Investing for a better future

Our responsible investment outcomes over 2020/21

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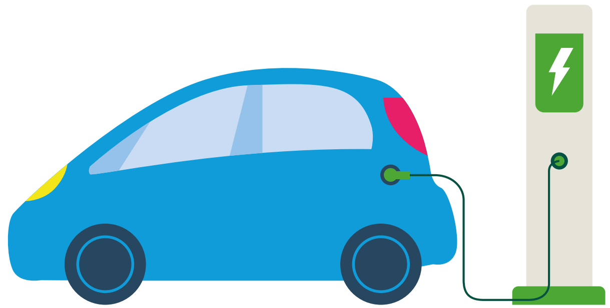
Contents



Foreword

Mark Fawcett
Chief Investment Officer

As the global coronavirus pandemic continues to have an impact on people's lives, economic prospects and financial markets, Nest's role as a long-term steward of our members' money has never been more important.

The pandemic prompts us to take a step back, reflect and ask bigger questions about the society and environment our members will continue to save and retire in, and how companies can positively impact both of these things. Ideally, we want to help ensure that companies and economies emerge stronger, more sustainable and more resilient. In turn, this will support our members' returns as well as their livelihoods.

Governments and organisations around the world are exploring ways to improve people's lives as economies bounce back, with many of these conversations focused on a green recovery. We urge industry and government alike to keep their attention on the climate emergency. It's a looming crisis, with the power to threaten the stability of business, economies and people's lives, and the potential to pose the greatest threat to global security in our times. We're calling on business and industries to make serious, tangible commitments to address it before we reach the point of no return.

We believe that change starts with us. That's why in July 2020 we announced our ambition to align our entire portfolio with the goals of the Paris Agreement to limit global warming to 1.5C above pre-industrial levels. As a first step we've transitioned our passive equity mandates into climate-aware funds. We're working to evolve our other mandates to bring them closer in line with our policy. We've also taken steps to expand our portfolio to private infrastructure equity, where we'll be able to actively invest in more renewable energy and technology for the low-carbon future.

Over the last year we've strengthened our approach to responsible investment in other areas as well. We've done this through our commitment to existing priorities like diversity and fair work practices and by focusing on new areas like sustainable food retail and production. We've also been able to support emerging opportunities to help with the response and recovery from the pandemic, such as our investments in bonds earmarked specifically for Covid-19 projects.

In January 2020, the Financial Conduct Authority (FCA) authorised Nest Invest Limited as an investment subsidiary of Nest. This move has allowed us to implement more sophisticated ways of investing on behalf of our members, including exciting responsible investment opportunities in private markets.

As responsible stewards, our members and their interests always come first. This attitude drives our long-term goal to deliver bigger pensions in a better world. We hope this report provides a clear view on how we aim to achieve this.

"

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"

Chapter 1

Purpose of this report

Responsible investment and stewardship are built into the core of our investment strategy. This report demonstrates the outcomes of our approach, showing how our investment beliefs and policies translate into the decisions we make, our engagement with companies and other organisations, and how this affects our members' money.

This is the fifth annual responsible investment report produced by Nest. It meets the requirements of new regulations introduced by the government requiring all pension schemes to be transparent about how we and our fund managers deliver on our responsible investment commitments. In particular, it explains how we vote and engage with companies we invest in on behalf of our members.

This report also meets the principles of the Financial Reporting Council's (FRC) **Stewardship Code 2020**. By outlining our mission, purpose, governance, approaches and processes and explaining why they're appropriate, we hope to be early adopters to the new Code. You'll find a breakdown of how this report addresses each principle in **chapter 9**.

Chapter 2

At a glance

Key figures
as at 31 March 2021

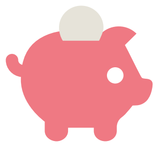
9.9m

Total members

£17.2bn

Assets under management

£4.7bn



Total annual contributions

16

Fund managers

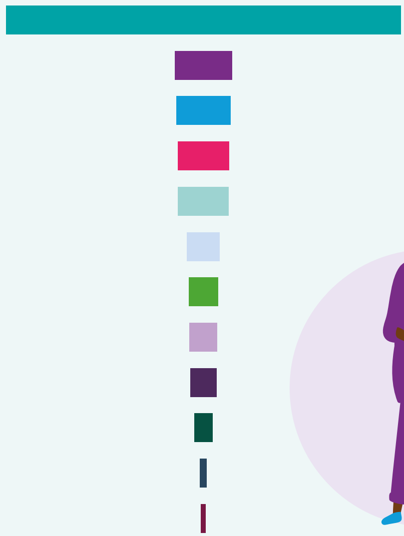
9.8%

Five-year rolling annualised returns in the Nest 2040 Retirement Date Fund*

* After annual management charges to 31 March 2021

Nest 2040 Retirement Date Fund

Asset allocation



Asset	Allocation
Climate-aware global developed equities	52.3%
Global emerging market equities	7.6%
Global high yield bonds	7.2%
Emerging market debt	6.8%
Global investment grade bonds	6.7%
Private credit	4.3%
Hybrid property	3.9%
Sterling corporate bonds	3.8%
Global listed property	3.5%
Commodities	2.4%
Infrastructure equities	0.9%
Global short duration investment grade bonds	0.6%

Global breakdown of equity*

- **56.1%** North America
- **15.3%** Europe and Central Asia Ex UK
- **14.9%** East Asia and Pacific Ex Japan
- **1.1%** South Asia
- **0.7%** Middle East and North Africa
- **7.2%** Japan
- **3.2%** UK
- **1.0%** Latin America and Caribbean
- **0.5%** Sub-Saharan Africa

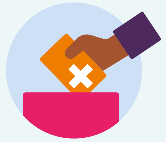
* Made up of emerging market and developed market equities; worth 59.9% of this fund

Voting activity across our portfolio[1]

58,362

Votes cast on our behalf at company annual general meetings (AGMs)

7,195



Votes cast against company management at AGMs

1 1 April 2020 – 31 March 2021

Engagement activity in our climate-aware developed equities fund

266

Companies engaged with

418

Engagements on 11 different themes[2]

232

Engagements on corporate governance

145

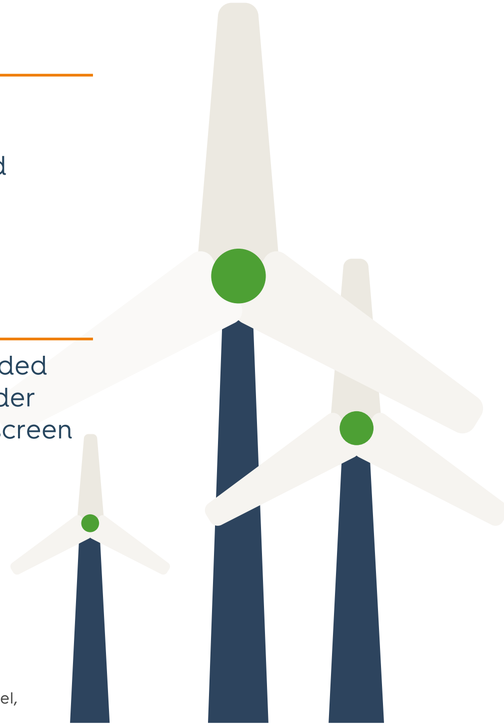
Engagements on environmental management and climate change

144

Companies have shown progress following engagement

21

Companies excluded from this fund under Nest's fossil fuel screen



2 These are: environmental management and climate change, human capital management and labour standards, community impact and human rights, corporate governance, remuneration, business conduct and culture, audit and accounting, strategy and business model, capital management, diversity and transparency and disclosure.

Chapter 3

Our mission

Around one in three workers in the UK saves with Nest. The privilege of looking after their money comes with the responsibility to do everything we can to grow our members' savings and help them enjoy a better retirement.

Nest is a UK-based defined contribution master trust. We're unlike all other pension schemes in the UK. We're open to every company, big or small, and to all their employees. By operating at scale, Nest can have a significant impact. We can achieve better value for money in our administration and investments, which in turn supports our ability to deliver better financial outcomes for our members. Our strong social purpose and role as a responsible investor run through the whole corporation, which means we can also make a difference to the society and world our members live in.

All this supports our goal to give members a bigger pension in a better world.

Our investment beliefs

Our clearly defined investment beliefs help us make better decisions about how we invest members' money. They're set out in our governing document, the **Statement of investment principles** (SIP), and are periodically reviewed as the scheme and investment practices evolve.

Two of our evidence-led beliefs set out the importance of sustainability and the consideration of environmental, social and governance (ESG) risk factors.

> **"We're open to every company, big or small, and to all their employees"**

Two of our beliefs

1. As long-term investors, we believe that integrating environmental, social and governance considerations into the investment management process improves risk-adjusted returns.
2. Long-term returns to investors are likely to be more sustainable if companies consider the interests of wider stakeholders – customers, employees and the wider public as well as shareholders and lenders.

