Organisational overview

Employers in the UK now have a statutory duty to provide a pension scheme for their workers that meets or exceeds certain legal standards. In most cases they’ll have to enrol some or all of their workers into that scheme. It’s also likely they’ll need to make minimum contributions for those workers as well.

NEST is a defined contribution pension scheme that UK employers can use to meet their new legal duties. It’s an easy-to-use, low-charge scheme that has a public service obligation to accept employers of any size or sector that want to use NEST to meet their legal duties.

NEST Corporation is the Trustee body responsible for NEST. It’s a non-departmental public body that operates at arm’s length from government and is accountable to Parliament through the Department for Work and Pensions.

NEST invests and owns stakes in hundreds of UK-listed companies and is likely to be among the very largest institutional asset owners in the UK. How these companies operate and report publicly on their activities and risks is of concern to NEST. NEST’s voting activity and other engagement with the companies it owns is entirely driven by its investment belief that well run and appropriately stewarded companies are more likely to perform better and produce improved risk adjusted returns for their shareholders over the longer term.

NEST’s members are the ultimate beneficiaries and it’s our role to act on their behalf in order to ensure the companies their savings are invested in are working in their best financial interests.

If you’d like to find out more about NEST visit nestpensions.org.uk
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Introduction

This document sets out our high-level stance on corporate governance and our policy on voting. The intended readership is the companies in which we invest, our fund managers and investment industry stakeholders.

Voting rights present both an opportunity and responsibility for shareholders to participate in the stewardship of companies. This can be an influential and important activity, because corporate directing can be supported and shaped through voting. We’re in no doubt that sound corporate governance can contribute to long-term value for our members. We always seek to vote in the interests of our members and in accordance with our approach to corporate governance and policy on voting. We also work with our fund managers where they have voting responsibility.

The UK Corporate Governance Code sets out good board structures that are considered supportive of effective directing and leading. The structural environment in which directors operate has often been a focus of investors as it reflects some of the more visible decisions that a board takes. However, applied without proper planning, a focus on structure has in the past led others to accuse investors of a box-ticking approach. The recurring pattern of corporate failure followed by the gradual firming-up of regulation demonstrates that a focus on structure alone is no guarantee of good conduct and performance. Other elements of directors’ widely varying agenda include conduct, performance, conformance and risk appetite. We believe strongly that all the elements above should be considered as a whole when deciding how to vote. We don’t follow a ‘one-size fits all’ approach but we explore structure, conduct and performance as a whole when voting.

Application of the policy

As an organisation, NEST takes its responsibilities as an asset owner seriously. We recognise that being an active and vigilant owner while our assets under management remain modest requires prioritisation and pragmatism. Presently we invest in pooled funds managed by external managers. As clients, we work closely with our fund managers to get the best from the companies they invest in on our members’ behalf.

We expect our fund managers when exercising our voting rights to do so responsibly and in accordance with their own documented voting policies. Having a NEST policy on voting makes us accountable as a responsible and long-term owner of assets. Although we don’t currently use our voting rights directly, having our own policy enables us to document our viewpoints and expectations to our fund managers on how companies should function. We use it to hold our fund managers to account on the decisions they make and to identify differences in how they vote to how we might vote on a particular issue. Having our own established policy in place helps facilitate healthy discussion and debate and allows us to fully participate in the wider dialogue on corporate governance.

We expect our fund managers to take a serious and considered approach to using our voting rights. While our views are often aligned with those of our fund managers we have adopted different approaches on some areas in line with our responsible investment objectives and principles. In particular these areas include audit, board diversity and executive remuneration.
How to read this document

We assume our audience is familiar with voting rights, as well as the UK Corporate Governance Code whose principles and guidance we support. We’ve used orange coloured text boxes throughout the document to signpost some of our high-level corporate governance beliefs. These build on the UK Corporate Governance Code rather than repeat it. Not every point or belief has been included, as we intend to focus on those we believe are most important. This document will be updated as the debate on corporate governance develops, our investment strategy evolves and as we gain greater insight into our members’ views and concerns. We consider it part of our role to be firmly involved in such discussions on behalf of our members. Corporate governance beliefs that don’t lend themselves to representation through the voting process aren’t included. Beneath each orange text box we list principles and voting guidelines. The principles put into practice the high-level corporate governance beliefs and the voting guidelines indicate how we’ll use our voting rights for each principle. Both principles and voting guidelines are written at a summary level.

1. Leadership

This refers to section A of the latest UK Corporate Governance Code.

