# The Nest Ethical Fund

For members who want to make sure that ethical considerations are a key factor in deciding how their money is invested.

# Contents



## Chapter one

# What is ethical investment?

This guide explains how we designed the Nest Ethical Fund, what it invests in and how we make sure it works in the way it should. It's worth reading if you're considering whether this fund is right for you.

We created the Nest Ethical Fund for members who want to make sure that ethical considerations are a key factor in deciding how their money is invested.

Some people want their money invested in line with their moral beliefs. Ethical investment tries to cater for that need. That means decisions about how and where to invest are guided by moral values as well as the drive to maximise returns. It's a suitable approach for people who want to make sure that their money isn't being used to support organisations, products, policies or practices that concern them.

Of course, values, morals and ethics vary from person to person. It wouldn't be practical to design individual funds to reflect the broad spectrum of views and concerns of everyone who might want an ethical fund.

We researched what people wanted from ethical and socially responsible investment and looked at best practice worldwide to design the Nest Ethical Fund. We made sure we created a fund that offers a genuine choice for members, reflecting their key ethical concerns while working hard to keep their money safe and generate good returns.

### How is ethical investment different from responsible investment?

We're committed to responsible investment for all our members and consider environmental, social and governance (ESG) issues across all the asset classes and markets we invest in. We believe that this approach protects and enhances the value of investments over the long term.

Our main goal is to secure good returns by managing the risks that ESG factors can bring to investment. We do this by:

- selecting fund managers that integrate the management of ESG risks within their investment processes
- engaging with companies to discuss their approach to managing ESG risks. Where we have voting rights we'll use these votes to look to improve long-term performance and sustainability
- monitoring ESG risks across the whole of our portfolio

See how Nest grows your money with **responsible investment**.

Ethical investment is different to other approaches in that all decisions are made within a moral framework that considers both values and value. For example, there are companies or sectors that won't be acceptable for some investors no matter how well they manage ESG factors, such as the armaments industry.

This guide explains how we approach this in our Nest Ethical Fund.

## Chapter two

# What is our ethical investment policy?

The definition of ethical investment isn't clear cut or universal. What seems ethical to one person may not be the same for another. To help us develop our approach to ethical investment we looked at three key drivers.

1. We conducted research into what ethical investors want from their funds.
2. We investigated international and UK norms about what's ethical.
3. We reviewed the experience of ethical investment providers in the UK and beyond.

You can find out more about how these helped shape our ethical investment policy in **chapter four**.

We regularly review our ethical investment policy to make sure it still reflects our members' concerns on various issues. This means we can also take into consideration any changing societal norms and market innovations.

## Our ethical investment policy at a glance

| Ethical issue | We avoid investing in companies that… | We want to invest in companies that… |
|---|---|---|
| **Human rights and labour practices** | — breach or don't endorse:<br>– human rights conventions<br>– UK and international labour standards | — maintain good control of their supply chain, for example they won't source goods from a third party that uses child labour |
| **Climate change and the environment** | — have ownership of geological reserves of oil, gas or coal<br>– are engaged in the extraction of fossil fuels, including the most harmful activities such as arctic drilling or extraction of oil sands<br>– breach our portfolio-wide **climate change risk policy**<br>— don't actively avoid and minimise pollution<br>— engage in fracking and mining companies whose activities lead to unmitigated and severe environmental devastation<br>— are involved in unsustainable intensive farming<br>— derive more than 10% of revenue from the production of palm oil or the sale of products reliant on palm oil and are not members of the Roundtable on Sustainable Palm Oil (RSPO) | — take steps to reduce their carbon-intensive footprint<br>— are developing solutions such as renewable energy infrastructure and low-carbon technologies<br>— maintain robust environmental policies, reporting and management<br>— have a responsible approach to biodiversity<br>— employ best-in-class water management processes |
| **Governance** | — have no explicit code of ethics<br>— show evidence of engaging in acts of bribery or corruption | — apply a corporate code of ethics<br>— follow **Principle 10 of the UN Global Compact**<br>— have robust ESG risk management policies<br>— promote board diversity and a separation of the roles of chief executive and chairman |
| **Armaments and weapons of mass destruction** | — are directly involved in the production or sale of:<br>– weapons<br>– controversial and/or nuclear weapons components<br>— or derive more than 5% of their revenue from the manufacture of other weapons components and/or goods and services which are customised for strategic military use | |
| **Other ethical concerns** | — test cosmetic products on animals or produce or sell animal fur<br>— draw more than 10% of their turnover from:<br>– selling or producing tobacco or alcohol products<br>– providing gambling games<br>Are involved in:<br>— private prisons<br>— the production or distribution of pornographic, harmful or violent materials | — meet animal welfare codes of practice relevant to their industry<br>— have a responsible approach to reducing obesity and engage in health and nutrition disclosure initiatives |

# Our ethical investment policy in depth

## Human rights and labour practices

Respect for human rights and workers' rights vary from one part of the world to the next. Not only can companies directly affect their own workforce and people in their supply chain, they can also indirectly influence local communities and politics.

