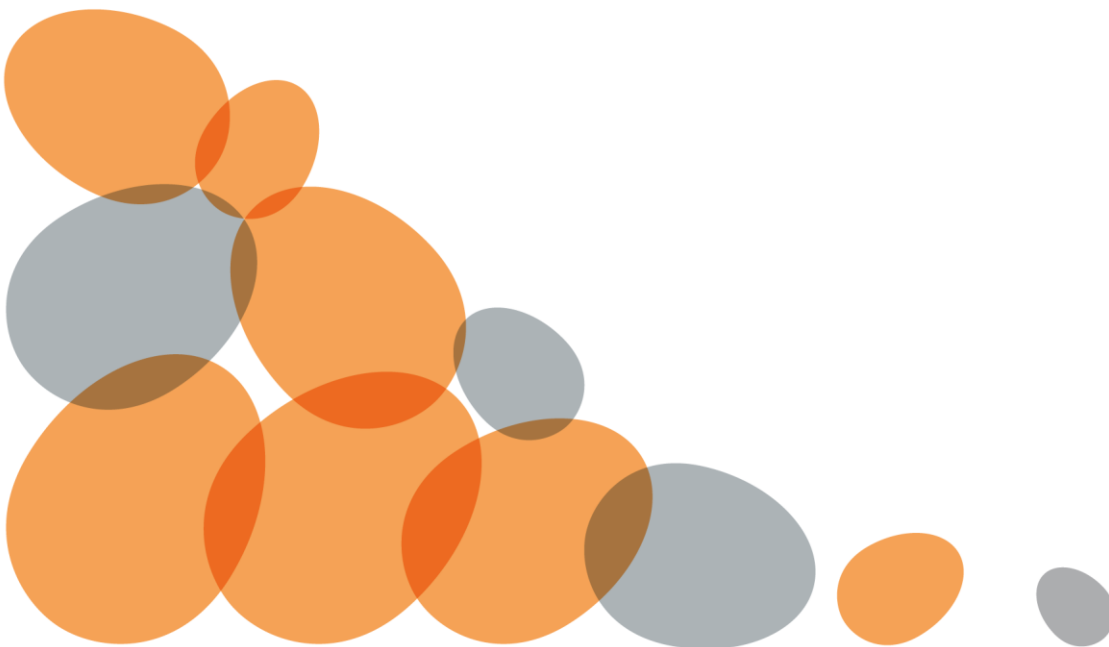




Value for money

NEST's TPR DC quality feature
assessment statement



NEST's value for money statement

Executive summary

The Pensions Regulator (TPR) issues regulatory guidance to help trustees meet the standards of practice that form the basis of quality governance and administration in occupational defined contribution (DC) trust-based pension schemes. One part of that guidance suggests that trustees of a DC pension scheme should assess the scheme on a regular basis to determine whether it provides value for money for its members.

This document is NEST's assessment of value for money, based on the model assessment set out in TPR guidance. The response to this assessment is based on the NEST Trustee making a judgement on what represents value for money on a reasonable basis, as described in this document.

Scope and structure of this document

TPR defines value for money in a DC pension scheme as follows:

'A scheme offers value for money (VFM) where the costs and charges deducted from members' pots or contributions (the costs of membership) provide good value in relation to the benefits and services provided (the benefits of membership), when compared to other options available in the market. It does not necessarily mean low cost, provided higher costs can be justified by improved benefits.'

TPR recognises that there's no common definition of what constitutes value for money. This is because employers, trustees and scheme members will place different values on the components of a scheme.

This means schemes have to exercise some judgement in undertaking their value for money assessments. For NEST, part of this judgement involves using its extensive existing research into the needs of the scheme's membership and target market to understand what they place the most value on when determining the overall value of a scheme and its individual components.

NEST's value for money statement reflects TPR's model process guidance.

Section one: criteria for assessing value for money for NEST

NEST has undertaken and continues to carry out in-depth research into its members' needs. This has led NEST to define its value for money criteria around a number of imperatives, relating to the suitability of the default investments and fund choices, clear and accessible information and low and transparent charges.

Section two: total benefits and costs of NEST membership

In this section the overall benefits and breakdown of member costs are considered.

