



Statement of investment principles

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2023 – 2026

Version record

Version	Change	Date implemented
1	Document created	1 October 2019
2	Governance section updated to reflect the creation of Nest Invest Update to investment beliefs following the triennial review	28 January 2020
3	Updated to reflect the introduction of Nest's new fund – the Nest Guided Retirement Fund, and to reflect new regulations for SIP content.	26 March 2020
4	Ad-hoc review - updated to reflect changes to the Consolidation phase, and the removal of the Pre-retirement fund choice	26th May 2022
5	Conclusion of triennial review – new SIP approved with updated investment objectives and investment beliefs.	29 July 2023

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1 Introduction

- 1.1 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 for the scheme's default investment strategy and the additional investment fund choices scheme members can make.
- 1.2 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, in respect of the default arrangement and the additional investment fund choices scheme members can make. It should be read in conjunction with our latest [quarterly investment report](#).
- 1.3 This SIP will be reviewed by the Trustee, the Members' Panel and Employers' Panel every three years, and without delay after any significant change in the investment approach or the demographics of the scheme.
- 1.4 Before revising this 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 trust-based pension schemes. The Trustee will also consult with the Members' Panel and Employers' Panel on proposed revisions to the default investment strategy and additional investment fund choices scheme members can make before any SIP revisions.

2 Governance of the Nest Trustee

2.1 Investment powers and compliance with the Pensions Act 1995

The Nest Order 2010 gives the Trustee the sole power to invest the assets of Nest.

- 2.2 Nest's assets, representing the balances on members' pension accounts, will be invested in the best interests of Nest's members and beneficiaries both for the default strategy and for any other investment choices members may make. In the event of a potential conflict of interest the assets will be invested in the sole interest of members and beneficiaries.
- 2.3 The Trustee's policy for securing that assets are invested in members' best interests is determined following extensive and continuing research into scheme member characteristics, circumstances and attitudes. This research is a mixture of quantitative data on the socio-economic characteristics of the scheme's membership, qualitative research into members' attitudes and aspirations for their retirement savings, and scheme management information about our members' savings patterns and behaviour.
- 2.4 Where significant changes to the scheme membership are detected the Trustee reviews the appropriateness of the default strategy and additional investment fund choices accordingly. Details of our latest member [investment research](#) can be found on our website.
- 2.5 With the Trustee's understanding of members' best interests, it has decided upon an investment approach that provides:
 - › 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 investment funds](#) for scheme members who do not wish to invest in the default fund.
- 2.6 Nest Corporation as Trustee is responsible for the governance and investment of Nest's assets but may delegate certain powers to appropriate committees, Board members, employees and investment fund managers. Nest Corporation has established a Financial Conduct Authority (FCA) authorised and regulated investment subsidiary, Nest Invest, to provide investment services and advice, as set out in an Investment Management Agreement between the Trustee and Nest Invest.

- 2.7 The Trustee is satisfied due to regular reporting, Trustee skills' audits, ongoing training and continuous professional development, that it, the respective committees and Nest Invest, have sufficient expertise, information and resources to carry out their roles effectively.
- 2.8 In preparing this SIP for both the default arrangement and the additional investment fund choices scheme members can make, the Trustee has considered written advice from the Chief Investment Officer (CIO) of Nest Invest who is qualified to provide this advice by their ability and practical experience of financial and pension scheme matters.
- 2.9 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 of both issues on which the committee can make decisions, and issues on which it makes recommendations to the Trustee. The **terms of reference** of the investment committee can be found on our website.
- 2.10 The Trustee has delegated certain powers in relation to investment decisions and oversight to the investment committee. These include the asset allocation strategy, fund manager selection and responsible investment, as well as the monitoring of investment performance and risk.
- Nest Invest is also delegated responsibility via the Investment Management Agreement to ensure and report to the investment committee that its investment powers are exercised in a manner calculated to ensure security, quality, liquidity, and profitability.
- 2.11 The following sections, except where explicitly referenced, set out the Trustee's policies in relation to the types of investment, the balance between such investments, the associated risks and the expected return on those investments in the context of both the default arrangement, and the other investment fund choices our scheme members may make.

