



# Nest's statement of investment principles

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April 2018 to March 2021

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This document was updated in March 2019

# Introduction

The Trustee of the National Employment Savings Trust (Nest) has produced this Statement of Investment Principles (SIP), which sets out how the Trustee invests the assets of Nest. This SIP has been prepared in accordance with all relevant legislative and best-practice guidelines. It outlines the principles and policies governing investment decisions made by or on behalf of the Trustee for the management of Nest's assets. It should be read in conjunction with the latest **Quarterly Investment Report** on our website.

It will be reviewed by the Trustee and the Members' Panel and Employers' Panel every three years, and without delay after any significant change in the investment approach.

Before revising the SIP, the Trustee will obtain and consider the written advice of a person who is reasonably believed by the Trustee to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of such schemes. The Trustee will also consult with the Members' Panel and Employers' Panel on proposed revisions to the SIP.

# Governance of the Nest Trustee

## Investment powers and compliance with the Pensions Act 1995

- 1.1 The **Nest Order** 2010 gives the Trustee the sole power to invest the assets of Nest.
- 1.2 Nest's assets, representing the balances on members' pension accounts, need to be invested in the best interests of Nest's members and beneficiaries. In the event of a potential conflict of interest the assets need to be invested in the sole interest of members and beneficiaries. The Trustee's policy for securing that the assets are invested in members' best interests is to provide:
  - a default fund (through a series of **Nest Retirement Date funds**) designed to provide appropriate outcomes for members retiring in different years
  - a choice of **other funds** for scheme members who do not wish to invest in the default fund.
- 1.3 The Trustee is ultimately responsible for the governance and investment of Nest's assets but may delegate certain decisions to appropriate committees, the Chief Investment Officer (CIO) and external investment fund managers.
- 1.4 The Trustee is satisfied that it, the respective committees and the CIO, have sufficient expertise, information and resources to carry out their roles effectively.
- 1.5 In preparing and revising the SIP, the Trustee has considered **advice from the CIO** of Nest's in house investment team. The CIO is qualified to provide this advice by his ability and practical experience of financial matters. The Trustee has confidence that the CIO has the appropriate knowledge and experience of managing investments for a trust based scheme. The written advice considers the suitability of the investments, the need for diversification, the suitability of Nest's external fund managers and the principles contained in this SIP. The Trustee will also take advice required for any future changes in investment strategy and fund choice.

## Investment Committee

1.6 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's **terms of reference** can be found on our website.

## In house investment team

1.7 Nest has an in house investment team led by the CIO. The in house investment team has certain powers delegated to it by the Investment Committee within pre-agreed frameworks. These include asset allocation, risk management, fund manager selection and monitoring, responsible investment and active ownership.

## Day to day management of Nest's assets

1.8 The day to day management of Nest's assets is performed by external professional fund managers, each of which is authorised and regulated by the Financial Conduct Authority (FCA). The Investment Committee and Nest's CIO are satisfied that the appointed fund managers have sufficient expertise and experience to carry out their role. The appointment, monitoring and dismissal of fund managers are the responsibility of the CIO with oversight by the Investment Committee.

1.9 Nest currently invests mainly in pooled funds. The fund managers are selected through a competitive tender process run by the in house investment team. The competitive tender process aims to achieve best value for money for members. Professional advice from the Trustee's external and FCA authorised investment advisers is obtained and considered in the selection of these funds and fund managers. As part of this selection, a due diligence process is performed to ensure that the assets are invested with sufficient security and liquidity and that each of the fund managers is of the appropriate quality and calibre to ensure the quality and profitability of the assets. The ongoing monitoring of these funds and fund managers is delegated to the CIO and in house investment team, to ensure all investments are undertaken in accordance with the Trustee's powers of investment.



## Nest's asset classes

1.10 The pooled and segregated investment funds are combined within the Nest funds to provide scheme members with exposure to a highly diversified range of asset classes.

The Investment Committee has agreed with the CIO, a set of asset class ranges within which the in house investment team can invest. Any proposal to amend these ranges must be agreed in advance with the Investment Committee. Details of the **asset class ranges** can be found on our website.