Through leadership people create and achieve. The quality of the interrelationships that are so vital to directing and achieving are underpinned by values, ethics and purpose. The latest Corporate Governance Code (2012) emphasises that these are matters for the board, along with a long-term perspective and leadership. All directors play a part in what, how, and to what effect board leadership is enacted.

Our confidence in boards is higher where we see values, ethics and purpose in clear focus underpinned by strategy. We believe that corporate ethics and values provide all who work for a company with a stable reference point as well as a moral compass for consistent everyday decision making and action in a changing world.

We believe that companies are more likely to sustain their performance when boards lead and achieve in ways that benefit all people in the whole organisation and don’t just benefit a select few or use ethically inappropriate practices.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Voting guideline</th>
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<tbody>
<tr>
<td>1.1 Leadership and conduct</td>
<td>We're more supportive of the Chair and board where we see values, ethics and purpose set and instilled across the company.</td>
</tr>
<tr>
<td>Sound ethics, values and professional integrity help to create a constant reference point for consistent decision making and behaviour. To attain these and instil them is the outcome of sustained focus.</td>
<td>We're more supportive of the Chair, chief executive officer (CEO) and Chair of the nomination committee where we see a strong grasp of the people side of the business.</td>
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<td>A common refrain by business leaders is that ‘people are our primary strategic asset’. One vital people dynamic is how, and to what effect, the board engages with all staff, to create a sense of vitality, energy, pride, and satisfaction in the work environment. People risk also necessitates the board paying attention to its own interrelationships, the leadership pipeline, board refreshment, renewal and succession. We expect the board to create a reliable and effective decision-making culture. It should include whether tasks and directives are framed to prevent unethical or promote ethical behaviour, and whether ethical behaviour itself is a requirement or subject to reward.</td>
<td>We're more supportive of the Chair, CEO and Chair of the remuneration committee where we see board involvement in how tasks and directives are framed.</td>
</tr>
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</table>
2. The role and structure of boards

This refers to section B of the latest UK Corporate Governance Code. 2.1 and 2.2 below also refer to section A.

The Code on Corporate Governance suggests good board structures that are supportive of effective directing and leading. These are based on soundly informed and framed principles, but ultimately it’s for directors to judge whether the suggested structures are right for their company and to explain this to investors. The context for our general approach is:

- The CEO and Chair relationship is the fulcrum of the board. The potentially powerful dynamic when combined suggests that the roles of Chair and CEO should generally be held by separate people.
- The board should have an appropriate level of independence from management. This brings the role of non-executives into focus and the skill set needed. The role is one of simultaneously balancing support and challenge. The work of board committees is generally considered to be more effective the greater their level of independence from the executive.
- Individual board members should each be competent, persuasive, open-minded, professional and sound in judgement. The board when looked at as a whole should be characterised by a collage of diversity, including cognitive, gender and contribution.
- All directors should stand for regular re-election.
- Commitment, attendance and limited outside workload is essential.

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<th>Principle</th>
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<tr>
<td>2.1 Separation of Chair and CEO roles</td>
<td>We don’t expect to find combined roles. When roles are combined there may not be effective counterbalance to the concentration of information and power. Over-reliance may be placed on one individual in order to counterbalance, such as the senior independent director, taking time and focus away from matters normally attached to that role. We may vote against re-election of the Chair of the nomination committee if the positions of Chair and CEO are combined and/or the individual in question.</td>
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<tr>
<td>2.2 Non-executive directors</td>
<td>We expect the Chair to create a constructive culture that facilitates effective non-executive director behaviour. Non-executive directors are then more able to work in partnership with executive board members to provide support as colleague and challenge as referee, all the while remaining ‘independent’ from them. We expect non-executive directors to look beyond day-to-day issues and provide independent and balanced advice. Powerful and persuasive communication skills are needed especially when there’s shareholder disagreement with the board or during times of company difficulty. We may vote against re-election of the Chair where there’s limited evidence of a board culture that facilitates effective non-executive director behaviour. We may vote against the re-election of one or more non-executive directors where the board fails to respond appropriately to significant company events.</td>
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<tr>
<td>2.3 Director independence</td>
<td>In recent years the emphasis has been on more independent boards. We expect to find at least half the board comprising independent non-executive directors. We expect a smaller company to have at least two independent non-executive directors. We support the definition of independence as set out in the UK Corporate Governance Code. The challenging questions and perspectives that independent non-executive directors are expected to ask are more likely where there aren't relationships or circumstances that could interfere with independent judgement. We may vote against re-election of the Chair, Chair of the nomination committee or other board members where we doubt the board’s overall independence.</td>
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<td>Principle</td>
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| **2.4 Effectiveness** | Boards are more effective when all directors play full parts and take collective responsibility. Boards drawn from a narrow section of society are less effective than boards that include members with a variety of experiences and backgrounds. Evidence suggests that boards with greater diversity – particularly more gender diversity – leads to better financial performance. This link may be explained by:  
  - diversity of thought, reduction of groupthink, and increased innovation  
  - decisions that better reflect and respond to client and customer bases  
  - utilisation of the entire corporate talent pool  
  - improved corporate governance and corporate ethics.  
  
