



Statement of investment principles

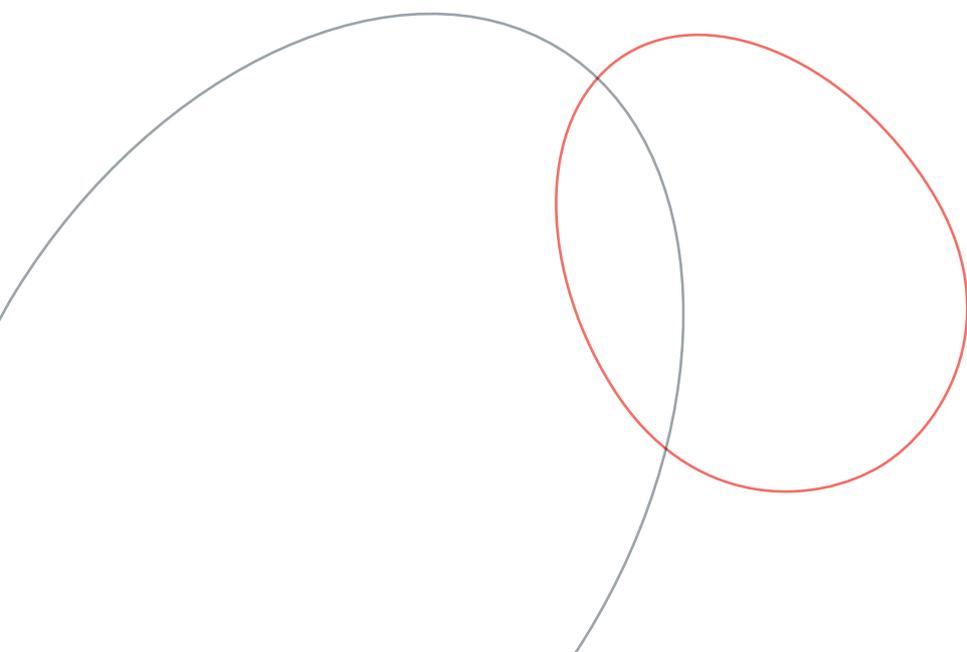
April 2015 to March 2018

About the SIP

This is NEST's *Statement of investment principles* or SIP. It outlines the policies and principles that guide NEST's decisions when managing scheme members' money. The Trustee took advice from NEST's investment team when creating it to make sure that it reflects a robust approach for scheme members.

This is a technical document that can be read in conjunction with a series of documents that describe NEST's investment process.

- *Looking after members' money* is a detailed description of NEST's investment approach and the thinking and research that went into creating it.
- NEST's quarterly investment information and the scheme's *Annual report and accounts* give more information about how the SIP has been implemented and how well NEST has delivered against its investment goals.
- Quarterly publication of voting activity on the NEST website.



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01 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 legislation 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 is 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 or persons who are 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.

02 Governance of the NEST Trustee

Investment powers and compliance with the Pensions Act 1995

- 2.1 The National Employment Savings Trust Order 2010 gives the Trustee the sole power to invest the assets of NEST.
- 2.2 NEST's assets, representing the balances on scheme 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 scheme 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 scheme members retiring in different years
 - a choice of other funds for scheme members who do not wish to invest in the default fund.
- 2.3 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.
- 2.4 The Trustee is satisfied that it, the respective committees and panels, have sufficient expertise, information and resources to carry out their roles effectively.
- 2.5 The appendix provides a breakdown of the governance structure and the associated responsibilities and delegations.
- 2.6 In preparing and revising the SIP, the Trustee has considered written advice from the chief investment officer (CIO) of NEST's in-house investment team, who 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 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

- 2.7 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 appendix sets out a table of delegations. The investment committee's terms of reference can be found on our website.

Day-to-day management of NEST's assets

- 2.8 The day-to-day management of NEST's assets is performed by professional fund managers, each of which is authorised and regulated by the Financial Conduct Authority. The investment committee is satisfied that the appointed fund managers have sufficient expertise and experience to carry out their role. The appointment, monitoring and dismissal of fund managers is the responsibility of the investment committee.
- 2.9 NEST currently invests in pooled funds but will move towards segregated funds when assets under management have increased. The investment committee approved the selection of these pooled funds through a competitive tender process. The committee obtained and considered professional advice from its investment advisers in the selection of these funds. A due diligence exercise as part of this selection process ensures that the assets are invested with sufficient security and liquidity and that each of the funds is of the appropriate quality and calibre to ensure the quality and profitability of the assets.
- 2.10 NEST currently invests through investment funds provided by leading fund management companies. Each of these funds has a clear investment objective and generally invests in a single asset class. NEST diversifies scheme members' money across different types of investment by using their contributions to buy units in each of these funds in varying proportions.