In other words, we need to think about how companies and markets operate and how they treat people and the environment. These issues are likely to have a material impact on the performance of the companies and other assets we invest in over various timeframes.

Our responsible investment objectives

We've created four responsible investment objectives to guide and prioritise our activities:

1. **Better risk-adjusted returns:** We want to target an improvement in ESG performance where there's evidence this can lower the risk we need to take to achieve a return.
2. **Better functioning markets:** We want to improve how markets operate and are regulated in jurisdictions where we invest.
3. **Support long-term wealth creation:** We want to encourage companies and markets we invest in to deliver sustainable and stable performance to support good returns for our members over many years.
4. **Manage reputational risks:** We want to protect Nest's reputation and grow trust with our members by encouraging companies to act in ways our members can feel confident about.

Delivering on our objectives

To achieve our responsible investment objectives, Nest focuses on four interconnected activities. We consider these the main pillars of our responsible investment approach.

Manager selection

We select and build relationships with fund managers who incorporate ESG factors across their investment approach and whose principles are aligned with ours.

Active ownership

We address certain ESG risks and opportunities in our portfolio by voting and engaging on issues with companies and standard setters.

Risk monitoring

We monitor, prioritise and manage ESG risks alongside other financial risks and opportunities across our investment portfolios. We do this with the help of our responsible investment partners and ESG data providers.

Asset allocation

We look for opportunities to create or access investment strategies where we can address ESG risks and opportunities across the asset allocation.

You can see more detail about how we work across these areas in **chapter 5** and find out more about how we make decisions and prioritise our work in **chapter 6**.

Our current ESG priorities

As an asset owner invested across many asset classes, sectors and geographies, we must prioritise what to focus on so that our resources are put to the best possible use.

Our investment team has identified six priority areas that guide our current work. These are based on research and analysis, and are likely to change over time.

You can see how we've been managing these issues over the last year in **chapter 4**.

Climate change: We aim to address the potentially catastrophic impacts of global warming and identify how investments, workers and communities can benefit from the transition to a low-carbon economy.

Human capital: Companies that treat their workers fairly are more likely to have improved productivity, reduced staff turnover, and be more competitive. It's a key reason to understand how well they manage their workforce.

Cyber security: Successful cyber attacks have major consequences for business continuity, reputation and customer data security. We engage with companies at high risk of attack to assess the potential damage to their organisation – and our members' investments.

Diversity: We believe promoting diversity of gender, ethnicity and thought can improve company performance and reputation as well as enhancing socio-economic conditions for many people.

Food manufacturing and retail: The sector needs to manage a host of environmental concerns to remain profitable over the long term. Getting ahead of issues that affect health and wellbeing, like obesity, will also help protect it from potentially loss-making government regulation.

Audit: We rely on financial statements and reporting from external auditors to see how companies are performing. Unless this process is fully independent and unbiased, we can't be confident in the quality of the auditors' report and therefore whether the company represents a good investment.

We've also identified newly emerging themes over the last year, like the risks facing social media companies. Concerns have been raised over the promotion of hate speech and harmful content on the major platforms, as well as the health implications of excessive social media usage. We'll research this and other topics over the next year.

Chapter 4

Highlights from the last year

Addressing the climate emergency

We've been monitoring how climate change will impact investments and wider society for the past few years and formalised our portfolio-wide policy on **climate change** in July 2020.

Our members are likely to be significantly impacted if climate change isn't addressed, with a strong chance of lower returns on their retirement savings and a lower quality of life in retirement. We also know members care about how we invest when it comes to climate change. A recent survey of our members found that half of respondents thought it was essential or very important that their money is invested in a way that supports a 'green' economic recovery from the pandemic.[3]

We've set a target to align our investment portfolio with limiting global warming to 1.5C. We aim to reach net zero emissions by 2050 and expect to halve emissions by 2030. We'll review our progress annually, which may allow us to set more ambitious goals as we better understand how to invest for the transition to a low carbon world.

3 Voice of Customer survey conducted among 1,737 Nest members in June 2020. Question asked: "Thinking again about post-pandemic economic recovery. Your pension is invested in the global economy and the way your money is invested could impact what the economic recovery looks like. How important is it for your pension to be invested in a way that supports a 'green' economic recovery from Covid-19?"

Our commitments

We've made four core commitments to help our investments reach net zero emissions by 2050.

- **Asset allocation:** Our ability to reduce emissions enough to reach net zero is driven by where we invest. So, we've committed to decarbonise our portfolio. This includes divesting from companies involved in thermal coal, oil sands and arctic oil and gas exploration by set dates, reducing other carbon-intensive holdings and investing more money in companies that are developing solutions such as renewable energy infrastructure and low carbon technologies. At the time of writing, Nest has divested or removed from its investible universe 116 companies involved in environmentally harmful business activities. We've also moved all of our developed market equity allocation into a segregated climate-aware fund. We'll be doing the same with our emerging market equity allocation.

> **"Nest has divested or removed from its investible universe 116 companies involved in environmentally harmful business"**

- **Fund manager selection and monitoring:** To get our portfolio to net zero by 2050, we expect all our fund managers to work towards aligning the portfolio they manage for us with the 1.5C global warming limit. This is also a requirement for all new fund managers. Ahead of announcing our new policy, we discussed our expectations with our managers and subsequently reviewed and benchmarked them based on their alignment with our policy. In addition to the key expectation set for all managers outlined in the policy, each manager has been set specific objectives tailored to how their investment approach will tackle the shift to a low-carbon economy. Our current managers have three years to demonstrate meaningful progress against these benchmarks.
- **Stewardship:** We believe that stewardship is one of the most powerful tools investors can use to influence a company's practices. By working with other investors to encourage companies to commit to net zero, we have a better chance of limiting emissions globally. Companies that aren't responding to engagement or are progressing too slowly are most likely to be financially impacted by a transition to a low-carbon economy. In these cases, we'll consider divesting to protect members' returns.
- **Public policy:** We'll actively contribute to public discourse on climate change risks and opportunities as one of the UK's largest pension schemes by membership. This includes addressing how climate change will affect the pensions industry and the global economy.

Reaching net zero global carbon emissions across our entire portfolio by 2050 will be challenging as there's no widely accepted methodology for assessing whether a portfolio is on track with a global warming temperature target. Data on organisations' carbon emissions is also limited, particularly for unlisted companies. As a result, we've been working with industry peers and other stakeholders to develop these tools and improve companies' disclosures around climate change.

Going forward, we'll continue to explore ways to measure whether investments in different asset classes are on track for the 1.5C target. We're also conducting further research on the impact of the physical risks of climate change on asset values.

Nest's climate-aware funds

In 2017 we worked with UBS Asset Management, our global equity fund manager, to set up our first climate-aware fund. It seeks to reduce the amount of money put in shares of highly carbon-intensive companies and invest more in companies that are well positioned to meet the goals of the Paris Agreement. Following the publication of our climate change policy, we're now investing all our developed equities through this fund – this is nearly 50% of Nest's total investment portfolio and is a significant step forward in delivering on our climate commitments.

We've also transitioned to a segregated mandate for this fund, allowing us to increase the tilt towards companies successfully managing the transition to a low-carbon economy, and underweight or even exclude companies that are failing to position themselves for the new economic realities.

By tilting away from high greenhouse gas emitters, we're putting pressure on companies and industries to change their practices – ideally, we want to be an agent for change and a supportive owner of companies that are taking the climate emergency seriously and positioning their business models accordingly. We also believe our actions will improve the risk-adjusted returns received by our members in the long term.

Tilting our climate-aware fund

£7.18bn

invested in developed market equities

£1.16bn

invested in companies that are transitioning to a low-carbon economy

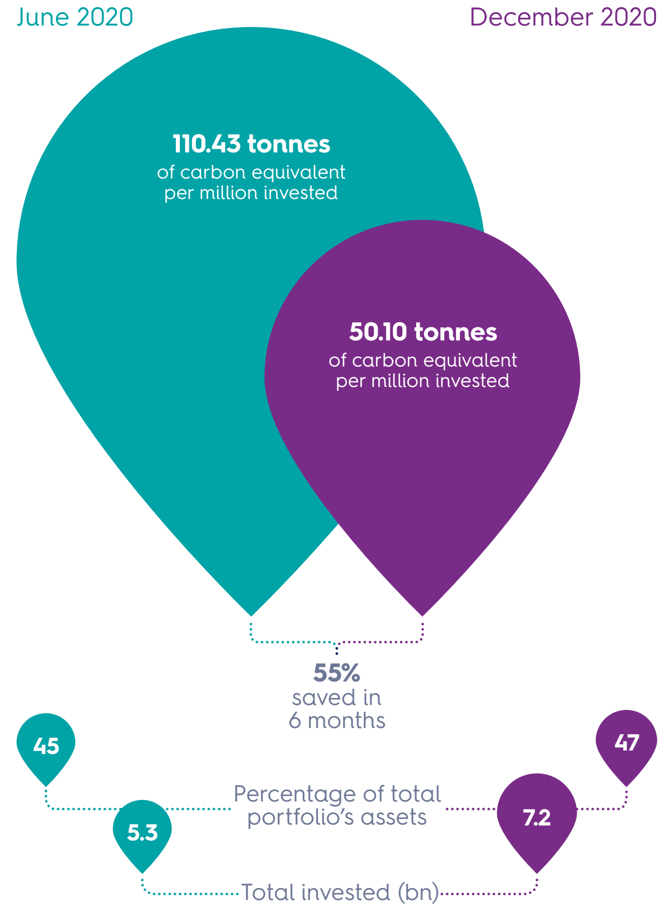
£1.16bn

withdrawn from companies that aren't positioned for a move to a low-carbon economy