We expect workers and other people influenced by the companies we invest in to get a fair deal regardless of where they live in the world. We also expect businesses that employ people in the UK to meet its high standards of offering employees fair terms and a good working environment.

We adhere to the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinationals, which outline the expectation that businesses conduct themselves responsibly. avoid and address negative impacts of their operations, while contributing to sustainable development in the countries where they operate.

### Relevant codes and standards

- **UN Protect, Respect and Remedy Framework**
- **International Labour Organisation Fundamental Principles and Rights at Work**
- **Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinationals**

### Supply chain

Our policy on human rights and labour practices applies not only to a company's own workforce, premises and local communities but to the entire supply chain. This includes suppliers as well as customers.

We appreciate that modern supply chains are very complex and that information isn't always easily available. However, we expect our fund managers and the companies we invest in to do their best to understand the supply chains and any potential issues they can cause.

### Human rights conventions

We carefully look into any allegations that a company in our portfolio has breached internationally recognised human rights conventions, both current and in the past.

We recognise that some companies are at especially high risk of being involved in breaches of human rights conventions. This can be particularly difficult when they or their suppliers operate in regions of poverty, under corrupt political regimes or somewhere with otherwise low standards of human rights.

We expect that any company that's been accused of or found guilty of complicity in human rights abuses, for instance through outsourced operations, will not have knowingly sanctioned that abuse. We also expect that they'll have taken significant steps to address the issues. In cases of severe breaches of human rights, we expect the company to have not only addressed their controls but also to have compensated the victims, where at all possible.

### International labour standards

Breaches of international labour standards can involve:

- use of child labour
- forced labour discrimination
- suppressing freedom of association and collective bargaining
- excessive working hours
- poor health and safety standards

We expect companies in our portfolio to uphold international labour rights. We also expect them to avoid and address any issues by improving standards, tightening controls and making amends where applicable.

## Climate change and the environment

Nest agrees with the scientific evidence of the risks and threat of climate change and believes that limiting global warming to 1.5C could help curb the catastrophic consequences of climate change. Our ambition is to align our whole investment portfolio with the Paris Agreement. This aims to limit global warming to 1.5C above pre-industrial levels by reaching net zero carbon emissions by 2050 or earlier. We expect that emissions in our portfolio will have to halve by 2030 to help us meet this ambition. Our **climate change policy** sets this out in more detail.

Every year, we review how we've implemented this policy. Our findings are reported to the Trustee's investment committee and any progress in reaching net zero carbon emissions across our portfolio by 2050 are published publicly.

We expect the assets in the Nest Ethical Fund to meet, if not exceed, the requirements of our climate change policy.

### Relevant codes and standards

There are many codes and practices related to environmental performance and reporting, including:

- **UN Global Compact**
- **2015 Paris Agreement**
- **Global Reporting Initiative**
- **Carbon Disclosure Project**
- **Task Force on Climate-related Financial Disclosures (TFCD)**

### Fossil fuels

The future business growth of companies with reserves of fossil fuels is based on their ability to extract and sell these resources, mainly for energy production. Even where the extraction of fossil fuels may be a small or falling part of current revenue, current market value incorporates assumed future revenue from those reserves.

The carbon embedded in these reserves will have an impact on the climate that is incompatible with limiting global warming to 1.5 degrees above pre-industrial levels.

Nest's Ethical Fund excludes companies with ownership of geological reserves of oil, gas or thermal coal or that are engaged in the extraction of fossil fuels, including the most harmful activities such as thermal coal, arctic drilling or extraction of oil sands. Companies that breach our **climate change risk policy** are excluded from Nest's entire investment portfolio.

### Climate and environmental policy

Companies involved in high-impact industries should have a comprehensive environmental policy detailing how they'll reduce any environmental damage they might cause.

An absence of any environmental policy is a telling sign that their business principles aren't aligned with those of the Nest Ethical Fund. We therefore expect to exclude companies in high-impact industries that don't have an explicit environmental policy.

Companies in any industry that show progressive and thought-leading environmental policies raise the standards expected of other businesses. We believe that this should be commended. As a result, we think more money should be invested in companies that are developing solutions such as renewable energy infrastructure and low carbon technologies. We expect our fund managers to take this into account.

### Climate and environmental reporting

It would be impossible for our fund managers to evaluate the effectiveness of environmental policies if companies don't provide relevant information. We therefore exclude those that don't offer sufficient data. While what 'sufficient' means can vary according to the industry the firm works in, we expect companies to at least meet the regulatory standards for their industry where available.