3 Day-to-day management of Nest's assets (default and non-default)

- 3.1 The day-to-day management of Nest's assets is performed by external professional fund managers and from time to time, Nest Invest. The investment committee are satisfied that the appointed fund managers and Nest Invest have sufficient expertise and experience to carry out their role.
- 3.2 Fund managers are monitored on a regular basis and performance is reported to the investment committee quarterly. The appointment and dismissal of fund managers is the ultimate responsibility of the investment committee, based on recommendations from Nest Invest. The monitoring of fund managers is the responsibility of Nest Invest with oversight by the investment committee.
- 3.3 Fund managers' activities are defined and constrained by detailed agreements. They have discretion to buy and sell investments within the terms of these agreements. Fees are negotiated individually when a fund manager is appointed and are reviewed periodically to provide ongoing value for money for members.
- 3.4 Fund managers are listed in the scheme's **annual report and accounts**, which also contains information about investment performance, asset allocation and major investment decisions taken during the year.
- 3.5 The fund managers are selected through an open and transparent process. The process aims to achieve best value for money for members.
- 3.6 Professional advice from either Nest Invest or the Trustee's external FCA-authorized and regulated 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 calibre to ensure the quality and profitability of the assets. The ongoing monitoring of funds and fund managers is delegated to Nest Invest, to ensure all investments are undertaken in accordance with the Trustee's powers of investment.

4 Policy in relation to the Trustee's arrangement with existing asset managers (default and non-default)

- 4.1 Nest's approach to constructing its investment strategy is to use a 'fund- of-funds' building block model. Nest works with multiple fund managers with multiple mandates for different asset classes. Nest is not reliant on any one fund manager to deliver the investment objectives of the default strategy or in most cases the fund choices that members can make.
- 4.2 Each manager is procured through an open competition, to find the most suitable fund manager for each asset class. A thorough procurement process and regular ongoing monitoring ensures that each fund manager is fully aware of Nest's particular objectives for any given asset class in order to enable it to align its investment approach with that of Nest and to ensure each manager is appropriately incentivised.
- 4.3 Nest shares a summary of its policies and expectations on issues such as responsible investment; (including Nest's approach to managing climate change risks) engagement and voting; divestment; unit pricing and fair value; securities lending and the use of derivatives, with fund managers as part of the procurement process where relevant and provides to managers updates to these when relevant.
- 4.4 As part of our procurement process, Nest sets out the detail of our responsible investment policies and expectations, and prospective managers are evaluated on their approach to being long-term and responsible stewards of the assets they manage on behalf of Nest members where relevant. Nest shares with our managers this SIP, within which we set out investment beliefs about the importance of making decisions with a long-term mindset.
- 4.5 Nest Invest conducts regular manager monitoring and meets with each of the managers at least once a year, and more frequently for active managers. Manager performance is reported to the investment committee on a quarterly basis. As part of our regular evaluation of our managers to ensure they are delivering in line with the objectives for which they were appointed, we monitor fees and charges in the context of our ongoing market evaluation of the price of fund management services.
- 4.6 Our contractual relations with fund managers are open ended (subject to termination provisions which are negotiated as part of the appointment terms) as we believe in building long-term partnerships with fund managers. Where managers are no longer delivering on the objectives for which they were appointed, we will move assets to an alternative manager, or re-procure for that particular asset class – there are no contractual impediments to doing this.
- 4.7 Nest Invest monitors the costs of portfolio turnover as part of its regular fund manager monitoring. When selecting a new fund manager or new asset class Nest Invest makes an assessment as to our expectations of turnover range for any given asset class or manager style. Where relevant for a particular asset class or manager style, as part of our regular manager review, we monitor levels of turnover to ensure they remain in line with our expectations for that mandate.
- 4.8 Nest requires its fund managers to vote on all resolutions of shares managed on behalf of Nest members – this includes voting and engaging on a company's capital structure. Where there is a potential for any conflict of interest between a fund manager and the way they vote, we expect these conflicts to be managed in accordance with the Financial Reporting Council's (FRC) stewardship code.
- 4.9 As part of Nest's policy on responsible investing, Nest and Nest's fund managers collaborate with other institutional investors and asset managers. Nest is a signatory to the FRC's stewardship code and other relevant shareholder initiatives. We report engagements undertaken with our fund managers and other stakeholders in our annual responsible investment report.