As at December 2020

Halving our carbon emissions intensity

Transitioning to the fund also helped to halve the scope 1 carbon emissions intensity of our developed market equity allocation[4]

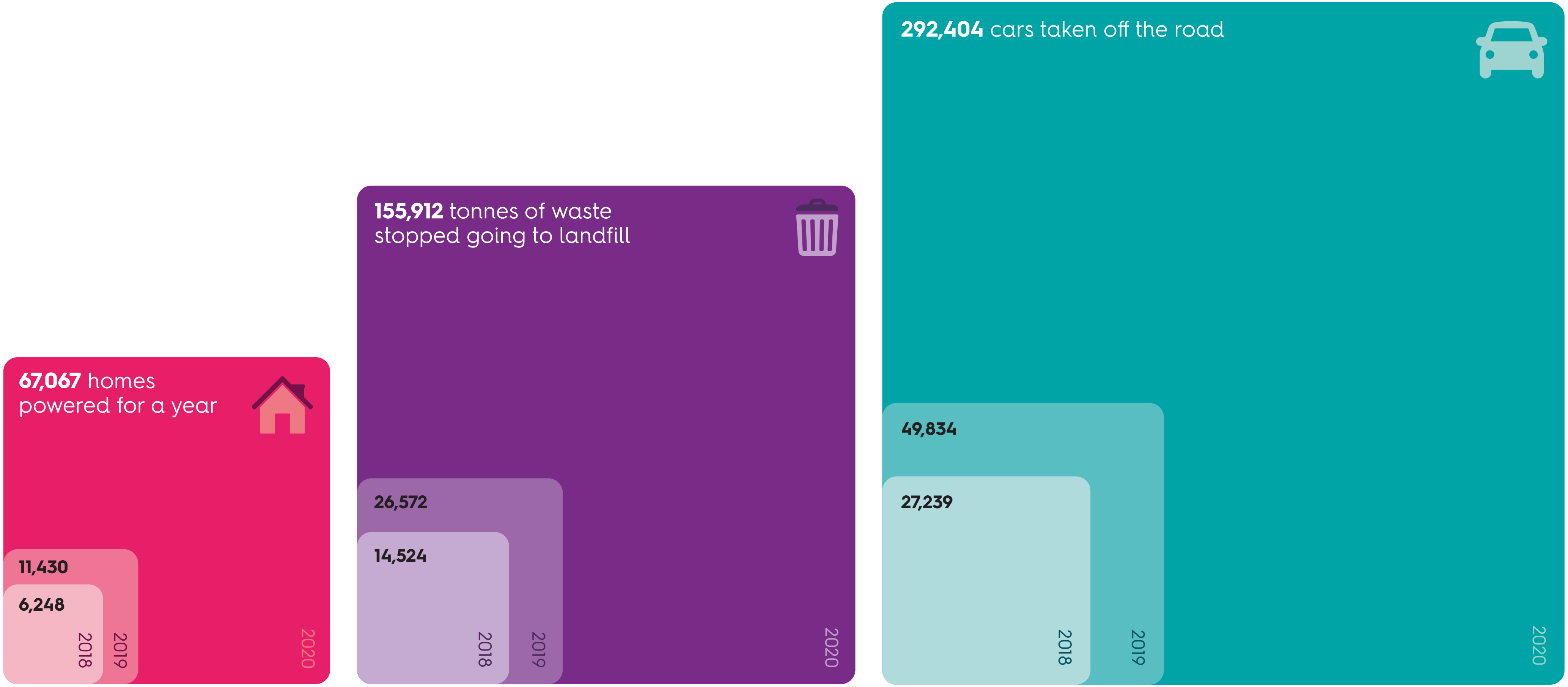


Source: UBS Asset Management, Trucost, EPA, IEA as of December 2020.

4 The Greenhouse Gas Protocol, an international accounting tool, categorises carbon emissions into three groups or 'scopes'. Scope 1 covers direct emissions from the reporting company's owned or controlled sources. Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling that has been consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in the reporting company's value chain. Nest will report more detailed carbon data in our TCFD statement to be published in July 2021.

Reducing our investments' carbon footprint

Our climate-aware strategy helped reduce the carbon footprint of our members' investments by the equivalent of one of these models:



Source: UBS Asset Management, Trucost, EPA, IEA as of December 2020. Metrics are estimates based on model assumptions, for illustration purposes only.

Addressing climate risk in emerging market equities

Emerging markets such as China, India and Brazil have younger populations and rising middle classes, so their economic growth is likely to outpace that of developed markets in the coming years. We're therefore increasing our exposure to emerging markets in a way that enables us to make the most of growth opportunities particularly those presented by green technology.

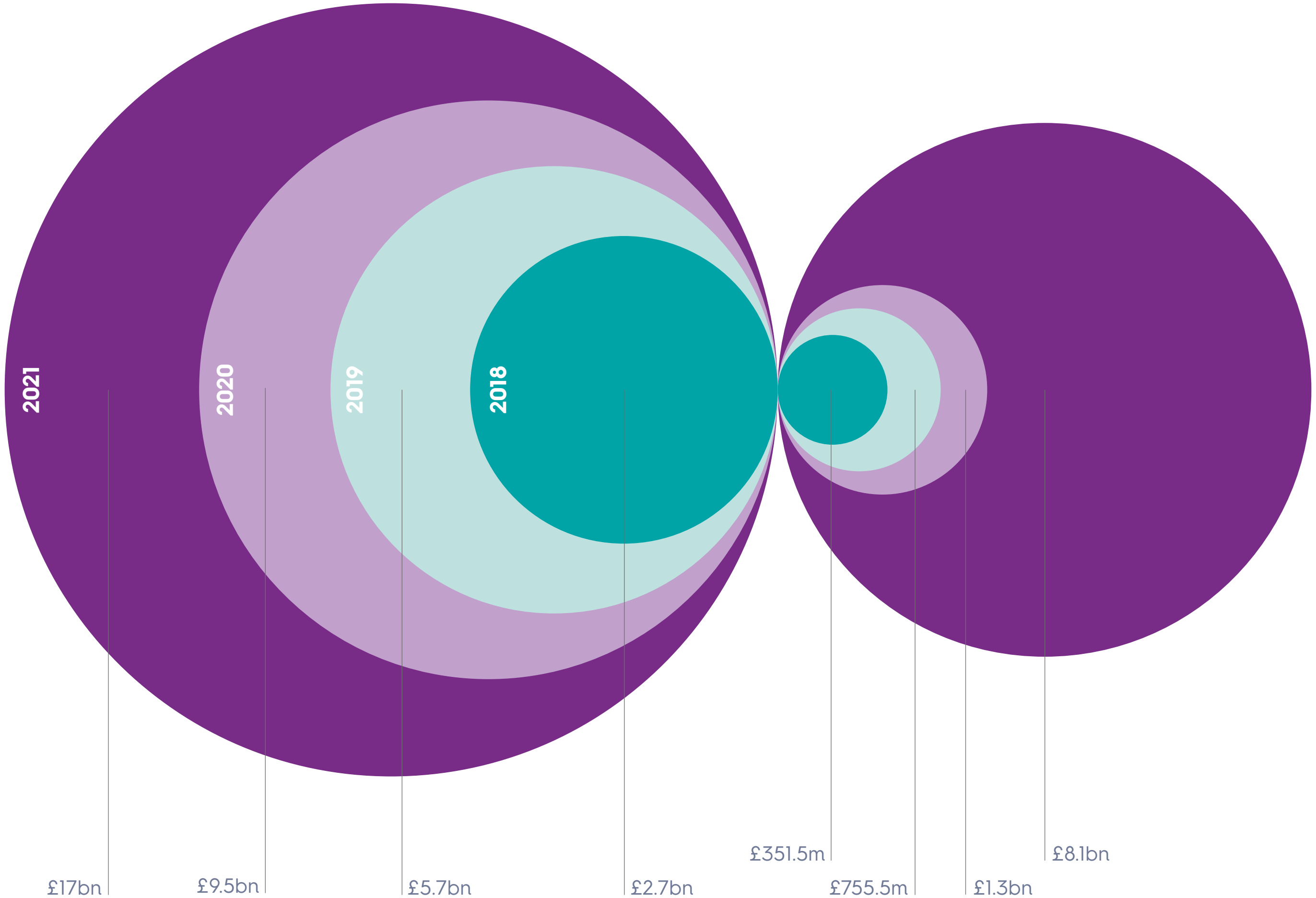
Working with our existing emerging markets fund manager Northern Trust, we've designed a customised approach to tilt investment in companies based on:

- **Fossil fuel reserves:** We'll reduce investment in companies that have large oil or gas reserves.
- **Carbon intensity:** We'll reduce investment in companies with high carbon intensity but will increase investment in a company if it has low carbon intensity compared to its sector or is reducing its carbon intensity over time.
- **Energy efficiency:** We'll increase investment in companies that show strong energy efficient business practices.
- **Alternative energy:** We'll increase investment in renewable energy opportunities.
- **Green building projects:** We'll tilt towards companies that present opportunities in clean technology and sustainable construction.

