

# SUSTAINABLE INVESTMENTS

Annual Report 2018





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Linköping Cathedral Parish is responsible for the cemetery in Lilla Aska which has been given a substantial investment in solar panels that are expected to generate 250,000 Kwh per year. All the electricity will be used directly for everyday activities.





# About Sustainable investments

– the Church of Sweden at the national level

THIS IS THE EIGHTH YEAR in a row that the Church of Sweden has published a report on its work with sustainability issues in asset management at the national level. The report has been produced by the financial staff after consultation with the Central Board Asset Management Council. Asset management in dioceses, parishes and congregations is not included in this report.

This is the eighth year in a row that the Church of Sweden has published a report on its work with sustainability issues in asset management at the national level. The report has been produced by the financial staff after consultation with the Central Board Asset Management Council. Asset management in dioceses, parishes and congregations is not included in this report.

More documentation on our sustainable asset management investments, our working methods, our cooperation partners and how the work has been managed in previous years has been published directly in the report, but this documentation is now available together with other more in-depth texts on our website. There you will also find information about our holdings, finance policy and more.

 **Read more about sustainable investments on our website:**

[www.svenskakyrkan.se/responsible-investments](http://www.svenskakyrkan.se/responsible-investments)

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Do you have ideas or views on our sustainable investments?  
You are welcome to contact us.



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# Introduction

## – The year in brief

2018 was an eventful year in the capital markets, both for sustainable finances and for the Church of Sweden's asset management at the national level. We made the decision to invest in three start-up funds focusing on small, sustainable companies, and produced a green bond in cooperation with the World Bank. The EU got an action plan for a sustainable financial market and many of the world's leaders gathered in San Francisco to show concrete action on climate goals and how to finance them.

THE TURBULENCE ON the world's stock markets towards the end of the year meant that many stock exchanges eventually ended with minus when the year was summarised. The Church of Sweden's asset management at the national level with more than 50 percent in equities of course also suffered as well, but thanks to a well-diversified portfolio and skilled fund managers of the funds we invest in, we can still – as we close the annual accounts – be satisfied with the past year. The focus of recent years on investments in the asset classes of real estate and alternative investments has contributed to this diversification and to the positive result. The result at the national level in 2018 was SEK 142.9 million, which corresponds to a return of 1.8 percent. We now manage capital of almost SEK 8.3 billion at the Church of Sweden's national level. Most important and even more gratifying is that, with an average return of 8.4 percentage points over the past ten years, we have managed to achieve the Central Board of the Church of Sweden's long-term real return targets with a good margin.

### The Church of Sweden is a pioneer in sustainable asset management

Sustainability and long-termism have long been two of our key words for asset management. In asset management, we only use external fund managers, and nowadays we almost exclusively invest in funds. More than 10 years ago, when we began to use fund managers who

saw sustainability as a factor that creates business opportunities for companies; it was something new and different. To the extent that sustainability existed at all on the agendas of fund managers, it involved primarily the exclusion of sectors and companies with activities that were harmful or unethical.

### Sustainability and long-termism are prerequisites for stable returns

What most fund managers previously saw as an obstacle for asset management is today seen by an increasing number as more like a prerequisite for creating long-term, stable returns. By including sustainability aspects in fund management work, one gains not only better risk management, for example in the climate issue – one also gains space for better returns by moving the focus from excluding companies to focusing on opportunities to, for example, identify new markets and companies that become winners in the market repositioning that comes about when fossil fuels are replaced by renewable energy and when a more resource-efficient economy is created.

See for example our fund manager Generation Investment Management. They understood this more than ten years ago. Since then, their Global Equity Fund has delivered an average return of more than 4.5 percentage points, net of all fees, above the benchmark index of MSCI World\* each year. Today, it is our largest holding!







# Assignment, asset management model and follow-up

The assignment from the Central Board of the Church of Sweden focuses on the long-term result of asset management for the Church of Sweden's national level. The overall real return target is three percent per year above inflation, measured over rolling ten-year periods. The model we have within asset management to achieve this goal consists of: allocation of the capital, choice of fund manager and follow-up of the asset management.

## Allocation based on a strategic reference portfolio

In order to create the conditions for achieving the long-term goal, we start from a strategic reference portfolio, which we then also use as a reference portfolio when evaluating our asset management.

When we determine the reference portfolio, we assume a real return target of 3 percent and a 10-year time horizon.

The reference portfolio<sup>1</sup> shows the optimal distribution between the asset classes of equities, fixed income investments, real estate and alternative investments in order for us to be able to reach our long-term goal, taking into account the risk level we have set. The calculation is based on data of historical returns and correlation between the asset classes and on forecasts for the expected future long-term return for each respective asset class.

The distribution within the reference portfolio is a reference we continuously follow. Depending on how the different markets develop, the distribution between the asset classes in our portfolio is also constantly changing. We can choose to regularly balance back to the reference portfolio distribution, but we also have the opportunity to deviate within certain set frameworks,

so-called tactical allocation. During 2018, for example, we had an overweight in equities of between five and nine percentage points compared to the reference portfolio.

In this reference portfolio, the distribution between the asset classes during 2018 was as follows:

- Global equities 20%
- Swedish equities 20%
- Equities in emerging markets 10%
- Fixed income investments 25%
- Corporate bonds 5%
- Real estate 10%
- Alternative investments 10%

<sup>1</sup> Our weighted benchmark index is based on the long-term strategic allocation. The table on page 14 shows which benchmark index we use for each respective asset class.