5 Types of assets held (default and non-default)

- 5.1 The Trustee invests in a mix of financial assets through a variety of legal structures and investment vehicles, deemed suitable for pension schemes, balancing expected returns against investment risk. 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.
- 5.2 The Trustee carries out due diligence and takes advice from Nest Invest and may also take advice from external investment advisers to ensure new areas of investment are appropriate.
- 5.3 The investment committee has approved a set of asset classes and constraints within which investments can be made. Any proposal to invest outside these constraints must be agreed in advance with the investment committee and the relevant schedules of the Investment Management Agreement updated accordingly.
- 5.4 The detail of the current asset allocation for the scheme's default investment strategy and the additional investment fund choices scheme members can make, is published via the [quarterly investment report](#) on the Nest website.

6 The balance between different types of investments (default and non-default)

- 6.1 Long-term strategic asset allocation is driven by the specific characteristics of the scheme, in particular its demography, and members' capacity and appetite for risk. The Trustee also considers long-term projections of the likely performance of different types of investments in different economic conditions.
- 6.2 The scheme's strategic asset allocation is reviewed on an annual basis. The methodology for changing the strategic asset allocation is periodically revisited to ensure that changes to the strategic asset allocation are appropriate.
- 6.3 The investment committee is responsible for ensuring both the default strategy and the additional investment fund choices scheme members can make 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.

7 Liquidity (default and non-default)

- 7.1 The liquidity profile of Nest's investments is regularly reviewed by Nest Invest.
- The majority of the scheme is invested in liquid assets and the investment committee reviews what proportion of the portfolio should be in illiquid assets for members at different stages of their investing lifecycle. Some investments, such as property and other assets not listed, are less easy to sell. Such

illiquidity normally allows the Trustee to capture an improved return and is not expected to constrain its investment decisions.

8 Risk (default and non-default)

- 8.1 The Trustee recognises that the scheme is exposed to a number of investment and operational risks. It gives qualitative and quantitative consideration to these risks when deciding investment policy, strategic asset allocation, the fund manager structure, choice of fund managers, the terms of their agreements and other aspects of the ongoing management of the scheme.
- 8.2 The scheme maintains a risk register of the principal risks, including investment performance risk, to which it is exposed. The register rates the impact and likelihood of the risks and summarises existing mitigations and additional actions. The investment performance principal risk is reviewed quarterly by the investment committee. Details on the types of risks reviewed are shown in Annex 1..

9 Expected return on investment (default and non-default)

- 9.1 The types of investment chosen by the Trustee are selected and combined with the aim to achieve the specific objectives of the default strategy and the additional investment fund choices scheme members can make.

The Trustee seeks to take account of financially material considerations in the selection, retention and realisation of investments. The key inputs in setting the investment strategy are the long-term capital market assumptions of expected return and expected investment risks. These capital market assumptions incorporate long-term forecasts of the key drivers of risk and return including economic growth, inflation and asset values.

Nest Invest reports to the investment committee on a quarterly basis the risk and return characteristics of the Retirement Date Funds and additional investment fund choices, and how each fund manager is delivering against their specific mandates.

- 9.2 Risks and opportunities are assessed for materiality and impact within a broader risk management framework, which takes account of the Trustee's investment time horizon for a diverse member demographic. While our focus is predominantly long-term, as is appropriate for a pension scheme, the risk management framework allows us to consider a variety of risks including the short- to-medium-term outlook for economic growth and inflation as well as currency, interest rate, liquidity, environmental, social & governance and political risk.