To give us the control and flexibility needed to evolve our methodology in the interest of our members, our emerging market equities fund will be implemented using a segregated account. This move will take Nest's investments in dedicated climate-aware strategies to over £8 billion, representing 48% of the scheme's overall portfolio.

Our shift towards climate-aware assets

As our total assets under management have increased over the years, the proportion allocated to dedicated climate-aware strategies has increased. Nearly half of our portfolio is currently invested in climate-aware funds, and we expect that amount to increase by next year.



Investment in Covid-19 bonds

This year saw an increase in the number of social bonds being issued, many specifically set up with their proceeds earmarked for use in responding to and recovering from the pandemic. These Covid-19 bonds have the potential to generate competitive yields while also helping the various issuers meet the unique financing needs created by the pandemic. It also helps us support economic recovery in the wake of this seismic crisis.

While the majority of these bonds have been issued by supranational or government-related agencies, some have been issued by corporations too. Our global investment grade corporate bond fund manager, Wells Fargo Asset Management, invested on Nest's behalf in the Bank of America's Covid-19 bond issuance. The proceeds from this bond will be allocated to the healthcare industry, including:

Not-for-profit hospitals

Skilled nursing facilities

Manufacturers of health care equipment and supplies

Acting as effective stewards

We take a holistic approach to active ownership. That means we vote in our members' long-term interests, have direct dialogue with companies and contribute to the development of public policy across a range of ESG issues. Each of these activities complement each other, allowing us to align voting and engagement at each stage of the stewardship process.

More detail on our active ownership approach and policies can be found in **chapter 5**.

How we voted

The 2020 voting season was like no other. AGMs usually present an opportunity for investors to engage with a company's board and management, ask them questions and make statements. They moved online from mid-March 2020 as a result of the pandemic, but that didn't stop investors from voicing their concerns.

We use Minerva Analytics as our proxy voting advisor. They're guided by our policies on a range of topics and specifically by our **UK voting and engagement standards** and **global voting engagement and standards**. We take investment considerations, research and analysis, and our engagement history into account to inform our voting decisions. We have no hesitation in overriding our developed equity fund managers' votes if we disagree with their views.

Since our last report, we've voted on a range of topics, from audit and reporting to executive remuneration to corporate actions that could affect a company's performance. We've also supported shareholder proposals where we believe they seek to address important sustainability issues.

Over the last year, we voted in 4,491 company meetings. That's 99.8% of total voteable meetings, highlighting our commitment as active owners.

We voted against management 7,195 times, with remuneration and board composition the areas with highest dissent.[5] Full details are available **online**.

5 LGIM Q1 2021 voting data not included.

Voting-led engagement

We engage directly with some companies if we vote against management recommendations and our view is different from that of UBS. In the last year, we wrote letters to several companies to explain our voting decisions and areas of concern, seeking resolution or ongoing dialogue.

Company	Topic
Northern Trust Corp	Board composition
Bank of America Corp	Board composition and audit
Johnson & Johnson Inc	Audit
Boeing Company	Audit
Barclays plc	Climate change
Duke Energy	Audit
JPMorgan Chase & Co	Audit
BlackRock Inc	Board composition
Home Depot Inc	Remuneration
McDonald's Corp	Remuneration, culture and audit
NextEra Energy Inc	Audit
Amazon.com Inc	Board composition, food waste
Walmart Inc	Audit
Daimler AG	Remuneration

We'll report on the outcomes of these engagements in next year's report.

Climate change

As long-term investors, we expect companies to act now if they're to remain profitable over time, including increasing disclosure and setting strategies to address the climate emergency.

Joint initiatives for tackling climate change

We joined **Climate Action 100+** in November 2019 and are a member of the Institutional Investors Group on Climate Change (IIGCC).

As part of Climate Action 100+, we're regularly engaging with companies that are collectively responsible for up to 80% of the world's greenhouse gas emissions, calling on them to develop net zero business plans and set hard targets for delivery.

Our actions and outcomes

Climate Action 100+ prompted several oil and gas companies to transition towards net zero emissions by 2050, including BP and Repsol who are aiming for net zero in scopes 1, 2 and 3. More details are available in the **2020 progress report**. We're engaging with four companies in developing markets to adopt three key pledges: governance of climate risks, reduction of emissions across their value chains, and disclosure in line with the **Task Force on Climate-related Financial Disclosure's** (TCFD) recommendations. Two of these have now set net zero targets.

We voted for a number of shareholder resolutions asking companies to align their strategies with the goals of the Paris Agreement, including resolutions brought to a vote at AGMs for Barclays bank, French oil and gas company Total and Australian oil exploration company Woodside Petroleum. We voted against the re-election of the CEO at ExxonMobil as the company has made little progress in setting emissions reduction targets despite continued engagement by investors. And following engagement with investors including Nest, HSBC committed to bringing a management resolution to its 2021 AGM that will set targets for phasing out its financing of coal-financing and thermal coal mining and aligning its business with the goals of the Paris Agreement.

Case study:
Applying a holistic approach

Barclays

In February 2020, we announced our support for a shareholder resolution at Barclays' AGM in May. This resolution was developed by ShareAction and called on the bank to make specific targets on tackling climate change.

Nest had a meeting with the Chair of Barclays to discuss the asks of the resolution and the bank's response. The Chair acknowledged that Barclays needed to do more and explained that the bank would shortly be setting long-term climate targets. At the end of March Barclays formally announced their commitment to become net zero by 2050 which we publicly welcomed. It also proposed a resolution for shareholders to approve this commitment at its May AGM.

We supported both Barclays' resolution and the original shareholder resolution as we considered the two to be complementary. We'll continue to engage with the bank about its strategy to reach net zero.

Total

We supported a shareholder resolution at the AGM of oil and gas company Total to set Paris Agreement-aligned emissions reduction targets for all its products and operations. We engaged with Total in March ahead of its AGM and discussed its strategy for addressing climate change risk. While Total had strong short-term targets, it hadn't set any for the long term. Unlike some of its peers, it hadn't committed to become carbon neutral either. Finally, the company announced its ambition to become carbon neutral by 2050 ahead of the AGM.

Despite Total's change, we still decided to support the shareholder resolution because its commitment didn't include becoming carbon neutral with respect to scope 3 emissions.

Scope 3 emissions are generated when Total's products are used by its customers and they make up the majority of the company's impact on global emissions.

We continue to engage with Total about its strategy to reach its climate goal.

Human capital

The way companies look after people directly impacts performance, productivity, business resilience and reputation. Simply put, we believe a well-treated, fairly paid workforce makes a company more likely to be successful over time. Disclosure on issues like pay, working conditions, and company culture are therefore essential to help us assess an organisation's social risks.

The real Living Wage and secure work

Paying workers the real Living Wage as calculated by the Living Wage Foundation doesn't just help staff – it can boost company performance too. **Cardiff Business School** found that 93% of Living Wage employers reported that they'd experienced some form of benefits from accreditation with the Living Wage Foundation.

Nest has been actively supporting the ShareAction-led Good Work Coalition, which encourages companies to pay the Living Wage to their employees and ensure that their work contracts provide for set working hours, sick pay and holiday pay.

Pay disparity

Investors have been questioning companies about disparities in pay between workers and leadership for some time. Throughout the crisis, we saw some companies paying their executive team as planned, with the rationale that their bonuses were based on performance over 2019. Conversely, other executives have foregone their remuneration packages, including at HSBC, Standard Chartered and United Airlines. At Boeing, both the CEO and Chair offered to forego their salary for the entire year.

We believe it's appropriate for a company to review executive pay in the context of dividend cuts, redundancies, receipt of government subsidies and furloughing staff. We'll step up our scrutiny on executive pay over 2021 in the context of the pandemic.

The Workforce Disclosure Initiative

As a founding signatory of the **Workforce Disclosure Initiative** (WDI), now a coalition of more than 40 investors, we continue to encourage companies to disclose meaningful data around corporate workforce and supply chain practices so we can benchmark corporate performance. Every year, the WDI invites hundreds of companies globally to respond to a questionnaire on how they manage areas such as workforce health and safety, pay, human rights and supply chain management.