Total benefits of scheme membership

- Scheme features:
 - investment objectives, risk management, performance and fund choice
 - design of the default strategy - its suitability for members and approach to risk management
 - member communication and online experience
 - employer and adviser online experience
 - financial advice
 - support at retirement.

- Scheme administration:
 - NEST's outsourced business model
 - record-keeping
 - investment operations
 - error and complaint handling.

- Scheme governance:
 - NEST's governance
 - investment powers
 - NEST's *Statement of investment principles (SIP)* and *Investment beliefs*
 - responsible ownership and ESG factors.

- Other factors:
 - NEST as part of the auto enrolment framework
 - NEST as 'a pot for life'
 - pathfinder behaviour
 - economies of scale.

Total costs of membership

- Member-borne costs and charges
- Portfolio transaction costs

Section three: comparison with other schemes

This section considers NEST's charges compared to those of other schemes, in light of the scheme's public service obligation and its single pricing structure. It also considers the Pension Quality Mark and the cap on member-borne deductions.

Section four: evaluation of NEST and value for money

This section sets out the basis on which NEST has based its assessment that the costs and benefits outlined in this document represent value for money for members.

Section one: criteria for assessing value for money for NEST

NEST is unique in having a public service obligation, legally requiring it to accept any UK employer that wishes to meet their workplace pension duties through NEST, and to admit any worker that the employer enrolls. This has a significant impact on the make-up of its membership.

NEST's Trustee has considered how to appropriately determine value for money in the context of research into members' characteristics, needs and preferences. This evidence is set out in the 2012 *Member research brief* document, available on the [NEST website](#). It shows that NEST's membership is likely to be younger than that of other workplace pension schemes, with less experience of pensions and financial products, and a higher level of ethnic diversity.

While the median average earnings of the NEST target group look similar to the entire private sector workforce, they're strikingly different from those seen in the population previously saving into pensions. Median earnings were found to be around £19,800, while median earnings of those already contributing to a pension were around £30,600. Those who already had pensions before auto enrolment began were more likely to have higher levels of savings and to work in managerial or professional jobs. They were also likely to have a higher level of education and be older.

As such, the average risk capacity of NEST's membership is considerably lower than that of those previously saving into a pension. They may also be more sensitive than the population as a whole to seeing excessive volatility in their investments. Many in the target group are also likely to be unfamiliar with information and concepts related to pensions and investments, and have less access to detailed financial advice. As a consequence they may find making decisions, for instance fund selection, challenging.

Taken together, these insights into NEST's future membership have enabled the scheme to define the criteria for 'value for money' for members as centring on the following imperatives:

- **default investment funds** should meet the needs identified by research for both managing risk and meeting the stated investment objectives
- **other fund options** made available should suit the needs of members, without requiring individual members to have any level of investment expertise to select a fund which is appropriate to their needs
- **information** on their pension pot should be available to members in an easily accessible manner and at a time of their choosing, and it should be simple to make decisions based on this information
- **charges** should be low, transparent and published; and the effects of these costs and charges should be made clear.

NEST's research documents are available on the [NEST website](#). Alongside the *Member research brief*, the evidence base is set out in two further documents:

- 2009 - The Personal Accounts Delivery Authority - *Building personal accounts: designing an investment approach*
- 2014 - *Improving consumer confidence in saving for retirement*.

Section two: total benefits and costs of NEST membership

Total benefits of membership

Scheme features

Investment objectives, risk management, performance and fund choice

The NEST Trustee has set an over-arching investment objective for NEST's default funds:

'To target investment returns in excess of inflation after all charges over the long term.'

NEST doesn't believe that positive performance by any scheme, including NEST, is on its own sufficient to demonstrate value for money. NEST also believes that performance needs to be measured over the long term. It's not possible to provide long-term performance history here, due to NEST only having been established for a few years. This section therefore considers short-term data.

NEST's retirement funds have been delivering against their benchmarks since inception. The performance of NEST's funds from the financial year to 31 March 2015 is available in the *NEST scheme annual report and accounts* on the [NEST website](#). Quarterly performance information is available in NEST's *Quarterly investment report*, which can be found at the same address.

