Corporate Governance in Sweden
- An International Trade Union Perspective

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Table of contents

Inboxes

Introduction: the choice of Sweden

This report is the outcome of a descriptive exercise of the Swedish corporate governance system in an international trade union perspective. This exercise has consisted in screening the Swedish system through the conceptual framework identified in a 2005 Global Unions discussion paper on corporate governance: "Workers' Voice in Corporate Governance – A trade Union Perspective"[1]. Hence the aim and ambition of this report are less to fully encompass and analyse the Swedish regime – a task that would be out of reach of this project – than to test the key findings of the 2005 report in a specific national context, and Sweden was an ideal choice for such exercise.

The 2005 Global Unions report outlines two parallel strategies to promote workers' interests in corporate governance: (i) workers as employees of the companies and (ii) workers as shareholders of companies via their pension funds' and/or other long term saving schemes' holdings.

The first approach – workers as employees – is an obvious and universal labour condition to effective corporate governance. Workers invest specifically in the company that employ them and are equally exposed to firm specific risk. Accordingly workers need to participate in the governance of the firm above and beyond the mere respect of the contractual terms that bind them with the company, be it the employment contract or the collective agreement. Legislations on worker participation are most developed in civil law jurisdictions, notably in continental Europe, where workers' employment contracts and collective agreements are usually supplemented by institutional representation in the firm. Worker representation mechanisms (also known as "worker participation") can take various forms: elected employee representatives sitting in "works councils", in occupational health and safety committees, board level employee representatives.

The second approach – workers as investors – is not a universal condition to labour's approach to corporate governance so far as it is strongly correlated with the mode of financing of the national pension system. However it is no less crucial for the labour movement in a globalised and financialised economy. Workers' capital constitutes an important policy issue in jurisdictions where pension financing relies extensively on pre-funding (by opposition to pay-as-you-go redistributive pension systems) as it is the case in Anglo-American common law jurisdictions. Workers' pension savings are invested in financial markets by their pension funds, including in equity. In the US, the UK, Canada, and Australia, pension funds' holdings in equity amount to circa a fifth of those countries' stock market capitalisation.

[1] TUAC 2005.

The 2005 Global Unions discussion paper shows the complementarities between the two approaches to achieve effective corporate governance and in particular to ensure accountability of the board of directors. In practice however, most OECD jurisdictions lean toward one or the other and few can pretend to encompass both approaches. Sweden does. Not only that, part of the Swedish workers' capital relies on a pay-as-you-go system (the 'buffer' funds of the AP nation-wide pension scheme) and not on a pre-funded system as in Anglo-American economies. This feature – that is workers' capital not relying entirely on a pension pre-funded system – may facilitate comparative analysis within Europe and, perhaps, help draw lessons for other OECD countries.

Corporate governance reforms should be judged upon their appropriateness to the national context, to the country's economic and social heritage and culture. Reforms proposal should be assessed bearing in mind the specificity of national jurisdictions, of ownership structures and modes of financing of the economy. International institutions such as the OECD and the World Bank often claim, but regrettably not always apply such no-one-size-fits-all principle. While setting out broad objectives, the 2005 Global Unions discussion paper emphasises the diversity of solutions. In doing so, the report stresses the importance of history in assessing national corporate governance regimes. This report on Sweden thus brings particular attention to the post-war developments that help understand the country's current regime.

The report is structured in three chapters:

- In the first part ("A brief retrospective") the report begins with a broad overview of the Swedish model and its ownership structure ("a Rhineland model pushed to the extreme"), the role of shareholders ("widespread use of controlling enhancing mechanisms") and the typical organisation of the board of directors ("an entrepreneurial model of board governance"). From there, the paper explains a paradox in the system: the fact that a heavily concentrated corporate power has co-existed with an equally heavily egalitarian and solidarity-based welfare society ("the Swedish paradox") and how that paradox led to an ambitious labour and – retrospectively – workers' capital project in the 1970s ("the wage earner fund project"). The failure of the project took place in a context of vast de-regulatory reforms in the following decades ("the years of de-regulation 1980-1990"). Surprisingly enough, the brutal changes that occurred then in the Swedish economic and corporate landscape did not substantially alter the corporate governance regime of the country.

- In the second part ("the Post-Enron era") the paper focuses on the corporate scandals and controversies in the aftermath of the burst of the IT-internet bubble in 2002-2003 ("Scandals and controversies"), the regulatory reaction that followed ("the regulatory reaction") including the outcome of an almost 10-year long discussion on reform of corporate law (“the 2005 Companies Act”) and the introduction of a national code (“the national code”).

- Having set the broader context the final chapter (“Labour issues and challenges”) addresses how the two labour approaches to corporate governance are developed in Sweden: first worker participation (“Representation in the board”) and its broader CSR environment (“high governmental profile on CSR”), then Swedish workers’ capital with a particular focus on state-owned pension funds (“The policies of the AP funds”). The chapter ends with a brief discussion on the wave of private equity investments in Sweden (“The challenge of private equity”).

A brief retrospective

1. At first glance Sweden, Denmark, Norway and Finland are similar societies and economies: robust and extensive welfare systems, export-oriented and competitive, diversified economies, stable and consensus-driven political systems. If cultural and historical similarity is undeniable, there is however a diversity of economic systems in the Nordic region. In fact one could argue that the two historical Scandinavian nations, Denmark and Sweden, are as close to each other as England and France would be. The Danish economy is known for its vibrant network of small and medium size enterprises and by the relatively marginal role of large corporate groups. Sweden by contrast, has always relied on large industrial groups. This difference is reflected in the ownership structure of the private sector: small and diverse in Denmark, big and concentrated in Sweden. Analysing corporate ownership structure is the first step to understand a country's corporate governance regime.

2. The concept of corporate governance can be interpreted in different ways and can have different meanings depending on the political orientation and the stakeholder perspective. Here it is understood in its widest definition: "Corporate governance is the system in which companies are directed and controlled"[2]. There are obviously different possible governance arrangements within such definition. These will essentially depend on the combination of three core sources of law:

- capital market regulation, including laws and other regulations that apply to corporate access to equity and debt financing;
- corporate law, including the accountability mechanisms between shareholders and management; and
- labour regulations that determined the rights of workers within the firm.

3. Other sources of law will influence national corporate governance regimes, such as competition and tax laws (including corporate and household income and capital tax regimes). More broadly, the role of government in the economy and the extent to which it is tolerated as an economic operator via active industrial policies and state-ownership is a key determinant of corporate governance. As the substance and the respective weight of those sources of law and public policies vary from country to country so will the various accountability mechanisms between the core constituencies of the firm – shareholders, management, workers – and with external parties investing in the company – creditors, suppliers, customers, local communities, NGOs – as well as with regulators, other market-based gatekeepers such as auditors.

4. This regulatory mix dimension of corporate governance appears very clearly in the Swedish context. Like most industrialised countries the origins of the Swedish system are to be found in the regulatory response to the stock market crash in 1929 and the economic crisis that followed which led to a review of the Companies Act and of bank

[2] CADBURY 1992

legislation. What distinguishes Sweden however is the historical continuity of its corporate governance regulatory mix. This continuity is largely explained by the un-comparable stability of the political and constitutional system and the almost uncontested leadership of the Social Democratic Party throughout the 20^{th} century. The Social Democrats' project was built around three successive objectives: first achieving *political democracy* (free election and parliamentary regime), then *social democracy* (social security and welfare system), and finally *economic democracy*. The latter was theorised by the Party's leading economist, Ernst Wigforss[3], and aimed at ensuring alignment between economic decisions and wider social interests: Wigforss' vision was to transform "private enterprises into social enterprises". While the political and social democracy objectives were achieved early on in the post-war era, reforms toward achieving the third stage, economic democracy, followed a more uncertain and bumpy road, particularly in the 1970s.

A Rhineland model pushed to the extreme

5. The foundations of the Swedish corporate governance systems are to be found in a deep rooted alliance between financial entrepreneurs and wealthy families on one side, and engineers and technology innovators on the other. This alliance was supported by a consensus-driven political system in which decision making process and management of institutions gave prominent role to social partnership negotiation. Using a simplified model of governance regimes (see table 1) it can be labelled as a "Rhineland model" pushed to the extreme:

- a corporate sector dominated by large industrial groups (by opposition to diversified businesses in size and activity),
- privileging organic growth (by opposition to external growth made of mergers and acquisitions, M&As)
- in a context of coordinated market economy (by opposition to liberal market economy).

Table 1: Simplified comparison of Anglo-American and Rhineland systems

Anglo-American	**<**	**Systems**	**>**	**Rhineland**
Common law	<	**Law**	>	Civil law
Liberal	<	**Market organisation**	>	Co-ordinated
Diluted	<	**Ownership structure**	>	Concentrated
Equity	<	**Corporate financing**	>	Debt
High	<	**Labour market turnover**	>	Low
External	<	**Acquisition of labour skills & innovation**	>	Internal and incremental
Decentralised, company level	<	**Collective bargaining**	>	Centralised, sector level
Marginal	<	**Institutionalised worker representation**	>	Generalised

Source: TUAC 2005

[3] Minister of Finance in 1925 and from 1932 to 1949

6. In an international perspective, the history of Swedish corporate governance resembles to a large extent German and Japanese bank and relationship-based systems. Economic growth was driven by large and export-oriented companies in which corporate decisions were not dictated by market opportunities only, but also by targeted tax and credit regulations and active industrial policies. Much of the regulatory environment was aiming at having capital locked in the firm, as seen in the tax regime bias toward retained earnings (tax of profits re-invested in the company) versus dividends (tax on profits distributed to shareholders). Active industrial and public procurement policies favoured for the creation and the success of large scale export and investment oriented companies. Combined with free trade, the system could extract more innovation capacities from the exposure of Swedish multinational enterprises to foreign competition.[4]

7. As far as labour regulation is concerned market coordination was manifest in the building of the Swedish labour market model. The tools were, and still are, basic labour law – from which collective agreement between trade unions and employers can build on – the key role of local trade unions on the workplace and collective bargaining and agreements. All together these mechanisms have played a central role in shaping the evolution of Swedish society. Wage-setting, working-time and working conditions were, until the 1980s, exclusively determined by sector- and nation-wide agreements between labour and employers: the blue-collar national confederation union LO and its white-collar counterparts under the cartel PTK, including affiliated organisations to TCO & SACO on the one hand, and the employer federation SAF on the other. Despite decentralisation since the 1980s, collective bargaining remains highly centralised and coordinated in Sweden compared to OECD standards.

8. A central feature of Swedish system is the stability and concentration of its ownership structure. The private sector has been built around a few families (*Wallenberg, Lundberg, Stenbeck, Klingspor, Von Horn*) and banks (*Svenska Handelsbanken SHB, Skandinaviska Enskilda Banken SEB*). What differentiates Sweden from other similar systems is the longevity: the companies leading the Swedish economy today were already among the largest employers half of century ago. Looking at the 23 largest non-financial companies measured by their listed capitalisation – i.e. Swedish companies listed on the OMXS30 index –the following emerge:

- 13 were among the top 25 employers 40 years ago (in 1967) and 7 were in the top 25 in 1925[5];
- two investment funds *Investor* (owned by the *Wallenberg* family) and *Industrivärden* (partly owned by the *Lundberg* family) hold a controlling stake in 13 of the top 20 largest capitalisations;
- within the top 10, *H&M* textile and retail group is the only company <u>not</u> to have a representative of either of those two investment funds on its board of directors;
- members of the *Wallenberg* family alone (Marcus, Jacob and Peter Jr) sit on the board of 9 companies;

[4] For an in-depth historical review see Högfeldt 2004 & Henrekson et. Al. 2003
[5] *Ericsson, Sandvik, Skanska, Asea / ABB, SKF, Swedish Match & Stora Enso*

- As a whole, the 30 largest capitalisations concentrate 70% of the total value of listed equity in Sweden