At any one time, the asset allocation of Nest's funds can include the following asset classes. The following list is not exhaustive:

- developed market equities
- emerging market equities
- developed market small cap equities
- high yield bonds
- real estate
- emerging market sovereign bonds
- gilts
- index linked gilts
- UK investment grade bonds
- global investment grade bonds
- developed market sovereign bonds (ex UK)
- inflation linked bonds (ex UK)
- money market investments
- commodities
- infrastructure.

1.11 The current asset allocation of Nest's funds are included in **Nest's Quarterly Investment Reports** and found on our website.

The Investment Committee regularly monitors Nest's funds to ensure that:

- they invest primarily in regulated markets
- investment in non regulated markets is kept to a prudent level
- derivatives are used in a prudent and appropriate way to manage risk or manage the portfolio more efficiently and without excessive risk exposure to a single counterparty or other derivatives.

Each quarter, the Investment Committee reviews a wide range of management information in relation to asset class exposure, a wide range of risk factors and the performance and risk profile of each external investment manager.

The external investment fund managers have full discretion to buy and sell investments on behalf of Nest within the framework set down by the Trustee, and through delegated powers to the Investment Committee and in house investment team.

# Investment objective

2.1 The Nest investment approach is determined following extensive and continuing research into scheme member characteristics, circumstances and attitudes. This research is a mixture of quantitative data on socio-economic characteristics of the scheme's membership, qualitative research into members' attitudes and aspirations for their retirement savings, and increasingly, management information about our members' savings patterns and behaviour. Details of our **member research** can be found on our website. The Trustee has set the following as the overarching investment objective of the default funds:

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

The way this objective is quantified in the different phases of saving is set out in Chapter 4 'Delivering the investment objective'.

- 2.2 The Trustee's chosen measure of inflation is the Consumer Price Index (CPI). The investment objective provides a clear and measurable target that seeks to preserve and grow members' capital by more than CPI over the long term.
- 2.3 In order to achieve this objective and the objectives of other Nest funds the Trustee has established:
  - effective and efficient investment policies and processes
  - a rigorous approach to risk management and risk budgeting
  - a rigorous approach to the management of investment costs.

# Investment beliefs

- 3.1 Investment beliefs are a set of high-level principles established by trustees or investment managers to provide them with focus and assist effective internal decision making in a complex environment.

Investment theory and practice have evolved dramatically over the last five decades, yet no objective framework exists that adequately describes how we view capital markets, or how to apply these insights for investment purposes. Investment beliefs accept this reality.

The Trustee has established a set of investment beliefs to provide an objective and transparent framework for consistent decision making. These beliefs act as a guide to enable effective delivery of all investment functions. The beliefs and the rationale behind them can be found on our [investment principles](#) web page.



# Delivering the investment objective

## Default strategy

- 4.1 In delivering the overall investment objective for the default funds, the Trustee pays heed to the following supporting objectives:
- to maximise the pension income and other pension benefits at retirement by taking appropriate risk
  - to seek to deliver similar outcomes for cohorts of scheme members who have similar contribution histories
  - to aim to dampen volatility in members' pension accounts.
- 4.2 The Trustee recognises that there will at times be tensions between these supporting objectives. The Trustee will seek to find an appropriate balance between them.
- 4.3 The Nest scheme and its default investment approach have been designed to ensure that scheme members who do not wish to take an active role in how their contributions are invested can do so in confidence. The availability of a well constructed default strategy is an essential part of auto enrolment and is central to Nest's investment approach.
- 4.4 Investment risk should be taken in varying amounts throughout a member's time saving with Nest. The Trustee has therefore adopted a series of target date funds called the 'Nest Retirement Date Funds' to deliver the default investment strategy. Each Nest Retirement Date Fund has an asset allocation that is consistent with the expected amount of risk that is appropriate for the age of a member and/or their expected retirement date.
- 4.5 The Retirement Date Fund that a member is placed in will be invested appropriately throughout their time saving with Nest in a way that reflects when they are expected to take their retirement benefits.
- 4.6 At any time, members can change their Nest Retirement Date Fund to reflect a different expected retirement year.
- 4.7 The asset classes that form the investments of the default strategy are selected to meet the appropriate risk level identified for each Retirement Date Fund. As set out in the Nest Order, the Trustee may invest in any asset class, subject to the same investment restrictions that generally apply to UK trust-based occupational pension schemes.