Our actions and outcomes

This year, Nest provided input on enhancing the WDI survey with questions relating to:

- the safe return to work during and post-Covid-19
- mental health risk monitoring and safeguarding
- diversity and inclusion initiatives and transparency on composition in terms of gender and age
- the mitigation of modern slavery risk in supply chains
- living wage levels and addressing pay gaps

In 2020, the WDI signatories reached out to over 260 companies to ask them to respond to the survey, growing the number of responding companies by 20% to 141. Once the data is analysed, we'll be in a better position to understand workforce practices across a number of new dimensions.

Nest was also nominated to sit on the WDI advisory board, which provides strategic advice to the initiative as it enters an accelerated period of growth.

We've also co-signed letters to several FTSE 100 companies asking them to become accredited by the Living Wage Foundation and to a further four firms asking them to become **Living Hours accredited**. Since the start of the engagement in 2018, over 40 companies in the FTSE 100 have become accredited Living Wage employers.

Cyber security

Markets are quick to punish companies that have suffered security breaches, making cyber and data security an important factor in our investment decisions. This is especially relevant during the pandemic when companies around the globe have moved staff to working from home, potentially making them more vulnerable to attack.

Our actions and outcomes

Last year, we started an engagement programme alongside one of our fund managers, Royal London Asset Management, and a coalition of other pension schemes, including RPMI Railpen, Brunel Pension Partnership, USS and Border to Coast. We identified 33 companies at risk of cyber attacks and met with some of them to learn about their processes and gather examples of best practice. We spoke to the senior management of companies including HSBC, Iberdrola, National Grid, Adidas and NatWest Group. The meetings developed our understanding of cyber risks and gave us an opportunity to push for increased scrutiny and reassurance on areas such as governance oversight, training and the cyber security standards of suppliers and partners.

We were surprised to hear a few organisations say that they didn't think that cyber security was an issue that investors cared about. We believe our continued engagement raises the relevance of this issue at senior level and helps companies understand investors' need for better disclosure. We'll continue our engagement throughout 2021.

Diversity

An exhaustive study by the Centre for Economics and Business Research found that the UK's most diverse workplaces were 12% more likely to outperform their industry average compared to the least diverse firms.[6] Yet the Parker Review, published in February 2020, found that 37% of FTSE 100 companies have no directors from Black, Asian or minority ethnic communities.

6 cebr.com/reports/cebr-research-with-involve-on-the-value-of-diversity/

The **Women Count 2020** report found that FTSE 350 companies with more than 33% female executives were up to 10 times more profitable than those run exclusively by men, but work still needs to be done to increase representation at senior level.

Diversity is much more than a social, political or moral issue - it has clear business and financial implications. Companies that don't pay close attention to their hiring and development programs risk:

- failing to make use of broader talent pools
- fostering a leadership culture that may be narrow-minded, leading to worse business decisions
- having a workforce that doesn't reflect their customer base
- negative PR

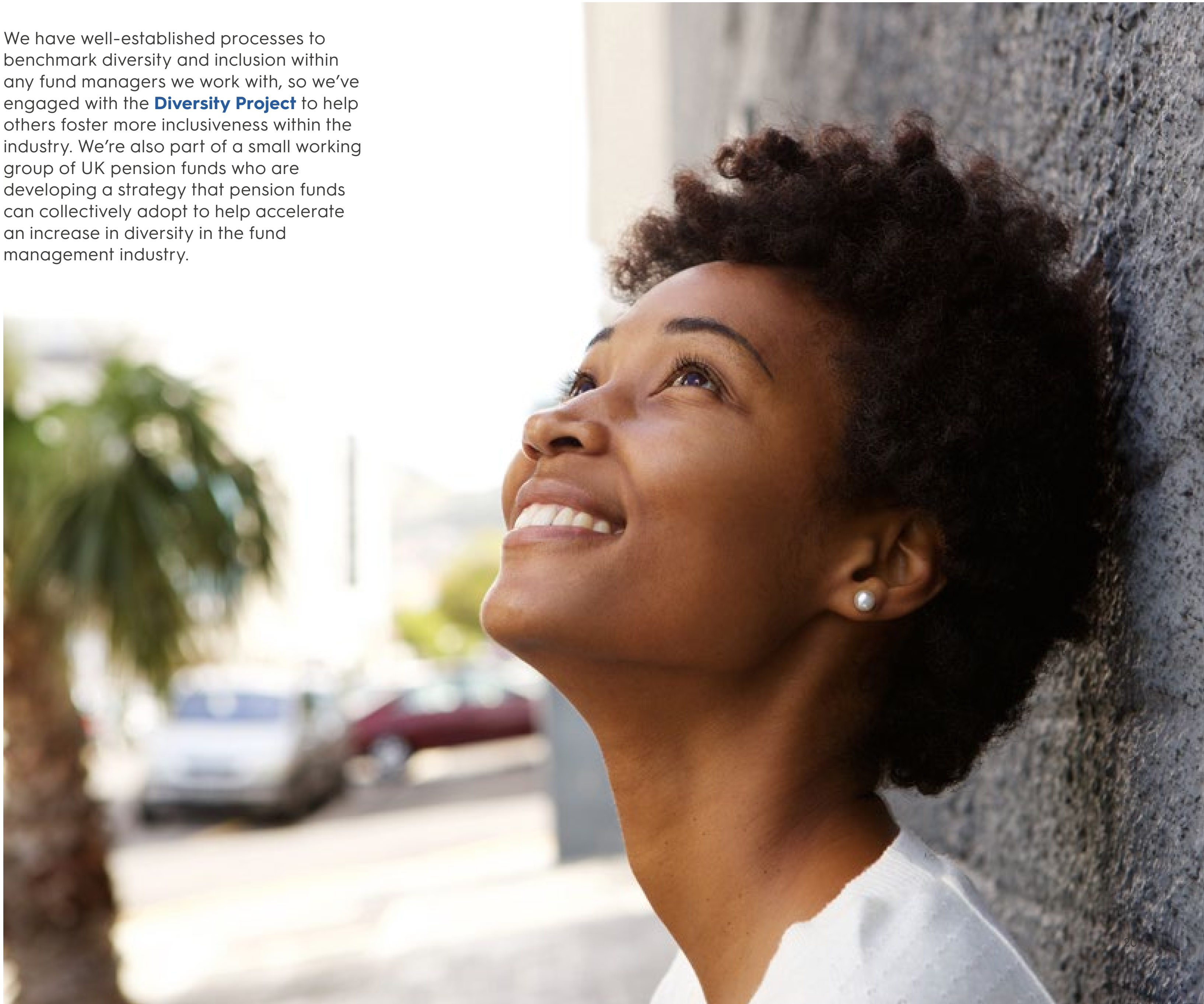
Our actions and outcomes

There are increasingly high expectations for companies to meet diversity targets and regularly report on their policies, activities and approaches. However, the companies we've engaged with have noted that it's not clear what good reporting looks like in this area. We're leading on a piece of work with the **30% Club** to develop a new guidance report on diversity. We're also collating good practices in corporate reporting with a view to creating a global benchmark that allows investors to compare diversity across different companies.

Following our work in the area, Nest's Head of Responsible Investment, Diandra Soobiah, and Senior Responsible Investment Manager, Mais Callan, have been announced as two of the 30% Club's co-chairs. They plan to expand the initiative's approach to broader areas of diversity and inclusion.

In March 2021, we wrote to the chairs of 26 FTSE 100 companies which hadn't shown clear progress on the Parker Review's recommendation for organisations to have at least one director from an ethnic minority background on the board by 2021, known as 'One by 2021'. We were encouraged by the level of responsiveness to our letters and will follow up with meetings.

We have well-established processes to benchmark diversity and inclusion within any fund managers we work with, so we've engaged with the **Diversity Project** to help others foster more inclusiveness within the industry. We're also part of a small working group of UK pension funds who are developing a strategy that pension funds can collectively adopt to help accelerate an increase in diversity in the fund management industry.



Food manufacturing and retail

Food manufacturing and retail is one of the world's largest sectors and is at the heart of some of our biggest environmental, social and economic challenges. Meeting the world's growing demand for food while natural resources are quickly diminishing means that businesses must adapt to stay resilient. There's growing evidence these ESG risks could affect production, pricing, corporate reputation and regulatory action across the whole value chain – in turn eroding company profits and the long-term security of our members' investments.

Sustainability in the food industry

Scientific evidence shows that the world's reliance on meat and dairy in our diet is accelerating biodiversity loss, water use and climate change.

- 15% of the world's greenhouse gas emissions come from livestock production alone. That's more than the transport sector[7]
- Demand for animal-based protein is expected to rise by 80% between 2006 to 2050[8]

We joined the **FAIRR Initiative** to raise our voice in this arena. It's a collaborative investor network that raises awareness around the sustainability risks and opportunities in the meat, fish and dairy industries. As pressure mounts to move towards a low-carbon future and consumer demand changes, we want to ensure the companies we invest in are adapting to a more sustainable food system.