## Choice of fund manager

When the Church of Sweden at the national level chooses a fund manager, it focuses on two overarching areas – the sustainability focus of the fund and its ability to deliver a stable financial return.

In terms of sustainability, the fund manager must live up to our requirements according to the financial policy and our investment rules for ethics and sustainability. The fund manager must have a good ability to integrate factors relating to the environment, social issues and corporate governance<sup>2</sup> in the financial analysis of the companies. The fund manager must also see sustainability issues as opportunities in asset management and not just something that has to do with risk management, although that is of course also an important area. One should thus be able to identify companies that see sustainability work as a way to create new business opportunities and not just as a limiting factor or encumbrances.

In the analysis we make of the fund manager and the fund, it is also important that there is a regulatory framework that ensures that we can avoid invest in any companies that violate the ethical requirements of our policy regarding for example, fossil fuels, weapons, tobacco and pornography.

The description above applies primarily to equity fund management, but the sustainability requirements apply to all asset classes.

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<sup>2</sup> A common abbreviation for this is ESG, which stands for Environmental, Social and Corporate Governance. Corporate governance is about how companies should be governed, regulated and controlled to satisfy the owners and other stakeholders. The Swedish Code of Corporate Governance addresses issues such as the Board's responsibility and role, audit and reporting.



## Follow-up of the fund

In addition to the ten-year real return target, we have a continuous evaluation of the individual funds and the total portfolio. The funds are compared against the relevant benchmark indices, and for the total portfolio we compare the return against our weighted benchmark index. We calculate a benchmark return based on the weight of the different asset classes in the strategic reference portfolio, based on the return that the respective index has produced.

All asset management at the national level takes place with external fund managers and is now almost exclusively in various funds. Unlisted holdings are only in the asset classes of real estate and alternative investments. In both of these asset classes, the running valuation can often be associated with a large portion of uncertainty. The idea of the holdings is to hold to maturity or exit. Only then can one see whether one has been rewar-

ded for the greater risk that these often illiquid holdings are associated with.

In addition to the financial evaluation, we also look at the fund managers and the holding on the basis of our sustainability requirements with the help of independent external screening of the holding. The finance policy for the Church of Sweden's national level expressly states that the companies we invest in shall comply with international frameworks and norms for human rights, environment, working conditions and corporate governance.





# Financial developments

The 2018 result for the Church of Sweden’s asset management at the national level was SEK 142.9 million, which corresponds to a return of 1.8 per cent. Thus, for the seventh consecutive year, the return of fund exceeded its benchmark index. The market value of the investment assets as of 31 December 2018 amounted to SEK 8,295 million (previous year SEK 8,155 million).

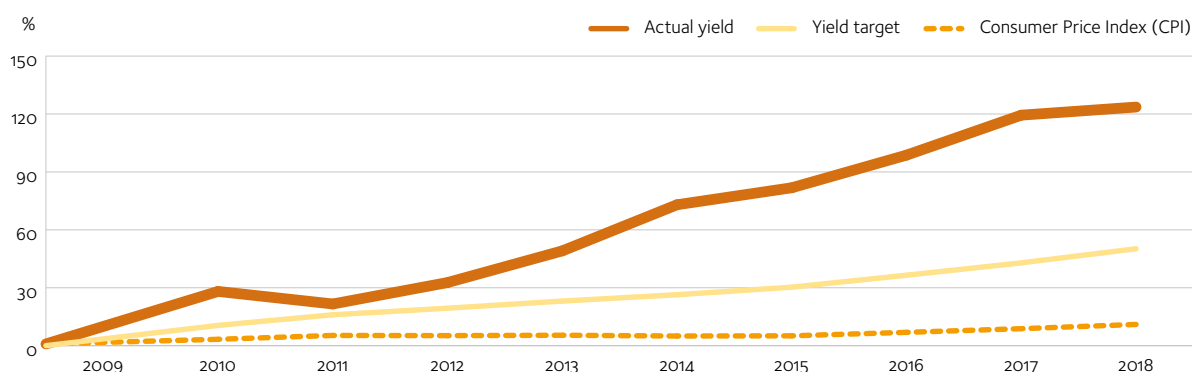
## Ten-year result and return

For the ten-year period 2009–2018, the accumulated return was 123.2 percent, corresponding to 8.4 percent in annual return. The real return target for the same period was 50.2 percent, corresponding to 4.2 percent per year. The graph below illustrates this. The annual real return, i.e. adjusted for inflation, was 7.3 percent on average during this period. The yield requirement in real

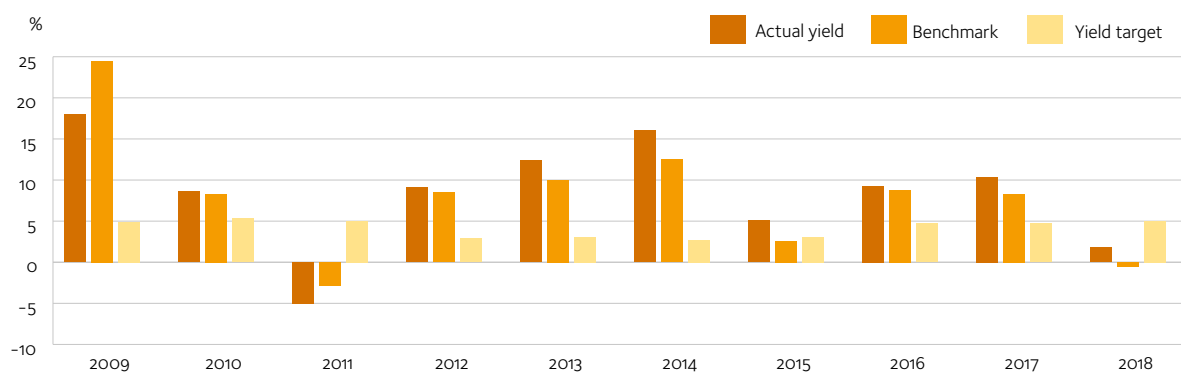
terms has been three percent per year since 2010 and was four percent per year up to 2010.

