure to different equity market sectors and a highly liquid and diverse bond market.

Focus on Sweden

The AP3 investment model has been evolving for 20 years and is designed to make best use of the Fund's investment

advantages and opportunities. A significant proportion of capital assets is held in Sweden through directly owned companies and listed equities, as well as through relatively low-risk fixed income securities. Local proximity to Swedish investments allows the Fund to exercise proactive and effective corporate stewardship. AP3 is well acquainted with the Swedish market thanks to its expert fund managers and extensive network.

External expertise an added dimension

Investment management is handled largely by AP3's 60-strong team in Stockholm. This approach ensures transparency, effective corporate governance

and high cost-efficiency. In selected areas such as emerging markets, global small-cap equities and private equity, AP3 uses external managers with specialist skills.

AP3 works closely with external managers, so they can share their expertise but also get to understand the Fund's sustainability commitments. External managers are encouraged to carry AP3's sustainability engagement into their portfolio investees through advocacy and by committing to high standards in this arena.

Investment opportunities in turbulent times

2020 will go down in history as a landmark year in several respects. The market's initial reaction to the pandemic recalled its response to the 2008 financial crisis. However, monetary and fiscal countermeasures came much quicker than 12 years ago and were able to reverse the market slide. Nevertheless, the impact on the economy, political landscape and society at large will remain with us for years to come.

The year began amid signs of an upswing in global economic growth. This was reflected in the financial markets, which ended 2019 in robust shape and continued to make headway at the start of the year. The main market risks were high valuations, the conflict between the US and Iran and the trade war between the US and China. A loosening of monetary policy by central banks during 2019 had created scope for higher economic growth. The emergence of Covid-19 attracted attention in January, but it was not until the end of February that the market grasped that the pandemic would have global impact. The reaction was forceful.

Deep falls in global equity markets

The 35% fall in global share prices between 20 February and 23 March was not only deep but rapid. Historically, the intensity was matched only by two previous crashes: those of 1929 and 1987. The reaction reflected the realisation that losing 70-80% of world economic output would effectively shut down the global economy, with no indication of how long the situation would continue. The global economy found itself on the precipice of depression. This scenario was averted, however, when central banks and governments finally realised they had to intervene. At the time of writing, these interventions have so far cost more than 22 trillion dollars. Fiscal measures accounted for over half of this amount and came on top of the monetary easing that began in March. The rescue packages have sharply raised national debt and increased central bank balance sheets from already-high levels, but the scale of the emergency left no real alternative.

Crisis creates investment opportunities for long-term investors

The value of the AP3 portfolio fell as the markets dropped. Nevertheless, the portfolio's structure cushioned it from extreme losses. The Fund experienced no liquidity problems because only a small part of the portfolio was exposed to the riskiest and most illiquid parts of the market. AP3's unlisted investments survived the turmoil without any major



ECB president Christine Lagarde played a key role in coordinating EU rescue packages.

“

Climate change remains the biggest issue, but social concerns are also in the spotlight. Topics such as working conditions, healthcare and human rights came into focus during the pandemic.

negative impacts. The portfolio also benefited from its more defensive positions in highly rated government bonds, US dollar exposure and relatively large allocation of high-quality equities.

The Fund was also able to capitalise on the opportunities that emerged in March at the peak of the market turmoil. AP3's long-term mandate and unique investor attributes enable the Fund to provide liquidity in critical situations. This not only plays a role in helping markets to function but also creates investment opportunities. The challenging market climate during the spring also enabled the Fund to pursue interesting business opportunities in alternative investments.

The crisis is not over

Although the financial markets have returned to levels close to, or even above, those at the start of the crisis, the social impact of the pandemic remains massive. Unemployment is high in many parts of the world. Many sectors have been unable to resume full operations while infection risk persists. A vaccine is part of the solution, and the prospects currently look good on this account. However, new lockdowns to ease the burden on healthcare systems and save lives may still be necessary.

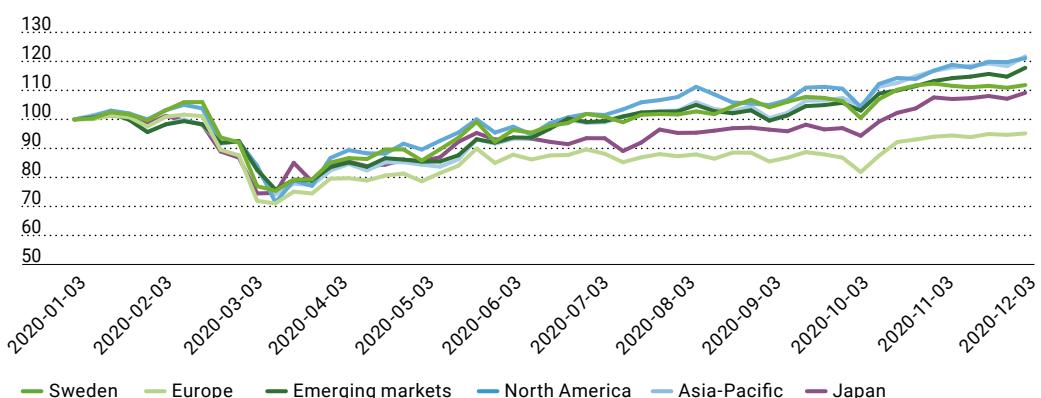
Stronger focus on sustainability

For most actors, sustainability rose clearly up the agenda during the crisis. Climate change remains the biggest issue, but social concerns are also in the spotlight. Topics such as working conditions, healthcare and human rights came into focus during the pandemic.

Performance in equities

Equity markets rose in the first weeks of the year, despite the early signs of the pandemic. Shares then slumped nearly 35% from the end of February to the end of March before rebounding strongly during the rest of the year.

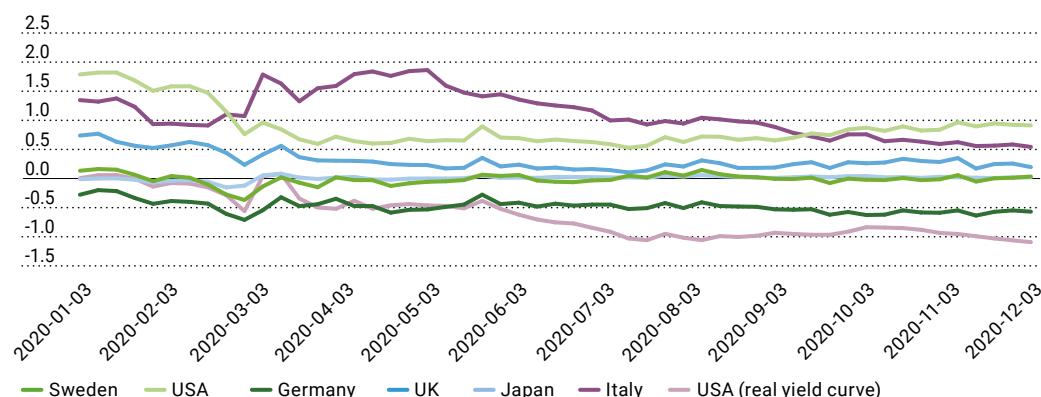
Equity markets 2020 (local currency)



Performance in fixed income

Among the main fixed income markets, US bond yields fell most during the year. Ten-year yields dropped from 1.79% to 0.91% and the 10-year real yield in the US fell to -1.09%. Japanese, Swedish and German bond yields remained at low levels.

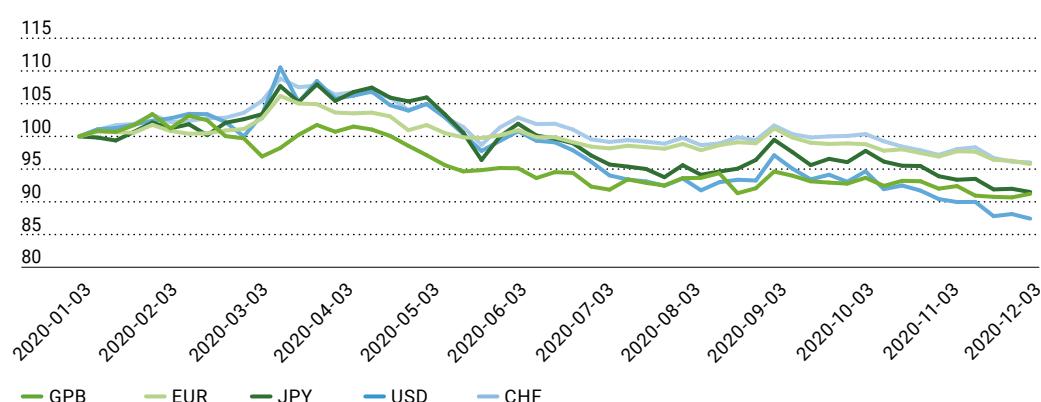
Yield curves 2020 (10-year government bonds)



Performance in currencies

The major global currencies strengthened rapidly against the Swedish krona during the height of the market turmoil in March. Thereafter, the krona gained ground and continued to do so for the rest of the year. By year-end the US dollar had weakened to SEK 8.22 SEK.

Currencies 2020 (indexed to 100 at 31 Dec 2019)



Listed equities enable return and stewardship

During the spring AP3 launched a new team to manage listed equities. Equities have long been the fulcrum of the AP3 investment model and the Fund has a group of highly skilled professionals in equity management. Conditions for active management and effective corporate stewardship have now been further improved.

AP3 invests close to half its assets in global equity markets, which over the years have provided a prime source of investment return. Nevertheless, they have also given rise to periodic losses in the Fund's portfolio. This is because the higher long-term returns offered by equities come with an elevated level of risk. Investing across different geographies, sectors and companies is an excellent way to capitalise on economic growth and new innovations.

Higher level of active management

A long-term investor can engage in fundamental equity analysis in order to actively adjust exposure to different parts of the market and elect to buy or sell different companies. AP3 as a long-term investor thus contributes to making the market more efficient and a good economic and financial bellwether. As a long-term asset owner the Fund has responsibilities, as well as opportunities to influence individual companies and social development. As a responsible investor and owner, AP3 exercises that responsibility through sustainable engagement.

The equity team has increased the level of active management by expanding risk mandates,



Return:
+15.1%

Contribution:
+8.0%

converting passive mandates to active ones, insourcing externally managed mandates and by launching a new internally managed global mandate.

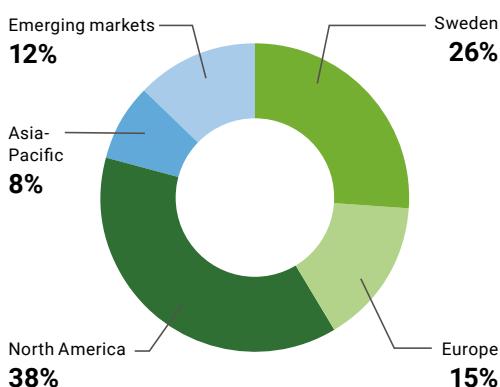
Listed equity management is now structured as follows:

- **Internal management** – management of internal portfolio mandates is primarily based on fundamental analysis in which projected value creation is compared to a share's market value. AP3's internal portfolios are primarily focused on Sweden, Europe and North America.
- **External management** – the Fund uses external managers in areas where it lacks specialist skills. This is the case particularly in regard to emerging markets, the Asia-Pacific region and small cap companies outside Sweden. External manager selections consider to what extent a manager creates value by applying a sustainability perspective.
- **Active and passive management** – index-based (passive) management is a way to gain exposure to a particular market or region at a low cost in cases when AP3 or external parties have limited scope to create value through active management.

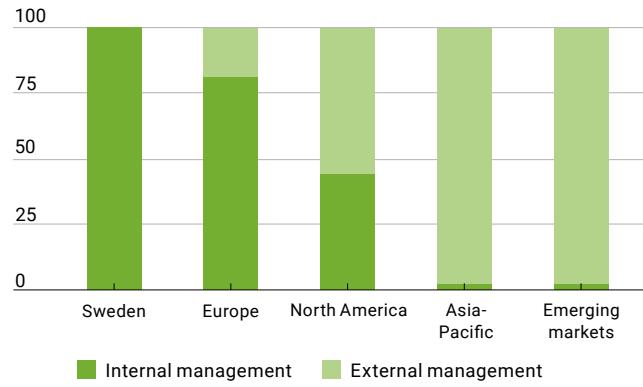
Spotlight on corporate stewardship

In AP3's experience, companies which are well managed produce higher risk-adjusted returns over time. Successful integration of sustainability into a company's business operations boosts competitiveness and profitability. Equity markets also value such companies more highly for reasons of quality and stability.

Listed equities by region



Internal/external management by region



Pandemic underlines value of being a global investor

Sweden accounts for a substantial part of the Fund's equity portfolio. In 2020, the Stockholm stock exchange was one of the world's strongest-performing equity markets. Swedish companies are highly competitive in the global market place across sectors represented on the Stockholm exchange.

AP3 has a home bias in listed equity investments, allocating a larger share of the Fund's assets to Swedish equities than warranted by its share of global market capitalization. This is because AP3's portfolio managers have good knowledge of the Swedish market and are well placed to exercise effective corporate stewardship in Swedish companies. Moreover, the investment opportunities available in the Swedish market are relatively attractive. Engineering and IT are two sectors in which Sweden



Return:
+17.3%
Contribution:
+2.4%

has a global edge. Other sectors that stand out internationally are pharmaceuticals, consumer goods and commodities. The emergence of new dynamic companies in the healthcare and entertainment sectors further increases AP3's scope to compile a diversified domestic portfolio.

Small companies bring large responsibilities

In Sweden, AP3 is an active owner and is well placed to effectuate active corporate stewardship because the Fund often holds significant equity holdings in small cap companies and is familiar with their operating conditions. The interplay between an institutional investor and an emerging business comes with a large measure of responsibility and an opportunity for favourable returns over time.

Around the world, the pandemic accelerated a number of ongoing trends that left their mark on global equity markets. This resulted in some new-economy businesses experiencing a boost arising from the impact of Covid-19.

New consumption patterns around remote working created new demands in areas including information technology, transport and communications. As a result, the market capitalisations of the largest US technology companies soared to all-time highs. Apple, Microsoft and Amazon are now the largest holdings in the AP3 portfolio. Together they have surpassed the value of the Fund's largest investments in Swedish companies (with the exception of our strategic holding in Sagax).



Return:
+14.3%
Contribution:
+5.6%

Tailored global equity management

Broad-based market exposure is a cost-effective strategy for gaining a share of global economic growth and corporate innovation.

In the last decade the markets have increasingly rewarded business quality and stable profitability with high valuations. The growing market focus on sustainability underlines the importance of AP3's corporate engagement activities to improve the equity portfolio's risk profile. It also highlights the increasing demands on companies to play an active role in social development. Competent management of supply chains, personnel and materials is especially important in a crisis. Although AP3 holds small ownership stakes in global companies, the Fund's influence over a company's strategic direction can be significant when combined with that of other investors.

Five largest holdings in Swedish listed companies

Name	No. of shares	Percentage of equity	Percentage of voting rights	Market value, SEK m
Sagax AB	24,227,658	5.25	3.44	4,109
Volvo AB	14,775,036	0.73	0.34	2,864
Investor AB	4,717,053	0.61	0.46	2,824
Atlas Copco AB	6,974,705	0.57	0.10	2,578
Telefonaktiebolaget LM Ericsson AB	25,160,345	0.75	0.44	2,457

Five largest holdings of foreign listed companies

Name	No. of shares	Percentage of equity	Percentage of voting rights	Market value, SEK m
Apple Inc	3,554,485	0.02	0.02	3,873
Microsoft Corp	1,977,819	0.03	0.03	3,613
Amazon.com Inc	108,981	0.02	0.02	2,915
Alphabet Inc	161,791	0.03	0.01	2,328
Nestle SA	1,488,698	0.05	0.05	1,442

Investing in fixed income to manage risk and spur green transition

AP3 established a new fixed income and FX team in 2020. The team manages the Fund's fixed income investments, which are subdivided into government, inflation-linked and corporate securities. The team is also responsible for currency management, including hedging, active currency risk-taking and the treasury function.

AP3 manages the bond portfolio internally and actively. A large portion of the investments are liquid, which is a prerequisite for active fixed income management. The current low interest rate environment means that expected returns are very low, making it even more important to invest cost-efficiently.

Reduced exposure to dollar bonds

The Fund's fixed income holdings have previously focused on US bonds because of their attractive yields and strong liquidity. This stance remained in place at the beginning of 2020 but was scaled back as US yields came into closer line with government bonds in other currencies.

Higher weight in inflation-indexed bonds

Higher inflation poses one of the most significant risks to the AP3 portfolio and the Fund therefore invests in inflation-linked bonds, which partly protect against rising prices. As inflation rates dropped sharply during the spring the Fund increased exposure to these assets.

31.0

percent of
the portfolio

Return:

+5.1%

Contribution:

+1.6%

Increased global focus in corporate bonds

AP3's corporate investment activities expanded during the year both in terms of capital allocation and the size of the team that specialises in this area. Investing in corporate credit has evolved from a focus on Scandinavian companies to a more global footprint. This change was aided by the addition of two people to the fixed income team during the year.

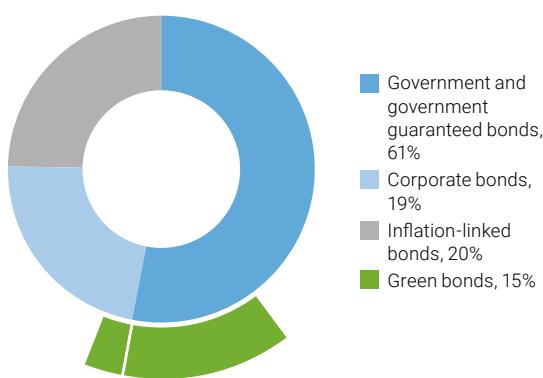
The Fund's success in making investments at more attractive yields during the most volatile months of the year resulted in an increase in total corporate bond allocations during 2020.

AP3 continues to take a cautious approach to corporate bond investments because they compensate the investor relatively modestly for the credit and liquidity risks involved. This highlights the value of investing in sustainable businesses and sectors that offer scope for positive price growth – a fact that applies especially to companies that still have a journey ahead of them when it comes to transitioning to an economically sustainable business model.

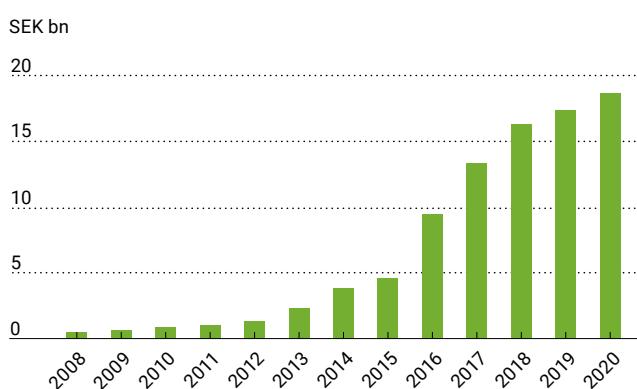
Green bonds – good progress towards target

AP3 is among the pioneers of the green bond market, having made its initial investment in 2008 in the first green obligation issued by the World Bank. The Fund's green bond holdings have steadily grown since then and now stand at SEK 18.7 billion. AP3 has a goal of raising green bond holdings to SEK 30 billion by 2025 because these instruments are an effective way to mitigate climate change while offering a satisfactory return in a bond market context. Green bonds are a financial instrument whose capital is

Fixed-income portfolio structure



Fast growth in the green bond portfolio since 2015





used to fund environmental projects, an investment model that directly impacts the borrower's activities. The ability to attract capital by issuing green bonds also has an effect on the issuer's focus and commitment to environmental issues.

AP3 has created a diversified portfolio of green bonds invested with names such as the World Bank, the Asian Development Bank, the African Development Bank, the Nordic Investment Bank, EDP, Ellevio, Vasakronan, Stockholm Energi, Riksheim, Stora Enso, European Energy and Scatec Solar.

Each green investment is verified by the sustainability team that is separate from the fixed income team in order to ensure that the green bonds really are green.

AP3 has also contributed to the development of the green bond market through its real estate companies Vasakronan and Hemsö, which issue green bonds to raise finance. In 2013, Vasakronan became the first company in the world to issue a green bond.

Currencies

Diversified value creation through currencies

60 percent of AP3's investments are in other currencies than the Swedish krona. Currency management is thus one of the Fund's most important areas to manage risk and generate returns.

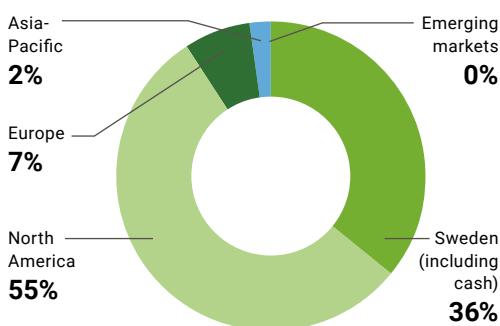
Currency management in a global portfolio

Currency management is an important part of the AP3 investment universe and exerts a strong influence on overall returns. All currency management is handled internally. The Fund takes on currency risk by not hedging all foreign holdings and by taking active currency positions. Currency exposure helps to reduce portfolio risk and over time has also generated positive investment returns.

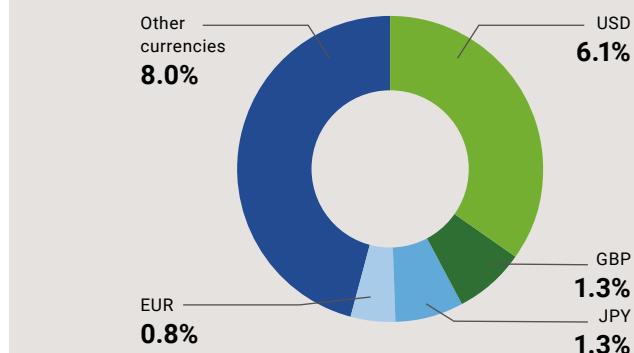
Currency strategy 2020

AP3's currency exposure decreased during the year as the economy stabilised and conditions became established for a stronger krona. Currency exposure was reduced from 19.5 percent to 17.5 percent during the period. The composition of the currency portfolio was adjusted to reflect the strengthening of the US dollar against most currencies when market turmoil reached its peak during the spring. Thereafter, the Fund scaled down its dollar exposure while increasing exposure to the euro.

Fixed income investments



Currency exposure (share of AP3 portfolio)



Alternative investments grow in importance

Alternative investments are the part of the AP3 investment model that has grown fastest in the last 15 years through allocations of assets from listed equities and fixed income instruments. Several factors are driving this trend, which is mirrored by many long-term investors at global level.

The initial impetus came from looking for new ways to diversify the portfolio. In recent years, the driving force has been a quest to find attractive investment opportunities that are capable of generating favourable returns and also offer clear benefits to society. The AP funds' real estate and infrastructure companies serve as models for the transition to a more sustainable system. These factors were prime considerations when the AP funds received an expanded mandate in January 2019 to invest in unlisted assets.

Advantages of alternative investments

Alternative investments reduce risk concentration in listed equities and can complement traditional market investments in several ways. They are not subject to daily market fluctuations and can reduce portfolio sensitivity to inflation and future changes in economic growth rates.

24.9

percent of
the portfolio

Return:
+9.1%

Contribution:
+2.3%

Value creation beyond traditional financial theory

Alternative investments typically offer higher returns that are sometimes described as compensation to the investor for lack of liquidity. The investor is committed for a long period of time and cannot easily sell the asset if needed. Many investors cannot take on this reduction in flexibility. This reduces competition and creates opportunities for long-term investors like AP3. Several of the Fund's alternative investments are examples of alternate sources of value creation that are not available on listed exchanges. They include private equity funds, which specialise in corporate development and restructuring, and directly owned real estate and infrastructure companies with unique strategies, such as those owned by AP3 and the other AP funds.

Leveraging AP3's investor specifics

Alternative investments are well suited to creating value as they leverage AP3's specifics as an investor. Only long-term investors can fully harness the potential of investments in assets such as real estate, infrastructure and timberland. Long-term investors are also best placed to exploit the attractive investment opportunities that can arise during times of market stress, when other investors are less

Higher diversification through increased allocation to alternative investments



AP3's journey to a higher weight in alternative investments continues following amendments to the National Pension Insurance Funds Act that took effect on 1 January 2019.

The Fund is now able to draw on a wider range of investments, which improves its ability to promote sustainable social development.

competitive relative to an investor like AP3. The AP funds' investment rules now allow them to invest in illiquid assets as part of their long-term mandate.

AP3 has chosen to allocate significant capital to alternative investments in Sweden and neighbouring countries. It is a way to utilise the Fund's knowledge of Swedish conditions and build wholly owned companies based on strong stewardship and hands-on control.

AP3's unlisted investments

The Fund's alternative investments are generally unlisted, meaning they are not quoted on a market or regularly traded. The alternative investment portfolio accounts for 22.5% of the Fund's assets. It consists of:

- **Private equity funds** – international investments in funds managed by specialists in private equity.
- **Real estate** – investments in wholly or partly owned Swedish real estate companies with a well-defined niche and strategy.
- **Infrastructure** – investments in different types of infrastructure, led by Ellevio and Polhem Infra.
- **Timberland** – investments in Swedish and international timberland, increasingly via jointly owned timberland companies.

AP3's unlisted investments are presented on pages 28 to 37.

Alternative investments not always unlisted

The Fund has two exceptions to its rule that alternative investments are non-listed: Sagax, a listed real estate company, and the insurance risk asset class.

Sagax – a strategic partnership

AP3's strategic real estate investments include a stake in Sagax, a listed property company. Sagax is an important strategic partner in the real estate sector and a shareholder in another AP3 property company, Hemsö. The Sagax holding is included in the Fund's alternative investment portfolio and its exposure to logistics properties helps provide diversification in AP3's real estate holdings. At year-end, AP3's stake corresponded to 5.2% of Sagax's equity and had a market value of SEK 4,109 million.

Insurance risk – primarily listed investments

Due to their specific nature, the Fund manages insurance risk investments through the alternative investments team. Nonetheless, the investments are typically in listed securities.

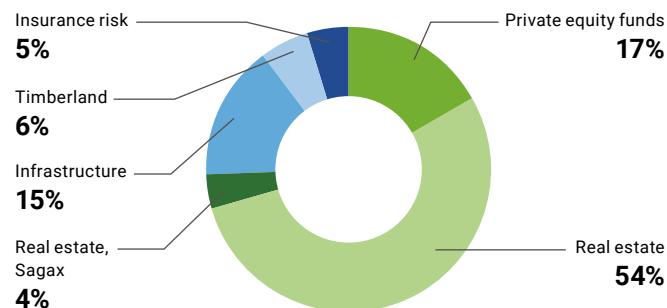
Read more about insurance risk on page 39.

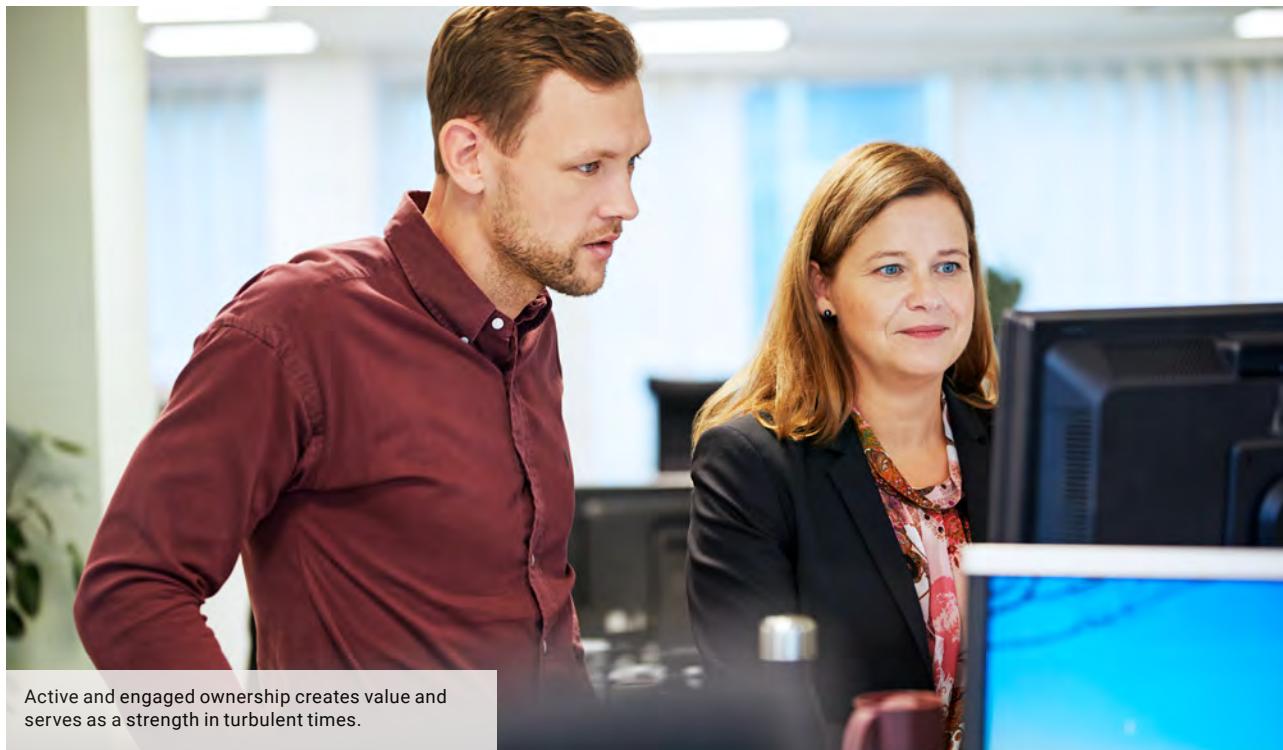


AP3's unlisted investments are presented on pages 28 to 37
Read more about insurance risk on page 39

Alternative investments in the AP3 portfolio

Alternative investments account for 24.9% of the AP3 portfolio. They consist of private equity funds, real estate, infrastructure assets, timberland and insurance risk. Some 2.4 percentage points of these investments are listed holdings (primarily in the listed real estate company Sagax and insurance risk). They are long-term and create value that is typically unavailable in the equity market. They are also not suitable for all types of investor.