Table 2: Ownership structure of Swedish multinational enterprises

Largest capitalizations (OMXS 30 index, as of Dec. 06)	Weight in the index	Controlling or significant shareholders (and where available the % of voting rights in AGM)
Ericsson	14.46	Investor (19,4), Industrivärden (13,3)
Nordea Bank AB	9.65	State-ownership (25)
H&M	8.91	Stefan Persson and family
Skandinaviska Enskilda Banken (SEB)	5.09	Investor (18,5), Trygg-Foundation, Wallenberg Family foundation
Atlas Copco	5.04	Investor (21)
Volvo	4.83	Trygg Foundation, Renault, AP funds, Industrivärden (1,2)
Svenska Handelsbanken (SHB)	4.65	Industrivärden (10,3), The Oktogonen Foundation (ESOP)
AstraZeneca PLC	4.58	The Capital Group Companies Inc, Investor (3,3)
Swedbank	4.52	Sparbanken foundation (cooperative structure)
Sandvik	4.16	Industrivärden (11)
Investor	2.7	Wallenberg Family foundations (46,9)
Svenska Cellulosa Aktiebolage (SCA)	2.49	Industrivärden (28,8), SHB, SEB
Scania	2.49	Volkswagen, Investor (19,3), MAN, Wallenberg foundation
Skanska	1.89	Industrivärden (26,9)
ABB Ltd	1.86	Investor (8)
ASSA ABLOY	1.82	Investment AB Latour & Melker Schörling
SKF	1.81	Wallenberg foundation (+ SwedBank, Skandia, Alecta)
Boliden	1.8	diluted, SEB
Electrolux	1.45	Investor
TeliaSonera	1.43	Swedish & Finnish state ownership
tele2	1.43	Investment AB Kinnevik
Securitas	1.3	Investment AB Latour & Melker Schörling
Swedish Match	1.26	Wellington Management Co
Alfa-Laval	1.22	Tetra Laval B.V. (NL), Fidelity
Vostok Nafta, Inv Ltd SDB	0.8	Lundin Family
Eniro	0.58	Fidelity, Hermes Focus AM
Nokia	0.57	
Stora Enso	0.27	Finnish State, Wallenberg Foundation
Autoliv Inc. SDB	0.24	Barclays Global Investors
Total market valuation end-2005	**€263bn**	
Major investment & holding companies		
L E Lundbergföretagen		Lundberg Family
Investment AB Latour		Gustaf Archibald Douglas
Investment AB Kinnevik		Stenbeck Family, Klingspor and Von Horn families
Investor		Wallenberg Family's foundation (46,9)
Industrivärden		SHB sphere (25,1), Lundberg Family (16), SCA sphere (14,6), Wallander & Hedelius Foundation (8,1)

Source: OMX and company websites

Widespread use of controlling enhancing mechanisms

9. The exceptional stability and concentration of Swedish ownership structure is mainly explained by the extensive use of controlling enhancing mechanisms (CEMs) throughout the history of Swedish private sector. CEMs are governance arrangements whereby shareholders' financial ownership is disconnected from their controlling rights

over the company. CEMs allows for a shareholder who holds a minority stake in the share capital of the company – usually the founding family – to exert effective control over the board. CEMs provide for the company's needed equity financing without the inconvenience of diluting or losing control over the company. CEMs include cross shareholding structure (two or more companies owning each other mutually) and pyramid structures (an entity controls 51% of another entity which in turn owns 51% of another entity which in turn owns etc...). Five of the largest Swedish capitalisations have cross-shareholding arrangements and thirteen have pyramid group structure[6]. When corporate expansion could not be satisfied by debt and retained-earnings financing, as seen from the 1970s and on corporations used another CEM: multiple voting rights, whereby several classes of shares give different voting rights. Sixteen of the largest capitalisations have dual-classes system in which B-shares have typical 10 times less voting rights than A-shares. In fact Sweden has today the highest proportion of companies with differentiated rights in Europe. Without widespread use of multiple voting rights, family foundations and family- or bank-owned investment funds would have ceded control of the largest capitalisations long time ago. In 1998 the Wallenberg family foundation's ownership of approximately 1% of the total market value of the stock exchange – through its investment fund *Investor* – was sufficient to control 42% of the total market value. In 2005, with just above €20bn invested in domestic listed equities the two investment holdings *Investor* and *Industrivärden* exert significant influence over the boards of 13 OMXS indexed companies whose total market value approximate €144bn[7].

10. Given the popularity of CEMs in Sweden the steady rise in institutional ownership since the post-war period and the parallel decline in direct household ownership did not altered control structure of Swedish companies. When pension reform in 2000 increased the role and size of Swedish national pension funds – the AP funds – the corresponding increase in Swedish workers' institutionalized savings did not result in a dilution of ownership concentration. To the contrary, the entry of the AP funds in Swedish large capitalisations was actually met by a strengthening of CEMs, of controlling blocks and of voting power of controlling shareholders[8].

11. Tax regulation also played a key role in the institutionalisation of corporate ownership. Up until 1976, households' gains on sales of assets and shares owned for over 5 years were almost tax exempted, while taxation of dividends reached 80-85% until the early 1990s[9]. Foundations, the main investment vehicles of family fortunes, are exempted from taxes on their income provided that 80-85% of their capital incomes are re-distributed to regulated charities (on a five year average). For example, in 2005 the *Knut & Alice Wallenberg Foundation* received €980m in dividend proceeds and other capital revenues of which €600m were distributed in donations to charities, thus leaving roughly €380m tax free for the foundation and the Wallenberg family[10].

[6] EC 2007
[7] Companies are: Ericsson, SEB, Atlas Copco, Volvo, SHB, AstraZeneca, Sandvik, SCA, Scania, Skanska, ABB, and Electrolux.
[8] Giannetti et al 2006
[9] today dividends are subject to a flat tax of 30% except for private equity which has special exemption arrangements.
[10] WALLENBERG 2005

12. Beside facilitating banking and institutional ownership, tax regulation has also influenced on corporate financing strategies. The Swedish corporate income tax system has historically been biased toward organic corporate growth by treating favourably retained earnings (i.e. profits kept in the company for re-investment) at the expense of shareholder remuneration dividend distribution (which is a prerequisite for external growth strategies, as well as for M&As). The tax system also allowed for accelerated depreciation of long term productive assets such as machines and equipment, by making those investments rapidly deductible from the corporate income tax base – and thus very attractive. A part from high dividend taxation, other regulations severely restricted shareholder remuneration. For example, share buy-back programmes (whereby the company acquires its own shares to artificially inflate shareholder value) were banned until as late as the new Companies Act in 2005. Tax regulation thus constituted a strong disincentive for external growth equity financing strategies and associated M&As operations and favoured corporate debt financing. The latter was also made attractive thanks to governmental intervention on the credit market. Overall, with the extensive use of CEMs, controlling owners had more interest in allowing companies to retain earnings, rather than distribute dividends, and to favour debt financing rather than issue new shares.

13. Organic growth was also supported by active industrial policies, as well as a long history of nation-wide public infrastructure projects, procurement programmes and public-private partnerships. For instance, carmaker Volvo benefited from public procurement in the transportation sector, Tetrapac – the world leader in packaging and long term conservation – from Swedish agrarian polices and support to the dairy industry, while IKEA supplied much of the "million flats" social housing project in the 1960s. Infrastructure and broader industry policies were partly debt financed by the surpluses of the pay-as-you-go pension system, which funds had their investment policies regulated by law to invest in public bonds. Industrial policies were also supported by substantial state ownership in the private sector.

An entrepreneurial model of board governance

14. Given the pre-eminence of controlling blocks in the corporate landscape, Swedish boards of directors require a careful balanced representation of outsiders and the controlling shareholders in particular and of insiders – including executive management and the chief executive officer (CEO). This materialises in a Swedish "entrepreneurial control" model of governance of the company, which would be located half way between family control (the family is in charge of the executive management) and management independence (a group of engineers and managers steer the company).

15. Legislation and practice have favoured a board organisation structured around a powerful CEO entrusted by the controlling shareholder or the founding family to run the company. Other than the CEO, the board would be composed of members who at an overwhelming majority would be outsiders to the management and would either represent

the controlling group or be senior executives from other industrial or financial entities belonging to the same ‘sphere’ of the controlling group. This “CEO versus controlling shareholder representatives” board structure was largely based on informal relationship mechanisms. The controlling shareholder trusted the CEO to operate successfully the company as it was difficult for other board members – all being outsiders to the company – to bypass the CEO in getting access to information on the company’s situation. In turn the CEO had strong incentives to remain loyal to the controlling group: Swedish boards had comparatively more authority and initiative to dismiss and replace a CEO who would not longer be trusted.

16. The Swedish entrepreneurial governance system resisted well to the traditional weaknesses associated with Rhineland models, namely:

- The risk of *company resource diversion* due to abuse of power by the controlling shareholder (ranging from family day-to-day expenses being paid by the company treasury to Parmalat-size financial scandals);
- An *inefficient allocation of capital*, such as over-investment in old industries and passive management strategies (such as generational gap of a family leader who does not understand new investment opportunities in innovation and new products) and/or missed opportunities of financing from the equity market (potential investors being discouraged by the extensive use of CEMs or by the low level of dividends);
- The *risk of collusion* between political and economic powers.

Table 3: Board organization in the 25 largest companies since 1925

	1925	**1945**	**1967**	**1990**
Family controlled (CEO is member of the founding family)	6	2	2	0
Entrepreneurial control (controlling owner appoints the CEO and is active in the board)	4	8	11	17
Management independence (CEO and board are independent from the controlling owners)	18	16	13	14

The total number of occurrences may exceed 25 as companies may combine different board control models
Source: Högfeldt 2004

17. The risk of resource diversion, of having the controlling family abuse its power to divert part the productive assets of the company was largely contained by the strict regulatory environment, which essentially locked the ownership capital into the company. In response to the risk for sub-optimal allocation of capital, the Swedish corporate asset allocation was framed by a coordinated market systems in which regulations favoured internal growth strategies (via retained earnings and debt financing) supported by active industrial policies. Combined with free trade, the internal corporate growth and industrial policies facilitated export-oriented strategies whereby Swedish corporations were directly confronted with international competition and innovation. In fact, among the drawbacks of the Rhineland model as listed above, the only real risk that emerged in Sweden was the collusion between corporate and political powers; however, political collusion was arguably a condition to the sustainability of the system, leading to a paradox in the system.

The Swedish paradox

18. The previous historical account presents an apparent contradiction between (i) a well established welfare and egalitarian society and (ii) a very unequal distribution of corporate power. Given the prominent role of the Social Democrats the Swedish political history, and its three-step political project for political, social and economic democracy, one could have anticipated a different – or at least less concentrated – organisation of corporate ownership and power. More specifically, why did the social democrats consistently support the effective control of the largest, most active and innovative parts of the economy by an interlocked network of family fortunes and banks? And how could this exceptional corporate power concentration be in any way consistent with the Social Democrats' objective of economic democracy? Part of the answer to this apparent contradiction lies in the definition of corporate control, which was historically very relative in Sweden.

19. Concentrated and private ownership was politically legitimised because it gave the assurance of being stable and long term interest driven. The broader regulatory and political environment in effect removed key decision-making power from corporate management and boards of directors. The power of family fortunes was tolerated to the extent that their invested capital was locked-in by regulation and by industrial and credit policies. And their fortunes were to some extent locked-in in private, but regulated, foundations. The bias toward organic growth and the restrictions to equity-based transactions formed strong barriers against the flight of capital or short-termist behaviours by shareholders. Regulation limited the risk of resource diversion which is so frequent in concentrated ownership regimes. Until the 1980s wage bargaining was highly centralised between organised labour and employer federations, as was social security, health and pension coverage. Centralised wage and social benefit negotiation has an important implication for corporate governance: they were negotiated irrespectively of individual corporate performance and governance arrangements. In sum, rather than combating private ownership, the constant policy of the Social Democrats was to strip shareholders of key ownership functions, including labour management, and to limit the room for manoeuvre for what was left to the decision of corporate owners via active industrial and credit policies and biased tax regimes.

20. This apparent paradox in the Swedish system came to a turning point in the middle of the 1970s when Social Democratic Party leader Olof Palme launched the third stage of the Party's project: economic democracy. Within the labour movement the Social Democrats political project was relayed by LO. In 1973 the blue-collar confederation set up a policy working group with a mandate to develop policy proposals in response to three key policy concerns[11]:

- Despite the implicit contract with the corporate elites, the excessive ownership concentration was considered as problem for democracy;

[11] MEIDNER 1993

- worker representation within companies needed to be reinforced following political claims by the labour movement across Europe, notably in Germany, Denmark, and Austria;

- Finally, the centralised wage bargaining systems left un-addressed the massive corporate profits that were generated by rising exports.