The outcome for individual years can however vary considerably. The bar chart below illustrates this. Since 2009 we have exceeded our yield targets in eight of the past ten years.

ACCUMULATED RETURN SINCE 2009



ANNUAL RETURN SINCE 2009



## Results and return 2018

The 2018 result including bank and administration fees amounted to SEK 142.9 million (SEK 761.6 million the previous year). The return on the overall portfolio amounted to 1.8 percent (10.3). This is 2.4 percentage points better than our benchmark index, but 3.2 percentage points lower than the real return target. This is the seventh consecutive year that the return exceeded the return of the weighted reference portfolio.

### THE EQUITIES FUND

The equities fund contributed SEK 62.6 million net, but as shown in the table below there are large differences both between different markets (index) and different fund managers. The fund managers of asset classes Global Equities and Emerging Markets outperformed their benchmark indices by fully 7.0 and 6.5 percentage points respectively, while Swedish equities as a group had a negative result and in addition a return of 2.3 percentage points below index.

### FIXED INCOME INVESTMENTS

Fixed income investments contributed a return of 0.9 percent, in line with the index, while the corporate bonds fund declined 2.5 percent, which is 1.3 percentage points lower than the index.

### REAL ESTATE

The real estate asset class contributed a return of fully 6.3 percent. However, the return is largely based on annual external valuations of the various real estate funds that we have invested in. These valuations are made annually but are often presented well into the first quarter, which is why we get a lag of one year in valuation development. The return in the 2018 results therefore includes the valuation as of 31 December 2017.

### ALTERNATIVE INVESTMENTS

Alternative investments gave a return of 5.2 percent, in line with the benchmark index of inflation plus 3 percent that we required from them. However, as previously stated, the running valuation of some of these unlisted and largely illiquid assets is often associated with a large portion of uncertainty. As in previous years, it is mainly SEB's Microfinance funds which contribute to a steady ongoing return within this asset class. In most of the other holdings one has to wait until maturity before one can determine the result.

### RESULTS AND RETURNS 2018, FOR EACH ASSET CLASS, AND A 5-YEAR OVERVIEW

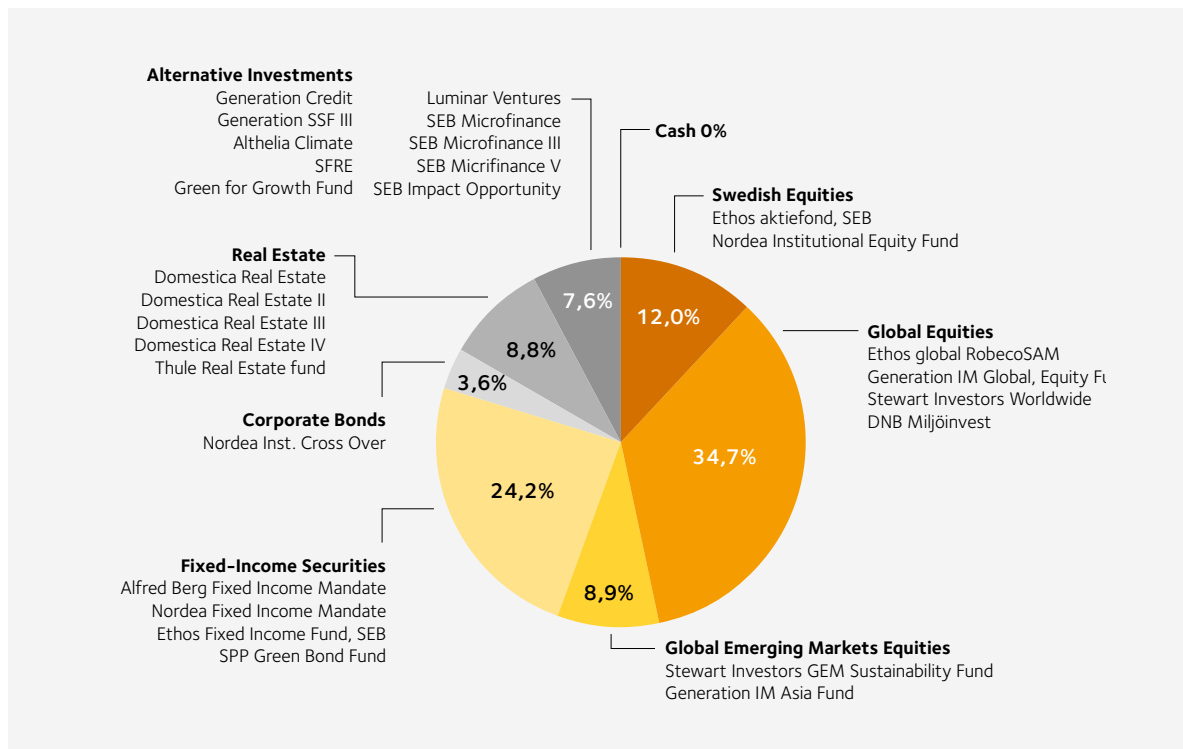
Asset class	Result 2018 mnkr	Return 2018		Return 2017		Average annual return 2014-2018		Benchmark
		Portfolio	Index	Portfolio	Index	Portfolio	Index	
Swedish Equities	-71,1	-6,7%	-4,4%	10,6%	9,5%	6,8%	8,0%	SIX RX
Global Equities <sup>3</sup>	139,6	6,1%	-0,9%	18,9%	14,5%	15,3%	10,7%	MSCI World <sup>4</sup>
Emerging Markets Eq.	-5,9	-0,8%	-7,3%	19,0%	23,6%	10,8%	8,4%	MSCI EM
Fixed-Income Securities	16,4	0,9%	1,0%	0,8%	0,3%	2,3%	2,3%	OMRX Bond
Corporate Bonds	-7,8	-2,5%	-1,2%	4,0%	2,3%	2,9%	2,7%	Merrill Lynch EMU
Real Estate	40,9	6,3%	5,0%	15,4%	4,8%	9,4%	4,1%	Annual inflation +3 %
Alternative Investments	30,8	5,2%	5,0%	0,3%	4,8%	3,6%	4,1%	Annual inflation +3 %
<b>Total</b>	<b>142,9</b>	<b>1,8%</b>	<b>-0,6%</b>	<b>10,3%</b>	<b>8,3%</b>	<b>8,4%</b>	<b>6,2%</b>	