NEST's asset classes

- 2.11 The pooled funds are combined within the NEST Retirement Date Funds to provide scheme members with exposure to a highly diversified range of asset classes.

At any one time the asset allocation of NEST Retirement Funds' can include the following asset classes. The following list is not exhaustive and the Trustee regularly reviews the scheme's asset class requirements:

- developed market equities
- emerging market equities
- developed market small-cap equities
- high yield bonds
- real estate
- emerging market sovereign bonds
- UK gilts
- UK 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.

- 2.12 The current asset allocations of all NEST Retirement Funds are included in NEST's quarterly investment information.

The investment committee regularly monitors NEST's funds to ensure that:

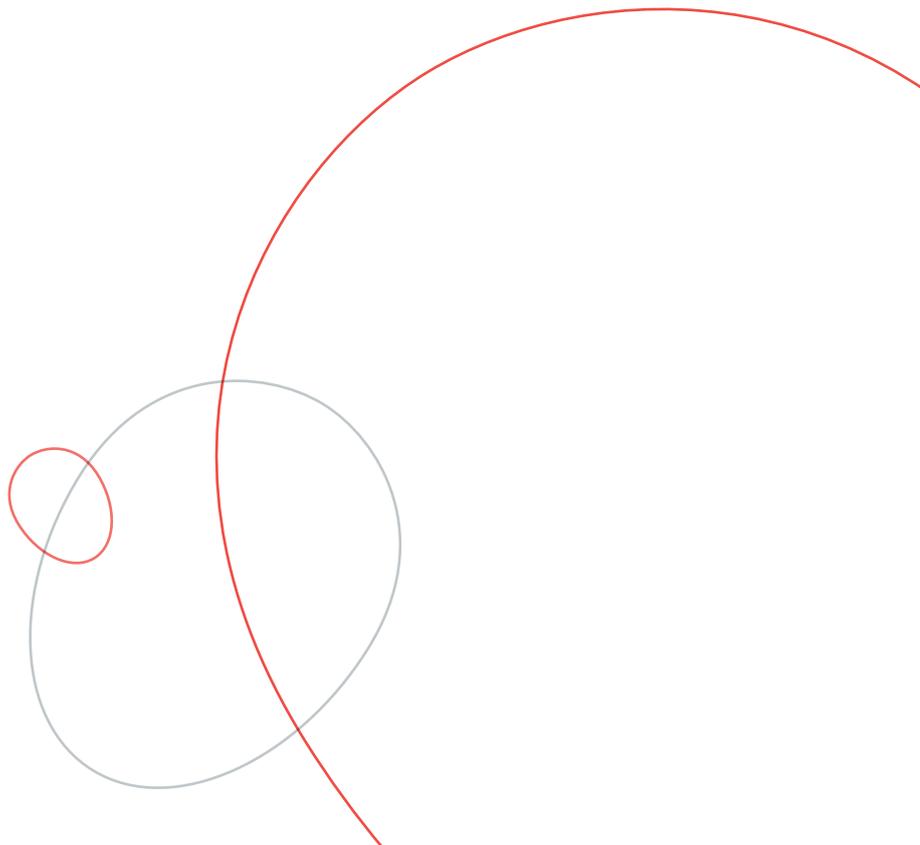
- they invest primarily in regulated markets
- investment in non-regulated markets is kept to a prudent level
- derivatives are used in a prudent and appropriate way to manage risk in the portfolio more efficiently and without excessive risk exposure to a single counterparty or other derivatives.

The funds have full discretion to buy and sell investments on behalf of NEST within the framework set down by the Trustee.