21. The objective of strengthening worker representation was met in 1976 by a landmark Co-determination Act enhancing the rights of workers and their representatives to information and consultation on corporate restructuring, as well as by the Act on Board Employee Representation in listed companies. The two other policy concerns – excessive ownership concentration and corporate profits – were to be addressed by an LO proposal wage earners' fund. The proposal was presented at the Confederation congress in 1975 and prompted a vigorous political debate in the following decade.

The wage earner fund project

22. Historically, the Swedish labour market has been shaped by a trade-off between full employment and price stability. Centralisation of wage negotiations aimed at measured, non-inflationary wage increases. Pockets of unemployment created by non-inflationary employment levels would be treated not by increasing overall demand, but by active labour market policies in areas such as training, professional mobility, support for disabled and older workers. A core principle of the Social Democratic project was that equal work should be paid equally irrespectively of the profitability, the size or location of the firm.

23. In effect this egalitarian wage policy framework squeezed out uncompetitive companies that were not able to pay sector-agreed wage levels and favoured performing and expert-oriented companies by fixing below optimal levels of wages. In doing so, general productivity would increase as assets and labour were transferred from less to more competitive sectors and firms, from less to more export-oriented and capital-intensive technologies. The system worked. However concerns arose with the creation of "excess profits" generated by wage restraint in profitable firms, which distribution was left in the hands of shareholders. This un-used capacity became a policy issue on its own in the 1970s as Swedish exports began to rise.

24. The proposal to resolve the problem of excess corporate profits was presented in 1975 at the LO Congress. Developed by LO's senior economist Rudolf Meidner[12], the project consisted in an ambitious long term plan of building up wage earner funds financed by corporate profits. The basic idea was for all sizeable companies to issue new shares every year *in pro rata* of 20% of their profits which would be transferred to wage earner funds. At a 10% profit rate the wage earner funds would have taken 35 year to have a majority stake in the company. The equity that was issued and transferred to the

[12] Meidner 1993

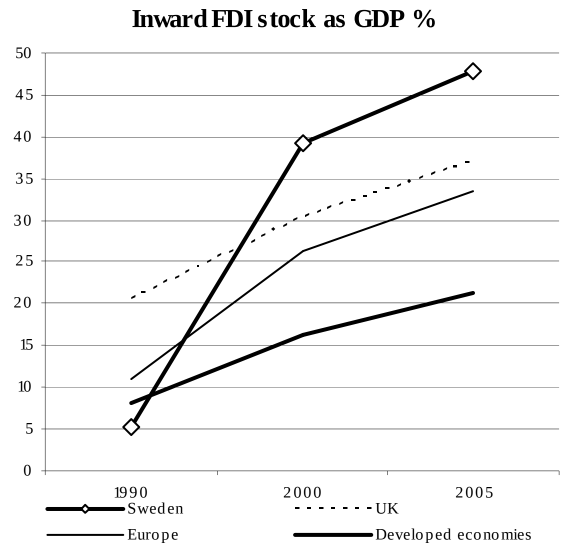
wage earner funds were locked-in capital: the funds would not be permitted to sell their stakes on trade exchanges.

25. Given that the capital accumulated by the funds could not be traded, the objective of the wage earner funds was not to establish collective control of the Swedish private sector. The aim was to redress a bias in the centralised wage restraint bargaining system. Still, the wage earner funds proposal met fierce opposition from the conservative parties and the employers' federation SAF. SAF withdrew in the early 1980s from the centralized wage negotiations, thus opening the way to decentralised bargaining at sector- and company- level. A considerably diluted version of the wage earned funds was finally implemented in 1984: the funds were regionalised and the build-up process limited to seven years. These funds were abolished in 1992 by the then conservative government.

The years of deregulation 1980-1990s

26. Like most OECD countries, Sweden underwent structural financial reforms in the 1980s and 1990s to diversify sources of financing for Swedish companies and investment funds. In the 1980s financial capital flow controls including exchange rate fixing, foreign ownership and credit restrictions were gradually removed. Financial services were de-regulated, regulation of M&As were eased, and access to stock exchange listing was facilitated. . In 1993 restrictions on foreign investments in the share capital – limits on ownership and control levels in domestic companies – were removed. The most immediate impact of financial liberalisation was a brutal increase of foreign ownership in listed companies, which share rose from 7% in 1989 to 43% in 2001. During the 1990s foreign direct investment inflows fuelled a third of the country's total gross fixed capital formation compared to 18 % in the UK and 11.8% on average in Europe. Today, the stock of foreign investments represent almost half of the country's GDP, compared to 5% in 1990. Employment in foreign owned companies rose from 204,000 workers in 1990 to 447,000 in 2000; much of the increase was concentrated in the car industry, the chemical industry and, in the service sectors, telecommunications, research and development and business activities.

Figure 1: Foreign direct investment in Sweden in international comparison



source: UNCTAD WIR

27. Corporate ownership also diversified with the phasing out of restrictions on institutional investors' investment policies. While pension funds and insurance companies used to be regulated by quantitative restrictions on their investment policies – for example, a 10% ceiling on portfolio investment in equity – these restrictions have been considerably weakened and gradually replaced by "prudent person standard" principle and risk management techniques following transposition of the EU directive on Undertakings for Collective Investment in Transferable Securities (UCITS). In a regulatory environment which so far had been framed for large companies and financial groups, efforts were undertaken to promote access to external financing for small and medium size companies.

28. After the financial de-regulation in the 1980s, domestic market competition was increased in the 1990s. Product and service markets were liberalised, ranging from taxis service to air transport, telecommunications and electricity. The reforms were breaking with Sweden's history of active industrial policies and public procurement and infrastructure programmes that had benefited large industrial groups. Price controls as a policy instrument were abandoned in 1990. The accession to EU membership in 1995 further accelerated the trend toward market and financial liberalisation. The stock exchange, OM Stockholmsbörsen, was deregulated in 1993 and several SME-focused and venture capital trade exchanges were created in the following years. Between 1997 and 2005, administrative procedures for stock exchange listing and for M&As were eased several times, while the investigation power and enforceability of the decisions of competition authorities were strengthened. Today, the Swedish competition authority can engage inspections in the private homes of board members and employees of companies under investigation[13].

[13] OECD 2003 & OECD 2006

29. EU competition regulation on corporate takeovers has become a sensitive issue in recent years. Several projects of merger between Swedish companies were opposed by the European Commission on competition grounds, such as a proposal of merger between *Scania* and *Volvo* in 2004. *Volvo* was ordered by the EC to transfer to a separate investment entity – created for the purpose – the shares it had acquired in *Scania* and which accounted for 25% of *Scania*'s voting rights. Ownership of the new entity was first distributed to *Volvo*'s own shareholders and, after a tough legal battle with *Scania*'s controlling shareholders, including the *Wallenberg* family, the entity was taken over by *Scania*. M&A activities have increased in intensity with the surge in hostile takeover bids. In many cases, these have put the incumbent Swedish shareholders on the defensive, as seen in the case of the *Wallenberg*'s investment fund *Investor* fight against a hostile bid by German group *MAN* o take over *Scania*, and in 2006 – and as outlined below – the South African insurance group *Old Mutual* taking over of *Scandia*.

30. Interestingly during the years of profound changes in the 1980s and 1990s, the Swedish corporate governance regime remained relatively untouched. Although ownership structures diversified to some extent the essential rules governing the relations between shareholders, the board, the management and workers remained in place. Thanks to the development of CEMs, the Swedish system could afford a rise of new investors, foreign and institutional investors, in the share capital of companies: the historical owners, family- and bank-owned holdings retained effective control of the boards despite dilution of their economic ownership. In practice, Swedish boards were exclusively composed of non-executive directors representing controlling shareholders, of a minority of worker representatives – as required by the Board representation Act, two to three board level employee representatives depending on the size of the company – and the CEO. The mode of governance was essentially relationship based, relying on networks, cross-ownership and multiple directorships. Overall the Swedish governance favoured insiders and had few incentives – to say the least – for outsiders' shareholder activism.

<u>The Post-Enron era</u>

31. Like in many other OECD countries, Swedish corporate governance was put at a test in the aftermath of the burst of the IT bubble in 2001 and the series of financial and corporate governance scandals that followed. A post-Enron debate on the validity of corporate governance regime swept across the OECD, and Sweden was no exception. Public confidence in corporate governance was severely hit in Sweden f by a series of controversies and scandals affecting flagship companies, re-known industrialists and financial leaders from the inner circles of corporate elites and controlling families. At the EU level, the regulatory reaction to the crisis of confidence came with the adoption by the European Council in 2003 of an Action Plan for Modernising Company Law and Corporate Governance. With the increasing pressure from foreign, but also domestic shareholder activism, debates in Sweden were torn between the need to reform on one side, and the risks of importing governance solutions that in effect would be alien to the Swedish model, its ownership structure and broader regulatory environment.

Scandals and controversies

32. The most common form of mismanagement and scandals in Sweden in the post-Enron period was related to management and director remuneration packages. Blue chip companies such as *Ericsson* and *Scandinavian Airline System*, but also state-owned pension funds brought attention to the pays-outs to directors or top managers in spite of poor financial performance. Among the controversies, *AP3*, the third national pension fund, paid Skr15m in bonuses to its 41 management employees in 2003, although its asset under management had fallen by SKr17.5bn in 2002. Gunnar Lund, the then deputy finance minister, qualified these bonuses as "offensive". Two scandals in particular concentrated public attention: the golden handshake package of ABB's leader Percy Barnevik in 2002, and the collapse of *Skandia* in 2003:

- <u>Percy Barnevik:</u> In 2002, Percy Barnevik the then CEO of *Asean Brown Boverie (ABB)*, the Swiss-based automation equipment company[14], stepped down following the disclosure of a pension and severance package of SFr148m (circa €88m), which had not been properly authorised, The story became famous in Sweden because Barnevik was a *Wallenberg* insider. In addition to his directorship at *ABB*, he was also chair of the family's investment fund *Investor* and of *AstraZeneca*, the pharmaceutical group. Although Barnevik subsequently repaid part of the package to *ABB*, some SFr90m (circa €53m), his reputation was badly hit and he was forced to resign from all of his mandates in the following two years.

- <u>Skandia:</u> In the case of Skandia, the CEO Lars-Eric Petersson granted SKr156m (€16.6m) in bonus schemes and other in-kind benefits[15] without board approval in 2000. Following the disclosure of the schemes and the failure of an overly aggressive overseas investment strategy, *Skandia*'s share price collapsed in 2003. Petersson was fired in April 2003 and was sentenced to two years in prison in 2006[16]. The scandal also raised suspicion as to the responsibility of the chair of the board, Lars Ramqvist, another well respected Swedish industrial leader, in Skandia's management and director remuneration practices. He was, however, not prosecuted and settled an agreement with the newly elected board of *Skandia*, including paying back over SKr2.2m to the company (thereby violating insurance law, as such a settlement should have been endorsed by the AGM).

33. The case of *Skandia* is emblematic of the crisis of confidence not just because of the remuneration scandal in 2003, but also because of the shareholder battle that followed in 2005-2006 to gain control over the group. Towards the end of 2005, *Old Mutual*, a South African investment and financial services group, launched a hostile bid over *Skandia*, with the support of several foreign and Swedish investment funds, including US mutual fund *Fidelity* and Swedish hedge fund *Cevian*. The bid was opposed by the

[14] *ABB* was formed after the merger in 1988 between Swedish Asea and Swiss Brown, Boverie & Co - employing at the time 150,000 workers in around 100 countries.
[15] such as free access to high priced downtown Stockholm apartments in the heavily regulated Swedish housing market.
[16] End-2007 his (suspending) appeal was under consideration by the Supreme court.

management of Skandia and by most Swedish institutional investors, including *Nordea* bank, AP4 and AP2, the third largest shareholder. The fierce battle for the control of the board ended early 2006 with the successful takeover by *Old Mutual*.

34. In parallel with the increase in M&A activities and – as seen in the latter case of *Skandia* – of hostile takeover bids, Swedish corporate governance practices have been transformed with increasing shareholder activism in AGMs. Shareholder activism relates to various active shareholder strategies, ranging from continuing 'engagement' throughout the year with the management of the group to hostile resolutions at the AGM. Activism can pursue several objectives:

(i) to enhance financial performance on short or long term, for example by forcing strategic disinvestment of the company or by augmenting shareholders' dividend proceeds,

(ii) to enhance accountability of the board or of the company management, for example by forcing new composition of the board, disclosure of directors' remuneration packages.