Tapping into the healthy food market

Obesity has become a global issue with far-reaching implications for the health of society and economies. In the UK alone, where obesity is now a bigger cause of death than smoking, it has a wider economic cost of £27 billion.[9]

7 fao.org/news/story/en/item/197623/icode
8 wri.org/blog/2016/04/sustainable-diets-what-you-need-know-12-charts
9 independent.co.uk/news/health/obesity-deaths-smoking-health-b1800815.html

We believe that food companies will be more successful and resilient in the long run if they're ahead of the curve. Not only do companies need to manage the risk of increased government intervention to tackle obesity, there's also an opportunity to capitalise on growing consumer demand for healthier products.

With the majority of money spent on food in the UK going to a handful of supermarket chains that dominate the UK market, Nest can be part of the solution. In early 2020 we joined ShareAction's **Healthy Markets initiative**. Supported by research carried out by the **Access to Nutrition Foundation**, the Healthy Markets initiative brings together investors with more than $1 trillion in combined assets under management to engage with UK food and drinks makers and retailers.

Our actions and outcomes

Along with other FAIRR participants, we're also engaging with global food companies to improve their sustainability performance. So far, we've been focused on getting large fast-food chains to switch to more responsible meat sourcing and talking to major food retailers about protein alternatives. While two of the five companies we're engaging with have stated their intention to disclose emissions targets, only one company has started to undertake climate scenario analysis. None have set time-bound targets explicitly addressing the water use and pollution impacts of their animal protein supply chains. This is something we want companies to improve on.

On health, we encourage supermarkets to do all they can to evolve their strategies, products and marketing to reduce rates of obesity. This includes creating more affordable healthy food lines, limiting marketing of sugary products to children and making food nutrition labels clearer. We've publicly supported questions posed by ShareAction at the Tesco AGM on setting nutrition and health strategies. We've also engaged with senior management of major UK retailers such as Sainsbury's, Tesco and Asda, encouraging them to publish their plans to drive healthier food and drink consumption. We've subsequently seen stronger commitments made by Sainsbury's and Tesco in disclosing their targets. We'll continue to monitor the companies within the scope of the initiative on their progress.

In 2021, the Healthy Markets initiative plans to extend this engagement to the largest food manufacturers globally, and we intend on holding those companies to account on their role in promoting healthier products.

> **In the UK, obesity is now a bigger cause of death than smoking, with a wider economic cost of £27 billion**

Chapter 5

How we invest responsibly

In working towards our responsible investment objectives, we take action in four core areas: manager selection, active ownership, risk monitoring and asset allocation. These activities don't sit in isolation, they complement each other as part of a well-rounded approach.

More detail on how we make decisions and prioritise work within this framework can be found in **chapter 6**.

Manager selection

An important requirement in our manager selection process is the demand for high-quality ESG and stewardship approaches. We expect appointed fund managers to exercise responsible investment in line with their own considered and documented policies and to engage with companies to drive behavioural change and reduce long-term investment risk.

We want to understand how managers integrate ESG considerations into their investment analysis and decision-making. This can also give deeper insight into the quality of the firm's operations, culture and risk profile. If we see the potential for development in certain areas, we'll work as partners to help our managers improve their operations. That's because we're committed to identifying opportunities for growth and setting a higher benchmark in the industry.

Case study:

Finding the right managers

Our private infrastructure equity procurement involved a rigorous selection process to identify fund managers who could work in line with our policies and beliefs within our three different mandates:

- Global core and core-plus infrastructure: We'll invest in the infrastructure essential to everyday life, such as utilities and transport.
- Clean and renewable energy infrastructure: This mandate will only invest in renewable energy projects such as wind and solar farms. This is an important strategy to help achieve our climate change ambition and allows us to allocate more of our assets to climate change solutions.
- UK infrastructure: We'll seek assets linked to UK inflation to provide a hedge against the risk of rising price levels.

Infrastructure assets usually have a long lifespan and are illiquid, which means that they're more difficult to buy and sell compared to liquid assets like cash. That's why it's important to consider how the asset could be affected by ESG factors over its lifetime, as it's often difficult to divest if circumstances change. Things like the health and safety of workers and the impact of infrastructure on biodiversity and local communities can be critical to the performance of an infrastructure asset.

Following a rigorous search, we appointed CBRE Caledon Capital Management, Octopus Renewables Infrastructure Trust, and GLIL LLP. Each manager impressed us with their clear commitment to ESG integration across their activities, from the due diligence phase of assessing new projects to their ongoing management of the assets in their portfolios. They showed strong alignment with our climate change policy in their existing governance and operations and also committed to excluding investments that would breach our guidelines, such as thermal coal infrastructure or bioenergy derived from unsustainable sources.

Active ownership

As an asset owner invested in thousands of companies across many asset classes, sectors and geographies, we prioritise what to focus on so that our resources are put to the best possible use.

Underpinning our approach is the consideration of financial materiality, alignment with our members' interests, our responsible investment objectives and how much impact we can have when deciding what issues to engage on.

In addition to engagement activity carried out by our external fund managers on our behalf, over the past year we have engaged directly and collaboratively with other investors with over 60 companies on our priority themes and voting issues.

Ways we engage

Engagement is about communicating and building constructive relationships with companies in which we invest. It can take a number of forms such as :

- Writing letters
- Having discussions in private meetings
- Taking part in group meetings with other like-minded investors

Where our usual engagement methods fail to effect the appropriate response, and depending on the importance of the issue, we may seek to escalate our engagement by using other tools such as co-filing shareholder proposals or taking our engagement to the public arena. You can find out more about our escalation process on **page 30**.

> **Engagement is about communicating and building constructive relationships with companies in which we invest**

Nest's voting policy

We regularly review our **voting and engagement policy** to ensure it reflects our responsible investment principles and objectives. Following our most recent review, we've strengthened our voting standards in a number of areas including:

- climate change
- cyber security
- workforce issues
- tax management
- bribery and corruption

We also developed more specific voting guidelines for UK banks, carbon-intensive industries, commodities and digital, technology and financial companies to reflect the specialised ESG considerations for these sectors.

Nest's voting subset

We actively monitor a subset of companies during voting season. This focus helps us to prioritise important issues and understand how our fund managers are exercising votes in our largest holdings, companies in high risk sectors and companies identified as having governance issues in the past. We've updated our voting subset to include companies that are targeted by the Climate Action 100+ list and those that haven't responded to the WDI.

We receive bespoke voting recommendations from our proxy voting service provider, Minerva Analytics, based on our policy. We do not follow any default voting recommendations from Minerva.

Stewardship across asset classes

Our diversified investment approach means that we invest not only in publicly traded funds, but also in real assets such as infrastructure and property. We believe diversifying our portfolio will offer better risk-adjusted returns for our members.

In listed equities, we exercise active ownership through proxy voting, direct or indirect company and industry engagement. In listed corporate debt and private credit, stewardship is more focused on assessing the approaches that the investment managers take by conducting thorough due diligence, engagement with and ongoing monitoring of issuers. Here's how two of our managers operate in different asset classes:

Asset class:
Listed corporate debt

Fund manager:
Royal London Asset Management

The responsible investment and credit teams collaboratively assess ESG issues to understand where risks and opportunities lie within a business model before investing.

They assess the relative value of the credit, including how the materiality of these factors may be mitigated by their lending position in a company's capital structure and the price they need to be paid for the overall credit.

They engage companies where they think we can genuinely have influence and impact.

Asset class:
Private credit

Fund manager:
BlackRock

As a lender to private infrastructure project, BlackRock undertakes a thorough ESG due diligence process when reviewing any investment opportunities, which includes the use of proprietary ESG questionnaires and other toolkits. Where practical, BlackRock may seek to contractually oblige their borrowers to operate in line with agreed ESG requirements and industry best practice. ESG performance indicators may also be agreed for specific projects to help drive continuous improvement.

Risk monitoring

Identifying and addressing risks in our portfolio

Our investment team meets every quarter to review how our portfolios are performing, how the economy is looking and what investment risks and opportunities exist or could emerge, including those we monitor through our ESG risk dashboard. As part of this, we often bring in external experts to present data on key market trends and outlook.

If we've identified investments that fail to meet our ESG risk management expectations, we discuss the best way to approach the issue. This may include having a conversation with the external investment firm that manages our members' money in the particular asset category.

If, after additional research and monitoring, we believe that the investment isn't in line with our responsible investment policies and standards or the risk isn't being managed appropriately, we'll take action. This may include:

- reducing or increasing investments in specific assets classes
- choosing a different investment management firm after placing it on a watchlist
- changing the terms of the mandate given to the investment manager

ESG risk dashboard

Our ESG risk dashboard helps us collate information and identify risks that companies in our portfolio are exposed to through their business activities.