03 Investment objectives

- 3.1 The NEST investment objective is set in the context of broader policy objectives to ensure that all scheme members and their employers have access to a suitable low cost, qualifying occupational pension scheme.
- 3.2 To meet this policy intent the Trustee has set an 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 05 'Delivering the investment objective'.
- 3.3 The Trustee's measure of inflation is the Consumer Price Index (CPI). The investment objective provides a clear and measurable target that seeks to preserve and grow scheme members' capital by more than CPI over the long term.
- 3.4 In order to achieve this objective 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.



04 Investment beliefs

- 4.1 Investment theory and practice have evolved considerably over the last fifty years. Despite this there is no generally agreed objective framework for investors that adequately describes how to view capital markets, or how to apply these insights for investment purposes. Investment beliefs accept this reality and are established by investors to provide them with focus and assist effective decision making in a complex environment.

The Trustee has set out its investment beliefs to provide a transparent framework for consistent decision making. These beliefs act as a guide to enable effective delivery of all investment functions.

The Trustee's investment beliefs

- 4.2
1. Understanding scheme member characteristics, circumstances and attitudes is essential to developing and maintaining an appropriate investment strategy.
 2. As long-term investors, incorporating environmental, social and governance (ESG) factors is integral to the investment management process.¹
 3. Taking investment risk is usually rewarded in the long term.
 4. Diversification is the key tool for managing risk.
 5. Risk-based asset allocation is the biggest driver of long-term performance.
 6. Taking account of asset values and asset prices, economic conditions and long-term market developments enhances long-term performance and informs strategic decisions.
 7. Indexed management, where available, is often more efficient than active management.
 8. Good governance, including an appropriately resourced in-house investment function, is in the best interests of NEST members.
- 4.3 NEST's investment beliefs are subject to an evidence-based review at least every three years. More details are available on the NEST website.

¹ see section 8 for more detail of how the Trustee applies this belief

05 Delivering the investment objective

- 5.1 In delivering the overall investment objective for the default funds, the Trustee pays heed to the following supporting objectives:
- to maximise pension income and any cash lump sum 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 over the savings phase.
- 5.2 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.
- 5.3 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 fund is an essential part of auto enrolment and is central to NEST's investment approach.

Default funds

- 5.4 Investment risk should be taken in varying amounts throughout a scheme member's savings career.
- 5.5 The Trustee has therefore adopted a series of target date funds called 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 that stage in a scheme member's savings career.
- 5.6 The NEST Retirement Date Fund that a scheme member is placed in will be invested appropriately throughout their savings career in a way that reflects when they are expected to take their retirement benefits.
- 5.7 Scheme members can change their NEST Retirement Date Fund at any time to reflect a different expected retirement year.
- 5.8 The asset classes that form the investments of the default fund are selected to meet the appropriate risk level identified for each NEST 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 funds' glide path

- 5.9 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 and 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 CPI after all charges.
 - **The Growth phase** is where the maximum growth in assets is being targeted through 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.
- 5.10 The Trustee believes that members' best interests are met by dynamic asset allocation within a risk budget. 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 choices

- 5.11 Some scheme members may wish to choose an alternative to the default strategy. The Trustee provides a focused choice to meet identified member needs. The fund choices currently include:
- NEST Higher Risk Fund - invests in return-seeking assets
 - NEST Lower Growth Fund - invests solely in a sterling liquidity fund
 - 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.
- 5.12 The Trustee may add, change or remove any fund choices in accordance with the terms set out in the NEST Order and the NEST Rules.
- 5.13 The Trustee endeavours that, for scheme members who make an alternative fund choice, the risk being taken in the fund also takes into account the expected retirement age of the member, where this is applicable and practicable.
- 5.14 The investment committee is responsible for ensuring that both the default strategy and the alternative fund choices are, as far as practicable, sufficiently diversified so as not 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 to excessive concentration of risk.

06 Investment risk management framework

- 6.1 Investment risk management involves identifying the various factors that may affect scheme members' retirement funds, the sensitivity of the dependencies - that is, how changes to these factors interrelate - and what NEST has to do to alleviate them. In order to create a best practice risk management framework, the Trustee has identified four high-level guiding principles:
- identify the most significant risk factors and rate them according to the impact they are expected to have on investment performance
 - understand risks both individually and holistically
 - identify available risk management tools and options - for each identified risk factor, a set of tools is used to monitor exposure to the risk and help to choose between the solutions to mitigate them
 - invest within a clear and well-defined risk budget.
- 6.2 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 that 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.
 - Market risk - the Trustee manages market risk primarily through investing in a diversified range of assets.
 - Counterparty risk - the Trustee, with its advisers and its fund managers, assesses and manages its counterparty risk 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 fund manager's approach to managing risk. For relevant asset classes NEST carefully monitors credit risk where there is a risk of corporate default. In addition NEST 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 that 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.
- 6.3 The Trustee believes that the investment strategy outlined in this SIP is appropriate for managing the risks outlined above. In particular, 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 NEST Retirement Date Fund to help them manage all of the above risks. The Trustee pays close regard to the risks that 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.