35. These strategies became more frequent in AGMs in Sweden. In the fall of 2006, a group of activist investment funds – led by the same Swedish fund *Cevian* –acquired 5% of the shareholder voting rights of *Volvo* and pressed the company to increase dividends to shareholders. The case of *Volvo* was widely reported in the media and commented by political leaders as the country was in a pre-electoral period. Running for re-election, Prime Minister *Göran Persson* expressed concern about the rise of activist investors in the Swedish corporate landscape. The role of the Swedish fund *Cevian* created particular unease in the political sphere because one of its main clients was a national pension fund, AP1, which defended its investment in the fund. The discussion on shareholder activism thus touched upon the regulation of corporate governance and the organisation of the AGM as well as the regulation of pension funds' investment in alternative investment vehicles such as hedge funds.

36. Pension funds' investment in hedge funds became public concern not only because of the aggressive shareholder activism of the latter but also because of the pension funds' overall exposure to these highly risky asset classes. A few months later in September 2006 another AP fund, *AP7*, came under public scrutiny for its exposure in the collapse of the US hedge fund *Amaranth Advisors LLC* which was specialised in natural gas trading. *AP7*'s exposure to *Amaranth*'s losses was via a fund of funds managed by Swiss-based hedge fund *European Investment Management*[17]. The exact financial losses for *AP7* were not disclosed but added concern to Swedish authorities. In December 2006 the Swedish central bank alluded to the possibility of reinforcing regulation of pension funds' investment in hedge funds to protect the interests of pension beneficiaries.

[17] Ironically *AP7* awarded an SRI mandate to *EIM* in 2002 based on a negative screening system excluding companies in breach of UN Conventions.

The regulatory reaction

37. The crisis of confidence in the Swedish system that followed these controversies also questioned the capacity of the Swedish social partnership system to cope with a changing environment. Under normal circumstances such a crisis would have been dealt with by social partner negotiation and by the employer and financial groups in particular – not by law. In 2004 however the Swedish government threatened to implement hard law regulation in corporate governance in the face of a weak response by Swedish business to the recent corporate scandals. Finance minister *Gunnar Lund* stated in January 2004 that the response of the business community to the crisis of confidence among the Swedish people had "so far been pathetic". Law reform would make it obligatory for AGM to vote on board and top management remuneration and would enhance the power of the auditors in monitoring director remuneration. The government also made it clear that the regulation of stock listing and other securities transactions needed to be tightened by hard law, as self-regulation had proven unsuccessful.

38. The regulatory reaction to the scandals and the IT-led financial crisis consisted in two parallel initiatives. First the government completed a long time needed revision of the Companies Act of 1975, which ended in a new Companies Act in May 2005 (with effective implementation in January 2006). In addition, the government supported the creation in 2002 of a Commission on "Business Confidence" mandated to draft a national code on corporate governance for listed companies. The Commission included representatives of key business and financial constituencies: accountancy profession, investment funds, banking, insurance and shareholder associations, the Stockholm Stock Exchange and the Swedish employer federation. A first draft was circulated for public consultation in April 2004, leading to a final version taking effect in early 2005.

39. The discussions in Sweden took place in a broader European move towards reinforcing shareholder rights and board disclosure promoted by the European Commission DG Internal Market, the regulatory directions of which were not all necessarily in favour of the Swedish system. In 2003, the EU council adopted an "Action Plan on Modernising Corporate Law and Enhancing Corporate Governance" setting a roadmap for the adoption of new Directives and Recommendations on shareholder rights and board transparency. The Action Plan did overall fit the Swedish system with the exception of controlling enhancing mechanisms. While the Action Plan did not consider group pyramid structure needed additional EU-wide regulation, it marked a clear bias in favour of establishing one-share-one-vote principle across jurisdictions to establish a "real shareholder democracy in the EU". The Action Plan stopped short of proposing legislation on one-share-one-vote, and instead scheduled an EU-wide impact assessment study on proportionality of rights. However, the paper did cause concern in Sweden when EC Internal Market Commissioner Charlie Mc Greevy declared in an FT interview in October 2005 that he wanted to get the one-share-one-vote principle accepted across the 25 member states. Leif Pagrotsky, then Swedish industry minister, replied that "small EU countries must not be overridden by big ones" in deciding the appropriate corporate governance regime. The report commissioned by the EC was released in June 2007 and

proved to be un-conclusive about the virtues of one-share-one-vote principle in enhancing corporate governance and performance.

40. The defensive position of Sweden on corporate governance in the post-Enron period is further exemplified by the negotiations that led to the review of the OECD Principles of Corporate Governance in 2003-2004. Unlike most OECD member states Sweden did not produce written comments on the successive OECD Secretariat draft proposals of revision between June 2003 and February 2004 (and that led to a final version in May 2004). However, and as shown in annex 4, in the meetings of the expert group in charge of the revision process, Swedish representatives made several interventions to defend the system of differential voting rights as well as the rights of controlling shareholders in corporate governance (by opposition to minority shareholders).

41. Beside corporate governance, the Social Democrat leaders engaged discussion on the regulation of national pension funds' investment in hedge funds in the wake of controversial AGM activism by foreign – but also Swedish – investment funds. Towards the end of 2006, in the middle of the electoral campaign, the Swedish Prime Minister Goran Persson expressed concern at the explicit short term strategies of these funds and argued that Swedish institutional investors and AP funds in particular should take a more long-term approach to their investments in equity. This debate on the short termism of hedge funds shareholder activism came in late in the electoral campaign and disappeared from the regulatory reform agenda following the victory of the conservative block.

The 2005 Companies Act

42. Like most European countries, Sweden's corporate governance regulatory framework consists of a mix of hard and soft law. Sweden's fundamental law on corporate governance – the Companies Act 2005 – applies to all limited liability companies established in Sweden (circa 300 000). Other Acts have effects on corporate governance such as the 1987 Stock Market Companies Act. In addition to hard law, listed companies (i.e. excluding private equity companies) are required to comply (or to explain non-compliance) with the national code on corporate governance and with OMX listing requirements.

43. Like the previous Act of 1975, the Companies Act 2005 establishes a very clear hierarchy of powers between the AGM, the Board and the management. The AGM appoints the Board, which in turn appoints a managing director. It confirms the crucial role played by the AGM of shareholders in the life and governance of the corporation: unlike other jurisdictions that are *prima facie* considered as more pro-shareholder, by law Swedish AGM resolutions are binding on the board and on management. An important feature of the new law is to allowing proxy voting. Previous legislation imposed physical participation in the AGM meeting or alternatively to engage a lengthy administrative procedure with the attorney to be represented by another party. The Act also enhances the powers and responsibilities of the auditor. Under the new regime, the auditor is

nominated by the AGM – and not by the board as it is usual practice across the OECD – for a maximum of four years. The auditor is thus directly accountable to shareholders, not to directors. The responsibilities of the auditor's mandate cover not only the accounting and more broadly the financial integrity of the firm, but also its corporate governance: the auditor is required to review the firm's management and board organisation. In addition, the duties of the auditor vis-à-vis the company are enhanced to include protection of the interests of stakeholders other than shareholders, including employees and creditors.

44. Remuneration of shareholders is also strictly regulated in Sweden. Dividends are decided by the AGM but cannot exceed the value of the company's remaining unrestricted equity. They can only be granted on the basis of profits that are built up or expected; any other forms of distribution are prohibited (such 'interim dividends'). The size of the dividends and other forms of transfers to shareholders must also be justifiable relatively to the size of the company, its activities and the risks involved, and should obey to a general rule of prudence. The main change of the Companies Act regarding shareholder remuneration is to allow share-buy back programmes – which were forbidden under the precedent regime – on condition, however, of approval by the supervisory authority – the Companies registration office. The new Act leaves untouched the right to differentiate voting rights but puts a maximum ratio of 1:10. For major decisions however such as change in capital structures, a qualified majority of votes and capital is required. It sets into law rights for shareholders to vote in AGM via proxy voting mechanisms and the use of internet. The Act requires notice of the shareholdings crossing one way or the other 10%, 20%, 33%, 50% or 66% of the total number of votes in the company[18].

45. Regarding board organisation the Act specifies its structure is by law a one-tier system with at least three members under public listed regimes and two members under private regime (under a separate Act, the Board representation Act Board composition also includes rights to employee representation, see below). Importantly in a cross-OECD perspective, the Act establishes the separation of CEO and chair functions. Like other civil law jurisdictions the Act specifies that directors have a fiduciary duty to act in good faith and in the best interests of the company and not to act in the best interest of its shareholders exclusively. The Act gives the Board extensive rights over the CEO and executive management. By law the CEO has an obligation to comply with all the relevant instructions by both the board and the AGM. Not only that, the board explicitly holds the right to interfere in day-to-day management issues.

46. On director remuneration, the board has the competence to fix board and senior management remuneration. An early parliamentary draft proposed that the AGM should set the remuneration of senior managers; it met a strong opposition by Swedish institutional investors, including AP funds, on the grounds that such a change would "shift responsibility from the board and the CEO to the AGM, thereby blurring the line of responsibility between the various parts of the company and restricting the ability of shareholders to hold the board and the chief executive to account" (AP4 Annual report

[18] Stock exchange listing requirements are more demanding, requiring notice of crossing of ever fifth percentile (5%, 10%, 15%, etc.).

2005). Share-based remuneration of top management and employee share ownership programmes are regulated by the 1987 Stock Market Companies Act which was revised in 2006.

National code and stock exchange listing requirements

47. The Swedish code's main requirements relate to the board composition and evaluation – enhancing its transparency and accountability – and its accountability to the AGM. Unlike the Companies Act, it is silent on the ownership structure: it does not address unequal voting rights, or the difference between controlling and minority shareholders.

48. The Code's push for increased board accountability to shareholders is exemplified by its requirement that the chair of the board be appointed by the AGM (the Companies Act leaves that responsibility to the board itself). Similarly, under the code the AGM is to decide on directors' remuneration and on all other cost funding associated with Board and committee functioning, while the Act leaves remuneration issues to board decisions. The central instrument for shareholder empowerment under the code is the appointment by the AGM of a Nomination committee. Such committees appeared in Swedish companies in the early 1990s and since had become widespread. As a body of the AGM the nomination committee has considerable oversight responsibilities. Members are appointed by the AGM a majority of which are not to be a member of the board or part of the management of the company. The responsibilities of the nomination committee include making recommendations for the chair of the AGM, for members of the board and its chair, and for the aggregate and individual directors' remuneration. The Code specifies that directors should not be granted share-related incentive schemes. These requirements add up to those of the OMX stock exchange which impose public disclosure of individual director remunerations. Overall, the relatively strict framework for director remuneration may explain why levels of remunerations in Sweden are among the lowest in Europe. According to a recent study Swedish directors get an average €1,900 per board meeting attendance, compared to €6,400 in Switzerland[19].

49. The code prescribes that a majority of directors be independent from the company's management and that only one executive director (which by law must be the CEO) be a member of the board. The code's definition of independence is focused exclusively on direct and indirect material interests in the company's operations that may threaten a director's independence of judgement. It does not cover relationships with shareholders, and in particular controlling shareholders, although it suggests that at least two directors need to be independent from shareholders as well. The code also requires the board to conduct periodic evaluation of its own governance and functioning. The committee should also review the evaluation by the board of its own work.

50. Like other national codes, the Swedish code requires the establishment of an audit committee and a remuneration committee. The audit committee's mandate and

[19] Heidrick & Struggles 2007

composition follows more or less mainstream international governance standards: a majority should be independent of the company and senior management, and at least one member should be independent of controlling shareholders. The CEO, or any other executive director, may not be part of the committee. The mandate of the remuneration committee differs from other national codes as it is only concerned with executive management remuneration, the board's remuneration falling under the responsibility of the AGM's nomination committee.

51. In sum the code is in line with the Swedish entrepreneurial model. In addition to the Act's requirement of separation of CEO and chair functions, the Code restricts executive management board representation to the sole presence of the CEO. It also facilitates controlling shareholder domination of the board because of its restrictive definition of independence. In practice Swedish Boards are in an overwhelming majority composed of controlling shareholder representatives, among whom the chair is selected, in addition to two to three employee representatives, the CEO and a minority of truly 'outsiders'.