<sup>3</sup> DNB Miljöinvest Fund is measured against Wilderhill New Energy index, but the asset class in total has MSCI World as benchmark.

<sup>4</sup> As from 2018 the benchmark is MSCI World, before that it was DJSI World.



## DISTRIBUTION BETWEEN DIFFERENT ASSETS AS OF DECEMBER 31, 2018



## THE TEN LARGEST STOCK HOLDINGS

Swedish Equities	Share	Global Equities	Share	Emerging markets Equities	Share
Volvo B	6%	Taiwan Semiconductor Manufacturing Co Ltd	4%	Unilever Plc	5%
Essity B	6%	Henry Schein Inc	3%	Tata Consultancy Services Limited	4%
SEB A	5%	Dentsply Sirona Inc	3%	Taiwan Semiconductor Manufacturing Co Ltd	4%
ABB	5%	Microsoft Corp	3%	Unicharm Corporation	3%
Hennes & Mauritz B	4%	Analog Devices Inc Com	3%	Texas Instruments Inc	3%
Tele2 B	4%	Thermo Fisher Scientific Inc	3%	Indusind Bank	3%
Sandvik	4%	Deere & Co	3%	Marico Limited	3%
Swedbank A	4%	The Cooper Companies Inc	3%	Tech Mahindra Limited	3%
Atlas Copco A	4%	Unilever Nv	3%	Vitasoy International Holdings	3%
Kinnevik B	3%	Charles Schwab Corp	2%	Delta Electronics, Inc.	2%



The church in Vargön in the Parish of Western Tunhem, power from above. Their electricity and heating have come from solar panels on the roof for the past three years.

## Our core values in finance asset management – the stewardship concept and the human dignity principle

All the activities of the Church of Sweden are imbued with long-termism and sustainable development for people and the environment. It is therefore obvious that our investments should also be compatible with these values. How this is to be done is expressed in the Church of Sweden's finance policy, which the Central Board of the Church of Sweden decides on. Guiding ideas are the stewardship concept and the human dignity principle.

### THE CHURCH OF SWEDEN'S FINANCE POLICY

The policy is clear in stating that:

- Our assets shall be managed responsibly and sustainably for both people and nature, and generate a good financial return.
- We shall be responsible asset owners and influence the finance sector to follow suit. We do

not want to make money from some activities, such as the extraction of fossil energy, weapons or tobacco.

- We would, however, like to get a good return on investments in the green adjustment and in good working conditions. We are convinced that well-managed companies are also a good investment. In the short term, long-term factors such as quality and sustainability generally are less crucial, because they are not visible in the turbulence of the market, but in the somewhat longer term, those who work systematically with sustainability become evident. Research also shows that they are often more profitable and are rewarded by lenders with lower borrowing costs.

# The financial policy of the Church of Sweden – Investment rules for ethics and sustainability

## Based on principles of human rights and environmental protection

Our finance policy is based on two fundamental principles: the principle of human dignity and the principle of stewardship, which are today reflected in international conventions on human rights and the environment.

## Investing with benefit for the common good

The Church of Sweden has two ambitions with its investments In addition to managing financial objectives. The first is to make a difference with its own capital and the second is to drive developments in the financial sector towards increased sustainability and long-termism. This means that investments should be assessed in accordance with an analysis of sustainability and of ethics as well as the financial aspects. The starting point for the analysis is our investment rules for ethics and sustainability as described below.