07 Day-to-day custody of the assets

- 7.1 In the early years of NEST, the scheme is investing through 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.

08 Responsible investment

- 8.1 The Trustee has a duty to act responsibly with regards to the assets it owns on behalf of NEST members.
- 8.2 At this stage of NEST's development the focus when integrating ESG considerations into the investment process is predominantly through how we act as an owner of securities, a client of fund managers, and as an active market participant.
- 8.3 The Trustee believes that 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.
- 8.4 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.
- 8.5 The Trustee expects its fund managers, where appropriate, to have integrated ESG risk factors as part of their investment analysis and decision-making process.
- 8.6 In line with its commitment to transparency, the Trustee reports to its scheme members and stakeholders on its responsible investment activities via NEST's quarterly investment information, the scheme *Annual report and accounts* and through the quarterly publication of voting activity on the NEST website.
- 8.7 NEST Corporation's investment team provides quarterly reports on NEST - and agents on its behalf - as to engagement activities over the previous quarter and planned engagement and voting activity in the future. The operation of NEST's voting and engagement process is overseen internally and assessed and planned based on quantitative and qualitative data drawn from independent external providers.
- 8.8 NEST is a signatory to the following initiatives:
 - Principles of Responsible Investment (PRI), which is a set of best-practice principles on responsible investment
 - the 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.
- 8.9 The Trustee uses 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.

09 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
 - promote employers' confidence in using NEST for their workforce
 - provide clear information for stakeholders and the advisory market of the Trustee's investment approach.

10 Compliance with this SIP

- 10.1 The investment committee monitors compliance with this SIP regularly.