  Individual board members should each be competent, persuasive, open-minded, professional and sound in judgement. The purpose, priorities and skill contribution of each director should be clear to shareholders.  

  We may vote against re-election of the Chair of the nomination committee or other board members where we doubt the effectiveness of board composition.  

  We may vote against the appointment or re-election of any director where we doubt their capacity for focus, contribution, or where the appointment seems not to clearly meet a skill-set need. |
| **2.5 Nomination** | Evolving the board when vacancies arise by including an assessment of the potential need for diversity can increase and maintain a broad mix of thought and flow of ideas that contribute to more effective decision making. Companies should publicly state both an aspirational level of women on their boards, as per Lord Davies’ recommendations, and the steps being taken to ensure that Boards include more women. If not achieving adequate diversity throughout the company, boards need to explain why not.  

  We’ll vote against the re-election of the Chair of the nomination committee where a company fails to disclose an aspirational target for women on the board and there’s no indication of momentum or progress of electing women onto boards as per the Davies recommendations. |
| **2.6 Director re-election and commitment** | We don’t believe that annual contracts are a cause of short-term thinking. This makes us favour annual elections for all directors. Increasing regulation, compliance and complexity have changed the context and tempo of directing. Immersion in directing is now essential for effective stewardship of today’s large companies. Part-time non-executive directors need to allocate significant time if they’re to be able to ask challenging questions based on a sound knowledge of the business and overcome significant differences between themselves and executive directors. Full time executive directors with significant external professional commitments are unlikely to be fully effective.  

  We don’t support non-annual elections without convincing explanation and justification.  

  We’re less supportive of part-time non-executive directors with more than a few significant external roles.  

  We’re generally not supportive of full time executive directors taking on a chairmanship or more than one non-executive directorship. |
3. Accountability and reporting

This refers to section C of the latest UK Corporate Governance Code.

We rely heavily on company reporting. Company reporting keeps the board accountable for its stewardship of company resources and reduces the information gap between the board and shareholders who appoint them. Through company reporting we improve our understanding of the purpose, objectives and principles set by the board for the company, their translation throughout the company, as well as structure, conduct and performance.

The annual report and accounts are signed off by the board and much of the content is audited. The company presents its story, past and forward-looking, as a coherent whole, and reports on performance and conformance. Historically, many have seen the annual report as a conduit for good news that glosses over or leaves out the negative or the nuanced. We believe that the annual report must provide a balanced message, with emphasis on the company’s future alongside risks and opportunities.

Companies also publish information outside of the annual report. Collating these more fragmented pieces of separate information can help investors achieve a more rounded picture of the company but it can be difficult to understand what standard to hold the additional information to. Where metrics are used, such as on governance, people, community and the environment, there’s often a lack of verification, validation and sign-off. Reliability of the information has at times been questioned and this serves to reduce confidence in some metrics. We believe that more information outside of the annual report should be subject to verification, validation and assurance.

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<tr>
<td>3.1 Informative and future orientated reporting</td>
<td>We’ll vote against a resolution to approve the report and accounts where it lacks substantial read across to the FRC’s characteristics of a good annual report.</td>
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<td></td>
<td>We may vote against a resolution to approve the report and accounts where it lacks read across to the FRRP’s guidance on reporting of principal risks and uncertainties.</td>
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<td>We may vote against a resolution to approve the report and accounts where discussion of internal control fails to include appropriate levels of detail and substantiation.</td>
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<td></td>
<td>We’re more supportive of a resolution to receive the report and accounts where there’s an informative explanation on purpose, values, standards, ethics, instilling them and leadership and succession.</td>
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<td></td>
<td>We’re more supportive of a resolution to receive the report and accounts where there’s independent assurance of key non-financial metrics.</td>
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Principle | Voting guideline
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3.2 Environmental, employment, social and community issues | We’re less supportive of a resolution to receive the report and accounts where a company doesn’t present a balanced and informative assessment of significant environmental, employment, social and community risks and opportunities.

### 4. Audit

This refers to section C of the latest UK Corporate Governance Code.

External audit aims to ensure that companies publish fair and truthful information in their annual report and accounts. Validation by the external auditor provides important reassurance to investors and stakeholders and contributes to public trust in company statements.