Active and engaged ownership creates value and serves as a strength in turbulent times.

Private equity funds' stewardship valuable in turbulent times

The private equity market continues to grow rapidly. AP3's access to private equity funds with extensive expertise and experience is crucial to creating value in this area.

The Fund's primary reason for investing in private equity is to generate a higher return compared to listed equities. The value creation process differs between listed and non-listed companies, making these investments a way to diversify the portfolio. AP3 focuses on funds and managers which have demonstrated strong returns over an extended period and with which relationships are well-established. AP3's strategy is primarily oriented to mid-market buyout funds.

Stable returns in extreme conditions

The pandemic created highly challenging and unpredictable conditions for the private equity market. There was great uncertainty at first over how the economic situation and nervousness in the debt market would impact the sector and its access to capital. However, a rapid easing of monetary policy enabled private-equity-owned companies and private equity fund investors to avert liquidity problems.

Several trends became apparent during the year. First, illiquid markets, to which private equity funds belong, remained open for business as investors worked remotely, albeit with a focus on established contacts. This increased the concentration of capital

4.2

percent of
the portfolio

Return:
+15.1%

Contribution:
+0.6%

to existing fund managers and made it harder for newly established funds to attract capital.

Thus, the trend towards larger private equity funds continued. Second, private equity fund investments proved resistant to major swings in value.

Growing emphasis on sustainability

A third trend, and consequence of the pandemic, was an increased focus on sustainability among private equity investors. Initially, many looked primarily at the immediate financial consequences of this shift, but as time passed a broader perspective took hold amid growing interest in potential investment opportunities arising from the transition to a sustainable economy.

Partly as a result of the pandemic, attention gradually extended beyond climate change to include environmental, social and governance parameters. This applied both to investors evaluating fund managers and also to funds evaluating the companies they invest in.

Responsible long-term ownership

As a private equity investor, AP3's main responsibility is to ensure that private equity managers which manage assets on behalf of the Fund act professionally, sustainably and responsibly in combining long-term returns with sustainable practices. AP3 conducts these validations prior to investment and on a continuing basis.

BENGT HELLSTRÖM, HEAD OF ALTERNATIVE INVESTMENTS:

Retiring after 20 years of developing the AP3 portfolio



Few institutional investors were exposed to private equity when you joined AP3 20 years ago. Who were your role models when building the private equity portfolio?

"I didn't have any one person or organisation as a role model. I focused more on reading about the private equity market to help develop a strategy that could work. I also looked at how different types of investor operate, especially in North America."

What are your thoughts on the private equity portfolio the Fund has built?

"Today AP3 has a 'mature' programme of investments with managers that have achieved good returns over time. As a result, a majority of our investment commitments are with managers with which we've invested in the past. We only add a few new managers every year."

Success factors?

"We should never forget that this is a people business. It's the individuals and the fund managers who matter most in our analysis. You need to focus on

choosing the right managers. They're the ones who decide market timing and create the value on your behalf. It's also very important as an investor to be constantly active in the market."

How has AP3 adapted its portfolio?

"We've seen that it's difficult for funds-of-funds to deliver satisfactory returns, partly because they have two levels of cost. We've also focused the portfolio using our experience that broad exposure based on geography or investment stage doesn't add value in terms of return. What's important is choosing the right managers."

Any personal reflections on your years with AP3?

"I've enjoyed the challenge, it's been very interesting. And it's been fantastic to work with so many talented and nice people, both inside and outside the Fund. I really appreciate the faith my managers had in me to build our alternative investments from around 2% of the portfolio when I started up to the level of 25% where we are today."

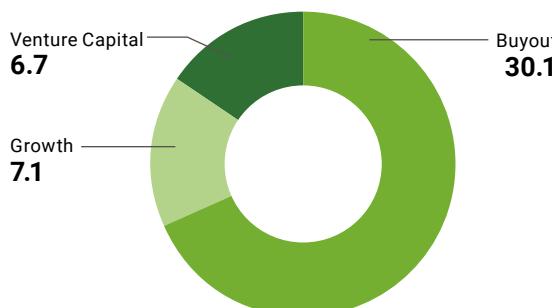
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I've enjoyed the challenge, it's been very interesting. And it's been fantastic to work with so many talented and nice people, both inside and outside the Fund.

Bengt Hellström will hand over to Maria Björklund as Head of Alternative Investments.

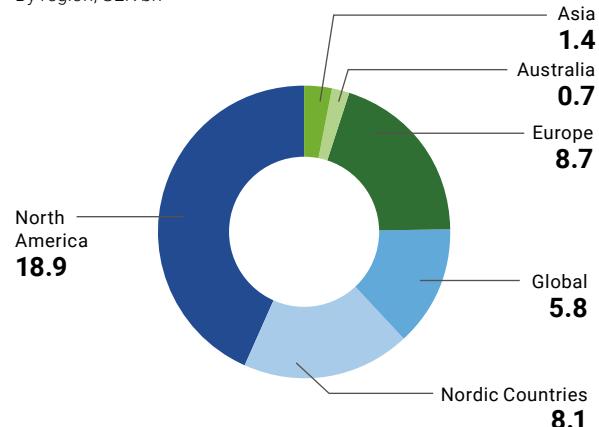
Private equity fund commitments

By investment stage, SEK bn



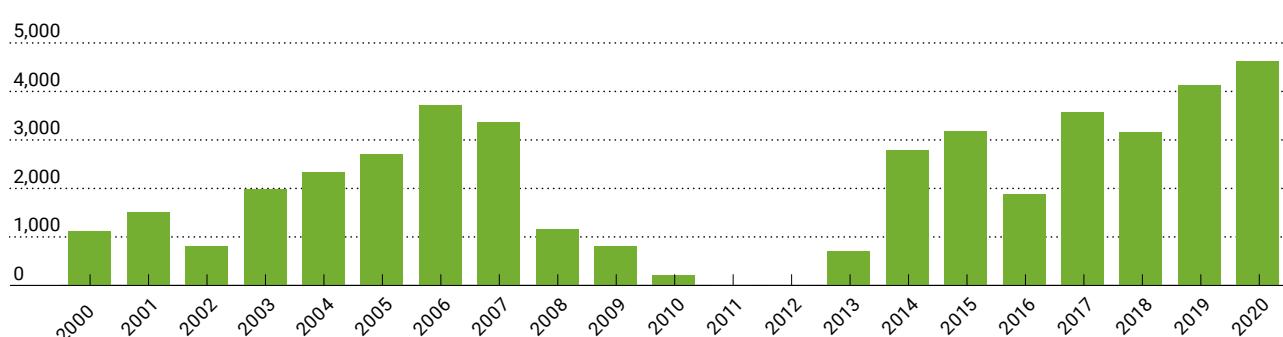
Private equity fund commitments

By region, SEK bn



Vintage years – when commitments were made

SEK bn



Large real estate holdings positive for sustainability

Investments in real estate, including majority-owned companies, account for a substantial share of the AP3 portfolio. As a large owner, AP3 can exert influence in terms of growth prospects, costs, financial risk and sustainability in a sector that has a substantial impact on society.

AP3 has been a responsible and long-term owner of real estate ever since inception. Today, the portfolio comprises five property companies: Vasakronan, Hemsö, Regio, Trenum and Trophi. These businesses work with long tenancy leases, which matches the Fund's long-term investment horizon. For AP3, various advantages apply:

- Running fully or partly owned businesses is a cost-effective way to manage assets. AP3 can exploit its status as a long-term investor to own companies rather than invest in funds with a limited life and that are subject to exit risk.
- The companies have growth potential, which allows the Fund to manage capital according to market opportunities. This is done at a low marginal cost.
- As an owner, AP3 can exert control over the companies' capital structure and hence over financial risk.

Ownership strategy

AP3 focuses strongly on the Swedish market through majority holdings in real estate companies that:

- Provide some protection from inflation
- Are illiquid assets specialised in a specific sector of the property market
- Offer relatively stable returns

13.4

percent of
the portfolio

Return:
+10.8%

Contribution:
+1.4%

Sustainability – a shared goal

Sustainability is a strategic imperative that is customised to each company's challenges. The Fund desires that all companies work actively with sustainability regardless of their specific business segment. AP3 expects the issues to be taken seriously and for sustainable practices to be fully embedded in the organisation. AP3's sustainability goals for 2025 include an expectation that directly owned real estate companies should remain – or become – sector leaders in sustainability. AP3 is committed to ensuring that directly owned unlisted companies in the real estate and infrastructure sectors are sector leaders in sustainability. Achieving this goal will involve an increased focus on sustainable production and construction.

In construction and refurbishment projects the Fund's companies work to reduce energy consumption, make responsible material choices, achieve environmental certification and maintain high standards. AP3 is represented on the boards and nomination committees of all its real estate companies, allowing the Fund to drive and prioritise sustainability related issues.

A strong year despite everything

Covid-19 had a strong impact on some segments of the real estate market in 2020 amid a need to adjust to pandemic-related challenges. AP3's real estate companies nevertheless navigated the crisis surprisingly well, proving resilient and strong given the circumstances.



VASAKRONAN

Vision of “the good city”

Vasakronan's owners have tasked the company with generating a high risk-adjusted return over time based on implementing a vision of “the good city”. Vasakronan is a sustainability leader with high ambitions. Its goal is to be climate neutral by 2030.

Vasakronan is AP3's largest real estate company. Its vision is to create “good cities” where inhabitants enjoy living and business prospers.

“We are addressing climate change so we can deliver better value to our owner and society and to live up to our vision at the same time as we hope to inspire others,” says Anna Denell, Vasakronan's head of sustainability. “We see no conflict between profitability and sustainability. On the contrary, we see that taking action for climate change has helped us to both drive and meet the market's demand for climate-smart solutions. This has contributed to our profitability.”

The construction and real estate sector accounts for more than 20% of Swedish greenhouse gas emissions. The primary sources are energy use by tenants and waste and construction activities. There are no legal standards for emissions disclosure, but the most commonly used international standard is to divide emissions into Scope 1, 2 or 3.

Vasakronan emissions by scope By emission category



Scope 1 and 2 – Own organisation is climate-neutral

Scope 1 and 2 emissions are generated by Vasakronan's own business activities. At this level, Vasakronan has been climate-neutral for many years. The company has since 2008 offset some of its Scope 1 and 2 emissions that could not be entirely eliminated. These relate to emissions from company-owned vehicles and cooling systems (Scope 1) and purchased electricity (Scope 2). Vasakronan offsets emissions by purchasing shares in voluntary emissions projects certified by Gold Standard, a carbon offset standard.

Scope 3 – Impact on tenants' operations

Vasakronan's business activities give rise to substantial Scope 3 emissions. These are emissions generated by tenants when using Vasakronan facilities and during building work performed on tenants' behalf. Even though Vasakronan cannot control Scope 3 emissions, the company can have an impact on them in areas such as purchasing and use of materials. Tenants and suppliers are also involved in creating this impact.



We are addressing climate change so we can deliver better value to our owner and society and to live up to our vision at the same time as we hope to inspire others. We see no conflict between profitability and sustainability.

Continuous fall in carbon emissions to 2030

Vasakronan's targets reflect the company's belief that the impact of climate change on its properties and on market demand is likely to accelerate. It is probable that regulatory standards and legislation will be tightened, with significant implications for Vasakronan's financial position and business model. As a result, the company decided in 2019 to be climate-neutral by 2030 across its value chain.

Vasakronan has committed to test, evaluate and invest in new technology that enables it to reduce carbon dioxide emissions continuously until 2030. As of 2020, the company is implementing available technology to reduce emissions. Using empirical data and data-based assumptions, Vasakronan has identified the level it needs to reach by 2025 to achieve climate neutrality in its value chain by 2030. The company decides annually on specific goals and initiatives.

Climate neutrality and climate offsetting

What do climate neutrality and carbon offsetting mean for Vasakronan?

“The goal is to continue reducing our direct and indirect emissions,” says Anna Denell. “Even if we do all we can, we won't be able to completely eliminate some emissions by 2030. That means we will need to offset our carbon footprint. We believe that by 2030 there will be large scale technologies and processes that will make it possible to reduce atmospheric carbon dioxide. This will enable us to remove from the atmosphere the amount of carbon dioxide that we ourselves emit. In 2020 we started offsetting all reported emissions in our value chain.”

Climate goals in line with the Paris Agreement

In 2018 the Science Based Targets Initiative (SBTi), a partnership between WWF, the UN Global Compact, CDP and the World Resources Institute, approved Vasakronan's long-term climate goals. SBTi is a scientific method which verifies that a company's climate goals are aligned with delivering on the Paris Agreement's goal of limiting global temperature rise to less than 2°C above pre-industrial levels. SBTi has certified that Vasakronan's 2018 goals, which have since become even stricter, are Paris-aligned.



HEMSÖ

Social impact and pension capital in partnership

Hemsö develops and manages nursing homes, educational establishments, care facilities and penal institutions. The company plays an active role in society through the provision of school buildings and safe and sustainable retirement homes.

Hemsö, owned by AP3 and Sagax, seeks to maximise its positive impact on society and act sustainably from a social, economic and environmental perspective. As a property owner and manager, the company is uniquely positioned to take long-term decisions from the outset. This can include investing in climate-smart and energy-efficient solutions or taking extra care to landscape outdoor areas in a way that promotes people's well-being.

Integrated sustainability and "NollCO₂ certification"

Hemsö's integrates sustainability in its business model and has ambitious energy and climate goals. In 2020, the company's Sköndalsvillan home for the elderly in Tyresö, Stockholm, was one of six pilot projects for a new zero-carbon certification scheme developed by the Sweden Green Building Council. NollCO₂ aims to drive progress towards climate-neutrality in Sweden's public buildings.

The creation of good overall conditions for the building, focusing on the use of the right materials and appropriate ventilation, acoustics and daylight, are key factors in eco-certification. Outdoor environments, which have a major impact on people's health and well-being, are another priority area.

In Sweden, the public sector plays a central role in providing facilities for schools, care homes

”

The creation of good overall conditions for the building, focusing on the use of the right materials and appropriate ventilation, acoustics and daylight, are key factors in eco-certification. Outdoor environments, which have a major impact on people's health and well-being, are another priority area.

and other social infrastructure. In Gothenburg, an ongoing project to build a combined school and retirement home exemplifies how resource efficiency and social sustainability can go hand in hand. Both facilities will share the same building on different storeys. Communal areas and activities will enable the school students and older residents to mix, allowing to interact with members of the older generation who in turn can use the school's indoor and outdoor facilities for exercise. Having the two organisations under one roof creates a range of financial synergies. Both share the same kitchen and garage and caretaker and cleaning services, for example. This results in lower rents and procurement costs and improved property utilisation.

Thanks to the expertise and experience it has accumulated over many years and hundreds of property projects, Hemsö can help local authorities to think in new ways and act sustainably over time while creating amenities tailored for their operations.

Hemsö is Sweden's leading private owner of community service buildings

The company owns, manages and develops retirement homes, education and care facilities and penal institutions in Sweden, Germany and Finland. These are let on long leases to stable tenants. The company's property portfolio has a market value of SEK 59.7 billion. AP3 holds a majority equity stake. Hemsö has held an A- credit rating from Standard & Poor's since March 2015 and an A rating from Fitch Ratings since April 2020.

FASTIGHETS AB REGIO

Regio – creating safe, climate-smart cities

Regio's mission is to be the best provider of commercial real estate in expansive regional towns and cities. The company seeks to upgrade all of its properties during ownership and in so doing contribute to economic development, a better environment and an inclusive society.

Regio is a long-term owner of commercial office and retail real estate. Its portfolio focuses on expansive regional towns and cities and comprises around 100 properties in 17 municipalities, with a market value of more than SEK 11 billion and a lettable area of 600,000 square metres. AP3 owns 98% of Regio, which is co-owned with and managed by Brunswick Real Estate.

Positive impact on people and planet

The value of Regio's property stock reflects the company's long-term approach and the central importance it attaches to sustainability. The company's goal is to contribute to safe, climate-smart and prosperous cities. A commitment to continuous improvement and sustainability means creating value at all levels of property ownership and management. Regio raises its ambitions in sustainability every year, introducing new measurable targets and initiatives to drive the agenda forward.

Climate reporting and classification

Digital collection and analysis of sustainability data is fundamental to Regio's approach. The company in 2020 produced its first climate report, disclosing its annual direct (Scope 1) and indirect (Scope 2 and 3) greenhouse gas emissions. Performance is measured to ensure that investments in the business as well as in individual properties are effective. All Regio properties are benchmarked using the BREEAM In-Use method for energy, resource and materials use. Energy efficiency improvements are performed continuously and the company is working to increase its use of renewable electricity.

Long-term ownership with local bias

Regio uses local partners to ensure a good level of service to its properties and tenants. The company also takes an active role in town planning, working with municipalities and other real estate owners. Creating accessible environments that promote social interaction helps to build a safe urban environment that is welcoming to all.

Working towards the UN SDGs

Regio's sustainability engagements relate primarily to five of the 17 Sustainable Development Goals



The goal is to contribute to safe, climate-smart and prosperous cities.

(SDGs) adopted by the United Nations and by the Swedish government as part of the Agenda 2030 initiative.

Good health and well-being

Regio contributes to this goal through its use of the SundaHus portal, which enables the removal of dangerous and environmentally hazardous substances in materials used in the company's properties. Affordable and clean energy involves investing in energy efficiency, using a higher share of locally produced renewable energy and providing green electricity in all buildings. Sustainable cities and communities involves developing the portfolio in a way that promotes inclusive, safe and resilient communities and socially sustainable towns and cities.



Regio's property in central Eskilstuna provides tenants like SEB, AFRY and KronansApotek with 2,800 square metres of high-quality space.

Fastighets AB Regio

Fastighets AB Regio owns and develops commercial real estate in expansive regional towns and cities and metropolitan suburbs. The company aspires to be a preferred landlord through an active local and regional presence. Its mission is to generate stable returns for its owners through long-term ownership and active, locally oriented management. Regio was founded in 2015 by AP3 and Brunswick Real Estate. AP3 is the majority owner, while Brunswick manages the property business. Read more at regiofastigheter.se

Infrastructure investments fit well with AP3's long-term mission

Infrastructure investments are based on playing an essential role on behalf of the overall economy. They offer long-term returns that are stable and predictable over time and generate inflation-protected returns that are resilient to economic ups and downs. Infrastructure also plays a key role in developing a sustainable society.

Focus on Sweden

Infrastructure assets have a long economic life and AP3's ambition is to own them for all, or a large part of, this period. The size and scale of the investment commitments mean that investors typically form consortia to invest in infrastructure. AP3's strong position in the Swedish and North European infrastructure markets is based on being a state pension fund with a large asset base and long-term investment horizon, as well as being an active owner.

AP3 has a strong focus on the Swedish market,

3.8

percent of
the portfolio

Return:

-2.3%

Contribution:

-0.1%

and most of the Fund's direct unlisted investments are in Sweden where:

- AP3 can capitalise better on its strength as a long-term investor by owning companies rather than investing funds with a limited lifespan.
- Investing in businesses is a cost-effective way to manage assets.
- The growth potential of directly-owned companies gives flexibility in managing capital according to need and at a low marginal cost.

AP3 also invests in international infrastructure funds. These investments typically do not offer the advantages of direct ownership, but they can sometimes be the most effective way to invest in this asset class outside Sweden and the Nordic region. AP3 can also make co-investments with infrastructure funds, which is a way to invest capital at a low management cost.

Returns in line with expectations

AP3's infrastructure investments are defensive in character. They offer lower returns but come with lower risk and a high degree of stability and predictability. The pandemic put the Fund's infrastructure investments to the test. In all, they proved rather resilient. Public transport facilities and airports suffered from reduced mobility, but fibre optic networks, data centres and wind power performed strongly. As in all asset classes, diversification is important.



Ownership with a long-term focus

AP3 is investing in the infrastructure of tomorrow. The aim is to create sustainable, long-term companies over a horizon of many years. In directly owned investees like Ellevio and Polhem, AP3 is represented in the board of directors and board committees and conducts active stewardship including through engagement with other investors. AP3's prime focus as an investor is to ensure that our infrastructure fund managers act professionally, sustainably and responsibly in combining long-term returns with sustainable practices. AP3 conducts validations prior to investment and on a continuing basis.

ELLEVIO

Ellevio – a key player in a zero-carbon Sweden

Swedish electricity consumption is projected to rise from 140 TWh to 190 TWh by 2045. Electricity grids need to be smarter and more flexible to meet this need. In 2020, Ellevio installed smart electricity meters in three Stockholm districts and will in the coming three years reach 1 million customers with this technology. This is essential for achieving society's climate goals along with other initiatives such as the electrification of the Swedish transport sector and other fossil-based industries. Next-generation meters give Ellevio more measurement coverage and clearer information about customers' consumption patterns. They make it easier to predict, prevent and shorten electricity outages. They also avoid demand spikes and combat grid shortages.

Ellevio has seen a seven-fold increase in solar cell customers in the last five years. The company is working actively to make it easier for these customers to generate their own electricity and raise the overall level of renewable energy generation. For AP3, Ellevio is a good investment prospect that will create value for society and long-term returns for the Fund by developing the solar power solutions of tomorrow in partnership with solar panel manufacturers. Ellevio is one of Sweden's largest electricity distributors, with close to 1 million customers in central regions and in Stockholm. The company's innovative capability in electricity distribution makes it a key player in the transition to a sustainable energy model.

ELLEVIO

Ellevio owns, operates and develops regional and local electricity networks and distributes electricity to 965,000 customers in Sweden. The company owns 77,500 kilometres of electricity grid cables – enough to circumvent the globe twice. Ellevio is owned by OMERS Infrastructure (50%), AP3 (20%), Folksam (17.5%) and AP1 (12.5%). Read more at ellevio.se



POLHEM INFRA

A whole new way to invest in infrastructure

In 2019 AP3 partnered with AP1 and AP4 to found Polhem Infra as a vehicle for long-term and cost-efficient direct investments in Swedish and Nordic infrastructure. The intention is for Polhem Infra to offer stable long-term returns while supporting the transition to a more sustainable society.

The company made two large investments in 2020. It partnered with three institutional investors and an infrastructure manager to invest in one of Sweden's largest wind power projects. The plant is being built at Skaftåsen in the province of Härjedalen, where 35 turbines will generate around 535 GWh of electricity for 100,000 homes when commissioned in 2021. The electricity produced will save 425,000 tonnes of carbon emissions compared to fossil-based generation.

Acquisition of Telia Carrier

During the autumn Polhem Infra announced a binding agreement to acquire Telia Carrier from Telia.

Telia Carrier is a leading global supplier of backbone infrastructure for data traffic. Telia Carrier and its 530 employees will make Polhem Infra the owner and operator of more than 74,000 kilometres of fibre cable networks with 320 access points globally.

Polhem Infra targets large infrastructure investments in the private and public sectors with a focus on collaboration and sustainability. It invests with other long-term industrial and financial partners and aspires to be a stable, responsible and long-term owner. Infrastructure investments are often in regulated monopolies, which from an investor standpoint generate predictable cash flows that grow over time in step with demographics. This fits well with AP3's long-term investment profile. Polhem Infra defines infrastructure as business activities that operate or provide socially beneficial services and assets. Examples include renewable energy production, energy storage and distribution, and digital infrastructure.

POLHEM INFRA

Polhem Infra is an investment company founded by AP1, AP3 and AP4. It specialises in direct investments in unlisted Swedish business activities that operate or provide socially beneficial services and assets. Examples include renewable energy production, energy storage and distribution, and digital infrastructure. Read more at polheminfra.se

Timberland – a long-term investment that captures carbon

AP3 began investing in timberland in 2004 and now owns around 150,000 hectares of production forest via funds or directly. The forests are sustainably managed and more than 90% are environmentally certified. Around 18,900 hectares are set aside for nature conservation. The timber is used primarily for manufacturing paper products, building material and furniture.

AP3 owns timberland in Sweden, North and South America, and Oceania. New investments primarily target a small cluster of developed markets through fund investment mandates, joint investments and directly owned investee companies. Portfolio risk diversification is achieved by the fact that forests grow at different rates in different regions and contain a variety of tree species. In addition, the products are sold to different markets.

Focus on partnerships

In June 2020 AP3 formed a strategic partnership with Lone Rock Resources for long-term investment in timberland in Oregon. The investment reflects a shift in the Fund's timberland strategy towards direct, long-term ownership. Gysinge Skog, formed by AP3 and Kåpan Pensioner in 2019, is another

1.4

percent of
the portfolio

Return:
+13.4%

Contribution:
+0.2%

example. The company primarily manages the forest assets that AP3 received in conjunction with the dissolution of Bergvik Skog, which the Fund co-founded in 2004.

Valuable carbon sink

As a long-term investment, timberland is an excellent fit for the AP3 portfolio. Forests take decades to grow and as they do so they store carbon dioxide independently of the business cycle. AP3's forests store a total of 25 million tonnes of carbon and in 2020 their annual growth captured 1.2 million tonnes of atmospheric carbon.

The Fund's timberland holdings can also be expected to generate favourable returns if climate scenarios turn negative.

Wood instead of concrete and steel

Forests are the historic source of raw material for the pulp and timber industries and remain so today. New segments such as wood chips, biofuel and new alternative materials are also emerging. In the construction industry, interest is growing in replacing materials like concrete and steel with wood as a way to save energy and capture carbon.

By working closely with new and existing strategic partners, AP3 sees great potential as a source of sustainable wood-based materials.

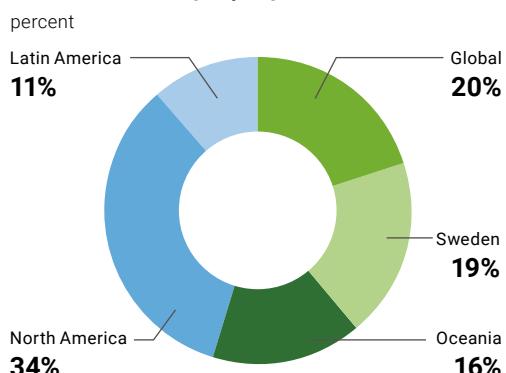
Developing the Fund's timberland investment strategy – partnerships with Gysinge Skog AB and Lone Rock Resources

Southwest Oregon is one of the areas AP3 has identified as attractive for long-term sustainable investment in timberland. The region has a long forestry tradition, a mature timberland industry and the right prerequisites for modern, sustainable forest management. The dominant species, the Douglas spruce, is widely used for construction timber. The partnership with Lone Rock Resources gives AP3 access to local expertise and market knowledge as well as an opportunity to own and manage forest sustainably over time in accordance with the Fund's strategy.

Gysinge Skog AB is a further example of how the strategic shift to more direct, sustainable and long-term ownership. The Fund co-founded the company with Kåpan in 2019 to manage the timberland holdings it received after the dissolution of Bergvik Skog. Gysinge Skog is a professional and sustainable forest manager with 70,000 hectares of forest, mostly in central Sweden. The primary tree species are spruce and pine. The company provides wood pulp and sawn timber to its strategic partners Sveaskog and Mellanskog. Gysinge Skog is certified both by the Forest Stewardship Council and the Programme for the Endorsement of Forest Certification.

As a board member, the Fund is well placed to influence the company's strategic direction and to guide it towards effective, sustainable timberland management.