Appendix

Governance structure

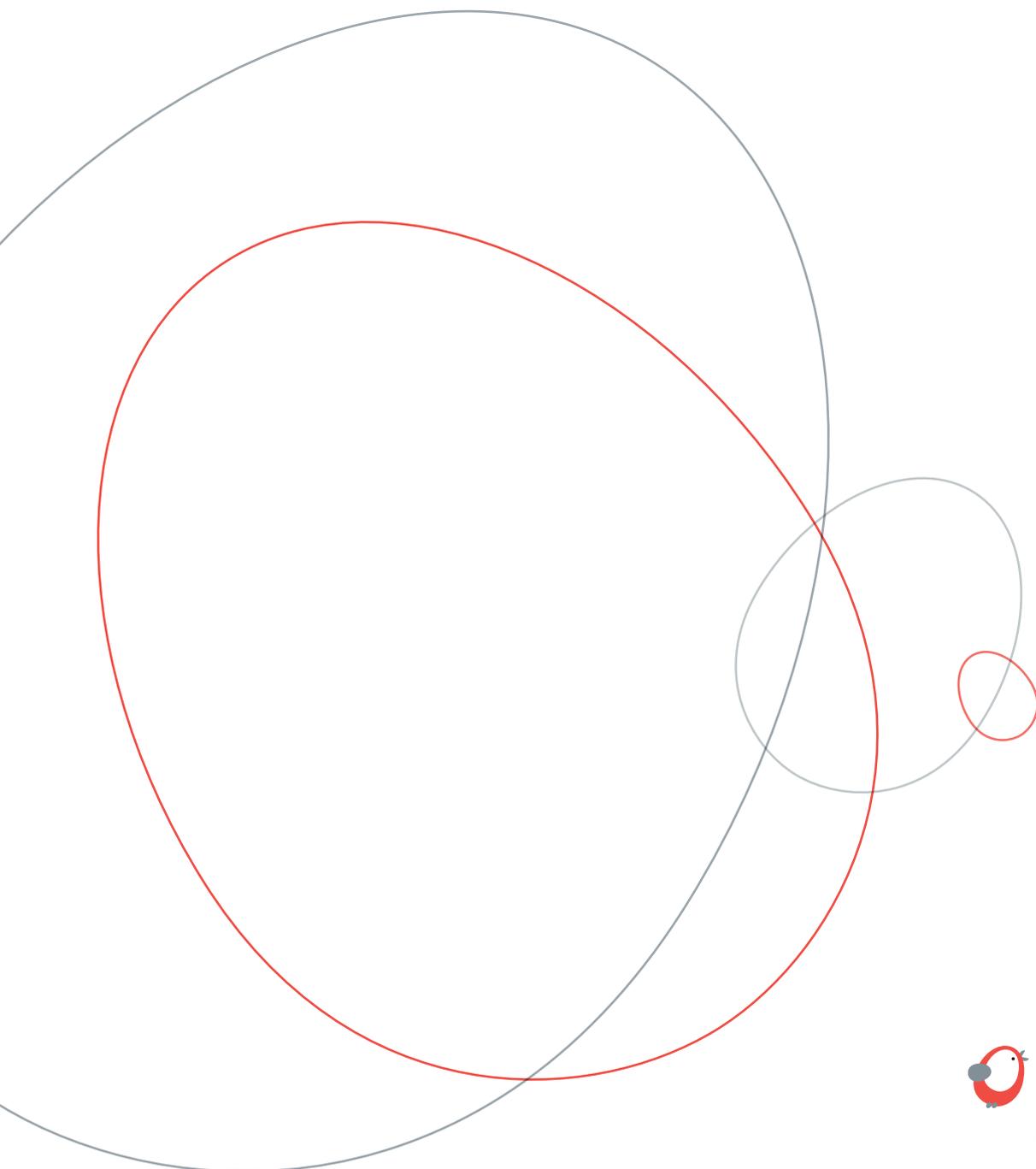
Decision	Recommending body	Decision-Making body (see note 1)	Overseeing bodies (see note 2)	Notes
SIP	Investment committee	Trustee Members		Need to consult with Members' Panel and Employers' Panel.
Investment advisers	(chief investment officer)CIO	CIO - internal work and manager selection, investment committee - governance issues		
Investment costs	CIO	Investment committee	Trustee Members	Parameters set by the Trustee Members in line with overall costs. CIO to alert the investment committee if breach is involved.
Investment reporting and investment compliance		Investment reporting and compliance committee made up of senior members of investment operations, investment policy and investment research	1. Investment committee 2. General counsel	All investment reporting and compliance functions. Escalation criteria set and agreed with investment committee and Trustee Members.
Investment risk management	CIO and head of investment risk	Investment committee	Trustee Members	Parameters set by investment committee.
Strategic asset allocation and risk budget allocation	CIO	Investment committee	Trustee Members	
Dynamic asset allocation		CIO	Investment committee	Parameters agreed, from time to time, by the investment committee. If decision is within the agreed parameters, CIO can make decision.
Rebalancing		CIO	Investment committee	Parameters set by investment committee.
Changes to fund choice range and number and type of target date funds in the default offering	CIO	Investment committee	Trustee Members	Parameters set by Trustee Members and investment committee.

Decision	Recommending Body	Decision-Making Body (see note 1)	Overseeing bodies (see note 2)	Notes
Manager selection and removal	CIO	Investment committee		Must take authorised advice, as per legislation. Due diligence criteria agreed by investment committee. Actual due diligence performed by CIO.
Monitoring fund managers and other third-party providers		Investment reporting and compliance committee	CIO	
Responsible investment	CIO	Investment committee	Trustee Members	Implementation and day-to-day decision making on voting and engagement to reside with responsible investment team but will be escalated on an exceptional basis. Controversial engagements, engagements with the press and engagements with the government will be escalated to the investment committee.
Member and external communications	CIO	Investment committee	Trustee Members	
Fair valuation of assets and unit pricing		Investment reporting and compliance committee	Investment committee	
Breaches and errors		Head of investment operations	Investment committee and General counsel	Parameters set by Trustee Members and investment committee.

Notes

1. These decisions will be policy/strategic and implementation will be delegated to the executive.
2. Where there is a hierarchy this is stated as follows 1 = first level of oversight, 2 = higher level of oversight.

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Find out more online at
[nestpensions.org.uk](https://www.nestpensions.org.uk)