10 Realisation of investments (default and non-default)

- 10.1 The Trustee will realise assets following member requests on retirement or earlier where required. In selecting assets, the Trustee considers the liquidity of the investments in the context of the likely needs of members.

11 Investment beliefs (default and non-default)

- 11.1 The Trustee has established a set of investment beliefs to provide an objective and transparent framework for consistent investment decision making. These beliefs act as a guide to enable effective delivery of all investment functions. The beliefs are reviewed at least once every three years. The beliefs can be found in Annex 2.

12 Investment aims and objectives for the default strategy

- 12.1 The Trustee's overarching investment objective for the default strategy is:

Delivering the best retirement income for as many as possible.

The Trustee has selected different types of investments and adjusts the balance between these investments to meet this overarching objective.

- 12.2 To support this overarching objective the Trustee has also agreed the following supporting sub-objectives which aim to:
- › Grow member savings faster than inflation (CPI) after all charges during a member's working life.
 - › As a member approaches retirement invest to deliver a predictable retirement income.
 - › Provide members with a smooth transition between their working and retirement years.
 - › Deliver similar outcomes for cohorts with similar contribution histories and similar ages.

The Trustee recognises that there will at times be tensions between these supporting objectives and will seek to find an appropriate balance between them.

13 Delivering the investment objective for the default strategy

- 13.1 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 automatic enrolment and is central to Nest's investment approach.
- 13.2 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 aims to be consistent with the expected amount of investment risk and return that is appropriate for the age of a member in order to meet the investment objectives of the Nest Retirement Date Funds throughout a members' savings journey.

14 The default strategy portfolio building blocks

- 14.1 The Trustee uses five portfolio building blocks in different proportions for each of the Nest Retirement Date Funds. The building blocks are:
- › Growth
 - › Illiquid Capital preservation
 - › Income
 - › Liquid Capital preservation
 - › Longevity risk management.
- 14.2 By varying allocations between growth-seeking, capital preservation and income-seeking assets, as well as varying the allocations to liquid and illiquid assets, through time, the Trustee aims to best meet members' different needs throughout their savings journey. These building blocks allow for the construction of four broad phases in a member journey depending on their age:
- › the foundation phase
 - › the growth phase
 - › the consolidation phase
 - › the retirement income phase.
- 14.3 The foundation phase refers to the early years of younger scheme members' working lives as they develop the savings habit. This phase typically lasts two to five years. The objective for the foundation phase is to give younger members confidence in saving for the long term by aiming to grow their pots by more than inflation (CPI), whilst reducing the impact of short-term volatility. This phase allows for investment in a relatively high proportion of illiquid assets, reflecting younger members' longer investment horizon.
- 14.4 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. This phase has a proportion of illiquid capital preservation assets that gradually decrease as a member gets closer to needing a retirement income. The objective for this phase is to outperform inflation by 3 per cent a year after all charges over the long term.
- 14.5 The consolidation phase prepares a scheme member's assets for taking an income in retirement and typically begins ten years before their Nest Retirement Date Fund matures. Investments in this phase are progressively switched out of growth and illiquid capital preservation portfolios, into a mixture of liquid capital preservation, income, and longevity risk management building blocks. The objective of the consolidation phase is to provide a smooth transition from the growth phase into assets that better meet members' needs of an income in retirement. The retirement income phase is for those members who have not chosen to withdraw all their savings when their Nest Retirement Date Fund matures and closes.
- 14.6 Those members who are aged between 60 and 70 and whose pot sizes are £10,000 or more, are automatically moved to the **Nest Guided Retirement Fund**. This is an investment strategy designed to provide a retirement income. It consists of four sub-funds – each of which has a specific purpose to meet members' needs throughout the retirement income phase. Members will have different allocations in each of the sub-funds depending on their age. As they get older and progress through the strategy they will be gradually de-risked from a sub-fund which has an objective of outperforming CPI after all charges, to sub-funds primarily invested in liquid capital preservation assets and assets that help manage longevity risk.
- Nest manages and invests the members' overall pot with the aim of providing them with regular, sustainable, and predictable withdrawals until age 85. The remaining pot can then be used to purchase a lifetime income from age 85 if the member wishes.
- 14.7 Those members whose pot sizes are below £10,000 are automatically moved into the Nest Post Retirement Date Funds. These funds invest in asset classes with high liquidity and lower volatility in order to reduce the pension conversion risk associated with converting a member's accumulated savings into one, or several, cash lump sums relatively quickly.