## The default strategy glide path

4.8 The varying allocation between return seeking and income seeking assets through time is known as the 'glide path'. The Trustee has split the glide path into three phases:

- the foundation phase
- the growth phase
- the consolidation phase.

The foundation phase refers to the early years of younger scheme members' working lives as they develop the savings habit. This phase typically lasts five years. The objective for the foundation phase is to keep pace with the CPI after all charges.

The growth phase is where the maximum growth in assets is being targeted through investing in asset classes that are expected to grow in value relative to inflation more than other investments. The objective for this phase is to outperform CPI plus 3 per cent a year after all charges over the long term.

The consolidation phase prepares a scheme member's assets for retirement and typically begins ten years before their Nest Retirement Date Fund matures. Investments in this phase are progressively switched out of higher risk assets. The primary objective of the consolidation phase for funds maturing after 2020 is to outperform CPI after all charges while aiming to progressively dampen volatility as a scheme member's fund approaches maturity. For Nest Retirement Date Funds maturing through 2020, the consolidation phase objective is to manage the risks associated with converting a member's accumulated savings into a cash lump sum.

4.9 The Trustee believes that members' best interests are met by dynamic asset allocation within a managed investment risk framework. The Trustee also believes that within certain risk constraints, the shape of the glide path should be managed dynamically and factor in market conditions that contribute to delivering the investment objectives in different phases.



## Additional fund strategy choices

4.10 Some members may wish to choose an alternative to the default strategy. The Trustee provides a focused choice to meet the identified member needs. The fund choice strategies currently include:

➤ **Nest Higher Risk Fund**

Invests in return seeking assets

➤ **Nest Lower Growth Fund**

Invests in very low volatility assets

➤ **Nest Ethical Fund**

Invests primarily in ethical securities and ethical property as well as government bonds

➤ **Nest Sharia Fund**

A fund with an investment approach based on Islamic law

➤ **Nest Pre-retirement Fund**

Invested for those who wish to buy an annuity in the near future.

4.11 The Trustee may add, change or remove any fund choice strategies in accordance with the terms set out in the **Nest Order and the NEST Rules**.

4.12 The Trustee endeavours that, for members who choose an alternative fund choice strategy, the risk being taken in the fund also takes into account the expected retirement age of the member, where this is applicable and practicable.

4.13 The Investment Committee is responsible for ensuring that both the default strategy and the alternative fund choice strategies are, as far as practicable, sufficiently diversified so as not to be reliant on any particular asset class, issuer or group of undertakings. The Investment Committee is responsible for ensuring that investments in assets issued by the same issuer or by issuers belonging to the same group do not expose Nest members to excessive concentration of risk.

# Investment risk management framework

- 5.1 Investment risk management involves identifying the variable factors that may affect the investment performance of Nest members' funds, the sensitivity of the dependencies (how changes to these factors interrelate), and what the Trustee or those it delegates to will do to manage these risks.
- 5.2 The Trustee recognises that uncertainty in the following factors can be managed, to some extent, by the choice and allocation of investments. The list below is not exhaustive but covers the main risks that the Trustee faces and how they can be managed:

## ➤ Inflation risk

The Trustee invests in a diversified range of assets which are likely to grow in real terms

## ➤ Pension conversion risk

In the consolidation phase, the Trustee increases the proportion of assets that more closely match how we expect scheme members to use their pots in retirement. This is particularly important in light of the changes introduced by 'Freedom and choice'

## ➤ Market risk

The Trustee manages market risk primarily through investing in a diversified range of assets.