52. Compliance with the code was already high a year after its implementation in 2006, notably on transparency issues and 100% of all listed companies had proceeded with internal board evaluation, a figure that is well above European standards. The proportion of board having an audit committee rose from 8% in 1999 to 93% in 2006. All listed companies have separate remuneration and nomination committees[20]. On the other hand the code has had little effect on board diversity because of the interlocking structure of the Swedish corporate landscape and the presence of controlling shareholder representatives on board. Gender diversity is nevertheless very high by all standards: with 21% of female directors, Swedish boards rank second in Europe[21]. Six companies have four or more female directors including Electrolux, H&M and Teliasonera.

Labour issues and challenges

53. The two parallel labour strategies on corporate governance, workers as employees and workers as investors, are both valid in the Swedish context. Worker participation in the company is supported by substantial regulation including the Co-determination Act – and the role of union representatives – and the Board employee representation Act. In fact Sweden, alongside Germany and Austria, ranks among the OECD countries that have the most extensive and most closely labour-connected, employee board representation regime. The other approach, namely workers' capital strategies, is also well served in the Swedish context. Despite being predominantly financed by pay-as-you-go flows, the pension system includes a large proportion of pre-funding including even within the first tier AP funds. The pension system is also firmly based on tripartite governance regimes, which mean that union representatives are present in the governing bodies of the most important and powerful pension-related institutions.

[20] Heidrick & Struggles 2007
[21] after Norway where 40% female composition is compulsory by law.

From a labour point of view, the comprehensiveness of the Swedish system is further supported by an overall political environment that has facilitated corporate social responsibility (CSR) standards and initiatives based on intergovernmental norms and conventions.

Representation in the Board

54. Unlike similar continental European systems, worker participation in corporate governance in Sweden is limited to board-level representation does not extend to company-level works councils, exception being made of the recently established European Works Councils (EWCs). The Swedish system thus presupposes a close relationship between local unions, the prevailing collective agreement and the board representatives, without the intermediary level that is offered by works councils in other comparable European jurisdictions..

55 The Board Representation Act of 1987 regulates board-level employee representation[22]. Workers of companies established in Sweden employing at least 25 workers have the right to be represented by two board representatives and one 'alternate' (an additional representatives attending and participating in board discussions meeting without voting rights). Representation is brought to three representatives and three alternates for companies with a workforce of at least 1000 workers employed in Sweden. In the case of group companies and MNEs, these provisions apply to the entire group's operations in Sweden; the board representation of the parent company is nominated on behalf of the entire workforce of the group, including subsidiaries, in Sweden. The Act specifies that the total number of employee representatives may not exceed half of the total number of directors.

56. The appointment process is made in close association with unions: employee representatives are appointed by the unions that have contracted a collective agreement with the company. In case a local union covers at least 4/5 of the total workforce (in Sweden) it appoints all representatives. Otherwise appointment is made pro rata by the two largest unions present in the company or the group company. The other conditions imposed by the Act are that the representatives are salaried employees of the company or of one of its subsidiaries and that the duration of the appointment by unions does not exceed four years. Otherwise unions have discretionary powers over all other appointment modalities. In fact, they have the ultimate right to decide if board representation is appropriate or not. According to a 2000 survey[23], in one third of the cases, the representatives are chosen at the plenary meeting of the workshop union. Other nomination processes include appointment by the union's board, direct election by unionised workers and selection by an *ad hoc* company or group wide councils or

[22] The Act came into effect in 1998 in replacement of a transitory Board representation of joint stock Companies and Cooperative Societies Employees Act. It is worth noting that this regulation is an exception in Sweden where labour issues are otherwise usually ruled by social partnership negotiations in collective bargaining and sector wide agreements.

[23] Levinson 2001

committee. The Act also prescribes public funding for board employee representatives training and education programmes. These public financed programmes are essential to the well-functioning of board representation. They were dramatically cut down by the new Conservative government that came to power in 2007.

57. The Act specifies that the duties and responsibilities of board employee representatives are no different than those of other directors as regulated by the Companies Act 2005. There is however one major exception: the Act exempts worker directors from board decision-making on issues that relate to collective bargaining, industrial action or any other workplace issues. Worker directors have in principle the same duties than other directors to act in the best interest of the company, their right to weigh in on some social aspects of the company is limited by law. The argument put forward for this restriction to worker directors' responsibilities is that the local union "has a material interest" in labour issues "that may conflict with the interests of the company". In addition, under the Act the appointing union can be held liable, including financially, for breach of directors' duties of its representatives.

58. According to the survey cited above, a clear majority of CEOs and Board chairs view employee representation positively. The main advantages cited in the survey are that employee representatives contribute to "a positive climate" in the board discussions, facilitate making "tough decisions" and decisions that are "deep rooted among employees". The main negative attribute, which is yet supported by a minority of CEOs and Board chairs, is the risk of information leaks. On the unions' side, the issue of board secrecy – i.e. the fact that the employee representative cannot report back to their unions on all board meeting discussions – seems to be well accepted and has become an internal problem between the board representatives and their unions only in a few cases. For unions, the main barriers to effective representation are that "decisions are taken outside the board" – i.e. *ex ante* agreement between the CEO and controlling shareholder representatives on the board meeting agenda – and the lack of preparation ahead of meetings.

59. Employee representation has had a positive influence on gender balance in the past years. In the precedent 2000 survey the female ratio of union representatives was the double of the national average. Gender balance in corporate boards is in fact a key policy position of Swedish unions[24]. Looking at board meetings employee representatives act cautiously and are generally passive; in about half of companies surveyed, representatives support decisions without thorough discussions, in only 6 out of a 411 surveyed companies did representatives submit recommendation or suggestions. Exception to this is when the board addresses employment and working conditions on which employee representatives are said to be particularly vocal – although under the Act, and as developed above, they may not necessarily have decision rights on those issues.

60. Looking at board structure and organisation, participation of employee representatives in board sub-committees seems to be marginal. Among the 30 largest capitalisations no board level employee representative sits on audit or remuneration

[24] LO 2006

committees – with the exception of Ericsson where they sit on both the audit and the remuneration committees. This absence may be explained by the Code's definition of independent directors which explicitly excludes employee representatives. More generally, there appears to be insufficient articulation between the provisions of the Code and those of the Board representation Act. The role and responsibilities of employee representatives appear nowhere in the Code apart from a factual acknowledgment of their existence in the preamble (explaining "in a few words" the existence of the Board representation Act). Not only that, the Code also states that it does not "deal with relations with customers, employees or the general public" because "these matters have not been considered part of corporate governance". This exclusion of employees from the definition of corporate governance and from the code itself is particularly astonishing in the Swedish context of widespread board level employee representation. Regarding other forms of worker participation, workers councils and employee share ownership plans, these are relatively marginal. The only regulation on works council that applies in Sweden is the EU-level 1994 Directive: approximately 90 Swedish MNEs are covered by the directive, so are circa 240 foreign MNEs operating in Sweden. Employee Share Ownership Plans do exist as well but appear to constitute a relatively marginal source of capital with exceptions such as *SHB*.

Table 4 Board-level employee representation in the top 25 largest capitalisation

OMXS 30 index Swedish companies only	**weight**	**Nb of directors**	**Of which BLER†**	**EWC**
Ericsson	14,46	13	3	y
Nordea Bank	9,65	15	0	n
H&M	8,91	9	2	y
SEB	5,09	12	2	y
Atlas Copco	5,04	9	2	y
Volvo	4,83	11	3	y
SHB	4,65	13	2*	y
Swedbank	4,52	9	2	-
Sandvik	4,16	10	2	y
Investor	2,7	10	0	-
SCA	2,49	11	3	y
Scania	2,49	11	2	y
Skanska	1,89	12	3	y
ASSA ABLOY	1,82	10	2	y
SKF	1,81	8	2	y
Boliden	1,8	11	3	y
Electrolux	1,45	10	3	y
TeliaSonera	1,43	11	3	y
Tele2	1,43	7	0	-
Securitas	1,3	13	3	y
Swedish Match	1,26	11	3	y
Alfa-Laval	1,22	12	4	n
Eniro	0,58	11	3	-
Stora Enso	0,27	10	0	dissolved or merged
Autoliv Inc. SDB	0,24	12	0	-

† Board level employee representatives; * representatives of the fund managing the employee share ownership plan (Oktogonen Foundation);.
Source: OMX, ETUI & company websites.

High governmental profile on CSR

61. Sweden has had a comparatively high profile on corporate social responsibility (CSR) ever since the emergence of the concept in the 1990s and its recognition as a policy field on its own. In particular the government has promoted an offensive agenda on CSR in key global fora including the ILO, the UN, the OECD and even at the WTO – a forum that has proven to be difficult to penetrate for proponents of CSR and of linkages between ILO and WTO[25]. In 2002 Prime Minister Göran Persson launched *Globalt Ansvar*, the Swedish Partnership for Global Responsibility – a permanent forum of dialogue between the Swedish Government and signing companies[26] on the implementation of key CSR initiatives, including the OECD Guidelines and the UN Global Compact. The Partnership has a permanent Secretariat that carries information on networking activities on standards, practices and performance results. At the OECD, Sweden has defended an ambitious understanding of the Organisation's CSR flagship, the OECD Guidelines for Multinational Enterprises. Its implementation of the Guidelines, including a quadripartite Swedish National Contact Point and considerable efforts to promote awareness and education around the Guidelines, is praised by observers. When Sweden chaired the OECD Ministerial meeting in May 2005, Thomas Östros, the then Minister of Industry and Trade, made a strong plea in favour of CSR and the OECD Guidelines in particular[27]. The Swedish government also actively supports other CSR initiatives, such as the UN Global Compact, for which it is a key funder, as well as the Global Reporting Initiative (GRI), the global benchmark on corporate social and environmental reporting. In 2007 the government announced that all state-owned enterprises would publish from now on annual sustainability reports in accordance with the GRI Reporting Guidelines.

[25] At the WTO Meeting in Hong Kong in December 2005, the Swedish Minister of Industry and Trade said: "For Sweden Corporate Social Responsibility is about establishing a floor for human decency in business. The starting point should be internationally negotiated and universally accepted norms, such as the ILO Core Standards."

[26] Current membership: *ICA, Löfbergs Lila, the Body Shop, Folksam, H&M, OMX, ITT Flygt, Vattenfall, KPA, Sweco, Banco, V&S Group, Lernia, Apoteket, Sveaskog, SJ, Sweroad* and *Akademiska Hus*.

[27] In a letter to the Editor published in the FT on 3 May 2005, Mr Östros wrote: *"Sir, The debate on corporate social responsibility, insightfully highlighted in your recent report and editorial on how Chinese suppliers try to cover up irregularities such as excessive working hours, underpayment and sub-standard health and safety arrangements, raises some concern in a country like Sweden. My country is small and highly dependent on open markets and free trade. This has made Sweden an international country. The main road to economic growth and prosperity in times of globalisation goes through free and open trade combined with a strong engagement for CSR. We see a clear link between responsible business behaviour and the acceptance of a just and fair globalisation that benefits all. CSR is not about protectionism, but about establishing a floor for human decency in business. By aligning business practices with universal norms and principles, such as UN Global Compact and the Organisation for Economic Co-operation and Development Guidelines for Multinational Enterprises, we can create responsible growth. The Swedish government believes that intense work on CSR is a prerequisite for the acceptance of continued globalisation. […]. Sweden is chairing this week's OECD ministerial meeting "Enabling Globalisation". In conjunction with the ministerial, an open forum will take place. […] I will ask fellow OECD governments to step up inter-governmental co-operation and dialogue. We need to be clear on how we can create an enabling environment for responsible business practices".*

62. The activism of the government in promoting CSR and its global standards worldwide and at home has had some impact on Swedish corporations' handling of CSR. Half of the 20 largest stock capitalisations produce sustainability reporting that are in accordance with the GRI (*Ericsson, H&M, Atlas Copco, Volvo, Swedbank, SCA, Skanska, SKF, Electrolux & TeliaSonera*). Sweden also ranks well in the number of International Framework Agreements (IFAs) signed between individual multinational enterprises and global unions covering the sectors under which signing companies operate. Out of the 56 IFAs signed and implemented as of early 2007, 6 were with Swedish MNEs (*Ikea, Skanska, SKF, H&M, SCA, Securitas*), ranking Sweden as the third country by the number of IFAs, after Germany (16) and France (10).

Table 5: Commitment of the largest non-financial capitalisations to key CSR initiatives

Initiatives include the Swedish Partnership, the Global Reporting Initiative and the UN Global Compact. The OECD Guidelines for Multinationals are not selected because their applicability is universal and does not require ex-ante agreement or commitment by company.