In designing the default investment approach the Trustee has paid heed to the broader auto enrolment policy objectives and an understanding of members' needs, preferences and characteristics. Our research tells us that our members want their money to grow, but not at the price of dramatic volatility and losses. To deliver this, NEST implements a sophisticated risk management approach that's tailored to the year each individual saver is due to retire. Members also value having choice, but not if this is overwhelming. NEST offers them a small range of carefully chosen alternatives to help ensure they don't feel that the default discriminates against their specific needs.

Design of the default strategy - its suitability for members and approach to risk management

Further detail on the design and delivery of NEST's investment approach including the suitability to NEST's membership and the approach to risk management can be found in the document *Looking after members' money*, as well as NEST's *Statement of investment principles* (SIP). Both documents are available on the [NEST website](#).

Member communications

NEST is committed to producing clear and concise communication materials that are appropriate for its members. It has researched the communication needs of members, the key findings of which have been captured in the document *Golden rules of communication*.

Throughout the member's journey, NEST provides a range of communications including information on NEST's costs and charges, on investment choices, and on when and how members can access their retirement savings. This information is designed to assist members in understanding the impact of their decisions.

Although NEST's default communication channels are online, the scheme recognises that some members may not wish or be able to communicate with the scheme in this way. NEST therefore allows members to elect for paper communications if they prefer or they can telephone the NEST contact centre.

Research has also demonstrated that it's important to provide good quality information to workers before they're enrolled. However, NEST is unable to communicate directly with individuals until they're enrolled, because it doesn't have their contact information at this stage. NEST therefore provides employers using the scheme with a suite of workplace communication templates.

Member online experience

Each member has an online account they can access at any time. This lets them:

- check their retirement pot and contributions
- change their retirement date
- switch funds
- make one-off or regular additional contributions
- edit their personal details
- take their money out at retirement
- name a nominated beneficiary to receive their retirement pot if they die while saving with NEST.

The online user experience was designed following extensive testing with individuals matching the characteristics of the NEST target group. NEST continues to make regular improvements to the user experience based on customer feedback. The scheme also provides extensive information and tools on its website, including videos and a pension income calculator.

NEST recognises that some members may not be able to use websites. This is why all members can elect an individual to act as a delegate on their account.

Employer and adviser online experience

NEST is free for employers to use. They can set up NEST entirely online, then use their online account to perform all scheme administration tasks. NEST has designed tools to simplify technical tasks, including pre-set enrolment types and electronic member opt-outs. Employers can get guidance on administering the scheme through step-by-step guidance in NEST's help centre, via the web chat service and the contact centre.

NEST also provides a dedicated online service for professionals advising employers, called 'NEST Connect', as well as payroll integration options. Further details can be found on the [NEST website](#).

Financial advice

NEST has been designed in line with the policy intent of auto enrolment - that in order to save for retirement, individuals don't have to take any action to get a good outcome. This model, which doesn't price in the cost of advice, enables NEST to deliver a high quality offer at low charge.

NEST's website includes help and guidance, and members have access to a contact centre. NEST also signposts other sources of guidance and advice, including the Money Advice Service, The Pensions Advisory Service and PensionWise.

Support at retirement

As a young scheme, NEST's members who are currently approaching retirement have only built up relatively small levels of savings. The retirement options currently available are designed to meet their needs. Following the introduction of pension freedoms in April 2015, all members aged 55 and over can now access 100 per cent of their pot as cash, with 25 per cent tax free. They can also transfer their pot if they want to consolidate it with another pension pot elsewhere, or purchase an annuity on the open market. NEST has been writing to members who are affected to let them know these options, as well as signposting them to the PensionWise service.

NEST also writes to each member six months before their NEST retirement date to provide information about the different ways they can access their pension pot and outline their options based on their specific circumstances. These communications have recently been reviewed in the light of TPR's guidance on ensuring members receive effective communications as they approach retirement.

Scheme administration

NEST's outsourced business model

NEST operates an outsourced business model and its internal controls are designed to ensure that the administration services are managed and delivered effectively and that financial information and member data is kept safe. Service level agreements with NEST's scheme administrator, Tata Consultancy Services (TCS), set out standards for accuracy and the timeliness of processes. They also detail the processes to be followed if these standards aren't met.