## We invest in responsible companies that contribute to sustainable solutions

In line with this, the focus is on companies that:

- Integrate sustainability in their business model and strategy.
- Present and follow up their sustainability work on the basis of such things as their codes of conduct and other guidelines and commitments.
- Comply with international regulations aimed at protecting people and the environment, and act to rectify faults and shortcomings. The company should use its ability to influence the entire value chain. This means also in relation to suppliers and customers.
- Contribute positively economically, environmentally and socially, to affected communities.
- Limit their detrimental effect on the environment (globally, regionally and locally) and act with consideration for the needs of present and future generations by, for example, using the best available technology and reducing their use of natural resources and protecting these natural resources.
- See new business opportunities by contributing to reducing the utilisation of resources in a world with declining resources.

## We do not invest in controversial activities

A Christian outlook on people and responsibility for the well-being of other people, which are important expressions of Christian ethics, motivate us to refrain from investing in certain sectors.

### CLIMATE CONSIDERATIONS

The Church of Sweden perceives climate change as a serious threat to creation and to the fundamental conditions of life on our planet, and therefore we do not invest in companies that conduct extraction from fossil energy sources.

### WEAPONS

The Church of Sweden abstains from investment in companies that manufacture or sell weapons or war materiel to a not, inconsiderable extent.

### ALCOHOL, TOBACCO, PORNOGRAPHY AND GAMING WITH MONEY

We completely avoid companies that produce in pornography or tobacco. Nor do we invest in companies that have more than five percent of turnover from alcohol or gaming with money.







# A year with focus on action

THE EFFECTS OF CLIMATE CHANGE are becoming increasingly evident, and the time needed to be able to reverse the trend to be able to create a sustainable journey into the future is growing shorter. The world's climate scientists issued a report<sup>5</sup> which was commissioned by the UN prior to the COP24 climate summit in Katowice. The conclusion of the report was that the solutions already exist – what the world needs is leadership, especially from politicians who set the playing field for companies and citizens. But politicians need support from the companies and citizens to dare to make the big decisions, such as phasing out subsidies for fossil energy and investing in renewable energy and green infrastructure.

The Church of Sweden is encouraging politicians to be tougher and therefore participated actively in Katowice. We gladly assume leadership for the climate throughout our activities, whether for support, parish work or in our role as investors and part of the global financial sector.

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<sup>5</sup> IPCC 1.5-Degree C Special Report [www.c2es.org/content/ipcc-1-5-degree-c-special-report](http://www.c2es.org/content/ipcc-1-5-degree-c-special-report)





# The Church of Sweden's new investments during 2018

During 2018, the Church of Sweden decided to make three new investments, all with an expressed sustainability profile. We continue to have considerable confidence in Generation Investment Management's sustainability funds and in SEB's microfinance funds. We also contributed to starting and investing in a sustainability bond from the World Bank.

DURING 2018, THE CHURCH OF SWEDEN decided to invest USD 20 million in a newly started fund with unlisted companies, i.e. companies that are not listed on any stock exchange. The fund manager for these investments is Generation Investment Management (Generation IM), which we have engaged for over ten years because we have great confidence in their investment process and have seen that it generates stable and good returns. The fund is called Sustainable Solutions Fund III.

Generation IM's chairman is Al Gore, former vice president in the United States, and his view of climate issues permeates the entire company. The companies that the fund invests in offer sustainable solutions in everything from food and e-health to transport, and are found around the world but mainly in the United States.

We also invested SEK 150 million in the new fund for micro-financing, SEB Impact Opportunity. It has a slightly broader mandate than its predecessor, and can invest in both larger and smaller projects and companies. This makes it possible to achieve even greater social benefits, with noticeable improvements for the people and the environment concerned. The Church of Sweden also has a place on the fund's advisory committee.

Another investment that we made in 2018 is in a sustainability bond from the World Bank within the network Swedish Investors for Sustainable Development (SISD). It is in Church of Sweden internal liquidity management and is therefore not shown in the list of our investments on page 15.