15 Responsible investing (default and non-default)

- 15.1 The Trustee considers sustainable investment factors, such as (but not limited to) those arising from environmental, social and governance (ESG) considerations, including climate change, in the context of our broader risk management framework.
- 15.2 The Trustee requires its fund managers, where appropriate, to have integrated ESG factors as part of their investment analysis and decision-making process. Fund managers are monitored on a regular basis by Nest Invest in this regard. On a regular basis the investment committee receives reports on the fund managers' voting performance and approach to responsible investing more generally.
- 15.3 The Trustee expects fund managers, to have integrated climate risk into their risk analysis and investment process and, we take it into account in the selection of new fund managers. When monitoring the performance of our fund managers, we also regularly consider and report to the investment committee how they are performing with reference to climate risk issues.
- 15.4 We set out our objectives for managing climate change risk within our climate change risk policy. Our ambition is to align our whole investment portfolio with limiting global warming to 1.5C above pre-industrial levels by reaching net zero carbon emissions by 2050 or earlier. We report annually on our progress towards meeting our targets using the Task Force on Climate Change-related Financial Disclosures (TCFD) reporting framework.
- 15.5 The Trustee has an active policy of soliciting members' views on non-financial matters in its investment decision making for one of the non- default investment funds – the **Nest Ethical Fund** choice strategy. These views are taken into account in the selection, retention and realisation of investments in the Nest Ethical Fund. The Trustee does not currently take into account members' views on non-financial matters in the selection, retention and realisation of investments for the other additional investment fund choices.
- 15.6 The Trustee does not currently take into account members' views on non-financial matters in the selection, retention and realisation of investments for the default investment strategy (the Nest Retirement Date Funds), as it has provided additional investment fund choices where members' views on non-financial matters can be sought and expressed.
- 15.7 The Trustee surveys members about its responsible investment approach in general and provides to members and stakeholders an **annual report** on its responsible investment activities.

16 Responsible investing – stewardship (default and non-default)

- 16.1 The Trustee has a duty to act responsibly with regards to the assets it owns on behalf of Nest members. 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.
- 16.2 As part of this duty the Trustee, or its agents on its behalf, exercises its ownership rights, including voting and engagement with investee companies on matters including performance, strategy, risks, social and environmental impact and corporate governance in order to safeguard sustainable returns in the long term. How the Trustee expects its voting and engagement rights to be exercised is set out in a Nest specific **voting and engagement policy**.
- 16.3 Nest takes its responsibilities as an asset owner seriously. As clients, we work closely with our fund managers to help us support good corporate behaviour. Part of our procurement process for choosing fund managers involves ensuring their voting policies are well thought out and documented. Having our own policy enables Nest to document our position and expectations to our fund managers on good corporate behaviour. We use it to monitor and hold our fund managers to account on the decisions they

make. Having our own established policy in place helps us have healthy discussion and debate with our fund managers.