Timberland holdings by region

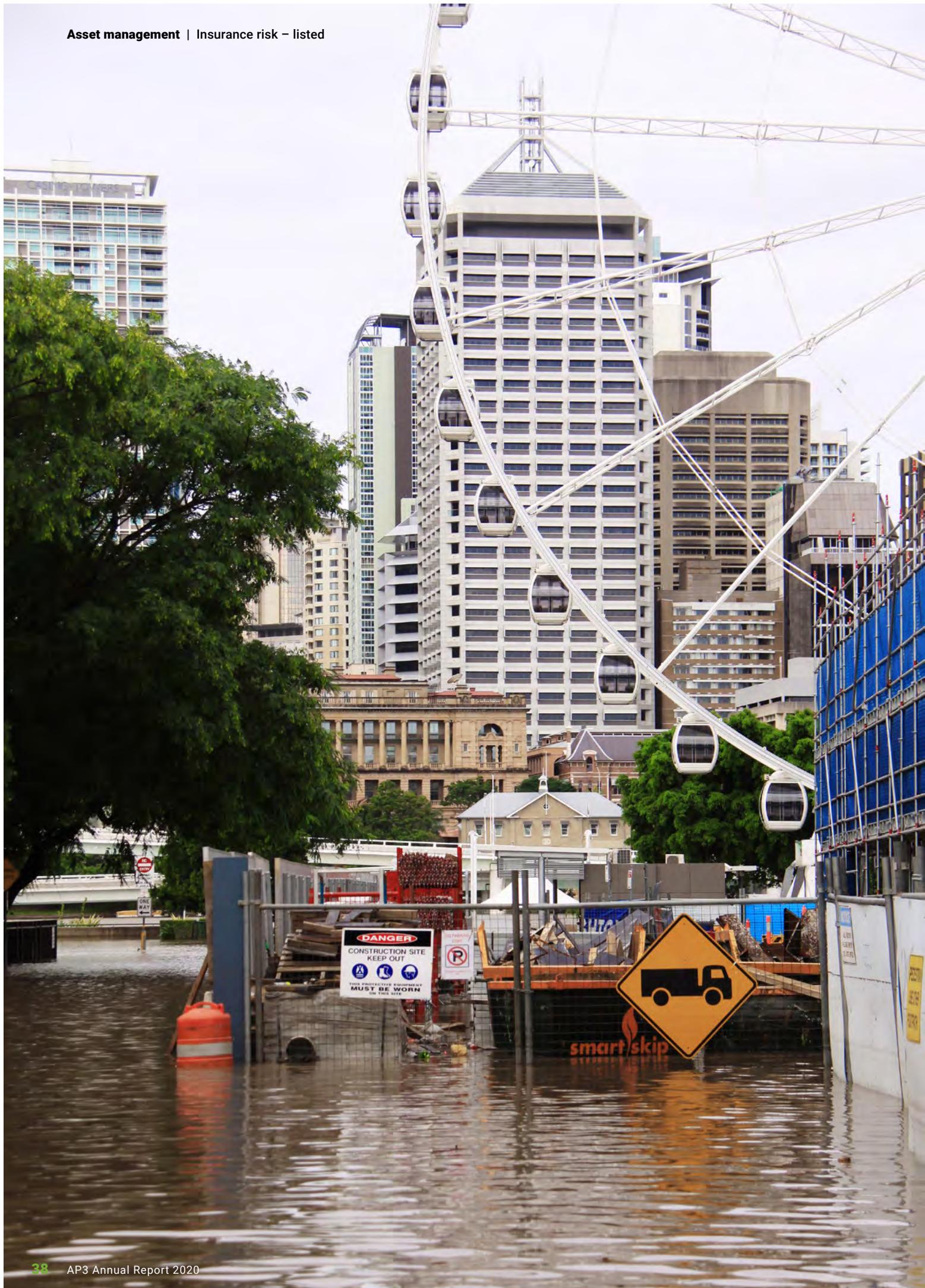


Climate impacts of timberland holdings:

25 + 1.2

million tonnes of CO₂
stored in tree vegetation
and below ground.

million tonnes of CO₂ are
stored by the annual growth
of AP3's forests. This is
more than the entire carbon
emissions of listed equity
portfolio investees.



Insurance risk – a systematic strategy

AP3 has been investing in different types of insurance-, climate- and weather-related securities since 2008. Holdings include catastrophe bonds, which are traded outside the traditional financial markets. Returns on these instruments have a low correlation with other investments, which means they help to diversify the portfolio.

Investments in insurance risk are strategic, long-term and help to make insurance markets more efficient. In the case of pandemic insurance, in 2020 the Fund's investments helped channel funds to countries with weak healthcare systems.

Systematic strategy

AP3 systematically takes on different types of insurance risk, for instance the risk of hurricanes, earthquakes or flooding. Good returns can be expected during years when disaster incidence is low. In years when disasters are more prevalent, significant losses can arise. It is this risk that AP3 is paid to take on. Over time, the Fund expects to earn favourable risk-adjusted returns in this area.

Expertise and effective networks

AP3 has developed specialist competence in this area and built effective networks by connecting with

1.2

percent of
the portfolio

Return:

-3.6%

Contribution:

-0.0%

strategic partners, universities and research institutions. This strategy illustrates the Fund's long-term approach and ability to conduct effective internal management of complex assets.

The strategy looked attractive when first designed 10 years ago. In hindsight, it has more than matched expectations. Returns have been favourable even in peak disaster years like 2011 and 2017.

Analysing and tracking climate trends enables AP3 to make informed investment decisions. Climate change may be a rapid process geologically speaking, but from a financial perspective it is slow. AP3 invests in instruments with a maturity of three years, which means that their pricing adjusts much faster than climate change risk.

Rapid response

Many countries in South and Central America and other vulnerable parts of the world issue catastrophe bonds as a source of finance in the event of natural disasters. AP3 is a leading investor in this type of bond and also takes part in initiatives like the World Bank Sounding Board for Famine Risk. Investing in, and helping to develop, new and effective ways to shift risk from vulnerable states to the financial markets enables relief to be provided faster and more efficiently than is possible, for instance, during a famine.



Stewardship for transition toward sustainable value creation

AP3 acts sustainably on multiple fronts through active corporate stewardship. The Fund believes that well managed companies produce superior risk-adjusted returns over time. Companies with effective governance also handle responsibly the major climate and social challenges that society faces.

It is crucial that AP3 inspires public confidence and acts responsibly in managing Sweden's pension capital. AP3 is a committed owner that uses proactive stewardship to press for positive change in investee companies. Engagement, action and positive change are AP3's three guiding principles in this arena. The Fund believes that investors with a strong position in the capital markets are well placed to exert a positive influence and to place demands on investee companies.

Strategy choice reflects ownership

AP3 has a comparatively diversified portfolio that spans multiple asset types. Stewardship strategies are tailored to the size of each holding and address the areas where the Fund sees maximum scope for achieving influence and impact, namely in the Swedish market. In companies where AP3 owns all or a large share of the equity – notably the unlisted real estate companies Vasakronan, Hemsö, Trophi, Regio and Trenum – direct influence is through board membership. AP3 engages actively with Swedish listed investees via dialogue, AGM voting and participation in nomination processes. At international level, the Fund seeks maximum impact by working closely with the other AP funds via the Council on Ethics of the Swedish AP Funds and by partnering with other institutional investors.

Broad-based engagement

AP3 takes a clear line on core stewardship issues at Swedish and foreign investees. The Fund seeks to influence the structure of corporate remuneration systems, to raise levels of female representation on corporate boards, to promote effective capital structures, to press for healthy working conditions and to combat financial crime, corruption and money laundering. Climate strategy is a key focus area, and AP3 encourages investees to measure and disclose carbon footprint and to adapt their business activities to reduce climate impact.

AP3 has exercised governance more actively over time and today participates in many more global investor initiatives than in the past, engaging extensively with investee companies. The Fund has also increased its voting activity at company meetings.

In 2020 AP3 voted at almost 1,100 AGMs, 71 of which were of Swedish investees.

Covid-19 impact on corporate governance

The coronavirus pandemic forced most countries to implement measures of varying severity to combat the spread of the disease. The measures made it difficult for many companies to operate and in many cases drastically affected their ability to earn revenue. In some cases, the impact on businesses' financial health was negative, causing extensive staff furloughs or layoffs and a sharp rise in corporate insolvencies.

The difficulties and uncertainties created by the pandemic make it even more important for AP3 to act responsibly as a long-term and active owner. During the year AP3 engaged constantly with investees about their challenges and also participated in share issues when necessary.

Stewardship report

AP3 publishes an annual stewardship report that summarises its AGM engagements and actions. The reports is available for download at ap3.se.



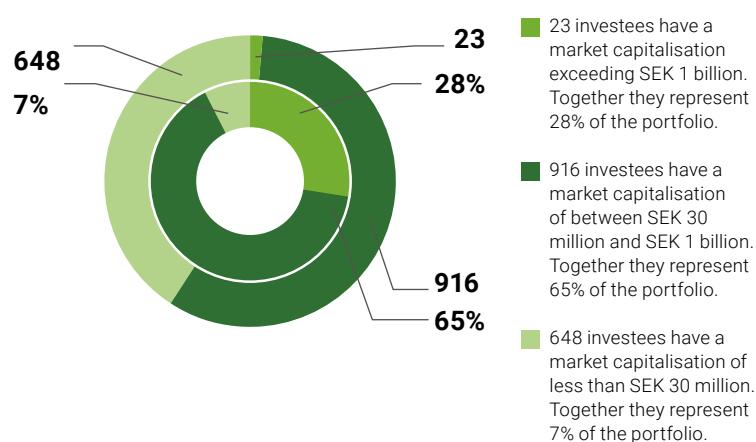
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Corporate governance strategies are tailored to the size of each holding and address the areas where the Fund sees maximum scope for achieving influence and impact.

Peter Lundkvist,
AP3 Head of Corporate Governance

Stewardship varies according to investment size

The size of AP3's equity holding in a company affects the Fund's level of influence. The larger the holding, the greater the opportunity to be seen and heard.



Council on Ethics wins award for mining safety standard work

The Council on Ethics of the Swedish AP Funds led the effort to develop a safety standard for the mining industry that in 2020 won the Stewardship Project of the Year Award from the United Nations-supported organisation PRI.¹ Anti-corruption and technology companies' human rights policies were other focus areas during the year.

The AP funds screen investee companies every six months with the help of an external consultant. The process seeks to identify any infringements of international conventions or other instances of non-compliance by portfolio investees. The Council on Ethics of the Swedish AP Funds' principles are based on the goal of making a difference through active engagement that leads to positive change.

The council identifies companies associated with treaty infractions and works to influence them to redress such non-compliance and to implement preventive systems and measures. Engagement is the council's primary tool for driving change. The council can make a difference by calling out non-compliance with international conventions and by demanding improvement. Only if it becomes apparent that these objectives cannot be accomplished within a certain period of time does AP3 consider divesting or excluding the company from the portfolio.

International investor collaboration on tailings dams safety

The collapse of the Vale dam in Brumadinho, Brazil in January 2019 had tragic consequences for human life, economic security and environmental protection. The incident prompted the Council on Ethics of the Swedish AP Funds, the Church of England Pensions Board and investors worldwide to work together to address safety concerns in the mining industry.



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In 2020 the Council on Ethics of the Swedish AP Funds took another big step towards responsible ownership by leading the effort to create a global standard for tailings dams.

John Howchin,
Swedish National Pension Funds' Council on Ethics
Secretary General

The investors, representing assets of more than SEK 10 trillion, demanded improved safeguarding of tailings dams and the creation of a global database (grida.no) that documented all tailings dams and was freely accessible to governments, investors and civil society. The investors wrote to 680 mining companies urging them to publish technical data on all tailings dams that they owned or part-owned. The project, led by the Council on Ethics of the Swedish AP Funds and the Church of England Pensions Board, resulted in January 2020 in a global safety standard and database for tailings dams. A comprehensive global standard for tailings dams was announced in June, winning the prestigious **Stewardship Project of the Year Award** from PRI.¹

Amazon deforestation and human rights at Big Tech

Dialogue continued in 2020 with JBS, Marfrig and Minerva in order to combat deforestation by ensuring that the three Brazilian companies do not process livestock originating from illegally cleared areas of the Amazon. The council also has an ongoing dialogue with JBS on work environment, including in regard to Covid-19 challenges.

During the year the council engaged with the large Tech companies on human rights and also initiated a project that included a report co-produced with the Danish Institute for Human Rights that set out investor expectations on large technology companies in this field.

Working against corruption

The Council on Ethics of the Swedish AP Funds engages with a large number of investees and often asks them how they tackle corruption. Corruption in its many forms is a risk for companies as it distorts competition and undermines asset values. It is essential that investees take active measures to reduce corruption risk in their business activities.

Corruption is pervasive in many countries and industries. Tackling it is a challenge for both business and society because corruption tends to exist in the shadows and is difficult to prevent and expose. The Council on Ethics of the Swedish AP Funds engages with companies and urges them to strengthen their anti-corruption policies. Methods include increased transparency, the creation of whistleblower channels and improved internal compliance monitoring. The council has previously hosted seminars on financial crime and money laundering and planned such events in 2020. These could not be held due to the pandemic.

AP3 will chair the Council on Ethics of the Swedish AP Funds in 2021.



Read more at
etikradet.se.

¹) Principles for PRI Responsible Investment. Read more about the six principles at unpri.org.

Following the TCFD transparency guidelines on climate reporting

AP3 supports the global framework of the Task Force on Climate-related Financial Disclosures and its recommendations on increased transparency in the reporting of climate-related risks and opportunities. The framework aims to make businesses more aware of their climate impacts as a route to mitigating them, and helps investors make more informed investment decisions.

The TCFD gives investors the information they need to assess climate-related risks and opportunities in investee companies. The framework is a tool to describe and communicate AP3's engagement with climate-related risks. AP3 encourages the Fund's investees and external managers to use it.

TCFD framework

The TCFD was launched in June 2017 and covers all types of organisations. The framework includes sector-specific guidance and advice for capital owners and asset managers. The main elements of the framework are:

- Governance of climate-related risks and opportunities.
- A strategy for how current and future potential climate-related risks and opportunities can be incorporated into business operations and financial planning.
- Risk management that covers the processes used to identify, assess and manage climate-related risks and opportunities.
- Metrics and targets that assess and manage relevant climate-related risks and opportunities.

AP3's climate-related disclosures

The Fund has a process for incorporating climate-related risks and opportunities in asset management operations and has applied the recommended guidelines the TCFD guidelines (see climate-related disclosures in this report). AP3 considers that its management is well positioned to evaluate and manage climate-related risks and that the Fund has an effective process for informing the board of directors about sustainability- and climate-related strategies. AP3 has evaluated its investment strategy using a scenario-based analysis of the climate transition. The analysis concluded that the climate-related risk in the Fund's portfolio is manageable but that more forceful measures will be necessary. Building on AP3's existing climate-based ambitions, the Fund has adopted three goals for 2019 to 2025. These goals will drive AP3's sustainability efforts and raise external stakeholder confidence in the Fund's activities in this arena.

AP3 has decided not to invest in certain companies with large exposure to fossil fuels. Generally, however, the Fund does not avoid responsibility for carbon emissions by divesting from companies that face climate-related challenges as this is not the most effective solution. AP3 prefers to use active governance to encourage investees to embrace positive change. The dialogue process with investees is ongoing and will in some cases intensify as part of the Climate Action 100+ initiative, in which AP3 is an active participant.



Climate is a key focus in AP3's asset management and the Fund is constantly working to manage the climate-related challenges that lie ahead.

AP3's carbon footprint for listed equities ¹	2020	2019	2018	2017	2016
Equity portfolio's absolute greenhouse gas emissions (million tonnes of CO ₂ e)	0.9	1.1	1.1	1.2	1.2
AP3 vs MSCI ACWI (%)	-57%	-49%	-48%	-45%	-47%
Change in portfolio's total carbon emissions from prior year (%)	-14.0%	1%			
Change due to changes in portfolio holdings (% points)	-10.0%	2%			
Change due to changes in investee emissions (% points)	-4%	-1%			
Relative carbon emissions (tonnes CO ₂ e/SEK million)	5.8	7.4	9.7	9.4	10.2
Carbon intensity (tonnes CO ₂ e/SEK million)	10.6	13.6	15.1	15.7	15.9
Portfolio weighted carbon intensity (TCFD) (tonnes CO ₂ e/SEK million)	7.1	9.3	13.2	14.8	-
Change in portfolio's carbon intensity (TCFD) from prior year (%)	-24%	-30%			
Change due to changes in portfolio holdings (% points)	-13.0%	-19%			
Change due to changes in investee emissions (% points)	-11.0%	-11%			
Market value of AP3 directly owned equity portfolio covered by data (SEK bn)	159.4	144.6	108.9	126.1	120.5
Percentage of assets under management for which data exists (%)	84%	82%	78%	83%	78%

1) Total carbon emissions. Total of equity share of each investee plus relative share of carbon emissions.

2) Relative carbon emissions. Total of equity share of each investee plus relative share of carbon emissions.

3) Carbon intensity. Total of equity share of each investee as a ratio of investee's total revenue.

4) Portfolio weighted carbon intensity (TCFD). Total of investees' carbon intensity (emissions relative to revenue) weighted by each investee's share of portfolio.

Sources: Trucost S&P Global and AP3

Contributing to the UN sustainability goals

The 17 United Nations Global Goals for Sustainable Development (SDGs) guide global collaboration between governments, civil society and the business sector. The goals, which are intended to be achieved by 2030, seek to abolish poverty, limit climate change and create an equal and sustainable world.

AP3 supports the goals and together with a group of Europe's largest pension funds has signed a statement stressing the need for institutional investors to allocate their capital to companies and

solutions that actively contribute to achieving the SDGs. It is challenging to measure the impact of the Fund's portfolio investments on achieving the SDGs. However, the Fund is doing extensive work in this area using the Global Reporting Initiative (GRI) and the Principles for Responsible Investment (PRI).

AP3 contributes to the SDGs through active stewardship and by making investments that help to drive the shift to a sustainable economy. Some examples of the Fund's governance engagement and investments that we believe have a positive impact on selected SDGs:



Goal 5: Gender equality

An equal society without discrimination is a prerequisite for AP3. That is why the Fund works to ensure a more even gender balance on corporate boards.



Goal 6: Clean water and sanitation

AP3 has invested in water infrastructure, particularly in water supply and water treatment, and is working with other investors to create further investment opportunities in the water sector.



Goal 7: Affordable and clean energy

Solar power is becoming an increasingly significant energy source for real estate companies. Take-up of this technology is increasing as it develops and becomes more efficient. Vasakronan, owned by the AP funds, is one company championing this trend. AP3 also invests in private equity funds and listed companies specialising in sustainability and renewable energy. In 2020 Polhem Infra invested in one of Sweden's largest wind power projects. The 35 turbines at the Skaftåsen plant in the province of Härjedalen will generate around 535 GWh of electricity – equal to the consumption of 100,000 homes – when commissioned in 2021.



Goal 8: Decent work and economic growth

Labour practices and health and safety are important issues that AP3 prioritises. The Fund engages with investees to combat unsafe working conditions, workplace accidents, discrimination and child labour. The Council on Ethics of the Swedish AP Funds operates a project with the Danish Institute for Human Rights to influence large technology companies. In 2020 this initiative focused on engagement with Facebook and Twitter on personal data security.



Goal 9: Industry, innovation and infrastructure

Modern and effective infrastructure promotes economic growth and development. AP3's investments and corporate governance help to make resource use more efficient, to raise production capacity, and to stimulate innovations and solutions that contribute to the shift to a sustainable economy and sustainable value creation. In 2020 Polhem Infra acquired Telia Carrier, a provider of digital network services and infrastructure. AP3 is a shareholder of SSAB, whose Hybrit project exemplifies how carbon-intensive industries can become sustainable.



Goal 11: Sustainable cities and communities

AP3's large investment holdings and active stewardship make the Fund a strong advocate of sustainable practices. Real estate investee Vasakronan is a leader in energy-saving and efficient offices and a role model for the Fund's other property companies. During the year Hemslö launched a construction project that will integrate resource efficiency and social sustainability aspects. The Fund's other real estate investees – Trophi, Regio and Trenum – are committed to resource efficiency and social responsibility.



Goal 12: Responsible consumption and production

AP3 owns 150,000 hectares of timberland, 90% of which is environmentally certified. The timber is used primarily for building material, furniture and to manufacture paper products.



Goal 13: Climate action

The AP3 portfolio helps to combat climate change through substantial investments in timberland and green bonds. Evaluating an investee's climate impact is closely integrated into the investment process. AP3 is committed to halving its carbon footprint between 2019 and 2025. The primary means involve engaging with investee companies to encourage them to reduce their climate impact and reviewing the portfolio's composition and exposure to fossil fuels.



Goal 15: Life on land

Sustainable forests are good for the climate. AP3 owns 150,000 hectares of production forest that is sustainably managed and has set aside 18,900 hectares for nature conservation.



Goal 16: Peace, justice and strong institutions

Tackling financial crime, anti-corruption and money laundering is a key pillar of the Fund's corporate governance. The aim is to prevent financial damage to investee companies and investors and to minimise the risk of loss of public confidence in the financial markets.



Goal 17: Partnerships for the goals

Collaboration and partnerships are important for a pension fund like AP3. The Fund is involved in climate-related initiatives including the Climate Action 100+, the Task Force on Climate-related Financial Disclosures (TCFD), the Transition Pathway Initiative (TPI), the Institutional Investor Group on Climate Change (IIGCC) and constructive collaborations with pension funds and investors in Sweden and abroad.

Stakeholder engagement with proactive communication

Dialogue with stakeholders helps to guide the Fund's sustainability commitments. In 2020 AP1, AP2, AP3 and AP4 and the Council on Ethics of the Swedish AP Funds asked stakeholders for feedback on the funds and their operations in relation to sustainability and return.

Feedback was solicited in a questionnaire sent to around 200 people in the funds' eight most important stakeholder groups. The stakeholders were the AP funds' principals (that is, the Parliamentary Pensions Group, the Finance and Social Insurance Committee and the Financial Markets Department), investee companies, suppliers, sector colleagues, beneficiaries, civil society, stakeholder organisations and employees. Knowledge of the AP funds and interest in their mandates, rules and profiles varies between the stakeholder groups, though the feedback showed relatively good knowledge overall of the funds' activities and a high level of trust in the funds' ability to accomplish their mission of responsible investment management that generates long-term returns. A majority also expressed a high degree of confidence in the funds' efforts to integrate sustainability into their investment models.

The feedback revealed room for the AP funds to improve in managing and communicating the sustainability-related risks that arise in their investments. In this context, the stakeholders emphasised the importance of the funds working proactively in support of the transition to climate-based sustainability in partnership with other players.

Key focus areas in sustainability

The questionnaire asked respondents to rank 12 selected areas of sustainability in the order of precedence that the AP funds should address them in their investment management and engagements with investee companies. Five priority areas were identified. In order of importance, these were:

- Business ethics
- Anti-corruption
- Long-term return
- Human rights
- Climate impacts

These were followed by:

- Environmental impact
- Corporate transparency
- Working conditions
- Sustainable supply chains
- Biodiversity
- Diversity and equal opportunity
- Data security

Various stakeholders stressed that all 12 areas were important and that the AP funds should take a comprehensive approach in this area, prioritising sustainability engagement on the basis of company type, sector and location.

Communication and follow-up

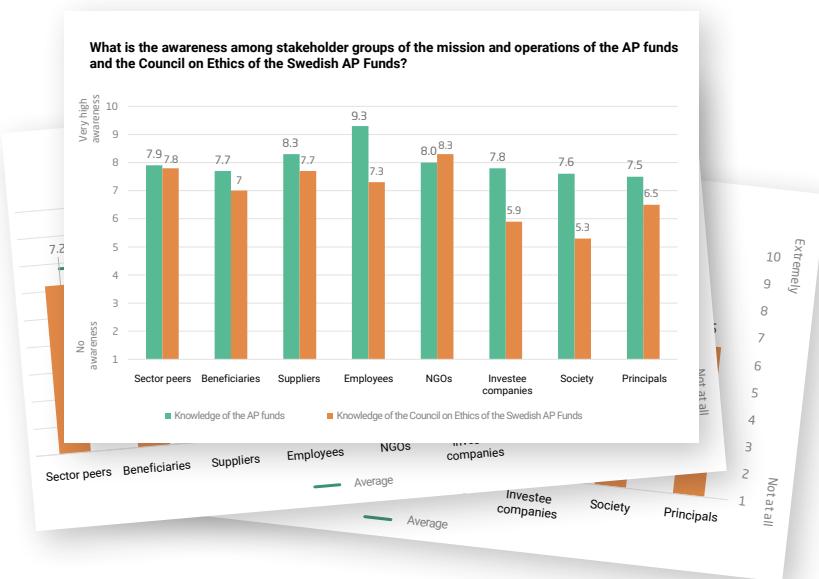
The stakeholders proposed that the AP funds could improve their communication through greater transparency and higher visibility in the public debate. They were especially keen to see more clarity around direct engagement with investees and the results of these conversations. Take-up of available information by the stakeholders was relatively low, creating an opportunity to tailor communications more precisely to the different target groups in the future. The stakeholders also expressed the view that regular dialogue was important to the process of driving changes that create value.

The AP funds intend to follow up on the feedback and to engage more deeply with certain stakeholder groups to gain a closer understanding of their views in key areas. This process continue in 2021.

"Strong communication with high transparency is an important factor. We must also keep in mind that when we engage with companies, we must guide them in a positive direction in trusting circumstances" says Lil Larås Lindgren, AP3 Head of Communications.

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Transparency is important. At the same time, we have to consider that discussions with investees to drive positive change are conducted in trusting circumstances.



AP funds strengthen their digital cooperation

AP funds' collaboration grows further

In 2016 the AP funds formed a Collaboration council charged with helping AP1, AP2, AP3 and AP4 to work together more closely in all areas outside investment management. In 2018 AP7 joined the Collaboration council.

The National Pension Insurance Funds Act requires the AP funds to manage their assets so as to generate maximum benefit for the income pension system. The structure of four funds that share the same mandate but pursue different asset management strategies diversifies risk for the income pension system. In a review of the legislative framework, the government encouraged the AP funds to collaborate when appropriate, for instance to reduce costs or achieve value in other areas. Greater cohesion offers a way to increase cost efficiency without compromising the funds' independence or eroding the differences between their respective investment models.

How do the AP funds collaborate?

In 2019 the AP funds decided to take a further step to increase the efficiency and to share knowledge on a broader level by introducing a more structured a more structured way to collaborate. Every year each collaboration group set up their work plan for the coming year. The collaboration groups report every six months to the Collaboration council, which produces a newsletter addressed to all the funds' employees. At year-end the council reports to all the funds' CEOs. This report forms the core of the funds' input to the government's annual review process.

What were the highlights in 2020?

The collaboration groups collaborated digitally in 2020, using online platforms to meet and share information. Notwithstanding each fund's strong focus on its own internal needs during the pandemic, the groups remained active and were able to share valuable input and learnings in areas such as how to balance office-based activity with working from home.

The funds studied the best options for increasing transparency on profit sharing in private equity holdings and concluded that the optimal path is to join existing initiatives operated by other global investors. This maximises the scope for guiding the industry towards enhanced transparency and for developing a shared reporting standard. During the year AP3 and a second AP fund joined the ADS Initiative, a group that works in this area.

Other areas in which the funds worked closely together during the year were procurement, innovation, new technology and data security. The funds



launched a stakeholder engagement initiative during the autumn and communicated jointly on multiple occasions. The AP funds' employees are also in constant touch to discuss issues relevant to their sectors and areas of expertise.

Due to the pandemic, the Collaborative Board decided against holding the AP Funds' Collaboration Day as planned during the autumn. This in-person event is aimed at sharing information and creating contact networks across the AP funds.



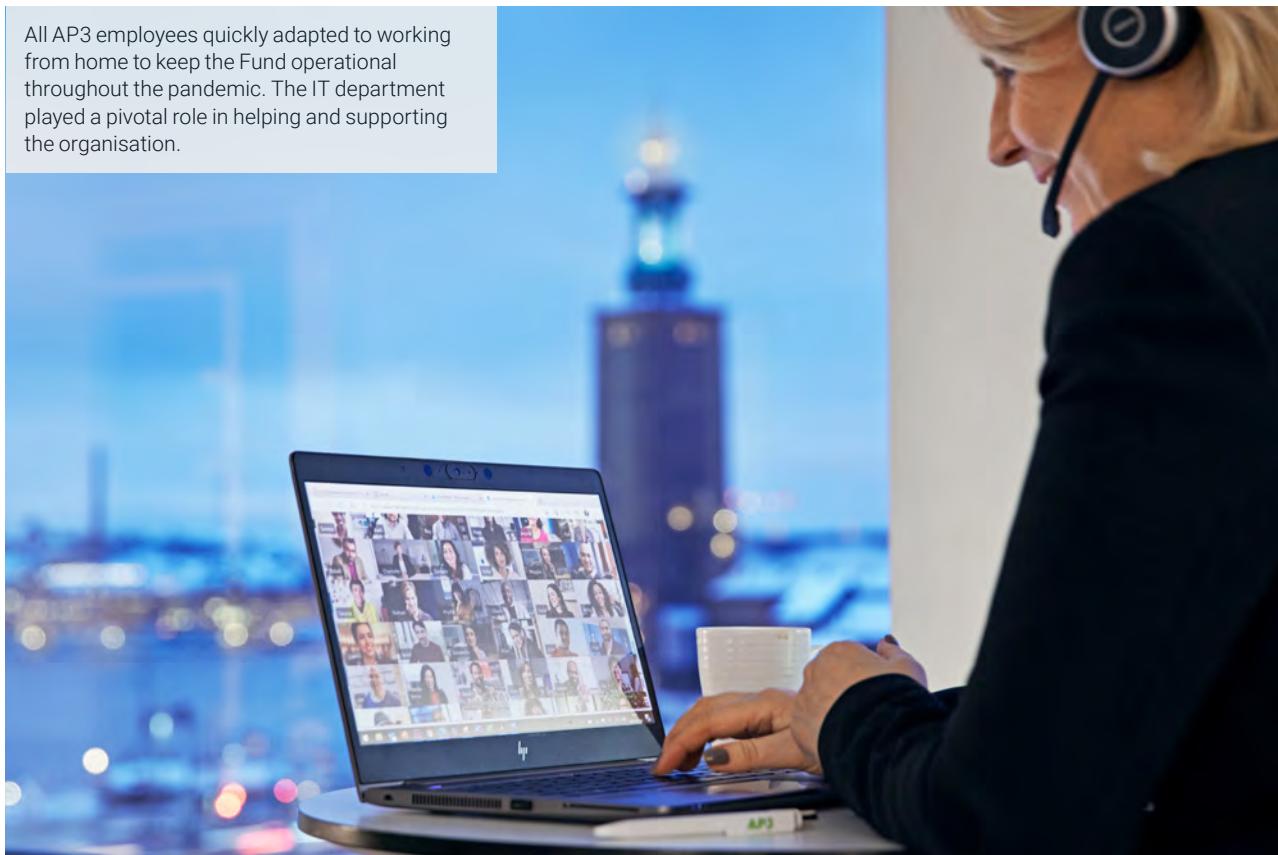
Collaborative sub-groups

Back Office, HR & Personnel, Legal affairs and compliance, Communications, Accounts, Risk and Performance, IT, Systems Management

Other collaboration

Since 2007, AP1, AP2, AP3 and AP4 have worked closely together through the Council on Ethics of the Swedish AP Funds. The funds also collaborate with AP6 and AP7 in a carbon footprint measurement project. The AP Funds' Innovation Forum was established in 2019 to promote collaboration in new technology. Its members are AP1, AP2, AP3, AP4 and AP7.