The role of external audit and the audit committee is at a crossroads. The gap between what they do and what’s expected has widened substantially, presenting new challenges. The depth and degree of financial detail and complexity has grown, requiring the external auditor to drill further down into corporate practice and be more intrusive. The audit committee is starting to be asked to take a more critical and transparent stance. As part of this it would discuss how ‘fair and true’ is decided, the reliability of the reported performance, variability either side, and how to break the reliance on a single valuation opinion with no supporting or surrounding context.

Many companies retain the same auditor for lengthy periods and there has long persisted an oligopoly of large audit firms among FTSE 350 companies who also provide extensive consulting services. While auditor persistence arguably allows deeper knowledge of client companies, extensive consulting services shared between few audit firms provides the potential to undermine objectivity and independence due to interwoven conflicts of interest.

We support the ongoing regulatory focus on audit committees, on how to dismantle perceptions of external auditor inertia, where tenure is often measured in decades, and how to invigorate the audit market and competition.
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<tr>
<td><strong>4.1 External audit independence</strong></td>
<td>We may vote against the re-election of the Chair of the audit committee where external auditor independence is doubted.</td>
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<tr>
<td>An independent audit process is one performed in the interests of the shareholders, free from management pressure and commercial conflicts. The financial incentives faced by the external auditor need to be managed so as not to influence their independence.</td>
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<tr>
<td><strong>4.2 Competition and re-tendering</strong></td>
<td>We may support shareholder proposals seeking the rotation of audit companies or an audit being put out to tender.</td>
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<tr>
<td>We believe in audit market competition. The introduction of re-tendering based on 'comply or explain' is an opportunity to invigorate competition and wider choice within the audit market. We see this as vitally important.</td>
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<tr>
<td>In order to encourage more participation by companies who aren't in the 'big four' in the external audit of FTSE 350 companies, we support proposals to limit the financial liability of external auditors based on proportionate liability.</td>
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<td><strong>4.3 Audit fees</strong></td>
<td>We're likely to vote against the re-election of the Chair of the audit committee where non-audit fees exceed audit fees paid to the external auditor in any 12-month period and the financial value of non-audit fees is significant.</td>
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<tr>
<td>We believe that the level of fees earned by the auditor for non-audit work can have the potential to affect auditor objectivity. We begin to have significant concerns about external auditor objectivity where the ratio of non-audit to audit fees is close to, or greater than, one and the absolute financial value of non-audit fees is significant. It’s important that audit fees are transparent and broken down for investors to see.</td>
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<tr>
<td><strong>4.4 Audit committee report</strong></td>
<td>We're likely to vote against the re-election of the Chair of the audit committee where the audit committee report fails to provide meaningful information to help shareholders understand how the audit committee operates and the issues it addresses.</td>
</tr>
<tr>
<td>There’s a lot that an audit committee acting independently from management can do to provide additional confidence in the integrity of the auditing process to users of annual reports. This could include more information on accounting judgements, on what basis ‘fair and true’ was decided, the reliability of the reported performance, and variability either side. We welcome a more critical and transparent approach that includes judgement, assessments and key decisions taken.</td>
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5. Remuneration

This refers to section D of the latest UK Corporate Governance Code.

Many directors and long-term shareholders alike are sceptical about the current level of executive pay and the coupling of pay and performance. Even with more information about remuneration now provided in annual reports, the link between pay and performance and the extent to which strategy and the key drivers of value contribute to executive pay has not become any clearer.

The link between individual action by executive directors and long-term company performance is probably far more imprecise than that put forward by supporters of pay and performance. Success is surely due to all people within the company, non-executive directors too.

We believe that many of the processes driving the level of executive pay upward are systemic. There is the interconnectedness of directors and companies, the use of board consultants with similar practices and similar advice, checklists of multiple parts to pay, and the use of relative reference points such as pay elsewhere. These have created herd-like behaviour across companies. The causes that are now sounding alarm bells among directors and shareholders need to be urgently addressed, but voting alone is unlikely to bring about the change in culture many see as vital.

We believe that many of those who ‘step-up’ to a board role will already be successful financially. Individuals stepping-up to a board director position are likely to be exercised by the puzzle and challenge of leadership and its achievement as much as pay. The heavy linking of pay to performance for already high achievers is unlikely to produce the motivational drivers that investors want executives to be energised by.