- 16.4 Where Nest has direct voting rights, we work closely with our proxy voting agent to ensure Nest's voting intentions are delivered in line with Nest's voting policy.
- 16.5 Each year we publish a voting summary report setting out how all our fund managers have voted and how this compares to Nest's voting policy. We report the votes our fund managers make every quarter.
- 16.6 In addition to engaging directly with companies, Nest also undertakes joint engagements with our fund managers, and other pension schemes. Nest works to engage with public, industry and regulatory bodies in the various markets in which the scheme invests to promote better practices.
- 16.7 Given the systemic nature of climate change, we seek to discharge our duties by robust engagement alongside our fund managers with investee companies to encourage alignment with a low carbon economy and with policy-makers and governments to advocate for the same.
- 16.8 The Trustee reports to its members and stakeholders on its stewardship activities through its annual [responsible investment report](#).

17 Policy on divestment

- 17.1 In general, divestment or exclusion goes against our principles of stewardship and responsible investment. However, in certain rare circumstances we believe it's merited for the reasons set out in our divestment policy.

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

- 17.2 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.

18 Additional investment fund strategy choices

- 18.1 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

Nest Sharia Fund

A fund with an investment approach based on Islamic law

Nest Guided Retirement Fund

A fund designed for members who:

- › are aged between 60 and 70,
- › have at least £10,000 in their retirement pot; and

- › want to start taking a sustainable and predictable income from their Nest pot in retirement while still being invested in a proportion of growth seeking assets.

Nest members who are in the default strategy (Nest Retirement Date Funds) and have passed their Intended Retirement Date (IRD) without making a retirement choice, and meet the age and amount criteria, will be automatically moved into this fund.

- 18.2 The Trustee may add, change or remove any fund choice strategies in accordance with the terms set out in Nest's **Order and Rules**.
- 18.3 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.

19 Compliance with this SIP

- 19.1 The investment committee monitors compliance with this SIP on a quarterly basis. The Trustee reviews the investment strategy to ensure it remains in line with the SIP on an annual basis and receives a report from Nest Invest to this effect.

The Trustee publishes a SIP implementation statement each year reporting on how they have followed, reviewed and, where relevant, changed the SIP during the scheme year.

Annex 1

Risks

As part of our risk management process, we have several executive committees which review and manage specific types of investment risk: illiquidity committee, manager monitoring committee, investment services procurement committee.

In addition, we have an executive investment risk committee that meets quarterly to oversee investment risk management activities across the investment process. The committee makes decisions on risk mitigation measures or resolutions, proposals for changes to existing risk limits, targets, or the risk management process itself. The following non-exhaustive list sets out some of the key investment risks our members face, and our approach to managing them.

Inflation risk

Nest invests in a diversified range of assets which are likely to grow in real terms over the long term. We pay particular attention to the challenges of UK inflation and seek opportunities to invest in assets that help manage UK inflation risk, such as property and infrastructure.

Market risk

We aim to follow best-in-class industry practices to measure, manage and monitor investment market risk, and ensure that the investment risk taken is appropriate to each of our portfolios and their expected return and income objectives. We knowingly take on investment risk, assess the consequences of member needs, and continually re-evaluate market conditions.

Counterparty risk

Nest manages its counterparty risk through a rigorous approach to the procurement and ongoing monitoring of investment services, regular monitoring of Nest's funds, regular reports of the funds' underlying holdings and our fund managers' approach to managing counterparty risk.

Credit risk

For relevant asset classes Nest and those it delegates to, carefully monitors credit risk where there is a risk of corporate default. In addition, Nest has indemnities in place with fund managers for certain activities.

Operational risk

Nest, with its suppliers, assesses and manages its operational risks through the receipt of frequent reports, and has clear key risk indicators for both internal and external activities. Nest receives regular audit reports on both internal and external operations. Nest regularly reviews both external contracts and internal systems, to ensure we understand the operational risks we face and where we should mitigate, accept, or remove the operational risk.

Liquidity risk

We carefully monitor the overall proportion of illiquid assets at different stages of our members' investment lifecycle and report regularly to the investment committee on the illiquidity risks we are taking, with a focus on private market investments, including infrastructure, private credit, private equity and property. We pay close attention to our current and projected cash flows to ensure there is sufficient liquidity to meet unexpected demands for cash (i.e., through unforeseen member or market activity), whilst ensuring we expose our members to the opportunities that an illiquidity premium can afford them.