All AP3 employees quickly adapted to working from home to keep the Fund operational throughout the pandemic. The IT department played a pivotal role in helping and supporting the organisation.



Every employee makes a difference

Managing the pensions of Sweden's current and future pensioners is a prestigious and important mission. For AP3, it means acting sustainably, professionally and responsibly at all times. AP3 is a knowledge-centric organisation in which all employees play a vital role and whose collective expertise and experience were vital in 2020 for delivering strong results in challenging circumstances.

Work on streamlining the organisation and reducing complexity, particularly in asset management, continued during the year. The Fund implemented a new organisational structure, a new portfolio structure and a new format for leading and supervising the organisation. These changes, which had a major impact on all parts of the organisation, reduced internal complexity.

The restructuring of the asset management department and the implementation of the new structure and approach gave many employees an opportunity for competence development. Many took on new or expanded roles. We also succeeded in filling key positions with new colleagues whose knowledge and expertise will further strengthen the Fund. Strong external interest in the vacancies showed that AP3 continues to be seen as an attractive employer.



The pandemic and the restrictions it imposed were a major factor throughout the year. Many aspects of working life were different, and digital readiness took a big step forward. In a short space of time we transitioned to working from home and learned to master new technological solutions, tools and programs.

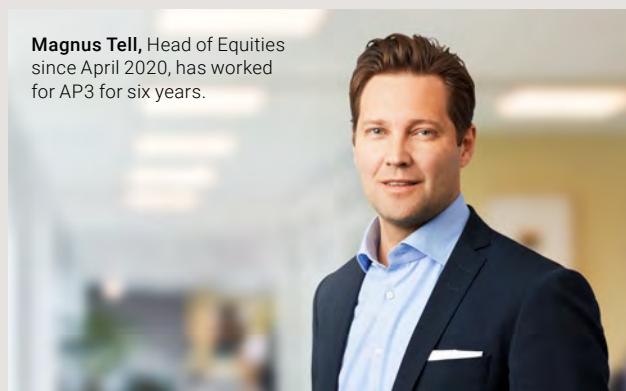
The pandemic and the restrictions it imposed were a major factor throughout the year. Many aspects of working life were different, and the Fund's digital readiness took a big step forward. In a short space of time we transitioned to working from home and learned to master new technological solutions, tools and programs. All employees showed great flexibility in handling the changes and quickly adapted to the digital transformation.

AP3 continues to have a strong focus on personal development and encourages employees to show initiative and to work across established boundaries. Diversity and equality create added value within the organisation and are central to AP3's ability to reach its goals. In 2020 the bi-annual staff survey attracted a 97% response rate, which was a solid result and somewhat better than the previous survey in 2018. Feedback from the survey was processed during the autumn and enabled the Fund to identify key areas in which we must maintain excellence and others where we need to do more to develop the organisational culture.

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Managing pension assets as a group of experienced professionals combined with our new colleagues went really well and we quickly found our feet as a team.

The year was very exciting and stimulating for me as the new Head of Equities. Obviously, leading the equities department and having responsibility for setting targets and structuring the team was a challenging task in the middle of a pandemic. Managing pension assets as a combined group of experienced professionals and new colleagues went really well and we quickly found our feet as a team. It's often not easy to jump straight into a new role, especially in a year like 2020, but I think the fact we'd worked together for quite a while made things much easier. Thanks to everyone's help and professionalism we came through well and that was very inspiring for me as the person in charge.



Magnus Tell, Head of Equities since April 2020, has worked for AP3 for six years.

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For me, the crisis also showed that AP3 has a highly skilled and well-organised asset management organisation where everyone makes a clear contribution and plays their part in the investment process and generating return.

I really appreciate being able to develop my skills in different areas despite being a relatively small organisation. That's a real strong point for AP3 and something that really helped me during the year because I transferred from external equity management to fixed income and currency management.

In my new role I'm able to draw on my previous experience from working for the Riksbank and other employers to develop my knowledge and join my colleagues in contributing to the Fund's asset management.

The year was a very interesting one for the fixed income market given the global scale of central bank interventions when the pandemic hit. For me, the crisis also showed that AP3 has a highly skilled and well organised asset management organisation where everyone makes a clear contribution and plays their part in the investment process and generating return.



Veronica Wahlberg, Fixed Income Manager, has worked at AP3 for five years.



Elena Westerdahl, Senior Quantitative Analyst and Systematic Quantitative Strategy Manager, joined AP3 in 2018.

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AP3's organisational culture is about being future-oriented and constantly streamlining and modernising our processes.

I'm very impressed and pleasantly surprised by the dynamic environment at the Fund and the learning culture. AP3 is a warm organisation where you feel welcome. The culture is future-oriented and looks constantly to improve our processes. All employees have a lot of freedom. You get to try new things, which in my case meant learning how to use machine learning and other mathematical models in my work.

When I joined the Fund at the end of 2018 my job was to support the strategic allocation process and conduct an ALM analysis. It's very inspiring being part of securing a stable pension system for future pensioners. My work involves building mathematical models that can analyse, simulate or optimise different investment phenomena and understanding the portfolio risks in our different asset classes. In 2020 I was given an investment management role with my own mandate, which is very stimulating.



Patric Pålsson, Head of Risk Analysis and Modelling, part of the Risk Control Team. He joined AP3 in 2016.

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What drives me is the Fund's long-term mission and the importance to society of what we do, plus the fact we have a lot of individual responsibility and freedom.

My job is to monitor investment decisions and risk using best practice methods and systems. More specifically, it's about having control over the risks that our assets are exposed to and how different investment decisions contribute to return.

We produce documentation and findings for presentation to the organisation and the board and, ultimately, for publication in the Fund's financial reports.

Coming into contact with all levels of the organisation – from the board to individual equity managers – is interesting and varied.

What drives me is the Fund's long-term mission and the importance to society of what we do, plus the fact we have a lot of individual responsibility and freedom. It's exciting to be part of a small organisation with a hugely important role. There's always a chance to take on more responsibility if you want. AP3 is a very mature organisation compared to my previous employers. Everyone helps everyone else out, which creates a positive atmosphere at all levels.

How AP3's investment model is measured

Evaluations apply four metrics that are based on the Fund's financial and sustainability goals.

1 Return against target

AP3 evaluates investment performance against the portfolio's long-term target for real return, both since inception and against rolling 10-year targets. Up until 2020 the long-term target was 4%. As of 2020, it is 3.5%. Average real return since inception stands at 5.0% per annum. In the last 10 years, this figure has been considerably higher, reaching 7.7% per annum.

2 Return compared to long-term static portfolio (LSP)

Investment returns are benchmarked against a long-term static portfolio (LSP) that represents the cheapest available asset management alternative. The LSP has a 55:45 mix of listed equities and bonds, is rebalanced monthly and has no transaction costs. The LSP represents a portfolio with a level of long-term risk on a par with that of the Fund. Potential return on this level of risk varies over time but in the long run there should be a reasonable chance of reaching the target set by the board. Benchmarking performance against the LSP evaluates the efficacy of AP3's chosen approach to invest in a more advanced asset management model and put greater reliance on active management. In 2020 the AP3 portfolio generated a return of 9.7% after expenses, compared to 6.8% for the LSP. In monetary terms, this represents a difference of SEK 11.5 billion. Since the introduction of the LSP in 2012, AP3's investment management has outperformed the LSP by 44 percentage points, which represents a gain of SEK 77.4 billion for the pension system.

3 Key figures benchmarked against peer group

AP3 aims to meet a high international standard in asset management and benchmarks its costs and expenses against global peers. Consultancy firm CEM Benchmarking compares AP3's cost base with that of other funds which share a similar profile in terms of assets under management, target returns and overall mission.

From 2015 to 2019, AP3's expenses were 29% lower than the benchmark group average. In that period, AP3 recorded an annual return of 8.5%, compared to 7.5% for the benchmark group.

4 Evaluation of sustainability goals

In 2019 AP3 introduced new climate-related sustainability goals that reflect the Fund's belief that setting measurable targets drives positive change. The goals address the areas in which AP3 is best placed to exert an impact without compromising its mission to maximise investment returns. They involve mitigating the risk of global warming by halving the portfolio's carbon footprint, by conducting scenario-based analysis of climate-related risks, by doubling holdings of green bonds and strategic sustainable investments and by driving the development of green real estate. The goals are intended to be reached by 2025. Read more about AP3's sustainability goals on page 17.

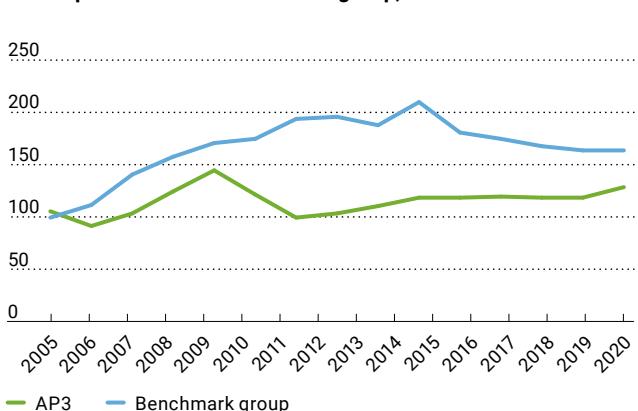


AP3 performance versus LSP, indexed 2012-2020

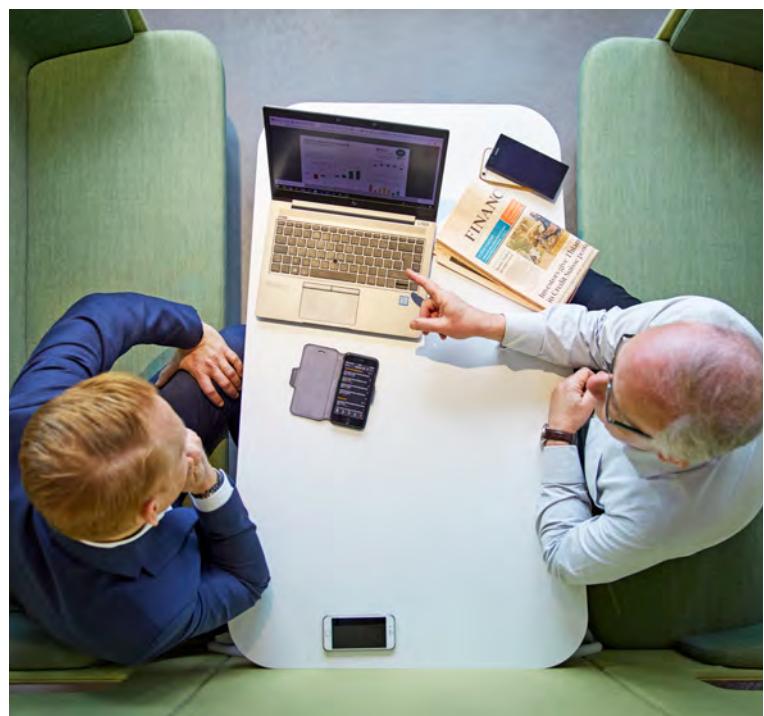


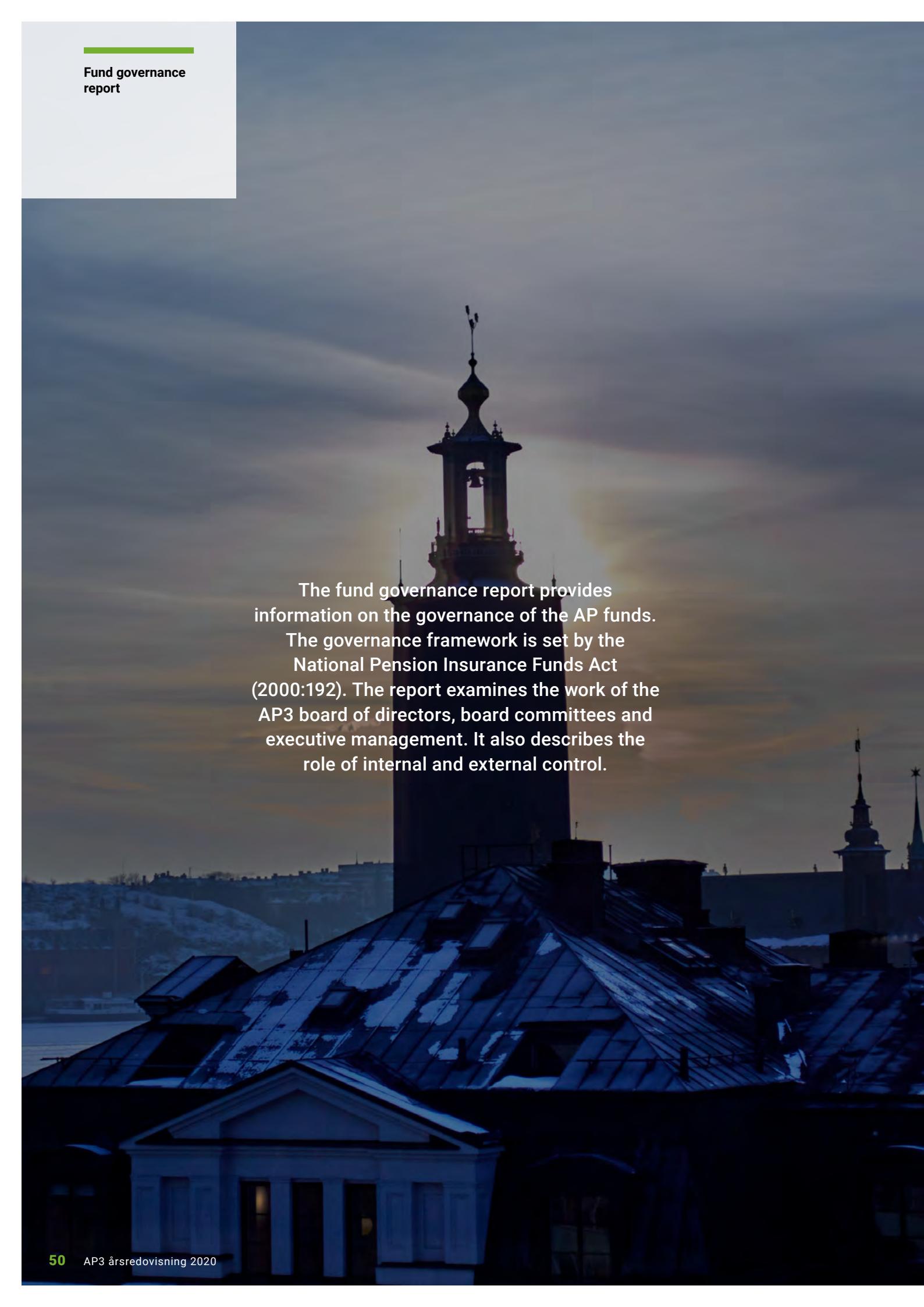
Since the launch of the benchmarking process in 2012, AP3's investment returns have outperformed the LSP by 44 percentage points,

AP3 expenses versus benchmark group, indexed 2005-2020



The 2020 survey by Canadian consultancy CEM Benchmarking showed that AP3's expenses were on average 29% lower than those of international peers with a similar profile in the prior five years. The Fund has participated in CEM's annual international survey since 2005. The survey benchmarks AP3 against other international pension funds with similar profiles.





The fund governance report provides information on the governance of the AP funds.

The governance framework is set by the National Pension Insurance Funds Act (2000:192). The report examines the work of the AP3 board of directors, board committees and executive management. It also describes the role of internal and external control.

Governance, board, executive management and control functions

This fund governance report was prepared in conformity with the Annual Accounts Act and relevant parts of the Swedish Code of Corporate Governance. It includes information about the Fund's governance, the work and remuneration of the board of directors, and a summary of board activities during the year.

Government body governed by National Pension Insurance Funds Act

Along with the other AP funds, AP3 is a state-owned pension fund whose operating activities are prescribed by the National Pension Insurance Funds Act (2000:192). The government has waived its regulatory oversight over the funds, which thereby differ from other government bodies in that each fund's board of directors appoints the CEO and each fund's operations are audited by an external auditor.

Board of directors

The AP3 board has nine members, all appointed by the government. Two directors are nominated by employee organisations and two directors by employer organisations. The government chooses the chairman and deputy chairman from its own appointees. The Policy for Governance and Evaluation



The National Pension Insurance Funds Act (2000:192) is also known as the AP Funds' Act

of the AP Funds stipulates that no director may hold board membership for more than eight years.

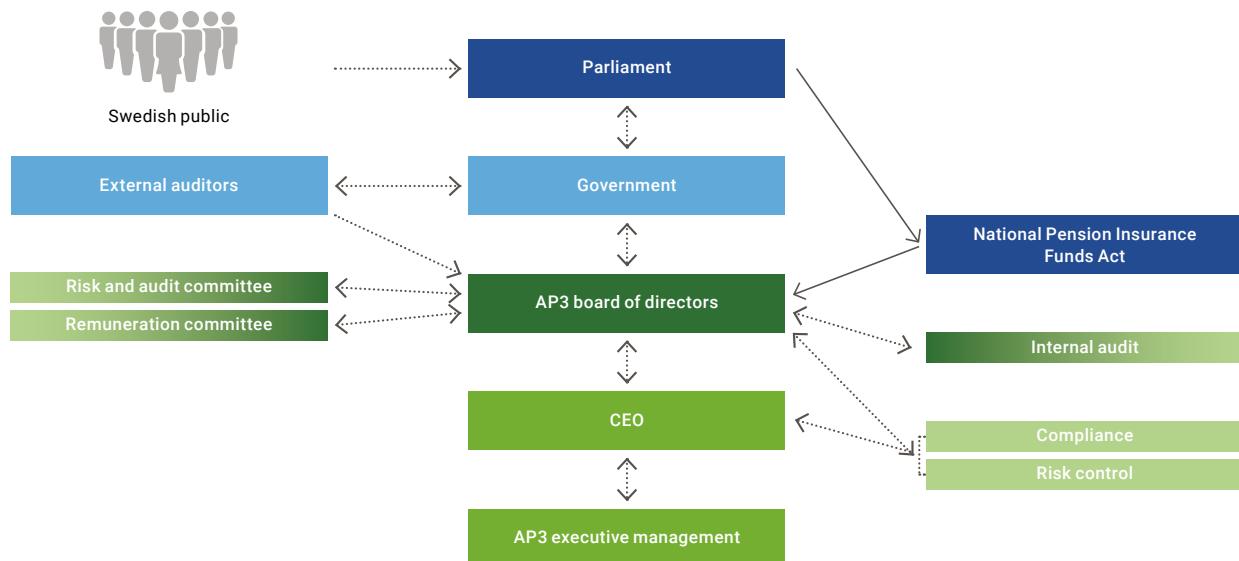
Board administration

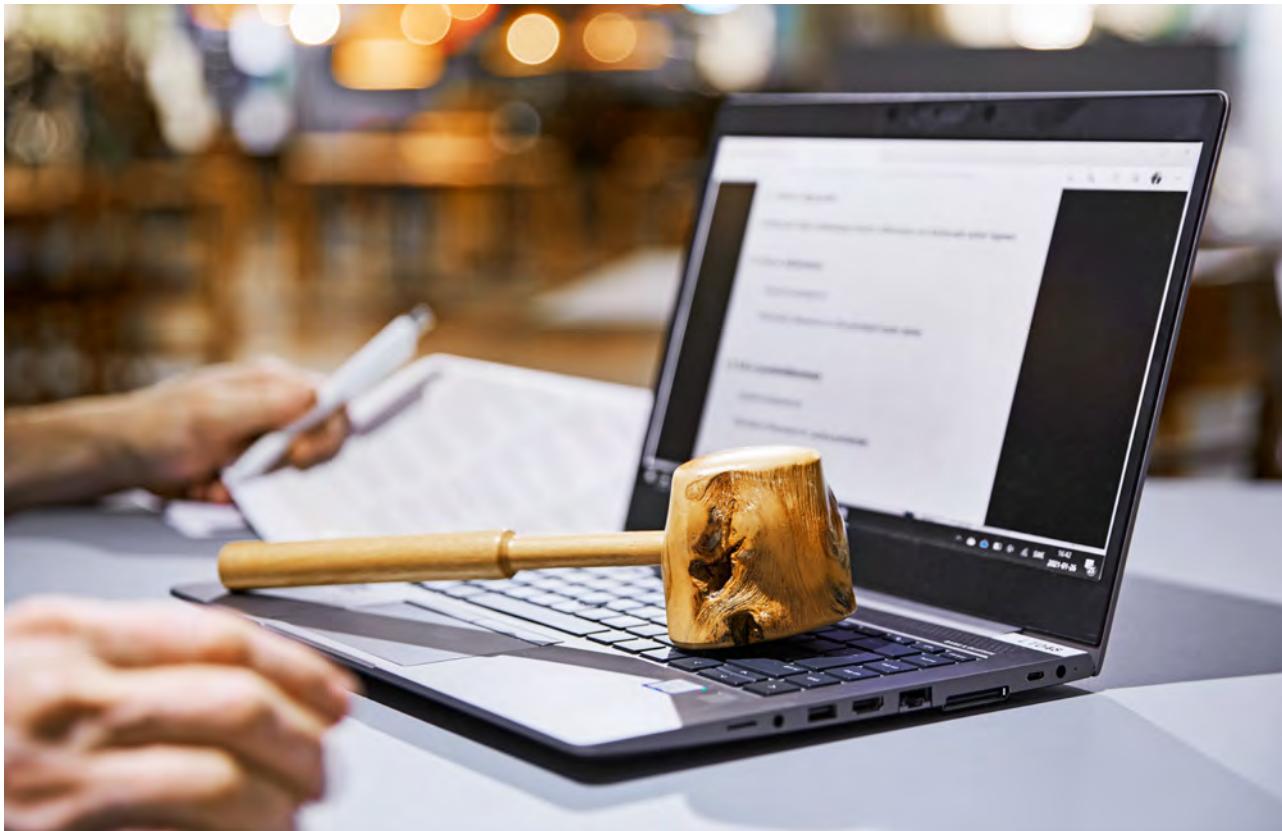
The National Pension Insurance Funds Act gives the board of directors full and collective responsibility for AP3's operations and administration, within the parameters set by Parliament. Board responsibilities and activities not prescribed by statute are set out in the board's work plan, which is approved annually by the directors.

The act also requires the board to approve an annual operating plan, which must contain guidelines for investing activities and for exercising AP3's voting rights in investee entities. It must also contain a risk management plan. Beyond this, the board's primary tasks are to set operating targets, to recruit and monitor the performance of the CEO, to manage strategic documents, to make decisions on overall Fund strategy – including risk appetite, exposure and risk limits, budget approval and monitoring – and to monitor results of operations.

At every board meeting the directors discuss current asset allocations and any potential changes to the portfolio. Execution of these limits is delegated to the CEO. Effective control and monitoring are necessary to ensure that board decisions are

How AP3 is governed





implemented, that risk management is effectual and that the Fund operates in an appropriate manner.

The risk policy (formerly the risk management plan) sets the structure for internal control and risk monitoring. The board is tasked with approving the Stewardship policy and managing other governance issues such as the Fund's focus areas for each AGM season. When it comes to stewardship, the board does not normally decide the Fund's actions in individual cases. Such matters are delegated to the CEO. However, any decision to exclude a company from the Fund's investment universe will be taken at board level. The CEO and other AP3 employees also attend board meetings as experts or in a reporting capacity.

Review of the board of directors

The board conducts an annual review of its own performance. The 2020 review was carried out using an external online evaluation tool and through internal discussions among directors.

Remuneration of directors

The government sets the fees and other remuneration payable to directors. In 2019 the government approved an increase in directors' remuneration, effective from 2020. Board fees are SEK 200,000 per year for the Chairman, SEK 150,000 for the Deputy Chairman and SEK 100,000 for other directors. The government has an annual fund of SEK 100,000 to remunerate directors for committee work and other assignments. In 2020 the board used this fund to pay fees of SEK 26,520 to the chair of the risk and audit committee and SEK 21,220 to other audit committee members, and fees of SEK 10,300 to each remuneration committee member (including the chair).

Board committees

The board has two committees – the risk and audit committee and the remuneration committee.

1 The risk and audit committee has a financial reporting advisory and oversight role on behalf of the board. It supervises financial reporting and monitors risk and the audit process. The Fund's auditors attend the audit committee meetings at which the final audit, the administration audit and the audit plan are discussed.

The committee also oversees the effectiveness of internal control and risk management, prepare for board decisions on risk management and risk tolerance, monitors financial reporting, receives reports on financial control and follows up the Fund's annual analysis of operational and enterprise risks. It also prepares the internal audit plan for board approval and receives reports from the internal auditors on their work. The committee reports to the board when necessary, ensures any observations or deficiencies are addressed and scrutinises the impartiality and independence of the auditors.

The committee members in 2020 were Malin Björkmo (chair), Johan Bygge and Peter Englund.

2 The remuneration committee is tasked with ensuring that salaries and other remuneration are market-based, competitive, appropriate and reasonable. It also oversees and monitors the implementation of government guidelines for senior managers. The remuneration committee reviews the CEO's salary and benefits and prepares the remuneration framework for other employees on behalf of the board and evaluates the Fund's performance-based remuneration system. In 2020 the committee members were Christina Lindenius (chair), Torbjörn Hållö and Ylva Hedén Westerdahl, who in June replaced Elisabeth Unell when she left the committee and AP3 board after eight years.

Board administration in 2020

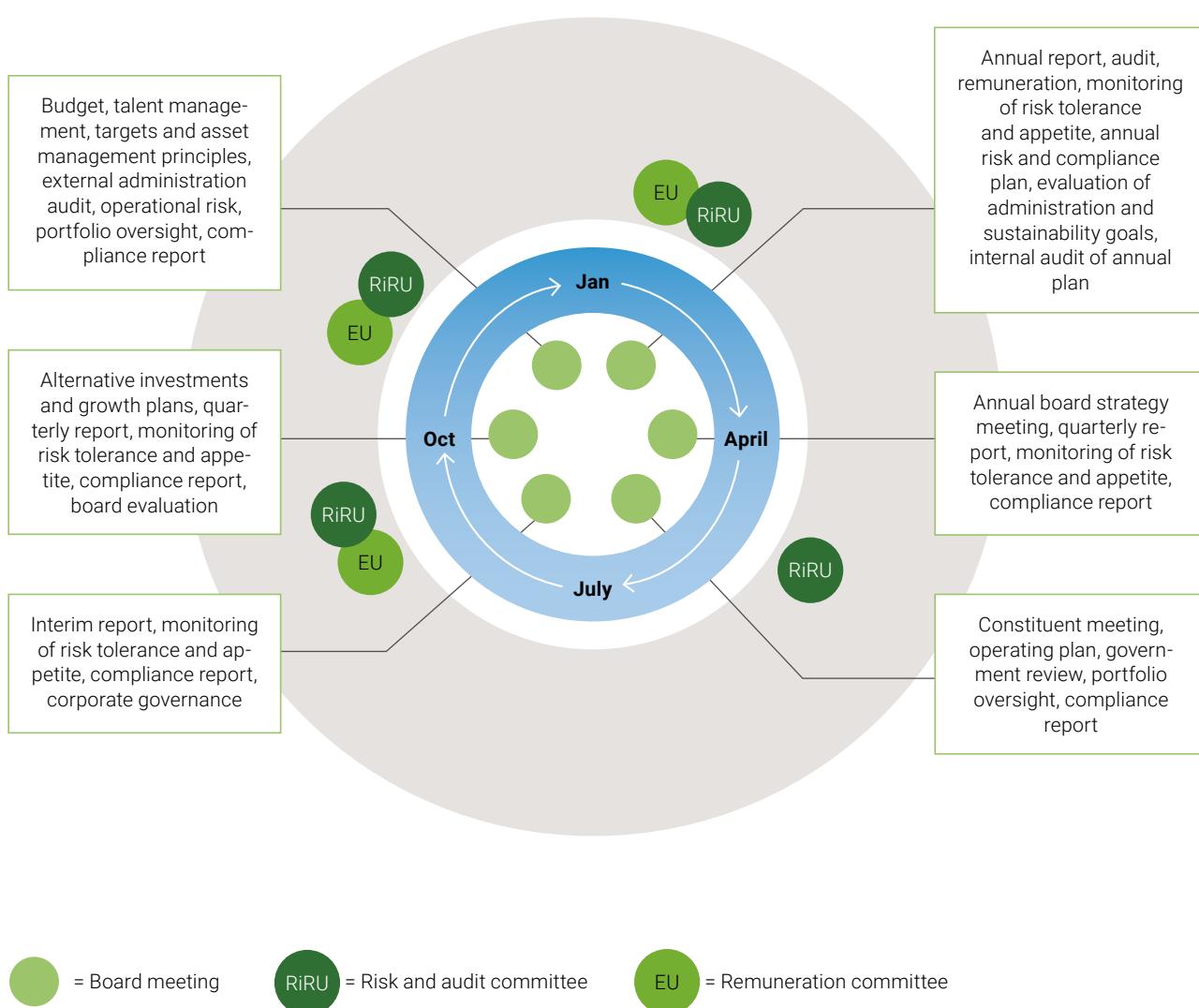
The board's calendar is governed by the 31 May date for the government's appointment of directors and the Fund's financial year, which runs from 1 January to 31 December. The annual accounts must be submitted to the government by the end of February to ensure sufficient time to review them and evaluate the AP funds' performance by 1 June.