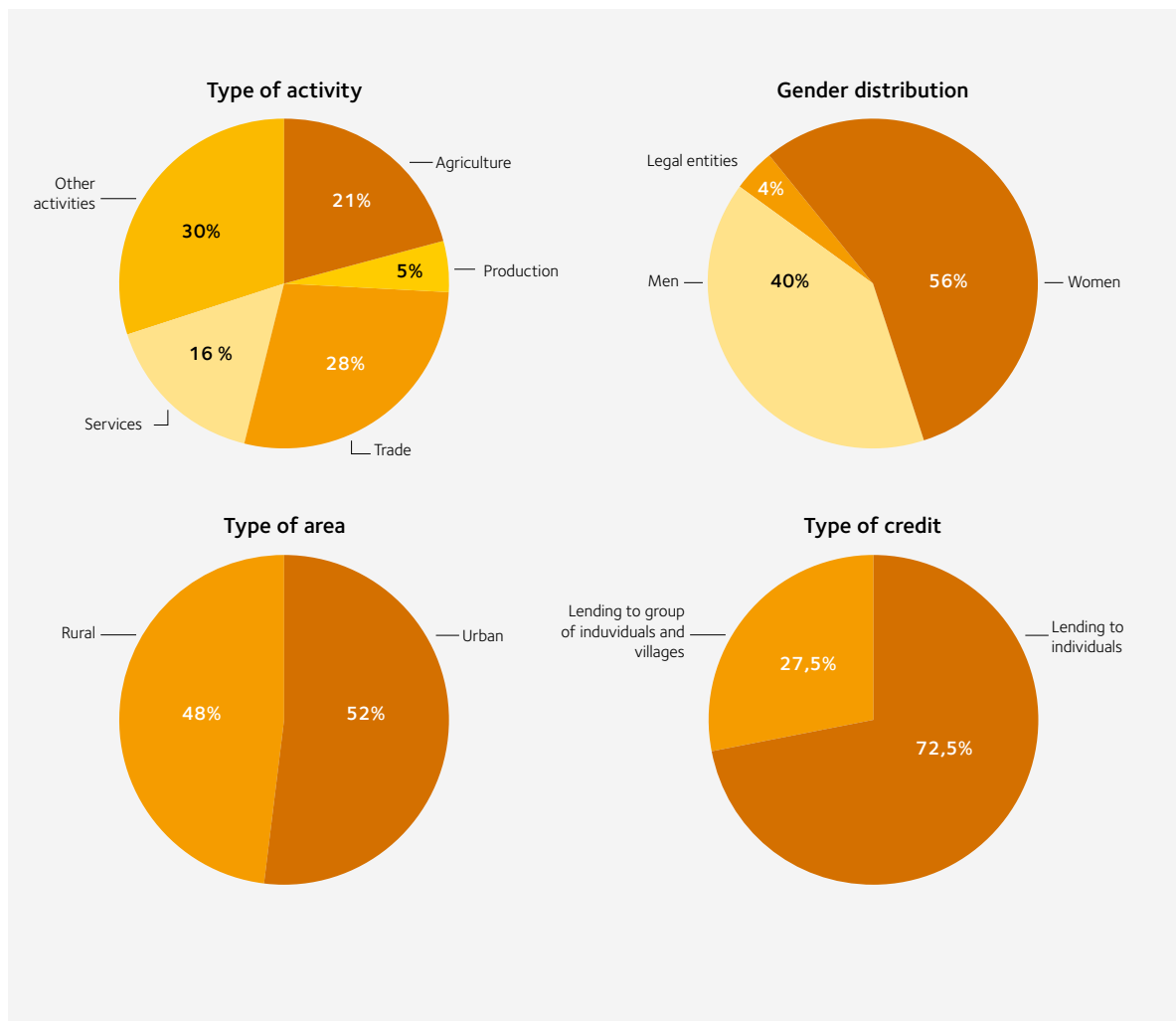
## Final report from our first micro-finance fund

When SEB launched its first micro-financing fund in 2013, we were included. SEB Microfinance Fund I has lent money to 62 micro-financing institutions in 27 countries. The fund has focused on people with a great need for financial services in countries where only four out of ten adults have an account with a bank or another financial institution.

It closed in 2018 after five years, according to plan, and gave a return of 9.0 per cent per year.

The social benefits of this investment are multiple. The 62 microfinance institutions that the fund has invested in have reached over six million people, of whom over half are women. The borrowers have mainly borrowed small sums, often equivalent to a few thousand Swedish kronor, to buy input goods for their micro companies. Thanks to the loans, they succeed in supporting themselves as, for example, goat breeders, vegetable traders or car tyre vendors.

### SEB MICROFINANCE FUND 1 – BORROWERS AND ACTIVITY



## The EU's action plan for financing sustainable growth

2018 was the year when action plans were at the centre of sustainable finances. One example is the EU's Action Plan for a sustainable financial market: Financing Sustainable Growth<sup>6</sup> that was adopted in March. It will contribute to sustainable growth in Europe and the world and has three objectives:

1. To redirect capital flows to sustainable investments.
2. To better manage the financial risks that can be linked to climate, environmental degradation, overused natural resources and social issues.
3. That financial and economic activity shall be more long-term and open for review.

The action plan summarizes its conclusions in ten areas of action. All of these are important, but some deserve to be highlighted as they will hopefully have great influence on sustainable investments.

The first two areas of action are about classifying what is sustainable and green, and then standardise sustainable products and give them a label. The idea is that these two areas of action can create good conditions for other measures. Hopefully, the combined measures will change the playing field for the financial market's players relatively quickly.

One concern about the classification, which we share with many others, is that one risks getting entangled in definitions that slow down development and are outdated when they are finally put to use. Many investors have, after all, worked with sustainable investments for over 20 years without these definitions. At best, the classification can lead to major fund managers deciding, for example, to follow a sustainable benchmark index. This would automatically redirect huge volumes of capital from unsustainable to sustainable operations.

Within the third action area, the European Commission is looking at the possibility of guiding a larger proportion of private capital into investments in sustainable infrastructure, both within and outside the EU. This is a key issue in the action plan, as the whole world is asking for green infrastructure, not least all the cities that are emerging in pace with urbanization. On average, every six days, another city with a million inhabitants is added somewhere in the world. The growing cities must be equipped with green infrastructure for water, energy, sewage, waste, mobility and real estate. The infra-

structure for food supply to the cities must also be made resource-efficient.

## Global Climate Action Summit

Although the current US President has chosen to leave the Paris Agreement, over 400 US mayors representing 70 million Americans have declared that they intend to follow the historic agreement that world leaders signed in Paris in 2015, and implement the adjustments required to reach the 1.5 degree goal.

In September, the world's leaders again got together in San Francisco at the Global Climate Action Summit (GCAS). Mayors, governors, politicians from all over the world and financiers told how their countries, states and cities act to both slow down and adapt to the climate changes. The summit was a showcase of leadership and how decision makers can combine their efforts and show ways to progress in difficult times.