### Environmental management

We expect the companies held in our portfolio to have robust environmental management systems. This is especially important for companies in high-impact industries. We'll look for evidence that companies are seeking to improve standards and find innovations to control their effect on the environment.

### Fracking & mining

Fracking and mining activities typically have a very high environmental impact. Open-cast mining, for example, irrevocably changes vast areas of important landscape and toxic tailing ponds have been responsible for damaging bird populations. Several mining projects around the world have been associated with human rights abuses and funding paramilitary activities.

We look carefully into any company with a significant exposure to fracking and mining companies whose activities lead to unmitigated and severe environmental and ecological devastation. We prefer to exclude these organisations from our portfolio. We may make exceptions where they can demonstrate best practice environmental and human rights controls that could raise the bar for the whole industry.

### Biodiversity

We believe it's important to preserve the diversity of species in different habitats – both for the sake of protecting ecosystems as well as to sustain food security. Agriculture and forestry are among the most obvious business activities that can affect biodiversity.

Companies we hold in our portfolio must take a responsible approach to managing biodiversity, particularly those involved in high-impact activities. We expect businesses of this kind to meet international biodiversity principles.

We expect companies to be excluded where there are serious allegations of clearance of ecosystems with a high conservation value. This includes companies engaged in environmentally damaging intensive farming practices, which are accelerating biodiversity loss, water use and climate change. We also exclude companies engaged in unsustainable palm oil production, which is linked to catastrophic deforestation.

### Pollution

Almost all companies have an impact on the environment and many contribute to pollution to some degree. We exclude companies in high-impact industries that fail to meet high standards of transparency or minimise the effect they have on the planet. We expect all businesses in our portfolio to act responsibly in terms of their levels of waste and carbon emissions.

Companies operating in certain industries have a greater risk of accidents resulting in severe pollution. We expect companies with a record of being ineffective in avoiding events like this to be excluded from our portfolio.

Local communities and habitats can be affected for a long time after a severe environmental or ecological disaster. We scrutinise any company involved in major incidents to look at whether they're providing enough compensation over time. We also explore if companies have a legacy of significant and credible claims for compensation, lawsuits or other material grievances for incidents in their history. If one of our fund managers wants to invest in such a company, we expect the company to prove that it's in the process of making amends and is committed to much higher standards.

### Water management

At its current rate of use, widespread water scarcity could become a real threat to a large portion of the global population. There are also significant environmental impacts from transporting water or from polluted runoff water that's used in heavy industry.

We expect water-intensive companies, such as textiles and apparel, to show best practice water management processes. Where possible, we expect them to introduce closed loop systems and treat used water so that it's harmless. We also expect companies to be transparent about their water use and management systems.

#### Relevant codes and standards

- UK Bribery Act 2010
- US Foreign and Corrupt Practices Act
- US Dodd-Frank Act
- OECD Anti-Bribery Convention

## Governance

Strong standards of governance underpin not only the long-term financial viability of an organisation but also its ability to manage its environmental impacts and social responsibility. We expect the businesses we hold in our portfolio to be run responsibly, sustainably and in accordance with agreed rules.

### Code of business ethics or statement of good governance

We believe a corporate code of ethics or equivalent is a useful way of formalising a company-wide policy for carrying out business responsibly. When monitoring the ethical portfolio we scrutinise companies that don't have an explicit code of ethics, and ask for proof that the company has policies and systems in place to discourage and avoid corrupt practices.

### Bribery

Bribery is not uncommon in international business. Some even see it as part of the normal course of doing business. The negative effects of bribery can range from stifled competition and higher prices for consumers to the sale of dangerous products as a result of bypassing regulations.

We expect to exclude companies that have been found guilty on charges of bribery or other serious forms of corruption in their recent history. We'll only make an exception if there's clear evidence that the company has successfully reformed its culture and severely sanctioned anyone involved. We expect companies that operate in industries and regions that are particularly prone to corruption to follow **Principle 10 of the UN Global Compact** by putting internal policies in place and reporting on their work against corruption. We expect the utmost transparency from all the companies held in the ethical portfolio.

### ESG risk management policies

Nest believes that ESG risk management is a legitimate issue for senior management. We expect the companies in our portfolio to show clear evidence of having ESG risk management embedded in the corporate culture. This will be apparent in written policies and transparent reporting on ESG standards in the company.

We analyse companies in our portfolio on an holistic basis and expect them to be rated highly across ESG issues in our data analysis.

### Board diversity

A diverse board and separation of the roles of chief executive and chairman is a key part of a governance structure that avoids entrenched ideas, conflicted interests and bad corporate habits. We prefer to include companies in our portfolio that show evidence of encouraging board diversity and other best practice in governance.