Record-keeping

NEST follows TPR's record-keeping guidance and will review the quality of data held from time to time. Members have a single record within NEST which may cover periods with more than one employer. When a new employer provides different information for an existing member this will be checked with the member. It's the member's responsibility to advise NEST of any change in personal details.

Investment operations

NEST's fund administrator is State Street Bank (SSB). The scheme administrator, TCS, collects contributions for all members. It passes consolidated trade data on to SSB to invest in NEST funds on behalf of members. NEST monitors the activity of its suppliers to make sure they're

providing the level of service expected. Every day they check that the asset allocations implemented by SSB match NEST's strategy and make sure that unit prices and member accounts are correctly valued.

Error handling

NEST recognises that pricing errors can happen so has a process to assess and correct them quickly. All pricing errors of more than a set threshold are recorded, reviewed and reported to NEST's investment reporting and compliance committee. As well as correcting the error, they investigate how it happened to make sure there are no problems with NEST's systems or processes. NEST will pay members compensation where a pricing error has affected the value of their retirement pot by more than 50 basis points, subject to a minimum loss. NEST will also correct any over-valuations of units so that all members are treated fairly and in line with industry best practice.

Complaint handling

Customers can tell NEST about a complaint by logging into their online account, calling the contact centre or writing to the scheme. NEST looks into each complaint and tries to resolve it as quickly as possible and within 20 working days. More information on complaint handling is available on the [NEST website](#).

Scheme governance

Governance standards

NEST is run by an independent Trustee in accordance with relevant legislation, including Trust Law and various Pensions Acts. It has high standards of governance. In common with other trust-based schemes, NEST's first obligation is to its members, there are no shareholder interests to consider.

NEST publishes a detailed statement setting out how it complies with the *TPR's Code of practice No. 13: Governance and administration of occupational defined contribution (DC) trust-based pension schemes* and *Regulatory guidance for DC schemes*. It's accredited as Pension Quality Mark (PQM) Ready and is independently audited in accordance with the AAF 02/07 framework.

Investment powers

The National Employment Savings Trust Order 2010 gives the Trustee the sole power to invest the assets of NEST. NEST's assets, representing the balances of scheme members' pension accounts, need to be invested in the best interests of NEST's members and their beneficiaries. In the event of a potential conflict of interest, the assets need to be invested in the sole interest of scheme members and their beneficiaries. The Trustee is ultimately responsible for the governance and investment of NEST's assets but may delegate certain decisions to appropriate committees and investment managers.

The Trustee has established an investment committee to consider, make decisions and provide oversight on investment issues. The delegated powers provided by the Trustee to the investment committee comprise both issues on which the committee can make decisions, and issues on which it makes recommendations to the Trustee. The investment committee has

taken advice on the selection, management and custody of funds. Details are available in the SIP and in the document *Looking after members money*.

The Trustee is satisfied that it, the respective committees and panels, have sufficient expertise, information and resources to carry out their roles effectively.

Statement of investment principles (SIP) and investment beliefs

NEST's *Statement of investment principles (SIP)* outlines the policies and principles that guide NEST's decisions when managing scheme members' money. This includes a set of investment beliefs to provide a transparent framework for consistent decision making. The Trustee took advice from NEST's investment team when drafting it to make sure that it reflects a robust approach for scheme members. The SIP is available on the [NEST website](#).

Responsible ownership and ESG factors

NEST's Trustee believes that companies with well thought out environmental and social policies and good corporate governance do better in the long run than companies that neglect these issues. It's in the interests of members for NEST to consider how companies behave and how it affects members' outcomes in the long term. Details of NEST's policies and activities in responsible investment can be found on the [NEST website](#).

Other factors

There are a number of other features specific to NEST that are likely to add value for members.