It also helps flag whether companies act in line with our policies and standards. For example, a company could be at risk of breaching human rights laws because they don't regularly monitor the labour practices of businesses in their supply chain, or it could be at risk of breaching our policies against investing in companies that manufacture controversial weapons through the acquisition of a subsidiary.

The dashboard gathers information from various sources, including:

- screening for breaches of the UN Global Compact principles and controversial activities and products through **Sustainalytics**
- significant negative media coverage through **RepRisk**

Outside of our ESG dashboard, we source information from a range of providers to help monitor risk. They include:

- carbon emissions and environmental footprint from our fund managers
- workforce-related issues through ShareAction's **WDI**
- Nest's proxy voting history through **Minerva Analytics**
- financial data through **Bloomberg**

Monitoring service providers

We frequently discuss voting-related issues with Minerva Analytics, our proxy voting agent – especially during voting season when there's a concentration of activity. We also review global developments in governance standards so we can update our policies where appropriate.

We meet with all our other providers on at least a semi-annual basis to ensure service is delivered to our expectations and to provide feedback and discuss any new developments. Our regular communication also allows us to actively investigate developments in our providers' service that could help meet our changing needs.

All contracts are monitored by Nest's internal procurement function, which includes a semi-annual evaluation carried out by the responsible investment team. In the past year, all of our contracts were fulfilled to our expectations but we continue to engage with our providers on how their service provision can further improve.

"Our ESG risk dashboard helps us collate information and identify risks that companies in our portfolio are exposed to through their business activities"

Identifying and addressing market-wide risks

Our process for identifying key market-wide risks comes from our own research, external information sources such as industry bodies and investor forums, news flow, fund managers and external service providers. We also seek our members' views on potential systemic risks and assess how they're likely to impact returns.

We discuss the materiality of each potential risk and agree an action plan for addressing it, including:

- responding to consultations
- direct dialogue
- collaborative initiatives
- advocating for better standards through thought leadership

Our effectiveness in identifying and responding to market-wide and systemic risks is reflected in our track record as early adopters of and advocates for key issues. For example, we were one of the first UK pension funds to exclude tobacco from its portfolios. We've also prioritised social issues such as workforce, fair pay and conditions long before these were propelled to the spotlight by the Covid-19 pandemic.

Here's how we've addressed systemic risks in climate change, auditing and shareholder rights through stakeholder and policy engagement.

Climate emergency

We responded to the Department for Work and Pensions (DWP) consultation on climate reporting guidance for pension schemes. This included participating in roundtables and commenting on how pension schemes can better align their reporting with recommendations of the TCFD. We support the guidance put forward by the DWP which provides an exhaustive and ambitious set of recommended disclosures for all schemes to consider in reporting against the TCFD.
We'll be drawing upon this guidance to continually improve our own TCFD reporting and pushing for more consistent and comparable reporting across the market.

Audit

We responded to the Department for Business, Energy & Industrial Strategy Committee's call for evidence on reforming the UK audit industry. The committee sought evidence on how well the various recommendations of the Brydon, Kingman and Competition and Markets Authority Reviews fit together as a coherent whole. We were especially keen to respond to the inquiry because none of the three reviews had addressed how audit reform could help track progress in meeting the UK's Sustainable Development Goal commitments, and in particular net zero contribution to climate change. We felt the question was very relevant and at the heart of our members' interests in sustainable, long-term investment performance.

In March 2020 we wrote to the FRC's Chief Executive and Chairperson to give our views on improving audit quality and the usefulness of corporate reporting within companies' external audit and annual reports.

Shareholder rights

We wrote to the US Securities and Exchange Commission (SEC) to contest proposed amendments to its rules on governing proxy solicitations, where a shareholder authorises another individual to cast their vote at a company's AGM. The new rules would have required proxy advisers to submit their recommendations to company executives for review and comment before they can be published for shareholders to review. Rather than increasing accuracy and transparency, it would negatively impact the independence of analysis received from proxy advisers and increase the operational and cost burden on investors considering positions on shareholder resolution. Fortunately, the SEC retreated from this position and dropped this measure. Our letter was mentioned in the SEC's regulation footnotes.

Asset allocation

We put our members' money into a broad range of assets to help protect the value of their savings from a variety of risks and achieve the best risk-adjusted returns at retirement. These decisions, made collectively by the investment team, are guided by investment data and analysis, including information about ESG risks and opportunities across all asset classes and geographies.

Research shows that well-run organisations with sound ESG practices have a better chance of long-term success and profitability. That's one of the reasons our responsible investment objectives and principles are a fundamental consideration for the asset allocation team.

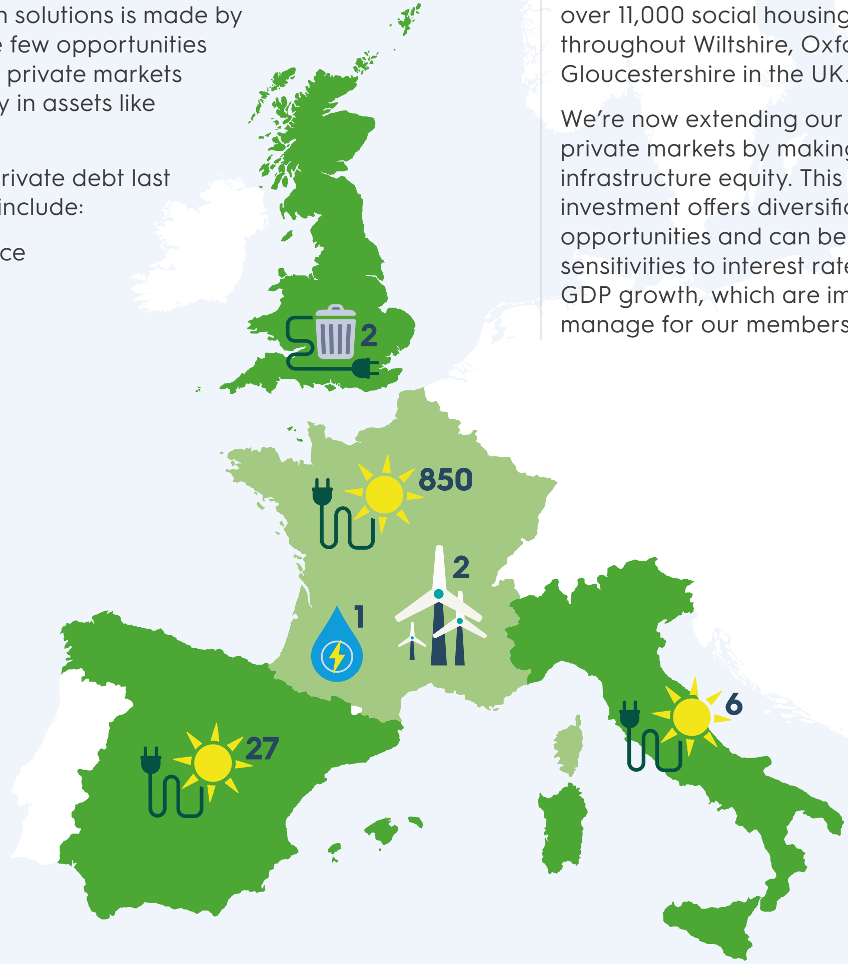
Case study:

Private infrastructure investments

In order to meet our ambition to become net zero by 2050, we need to decarbonise our portfolio while investing in solutions such as renewable energy and energy efficiency. In listed markets where shares in companies can be publicly traded, a lot of investment in low-carbon solutions is made by the big energy companies and there are few opportunities to invest in pure renewables. Investing in private markets gives us the opportunity to invest directly in assets like renewable energy infrastructure.

Since we announced our investment in private debt last year, we've financed 63 projects. These include:

- a portfolio of 850 solar assets in France
- 2 onshore wind projects in France
- 6 solar plants in Italy
- 27 solar plants in Spain
- 1 water management plant in France
- 2 waste-to-energy plants in the UK



We also invest in social infrastructure. For example, we've provided finance to a registered social housing provider with over 11,000 social housing properties throughout Wiltshire, Oxfordshire and Gloucestershire in the UK.

We're now extending our investments in private markets by making an allocation to infrastructure equity. This type of investment offers diversification opportunities and can be used to manage sensitivities to interest rates, inflation and GDP growth, which are important risks to manage for our membership.

Chapter 6

How we make and implement decisions

ESG risks and opportunities can cut across our entire investment universe. We can't work effectively if our efforts are spread over every potential issue, so we prioritise our work to have the greatest impact. Our decision-making and prioritisation process follows these key stages, underpinned by rigorous governance and oversight.

Identify and prioritise

Proprietary investment research carried out

Issues selected on relevance and interest for members

Analysis conducted to understand the market-wide and real-world impact of the issue

Understanding of codes and standards that allow us to meaningfully address issues

Objectives are defined

Implement

Develop an evidence-based policy

Asset allocation decisions are made

External fund managers are informed

Issues are incorporated in our voting and engagement standards

Issues are reflected in our voting subset

Direct or collaborative engagement is carried out

Governance and oversight

Review

Our responsible investment strategy is reviewed annually

Policies and standards are reviewed periodically

Third-party ESG data provision is reviewed tri-annually

Members are surveyed on their interests and priorities annually

Monitor

Regular meetings with external fund managers

Company engagement and progress against objectives is recorded

Risk monitored through the ESG risk dashboard

Escalation options are considered

> **"We conduct analysis to understand the market-wide and real-world impact of the issue"**

Review and assurance

Our stewardship programme is subject to a variety of internal and external assurances.