Valuation risk

Nest invests the majority of members' money in liquid quoted assets in order to manage valuation risk. We review the valuations of illiquid assets on a regular basis, and this is monitored and reported via our internal Illiquidity Committee, to review matters of both liquidity and valuation.

Environmental, Social and Governance (ESG) risks

We monitor, prioritise, and manage ESG risks alongside other financial risks and opportunities across our portfolios. We do this with the help of our responsible investment partners and ESG data providers and report the risks we face and our activities at the investment risk committee.

The investment risk committee aims to support a holistic investment risk management approach. Its remit includes reviewing key ESG issues including climate-related risks for Nest portfolios and developments in the responsible investment space which could have negative impacts on Nest portfolios. It also ensures ESG, and climate-related risk is properly integrated and considered across the process of the different investment team functions. This includes asset allocation, market risk and manager selection in both private and public markets. These risk factors can have a significant effect on the long-term performance of the assets Nest holds.

Climate risk

We actively try to reduce climate related risk in portfolios and seek investment opportunities in the transition to a low carbon economy.

Currency Risk

Investments denominated in currencies other than the scheme's base currency carry the risk of adverse exchange-rate movements. Nest looks to manage currency risk by hedging a proportion of its foreign currency exposure back into sterling.

Geopolitical Risk

As a global investor we carefully monitor environmental, social, governance, political, reputational, and economic risks when investing our members' money. As long term investors we look to manage the implications of a variety of political risks from climate change to military conflict. We also actively seek to diversify portfolios globally, to improve risk adjusted returns as well as giving access to investment opportunities not available in the UK.

Derivatives risk

We only use derivatives for efficient portfolio management and for managing risk. Nest maintains appropriate internal processes to verify the competency of external investment managers to use - and investment team members to supervise use of - derivatives as part of their investment mandate. These processes include at a minimum, the provision of necessary resources and controls to ensure appropriate and efficient implementation, reporting and monitoring and the appropriate contracts to manage the extent and way derivatives may be used. Reporting to the Investment Committee on derivative exposures occurs on a quarterly basis.

Concentration risk

This is the risk of loss arising from exposure, either directly or indirectly, within or across different risk types such as region, issuer, sector, investment partner, or investment type. Nest limits this risk by diversifying holdings within and across these exposures.

Sequencing risk

This is the risk that comes from the order in which your investment returns occur. During accumulation of savings this is less of an issue, but as Nest members start accessing their retirement savings through investment strategies such as the Nest Guided Retirement Fund (NGRF), managing sequencing risk becomes very important. Nest does this through a mixture of asset class diversification, and the application of dynamic spending rules. For each member cohort within NGRF, Nest annually reviews the level of income that is moved from the vault to the wallet, to ensure incomes remain sustainable until a member reaches age 85.