- **Open to all** - NEST has been designed specifically to meet the auto enrolment requirements. As noted above, it's the only scheme with a public service obligation to accept any worker whose employer chooses NEST to meet their auto enrolment duties. NEST provides the same offer to all members, regardless of whether their employer is a small business or multi-national company and regardless of their level of contributions.
- **Pot for life** - however many times an individual is enrolled into NEST by different employers, they can continue to accrue in a single retirement pot using a single NEST account.
- **Pathfinder behaviour** - NEST's unique role and approach have set an expectation that it will look at innovative ways of refining its offer to members. It's been a force for downward pressure on charges throughout the market. For the benefit of its members, the scheme is committed to continue evidence-based improvement and sharing best practice and intelligence with the rest of the market.
- **Economies of scale** - NEST is expected to become one of the largest DC schemes in the world. Economies of scale have already been 'priced in' for instance in terms of the sophistication of the investment approach and the scheme's ability to negotiate keenly priced arrangements with partners.

Total costs of membership

Member-borne costs and charges

NEST's member charges consists of:

- a contribution charge of 1.8 per cent, deducted from all contributions made the scheme
- an annual management charge (AMC) of 0.3 per cent, applied to all assets under management.

Although the NEST Trustee sets the levels of these two charges, the pricing structure itself is set by the Secretary of State for Work and Pensions. The Trustee is not, therefore, able to change this structure. It still believes, however, that it should consider whether the charge structure and level, in combination, represent value for money when compared to the benefits NEST offers.

NEST has considered the impact of the charging structure for members with different savings histories. This evaluation can be found in the document *Low charges for future NEST members* which is available on the [NEST website](#). It shows that NEST's charges are broadly equivalent to a 0.5 per cent AMC over the lifetime of someone saving in NEST.

Any pricing structure, however, has a different impact on individuals with different savings histories. For people with a short savings history, the effective AMC of NEST's pricing structure will be higher. For those with a long savings history, with regular periods during which they're not contributing but are experiencing fund growth, the effective AMC will be lower.

As a multi-employer auto enrolment scheme whose membership is expected to run to several million UK workers, NEST is designed to be a long-term savings vehicle. It continues to experience low rates of opt-out from automatically enrolled workers. It's reasonable to expect that the majority of NEST's members will save with the scheme for several decades.

On this basis, the NEST Trustee believes that the charge structure strikes the right balance in terms of its impact on what's expected to be the majority of its membership.

Information on costs and charges

NEST has produced a stand-alone document that includes information about NEST's charges, their impact on pot value and the services employers and their workers get in return. This information follows the *Pension Charges Made Clear: Joint Industry Code of Conduct* established by the National Association of Pension Funds (NAPF). This document is available on the [NEST website](#).

Portfolio transaction costs

NEST's charges cover all custodian, accounting and legal costs. The 0.3 per cent annual management charge is also the total expense ratio.

The transaction costs and dealing spreads of the NEST Retirement Date Funds vary depending on the types of investment that they hold. However, NEST has structured them in a way that allows the scheme to minimise trading costs. NEST has created an internal market between NEST Retirement Date Funds such that funds which are reducing exposure to certain asset classes will transfer those investments to funds still adding to them. This means the scheme is able to reduce the drag on performance caused by transaction costs, such as trading spreads and brokerage fees.

The internal market also keeps costs down for members leaving the scheme and those just joining. New member contributions can be used to balance allocations and for paying cash lump sums to members taking their money out.

The scheme's internal funds of funds structure also means that NEST can use this 'internal market' to either maintain the target asset allocation or re-balance funds.

More information is available in the documents *Information on costs and charges* and *Low charges for future members of NEST*, both of which are available on the [NEST website](#).

Section three: comparison with other schemes

NEST's charges fall within the recent 0.75 per cent cap on member-borne deductions for schemes used for auto enrolment. As already noted, over a lifetime of saving with NEST, the scheme's charges cause less drag on performance than a scheme charging a flat 0.5 per cent AMC.

Comparison with other scheme charges

It's difficult to make an objective assessment against other schemes designed for auto enrolment. While NEST doesn't put any restriction on who can be enrolled in the scheme, other providers may restrict membership and vary their offer depending on size of workforce or other factors. Furthermore, as commercial entities, these schemes tend to restrict the amount of information available.

Table 1 below is an indicative comparative assessment of the costs and benefits of NEST against major market participants. This is based on information that was in the public domain in the summer of 2015. This comparison table aims to make a like-for-like comparison at a high level, in order to provide a view on comparative features and prices in the market. It doesn't show the extent to which NEST's features are tailored to the specific needs of its membership, as compared to other schemes.