Hence, the board holds its foundation meeting in June and meets to approve the annual accounts in February. Six meetings are scheduled annually, and this was the case in 2020. On one occasion the board made decisions by correspondence. One of the meetings is a longer strategy session that addresses key strategic issues and themes. The pandemic made it impossible to conduct board meetings

in-person in the normal way. Attendance was primarily via digital video link, a setup that worked well.

At every board meeting, the directors receive a presentation on portfolio performance and risk utilisation that includes data on individual asset classes and return relative to the benchmark long-term static portfolio (LSP). The presentation includes executive management's outlook on market trends and investment strategy. The board also examines reports from the Chairman, board committees, the CEO and control teams. Quarterly reports and budget performance are presented at the first board meeting after the end of each quarter. These meetings also receive a report on risk and risk tolerance.

Organisational issues and talent management are discussed annually. Prior to the AGM season the board discusses relevant topics and receives



information on corporate governance as part of the annual stewardship report, which is approved at the August meeting. Sustainability-related issues are discussed on a continuing basis.

Impact of pandemic on board administration

Starting in March 2020, the Covid-19 pandemic affected all parts of society and resulted in major workplace changes for many people. AP3 commenced a transition to Microsoft Office 365 in the early part of the year, which enabled the Fund to launch an effective and secure videoconferencing service. This was also used for board meetings. With the exception of the first board meeting of the year at the end of February, all board meetings were attended both in-person and remotely.

In mid-March the economic measures taken to confront the pandemic sparked market turmoil and raised the Fund's level of risk. The CEO then began reporting to the board via weekly newsletters. The planned strategy meeting was changed to a standard board meeting to discuss the various issues raised by the market crisis. A combined foundation and strategy meeting was held in June. The strategy session discussed the financial status of the pension system and likely outcomes in the context of the Swedish Pensions Agency's forecasts. The board monitors the agency's forecasts on a continuing basis.

The strategy session also discussed the market turmoil and the Fund's handling of it, reaching various conclusions and insights. Other topics included

global trends such as digitalisation and new consumer behaviour. In addition to foundational issues, the meeting also discussed the government's review of the AP funds, which was presented to directors by Charlotta Brisell of the Ministry of Finance. The board also considered the Fund's strategies for cyber risk and data security.

Project launches in 2020

Despite the pandemic, the board launched several key projects during the year. The reorganisation of the asset management department took effect on 1 May after a short postponement during the height of the market turmoil amid by the pandemic. The reorganisation followed the strategic restructuring of the portfolio structure and investment model approved by the board in 2019. During the autumn the Fund commenced a review of its sustainability strategy with the aim of further integrating sustainability-related issues in the asset management process. A new sustainability policy will be drawn up during 2021.

The annual analysis of alternative investments was the focal point of the board's second autumn meeting. The board reviewed the alternative investment portfolio and discussed the geographical strategies of the portfolio's real estate, private equity, infrastructure and timberland holdings. The Board also supported the strategic project to review the Fund's system and data infrastructure. A project to review the processes around information security was initiated in the end of the year.

Board meetings in 2020

	Board meeting attendance (no. held)	Remuneration committee	Risk and audit committee
Christina Lindenius	6 of 6	Chair (3 of 3)	
Peter Englund	6 of 6		Member (4 of 4)
Malin Björkmo	6 of 6		Chair (4 of 4)
Johan Bygge	6 of 6		Member (4 of 4)
Magnus Emfel	6 of 6		
Hillevi Engström	5 of 6		
Ylva Hedén Westerdahl	6 of 6	Member from 1 June (2 of 2)	
Torbjörn Hållö	6 of 6	Member (3 of 3)	
Elisabeth Unell (left AP3 on 31 May)	2 of 2		Member until 31 May (1 of 1)
Carina Wutzler (joined AP3 on 1 June)	4 of 4		



Internal and external control

Under the National Pension Insurance Funds Act, the board of directors is responsible for AP3's administration, organisation and activities. These responsibilities include maintaining effective internal control. To ensure this, the board issues general policies that are operationalised by the CEO. The Fund's internal governance and control policy is a core document in this context. It lays out the framework for the Fund's internal control.

Internal control

AP3 follows the three lines of defence principle, under which the Fund's asset management teams are responsible for identifying and managing the risks that arise in day to day operations. The second line of defence comprises the risk control and compliance departments. Risk control analyses financial risk and the compliance team focuses on regulatory compliance and operational risk.

The risk control and compliance functions report to the risk and audit committee and the board at their scheduled meetings. When a significant incident occurs or the need arises, the board is informed immediately.

Internal audit is the third line of defence. Its role is to carry out controls to ensure that AP3's internal governance and control environment are fit for purpose and effectual and that the Fund is aligned with the policies approved by the board. Internal audit reports are reviewed by the risk and audit committee and reported to the board.

In 2020 KPMG performed two audit relating to the Fund's processes for securities lending and data security. The audit identified a number of areas for improvement that the Fund then addressed.

External auditors

AP3's auditors are appointed by the government, which selected PwC as auditor of the AP funds after a public procurement process. The auditors are Helena Kaiser de Carolis and Peter Nilsson. Peter Nilsson is also responsible for coordinating the audit process between the AP funds. The auditors' work includes reviewing AP3's operating activities, including internal control, administration, annual financial statements and accounting records. They express an opinion on the accounting records and the administration based on their audit. Their mandate also includes verifying that AP3 follows the accounting and valuation policies agreed jointly by the AP funds and that the accounting records give a true and fair view of the Fund's operating activities. The auditors report orally to the board of directors a minimum of once a year and submit written reports on their audit of the accounts and administration audit. The auditors normally meet the risk and audit committee three times a year. They are responsible for reviewing compliance with government guidelines on the employment terms and conditions of senior managers at the AP funds. The auditors report verbally to the Ministry of Finance once a year.



Read more about internal risk management on pages 64-65

AP3 board of directors



CHRISTINA LINDENIUS

Chairman, elected in 2017

Other current assignments: CEO of Swedish insurance industry and employers' association FAO, and head of Svensk Försäkring i Samverkan (SFIS). Chairman of Min Pension i Sverige, Swedish Motor Insurers (TFF), Svensk Försäkring Administration and National Government Service Centre. Board member at Försäkringsbranschens Pensionskassa (FPK), Centrum för AMP and Swedish International Olympic Committee Supervisory Board.

Previously: Director-General of Premium Pension Authority, Deputy Director at the Ministry of Finance and Head of Department at Swedish Central Bank.

BSc Uppsala University, studies at Masters of International Economics Programme, SAIS, John Hopkins University, Washington DC. Year of birth 1964.



PETER ENGLUND

Deputy Chairman, elected in 2013

Other current assignments: Professor emeritus at Stockholm School of Economics and Uppsala University. Director at Wenner-Gren Stiftelserna and Swedish Financial Supervisory Authority.

Previously: Professor at Uppsala University and University of Amsterdam.

PhD, Stockholm School of Economics. Year of birth 1950.



MALIN BJÖRKMO

Elected in 2016

Other current assignments: Corporate governance and financial regulatory affairs adviser. Director of Handelsbanken Fonder, Trygg-Stiftelsen, Itello and Euro Accident Livförsäkring. Deputy Chairman of Disciplinärnämnden för Försäkringsdistribution.

Previously: Area Director of Swedish Financial Supervisory Authority, Head of State Ownership Department at Government Offices, CEO of Storebrand Liv Sweden, Head of Asset Management at Skandia Liv.

Lic Econ, Stockholm School of Economics. Year of birth 1962.



JOHAN BYGGE

Elected in 2019

Other current assignments: Chairman of Nobina AB, director of Getinge, Lanmännen Ek Förening, Baltic Deep Water Life, supervisory board member at Centre for Business and Policy Studies (SNS).

Previously: Deputy Group Controller at Ericsson. Senior positions at Electrolux including CFO and Deputy Managing Director, CFO of Investor, COO of EQT. Director of AP1, Swedish Central Bank's Jubilee Fund, I-Med Australia, 3 Scandinavia, Anticimex, ILA Vietnam, Swiss AG and Sanitec OY.

BSc. Year of birth 1956.



MAGNUS EMFEL

Elected in 2019

Other current assignments: Finance Engagement Manager, WWF International.

Previously: Positions at Social Venture Network Sweden, Swedish Forum for Sustainable Investment, SWESIF and Etikakademien.

BSc Stockholm University and IHM Business School. Year of birth 1965.



HILLEVI ENGSTRÖM

Elected in 2019

Other current assignments: President of Södertörn Fire Protection Association, director of Samhall.

Previously: Cabinet minister, Member of Parliament, ombudsman, detective inspector.

Graduate of Swedish Police Academy, studies in employment law and human resources. Year of birth 1963.



YLVA HEDÉN WESTERDAHL

Elected in 2019

Other current assignments: Director of Forecasting and Acting Director-General of National Institute of Economic Research. Director of Swedish National Debt Office.

Previously: Director of National Accounts at Statistics Sweden, Director of Macroeconomic Affairs Unit of Ministry of Finance, Director of Monetary Policy Research Unit at Swedish Central Bank.

PhD University of London. Year of birth 1965.



TORBJÖRN HÅLLÖ

Elected in 2018

Other current assignments: Economist at Swedish Trade Union Confederation.

Previously: Member of Budget Group of Social Democratic Party in Parliament, positions at Stockholm City Hall and Ministry of Enterprise and Innovation.

BSc Gothenburg School of Business, Economics and Law, BA Lund University. Year of birth 1976.



CARINA WUTZLER

Elected in 2020

Other current assignments: Mayor, Commissioner and City Councillor of Vellinge Municipality. Director of Vellinge Koncern AB and Vellinge Kommunlokal AB, board member of the Swedish Association of Local Authorities and Regions' Negotiation Board and Sobona.

University studies in public and municipal administration. Year of birth 1970.

Executive management



KERSTIN HESSIUS

CEO

Joined AP3 in September 2004

Other current assignments: Director of Vasakronan, Hemsö, Trenum, Handelsbanken and Riksbanksens Jubileumsfond.

Previously: CEO of Stockholmsbörsen, Deputy Governor of the Swedish Central Bank, CEO of Östgöta Enskilda Bank Asset Management, Nordic Head of Fixed Income Alfred Berg, CEO of Alfred Berg Transferator.

BSc. Year of birth 1958.



PABLO BERNENGO

Chief Investment Officer, Joined AP3 in November 2019

Previously: CEO Öhman Fonder, CIO Öhman Fonder, Portfolio Manager DNB/Skandia/Carlson Investment Management.

BSc. Year of birth 1974.



EVA BORIC

Chief Financial Officer and Chief Risk Officer, Joined AP3 in August 2018

Previously: Senior risk management positions at SEB. Development specialist at Nasdaq OMX. BSc. Year of birth 1976.



LIL LARÅS

LINDGREN

Head of Communications, Joined AP3 in August 2014

Other current assignments: Director of Urban Design Arkitektbyrå.

Previously: Senior communications positions at Ericsson, Attendo, Tetra Pak, Hemfrid, Swedish Travel and Tourism Council, Philipson Bil and communications consulting.

Degrees from RMI Berghs and Uppsala University. Year of birth 1962.



ZORICA BODIROZA

Head of Human Resources

Joined AP3 in January 2016

Other current assignments: Small assignments for Bodiroza HR Performance AB.

Previously: Senior human resources positions at Ericsson, AstraZeneca, Coca-Cola, Hi3G Access and Carlson Rezidor and consulting in business transformation and human resources.

BA Stockholm University and Executive MBA Henley Risk Management School. Year of birth 1967.



Administration report 2020

Net result in 2020

Net profit was SEK 37,179 million (59,549), representing a return of 9.8% (17.7) before expenses and 9.7% (17.6) after expenses. Fund capital stood at SEK 422,974 million (393,696) at year-end, an increase of SEK 29,277 million from the prior year.

Real return (adjusted for inflation) was 9.1% (15.6). The inflation rate in 2020 was 0.5% (1.8). After an extensive evaluation, the board in 2019 decided to reduce the Fund's long-term annual target for real return to 3.5%. The new level better reflects the needs and risks of the Swedish pension system. In the last 10 years the Fund has achieved an average annual real return of 7.7% (7.4). The average annual nominal return for this 10-year period stands at 8.7% (8.7), which is higher than the 2.7% (2.4) increase in the income index during the same time frame. By outperforming its long-term target for real return, AP3 has thus made a positive contribution to the pension system during the period.

The Fund made a net payment of SEK 7,902 million (6,520) to the pension system in 2020. Since 2009 AP3 has paid SEK 65,125 million to the Swedish Pensions Agency to help finance the deficit between pension contributions and disbursements and the agency's administrative costs.

Income

Income after commission expenses was SEK 37,401 million (59,761) and consisted primarily of realised and unrealised changes in the value of financial assets, which are measured at fair value on the reporting date. Other income consisted of net interest income, dividends received and net currency income. Changes in foreign exchange rates had a negative impact of SEK 4,897 million (positive: 4,583)

on the net result. Net currency income consists of changes in exposure to different currencies, primarily through the Fund's foreign investments.

Commission expenses totalled SEK 126 million (122) and are recognised as a deduction from income because they are directly attributable to the cost of acquiring income. These costs comprise management fees for external mandates, fund management fees, custody fees and costs of holding collateral during clearing. Commission expenses totalled 0.03% (0.03) of average fund capital.

9.7

percent
Return after
expenses

Operating expenses

Operating expenses were SEK 222 million (212), of which staff costs accounted for SEK 138 million (130). Operating expenses were 0.06% (0.06) of average fund capital.

Risk exposure

AP3 tracks portfolio risk exposure daily using a variety of methods and metrics. One metric is value at risk (VaR). A VaR with a 95% confidence level indicates a 95% probability that the daily negative change in portfolio value will not exceed the measured amount. At year-end, VaR for the total portfolio stood at SEK 2,220 million (1,383). During the quarter VaR rose sharply due to market volatility but retreated thereafter. The listed equities asset class has the largest exposure and is also the portfolio's largest source of risk. Diversification between asset classes and geographic markets helps to reduce overall portfolio risk.

Significant events after the reporting date

No significant events occurred after the reporting date.

Change in fund capital

SEK m	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Fund capital at 1 Jan	393,696	340,668	345,239	324,375	303,031	288,332	258,475	232,956	214,106	220,829
Pension contributions	73,872	72,344	69,552	66,850	64,174	61,373	58,880	56,839	55,441	53,895
Pension disbursements	-81,564	-78,678	-76,109	-73,999	-70,595	-66,142	-63,777	-63,488	-59,009	-54,922
Administration fee to the Swedish Pensions Agency	-210	-185	-216	-226	-216	-176	-224	-230	-220	-213
Net result for the year	37,179	59,549	2,202	28,239	27,981	19,643	34,977	32,398	22,638	-5,483
Total fund capital at 31 Dec	422,974	393,696	340,668	345,239	324,375	303,031	288,332	258,475	232,956	214,106

Expenses in last 10 years

SEK m	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Commission expenses, SEK m	126	122	117	152	180	170	162	155	119	89
Operating expenses, SEK m	222	212	202	195	186	192	178	173	183	155
Asset management expenses, SEK m	348	334	320	347	366	362	340	328	302	244
Commission cost ratio, %	0.03	0.03	0.03	0.05	0.06	0.06	0.06	0.06	0.05	0.04
Operating cost ratio, %	0.06	0.06	0.06	0.06	0.06	0.06	0.07	0.07	0.08	0.07
Asset management cost ratio, %	0.09	0.09	0.09	0.10	0.12	0.12	0.12	0.13	0.14	0.11

A new portfolio structure

In 2020, the Fund implemented a series of changes to ensure it is well-positioned to achieve its investment and sustainability targets. Changes were made to the organisational structure, the portfolio and the Fund's sustainability engagements. The portfolio now consists of five asset classes: listed equities, fixed income, alternative investments, other strategies, and currencies.

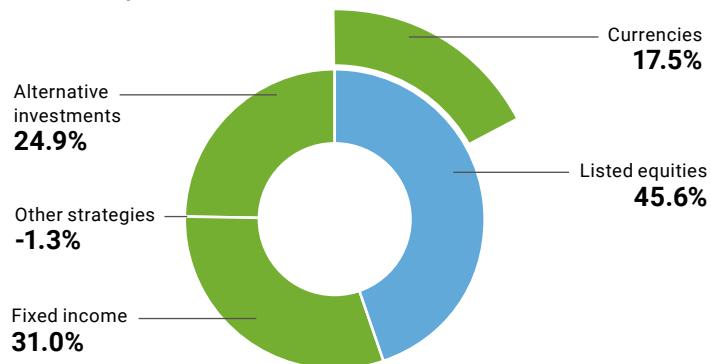
The changes were based on a programme launched in 2018 to streamline the organisation and its structure and processes. The programme began with administrative functions and extended into asset management in late 2019 and 2020. It is now more than 10 years since AP3 demerged its active and passive asset management operations and transitioned to an investment structure based on risk categories. This approach worked well for many years, delivering positive returns and helping to diversify the portfolio.

Now the asset management organisation has been realigned to facilitate the integration of sustainability, to optimise the Fund's investment management expertise in the context of increasing market pressures, and to create the best possible

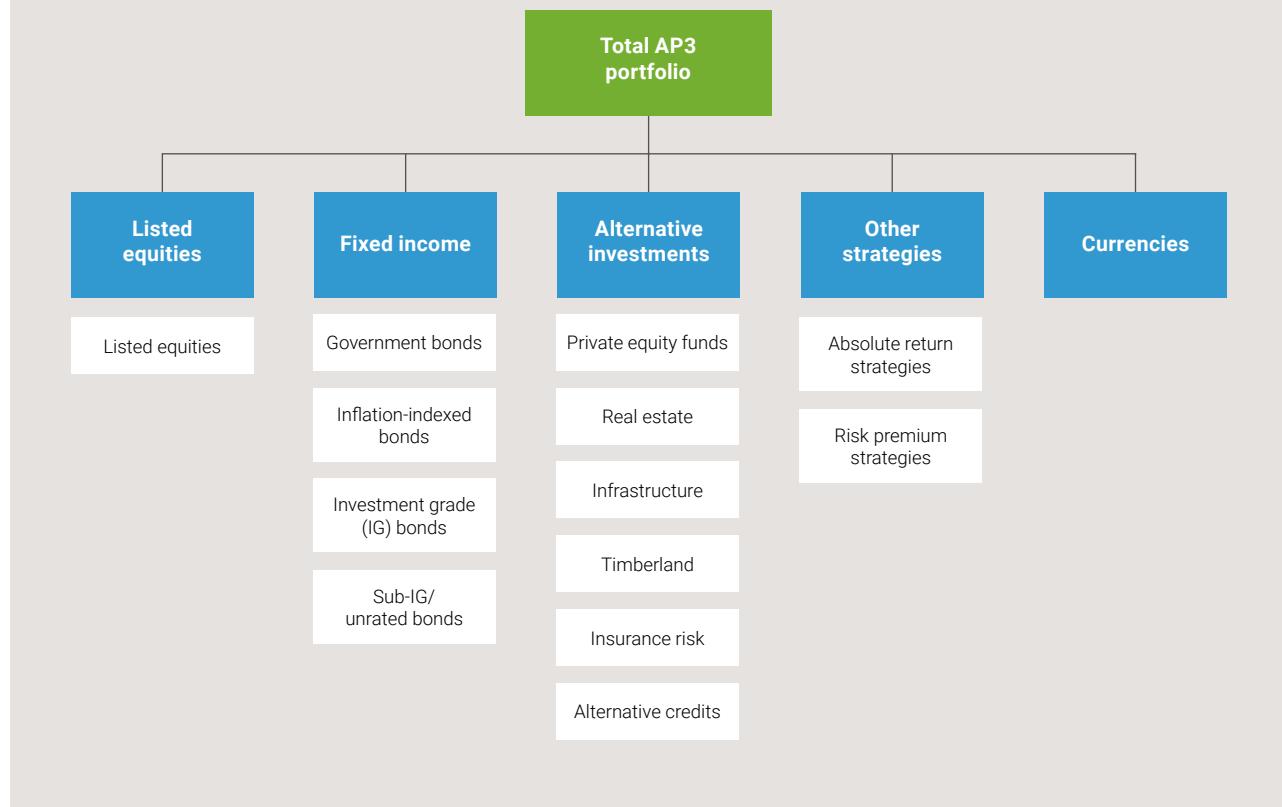
conditions for active management in appropriate areas.

Investment management is now divided into listed equities, fixed income and currencies, and alternative investments. A new team, the CIO Office, has been established to work on general investment management themes.

Asset class exposures



AP3 portfolio structure showing asset classes and sub-groups



Returns on the asset classes

AP3 recorded a return of 9.7% before expenses in 2020. Of the asset classes, equities was the strongest performer, contributing 8 percentage points to total return. Fixed income and alternative investments also made positive contributions, while currency exposures had a negative impact due to the appreciation of the krona during the year. Returns are reported net of foreign exchange effects, meaning that currency hedging costs are included in the figures. Foreign exchange effects are reported under currencies.

Listed equities

Listed equities are AP3's largest asset class and consist of shares quoted on global markets. They accounted for 45.6% (44.5) of portfolio exposure at year-end and represent the largest source of risk in the portfolio. The most important listed equity markets for AP3 are North America, Sweden and other European markets. The Fund also has equity investments in Japan, other Asian markets and emerging markets. North American and Swedish equities accounted for 38% and 26% respectively of the listed equity portfolio, with Europe (excluding Sweden) accounting for 15%.

Listed equities delivered a return of 15.1% (26.9) and contributed 8.0 percentage points (10.6) to total portfolio return. North American equity holdings performed best, achieving a return of 22.3%. They were followed by emerging markets on 18.4%, Sweden on 17.3% and Japan on 7.3%. Other European and Asian markets performed negatively, producing returns of -2.4% and -0.2%.

Exposure to listed equities varied from 40.0% to 47.8% during the year.

Fixed income

The fixed income asset class consists of bonds, other fixed income securities and cash. Together these holdings accounted for 31.0% (37.3) of portfolio exposure. At year-end, the fixed income portfolio was structured as follows: 61% government and government-backed bonds, 19% credit bonds, and 20% inflation-indexed bonds. Yields in all the main bond markets fell during the year, causing the value of the Fund's existing fixed income investments to rise.

The portfolio's return was 5.1% (2.6), representing a contribution of 1.6 percentage points (0.9) to overall return.

Holdings of green bonds increased during the year and stood at 15% of the fixed income portfolio at year-end. Some 14% (12) of fixed income investments were in bonds assigned the top AAA credit rating by Standard & Poor's and 41% (46) of the portfolio had AAA or AA ratings.

The National Pension Insurance Funds Act requires a minimum 20% of fund capital to be invested in low-risk bonds. AP3's holdings in this category averaged 25.5% (30.1) of fund capital in 2020.

Alternative investments

Alternative investments are mainly unlisted investments in real estate, private equity funds, infrastructure, timberland and insurance risk. Of the 24.9% (25.0) of the AP3 portfolio that is held in alternative investments, 22.5 percentage points relate to unlisted investments. Alternative investments generated a return of 9.1% (14.3), equal to a contribution of 2.3 percentage points (3.5) to total return.

Real estate accounts for more than half the Fund's alternative investments. Real estate exposure is 14.4% (13.9) of the AP3 portfolio and consists of direct investments in property companies Vasakronan, Hemsö, Trophi, Regio and Trenum, the listed property company Sagax, and smaller investments in real estate funds. Vasakronan, Sweden's largest property company, is owned jointly by AP1, AP2, AP3 and AP4. It invests chiefly in office and retail properties in central locations in Swedish cities. Vasakronan delivered a return of 5.6% (23.2) and Hemsö, which specialises in properties for public use, generated a return of 17.8% (20.2). Hemsö's owners funded a capital injection of SEK 1 billion in 2020 to finance continued expansion. Trophi, Regio and Trenum recorded returns of 13.1%, 4.9% and 9.3% respectively. Together, the Fund's real estate holdings produced a return of 11.6% (21.4).

AP3 owns a mature and diverse portfolio of private equity funds. During the year the Fund made new investment commitments to 13 funds. Investments in private equity funds totalled SEK 17.8 billion (15.5) at year-end and generated a return of 15.1% (11.6).

AP3's infrastructure investments totalled SEK 15.9 billion (17.5). They comprise the co-ownership of two companies, Ellevio and Polhem Infra, and investments in infrastructure funds. Ellevio owns and manages local and regional electricity grids and is owned by AP3, Omers Infrastructure, Folksam and AP1. Polhem Infra is an unlisted company owned by AP1, AP3 and AP4. It was founded in 2019 to invest in sustainable infrastructure. In 2020 Polhem Infra made a joint investment in the Skaftåsen wind power plant and signed an agreement to acquire the digital network company Telia Carrier. AP3 also co-invested in French fibre-optic network infrastructure with the French operator Vauban. Infrastructure investments recorded a return of -2.3% (2.8) during the year.

AP3's timberland holdings account for 5.7% of the Fund's exposure in alternative investments. These take the form of co-owned companies and holdings in funds. In 2019 AP3 and Kåpan established Gy-singe Skog to administer timberland assets inherited from the dissolution of Bergvik Skog. In 2020 the Fund signed a partnership with US company Lone Rock Resources. As part of this agreement, AP3 acquired two large timberland assets in Oregon. Timberland investments generated a return of 13.4% (7.6).



Insurance risk consists of exposures to reinsurance risk arising from natural disasters, weather events and epidemics. Insurance-related investments totalled SEK 4.8 billion (5.4) at year-end and generated a return of -3.5% (1.5).

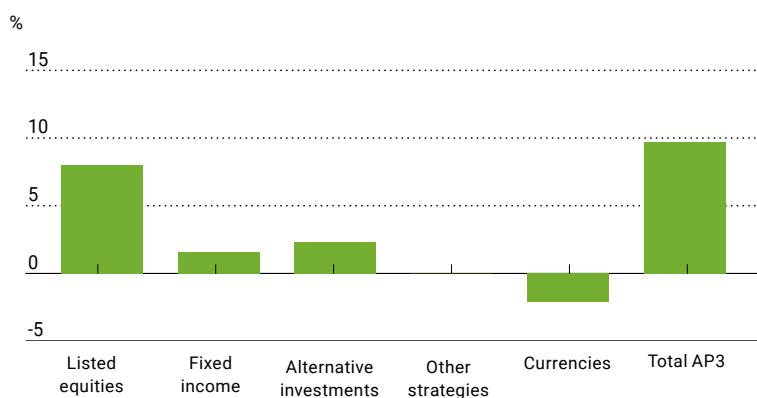
Other strategies

The other strategies asset class consists of internal absolute return strategies and external investments in hedge funds. Internal absolute return strategies are based on risk mandates instead of capital allocations. The mandates are for trading equities, bonds and currencies. Other strategies contributed 0.0 percentage points (0.3) to overall return.

Currencies

The currencies risk category relates to AP3's net income from currency exposure after hedging and from direct currency strategies. AP3's currency exposure was 17.5% (19.5) at year-end. Currency positions are taken to increase returns and to reduce risk in the overall portfolio. During the year the krona gained against most major currencies, with the biggest change being a 12% fall in the US dollar's value against the krona. A stronger krona results in negative currency returns because the Fund's foreign exchange investments lose value when measured in kronor. Currencies contributed -2.1 percentage points (2.4) to overall return.

Return by asset class



Asset classes

Exposure by asset class

31 Dec 2020	Listed equities	Fixed income	Alternative investments	Other strategies	Currencies ¹	Total AP3
Exposure, SEK m	192,865	131,288	105,314	-5,498	74,039	423,969
Exposure, %	45.6	31.0	24.9	-1.3	17.5	100.2

31 Dec 2019	Listed equities	Fixed income	Alternative investments	Other strategies	Currencies ¹	Total AP3
Exposure, SEK m	175,339	146,760	98,556	-16,507	76,932	404,148
Exposure, %	44.5	37.3	25.0	-4.2	19.5	102.7

Returns by asset class

31 Dec 2020	Listed equities	Fixed income	Alternative investments	Other strategies	Currencies ¹	Total AP3
Return, %	15.1	5.1	9.1	0.0	-	9.8
Contribution to total return, percentage points	8.0	1.6	2.3	0.0	-2.1	9.8
Share of total return, %	82.1	15.9	23.5	-0.3	-21.4	100.0

31 Dec 2019	Listed equities	Fixed income	Alternative investments	Other strategies	Currencies ¹	Total AP3
Return, %	26.9	2.6	14.3	0.3	-	17.7
Contribution to total return, percentage points	10.6	0.9	3.5	0.3	2.4	17.7
Share of total return, %	59.9	5.3	19.6	1.6	13.7	100

1) Currency exposure shows the ratio of assets held in foreign currency and cannot be added to total exposure.

2) Absolute return strategies consist of risk mandates to which no capital is allocated. Hence, return cannot be fairly measured.

Costs and expenditure

Responsible management that delivers high cost effectiveness and stability over time is a top priority for AP3.