## Controversial armaments and weapons of mass destruction

It's widely known that certain types of armaments cause very high levels of deaths and injuries to civilians. In particular, cluster munitions and landmines can kill and maim long after conflicts cease, and are seen as unjustifiably indiscriminate even during combat. Chemical, biological and nuclear weapons are indiscriminate on a massive scale and their effects can linger for years. The appropriation of such weapons or the threat of use can serve to escalate and worsen political tensions and conflicts.

We exclude any company that produces key systems for weapons of mass destruction and weapons that kill and maim indiscriminately.

A number of international treaties ban signatories from manufacturing, using or facilitating landmines and cluster munitions respectively. Signatories also commit to decommissioning stockpiles of these weapons. As several national governments of developed market countries have yet to sign these treaties, we won't invest in sovereign debt outside the UK for the foreseeable future.

### Relevant codes and standards

- Ottawa Treaty 1997
- Oslo Convention 2012

### Military production and sale

We won't hold any company whose primary business is the manufacture or sale of weapons systems in our portfolio.

Companies that supply materials and goods and services to armaments businesses are assessed according to the nature of the product and its ultimate use. If there are freely available substitutes or if the material needs a significant amount of further processing, the supplier generally won't be categorised as making key components for weapons systems. Suppliers who make highly customised products for strategic military use will be excluded if they derive more than 5% of their revenue from this activity.

### Cluster munitions and anti-personnel landmines

Any companies that manufacture or sell cluster munitions or landmines are excluded from our portfolio. We also exclude companies that make key components of cluster munitions or landmines where military contracts are a significant part of their business.

We expect our fund managers to set appropriate thresholds for exclusion on this basis.

## Other ethical concerns

Our research suggests that our most ethically inclined investors would prefer us to take an active stance on issues of serious concern.

Tobacco and gambling are two areas that cause the most concern according to the weight of public opinion and trends in public policy as these are most likely to cause significant harm to the welfare of society. Alcohol, adult entertainment services, and profit from private prisons have also been identified by our members as incompatible with ethical investment and are excluded from our portfolio.

### Tobacco

Nest applies a **tobacco free policy** across our entire investment portfolio. This means we won't hold companies who draw more than 10% of their revenue from distribution of tobacco, supply of key products for tobacco manufacture or production, or sale of tobacco.

### Gambling

We won't hold companies who draw more than 10% of their turnover from providing gambling games such as casinos or bookmakers in our portfolio.

### Alcohol

We won't hold companies who draw more than 10% of their turnover from the production or sale of alcohol products in our portfolio.

### Adult entertainment services

We won't hold companies involved in the production or distribution of pornographic, harmful or violent materials in our portfolio.

### Private Prisons

Private prison companies are highly controversial from a human rights perspective. On that basis, we expect our fund managers to avoid investments in private prisons in the Nest Ethical Fund.

**Health and nutrition**

After smoking, the single greatest cause of early deaths in the UK is obesity. Nest is a member of ShareAction's Healthy Markets Initiative, which invites investors to encourage food companies be more transparent about the nutritional quality of their products, to shift their sales towards healthier products., and to improve disclosure of their nutrition strategy and targets.

Investing to promote health and nutrition initiatives differs from that of tobacco in the sense that voting and engagement does have an impact. Nest is continuing to find ways to further participate in this topic.

**Animal welfare**

We exclude companies that produce or sell animal fur from our portfolio. We also exclude companies that test cosmetic products on animals.

However, we recognise the legal obligation for pharmaceutical companies to test certain new medicines on animals, so we don't exclude companies from this sector on these specific grounds.

We expect any companies we invest in to meet the codes of practice regarding animal welfare that are relevant to their industry. We work with our fund managers to monitor this.

## Real assets and alternatives

Equities and bonds are a means of providing financial capital to businesses so that they can generate their products and services, and in return share in the profits associated with those products and services.

We therefore withhold this capital from businesses that don't meet our ethical investment policy. We may, however, invest in real assets used by those businesses. The primary example is real estate, but this also applies to infrastructure investments.

In real estate investment, the Nest Ethical Fund aims to invest in a way that promotes a net positive influence. In consultation with our fund managers we strive to do this in several ways.

- We pick assets with very high environmental sustainability credentials.
- We manage assets across the spectrum of environmental sustainability, significantly raising their quality. This includes taking opportunities to improve sustainability through refurbishments and engaging with tenants on issues like energy consumption and recycling.
- We use our fund managers to select and manage assets that benefit people in their locale or that mitigate potentially negative social impact. We believe that when we invest in real estate we don't materially assist or benefit from the business leasing that property. We therefore invest in properties such as office units, retail space or generic industrial units regardless of the nature of their tenants. We won't, however, invest in assets that are specialised to a significant degree to accommodate industries associated with our negative screening policy. For example, we won't include specialised units in a strip-mining complex in our ethical portfolio.