Annex 2

Investment beliefs

- 1. An expert, well-resourced and well-governed in-house investment function will deliver better long term investment outcomes for Nest's members than a wholly outsourced solution.**
 - An ambition to be a world class investment organisation will result in better retirement outcomes for our members – international benchmarking is central to this ambition.
 - Having a highly skilled fiduciary Board provides effective challenge and oversight and leads to better decision making and better outcomes for members.
 - An efficient in-house team provides closer alignment between investment decision making and member needs and aspirations.
 - The functions of Nest's in-house investment team will evolve with our growing scale and range of skills, to continue to deliver innovative investment strategies and excellent value to our members.
- 2. Rigorous and careful selection of fund managers and effective monitoring and evaluation of their activities can provide additional value to our members.**
 - Through the construction of specific mandates and benchmarks we can align fund managers' commercial imperatives to our members' needs.
 - We flex our use of external fund managers and the in-house team and the way in which we access their expertise (co-investments, segregated mandates, pooled funds) based on alignment with members' needs, costs, and internal expertise.
 - Our scale and reputation mean we can have a positive effect on fund manager behaviour and improve industry standards.
- 3. Strategic asset allocation is the most important contributing factor to long term performance.**
 - Different asset classes have different characteristics, and these vary in different market and economic cycles. We buy assets which improve the likelihood of meeting our portfolio objectives across these cycles.
 - A strategic approach to investing in private markets can exploit opportunities and structures not available in public markets, bringing potential additional returns (including complexity and illiquidity premia) as well as diversification.
- 4. Long term investors earn better returns net of costs as they can invest in assets with higher risk premia, notably equity and illiquidity risk. Nest's membership profile means we are well positioned to take advantage of this.**
 - As a patient investor, we can invest primarily in assets which will generate a high return in the long term.
 - Measuring long term performance is more relevant than measuring short-term noise: we are trying to catch tides, not waves.
 - Being long term investors allows us to build more profitable long term partnerships with fund managers and leverage their resource to achieve better value for money for our members.
 - A long term horizon enables the integration and consideration of broader systemic risks and opportunities not afforded to investors with short term horizons. This has additional resonance with investment beliefs seven and eight.

- 5. Our members have different objectives throughout their time investing with us – carefully evaluating the amount and type of investment risk to take to achieve these objectives, coupled with robust risk management, leads to better outcomes for them.**
- Risk is much more than just volatility and risk premia are not static over time but fluctuate as a function of investors’ preferences and economic and market conditions; we harness and manage a variety of different risk premia to meet the differing needs of our members at different times.
 - A sensible approach to diversification improves risk-adjusted returns. We diversify across a range of asset classes and across the risk factors driving their performance.
 - There are limits on the overall risk-reduction achievable from diversification and there are scenarios in which correlation between asset classes increases and diversification may be less effective.
- 6. Investors who are cash flow positive¹ for long periods can utilise this as an additional source of value.**
- Taking account of assets’ fundamental values and market prices and deploying capital counter-cyclically provides better long term outcomes.
 - Withstanding short-term investment shocks without being a forced seller, is likely to be advantageous for our members.
 - Active rebalancing in times of market stress adds additional value.
- 7. Incorporating and acting upon climate risk and other environmental, social and governance (ESG) factors is a significant driver of investment outcomes.**
- Integrating sustainability factors into our investment process, from asset allocation and benchmark construction to manager selection and risk management, supports the identification and ultimately the pricing of ESG risk and opportunity.
 - Capital allocation by investors and corporations can make a difference in how ESG risks play out and is particularly effective when aligned with policy and regulation.
- 8. Acting as responsible long term stewards has a positive and broad impact on member outcomes.**
- Where portfolios are well diversified, performance is broadly determined by the global economic systems in which investees operate – engaging with companies, fund managers, and policy makers to improve financial markets and influence the long-term health of these systems is in our members’ best interests and part of our fiduciary duty.
 - We consider the impact of our investments as an economic actor in our own right and as part of a wider investor community. We believe we can deliver on our investment objectives and have a net positive impact on externalities that affect members’ investments and retirement outcomes.
- 9. Building and maintaining Nest members’ trust in our investment approach throughout their time saving with us will support better retirement outcomes.**
- Transparency and clear communications about how we invest promotes trust and leads to better member outcomes.
 - Our members have agency as to where, when, and how much they save for their pension – we do not assume inertia is the same as indifference to the investment experience members have, or the way their capital is allocated.
 - Member behavioural as well as socio-economic factors influence how we manage different risk premia at different times – this is complementary to our fiduciary responsibility to achieve the best risk adjusted returns to meet members’ different investment objectives.

¹ Nest has much higher in-flows of contributions than outflows to retirees, for decades to come.

- As a large institutional investor, we can be increasingly circumspect about where and to whom we allocate members' capital; consideration of reputational risks and their impact on members' trust in Nest is a factor in some investment decisions.



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<publishing number>