The NEST Trustee believes that its comprehensive efforts into understanding the needs of members, particularly in the development of the investment proposition, mean that many NEST members could not simply purchase an 'off the shelf' product which offered the same benefits. Investment approaches that call upon well-diversified and precision risk-managed funds have traditionally been offered only to higher net worth individuals willing to pay higher charges. It's NEST's position that the investments it offers its members represent a quality, sophisticated approach, run by experts using top-flight research and analysis, but at a mass market price. It's doubtful whether the keenest rates available, where careful risk management is also part of the offer, will be available to those likely to accumulate relatively small pots and to do so slowly.

Table 1 Indicative comparison of NEST and other major auto enrolment participants

Feature	NEST	Other auto enrolment participants
Published charges	NEST charges 0.3% AMC and a 1.8% contribution charge as contributions are made. This is broadly equivalent to a 0.5% AMC over a typical lifetime of saving.	<ul style="list-style-type: none"> • One participant charges 0.3% AMC and a £1.50 monthly administration fee (£0.30 for workers earning less than £18,000 p.a.). • One participant charges 0.5% AMC and £500 for pensions sharing on divorce. • One participant charges 0.5% AMC for its default investment option. Charges for other funds may be more than 0.5%. • One participant charges 0.70% AMC and a £100 monthly employer charge or £25 yearly charge per member if contract volumes not met. • One participant charges between 0.7 and 0.75% AMC and between £25-£100 monthly employer pension charge.
Investment options	NEST offers single year target date default funds with risk profile modelled against target market research plus five other investment choices including ethical and Sharia.	<ul style="list-style-type: none"> • One participant offers a default lifestyled diversified growth fund. • One participant offers a default lifestyled investment option meeting DWP, TPR and FCA guidelines and an option to upgrade to a group self invested personal pension. • One participant offers a default that has a balanced lifestyle approach, two other lifestyle approaches and seven funds, including ethical and Sharia. • One participant offers a default fund which is a multi asset lifestyle profile fund and employers can select specific funds to make available to their members. A sub-set of the fund range are governed funds. • One participant's default fund is described as a lifestyled fund for 'hands-off' investors and the alternative fund range includes more than 260 investment funds.
Online services for members	Yes	<ul style="list-style-type: none"> • All major participants offer online services for members.
Formal governance standards met	PQM Ready and has obtained AAF 02/07	<ul style="list-style-type: none"> • Two participants are both PQM Ready and have obtained AAF 02/07. • One participant is PMQ Ready with not being AAF 02/07 applicable. • Two participants are not listed on the PQM Ready website and AAF 02/07 is not applicable.
Will accept all workers and employers	Yes, NEST has a legal obligation to be open to any employer for auto enrolment. It also accepts self-employed workers.	<ul style="list-style-type: none"> • One participant accepts all workers and employers but applies terms if the employer's performance is not deemed commercially viable. • One participant describes itself as suitable for any organisation, large or small, in any sector. • One participant welcomes all employers and workers as long as the scheme meets auto enrolment requirements. • Two participants will not accept all workers and employers.

Section four: evaluation of NEST and value for money

There are many ways a Trustee might apply judgement about value for money and evaluate benefits and costs against other schemes. Any evaluation, whether in isolation or when compared to peers, will inevitably be subjective. TPR suggests that trustees consider what their members value most and that they evaluate their benefits and costs against other similar schemes.

The NEST Trustee's assessment of value for money is based on three considerations.

- As described in section 2 of this document the Trustee believes that NEST delivers what its members want, at a high quality and with excellent standards of governance. NEST is unique in that it can say with confidence that there's no differentiation in the features on offer, regardless of level of contributions or size of employer.
- As further shown in section 2 although the NEST price structure inevitably has different impacts on members with different savings patterns, the Trustee believes that it delivers a reasonable balance of impacts given the characteristics of the membership as a whole.
- Finally, as shown in section 3, NEST's price is reasonable when compared to the terms its members might experience in other schemes that are available to them.

On this basis, NEST is confident in its assessment that the costs and benefits outlined in this document reflect value for money for members.