Securities Lending Policy

May 2023

Introduction

Securities lending is a mature, well-regulated practice that can be a source of revenue for institutional investors. Investors temporarily lend their securities to borrowers in return for a fee. As security for the loan the 'lender' receives pre-agreed collateral, typically with an additional margin, in the form of other securities or cash before transferring the title of the securities to the borrower. A legal agreement protects the lender's entitlement to all the economic benefits of the lent securities (such as dividends) and, in the unlikely event of the borrower defaulting, the collateral is used to fund the replacement of the securities borrowed.

Nest's policy on securities lending

Nest allows securities lending to take place in both its pooled fund and in its segregated mandates. Our approach is based on a number of factors that seek to balance financial, risk and responsible investment considerations, as guided by **Nest's Investment Beliefs** and **Responsible Investment Objectives**.

Core to Nest's securities lending approach are robust fund manager procurement, engagement and monitoring standards to ensure alignment with our members' long-term interests, managing risks and behaving as responsible market participants. We will be working with our Custodian to incorporate Nest's expectations and with existing pooled fund mandates to ensure understanding of Nest's position and provide support to develop their approach.

Roles and responsibilities

Chief investment officer

The CIO will maintain appropriate internal processes to verify the competency of external investment managers to use securities lending as part of their investment mandate.

These processes will include at a minimum:

- Provision of necessary resources and controls to ensure appropriate and efficient implementation and reporting
- Appropriate contracts to manage the extent to and manner in which securities lending may be used

Third party fund managers

Third party fund managers may use securities lending in a manner consistent with Nest's members' best interests, regulations, industry codes and standards, trustee delegations, and the investment objectives of the overall fund.

Nest's approach

Nest permits securities lending to take place in its pooled and segregated funds, subject to certain conditions.

Segregated mandates

Nest's custodian is charged with managing its securities lending programme for its segregated mandates. Nest expects the custodian to:

- Comply with applicable regulatory and reporting requirements such as the Securities Financing Transaction Regulation (SFTR) and any other regulatory requirements in relation to the relevant securities lending transactions
- Adhere to the side letter agreement entered into with Nest and any other relevant documentation such as policy documents or prospectuses
- Consider Nest's Voting and Engagement policy

Pooled fund mandates

Nest uses pooled funds that may engage in securities lending. Given the nature of pooled funds, Nest does not directly control the securities lending arrangements but places importance on carrying out appropriate due diligence and monitoring to ensure key risks are mitigated. Nest expects managers to:

- Comply with applicable regulatory and reporting requirements such as the Securities Financing Transaction Regulation (SFTR) and any other regulatory requirements in relation to the relevant securities lending transactions
- Adhere to the side letter agreement entered into with Nest and any other relevant documentation such as policy documents or prospectuses
- Consider Nest's Voting and Engagement Standards

Controlling risks associated with securities lending

Securities lending, although subject to increased regulation and transparency requirements, still carries with it risks that can be significant if not properly managed. In most cases it is expected that the custodian and fund managers will have policies in place to manage these risks and Nest will rely on the effective execution of the custodian and managers' policies to fulfil Nest's standards.

Counterparty risk

Nest expects its fund managers and custodian to minimise counterparty risk by expecting that they:

- Lend to high quality borrowers
- Carry out extensive credit checks and regularly monitor the creditworthiness of borrowers
- Diversify their borrow-base to avoid concentration risk
- Disclose to Nest a pre-approved list of its borrowers in their reporting and upon request

Collateral risk

There is a risk that the value of the collateral falls below the replacement cost of the loan. If the borrower defaults on the loan the lender can suffer loss due to the shortfall. Nest expects the custodian/fund managers to minimise collateral risk by ensuring that:

- The type of collateral offered is acceptable in terms of value and liquidity, with consideration given to country risk, asset class, type (cash, non-cash, open, end)
- Collateral is marked-to-market daily