Non-financial companies (ranked by weight in the OMXS index)	**Has an IFA with**	**GRI**	**UNGC**
Ericsson	-	X	X
H&M	UNI	X	X
Atlas Copco	-	X	
Volvo	-	X	X
Sandvik	-		
SCA	ICEM	X	
Scania	-		
Skanska	BWI	X	X
ASSA ABLOY	-		
SKF	IMF	X	X
Boliden	-		
Electrolux	-	X	X
TeliaSonera	-	X	
tele2	-		
Securitas	UNI		
Swedish Match	-		
Alfa-Laval	-		
Eniro	-		
Stora Enso	-		
	-		
Other companies	-		
IKEA	BWI		

Source: UNGC website, GRI database, Hellmann & Steiert 2007

63. Swedish financial institutions have also invested in and been committed to CSR initiatives and standards. As developed in the following section on workers' capital, the Swedish pension and insurance industries have followed the move toward explicit recognition of social and environmental concerns in their investment policies, such as the two Swedish banks, *SEB* and *Swedbank*, which have signed on the Global Compact. Among private pension funds and insurance companies, *Folksam* pension fund has a distinguished commitment as it is a Global Compact signatory, a GRI reporter (i.e. its sustainability reporting is in accordance with the GRI framework) and is a member of the *Globalt Ansvar* Partnership.

64. Corporate commitment to CSR has however not gone without some controversies regarding the effective implementation of (highly publicised) ethical commitments. In 2006, construction company *Skanska* which was one of the most CSR active Swedish companies was caught in the public eye for its involvement in a huge gas pipeline construction corruption scandal in Argentina. Ironically *Skanska* had been a key initiator of a global engineering & construction industry commitment in 2002 to a "zero tolerance" policy on bribery and corruption[28]. Similarly, in early 2007 Swedish prosecutors launched an investigation into bribery allegations at *Saab* regarding negotiations in 2001 of the sale of fighter jets to the Czech military. Given the overall international exposure of Swedish companies, it may be argued, however, that these cases are comparatively rare.

Workers' capital

65. Many trade unions have either by law or through collective agreements a responsibility in ensuring stewardship of the investment of workers' retirement and other long term savings – workers' capital – in financial assets[29]. In the case of Sweden and despite the pay-as-you-go nature of its pension system, workers capital is an increasingly important aspect of corporate governance under the current regulation. Using a simplified and World Bank-inspired three-pillar model ((i) universal, (ii) occupational, and (iii) individualised), the system is mainly structured around the first two pillars:

- In addition to a means-tested basic guaranteed pension, the first universal pillar consists in a compulsory notional (wage-indexed) pay-as-you-go scheme in which differences between inflows (contributions) and outflows (payments of pension benefits) are managed by several state-owned buffer funds: the AP funds.

- Under the second occupational pillar, depending on the sector (public/private),the professional status (blue/white collars) and union affiliation workers can supplement their AP pension rights with additional life insurance or pension benefits. Two supplementary regimes co-exist in the private sector: *Collectum* for salaried employees (white-collars) and *Fora* for non-salaried employees (blue-collars) which administer ITP and Avtalspension SAF-LO pension plans respectively. In the public sector the main pension plans are the municipal employees KAP/KL and the government employees' plan PA 03. The schemes are either defined benefit (DB) or defined contribution (DC) plans, depending on the governing collective agreement. Over 80% of workers – as it happens the rate of unionisation in Sweden – are covered by such supplementary schemes.

[28] The initiative was within the framework of the Engineering & Construction Task Force, a group affiliated with the World Economic Forum.

[29] Generally workers' capital refers to the financial assets (debt, equity, other asset classes) that are accumulated in collectively-funded retirement schemes as they exist in countries where pre-funded occupational pension schemes represent a substantial part of the total pension retirement of workers. It can also include non-retirement collectively negotiated employee-savings and insurance schemes, as well as reserve funds and buffer funds operating in pay-as-you-go retirement schemes. More information on www.workerscapital.org .

66. The general AP regime is regulated by the Swedish National Pension Funds Act of 2000. Pension contributions constitute 18.5% of individual wage earnings (with lower and upper limits) of which 16% are versed into the general wage-indexed pension system (the Income pension) and 2.5% are invested in a purely pre-funded scheme, the Premium pension.

67. Under the Income pension scheme the surpluses that are currently accumulated due to the population demography are managed by five public pension reserve funds: AP1, AP2, AP3, AP4 and AP6. AP funds 1 through 4 have a classic investment mandate allowing them to invest in the whole investment universe (listed equity, bonds, real estate, alternative funds). AP6 is specialised in private equity and venture capital investments. Under the Premium Pension scheme the individual workers can choose to invest his/her contribution either in a private investment funds (over 500 are registered) or in the default government-backed AP7. 30% of workers do not choose and have their 2.5% contribution versed in the default fund the AP7[30]. Contributions vary under supplementary schemes, such as *Collectum* and *Fora*, and can reach 12% of wage earnings but are typically between 2 and 5%. The main pension funds under the schemes *Collectum* and *Fora* are *Alecta* and *AMF Pension* respectively.

68. The total value of assets under management by Swedish pension-related institutions is estimated to be over €240bn. At the time of the reform of the pension system in 2000 each AP funds was given SKr134bn (€14.3bn at current prices) in diversified portfolio including equities, fixed income securities, cash and real estate properties. Asset under management by these funds are now well above SKr200bn each (€20bn). Today the AP funds collectively, *Alecta* and *AMF Pension* rank among the largest pension funds in Europe[31].

Table 6: Asset management structure of the national pension system in 2005

Pension plan	**Rate**	**Governing institution / regime**	**Key managing institutions**	**AUM * (€ Bn)**	**/ equity**	**/ Swedish equity**
Income pension	16%	Wage-indexed pay-as-you-go, balance between inflows/outflows managed by AP buffer funds	AP1	20	11,8	2,5
			AP2	20,4	12,7	4,4
			AP3	20,5	11,5	3,1
			AP4	19,3	12,1	3,9
			AP6†	1.6	n/a	n/a
Premium pension	2.5%	Pre-funded DC	AP7	6,2	5,1	1,1
Supplementary regimes	Up to 12%	Sector specific, Pre-funded DC, DB or life insurance.	AMF	28,7	13,5	6,7
			Alecta	42,4	16,1	7,3
			Other large pension funds includes: Länsförsäkringar, Electrolux, SKF. Insurance and pension providers: Folksam, Skandia Liv, Swedbank, SEB Trygg Liv, etc			

* other than the AP funds, estimates are for the total portfolio under management, and not the AUM of the corresponding pension scheme; † AP6's investment mandate is limited to unlisted securities (private equity buy-outs and venture capital).

[30] The Premium pension's individual choice system has been criticised for its inefficiency, the number of investment funds to choose from (over 500), the opacity of the fees taken by the fund managers and the lack of awareness and education that is needed for such sophisticated investment decisions.

[31] respectively 3rd, 7th and 16th by AUM, according to IPE.

69. Most of the Swedish pension system' asset management is governed either by state-owned institutions under the Income Pension and/or by social partnership agreement – *Alecta*, *AMF Pension*, etc. Under the Income pension the boards of directors of AP1-4 and AP7 consist of nine members appointed by the Swedish government of which two are nominated on proposal of trade unions and two on proposal of the employers' federation. AP6, the private equity and venture capital state-owned investment, has no such requirement. Regarding the supplementary schemes, *AMF* and *Alecta* are jointly owned and governed by employers and unions[32]. In addition several private and cooperative groups have a share of asset management in the supplementary schemes, including *SEB* (private bank), *Swedbank* (cooperative bank), *Skandia* (private insurance company), *Folksam* and *Länsförsäkringar* (respectively mutual and cooperative insurance groups).

70. Regulation of pension fund investment has been considerably eased following Sweden's accession to the EU and compliance with the EC Directive 2003/41. Once tightened by strict quantitative rules Swedish pension funds are today subject to relatively light regulation (see annex). There is no restriction any more on pension fund holdings in equity as a proportion of their total portfolio. However AP funds have more stringent portfolio composition requirements[33] including:

- Minimum 30% in fixed-income securities (i.e. bonds);
- Maximum 2% equity ownership in a single listed company, or 10% of its voting rights, and maximum 10% total exposure (equity and debt) to a single listed company or group company;
- Maximum 5% in unlisted securities (private equity, venture capital, infrastructure) and ownership must be via holdings in a private equity fund (i.e. no direct ownership allowed);
- Maximum 40% of assets exposed to currency risk;
- Minimum 10% of total portfolio managed by outside asset managers.

71. Recent public debates have centred on further weakening AP's investment regulation. In particular, the appetite for private equity investments (see section below) have led some AP managers, such as AP3, to ask for a higher ceiling on private equity ownership above the current 5% or for infrastructure funds to be excluded from the current restriction level.

The corporate governance and CSR policies of the AP funds

72. AP funds have integrated corporate governance and CSR issues in their investment policies to an extent that surpasses their counterparts in the social partnership sector, *Alecta* and *AMF Pension*, and the private and mutual sectors. The regulated restriction that applies to AP funds on their equity holdings in a single company as

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[32] LO for AMF, and PTK (coalition of private sector unions) for Alecta.
[33] Mercer 2006

indicated above (max 2% share ownership and 10% voting rights) in essence prohibits any AP fund to become a significant shareholder in a listed company. Despite this important restriction though AP funds are relatively active in the corporate governance of listed companies in Sweden. All AP funds have a specific corporate governance policy which content is in line with the Swedish Code.

73. Key issues in 2005-2006 have been directors' remuneration for which APs tend to favour very careful assessment – to say the least – of any share-based component. For example *AP1* and *AP2* voted against the proposal of director share-based remuneration package at the 2006 AGM of *Swedish Match*. In November 2006 *AP1* went as far as to explicitly call for all board members to be remunerated in fixed fees and to ban all forms of share-based incentive schemes. For *AP1* the board of directors "should not have the same incentive program as the CEO (and the rest of the management)". AP funds are also present in the AGM-appointed nomination committees which give them privileged oversight over the board's organisation and functioning. AP1-4 funds have each up to 25 representations in the nomination committees of Swedish companies – and hence need to have specific resources to meet up to these specific responsibilities. Among Sweden's largest capitalisations, AP funds were present in the nomination committees of *Atlas Copco, Volvo, SHB, SCA, Electrolux, Securitas, Swedish Match, Alfa-Laval*, and *Skandia* (until its takeover by *Old Mutual*). However they were absent from the committee of the largest capitalisation in Sweden, *Ericsson*, despite accounting for the largest equity holding by AP funds who cumulatively owned over 4.4% of the capital end-2005, but less than 3% of the voting rights (as most AP-s holdings are in B-shares that have 10 times less voting rights than A-shares).

74. Similarly, AP Funds have comparatively very active CSR-related policies. Unlike the general regulation on occupational pension funds, the regulating Act of AP funds specifies that "environmental and social considerations shall be taken into account in [AP funds'] investment activities without impinging on the overall goal of a high return on capital" and that AP funds should report annually on their integration of such considerations in their investment policy. The general regulation on occupational pension requires Swedish occupational pension funds to publicly disclose any integration of social, environmental or ethical criteria in the investment policy. The national pension Act further allows the exclusion of individual companies from AP funds' portfolio based on those social and environmental criteria. Unsurprisingly the CSR investment strategies of AP funds consist for a good part of ethical "engagement" activities. *AP2*, *AP3* and *AP4* have engagement policies, the benchmarks of which are in the UN Human rights conventions, the ILO core labour standards, the OECD Guidelines for Multinational enterprises, as well as the OECD convention against bribery and corruption and in some cases the Global reporting Initiative. For example, *AP1* management staff was actively involved with foreign companies over alleged breaches of international conventions. According to *AP1*'s annual reports, the following cases were dealt successfully in 2005-2006:

- *Nomura Holding*, a Japanese financial services group, concerning cases of gender discrimination;

- *Coca-Cola*, over its respect of human rights in its Colombian operations;
- *Marriott Hotel,* concerning reports of sexual exploitation of minors in Costa Rica;
- *BASF*, for unlawful use of pesticides in the US;
- Oil companies *Kerr-McGee* and *Pioneer Natural Resource*, for their involvement in the military occupation of West Sahara by Morocco;
- *Occidental Petroleum*, for its alleged involvement in massacre of civilians in Colombia;
- *Repsol,* regarding the construction of a pipeline in Ecuador.