One word permeated all the seminars: collaboration. We need to work together, at all levels, to meet the climate challenge. Climate change is not an isolated phenomenon but it requires changes in entire systems such as energy, transport, agriculture and urban construction. Or, as a California representative put it, "How should we deal with the fact that two thirds of our shores will probably be under the sea in the future?"

Parallel to the summit, there was another large conference: PRI in Person, for investors who have signed the UN's six principles for responsible investment<sup>7</sup>. The seminars were about everything from how sustainability can be integrated into analyses of companies that are not stock-exchange listed to how investors should look at water issues as a risk factor in times of climate change.

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<sup>6</sup> [ec.europa.eu/info/publications/180308-action-plan-sustainable-growth\\_en](http://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en)

<sup>7</sup> Principles for Responsible Investment (PRI)



## Agenda 2030 and the global development goals

Action was also the key word for a renowned group of investors, including the Church of Sweden, which are included in the Swedish Investors for Sustainable Development (SISD)<sup>8</sup> network. There is now considerable interest in investing in the Agenda 2030 climate change goal and its other global goals.

Sustainable development with the stewardship concept and the human dignity principle in the centre are central for the Church of Sweden. Therefore, we are also involved in Swedish Investors for Sustainable Development (SISD), an investor network that Sida started in

2016 and which today consists of 18 investors. Most of these are large pension fund managers and banks. The network has a handful of working groups that focus on various goals within Agenda 2030 and its 17 development goals. The Church of Sweden is especially active in Goal 6 for clean water and sanitation and Goal 11 for sustainable cities.

<sup>8</sup> [sida.se/English/how-we-work/approaches-and-methods/funding/financing-for-development/swedish-investors-for-sustainable-development](https://sida.se/English/how-we-work/approaches-and-methods/funding/financing-for-development/swedish-investors-for-sustainable-development)







## There are many good reasons for investors to care about Agenda 2030!

THE READJUSTMENT in the approach to climate and the global development goals in Agenda 2030 open the field to create new economic and financial values as it is "The biggest business opportunity in history for investing in the global goals"<sup>9</sup>. If we do not change course we risk losing the value of our assets if the planet warms more than four degrees, which is what the present trend is expected to lead to. Yet another reason for investors to care about Agenda 2030 is that the role of the financial sector is completely decisive because significant investments are needed to reach the targets.

There is money in the system but more needs to be redirected. Companies will have to change their business models to become resource efficient and climate smart. Some companies disappear and others are added when the map is redrawn. This has always been the case, but now we must accelerate the process if we are to have a habitable planet in the future. And thanks to major technological advances, especially in renewable energy, we have an open window for a few more years to take the big steps that are needed towards a liveable future.

In Sweden, the most energy-intensive companies have got together and devised roadmaps within the government's Fossil-free Sweden<sup>10</sup> initiative. Sweden's climate target is to have no net emissions of carbon dioxide by 2045 – our industry can achieve this if they get the right tools. These tools can be government support for technological development or various policy instruments and amended regulations. They can also be customer requirements and collaboration across the entire value chain in a sector. By taking the lead, Swedish companies will also get a competitive advantage, as this is about global development. It gives great hope for both Sweden and the world.

As investors we have a key role to play in supporting these necessary changes, for example by pushing to develop new investment products for the various roadmaps for readjustment for climate change.

<sup>9</sup> Quote from Unilever's CEO Paul Polman.

<sup>10</sup> Read more on the website here [fossilfritt-sverige.se](http://fossilfritt-sverige.se)



## Our work for clean water and sanitation

In late 2017, together with other members of SISD, we launched a study to find out what it is that hinders the large investments that are required for water infrastructure in Sweden. The results of the study were released in connection with a seminar in the Riksdag. One challenge is that there is often no technical expertise in the municipalities, and it is also difficult for the politicians to increase the water rates when residents would rather that their tax money is spent on a new swimming pool or more teachers. By highlighting the existing obstacles, one can more easily see solutions and ways forward. We hope to continue working with this issue during 2019.

The situation in Sweden is not unique. On the contrary, it reflects the situation in the world in general. During the World Water Week last summer, we arranged a seminar with the Stockholm International Water Institute (SIWI). There, participants from different parts of Africa discussed possible ways forward with Swedish investors. The mutual exchange gave everyone inspiration, and in 2019 we intend to follow up on this work. The ultimate goal of the group is to create an investment product for both Sweden and the rest of the world. It could accommodate both refurbishment and expansion of water and drainage connections or water purification and technology for more efficient use of water.





## Our work for sustainable cities

After the summer, in SISDs group for sustainable cities, we managed to create a green bond with the World Bank. The Church of Sweden together with Skandia, Handelsbanken and SEB invested SEK 2.5 billion in various sustainable projects financed by the World Bank, several of which are targeted to cities. The projects cover everything from sustainable public transport to water treatment. It was a first step in our quest to jointly create investment products for sustainable cities. It is the first time that Swedish investors have made a joint venture by creating a new bond with the World Bank.

Another track we continue to work on in 2019 is to create a social or sustainable bond for urban district development in Sweden, together with researchers, business, municipalities and other actors.

## Collaboration is necessary to find new solutions

A key concept in today's complex world is collaboration between different actors, such as companies, financiers, civil society and municipalities. This of course also applies within sustainable investments because it is only when we change our approach that we can create the new and necessary solutions. These can, for example, be circular business models, where companies' goods and services are given a much longer life by being reused and recycled, in order to save both material and energy. This requires a functioning ecosystem for the collection of materials and for technology for recycling, and also new forms of financing. The Church of Sweden is a great friend of collaboration throughout its operations, from parish welfare work and international assistance to sustainable investments.