Cost efficiency is always in the spotlight and the Fund carefully monitors expenditures in multiple ways.

An annual cost budget provides oversight and control. Asset management costs comprise operating expenses, which are the Fund's internal costs, and commission expenses, which are the costs of external management and for managing securities and collateral. Analysing any deviations that arise between budget and actual outcomes provides valuable information that is used to guide operational decision-making. Changes from year to year are a source of insight for management and the board of directors on the Fund's cost base. Naturally, costs tend to rise over time due to inflation and the growth of the Fund's capital. This makes it important to measure costs in relation to fund capital using a metric known as the asset management cost ratio. Cost comparisons also facilitate benchmarking against other funds.

Lower costs than international peers

As part of efforts to ensure that AP3's asset management is cost-effective by international standards, AP3 has since 2005 participated in an annual survey performed by Canadian consultancy CEM Benchmarking. A large number of funds from all over the world participate in the survey, which benchmarks AP3 against funds of a similar size and profile, as well as against European funds. The study also

Cost control

- 1 Budget oversight
- 2 Analysis of changes in absolute figures
- 3 Costs in relation to fund capital
- 4 Benchmarking against international peers

compares returns, portfolio structure, management style, risk and other parameters. CEM's analysis shows that AP3 generates high returns at a low cost.

The most recent CEM study, from 2019, showed AP3's expenses to be 29% lower than the benchmark group average over the prior five years.

Operating expenses

Operating expenses, meaning the costs of running the Fund, totalled SEK 222 billion (212) and corresponded to 0.06% (0.06) of fund capital. Operating expenses arise from asset management, administration and operational management and are divided into staff costs and other administrative expenses. Staff costs include salaries, social insurance fees, pension contributions, staff training and recruitment. Staff costs account for the major share of operating expenses and in 2020 totalled SEK 138 million (130). The average number of employees was 60 (58).

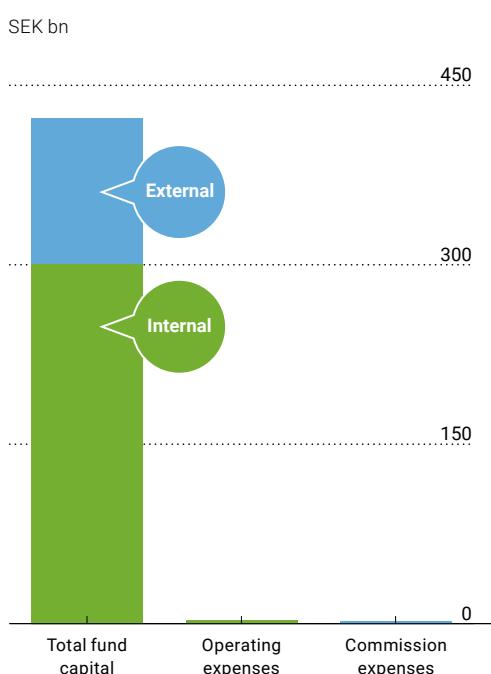
Other administrative expenses consist of costs for office space, IT and market data services. See Notes 6 and 7 for further information on operating expenses.

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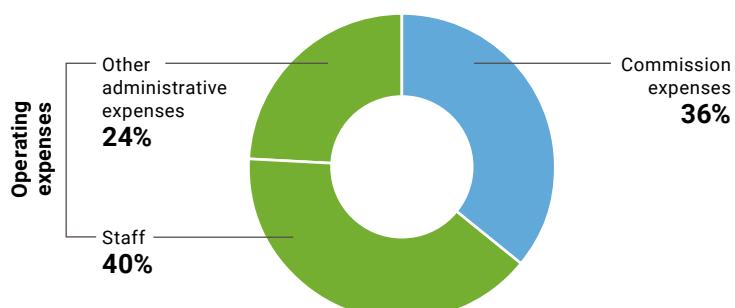
percent

Expenses in relation to fund capital

Internally and externally managed fund capital



Breakdown of expenses



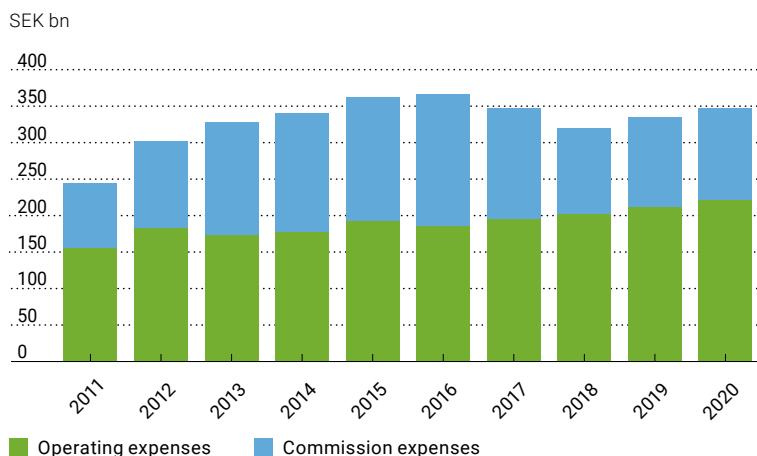
Other costs, fees and remuneration

Transaction costs relate to purchases and sales of securities and are the difference between the buying and selling rates. They are recognised as part of the asset's cost or as a deduction from income. Brokerage fees also arise in relation to equity trading. They totalled SEK 69 million (48) in 2020. Transaction costs have an impact on the net results of all asset classes.

Performance-based remuneration is a type of profit sharing paid to external managers in return for investment returns that exceed agreed goals. These fees are expensed directly against investment returns and are recognised as net income from financial transactions in the income statement. Performance-based fees totalled SEK 133 million (197). See Note 5 for further information on performance-based remuneration.

Tax costs that the Fund is entitled to reclaim under double taxation treaties are recognised in the balance sheet as a claim and hence have no effect on income.

Operating expenses 2011-2020



Risk management

AP3's asset management exposes it to different types of risk. The Fund's core activity is managing financial risk to deliver investment returns and achieve stated targets.

Risk is defined as uncertainty over future outcomes arising from factors that affect the Fund's operating activities. Risk management is the process of identifying, evaluating and handling that risk. Because risk-taking can generate positive and negative outcomes, risks taken must be conscious, calculated and within the Fund's risk appetite.

In investment management, the Fund takes positions in financial instruments in order to earn a return. This means that fund capital is always exposed to financial risk. Diversifying fund capital into different financial assets, geographic areas, risk premiums and investment time frames enables risks to be limited. The board of directors sets the overall risk level by approving a risk framework within which asset managers must operate. The risk management policy is a steering document that describes the main operational risks, the board's risk appetite and how risks should be managed, monitored and controlled.

AP3's risks

The Fund classifies risk in three categories. Enterprise risk relates to the Fund's mission, objectives

and administration. Non-financial risk relates to processes, systems, human resources, reputation and legal and regulatory compliance. Financial risk arises in relation to investing activities.

Risk profile

The board of directors sets the Fund's overall risk tolerance limits on an annual basis. The CEO is responsible for managing overall risk and for ensuring that the risk profile accords with the board's risk tolerance limits. The Fund's control functions oversee, monitor and report on risk on a continuous basis.

Risk management

The board has ultimate responsibility for the Fund's administration and control. It ensures that the risk management system is effective and fit for purpose and sets the thresholds for risk levels and tolerance. The risk and audit committee has an advisory and oversight role on the board's behalf in the areas of financial reporting, accounting, internal control, risk management, compliance and audit. It reports regularly to the board.

The CEO is responsible for day-to-day management and compliance with board guidelines. The CEO is tasked with ensuring good governance and control and is responsible for risk control and reporting. The Chief Investment Officer (CIO) manages risk in the portfolio and is responsible for delegating

day-to-day portfolio management within the frameworks set by the board and the CEO. Each head of department and portfolio manager is responsible for managing the risk attached to his or her mandate in order to achieve targets within set limits.

The risk management committee (RMC) is the Fund's decision making body for handling issues relating to risks in day-to-day asset management. The RMC members are the CEO, CIO, CRO (chair), Compliance Officer and Head of Risk Control. The committee considers matters relating to risk management and control in advance of board decisions and makes decisions on operational risk issues.

“

Thanks to well-established risk management processes and good control we were able to manage the turmoil on financial markets successfully during the year and to make the right decisions for the portfolio when it mattered most.

Eva Boric,
Chief Financial Officer
and Chief Risk Officer



Three lines of defence

1

The first line of defence is the investment organisation, which includes all asset management department teams as well as supporting business functions. Responsibility for risk management thus exists where the risk arises. Controls are continuous and along the entire transaction flow. Each employee and head of department is responsible for managing risk within his or own area of responsibility.

2

The second line of defence comprises the risk control and compliance functions. The control teams ensure that the organisation and its relevant parts stay within stipulated limits and comply with applicable restrictions and instructions while the first line of defence manages identified risks effectively. The compliance function oversees regulatory compliance and monitors operational risks. The risk control function supervises financial risks. The risk control and compliance teams are both independent and organisationally separate from the parts of the organisation that make investment decisions. The CRO, who is responsible for the risk control function, and the Compliance Officer report to the CEO and to the board of directors.

3

The third line of defence is internal audit. The internal audit function is in charge of safeguarding the quality of the Fund's risk management by performing regular audits and evaluations of relevant areas to ensure they are effectual and appropriate. The results of these valuations are used to strengthen the processes of the other lines of defence. AP3 subcontracts internal audit to an external audit firm appointed by the board. The firm reports to the board and the risk management and audit committee and is independent from AP3 and its operating activities. The risk and audit committee commissions an annual review of internal audit.

Risk types	Board's risk tolerance	Metric used	Results in 2020
Market risk	Optimise exposure through a diversified portfolio that generates high returns over time and whose losses are manageable in normal circumstances.	<ul style="list-style-type: none"> ● Share per asset class ● Value at Risk ● Tracking error ● Sensitivity analysis ● Stress tests ● Stop loss 	Market risk is the dominant risk in the AP3 portfolio. It is monitored on a daily basis for the entire portfolio and for individual mandates. Financial market volatility was high during the year, which raised market risk.
Credit risk	Optimise credit exposure through diversification by country, segment and rating. Limit counter-party risk through central clearing and agreements on pledged collateral.	<ul style="list-style-type: none"> ● Share of credits ● Issuer limits ● Rating limits 	Credit exposure well balanced and primarily focused on investment grade bonds in developed markets.
Liquidity risk	AP3 must always have available liquidity to settle its commitments as a capital buffer for the pension system and to have investment flexibility in the portfolio.	<ul style="list-style-type: none"> ● Payment readiness ● Share of liquid or illiquid assets ● Securities lending limits 	Good ability to pay and sufficient liquidity to fulfil commitments.
Operational, reputational and compliance risks	Limit operational risk and preserve the Fund's reputation	<ul style="list-style-type: none"> ● Number of incidents ● Limit infringements ● Staff turnover 	Low incident levels and healthy risk culture.

Enterprise risks

Enterprise risks are operational-level risks relating to AP3's mission, objectives and administration. AP3 manages enterprise risks using asset liability management (ALM) to, for example, analyse the risk of a change in the Fund's operating conditions. The board uses this ALM analysis to set long-term operating targets.

Financial risks

Market risks	Credit risks	Liquidity risks
<ul style="list-style-type: none"> ● Market risks ● Equity risk ● Fixed income risk ● Inflation risk ● Currency risk ● Sustainability risk at portfolio level 	<ul style="list-style-type: none"> ● Issuer risk ● Counterparty risk ● Settlement risk 	<ul style="list-style-type: none"> ● Rollover risk ● Refinancing risk

Financial risk arises in the Fund's core business, which is the management of investments in different asset classes. These risks are taken knowingly to generate returns and are managed through different types of limits.

Non-financial risks

Operational risks	Compliance risk	Reputational risk
<ul style="list-style-type: none"> ● Process risk ● Personnel risk ● Systems risk ● Data security risk ● Model risk ● Legal risk 		

Non-financial risks exist in all parts of the Fund's operations and are the risk of non-compliance with external and internal regulations applicable to the business, the risk of adverse publicity or events that damage trust and confidence in the Fund, or the risk of losses arising from inadequate or deficient processes, systems, staff or external events such as fraud.

AP3 conducts an annual evaluation to identify and evaluate all non-financial risks. The result of this process is reviewed by the risk and audit committee and the board of directors.

Ten-year summary

	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Income and flows										
<i>SEK bn</i>										
Net result	37.2	59.5	2.2	28.2	28.0	19.6	35.0	32.4	22.6	-5.5
Net flow to pension system	-7.9	-6.5	-6.8	-7.4	-6.6	-4.9	-5.1	-6.9	-3.8	-1.2
Fund capital at 31 Dec ¹	423.0	393.7	340.7	345.2	324.4	303.0	288.3	258.5	233.0	214.1
Return and expenses, total portfolio										
<i>%</i>										
Return before expenses	9.8	17.7	0.7	8.9	9.5	6.9	13.8	14.2	10.7	-2.4
Operating expenses	0.06	0.06	0.06	0.06	0.06	0.06	0.07	0.07	0.08	0.07
Commission expenses	0.03	0.03	0.03	0.05	0.06	0.06	0.06	0.06	0.05	0.04
Operating and commission expenses	0.09	0.09	0.09	0.10	0.12	0.12	0.12	0.13	0.14	0.11
Return after expenses	9.7	17.6	0.6	8.8	9.4	6.8	13.7	14.1	10.7	-2.5
Rate of inflation	0.5	1.8	2.0	1.7	1.7	0.1	-0.3	0.1	-0.1	2.0
Real return after expenses	9.1	15.6	-1.4	6.9	7.6	6.7	14.1	14.0	10.7	-4.4
<i>SEK bn</i>										
Income (incl. commission expenses)	37.4	59.8	2.4	28.4	28.2	19.8	35.2	32.6	22.8	-5.3
Operating expenses	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2
Result after expenses	37.2	59.5	2.2	28.2	28	19.6	35.0	32.4	22.6	-5.5
Annualised nominal return after expenses										
<i>%</i>										
Five years (2015-2019)	9.1	8.5	7.8	10.5	10.9	8.4	8.8	9.3	1.9	0.8
Ten years (2010-2019)	8.7	8.7	8.5	6.1	5.7	5.7	6.8	6.5	6.7	4.2
Risk										
Risk (1-yr standard deviation) for total portfolio, %	10.8	4.2	5.4	3.5	6.2	7.0	4.7	4.9	5.3	9.2
Sharpe ratio	0.9	4.3	0.3	2.8	1.6	1.0	2.8	2.8	1.8	neg.
Risk (10-yr standard deviation), %	7.0	6.0	6.3	7.6	8.0	8.1	7.8	7.9		
Currency exposure										
% of total portfolio ²	17.5	19.5	17.7	15.0	17.5	22.8	24.4	20.4	22.0	19.3
External management										
% of total portfolio	29	31	26	25	29	31	33	35	36	35
Employees										
No. of employees at 31 Dec	60	58	59	57	57	51	57	53	56	57

1) Fund capital at inception on 1 January 2001 was SEK 134.0 billion.

2) Excluding exposure to SEK-listed companies with foreign domicile.

Income statement

SEK m	Note	2020	2019
Income			
Net interest income	2	2,149	2,738
Dividends received		4,375	6,830
Net income from listed shares and investments	3	25,950	36,013
Net income from unlisted shares and investments	4	6,702	7,166
Net income from fixed income assets		3,370	3,517
Net income from derivatives		-122	-964
Net income from currencies		-4,897	4,583
Net commission expenses	5	-126	-122
Total income		37,401	59,761
Operating expenses			
Staff costs	6	-138	-130
Other administrative expenses	7	-84	-82
Total operating expenses		-222	-212
Net result for the year		37,179	59,549

Balance sheet

SEK m	Note	31 Dec 2020	31 Dec 2019
Assets			
Shares and investments			
Listed	8, 19	202,410	181,800
Unlisted	9, 19	86,677	78,099
Bonds and other fixed income assets	10, 19	126,068	130,870
Derivatives	11, 19, 21	9,671	4,268
Cash and cash equivalents		1,107	2,082
Other assets	12, 21	5,577	5,488
Prepaid expenses and accrued income	13	1,030	1,028
Total assets		432,541	403,635
Fund capital and liabilities			
<i>Liabilities</i>			
Derivatives	11, 19, 21	384	1,438
Other liabilities	14, 21	9,120	8,443
Deferred income and accrued expenses	15	63	57
Total liabilities		9,567	9,938
<i>Fund capital</i>			
Fund capital at 1 Jan		393,696	340,668
Net payments to pension system	16	-7,902	-6,520
Net result for the year		37,179	59,549
Total fund capital		422,974	393,696
Total fund capital and liabilities		432,541	403,635
Memorandum items	17, 22		

Notes to the financial statements

The Third Swedish National Pension Fund (AP3), corporate identity number 802014-4120, is one of the funds that manage the capital buffer of the Swedish pension system. AP3 is headquartered in Stockholm. The board of directors approved the annual financial statements for 2020 on 18 February 2021. The income statement and balance sheet are subject to government approval.

NOTE 1 Accounting and valuation policies

The National Pension Insurance Funds Act (2000:192) requires the annual accounts to be prepared in conformity with generally accepted accounting principles, which involves recognition of fund assets at market value. AP1, AP2, AP3 and AP4 have agreed and applied shared accounting and valuation policies, as summarised below.

The AP funds are gradually adapting their accounting and valuation principles to the International Financial Reporting Standards (IFRS). Full adjustment to IFRS would not significantly affect reported income and capital. AP3 meets the qualification requirements for designation as an investment company as per IFRS 10. The only difference as against currently effective IFRS is that AP3 does not prepare a statement of cash flows or apply IFRS 16.

Transaction day accounting

Purchases and sales of securities and derivatives on the money, bond, equity and currency markets are recognised in the balance sheet on the transaction date, that is the point when material rights, and therefore risks, are transacted between the parties. Receivables and liabilities that fall between the transaction and settlement dates are reported under other assets and other liabilities respectively. Other transactions, especially relating to unlisted equities, are recognised in the balance sheet on the settlement date, in conformity with market norms.

Net accounting

AP3 recognises assets and liabilities net in the balance sheet where there is a legal right to offset transactions and an intention exists to provide net cash consideration or to realise the asset and receive consideration for the liability simultaneously.

Foreign currency translation

Foreign currency transactions are shown in Swedish kronor at the exchange rate on the transaction date. Foreign currency assets and liabilities are recognised in Swedish kronor at the exchange rate on the balance sheet date.

Changes in the values of foreign currency-denominated assets are divided into the change attributable to the change in the value of the asset or liability and the change caused by exchange rate movements. Exchange rate gains or losses arising due to exchange rate changes are recognised in the income statement under net income from currencies.

Shareholdings in subsidiaries and associates

Shareholdings in, and loans to, subsidiaries and associates are recognised at fair value, in conformity with the National Pension Insurance Funds Act. Fair value is measured using the same method as for unlisted shares and investments. There is no requirement to prepare consolidated financial statements. Loans to subsidiaries and associates that are intended to be held to maturity are measured at fair value under the fair value option in IFRS 9. However, the entire change in value is recognised as part of the equity holding under net income from unlisted shares and investments.

Measurement of financial instruments

All AP3's investments are measured at fair value. Realised and unrealised changes in value are recognised in the income statement. Hence, items presented under net income per asset category include realised and unrealised income. Equity instruments are held for trading and are therefore measured at fair in the income statement. Debt instruments are held for trading and are therefore measured at fair in the income statement. Loans to subsidiaries and associates are intended to be held to maturity, but here the fair value option is used to comply with the requirement of the National Pension Funds Insurance Act that these instruments are measured at fair value. When the financial statements make reference to benchmark indices, please consult the AP3 website for information on the specific

index. The AP funds track all their assets on a fair value basis. The method for measuring fair value is described below.

Listed shares and investments

Shares and units traded on a regulated market or trading platform are measured using the price quoted by the relevant index vendor. This price is usually the mid-rate. Holdings not included in an index are valued at listed prices observable in an active market. Brokerage fees are recognised under net income from listed equities.

Unlisted shares and investments

Shares and investments not traded on a regulated market or trading platform are measured at fair value based on the valuation received from the counterparty or other external party. Valuations are updated when new valuations are received and are adjusted for cash flows up to the reporting date. AP3 may revise a valuation where strong grounds exist for believing that the valuation is wrong. Fair value measurement of unlisted shares and investments follows the International Private Equity and Venture Capital Valuation (IPEV) guidelines or equivalent valuation principles and is generally based on transactions with third parties. However, other valuation methods can be applied.

Unlisted real estate shares are measured on the basis of their net asset value, provided they have not been transacted on a secondary market. Holdings in unlisted real estate companies are measured to reflect deferred tax liability and at the value applied in real estate transactions. This differs from the value that real estate companies apply in their financial statements.

Bonds and other fixed income assets

Fair value of bonds and other fixed income assets is measured using the official market price (usually the bid rate) quoted by the Fund's index supplier. Holdings not included in an index are valued at listed prices observable in an active market. Where an instrument is not traded on an active market and reliable market prices are unavailable, the instrument is measured using generally accepted valuation models, whereby cash flow is discounted to the relevant valuation curve.

Interest income is recognised using the effective interest method based on amortised cost. Amortised cost is the discounted present value of future payments, where the discount rate corresponds to the effective interest rate at the time of purchase. Acquired premiums and discounts are recognised as interest income until the coupon rate changes or the instrument matures. They are recognised in interest income. Changes in value arising due to movements in interest rates are recognised under net income from fixed income assets, while changes in value arising from exchange rate movements are recognised under net income from currencies.

Derivatives

The fair value of derivatives is measured using rates on the reporting date. In cases where instruments are not traded in an active market and no market prices are available, valuations are made using generally accepted theoretical models whose inputs consist exclusively of observable market data.

Derivative contracts with a positive fair value on the reporting date are recognised as assets, while contracts with a negative market value are recognised as liabilities. Changes in value arising from exchange rate movements are recognised in the income statement under net income from currencies, while other changes in value are recognised under net income from derivatives.

Buybacks

In a true buyback (repurchase), the asset remains on the balance sheet and cash received is recognised as a liability. The divested security is recognised under pledged assets in the balance sheet. The cash value difference between spot and forward legs accrues during the maturity period and is reported as interest.

Securities lending

Loaned securities are recognised in the balance sheet at fair value and consideration received is recognised as interest income in the income statement. Collateral received for loaned securities may consist of securities and/or cash. Where AP3 has the right to dispose over cash collateral received, this is recognised in the balance sheet as an asset and

a corresponding liability is created. In cases where AP3 does not have the right of disposal over the asset, the loaned security is recognised not in the balance sheet but separately under pledged assets, contingent liabilities and commitments. The value of loaned securities and the collateral paid to secure them is also recognised under this item.

Items recognised directly in fund capital

Payments to and from the pension system are recognised directly in fund capital.

Commission expenses

Commission expenses are recognised as a deduction from operating income in the income statement. They consist of external costs for asset management services, such as custody account fees and fixed commissions to external managers, and fixed commissions for exchange-traded funds. Performance-based fees, payable when a manager outperforms an agreed level that gives rise to profit sharing, are recognised as a deduction from net income for the relevant asset class in the income statement. Management fees for unlisted shares and investments are recognised in cost and included in unrealised income.

Operating expenses

All management expenses, excluding brokerage fees, fees to external managers and custodian fees, are recognised as operating expenses. Investments in equipment and proprietary and purchased computer software are normally expensed as they arise.

Taxes

AP3 is exempt from all income tax on investments in Sweden. Dividend and coupon taxes payable in some countries are recognised on a net basis in the relevant income category in the income statement.

As of 2012, AP3 is VAT-registered and liable to pay value added tax on purchases outside Sweden. AP3 is not entitled to reclaim VAT outlays. VAT is expensed under the relevant item.

Rounding off

Minor discrepancies may occur in the tables in this report due to the rounding up or down of individual figures. Figures are shown in millions of kronor (SEK m) unless otherwise stated.

NOTE 2 Net interest income

SEK m	2020	2019
Interest income		
Bonds and fixed income assets	2,014	2,593
Securities lending, equities	45	49
Securities lending, bonds	74	74
Other interest income	18	22
Total interest income	2,151	2,738
Interest expense		
Other interest expenses	2	1
Total interest expense	2	1
Net interest income	2,149	2,738

NOTE 3 Net income from listed shares and units

SEK m	2020	2019
Income from listed shares and investments	26,019	36,061
Brokerage fees	-69	-48
Net income from listed shares and investments	25,950	36,013

NOTE 4 Net income from unlisted shares and units

SEK m	2020	2019
Net capital gain	921	3,255
Unrealised changes in value	5,781	3,912
Net income from unlisted shares and investments	6,702	7,166

External management fees for unlisted assets are recognised in the cost of the asset and, therefore, under unrealised net income from unlisted assets. Thus, repaid management fees have a positive impact on unrealised income.

In 2020, SEK 457 million (344) was paid in management fees for unlisted assets, of which SEK 446 million (333) allowed for repayment. SEK 47 million (117) of management fees were repaid during the year, resulting in a charge to income from unlisted shares and investments of SEK 409 million (226).

NOTE 5 Commission expenses

SEK m	2020	2019
External commissions, listed assets	104	104
External commissions, unlisted assets	8	5
Other commission expenses incl. custodian bank costs	14	13
Total commission expenses	126	122

Performance-based fees of SEK 133 million (197) relating to listed equities are not recognised in commission expenses. Performance-based fees are recognised in net income for each asset class.

Underlying commissions for total return swaps (TRS)¹ are not recognised in commission expenses but as a change in value under net income from derivatives. Underlying TRS costs were SEK 1 million (1).

1) See Glossary

NOTE 6 Employees

	2020		2019	
	total	female	total	female
Average number of employees	60	25	58	23
No. of employees at 31 Dec	60	26	58	23
No. in executive management at 31 Dec	5	4	4	3

Notes to the financial statements

Staff costs in SEK thousand, 2020	Salaries and remuneration	Variable remuneration	Pension plan expenses	of which salary sacrifice	Social security expenses incl. special payroll tax	Total
Chairman of the board, Christina Lindenius	210				66	276
Other directors	940				259	1,199
Total	1,151				325	1,476
CEO Kerstin Hessius	3,963		2,444	998	1,838	8,246
Executive management excl. CEO						
Pablo Bernengo	3,353		751		1,236	5,340
Eva Boric	2,038		568		778	3,385
Lil Larås Lindgren	1,504		515		597	2,616
Zorica Bodiroza	1,515		493		614	2,622
Total executive management excl. CEO	8,410		2,327		3,225	13,962
Other employees	59,312	4,998	22,194	3,095	25,251	111,755
Total employees	71,684	4,998	26,966	4,093	30,314	133,963
Other staff costs						2,491
Total staff costs	72,835	4,998	26,966	4,093	30,640	137,929

Staff costs in SEK thousand, 2019	Salaries and remuneration	Variable remuneration	Pension plan expenses	of which salary sacrifice	Social security expenses incl. special payroll tax	Total
Chairman of the board, Christina Lindenius	86				27	113
Chairman of the board, Pär Nuder, left May 2019	50				16	66
Other directors	467				121	588
Total	603				164	766
CEO Kerstin Hessius	3,741		2,424	978	1,785	7,950
Executive management excl. CEO						
Pablo Bernengo, joined Oct 2019	717		258		288	1,262
Eva Boric	1,967		227		673	2,867
Mattias Bylund, left Aug 2019	1,244		394		487	2,125
Kerim Kaskal, left May 2019	1,042		621	265	478	2,141
Lil Larås Lindgren	1,325		485		534	2,344
Total executive management excl. CEO	6,296		1,985	265	2,460	10,740
Other employees	57,817	3,413	21,099	2,930	24,015	106,344
Total employees	67,854	3,413	25,507	4,172	28,259	125,034
Other staff costs						3,912
Total staff costs	68,456	3,413	25,507	4,172	28,423	129,712

Board of directors

The government sets the remuneration of directors. As of 2020, annual fees of SEK 200 thousand are paid to the Chairman, SEK 150 thousand to the Deputy Chairman and SEK 100 thousand to other directors. The government has approved additional remuneration of up to SEK 100 thousand for directors who sit on the remuneration committee and audit committee. Remuneration of SEK 100 thousand (100) was paid for committee engagements in 2020.

Committees

The remuneration committee had three members in 2020. It makes recommendations to the board on the CEO's salary and benefits and AP3's salary structure prior to salary reviews. It also makes recommendations to the board of directors on the variable remuneration programme. Decisions in these matters are taken by the board. The risk and audit committee has three members and its role is to monitor and issue recommendations to the board in financial reporting, accounting, internal control, risk management and external audit.

CEO's remuneration

The board of directors sets the salary and benefits of the CEO. Under the terms of the CEO's employment contract, AP3 pays retirement pension and sickness insurance premiums totalling 30% of gross salary. In the event of termination, the contractual notice period is six months for both AP3 and the CEO. If AP3 terminates the CEO's contract, 18 months' severance pay may be payable. Severance salary and pay are to be offset against any income from new employment or business activity. No contract provisions exist for early retirement. In 2020 the CEO received taxable benefits of SEK 5 thousand (2). The CEO does not participate in the performance-based incentive scheme.

Executive management committee excl. CEO

The executive management committee consists of the CEO, CIO, Head of Business Support & Control and CRO, the Head of Communications and the Head of Human Resources.