75. AP funds' dialogue process usually includes divestment as a last resort option – and public disclosure of such divestment For example, in 2006 *AP2* divested its stake in *Wal-Mart* after three years of unsuccessful efforts to change the company's anti-union policy. *AP7,* the default fund of the Premium Pension, is by far the Swedish champion of negative screening and ethical exclusion. Its annual reports include an annual list of over a dozen of foreign companies that are excluded from its equity portfolio for alleged breach of international conventions (see annex). The latest and most visible sign of the involvement of the Swedish financial sector in CSR was the creation early 2007 a joint "ethical council" uniting the four AP funds. The council's mandate is to review the socially responsible investment (SRI) holdings of the four AP funds in foreign companies, Swedish equity being excluded. The review will consist in a systematic screening of the funds' equity portfolios with regard to compliance with CSR-related international norms and conventions. The scope and implications of this initiative should not be under-estimated given the foreign equity exposure of the four AP funds – totalling €33bn – and the number of invested foreign companies – around 3500 globally.

The challenge of private equity

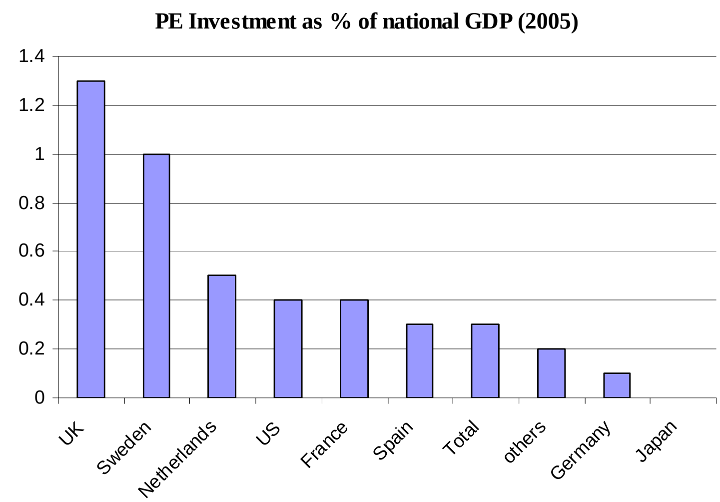
76. Historically the concept of corporate governance has been built on the assumption that stock exchange listing is the ultimate stage of good governance. According to theory stock listing provides for the best perspectives of corporate growth and wealth and requires the most sophisticated mechanisms of accountability and reporting, given the number of corporate constituents. By contrast unlisted company status was at best considered as a necessary – but hopefully – brief intermediary phase before 'going public'. At worst, it was tolerated as a default option for countries – and mainly developing ones – lacking robust capital market infrastructure and regulation. This conventional wisdom has been challenged in recent years by the transformation of the private equity industry from a relatively marginal investment class (start-up, seeds, risk capital investment, venture capital etc.) to a credible alternative to stock exchange listing for companies of all size and sector (buy-out). The underlying economic model of private equity makes extensive use of leveraged transaction and of un-regulated investment vehicles[34]. The growing share of private equity buy-out investments across OECD

[34] A private equity firm create a separate fund for the purpose of buying out target companies (acquisition of the totality of shares) thus leading to delisting if the company was publicly traded prior to the acquisition. The specific characteristic of private equity buy-out compared to traditional industrial consolidation is the short term horizon of the transaction: private equity firms have the explicit intention of

economies has been controversial among the labour movement notably with regard to the social impact and the un-regulated corporate governance regime of private equity[35].

77. The boom in the private equity business has been particularly acute in Sweden which has one of the highest levels of private equity investment as a share of GDP (see figure below) of which two thirds consist of 'buy-out' operations (by opposition to early start-up and seeds risk capital investment). The country has had a long history in developing private equity investments reflecting an on-going concern about the excessive concentration of the Swedish economy and the need to support and develop SMEs. The first venture capital fund *Företagskapital* was established in 1973 as a public-private partnership. Today Swedish venture capital mainly is channelled by the Swedish Business Development Agency (*NUTEK*) and the National Industrial Development Fund (*Industrifonden*). In addition to public and private partnerships various corporate and income tax incentives have been introduced to make private equity ownership attractive and/or to facilitate investors' exit strategies, including access to stock listing. Several trade exchanges were created following the de-regulation of stock listing in 1993 and were specialised in SME and venture capital.

Figure 2: Private equity investment in Sweden in an international comparison



source: Private Equity - City Business Series, October 2006, International Financial Services, London

selling the entity after a 3 to 5 year period of restructuring. The share of the cash input in the fund is usually marginal (as little as 20% of total cost of acquisition) and is complemented by debt contracted at mainstream banks. The investment vehicle set up to carry out the acquisition operation is designed around the concept that the vast bulk of the purchase money will come from debt, the servicing and repayment of which is financed by future earnings of the target company.

[35] As noted in a Global Union statement on private equity in March 2007: "Current national corporate governance frameworks focus on publicly traded companies and are not suitable to address the challenges of private equity's short-term ownership regime nor to deal with hedge fund participants' "hyper-activism". The responsibility and powers of the boards of directors to preserve long-term interests of companies needs to be reinforced.

78. Another major source of private equity funding appeared with the pension reforms in the 1990s. As discussed in the previous section, quantitative restrictions on pension funds' investment policies have been considerably weakened in the past decade to facilitate listed and un-listed equity ownership. *AP6* was set up in 1996 with a specific mandate to support private equity and venture capital investment and funds in Sweden. End-2005, *AP6* had around €1,5bn worth investment in venture capital and private equity investments of which approximately €250-300m were invested in buy-out funds. The other AP funds have also increased the share of their investment in private equity in recent years. According to estimates drawn from annual reports (see table 7 below), *AP3* and *AP7* have the largest exposure in terms of share of their total portfolio. The investment policy varies: some AP funds have concentrated their stake in a handful of private equity funds, others have dispersed their investments in large pool of funds. Other than AP funds, information on pension funds' investment in private equity is less known – private equity does not necessarily appear as a class of asset on its own in annual reports. By contrast, the *Wallenberg* family plays a crucial role in the private equity landscape via its holding company *Investor* and its wholly-owned private equity firm *EQT*. Early 2007, *Investor* announced that it would double its investments in private equity over the next five years from currently 13% share of its total portfolio to 25%.

Table 7: Private equity investment of major pension and investment funds in 2006

The figures below are estimates drawn from 2006 annual reports. They should be treated carefully as private equity is not always presented as a separate class of assets in the reports and/or scope and definition may vary. "Investments in PE" are the effective amount of money that has been transferred to the PE funds. The figures should be multiplied by 3 or more to evaluate the size of the commitments made over several years.

As of dec-06	**% of total AUM in private equity**	**Investment in PE buy-out funds (in €m)**	**Investment policy**
AP1		<20	Marginal InnKap
AP2	0.9%	203	Concentrated (incl. EQT, Carlyle, CVC, Nordic Capital, TPG)
AP3	3%	685	Diluted in over 50 funds
AP4	0.6%	140	Highly concentrated (2/3 in EQT and Goldman Sachs PE)
AP6	100%	242*	Concentrated
AP7	4%	171	Concentrated
Alecta	n/a	204	n. a.
AMF	n. a.	n. a.	n. a.
Investor	13%	1624	Of which €952m in EQT (pure buyout private)
Industrivärden	0%	0	

Source: annual reports 2006

79. The *Wallenberg*'s appetite for private equity buy-out became a public issue in 2006 when *Investor* and *EQT* led a successful buy-out offer on medical technology group *Gambro* leading to the largest public-to-private transaction in the history of Sweden. The buy-out transformed into an unusual open confrontation between the *Wallenberg* and the other shareholders over the valuation of the company. It also shed light on new corporate governance issues when the motives of the *Wallenberg* were unveiled. As the transaction was coming to a successful end in June 2006, a spokesman for *EQT* explained why private equity regime was superior to stock listing: "Stock listing corporate governance rules are becoming a burden. The decision making process is much quicker in a privately

owned company than in a listed company. We can make decisions in a non-public environment, meaning we don't have to explain every single step to the marketplace"[36].

80. Across the OECD economies, the recent development of private equity buy-out transactions has been accompanied by high profile cases of private equity-led restructuring processes. These cases point to an inherent – but not necessarily systematic – risk of short-termism under private equity regime. In Sweden, the management of the frozen food company *Findus* during its ownership by *EQT* between 2000 and 2006 appears to be one those cases of short-termism. The case is emblematic insofar it involves a Swedish, not a foreign, private equity firm. In May 2007, the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF)[37] published a report by two board level employee representatives of Findus on the *EQT*. Beside asset striping, the report exposes failures of governance that are characteristics of private equity including the lack of communication between board employee representatives and the managers appointed by *EQT*. One of the board level employee representatives explains: "We could see that money was being siphoned off to the UK [subsidiary]. [The managers appointed by *EQT*] told us it was invested in production facilities there." Although they had technical access to information, board representatives had difficulty to deal with the inherent complexity of private equity regime: "People seem to believe that we employee representatives are economists, but we aren't. We've been to a few courses, but there's a lot you can hide from us if you're a sharp financial controller." Like in other countries, the case of Findus suggests that private equity poses new challenges to board representatives – and to trade union representation at large.

[36] "On Europe: Wisdom of listing in question", FT.com site; Jun 09, 2006"

[37] "Swedish Union Reps Describe 6 Years of Asset Stripping at Findus under EQT", IUF Private Equity Buyout, May 6 2007, www.iufdocuments.org/buyoutwatch/2007/05/swedish_union_reps_describe_6.html .

Concluding remarks

81. In an international labour perspective, the Swedish corporate governance system appears remarkably well in setting the right regulatory environment for corporate accountability and transparency. In particular, the Swedish system rates favourably on some of the key policy areas identified in the 2005 Global Union Discussion Paper "Workers' Voice in Corporate Governance" as outlined in annex 1.

82. Historically the Swedish corporate governance regime has been exceptionally stable despite two decades of large scale liberalisation reforms. The successive waves of de-regulation jolted the Swedish model but in the end, had little impact on the structure of corporate powers. The rise of foreign investors and domestic pension funds in the ownership structure of Swedish companies did not translate into enhanced voting rights and effective corporate control. The Swedish top companies have remained firmly in the hands of a few family-related holdings:

- With circa €20bn invested in domestic listed equities the two investment holdings *Investor* and *Industrivärden* hold together decisive voting power in the AGM and/or are represented on the board of directors of 13 of the largest Swedish groups whose total market value approximates €144bn.
- By contrast, the state-owned AP funds, and the social partnership pension funds *AMF* and *Alecta* hold collectively €30bn in Swedish listed equities, but have comparatively poor voting influence in the governing bodies of Swedish multinationals.

83. What makes this very unequal distribution of shareholder power possible is the widespread use of differentiated voting rights: *Investors* and *Industrivärden* have disproportionate holdings in A-shares which have 10 times more voting rights than B-shares. On the other hand, pension funds and foreign investors' equity holdings are usually in B-shares. The Swedish paradox – extreme concentration of corporate power co-existing with a long tradition of social welfare and equality – is still very much alive.

84. Other than the heavy concentration of voting power – or perhaps *because* corporate control is so concentrated – the Swedish corporate governance regime appears to be well advanced in terms of board accountability, corporate and investor transparency and representation of workers. The main strength of the system lies in the mechanisms that preserve the independence and power of the board over the top management as seen in the regulated accountability rules that bind the board to the AGM and the CEO to the Board. Compared to other OECD one-tier systems the Swedish regime has the great merit of legally imposing the separation between the functions of chair of the board and of CEO and have the latter be forced by law to comply with all relevant resolutions by the board or the AGM. The legislation on shareholder remuneration also tends to prevent short termist behaviour: there are regulatory restrictions on the amount of dividends that

may be versed to shareholders and share-buy back programmes – which were prohibited before 2005 – require administrative approval.