## Greater reporting requirements

### CLIMATE-RELATED FINANCIAL DISCLOSURES

An investor tool that began to be applied during 2018 is the new reporting requirements that are primarily imposed on the fossil companies through an initiative from the G20 countries. Their body, the Financial Stability Board, has, through its Task Force on Climate-related Financial Disclosures (TCFD) working group, developed a framework for climate-related financial reporting.

Recommendations from TCFD will facilitate communication between companies and investors by asking the companies to make different scenario analyses for how they will meet climate change. Investors themselves are also starting to make scenario analyses for their capital investments. How will capital investments fare in a world that is 1.5 degrees, 2 degrees or 4 degrees warmer?

### EU DIRECTIVE FROM 2014

The EU directive from 2014 for greater reporting of sustainability work for larger companies required legislation in the member states by 2016. At the time, the Church of Sweden submitted a response and recommended, among other things, that all companies with more than 250 employees should be covered, while the EU proposal was 500 employees. To our delight, the government adopted our approach. In 2018, the first reports have begun to come in resulting from the new law. It makes it easier for investors to value the companies' risks and make more informed decisions.



## Tradition of active asset management

Just over ten years ago, we switched from buying into customised asset management to investing in funds. The advantage is, above all, that a fund is easier to administer. We exclude about half of the equities in the most common global index MSCI World, which contains some 1,600 companies, as a result of refraining from investing in certain types of controversial businesses. We therefore only have active asset management where the fund managers hand-pick a small number of shares in companies that they believe in for their fund, usually 30–60 companies.

So, ten years ago, it was difficult to find fund managers who shared our view on sustainable value creation and active asset management. For example, there were almost no actively managed funds that excluded companies within coal, oil and gas because these companies were included in the fund's benchmark index. Today it is much easier. However, active asset management is more difficult, as it requires a return that must cover the higher costs and also beat the index. However, we know that there are now fund managers who can manage this, year after year.

## Long-term, active asset management pays off

The fact that we think and invest in the long term has also been important. We have maintained our conviction

that sustainable value creation is more profitable in a time frame of several years. Thanks to the clear formulations in the finance policy, we are rooted in our values and have a mandate to honour them. This ethical compass makes us rather unique as asset owners. And the fund managers we meet attest that our finance policy is well known even outside Sweden.

## Company dialogues

A responsible owner should hold dialogues with companies that do not meet the requirements and expectations of the owner. This is also one of six principles included in the Principles for Responsible Investment (UNPRI)<sup>11</sup>. UNPRI comprises 373 investors with a total of SEK 19 trillion in managed capital which have committed themselves to adhere to the principles. The Church of Sweden undertook to comply with these principles in 2007.

Today, our corporate dialogues are based on the size of the problems we see in the companies, and to help us in this we have had the GES Investment Management<sup>13</sup> analysis house. However, we only get a few transgression hits in our portfolio and they are rarely so serious that we have to act. There are dialogues within, for example, the cocoa industry which have been ongoing for several years and where the companies show respon-

<sup>11</sup> [www.unpri.org](http://www.unpri.org)

<sup>12</sup> SEK 19,100 billion

<sup>13</sup> They are now called Sustainalytics





sibility in very complex issues where they have limited influence, but also issues concerning money laundering in a number of banks, where we follow developments closely. This is a sign of health that shows that our holdings consist of conscientious companies that are generally good at controlling their risks in environment, human rights and corruption.

## Climate analysis of our investments

Our climate strategy rests on:

- Opting out of fossil extraction
- Choosing climate solutions
- Having a high level of climate work in the portfolio
- Influencing other investors to redirect their portfolios

We participate in several investor initiatives that encourage companies and EU politicians to take responsibility in the climate issue. As early as 2008, we began our journey towards the two-degree goal of global warming. We sold off companies within fossil energy extraction and began to invest more in renewable energy and energy efficiency. We made climate analyses of our portfolio companies and saw that they had high ratings on climate work and low emissions compared to their competitors. The number of companies in energy-consuming industries is limited. When the divestment movement<sup>14</sup> that urges investors to sell off their shares in companies that extract coal, oil and fossil gas started in 2012, we

were already involved and were frequently engaged by other investors to explain about our journey.

We made a new climate analysis in 2018 according to the new model which the 2° Investing Initiative (2DII) has developed for equities and corporate bonds. It is called the Paris Agreement Capital Transition Assessment (PACTA) and is part of the EU-funded Sustainable Energy Investment Metrics project. As expected the results showed that carbon dioxide emissions from the companies in the portfolio were in total very low overall, and are in line with a goal of a maximum of 1.75 degree global warming. This means that our climate risks are also low, that is, the companies are only to a small extent exposed to the risks associated with the extraction, ownership or use of fossil energy or the transition to a low-fossil society that creates both winners and losers as the roles of the players in the market change. However, the analysis says nothing about the risks that the companies' assets or supplier chain could be affected by the climate effects, such as floods or droughts. An ultra-sustainable and financially strong property company with locations near sea and lakes could turn out to be a really bad investment if the properties become flooded.

<sup>14</sup> The Divestment Movement began among American students who demanded that their universities sell off equities in fossil companies.

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