## ➤ Counterparty risk

The Trustee, with the in house investment team, its advisers and its investment fund managers, assesses and manages its counterparty risk. This is done through a rigorous approach to the procurement of a variety of investment services, regular monitoring of Nest's funds, regular reports of the funds' underlying holdings and the investment fund manager's approach to managing risk. For relevant asset classes the Trustee and those it delegates to, carefully monitors credit risk where there is a risk of corporate default. In addition, the Trustee has indemnities in place with managers for certain activities.

## ➤ Operational risk

The Trustee, with its suppliers, assesses and manages its operational risks.

## ➤ Liquidity risk

As far as is practicable and necessary, the Trustee invests in liquid assets which can be quickly realised as required.

## ➤ Valuation risk

The Trustee invests primarily in liquid quoted assets in order to manage the valuation risk.

## ➤ Environmental and social risks

These risk factors can have a significant effect on the long-term performance of the assets Nest holds. Where applicable these factors will be considered in the investment process.

## ➤ Governance risk

This can have a significant effect on the long term performance of the companies we hold. Where applicable governance risk factors will be considered in the investment process.

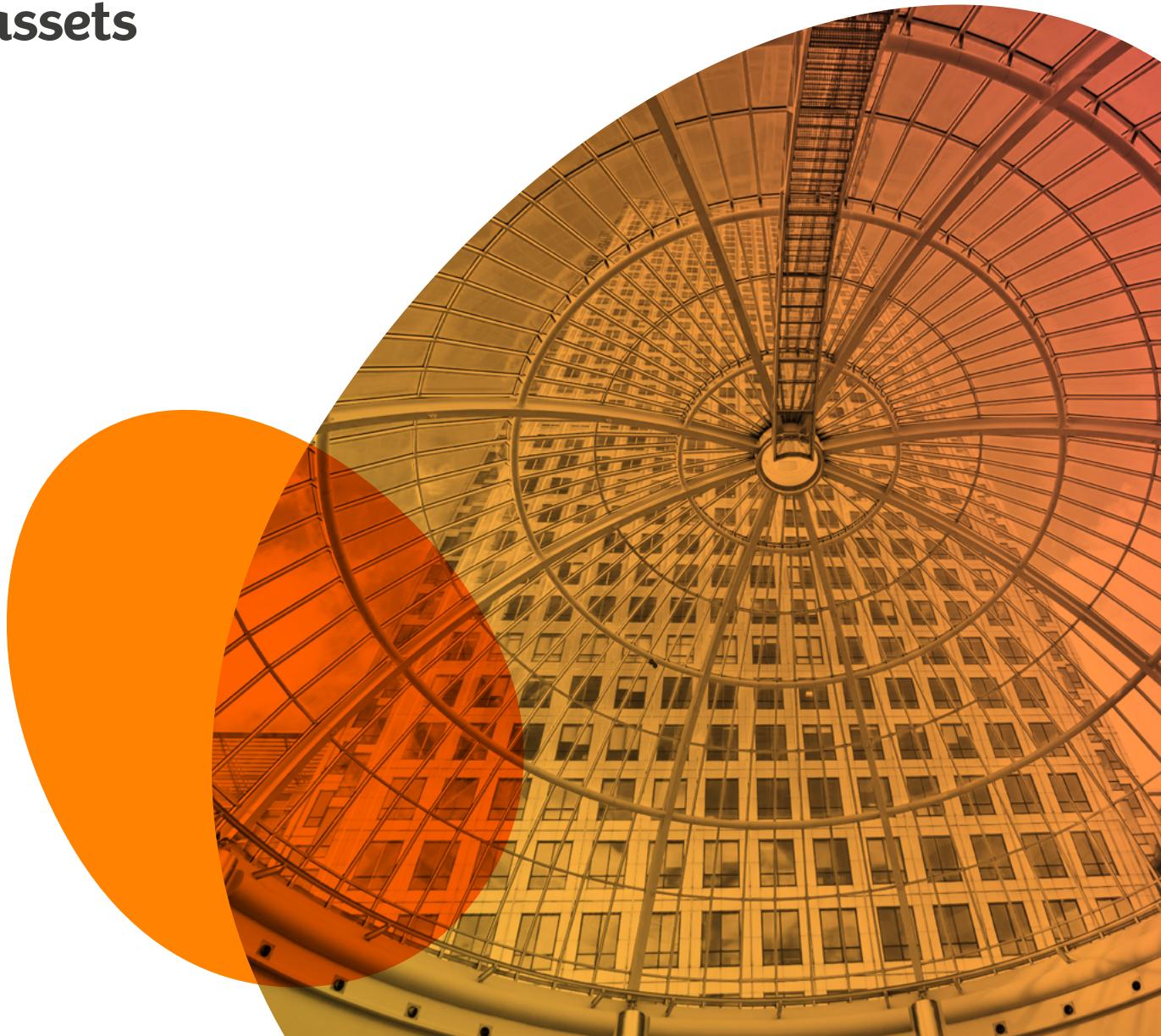
## ➤ Reputational risk

The Trustee carefully selects its counterparties, manages its investments responsibly and considers all aspects of its reputation as part of its investment strategy.

- 5.3 The Trustee believes that the investment strategy outlined in this SIP is appropriate for managing the risks outlined above for all Nest Funds. For scheme members who do not wish to take an active role in the investment decisions relating to their pension account, the Trustee offers a default investment strategy to specifically help them manage the first three risks listed above. The Trustee pays close regard to the risks which may arise from the lack of diversification of investments. The Trustee believes that each of the funds in place provides, as far as is practical, an adequately diversified distribution of assets.

## Day to day custody of the assets

- 6.1 In the early years of Nest, investments were generally made through pooled investment funds. The manager of each of these funds is responsible for appointing a custodian with regard to the safekeeping of the assets. Additionally, the Trustee has appointed State Street Bank and Trust Company (State Street) to facilitate and account for the investment in these funds and to provide custody services and fund accounting for any segregated investment mandates.



# Responsible investment

- 7.1 The Trustee has a duty to act responsibly with regards to the assets it owns on behalf of Nest members.