85. In a cross-OECD comparison, Swedish workers are very well represented in corporate governance. Workers are indeed represented in corporate governance-related issues via:

- information and co-determination statutory rights;
- statutory rights to representation on the board of directors of companies;
- trade union appointments on the board of the state-owned AP pension funds; and
- trade union co-management with employers of several occupational pension funds, including the largest two: *AMF Pension* and *Alecta.*

86. This multi-entry presence in corporate governance is supported by an enabling political and social environment in which trade unions constitute a strong social force – for instance Sweden has one of the highest union membership rates in the world (over 75%). It materialises, among others, in a high profile of Sweden on the international scene with regard to promoting CSR-related initiatives and standards. Governmental activism on CSR is relayed to some extent by Swedish multinational enterprises and institutional investors. Sweden ranks very well in terms of number of international framework agreements contracted by multinational enterprises with Global Union Federations. Similarly, the state-owned AP funds have very advanced CSR investment policies. AP funds are also well equipped in integrating corporate governance in their investment policies; however it should be re-iterated that the system of differentiated voting rights generally plays against them.

87. There are few minor downsides to the Swedish model, given the high level of trade union density in the country, and the depth and diversity of institutions and regulations to promote workers' interests in corporate governance. Among them is the lack of acknowledgement of workers in the official discourse on corporate governance. Even if workers do have a voice in the boards there is indication that more needs to be done to ensure recognition of that voice by all parties, not least by business groups. The Swedish code of corporate governance exemplifies this contradiction. While board employee representation is a "factual fact" in Sweden, the new code is in a state of denial of reality and go as far as to state that it "does not deal with relations with employees" and that employees are not to be "considered part of corporate governance". Another area that might need further investigation is the extent to which private equity investment will impact the Swedish system in the future. While all OECD countries were affected by the boom in private equity investments between 2003 2006, Sweden has by far the highest share of private equity in percentage of GDP.

Source

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Annex

Annex 1: Key issues of the 2005 Global Unions report in the Swedish context

The 2005 Global Unions discussion paper "Workers' Voice in Corporate Governance – A Trade Union Perspective" proposes a four-pillar framework for labour oriented corporate governance reform:

- Pillar 1: reinforcing worker representation;
- Pillar 2: encouraging responsible shareholders;
- Pillar 3: strengthening the accountability of the board of directors;
- Pillar 4: ensuring compliance through an enforceable regulatory framework

The following table lists some of the key policy issues identified under the pillars and their application within the Swedish context.

Pillar 1: Reinforcing worker representation	
2005 report	**Swedish regime**
"Workers have a right to be represented in company decision-making, by law or by collective agreement."	• The right to board level employee representation is guaranteed by law. • Works councils legislation does not exist; however the transposition of the European directive on Works Councils (applying to Swedish MNEs only).appears to be well implemented.
"Board-level employee representatives qualify as independent directors."	• The Swedish code excludes employee representatives from its definition of independent director (it does not distinguish between management and workers in determining the kind of relationships with the company that may affect independence of judgement). • As a result, no employee representatives sit on audit committees.
"Board-level employee representatives should have access to resource, education and support to fulfil their responsibilities. Trade unions have a key role to play here, especially in providing logistical support and training."	• Swedish law sets a framework for trade union support to board level employee representation (including education programmes). • As a general rule, local trade unions are closely involved in the nomination process for board employee representative.
"Board-level employee representatives must respect the fiduciary duty that often arises from membership of the board."	• Surveys indicate that board level employee representatives are not specifically at risk of breaching their duties. • By law they have the same duties and responsibilities than those that apply to shareholder nominated directors, with two notable exceptions: (i) they cannot vote or take part in decisions relating to employment in the company, (ii) the nominating trade union can be held financially liable for breach of their board duties.

Pillar 2: Encouraging responsible shareholders	
2005 report	**Swedish regime**
"Boards should ensure continuous dialogue with worker representatives and long term shareholders"	• Surveys indicate that the relationship between board level employee representatives, other directors and the CEO are overall constructive and satisfactory. • Long term controlling groups such as *Investor* and *Industrivärden* are well represented in the boards of the largest companies. • Pension funds and AP funds are not, but have active corporate governance policies and are represented in AGM board nomination committees.
"The regulatory environment should ensure that shareholders' investment policies are designed in accordance with the public purpose of invested corporations."	• Shareholder remuneration appears to be sufficiently regulated to avoid financial short termism: the law sets proportional limits to the size of dividends and administrative approval is required for certain types of share buy-back programmes – which were prohibited until 2006. • The broader regulatory and political environment seems to favour financial and corporate governance transparency. The Swedish government is among the most active OECD governments in the field of CSR and SRI.
"Workers' pension funds, because of their particular liabilities and size must be granted effective control rights."	• AP funds and occupational pension funds' holdings are mainly in B-shares; these investors do not benefit form the leverage effect of differentiated voting rights system. A-shares are mainly held by family and bank-based investment holdings such as *Investor* and *Industrivärden*. • AP-funds are however represented in some AGM-appointed board nomination committees.
"Regulation should facilitate the collective organisation of employee shareowners in a way that ensures independence from executive management. Above a certain amount of share capital, this should result in independent representation on the board of directors."	• Employee share ownership programmes (ESOP) exist but do not constitute a key source of employee savings or a mechanism for board representation. • *SHB* bank is an exception: its ESOP ranks among the largest shareholders of the group, and has two representatives on the board (who substitute to the two statutory board employee representatives)

Pillar 3: Strengthening the accountability of the board of directors	
2005 report	**Swedish regime**
"Binding regulations should make sure that the board – not the management – is in a position to discuss, approve and supervise the implementation of the corporation's strategy in an open and unrestricted way."	• Corporate law establishes a clear hierarchy of powers and responsibilities between the AGM, the board and the management. The board has extensive rights over top management and can even intervene in day-to-day management issues. • By law the CEO has an obligation to comply with relevant resolutions by the board or the AGM
"In one-tier systems, a majority of the board must consist of non-executive directors. The Chair of the board must be fully independent from the executive directors."	• The Code prescribes a majority of non-executive directors. In practice, only the CEO sits on the board. • By law CEO and chair functions must be separated
"Directors' remuneration policy (covering all remuneration and other compensation components) must be disclosed in details and consistent with the remuneration policy for its employees."	• The Code and stock exchange listing require disclosure of individual director remunerations. In practice, transparency on director remuneration is high. • According to the Code, directors should not be granted management share-based remuneration schemes.

Pillar 4: Ensuring compliance through an enforceable regulatory framework.	
2005 report	**Swedish regime**
"Laws and regulations affecting the fiduciary duties of trustees should be reformed to enable explicit integration of non-financial criteria in the investment policies."	• Legislation on the national AP Funds specifies that "environmental and social considerations <u>shall be taken into account</u> in [AP funds'] investment activities without impinging on the overall goal of a high return on capital" • Occupational pension regulation requires disclosure of whether environmental, social or governance issues are integrated in the investment policy of the fund.

Annex 2: Sweden's positions during the review of the OECD Principles

According to notes taken by the TUAC Secretariat the Swedish delegates held the following positions during the meetings of the negotiation team in charge of the review of the OECD Principles of corporate governance in 2003.

At a meeting in June 2003 Sweden expressed:

- opposition to new text in the Principles that would call for the board of directors to have exclusive responsibility for ensuring "a formal and transparent board nomination process". Sweden argued that the nomination committee in Sweden is appointed by the AGM and not by the board.

- concern with regard to a proposal to enhance the definition of "independent directors" to cover relationship with shareholders. Sweden said such wide definition would be detrimental and would be "importing a specific Anglo-American problem" (position shared by other continental European delegates).

At a meeting in November 2003 Sweden opposed the following addition (text underlined):

- "The legal and regulatory framework should protect minority shareholders from abusive and unfair actions by controlling shareholders <u>especially when important asymmetries exist between voting and ownership rights</u>." (position shared by Finland).

- "Disclosure should be made of any material interests that members of the board, managers <u>and controlling shareholders</u> should be required to disclose any material interests may have in transactions or matters directly affecting the corporation including transactions involving affiliated companies." (position shared by Italy, Switzerland and Japan).

Annex 3: Pension fund investment regulation in Sweden in an international comparison

<table>
<tr><th></th><th>Sweden</th><th>Canada</th><th>Australia</th><th>Ned.</th><th>UK</th><th>US</th></tr>
<tr><td>Equity</td><td>No limit if quoted, 10% max if unquoted.</td><td colspan="4">No limit</td><td>Restriction on employer related</td></tr>
<tr><td>Real Estate Bonds Loans</td><td>No limit for real estate, 10% max for unquoted bonds & unquoted loans</td><td>15% or 25% on real estate</td><td colspan="2">No limit</td><td>No employer-related loans</td><td>Restriction on employer related</td></tr>
<tr><td>Private Investment funds</td><td>No limit (Max 5% for AP funds, no direct ownership in PE companies allowed)</td><td colspan="4">No limit</td><td>Restrictions on investment vehicles not subject to ERISA.</td></tr>
<tr><td>Foreign assets</td><td>No limit (a part from currency exposure provision)</td><td colspan="4">No limit</td><td>Restriction on employer related</td></tr>
<tr><td>Investment in single issuer</td><td>5% max in shares, bonds and loans issued by a single company or real estate; 10% max in a single investment fund; 5% max in a single real estate investment.</td><td>10% (5% for property).</td><td colspan="4">Diversification principle</td></tr>
<tr><td>Self-investment / Conflicts of interest</td><td>5% max in a sponsoring undertaking;</td><td>10%.</td><td>5%</td><td>5% to 10%</td><td>5%</td><td>No self dealing, or transactions with parties in interest</td></tr>
<tr><td>Other quantitative rules</td><td>Some limits to currency exposure</td><td>Max 30% of voting shares of one company</td><td colspan="3">None</td><td>Ownership of plan assets must be under the jurisdiction of US courts; Investment vehicles with <25% benefit plan investors not subject to ERISA.</td></tr>
</table>

Annex 4: AP7' exclusion list, changes from the 2005 to 2006

Companies excluded in both 2005 and 2006	Reported case
Amerad Hess	Corruption cases in Equatorial Guinea.
Bayer	Continued sales of environmental toxins in developing countries in breach of FAO declaration
BHP Billiton*	Anti-union action in Australia.
Chevron Texaco*	Human rights violations at Chevron Nigeria Ltd in Nigeria as well as environmental crimes in the Amazon.
Exxon Mobil*	Corruption in Equatorial Guinea.
L-3 Com*	Breach of human rights conventions at operations in Iraq.
Marathon Oil*	Corruption in Equatorial Guinea.
Occidental Petroleum	Human rights violations in Colombia.
Repsol	Environmental crimes by the jointly owned company OCP in Ecuador.
Singapore Technologies	Breach of the convention banning landmines.
Total*	Human rights violations by using forced labour when operating in Myanmar (Burma).
Wal Mart*†	Discrimination against women in Guatemala as well as reported cases of anti-union action and labour legislation violations, as well as child labour at Wal Mart in the United States.

Entries in the 2006 exclusion list	Reported case
Alliant Techsystem	Developing landmines.
Anvil Mining	Involvment in the massacre of civilians in Congo.
AWB	Corruption crimes in connection with the oil-for-food programme in Iraq.
Bilfinger Berger	Anti-union activity in Poland.
General Dynamics	Developing landmines.
Group 4 Securicor	Breach of labour legislation in USA.
Halliburton*	Corruption cases in Nigeria and Iraq.
ING	Anti-union activity in Chile.
Textron	Developing landmines.
Thales*	Corruption cases in South Africa.
Toyota*	Anti-union activity at subsidiary in the Philippines.
Yahoo!*	Actions curbing freedom of expression in China.

Exits from the 2005 list	Reported case
BASF	Violations against UN environmental regulations in the United States.
Caci Int'l	Human rights violations during operations in Iraq.
Cathay Pacific	Labour rights violations.
Coca Cola	Labour legislation violations as well as reported cases of discrimination at Coca-Cola in the United States, Central and Latin America.
Dupont	Damages to people and crops caused by one of the company's products (environmental toxin).
Encana	Environmental crimes by the jointly owned company OCP in Ecuador.
Hyundai Motors and Kia Motors	Anti-union action as well as substandard working conditions in South Korea.
Marriott	Sexual exploitation of children on company premises in Costa Rica.
Sanyo	Discrimination against women at their plant in Mexico.
SAS	Illegal restrictive agreements and practices.
Titan	Human rights violations during operations in Iraq.
Uniliver	Dumping toxic waste with serious consequences by the subsidiary Hindustan Lever in India.
Pepsi Cola	Labour legislation violations at operations in Guatemala.
UNOCAL	Human rights violations by using forced labour when operating in Myanmar (Burma).

* companies targeted by AP1's ethical engagement activities
† company banned by AP2