## Sovereign debt and government bonds

Our current position is that it's acceptable to invest in gilts – debt issued by the UK government – for the Nest Ethical Fund. We don't currently invest in foreign government debt for this fund and we don't plan to for the foreseeable future. We'll assess debt issued by foreign governments on a case-by-case basis.

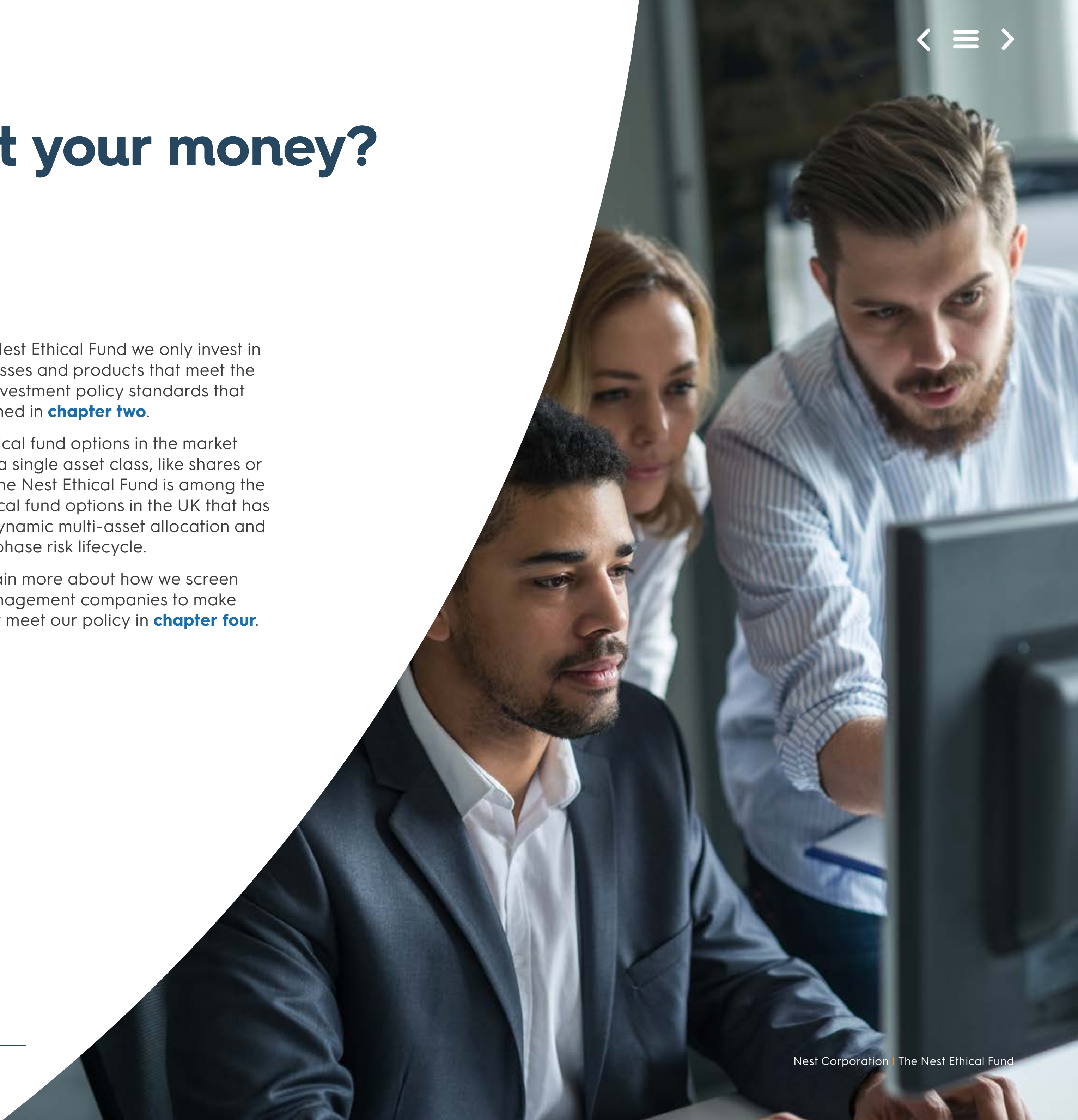
# How do we invest your money?

We invest your money in funds from global fund management companies. Each of these third-party funds has a clear investment objective and generally invests in a single asset class. Our in-house investment team buys units in each of these funds in varying proportions, using them as building blocks to create the different Nest fund choices.

For the Nest Ethical Fund we only invest in asset classes and products that meet the ethical investment policy standards that are outlined in **chapter two**.

Most ethical fund options in the market invest in a single asset class, like shares or bonds. The Nest Ethical Fund is among the only ethical fund options in the UK that has both a dynamic multi-asset allocation and a three-phase risk lifecycle.

We explain more about how we screen fund management companies to make sure they meet our policy in **chapter four**.