Operational risk

There is a risk that securities sold by the custodian/fund manager are returned late and that the lender's agent fails to claim a dividend or other entitlement. Nest expects the custodian/fund managers to mitigate such risks by:

- Ensuring that risks and liabilities are fully understood by any lending agents involved in the securities lending pro gramme
- Reconciliations, reporting, verification and management oversight

Responsible investment

Nest takes its role as a responsible investor seriously and expects its custodian and pooled fund managers to adhere with its policies in relation to proxy voting and engagement. Moreover, securities lending activities should not obstruct Nest's ability to discharge its duty as a responsible investor. Nest is a member of the **Global Principles for Sustainable Securities Lending (PSSL)** which is an initiative that seeks to align sustainable finance with securities lending. Many of the principles have been a useful guide in helping us set expectations on the management of risks and practices associated with securities lending.

Voting and engagement

Investors have an opportunity to act as good stewards of the companies in which they invest by voting at shareholder meetings. When shares are lent out, the voting rights are transferred to the borrower. As such, Nest expects that the custodian and pooled fund managers put in place processes and policies to ensure that:

- Lent-out shares can be recalled promptly in the event of a significant vote
- Securities lending can be restricted ahead of an important vote
- Not all shares of a company are lent out, so as to remain on a company's share register in order to retain voting and engagement access

However, Nest acknowledges that it is not always possible to control recalling or restricting securities lending in pooled funds, Nest shares with its equity fund managers a portfolio subset of Nest's watchlist for voting and engagement and has regular interactions with fund managers to discuss important company votes ahead of voting season and engagement activity.

Empty voting

Empty voting is a practice whereby stock is borrowed to influence the outcome of a vote at a company's shareholder meeting. Nest does not support empty voting, in line with the Bank of England's **Money Market Code**, which states that borrowing shares for the sole purpose of voting "can distort outcomes for all investors if temporary holders of shares use borrowing to influence voting and is therefore deemed unethical. Accumulating stock via borrowing for this purpose can disrupt the liquidity of the market in the underlying securities and so is against the Code's over-riding principles of promoting market integrity and effective market functioning".

While it is challenging to fully control this in practice, Nest expects the custodian to:

- Clearly set out in their contracts with borrowers that empty voting is not permitted
- Include previous empty voting as an indicator of borrower suitability in due diligence and monitoring

Short selling

Short selling is the sale of a security that the seller has borrowed; if a security's price falls then the short seller profits. Nest acknowledges that the compatibility of short selling with responsible investment is subject to debate, with arguments on one hand that it can be a legitimate tool that adds liquidity and price discovery to capital markets, and on the other hand that it can lead to volatility, negatively impact share prices and is not compatible with long-term investor ownership.

As such, Nest expects the custodian and pooled fund managers to:

- Put in place policies and procedures to ensure that they do not knowingly facilitate any form of manipulative market activity or abusive short selling
- Include previous abusive short selling as an indicator of borrower suitability in due diligence and monitoring

Future procurement

As part of Nest's procurement approach, where we use pooled funds, we will require potential new fund managers to produce a policy on securities lending. If managers undertake securities lending in the fund we are procuring, we will expect the policy to include the management of responsible investment considerations and other risks as set out above.

Where we select to use segregated accounts, we will expect our custodian to implement practices and policies to manage the investment considerations and other risks as set out above.

Monitoring

Nest's investment team will review the implementation of its securities lending programme annually. The review will take place as part of Nest's overall annual review with its fund managers and custodian and will consider the suitability, transparency and rigour of their approaches. If there are any changes to a fund manager's approach, we expect that they update us accordingly. We will also share information across our pooled fund managers to promote a closer alignment of policies and discuss any possible changes that should occur in line with best practice.

This policy will be reviewed by Nest's investment Committee on a triennial basis, or sooner in the event of significant change.

Next review date April 2026.

Version control

Version	Change	Date implemented
1	Document created	July 2020
2	Included new wording to address our decision to allow securities lending to take place in segregated funds and the mitigation of risks associated with that decision.	May 2023

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