The employment terms and conditions of executive management reflect collective wage agreements with the Employers' Organisation of the Swedish Banking Institutions and three trade union members of the SACO confederation: JUSEK, the Swedish Association of Graduates in Business Administration and Economics, and the Swedish Association of Graduate Engineers. Hence, there are no special agreements on termination, severance pay or early retirement for any members of executive management. Executive management committee members received benefits ranging from SEK 5 thousand (0) to SEK 6 thousand (24) in 2020. Executive management does not participate in the performance-based variable remuneration scheme.

Remuneration

AP3 follows the government's guidelines for employment conditions for AP fund employees. The guidelines state that remuneration should be competitive without being market-leading. The chair of the remuneration committee handles remuneration issues on behalf of the board of directors. The board sets the remuneration of the CEO and the remuneration committee approves the remuneration and benefits of senior managers based on the CEO's recommendations. The board also sets the remuneration framework for other employees.

As in prior years, AP3 participated in the Towers Watson annual remuneration survey in order to benchmark staff salaries against other financial market personnel. By taking part in the survey, the Fund seeks to ensure that its salary levels remain in line with the government's guidelines. The survey showed that the majority of AP3 personnel receive remuneration at or around the benchmark group median level. The board of directors concludes that the pay structure and remuneration levels for the CEO, senior managers and all employees are market-based, competitive without leading the market, and reasonable and appropriate. The board is also of the opinion that the Fund complies with government pay guidelines and that no exceptions exist which require separate reporting.

Performance-based remuneration programme

The board of directors has approved a performance-based remuneration programme modelled on government guidelines issued in April 2009 and adjusted for guidelines on remuneration in insurance and other financial entities issued by the Financial Supervisory Authority in March 2010. The programme applied in 2020 and gave employees in the asset management department the opportunity to receive performance-based remuneration of up to two months' salary on the fulfilment of specific agreed criteria. Sixty percent of variable remuneration is not paid until three years after the year in which it is earned. Employees in administrative departments have the chance to receive variable remuneration of one month's salary. AP3's net result must be positive before variable remuneration is payable to any employee. The CEO, members of the executive management committee, and the Compliance Officer and Head of Risk Control and Return Analysis are not part of the variable performance-based remuneration programme. AP3 reserved SEK 5.0 million (3.4) in the 2020 accounts for variable remuneration contingent on fulfilment of agreed targets. This sum was equivalent to the payment of an average of 1.0 months' salary (0.7) in variable performance-based remuneration to each employee covered by the programme.

Sickness absence

Total sickness absence in 2020 was 0.5% (1.7). The figures were 0.2% (0.5) for male employees and 0.8% (3.4) for female staff.

Other

Under the guidelines of the Global Reporting Initiative, companies should disclose whether freedom of association and collective bargaining exists and if any employees are younger than 18. In compliance with Swedish law, AP3 allows freedom of association and collective bargaining. The employment terms and conditions of AP3 employees reflect collective wage agreements with the Employers' Organisation of the Swedish Banking Institutions and three trade union members of the SACO confederation: JUSEK, the Swedish Association of Graduates in Business Administration and Economics, and the Swedish Association of Graduate Engineers. AP3 has no employees aged under 18.

NOTE 7 Other operating expenses

SEK m	2020	2019
Office rental cost	12	11
Market information and data costs	54	51
Services purchased	12	13
Other	5	7
Total other operating expenses	84	82

Services purchased include fees to auditors and in 2020 included fees of SEK 0.9 million (0.2) for consulting services ordered by the Government Offices.

SEK thousand	2020	2019
Audit assignments		
PwC	738	756
Other services by audit firms		
PwC	-	8
Total fees to audit firms	738	764

Notes to the financial statements

NOTE 8 Listed shares and investments

SEK m, fair value	31 Dec 2020	31 Dec 2019
Swedish equities	57,119	51,401
Investments in Swedish funds	-	-
Foreign equities	108,948	98,624
Investments in foreign funds	36,343	31,775
Total listed shares and investments	202,410	181,800

A schedule of the five largest Swedish and foreign equity holdings is shown on page 86. A schedule of all AP3's equity holdings is available at ap3.se. See Notes 1 and 17 for information on securities lending. Collateral received in relation to securities lending totalled an average of 103% of the market value of the assets loaned.

Shares and investments in Swedish subsidiaries and associates

	Corporate identity number	Registered office	Number of shares	Share of equity/voting rights	Fair value	100% equity 2020	100% result 2020
Vasakronan Holding AB	556650-4196	Stockholm	1,000,000	25%	20,956	70,869	3,714
Hemsö Fastighets AB	556779-8169	Stockholm	70,000,700	70%	15,001	20,082	3,333
Hemsö Intressenter AB	556917-4336	Stockholm	25,000	50%	3,214		
Hemsö Norden KB	969769-2961	Stockholm	-	50%	450	901	180
Trophi Fastighets AB	556914-7647	Stockholm	1,000,000	100%	6,902		
Fastighets AB Regio	559013-4911	Stockholm	4,000,012	96%/98%	4,476		
Ellevio Holding 1 AB	559005-2444	Stockholm	10,000	20%	2,050		
Trenum AB	556978-8291	Gothenburg	500	50%	1,377		
Gysinge Skog AB	559164-0817	Stockholm	25,000	50%	1,333		
Polhem Infra KB	969789-2413	Stockholm	-	33%	469	1,406	211
Polhem Infra AB	559183-3917	Stockholm	20,000	33%	0	0	-1
Total shares and investments in Swedish subsidiaries and associates					56,228		

Shares and investments in foreign subsidiaries and associates

	Registered office	Number of shares	Share of equity/voting rights	Fair value
OMERS Farmoor 2 Holdings B.V.	Netherlands	149	100%/49%	2,773
ThreeTree Holdings LLC	USA	10,000	100%	1,184
Total shares and investments in foreign subsidiaries and associates				3,957

Five largest holdings in other Swedish unlisted shares and investments

	Registered office	Share of equity	Cost 2020
Impilo AB Investment Pool 1	Stockholm	10%	313
Verdane Capital IX	Stockholm	10%	239
Altor Fund IV	Stockholm	2%	231
Verdane Edda	Stockholm	8%	172
Standout Capital I	Stockholm	20%	149

Five largest holdings in other foreign unlisted shares and investments

	Registered office	Share of equity	Cost 2020
Mirova Core Infrastructure Fund II SCS	Luxembourg	8%	941
Innisfree PFI Secondary Fund 2 (ISF2)	London	18%	898
Hermes Infra Spring II	Guernsey	26%	674
RMK GAC	USA	100%	558
Resonance Industrial Water Infrastructure Fund Limited	Guernsey	25%	495

A schedule of all holdings, including the initial year of investment and the size of investment commitment, is available at ap3.se.

NOTE 9 Unlisted shares and investments

As of 31 December 2020, AP3's investment commitments in unlisted securities via private equity firms and funds were as follows. The schedule below shows the five largest holdings in terms of invested capital.

SEK m, fair value	31 Dec 2020	31 Dec 2019
Shares and investments in Swedish subsidiaries and associates	56,228	50,321
Shares and investments in foreign subsidiaries and associates	3,957	3,187
Other unlisted Swedish shares and investments	2,069	1,684
Other unlisted foreign shares and investments	24,423	22,907
Total unlisted shares and investments	86,677	78,099

NOTE 10 Bonds and other interest-bearing assets**Bonds and other interest-bearing securities by issuer category**

SEK m, fair value	31 Dec 2020	31 Dec 2019
Government of Sweden	6,998	8,302
Swedish municipalities	-	101
Swedish mortgage lenders	4,673	4,854
Other Swedish issuers		
Financial institutions	1,795	630
Non-financial institutions	17,819	14,461
Foreign governments	63,195	71,890
Other foreign issuers	30,136	27,353
Total	124,616	127,592
Fixed income funds	1,452	3,278
Total	126,068	130,870

Bonds and other interest-bearing securities by class of instrument

SEK m, fair value	31 Dec 2020	31 Dec 2019
Inflation-indexed bonds	26,415	28,006
Other bonds	88,464	88,915
Certificates	1,289	2,432
Unlisted promissory notes	8,448	8,238
Total	124,616	127,592
Fixed income funds	1,452	3,278
Total	126,068	130,870

SEK 3,566 million (2,955) of bonds and other fixed income securities relates to reinvested cash collateral received for securities lending. See Notes 1 and 17 for information on securities lending. Collateral received in relation to securities lending totalled an average of 103% of the market value of the assets loaned.

NOTE 11 Derivatives, gross

SEK m		31 Dec 2020		31 Dec 2019	
		Positive fair value	Negative fair value	Positive fair value	Negative fair value
Equity-related instruments					
Options, cleared	Held, buy	24	-	-	-
	Held, sell	-	-	-	-
	Drawn, buy	-	-5	-	-
	Drawn, sell	-	-16	-	-
Forwards		-	-	1	-6
Swaps		1	-	-	-11
Total		25	-21	1	-17
- cleared		24	-21	1	-6
Fixed income and credit-related instruments					
Options, cleared	Held, buy	-	-	-	-
	Held, sell	-	-	-	-
	Drawn, buy	-	-	-	-
	Drawn, sell	-	-	-	-
FRAs/forwards		3	-3	7	-4
CDS		-	-	-	-
Swaps		287	-40	259	-684
Total		290	-43	266	-688
- cleared		3	-3	7	-4
Currency-related instruments					
Options, OTC	Held, buy	146	-	23	-
	Held, sell	152	-	125	-
	Drawn, buy	-	-137	-	-35
	Drawn, sell	-	-80	0	-35
Forwards		9,058	-103	3,852	-664
Swaps		-	-	-	-
Total		9,356	-320	4,000	-734
Effect of netting		-	-	-	-
Total derivatives		9,671	-384	4,268	-1,438

Notes to the financial statements

AP3 is mandated to use derivative securities primarily to improve the efficacy of asset management or to manage risk.

Equity and interest rate derivatives are preferably traded on standardised markets through cleared products, which limits counterparty risk to the clearing house. Currency and credit derivative markets are over-the-counter, which means that trades executed there are not standardised or subject to clearing. Thus, counterparty or settlement risk generally arises. Counterparties for non-cleared transactions are limited and sanctioned by the board of directors and all exposure to such counterparties is continuously monitored. AP3 uses standardised market contracts, including ISDA agreements, for OTC trading.

Drawn put options are positions in different options strategies taken to manage portfolio risk. Where a put option requires AP3 to deliver an underlying security, AP3 always holds enough of that security to meet its delivery obligation.

More information on AP3's risk management in relation to derivatives can be found in the risk management plan at ap3.se.

NOTE 12 Other assets

SEK m	31 Dec 2020	31 Dec 2019
Trade payables	204	17
Buybacks	781	927
Reinvested cash collateral	4,591	4,540
Other current receivables	0	4
Total other assets	5,577	5,488

NOTE 13 Prepaid expenses and accrued income

SEK m	31 Dec 2020	31 Dec 2019
Accrued interest income	628	635
Accrued dividends	86	98
Tax reclaimables	252	225
Prepaid expenses	54	59
Accrued premiums on equity loans	10	11
Total prepaid expenses and accrued income	1,030	1,028

NOTE 14 Other liabilities

SEK m	31 Dec 2020	31 Dec 2019
Accounts payable	18	13
Trade payables	158	2
Payroll taxes	0	1
Staff PAYE taxes	3	3
Buybacks	781	927
Cash collateral received	8,155	7,493
Other liabilities	4	5
Total other liabilities	9,120	8,443

NOTE 15 Deferred income and accrued expenses

SEK m	31 Dec 2020	31 Dec 2019
Accrued external asset management costs	39	34
Other accrued expenses	13	13
Variable remuneration incl. social security expenses	11	9
Total deferred income and accrued expenses	63	57

Forty percent of a payment of variable remuneration earned in 2018 was made in 2019. The outstanding balance will be paid in 2021. Forty percent of a payment of variable remuneration earned in 2019 was made in 2020. The outstanding balance will be paid in 2022. A provision for variable remuneration was made in 2020. Forty percent of this amount will be paid in 2021 and the outstanding balance in 2023.

NOTE 16 Fund capital

Net payments to the pension system

SEK m	31 Dec 2020	31 Dec 2019
Fund capital at 1 Jan	393,696	340,668
Paid-in pension contributions	73,872	72,344
Paid-out pensions	-81,564	-78,681
Transfer of pension rights to the EU	-2	-
Settlement of pension rights	2	3
Administration fee to the Swedish Pensions Agency	-210	-185
Total net payments to the pension system	-7,902	-6,520
Net result for the year	37,179	59,549
Fund capital at 31 Dec	422,974	393,696

NOTE 17 Pledged assets, contingent liabilities and commitments

Pledged assets, contingent liabilities and equivalent collateral

SEK m	31 Dec 2020	31 Dec 2019
Pledged assets for buybacks		
Collateral received	5,372	5,467
Collateral pledged	781	927
Pledged assets for derivatives trading		
Cash collateral received	7,637	1,085
Cash collateral pledged	-	-
Loaned securities for which cash collateral received		
Loaned securities	8,157	7,492
Cash collateral received	8,156	7,495
Securities loaned against collateral in securities		
Loaned securities	70,884	71,919
Collateral received in securities	75,201	77,354

Outstanding commitments

SEK m	31 Dec 2020	31 Dec 2019
Unlisted equities	8,771	8,526
Real estate, infrastructure and timberland funds	2,262	2,740
Subscription commitments	11,500	11,500

The collateral shown above is presented in Notes 10, 12 and 14.

NOTE 18 Currency exposure**Assets subject to currency exposure at 31 Dec 2020**

SEK m	USD	EUR	GBP	JPY	Other	Total
Shares and investments	87,419	22,915	8,295	10,671	38,394	167,694
Exposure to SEK-listed companies with foreign domicile	-	1,589	1,100	-	1,891	4,580
Bonds and other fixed income securities	72,785	6,725	3,018	2,087	565	85,179
Derivatives	-107	-132	21	-2	22	-198
Other investment assets	4,679	739	2,756	147	230	8,551
Foreign currency exposure, gross	164,775	31,836	15,190	12,902	41,102	265,806
Currency hedges	-138,955	-26,821	-8,525	-7,380	-5,505	-187,187
Total currency exposure	25,820	5,015	6,665	5,522	35,597	78,619

Assets subject to currency exposure at 31 Dec 2019

SEK m	USD	EUR	JPY	GBP	Other	Total
Shares and investments	68,800	18,088	12,925	10,910	39,958	150,681
Exposure to SEK-listed companies with foreign domicile	-	2,007	-	1,016	965	3,988
Bonds and other fixed income securities	80,442	2,216	-	8,525	642	91,825
Derivatives	-58	-502	2	-23	-10	-591
Other investment assets	6,661	788	153	3,359	140	11,101
Foreign currency exposure, gross	155,846	22,598	13,080	23,787	41,695	257,004
Currency hedges	-119,215	-27,891	-1,005	-18,757	-9,216	-176,085
Total currency exposure	36,630	-5,294	12,075	5,030	32,479	80,920

NOTE 19 Financial instruments, price and valuation hierarchy**Investment assets per valuation category at 31 Dec 2020**

SEK m	Level 1	Level 2	Level 3	Total
Listed shares and investments	202,410	-	-	202,410
Unlisted shares and investments	-	-	86,677	86,677
Bonds and other fixed income assets	117,581	-	8,488	126,068
Derivatives, positive market value	27	9,644	-	9,671
Total investment assets	320,017	9,644	95,165	424,827
Derivatives, negative market value	-24	-360	-	-384
Total	319,993	9,284	95,165	424,443

Investment assets per valuation category at 31 Dec 2019

SEK m	Level 1	Level 2	Level 3	Total
Listed shares and investments	181,800	-	-	181,800
Unlisted shares and investments	-	-	78,099	78,099
Bonds and other fixed income assets	122,600	-	8,270	130,870
Derivatives, positive market value	9	4,259	-	4,268
Total investment assets	304,409	4,259	86,369	395,037
Derivatives, negative market value	-9	-1,429	-	-1,438
Total	304,400	2,830	86,369	393,599

Change of Level 3 assets 2019-2020

SEK m	Listed shares and investments	Unlisted shares and investments	Bonds and other fixed income assets	Derivatives	Total
Carrying amount at 1 Jan	-	78,099	8,270	-	86,369
Invested	-	7,421	448	-	7,869
Sold/repaid during year	-	-1,585	-200	-	-1,785
Realised change in value	-	-18	19	-	-
Unrealised change in value	-	2,760	-49	-	2,711
Transfer from Level 1 or 2	-	-	-	-	-
Transfer to Level 1 or 2	-	-	-	-	-
Carrying amount at 31 Dec	-	86,677	8,488	-	95,165

Change of Level 3 assets 2018-2019

SEK m	Listed shares and investments	Unlisted shares and investments	Bonds and other fixed income assets	Derivatives	Total
Carrying amount at 1 Jan	-	67,905	7,631	-	75,536
Invested	-	6,255	4,405	-	10,660
Sold/repaid during year	-	-1,037	-3,764	-	-4,801
Realised change in value	-	1,161	-	-	1,161
Unrealised change in value	-	3,815	-3	-	3,812
Transfer from Level 1 or 2	-	-	-	-	-
Transfer to Level 1 or 2	-	-	-	-	-
Carrying amount at 31 Dec	-	78,099	8,270	-	86,369

AP3 measures all holdings at fair value using a three-level hierarchy of price sources and measurement methods. Fair value is defined as the amount for which an asset could be sold or a liability settled in a normal transaction between market players on the valuation date.

Level 1: Holdings shown in the benchmark indices that AP3 uses for liquid instruments in equities and fixed income securities are measured initially at the prices stated by index vendors. Where such holdings are not included in an index or the index vendor's price is not deemed to be reliable, measurement is at list prices observable in an active market. An active market relates to a market where prices are set more than once a week. Observable prices are always the preferred measurement option and apply to the majority of AP3's assets. However, when such prices are not available, the next step in the valuation hierarchy is used for measurement.

Level 2: Reliable listed prices are unavailable for some holdings, notably some fixed income securities and most derivatives not traded over an exchange or handled by a clearing house. Measurements are based on generally acceptable models that use observable market data to establish fair value. Valuation risk for this group is deemed to be limited. This group also includes certain types of transaction in which AP3 relies on price information from one or more external counterparties to establish fair value. In the case of assets whose price is deemed unreliable, for instance due to low market activity, AP3 obtains a third-party valuation to test the reasonableness of its own valuation.

Level 3: Some holdings must be valued using models based on non-observable market data. These are subject to a higher degree of subjective assessment and hence higher uncertainty. In AP3's case, they relate mostly to holdings in private equity funds and of unlisted shares in real estate companies.

AP3 measures private equity fund holdings using valuations received from external managers. AP3 requires that fund managers comply with IPEV valuation principles and that their funds are reviewed by an established audit firm. Valuations from fund managers are usually received within 90 days after the end of the quarter, which means that the declared values of AP3's holdings as of 31 December are based on fund managers' reports dated 30 September and adjusted for cash flow during the fourth quarter. AP3 assesses the reliability of these valuations to determine whether any adjustments are necessary to achieve a more accurate fair value. No adjustments were deemed necessary as of 31 December 2020. Valuations primarily reflect the underlying profitability of the investee but also how the equity market values comparable enterprises. Projected discounted future cash flow is of less importance from a valuation perspective because the AP3 private equity portfolio largely consists of buyouts.

The table provides a schedule of all AP3's investment assets by valuation category. Some 75% (77) of these assets can be valued at observable prices in an active market. A 10% write-down of the hardest-to-value assets, that is those at Level 3, would reduce AP3's fund capital by 2.2% (2.2). AP3 has limited valuation risk.

NOTE 20 Financial risk

Risk measured as value at risk for the AP3 portfolio

SEK m	Min. level	Max. level	Average	31 Dec	31 Dec ¹
2020	1,602	12,129	4,458	2,220	5,680
2019	1,297	2,840	1,883	1,383	2,143

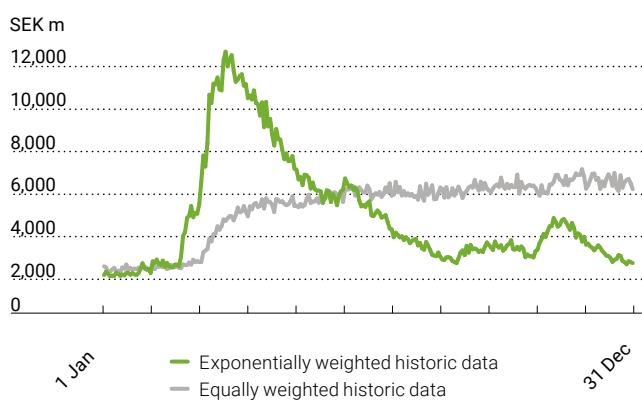
1) The column shows VaR for equally weighted historical data.

AP3's holdings are exposed to market and credit risks that can result in changes in value when equity prices, fixed income yields, credit spreads and foreign exchange rates change. AP3 uses the value at risk (VaR) metric to aggregate risk across all risk categories. At year-end, risk measured as VaR totalled SEK 2,220 million (1,383) for the total portfolio. AP3 measures VaR with a 95% level of confidence and a horizon of one day, meaning that negative changes in value should not exceed VaR on 19 days out of 20, assuming that market conditions follow historical patterns. AP3 bases VaR estimates on historical market data dating back 360 days. Historical data is weighted exponentially, meaning that market events in the preceding 80 days have overriding influence. The measurement method used is known as Monte Carlo simulation and is a random modelling of changes in value based on historical data. The table above shows maximum and minimum VaR and both average risk and year-end risk for the AP3 portfolio. The table also shows VaR at 31 December. Historical data is equally weighted, meaning that every day has equal significance.

AP3's risk measured as VaR varied from SEK 1,602 million (1,297) to SEK 12,129 million (2,840) during the year. Changes in the level of risk were due primarily to changes in market volatility, and to a lesser extent to changes in portfolio structure.

Risk exposure by risk class is shown on page 60.

Daily value at risk (VaR) for the AP3 portfolio 2020



Exposure to credit risk at 31 Dec 2020 ¹ SEK m	Credit rating				
	AAA	AA	A	BBB	<BBB ²
Government bonds	25,397	58,337	2,292	962	-
Mortgage bonds	4,942	-	-	1,183	-
Corporate bonds	517	2,490	3,637	11,856	4,406
Deposits and buybacks	-	-	4,591	-	-
Derivatives, net	-	1,594	7,721	-	-
Gross exposure	30,855	62,421	18,241	14,001	4,406
Collateral received	-	1,297	6,340	-	-
Net exposure	30,855	61,124	11,901	14,001	4,406

Exposure to credit risk at 31 Dec 2019 ¹ SEK m	Credit rating				
	AAA	AA	A	BBB	<BBB ²
Government bonds	27,702	72,573	-	-	-
Mortgage bonds	264	4,896	-	148	-
Corporate bonds	468	1,368	3,721	3,284	4,303
Deposits and buybacks	-	-	4,540	-	-
Derivatives, net	1,620	1,114	-	486	-
Gross exposure	30,054	79,951	8,262	3,917	4,303
Collateral received	-	439	646	-	-
Net exposure	30,054	79,511	7,616	3,917	4,303

1) Includes investments in listed fixed income securities; deposits and buybacks; non-cleared derivatives where AP3 has a claim on the counterparty; and repayments of collateral for securities lending. The table only shows exposure versus credit risk and cannot be read against the balance sheet.

2) Also includes unrated securities.

AP3's liquidity risk is limited by the National Pension Insurance Funds Act, which requires the AP funds to hold at least 20% of their fund capital in fixed income securities with low credit and liquidity risk. AP3's holdings in this category averaged 25.5% (30.1) of fund capital in 2020.

NOTE 21 Financial assets and liabilities offset in the balance sheet or subject to netting agreements

31 Dec 2020 Assets, SEK m	Offsetting of financial instruments						Total in balance sheet
	Gross amount	Amount offset in balance sheet	Net balance in balance sheet	per agreement	Collateral received	Net amount after offsetting	
Derivatives	9,644	-	9,644	329	7,637	1,678	27 9,671
Asset repurchases	781	-	781	781	-	-	4,591 5,372
Non-settled transactions	-	-	-	-	-	-	204 204
Total	10,426	-	10,426	1,111	7,637	1,678	4,822 15,247

31 Dec 2020 Liabilities, SEK m	Offsetting of financial instruments						Total in balance sheet
	Gross amount	Amount offset in balance sheet	Net balance in balance sheet	per agreement	Collateral pledged	Net amount after offsetting	
Derivatives	360	-	360	329	-	31	24 384
Debt repurchases	781	-	781	781	-	-	- 781
Non-settled transactions	-	-	-	-	-	-	158 158
Total	1,141	-	1,141	1,111	-	31	182 1,323

1) Other instruments in the balance sheet not classed as subject to agreements that allow netting.

Notes to the financial statements

31 Dec 2019		Offsetting of financial instruments per agreement							
Assets, SEK m	Gross amount	Amount offset in balance sheet	Net balance in balance sheet	Offsetting of financial instruments per agreement	Collateral received	Net amount after offsetting	Other ¹	Total in balance sheet	
Derivatives	4,260	-	4,260	871	1,085	2,303	8	4,268	
Asset repurchases	926	-	926	926	-	-	4,540	5,467	
Non-settled transactions	-	-	-	-	-	-	17	17	
Total	5,186	-	5,186	1,798	1,085	2,303	4,565	9,751	

31 Dec 2019		Offsetting of financial instruments per agreement							
Liabilities, SEK m	Gross amount	Amount offset in balance sheet	Net balance in balance sheet	Offsetting of financial instruments per agreement	Collateral pledged	Net amount after offsetting	Other ¹	Total in balance sheet	
Derivatives	1,429	-	1,429	871	-	557	9	1,438	
Debt repurchases	927	-	927	926	-	1	-	927	
Non-settled transactions	-	-	-	-	-	-	2	2	
Total	2,355	-	2,355	1,798	-	558	11	2,366	

1) Other instruments in the balance sheet not classed as subject to agreements that allow netting.

NOTE 22 Related party transactions

This note describes how AP3's results and financial position are impacted by transactions and outstanding dealings, including undertakings, with related parties as defined in IAS 24. Parties related to AP3 are companies in which AP3 has a shareholding that gives it significant or decisive influence or in which AP3 employees hold leading positions. AP3 rents its office space from Vasakronan at market rates. See Note 6 for salaries and remuneration to AP3's board of directors and executive management.

Related party, SEK m	31 Dec 2020	31 Dec 2019	Related party, SEK m	31 Dec 2020	31 Dec 2019
Vasakronan Holding AB			Ellevio AB		
Interest income	9	9	Interest income	248	294
Rental cost of premises	-10	-10	Shareholder loans	4,382	4,133
Commitment to purchase, at Vasakronan's request, commercial paper issued by the company for a maximum total amount of:	4,500	4,500			
Hemsö Fastighets AB			Trenum AB		
Commitment to purchase, at Hemsö Fastighet AB's request, commercial paper issued by the company for a maximum amount of	5,000	5,000	Interest income	23	16
Capital increases during the year	700	700	Shareholder loans	1,983	1,783
			Capital increases during the year	50	106
Hemsö Intressenter AB					
Interest income	98	96	Gysinge Skog AB		
Shareholder loans	1,470	1,470	Capital increases during the year	-	802
Capital increases during the year	150	150			
Trophi Fastighets AB			Polhem Infra AB		
Interest income	24	26	Capital increases during the year	-	0
Shareholder loans	613	635			
Commitment to purchase, at Trophi Fastighets AB's request, commercial paper issued by the company for a maximum total amount of:	2 000	2 000	Polhem Infra KB		
			Capital increases during the year	90	312
			Aphelaria AB		
			Capital increases during the year	0	5
			ThreeTree Holdings LLC		
			Capital increases during the year	1,266	-

Signatures of board of directors and CEO

Stockholm, 18 February 2021

Christina Lindenius
Chairman

Peter Englund
Deputy Chairman

Malin Björkmo

Johan Bygge

Magnus Emfel

Hillevi Engström

Ylva Hedén Westerdahl

Torbjörn Hållö

Carina Wutzler

Kerstin Hessius
CEO

Our auditors' report was submitted on 18 February 2021.

Peter Nilsson
Authorised public accountant
Appointed by the government

Helena Kaiser de Carolis
Authorised public accountant
Appointed by the government

Auditor's report

for the Third Swedish National Pension Fund (AP3),
Corporate Identity Number 802014-4120

Report on the audit of the financial statements

Opinion

We have audited the financial statements of the Third Swedish National Pension Fund for the 2020 financial year. The Fund's financial statements are included in the printed version of this document on pages 59-81.

In our opinion, the financial statements have been prepared in accordance with the National Pension Insurance Funds Act (2000:192) and present fairly, in all material respects, the financial position of the Third Swedish National Pension Fund as at 31 December 2020 and of its financial performance for the year then ended, according to the National Pension Insurance Funds Act.

The statutory administration report is consistent with the other parts of the financial statements.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISA) and generally accepted auditing standards in Sweden. Our responsibilities according to those standards are described in more detail in the Auditor's Responsibilities section below. We are independent of the Third Swedish National Pension Fund according to generally accepted auditing standards in Sweden and have otherwise fulfilled our ethical responsibilities according to those standards.

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

Other information than the financial statements

This document also contain other information than the annual report and this can be found on pages 1-58 and 84-91. The Board of Directors and the Chief Executive Officer are responsible for the other information.

Our opinion on the financial statements does not cover this other information and we do not express any form of assurance conclusion regarding this other information.

In connection with our audit of the financial statements, our responsibility is to read the information identified above and consider whether the information is materially inconsistent with the financial statements. In this procedure we also take into account our knowledge otherwise obtained in the audit and assess whether the information otherwise appears to be materially misstated.