## The building blocks of the Nest Ethical Fund

The Nest Ethical Fund choice currently offers you a diversified portfolio of ethically screened equities, corporate bonds, real estate and UK government bonds. We'll look for further ethical diversifying opportunities as the assets we manage continue to grow.

We choose fund managers for the Nest Ethical Fund through a robust due diligence process. This makes sure that their ethical polices match our members' concerns and that their investment and ethical screening process is thorough. We also review their performance to make sure that they're likely to deliver good outcomes for you.

The underlying funds we use for the Nest Ethical Fund can be found in the Nest **quarterly investment report**.

## The Nest Ethical Fund lifecycle

The Nest Ethical Fund is based on three distinct phases that mirror the phases of the Nest Retirement Date Funds. These are the foundation, growth and consolidation phases.

We're able to adjust the portfolio of each fund to match your place in your savings journey. When you reach certain anniversaries or change your retirement age, we move your investment into the appropriate mixture of assets as defined by the lifecycle matrix shown in table 1 opposite. This can involve both a redirection and a rebalance of your investment as your total pot is adjusted according to the number of years left until you reach your retirement age.

If you reach retirement age but don't take your money out, you'll stay invested in the funds as if you were at zero years to retirement. This is also the case for anyone that joins the fund after State Pension age and doesn't choose an alternative retirement age.

You can find out more about the breakdown of your pot by logging into your online account.

**Table 1 - The lifecycle matrix for the Nest Ethical Fund**

| Years from retirement | Ethical Foundation (%) | Ethical Growth (%) | Ethical Consolidation (%) |
|---|---|---|---|
| **46 years+** | 100 | - | - |
| **42** | 80 | 20 | - |
| **41** | 60 | 40 | - |
| **40** | 40 | 60 | - |
| **39** | 20 | 80 | - |
| **38** | - | 100 | - |
| **10** | - | 90 | 10 |
| **9** | - | 80 | 20 |
| **8** | - | 70 | 30 |
| **7** | - | 60 | 40 |
| **6** | - | 50 | 50 |
| **5** | - | 40 | 60 |
| **4** | - | 30 | 70 |
| **3** | - | 20 | 80 |
| **2** | - | 10 | 90 |
| **1** | - | 0 | 100 |

## Managing risk in the Nest Ethical Fund

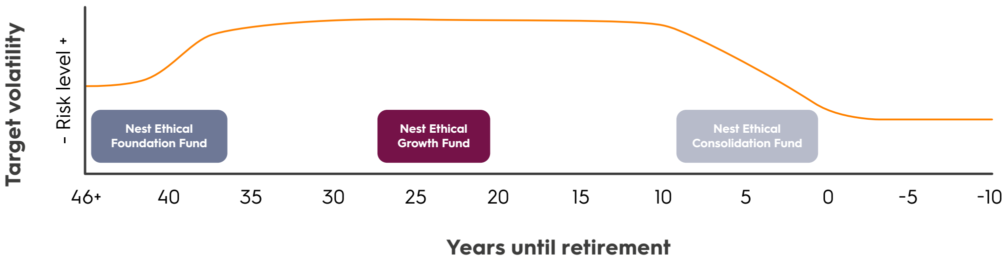
We seek to maximise the retirement income and any cash lump sum our members get by taking the appropriate risk on their behalf based on how long they have until retirement.

The levels of investment risk we expect to take at each stage of the lifecycle are set out in the glide path shown in figure 1 below. The aim is to balance the member's need to keep their money growing to significantly outperform inflation with their desire to avoid the unpredictable returns that they've told us they find alarming.

The glide path is defined by the risk budgets we allow for each phase. We've defined these through portfolio volatility levels for the Nest Ethical Fund's growth and foundation phases and as the tracking error to annuities for the consolidation phase. Broadly speaking, we've set risk budgets in terms of taking sufficient but not excessive risk.

However, we're able to vary the amount and type of risk taken according to economic and market conditions.

**Figure 1 - The glide path for the Nest Ethical Fund**




## Objectives of the Nest Ethical Fund phases

Nest monitors the performance of each fund against the investment objectives for the phases.

**The Nest Ethical Fund foundation phase aims to:**

- keep pace with inflation while preserving capital
- significantly reduce the likelihood of extreme investment shocks
- take appropriate risk at appropriate times, taking account of current economic and market conditions

**The Nest Ethical Fund growth phase aims to:**

- target investment returns greater than inflation plus 3% and cover all scheme charges
- maximise diversification
- aim for steady growth in real terms over the life of the fund
- maximise retirement incomes by taking sufficient investment risk at appropriate times while reducing the likelihood of extreme investment shocks

**The Nest Ethical Fund consolidation phase aims to:**

- gradually move our portfolio from the return-seeking assets held in the growth phase to lower risk assets
- continue to grow our portfolio in real terms where this doesn't clash with the above goals
- further reduce the likelihood of investment shocks

Chapter four

# How do we ensure the Nest Ethical Fund meets our standards?

We understand that it's really important for members saving in an ethical investment fund to be able to see that their money is invested appropriately.