- 7.2 The Trustee believes that in order to fulfil this duty and to protect and enhance the value of Nest's investments over the long term, it must act as a responsible and vigilant asset owner and market participant.
- 7.3 As part of this duty the Trustee, or its agents on its behalf, exercises its ownership rights, including voting and engagement rights, in order to safeguard sustainable returns in the long term.
- 7.4 The Trustee expects its fund managers, where appropriate, to have integrated Environmental, Social & Governance (ESG) factors as part of their investment analysis and decision making process.
- 7.5 In line with its commitment to transparency, the Trustee reports to its members and stakeholders on its responsible investment activities.
- 7.6 Nest is a signatory to:
  1. UN Principles of Responsible Investment (UNPRI), which is a set of best practice principles on responsible investment
  2. The Financial Reporting Council (FRC) Stewardship Code, which is seen as the UK standard for good stewardship. It is perceived by many institutional investors as a minimum requirement and a stepping stone to improving stewardship in the UK
- 7.7 Details of **additional initiatives** to which Nest is a signatory can be found on our website.
- 7.8 The Trustee intends to use these principles as a benchmark with which to guide its own approach to responsible investment, and in doing so will seek to apply responsible investment principles across all the assets in which it invests.

## Divestment

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# Divestment

- 8.1 In general, divestment or exclusion goes against our principles of corporate engagement and responsible investment. However, in certain rare circumstances we believe it's merited for the reasons set out in our divestment policy.
- 8.2 Nest supports internationally recognised norms of corporate practice. As such we actively seek to avoid investing in companies such as those directly involved in the production or sale of cluster weapons, anti-personnel landmines or chemical and biological weapons.

Further detail of our [divestment policy](#) and how it is implemented can be found on our website.



## Communication, reporting and transparency

- 9.1 The Trustee aims to achieve compliance with best practice in its approach to investment communication, reporting and transparency. This is in order to:
- promote scheme member confidence in saving and in saving with Nest
  - promote employers' confidence in using Nest for their workforce
  - provide clear information for stakeholders and the advisory market of the Trustee's investment approach.

## Compliance with this SIP

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# Compliance with this SIP

10.1 The Investment Committee monitors compliance with this SIP regularly, and at least annually.



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