Where remuneration is used to align executive director behaviour with objectives, the remuneration committee should formulate objectives based on the aims of the business and shareholder interests. Shareholders differ widely in their characteristics and this potential diversity is likely to lead to a variety of interests needing to be included. As well as financial performance, there are interests in risk, safety, financial stability and external credit rating. Broader still, at least for some, this is likely to also include ethical behaviour, reputation, and citizenship, among others.
## Approach to corporate governance and policy on voting

### Principle 5.1 Pay in context

We support recommendation 28 of the 2009 Walker Review: “The remuneration committee should have a sufficient understanding of the company’s approach to pay and employment conditions to ensure that it is adopting a coherent approach to remuneration in respect of all employees. The terms of reference of the remuneration committee should accordingly include responsibility for setting the over-arching principles and parameters of remuneration policy on a firm-wide basis.” We expect the remuneration committee to have some level of awareness and oversight of the remuneration policy of the entire company and reflect upon this in the approach to pay at all levels. The remuneration committee should be aware of pay levels in equivalent sectors and industries as well as wider public concerns.

The lowest paid in the company should be paid at least a ‘living wage’ and not the minimum wage, as evidence suggests that paying a living wage has benefits for business, individuals and society.

### Principle 5.2 Multiple incentive schemes

Part of the complexity of executive pay is the growing proliferation of component parts, with some studies reporting up to nine separate parts to pay. In instances where remuneration has more than three core components – base salary, incentive plan and pension - the remuneration report should explain what this is achieving and why this is needed.

We may vote against the re-election of the Chair of the remuneration committee where there are a significant number of incentive schemes in operation, resulting in an opaque incentive structure.

### Principle 5.3 Remuneration committee meetings

On average FTSE All Share company remuneration committees meet more times during the year than audit or nomination committees. This can lead others to form the impression that boards see the remuneration committee as more urgent than other committees. This herd-like characteristic is unhelpful. Without supporting explanation from the board we don’t see why the remuneration committee should be meeting more frequently than other committees.

We may vote against the re-election of the Chair of the remuneration committee where the remuneration committee meets more frequently than other committees without suitable explanation.

### Principle 5.4 Alignment with business aims and shareholder interests

Where remuneration is used to align executive director behaviour with objectives, the remuneration committee should formulate objectives based on the aims of the business and shareholder interests. Shareholders differ widely in their characteristics and this potential diversity is likely to lead to a variety of interests.

We are more supportive of the remuneration committee where business aims and shareholder interests are used as objectives to align and reward executive director behaviour.

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1. A wage sufficient to provide the necessities and comforts essential to an acceptable standard of living. The London Living Wage is currently £8.55 per hour. The UK Living Wage for outside of London is currently £7.45 per hour.
## 6. Capital

Existing shareholders collectively own the company, so companies should go to existing shareholders first for approval prior to undertaking certain transactions.

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<tr>
<th>Principle</th>
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<tr>
<td><strong>6.1 Purchase of own shares</strong>&lt;br&gt;We're generally supportive of proposals to return cash to shareholders that we believe enhance net asset value. We believe that the Association of British Insurers (ABI) guidelines on 'own share repurchase' is an appropriate good practice standard for industry.</td>
<td>We're generally supportive of buy-back proposals that follow ABI guidelines on 'own share repurchase'.</td>
</tr>
<tr>
<td><strong>6.2 Pre-emption rights</strong>&lt;br&gt;We believe that pre-emption is an important right. We believe that the pre-emption group Statement of Principles and ABI guidance on 'Directors’ Powers to Allot Share Capital and Disapply Shareholders’ Pre-emption Rights' provides a recognised basis of understanding between companies and investors.</td>
<td>We're generally supportive of share capital proposals that follow pre-emption group and ABI guidelines.</td>
</tr>
<tr>
<td><strong>6.3 Increase in share capital or preferred stock</strong>&lt;br&gt;Companies need to establish and maintain an efficient capital structure. The ABI’s guidance on ‘Directors’ Powers to Allot Share Capital and Disapply Shareholders’ Pre-emption Rights’ provides a basis of understanding between companies and investors on changes to share capital.</td>
<td>We’re generally supportive of share capital proposals that follow ABI guidelines.</td>
</tr>
<tr>
<td><strong>6.4 Mandatory takeover bid Rule 9 waiver</strong>&lt;br&gt;The requirement that a takeover bid be launched when a substantial percentage of the issued share capital has been acquired by one shareholder or by shareholders acting in concert is an important protection for minority shareholders.</td>
<td>We’ll generally vote against a Rule 9 waiver.</td>
</tr>
<tr>
<td><strong>6.5 Dividends</strong>&lt;br&gt;Dividend payments are a valued and relied on source of income for some shareholders and a source of financial discipline for corporate boards. We believe in a resolution to approve the final dividend regardless of size.</td>
<td>We're less supportive of the chief finance officer where a separate resolution to approve the final dividend is omitted.</td>
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