We work hard to make sure that the Nest Ethical Fund continues to meet members' expectations and that it works in the way it should.

## Monitoring our portfolio

We have an investment policy team responsible for making sure the underlying ethically screened funds continue to meet our ethical policies and that the portfolio meets our members' needs. The team also considers whether our ethical investment policy is consistent with the concerns of members who would choose this fund.

We dig deeper into each ethical issue to identify key areas and indicators which help us find out if, and to what extent, a company has a positive or negative exposure. These can be broadly grouped into:

- policies – corporate guidelines and strategic intent
- systems – the management framework and resources dedicated to implementing policies and reporting on success or otherwise
- performance – the company's track record in achieving standards of ethics and ESG responsibility, and direction of travel in that respect
- disclosure

It's common practice in the industry to evaluate companies against ethical issues using a risk matrix. In this approach, one axis is 'impact' and the other represents some measure of the company's performance, policies or systems concerning an issue. While we recognise the rationale for this, we're aware that a company operating in what's seen as a low environmental impact industry can have unacceptably poor environmental standards or, conversely, could be commended for exceptionally good standards. That's why we prefer to consider the ethical and ESG standards of a portfolio holistically. However, we do consider the risk matrix approach where there are constraints in research and data availability.

We work with third parties to help us monitor and analyse portfolios, develop policies and understand relevant ESG and ethical issues. This involves the use of extensive databases of companies' ESG performance as well as specific projects and analysis conducted in partnership with experts in ethical investment.

## Acting on potential issues

If a company within our ethical portfolio is flagged during our analysis, we look carefully at the reasons why and conduct further research. While we can't force our third-party managers to exclude specific stocks, we can engage with them to gain a better understanding of the issue and learn why they've decided on their position in relation to that stock. Where practical, we'll engage with the company itself.

If a fund manager identifies that a stock in our portfolio is no longer ethically viable then we need to have practical expectations. We accept they may need to sell down the position over time to avoid selling at unfavourable prices or developing a cash position which may constitute a severe drag on performance.

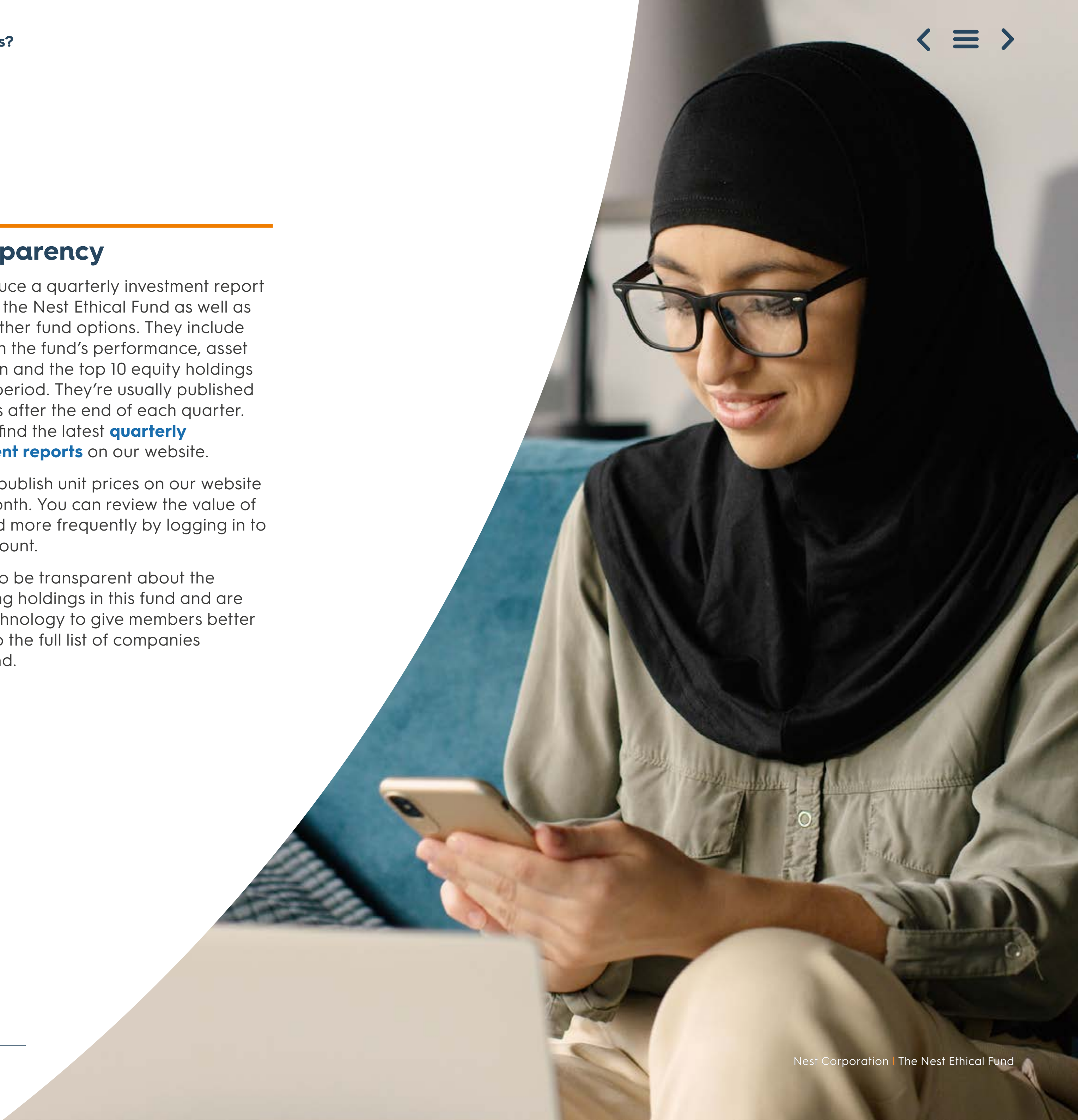
Ultimately, if a fund manager becomes materially misaligned with our ethical investment policy, we may replace the fund in as efficient and timely way as possible.