If we, based on the work performed concerning this information, conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the board of directors and the CEO

The board of directors and the CEO are responsible for the preparation of the financial statements and that they give a fair presentation in accordance with the National Pension Insurance Funds Act. The board of directors and the CEO are also responsible for such internal control as they deem necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or mistake.

In preparing the financial statements, the board of directors and the CEO are required to assess the Fund's capacity to continue its operations. They disclose, as applicable, matters related to such assessments and using the going concern basis of accounting. The going concern basis of accounting is, however, not applied if the board of directors and the CEO intend to liquidate the Fund or cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or mistake, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and generally accepted auditing standards in Sweden will always identify a material misstatement when it exists. Misstatements can arise from fraud or mistake and are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As a part of the audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement in the financial statements, whether due to fraud or mistake, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than one resulting from mistake, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of the Fund's internal control relevant to our audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of the accounting principles used and the reasonableness of the accounting estimates and related disclosures made by the board of directors and the CEO.
- Conclude on the appropriateness of the board of directors' and the CEO's application of the going concern basis of accounting in preparing the financial statements. We also draw a conclusion, based on the evidence

obtained, as to whether any material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion about the financial statements. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We must inform the Board of Directors of, among other matters, the planned scope and timing of the audit. We must also inform of significant audit findings during our audit, including any significant deficiencies in internal control that we identified.

Report on other legal and regulatory requirements

Opinion

In addition to our audit of the financial statements, we have also audited the inventory of the assets managed by the Third Swedish National Pension Fund. We have also examined whether there are any qualifications regarding the board of directors' and the CEO's administration of the Third Swedish National Pension Fund for the 2020 financial year.

The audit has resulted in no grounds for qualification regarding the inventory of the assets or the administration of the Fund.

Basis for opinion

We conducted our audit in accordance with generally accepted auditing standards in Sweden. Our responsibilities under those standards are further described in the Auditor's Responsibilities section below. We are independent of the Third Swedish National Pension Fund in accordance with professional ethics for accountants in Sweden and have otherwise fulfilled our ethical responsibilities in accordance with those requirements.

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

Responsibilities of the board of directors and the CEO

The board of directors and the CEO are responsible for the financial statements and for the administration of the Fund's assets according to the National Pension Insurance Funds Act.

The board of directors is responsible for the Fund's organisation and the administration of the Fund's affairs. This includes continuous assessment of the Fund's financial situation and ensuring

that the Fund's organisation is designed so that the accounting, management of assets and the Fund's financial affairs otherwise are controlled in a reassuring manner. The CEO is responsible for the ongoing administration according to the board of directors' guidelines and instructions and must among other matter take measures that are necessary to fulfil the Fund's accounting in accordance with law and handle the management of assets in a reassuring manner.

Auditor's responsibilities

Our responsibility concerning the audit of the administration and, thereby, our opinion on discharge from liability, is to obtain audit evidence to assess with a reasonable degree of assurance whether there is any reason for qualification in respect any member of the board of directors or the CEO of the Third Swedish National Pension Fund for the 2020 financial year.

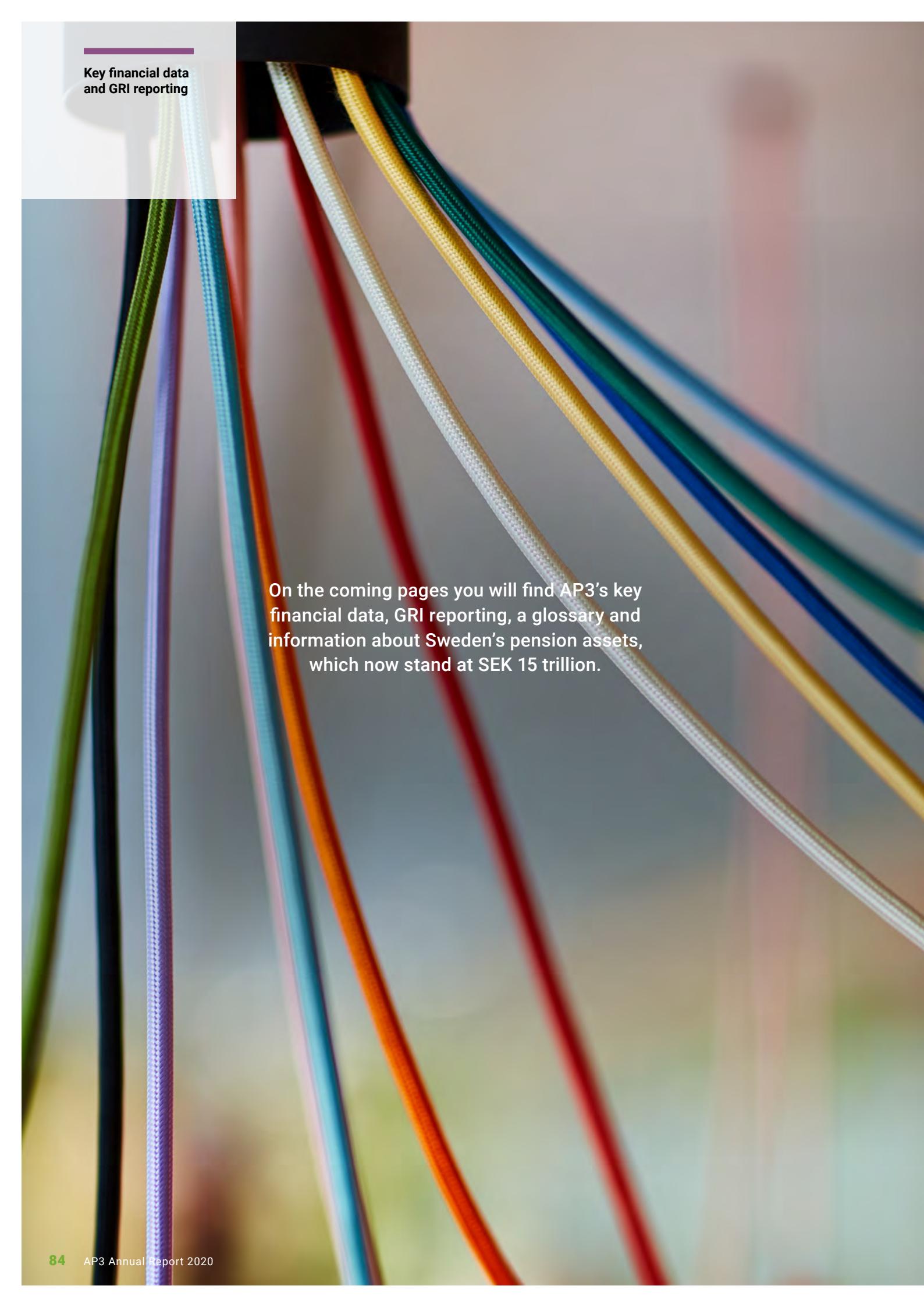
Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with generally accepted auditing standards in Sweden will always identify actions or omissions that can give rise to qualification.

As a part of an audit in accordance with generally accepted auditing standards in Sweden, we exercise professional judgment and maintain professional scepticism throughout the audit. The examination of the administration is based primarily on the audit of the financial statements. Additional audit procedures performed are based on our professional judgment, with the starting point being risks and materiality. This means that we focus the examination on such actions, areas and relationships that are material for the operations and where deviations and violations would have particular significance to the Fund's situation. We examine and test decisions undertaken, support for decisions, actions taken and other circumstances that are relevant to our opinion on the administration.

Stockholm, 18 February 2021

Peter Nilsson
Authorised auditor
Appointed by the government

Helena Kaiser de Carolis
Authorised auditor
Appointed by the government



On the coming pages you will find AP3's key financial data, GRI reporting, a glossary and information about Sweden's pension assets, which now stand at SEK 15 trillion.

Key financial data

Change in fund capital

SEK m	2020	2019	2018	2017	2016
Fund capital at 1 Jan ¹	393,696	340,668	345,239	324,375	303,031
Net flow to pension system	-7,902	-6,520	-6,773	-7,375	-6,637
Net result	37,179	59,549	2,202	28,239	27,981
Fund capital at 31 Dec	422,974	393,696	340,668	345,239	324,375

1) Fund capital at inception in 2001 was SEK 133,975 million.

Market value per asset category

SEK bn	31 Dec 2020	31 Dec 2019	31 Dec 2018	31 Dec 2017	31 Dec 2016
Listed equities¹					
Sweden	52.1	48.8	37.3	44.5	40.3
Europe	28.5	23.0	17.3	26.9	23.7
North America	72.2	57.4	44.1	54.0	50.4
Asia	16.0	19.3	11.2	7.6	9.2
Emerging markets	24.1	24.9	18.3	19.8	15.0
Total listed equities	193.0	173.5	128.1	152.9	138.7
Fixed income¹					
Nominal	Sweden	41.5	32.7	37.3	45.8
	Eurozone	6.3	0.0	0.0	0.4
	UK	3.1	8.3	8.2	9.0
	USA	44.8	52.7	58.4	44.8
	Japan	2.1			
	Emerging markets	0.4			
Inflation-indexed bonds	Sweden	3.8	4.9	4.9	4.8
	Eurozone	0.0	-	-	0.0
	Japan	0.0	-	0.0	0.2
	USA	22.6	23.8	19.0	15.8
Total fixed income	124.6	122.3	127.9	120.8	120.5
Alternative investments¹					
Real estate and infrastructure	Vasakronan	21.0	20.6	17.7	15.2
	Hemsö	20.2	17.1	14.0	11.8
	Farmoor	2.8	3.2	3.2	3.1
	Regio	4.5	3.8	3.3	2.3
	Sagax	4.0	3.2	1.5	1.1
	Trenum	3.4	2.8	2.2	1.6
	Trophi	7.5	6.7	6.2	5.3
	Ellevio	6.4	6.2	6.1	5.4
	Polhem Infra	0.5	0.3		
	Timberland and agricultural land	6.0	4.7	5.3	5.0
	International real estate funds ²	6.5	8.2	6.7	6.2
Total real estate and infrastructure	82.7	76.9	66.4	57.0	52.0
Unlisted equities		17.8	15.5	13.1	10.3
Other assets ³		4.8	5.6	5.3	4.1
Total alternative investments	105.3	97.9	84.7	71.4	65.1
Total	423.0	393.7	340.7	345.2	324.4

1) Cash used for position-taking in forwards has been divided among the relevant asset classes, which means the figures in the table are not fully comparable with those in the balance sheet.

2) Includes infrastructure funds.

3) Other assets include investments in convertible debentures and insurance-related risk.

Key financial data

Five largest holdings in Swedish listed companies

Name	No. of shares	Share of equity	Share of voting rights	Market value, SEK m
Sagax AB	24,227,658	5.25	3.44	4,109
Volvo AB	14,775,036	0.73	0.34	2,864
Investor AB	4,717,053	0.61	0.46	2,824
Atlas Copco AB	6,974,705	0.57	0.10	2,578
Telefonaktiebolaget LM Ericsson AB	25,160,345	0.75	0.44	2,457

Five largest holdings in foreign listed companies

Name	No. of shares	Market value, SEK m
Apple Inc	3,554,485	3,873
Microsoft Corp	1,977,819	3,613
Amazon.com Inc	108,981	2,915
Alphabet Inc	161,791	2,328
Nestle SA	1,488,698	1,442

Ten largest recipients of brokerage fees in 2020 (alphabetical order)

- Bank of America
- Bernstein
- Carnegie
- Citi
- Danske Bank
- Jefferies
- JP Morgan
- Nordea
- SEB
- UBS

Five counterparties that handled the largest volumes of AP3's fixed income trading in 2020 (alphabetical order)

- Bank of America
- Citi
- Danske Bank
- JP Morgan
- Nordea

Five counterparties that handled the largest volumes of AP3's foreign exchange trading in 2020 (alphabetical order)

- BNP
- Citi
- Danske Bank
- JP Morgan
- SEB

Allocation of fund capital between internal and external management mandates at 31 Dec 2020

Mandate	Market value, SEK m	Share of fund capital, %
External discretionary mandates		
<i>Equity mandates</i>		
<i>Passive mandates</i>		
BlackRock Investment Management	Europe – Large and mid cap	4,230
BlackRock Investment Management	Japan	10,602
BlackRock Investment Management	Asia-Pacific	4,914
BlackRock Investment Management	North America – Mid cap	8,377
<i>Enhanced mandates</i>		
BlackRock Investment Management	North America – Large cap	30,677
		58,800
		14%
Fund investments		
<i>Listed assets</i>		
Equity funds	26,480	
Fixed income funds	408	
Absolute return strategies and hedge funds	6,687	
<i>Unlisted assets</i>		
Private equity funds	17,792	
Infrastructure funds	5,210	
Real estate funds	287	
Timberland funds	5,970	
	62,834	15%
Internal management mandates		
Listed shares and investments	112,782	
Fixed income and credits	107,988	
Insurance-related risk	4,845	
Unlisted holdings in real estate companies	66,159	
	291,774	69%
Other assets and liabilities¹		
	9,566	2%
Total fund capital		
	422,974	100%

1) Consist primarily of cash and currency hedges.

GRI reporting

AP3 has a long tradition of taking close account of environmental, social and governance aspects in its operations. The Fund manages sustainability internally through investment analysis, governance and by focusing on environmental and ethical issues through participation in the Council on Ethics of the Swedish AP Funds.

Different sections of the organisation hold responsibility for sustainability. The asset management department has responsibility for sustainability in investment activities and a sustainability committee leads the Fund's work in terms of sustainability.

About the report

AP3's sustainability report has been prepared insofar as is possible to comply with the Global Reporting Initiative (GRI) standards, option Core, and the Financial Services Supplement (FS). The report applies the 2016 GRI standards. The report covers AP3's operating activities to the same degree as in the financial statements and with no limitations.

Significant reporting areas and indicators were selected on the basis of both the requirements and expectations of AP3's stakeholders and the Fund's own priorities, thus establishing a common view with regard to materiality.

Some of the GRI disclosures are incomplete according to the standards. AP3 intends to develop further its disclosures, data and procedures in relation to sustainability reporting. The GRI disclosures have not been reviewed by a third party.

The GRI index shows where GRI disclosures can be found in AP3's 2020 annual report (AR) and on the websites of the Funds and the Council on Ethics of the Swedish AP Funds.

Disclosure	Page number/reference
Organisational profile	
102-1 Name of the organisation	AR p. 2
102-2 Activities, brands, products and services	AR p. 8 AP3 does not sell products or services but manages pension capital on behalf of the state income pension system.
102-3 Location of organisation's headquarters	AR p. 70
102-4 Countries where the organisation operates	AR p. 6. AP3's sole office is in Stockholm. The Fund invests globally in different asset classes.
102-5 Ownership and legal form	AR p. 51
102-6 Markets served	AR p. 6-7
102-7 Scale of the organisation	AR p. 67-69
102-8 Information on employees and other workers	AR p. 71-73
102-9 Supply chain	AR p. 18-19, 71
102-10 Significant changes to the organisation and its supply chain	AR p. 18
102-11 Precautionary Principle	AR p. 14
102-12 External initiatives on sustainability to which the organisation subscribes or which it endorses	AR p. 14, 16, 43
102-13 Memberships of associations	AR p. 14, 16, 43
Strategy	
102-14 Statement from senior decision-maker	AR p. 4-5
Ethics and integrity	
102-16 Valuations, principles, standards and norms of behaviour	AR p.4-5, 14, 43 and https://www.ap3.se/om-ap3/867-2/vara-medarbetare-nyckeln-till-framgang/
Governance	
102-18 Governance structure	AR p. 18, 51-51
Stakeholder engagement	
102-40 List of stakeholder groups	AR p. 44
102-41 Collective bargaining agreements	AR p. 73
102-42 Identifying and selecting stakeholders	AR p. 44
102-43 Approach to stakeholder engagement	AR p. 44
102-44 Key topics and concerns raised	AR p. 44

GRI reporting

Disclosure	Page number/reference
Reporting practice	
102-45 Entities in the financial statements	AR p. 70, 85
102-46 Defining report content and topic boundaries	AR p. 13, 14, 18-19, 44, 85
102-47 List of material topics	AR p. 86
102-48 Restatements of information	No changes
102-49 Restatements of financial accounts	No changes
102-50 Reporting period	1/1-31/12 2020
102-51 Date of most recent report	February 2020
102-52 Reporting cycle	Annual
102-53 Contact point for questions regarding the report	AR p. 2 and info@ap3.se
102-54 Claims of reporting in accordance with the GRI standards	AR p. 85
102-55 GRI content index	AR p. 85-86
102-56 External assurance	AR p. 85

GRI indicator	Page number/reference
GRI 201: Economic performance	
Sustainability management approach	103-1, 2, 3 Explanation of the materiality of the topic, the management approach and evaluation of the management approach
Economic performance	201-1 Economic value generated and distributed
GRI 205: Anti-corruption	
Sustainability management approach	103-1, 2, 3 Explanation of the materiality of the topic, the management approach and evaluation of the management approach
Anti-corruption	205-3 Incidents of corruption
GRI 305: Emissions	
Sustainability management approach	103-1, 2, 3 Explanation of the materiality of the topic, the management approach and evaluation of the management approach
Emissions	305-1-4 Direct greenhouse gas emissions
GRI 401: Employment	
Sustainability management approach	103-1, 2, 3 Explanation of the materiality of the topic, the management approach and evaluation of the management approach
Employment	401-2 Benefits provided to full-time employees
GRI 412: Human rights assessment	
Sustainability management approach	103-1, 2, 3 Explanation of the materiality of the topic, the management approach and evaluation of the management approach
Human rights	412-3 Investment decisions that include demands relating to human rights
GRI FS: Product portfolio	
Product portfolio	FS6 Percentage of the portfolio by specific region, size and sector
GRI FS: Active ownership	
GRI FS: Active ownership	FS10 Companies with which the institution has engaged on environmental or social issues
	FS11 Percentage of assets subject to positive and negative environmental or social screening

Glossary

(definitions of financial terms and risk and return metrics)

Active management

Form of management based on taking active positions to achieve higher returns than the benchmark index. Active positions are taken by being overweight or underweight in assets relative to the benchmark index or reference portfolio and based on the projected market outlook.

Age cohort neutrality

The management of pension capital shall not benefit any single generation or age cohort at the expense of another. All age cohorts must be treated equally.

ALM

Asset liability management analysis undertaken to establish an optimal strategic portfolio structure that best corresponds to the Fund's role in the pension system.

Alternative investments

In AP3's case, alternative investments consist of private equity funds, real estate, infrastructure assets, timberland and insurance-related risk.

Automatic balancing

When the assets of the income pension system are insufficient to cover pension commitments, pensions indexing is reduced until the assets once again exceed pension commitments.

Benchmark index

Used to evaluate the return on a portfolio. Usually takes the form of a standardised market index and is also known as the reference index.

Buffer funds

A description of AP1, AP2, AP3, AP4 and AP6 and their role in evening out temporary variations between pension contributions and disbursements and assisting in the long-term financing of the pension system.

Buy-out

Acquisition of a majority of the shares in a mature company.

CDS

Credit default swap. See credit swap.

Clearing

All activities that take place after a transaction is completed in a market place and prior to settlement. Includes reporting, risk measurement and netting.

Clearing house

An institution with regulatory approval to conduct clearing operations. Most countries only have one or very few. In Sweden, clearing is via Stockholmsbörsen, which acts as the counterparty for all derivatives traded on the exchange.

Compliance

The role of checking and monitoring that a company and its employees comply with applicable laws and regulations.

Contribution to return

Describes the proportion of total return generated by a specific portfolio or investment decision. Is usually measured in percentage points. The sum of all contributions to return corresponds to total return in percent.

Convention violations

When a company or country breaches international conventions, treaties and agreements – often those of the United Nations.

Credit swap

Derivative contract between two parties, A and B, in which A pays B an interest premium for a specific period of time. B only pays a premium to A in the event that a predefined asset-related event occurs. The size of this premium is the difference between the nominal underlying value of the derivative contract and the market value of the asset in question (credit default swap).

Currency exposure

Describes the proportion of the portfolio that consists of assets denominated in currencies other than the Swedish krona and where currency risk has not been neutralised by hedging.

Derivative

Financial instrument whose price is determined by underlying value. Options, forwards and swaps are generally classed as derivatives. The value of a derivative depends partly on changes in the underlying value of the instrument.

Forward

A contract in which counterparties undertake to buy or sell an underlying asset at a predetermined price and at a prearranged moment in time. Examples include currency forwards, interest rate forwards, forward rate agreements (FRAs) and equity index forwards. The contracts are also known as futures.

UN Sustainability development goals

The 17 Sustainability development Goals 2030 aim to: abolish extreme poverty, reduce injustice and inequality in the world, promote peace and justice, and solve the climate crisis.

Global Reporting Initiative (GRI)

The GRI issues guidelines for structured and comparable sustainability reporting by companies and organisations.

Government bonds

Bonds issued by the government of a nation state. Are used to finance medium- and long-term borrowing.

Currency hedging

Neutralisation of currency risk, that is, the risk of investing in currencies other than the Swedish krona.

Illiquid assets

Assets that are not listed a market with continuous pricing and are the opposite of liquid assets.

Income index

Key metric that measures average annual income growth in Sweden. Is used as a benchmark for indexing pensions provided that automatic balancing has not been activated.

Index investing

Management designed to ensure only marginal deviations from a chosen benchmark index.

Inflation-linked bonds

Fixed income securities that give protection against inflation. They yield a fixed rate of interest and also include a payment to compensate for inflation.

Investment grade

Bonds which have a credit rating of BBB or higher. They usually carry a low credit risk.

IPEV

The International Private Equity and Venture Capital Valuation Board is an international organisation for private equity and venture capital firms. It issues valuation guidelines based on IFRS and US GAAP, which are regarded as industry standards.

ISDA agreement

Bilateral agreement between two over-the-counter counterparties that regulates the events that could be expected to occur between them.

Liquid assets

See illiquid assets.

Liquidity premium

A higher return that investors often receive for investing in assets that can be hard to sell compared to more "liquid" investments.

LSP

The long-term static portfolio is a zero-cost portfolio against which AP3 benchmarks its asset management. The LSP is a 55:50 mix of listed equities and fixed income instruments comprising Swedish (25%) and global indices (75%) that are weighted as follows: equities (55%) and fixed income (45%). Currency exposure is 22%.

Management expense ratio

Asset management costs in relation to average fund capital.

National Pension Insurance Funds Act

Government statute (2000:192) that established and regulates the AP funds. The act was passed by Parliament in 2000 as part of a five-party agreement to introduce a new income pension system.

Glossary

Option

Entitles the holder to buy or sell an underlying asset at a predefined price and moment in time. The option issuer has equivalent obligations. Options may include currency options, interest rate options and share options.

OTC

Short for over the counter. Refers to contracts agreed and settled between two counterparties without the involvement of a clearing house.

Passive management

Asset management that invests capital in accordance with a benchmark index or portfolio to achieve the same return as the benchmark or portfolio. Is also known as index management.

Principles for Responsible Investment (PRI)

An international network of investors that promotes the implementation of six principles for responsible investment.

Private equity

Collective term for equities that are not listed on an official or public market.

Rating

Measure of creditworthiness that reflects the probability of a counterparty being able to honour its commitments. The rating may relate to the counterparty itself or to a series of securities issued by the counterparty.

Real

Term denoting "minus inflation" as measured by the consumer or retail price index.

Real return

Nominal return adjusted for inflation.

Reference portfolio

A portfolio of different assets whose composition is designed to facilitate comparisons.

Risk capital

Generally refers to investments in a company's equity. Relates in practice to investments in entities that are not listed on a market, that is, private equity.

Risk-adjusted return

A means of evaluating management performance in which active return is considered in relation to the level of risk in the portfolio. The Sharpe and information ratios are two examples.

Sharpe ratio

Measurement of a portfolio's risk-adjusted return, that is, the efficiency of the portfolio. It equates to portfolio return minus risk-free interest divided by the standard deviation of portfolio return.

Stop loss

A predetermined level of cumulative losses over a specific period of time resulting in the immediate closure of all positions.

Swap

Contract in which counterparties agree to exchange flows based on an underlying asset and under prearranged terms and conditions. Often runs for periods of more than 12 months. Examples include interest rate swaps, currency swaps and total return swaps.

Taxonomy

Means classification, and in a sustainability context relates to the EU's framework for classifying economic activities as sustainable or not.

Tracking error

Measures the variation in active return and is calculated as the standard deviation of active return. Historic (ex post) tracking error describes the variation in realised active return and thus measures risk levels retroactively. Expected (ex ante) tracking error is a forecast.

Value at Risk (VaR)

A common measurement of the maximum loss that a portfolio can sustain for a given period and with a certain level of confidence. VaR is calculated daily for a period of one day and with a confidence level of 95%. Portfolio management often requires changes to the portfolio structure to keep this risk of loss at an acceptable level.

Volatility

A risk measure of the variation in return. Is measured as the standard deviation of return.

Measures of risk and return

Absolute return (r_p)

Portfolio return.

Absolute risk or volatility (σ_p)

Standard deviation of portfolio divided by active risk.

Information ratio (risk-adjusted active return)

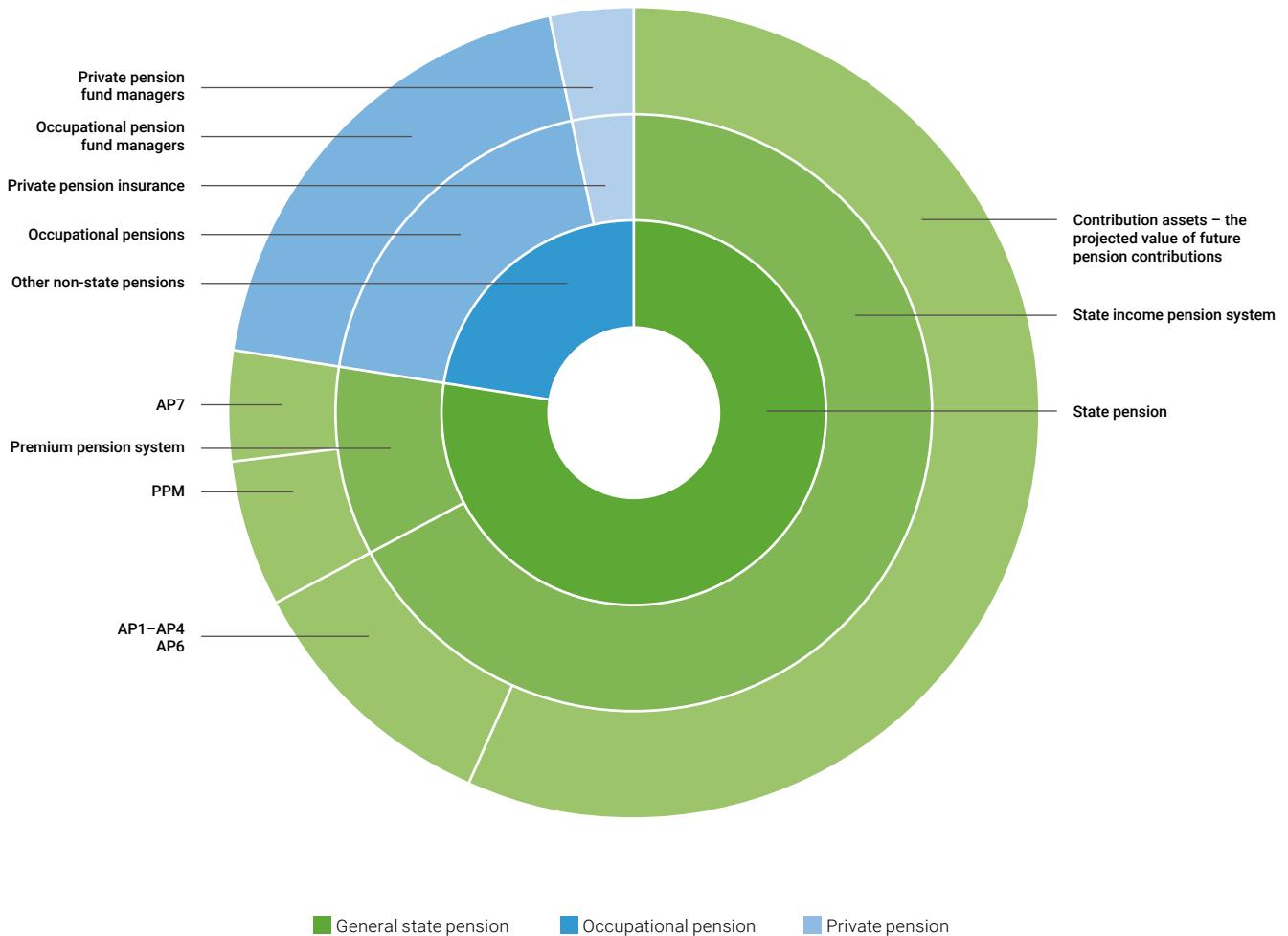
Active return divided by active risk = $\frac{r_p - r_f}{\sigma_{p,i}}$

Sharpe ratio (risk-adjusted return)

Portfolio return minus risk-free return divided by absolute risk = $\frac{r_p - r_f}{\sigma_p}$

Sweden's pension system capital above SEK 15,000 billion

The chart shows the relative size of different parts of the Swedish pension system. It covers the general state pension as well as different forms of occupational pension and private pension plans. The system has total assets of more than SEK 15,000 billion. Data is based on the Swedish Pensions Agency's Orange Report 2019.



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