## Transparency

We produce a quarterly investment report covering the Nest Ethical Fund as well as for our other fund options. They include details on the fund's performance, asset allocation and the top 10 equity holdings for that period. They're usually published six weeks after the end of each quarter. You can find the latest **quarterly investment reports** on our website.

We also publish unit prices on our website every month. You can review the value of your fund more frequently by logging in to your account.

We aim to be transparent about the underlying holdings in this fund and are using technology to give members better access to the full list of companies in the fund.



Chapter five

# How did we decide what's ethical?

Before we created our Nest Ethical Fund we carried out qualitative research involving in-depth interviews and group discussions with a sample of people who'd expressed an interest in saving with an ethical pension fund. We have since revisited our research to reflect our members' evolving views on what is acceptable from an ethical investment option.

We asked savers what aspects of ethical investment were most important to them. We found that there was a consensus in the most important negative screening criteria, which tended to be social and environmental in nature and global in scope. This showed us that the main issues to consider for our ethical fund choice should be:

- human rights
- labour practices
- operations in developing or the least developed countries
- doing business in countries with corrupt regimes
- environmental and ecological damage

We were also mindful that there are other ethical concerns that are relevant from a public health or international treaty perspective.

Based on this, we incorporated the following issues into our ethical investment policy:

- alcohol, tobacco and pornography
- controversial weapons such as cluster munitions and weapons of mass destruction
- irresponsible promotion of gambling
- corporate governance, such as concerns over bribery and corruption

We also looked at the experiences of a number of other ethical fund providers in the UK and internationally. We examined independent studies which explored the attitudes of individuals to ethical investment in general and specific ethical issues.

## How does the Nest Ethical Fund compare to our other funds?

The Nest Ethical Fund offers:

- the same low cost as all our other funds – 0.3% annual management charge
- the same award-winning approach to asset allocation and risk management delivered by our in-house investment team
- a similar three-phase lifecycling approach with dynamic risk management
- inflation-beating returns

Find out more in our **quarterly investment reports**.

Chapter six

# What else do you need to know?

## How can you switch to the Nest Ethical Fund?

It's easy for you to change funds at any time, free of charge, by logging in to your account at **nestpensions.org.uk**

## What other fund choices do we offer?

We've created a range of clearly labelled fund choices to offer you genuine alternative approaches at the same low charge as our **Nest Retirement Date Funds**.

### Nest Sharia Fund

This fund is for those who want an investment approach based on Islamic principles. It invests entirely in global equities judged to meet sharia standards. It carries a higher level of investment risk than our other fund choices.

### Nest Higher Risk Fund

This fund aims to grow retirement pots by making higher risk investments. You can choose which higher risk strategy you'd like to be invested in.

The first strategy moves your pot out of the higher risk fund into a Nest Retirement Date Fund ten years before your nominated retirement date. This will help protect you from the possibility of big falls in value close to retirement and get your retirement pot ready for you to take. Although there's a chance you could miss out on big rises, you're less likely to lose the money you've built up.

The second strategy keeps your pot in the Higher Risk Fund regardless of your age unless and until you choose to move their money to an alternative fund choice, or transfer or withdraw your funds.

### Nest Lower Growth Fund

This fund is designed for those who are very cautious about investing. It exposes your retirement pot to far less investment risk than a Nest Retirement Date Fund. In the long term, however, it will probably grow less than other fund choices and may not keep pace with inflation.

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