Internally, our formal policies are reviewed either annually or triennially by our investment committee. They also provide feedback on our research and position papers on emerging topics and industry developments.

Externally, we seek the insight and validation of a range of stakeholders such as our peers, fund managers, service providers, industry bodies and advocacy groups such as ShareAction.

As a signatory to the Principles of Responsible Investment (PRI), we receive external validation through our annual assessment report.

Case study:

Responsible securities lending

As part of implementing our climate change policy, we've been moving more of our investments into segregated mandates, giving us more direct control over parts of our investment approach. As a result, we've been considering how this will shape our approach to securities lending. This is a good example of how we consider issues, undertake research to understand them better, identify the right objectives, implement actions and then monitor results.

When assets – such as shares in a company - are lent out, Nest as the lender would no longer be able to exercise our voting rights on those shares unless we recalled them in time. It could reduce our influence through engagement activity because our shareholding would be diminished. There's also limited transparency as to who the borrowers are and what they intend to do with the shares. On the other hand, securities lending helps contribute to market efficiency, liquidity and transparency, which aligns with our commitment to improving how markets function.

We closely examined the pros and cons of participating in securities lending in our segregated mandates. The risks of these assets being not managed properly include:

- the collateral being inadequate to cover a potential default
- the borrowers' suitability and creditworthiness being substandard
- the potential for shares to be used to cause market volatility through manipulative short selling, where a seller sells a borrowed share at a high price intending to buy the actual asset when the price drops
- using borrowed shares purely to swing outcomes at shareholder meetings, known as empty voting

Our approach

We've decided not to carry out any securities lending in our segregated mandates at this time, and have set this out in our **approach to securities lending**. However, we'll continue to lend within pooled mandates, which include other investors, under more stringent requirements set out in our Investment Management Agreements (IMAs) with fund managers. This helps us pursue our responsible investment objectives and principles while also addressing the risks of security lending.

Our enhanced requirements include:

- ensuring that our fund managers can recall any lent-out shares or restrict the lending of shares so that we can vote or engage with key companies we're invested in
- asking our managers to ensure that they only lend to high-quality borrowers who are unlikely to default and who don't have a history of carrying out short-selling or voting in manipulative ways
- asking our managers to provide us with their securities lending policy and update us on any changes to it

We're also incorporating these considerations in our procurement, due diligence and ongoing manager monitoring activities.

By raising standards in the way securities are lent and borrowed within our sphere of influence, we hope to push the agenda forward and help improve how this market operates over the long term.

You can find out more about our governance and decision making processes in **chapter 8**.

Escalating high risk issues

We strive to be a pragmatic investor. That involves broadly supporting company management to do the best they can for their stakeholders. We favour constructive dialogue based on relationship-building, and avoid actions which can cause harm or volatility to the company. However, regular engagement doesn't always deliver the outcomes we hope for. If we strongly believe action needs to be taken faster, we'll bring an issue to the spotlight.

Before escalating our engagement, we'll think about:

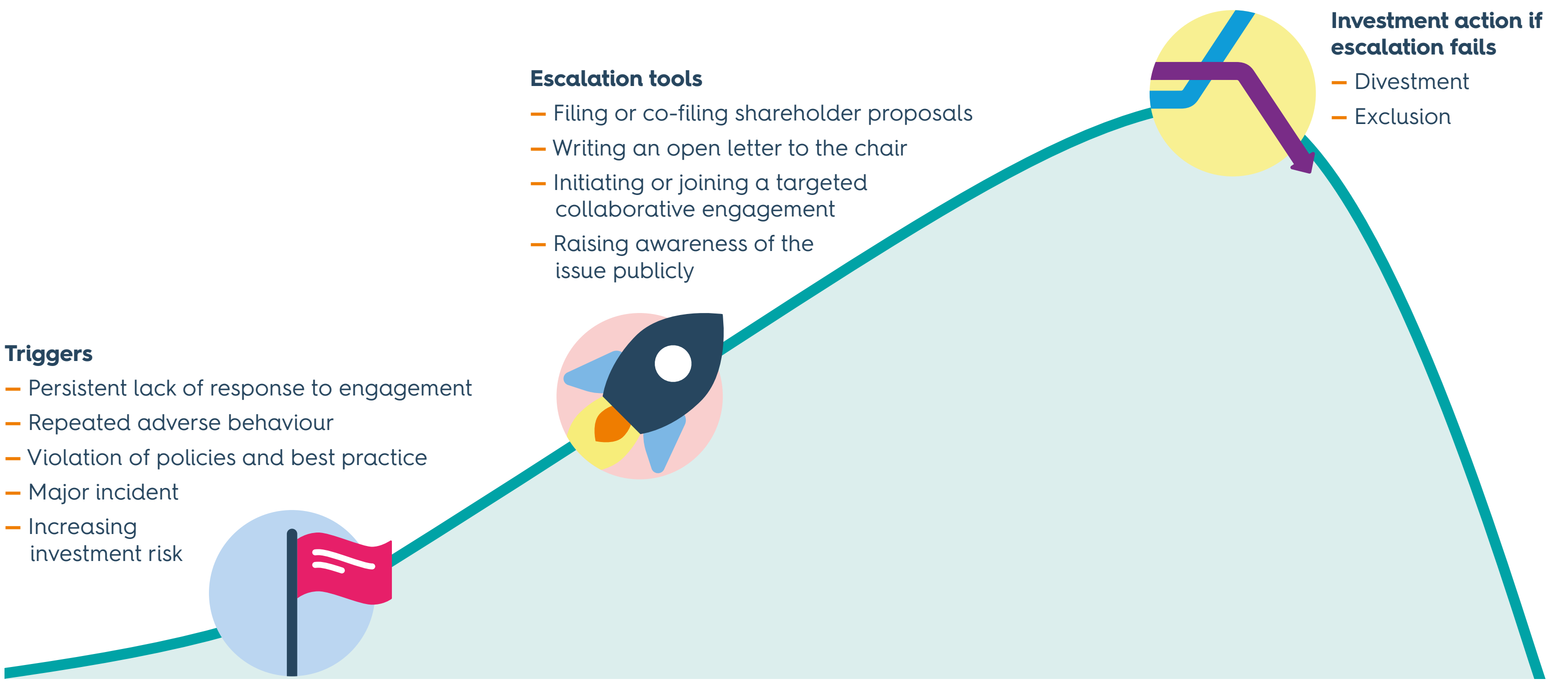
- the materiality of the issue
- the responsiveness of the company to engagement
- any historic patterns of negative behaviour
- the impact and likelihood of success of escalation

We've carried out a number of escalated engagements over the last year, including **Barclays and Total**.

We're also currently engaging with fund managers to agree a set of guidelines for escalation. One example is our need to set parameters for filing shareholder proposals.

Our escalation process is well developed in public equities and is applied in all geographies where we have significant exposure. However, we're looking to formalise our thinking across other asset classes, such as private credit and infrastructure.

Our escalation process



Divestment and exclusion

Engagement is usually the most effective tool for changing corporate behaviour. However, companies that refuse to change or aren't moving quickly enough to operate sustainably won't offer a good return for our members in the long term.

Divestment

If we think that engagement has reached its limits and the risk of holding the asset outweighs the benefits, we may decide to remove our exposure to a holding or industry. This is known as divestment.

We've already done this as part of our new climate change policy. We've divested or removed from our investible universe 116 issuers that make more than 20% of their revenues from thermal coal production and power generation, arctic exploration and oil sands at the end of 2020. We will look to phase out these activities entirely by 2025.[10]

Exclusion

We assess potential exclusions by conducting in-house research on the risks and benefits of continued exposure. Our investment committee is then tasked with reviewing and approving any proposals.

Our fund managers are regularly updated with any exclusion and divestment policies. If we spot a breach in our portfolios, we'll talk with the fund manager to understand why they're not aligned with our policies and to rectify the issue.

10 We'll be completely divested by 2025 at the latest, unless companies have a clear plan to phase out all related activitiy by 2030.

Managing conflicts of interest

An institutional investor's duty is to act in the interests of its beneficiaries. For Nest, these are the members of the scheme on whose behalf we invest their pension contributions.

Decisions about voting and engagement activity are agreed by the Nest investment team, with no influence allowed from any other areas of Nest Corporation, including any teams responsible for client relationships and client acquisition.

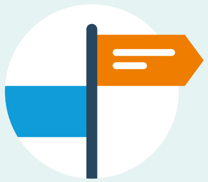
Our **conflicts of interest policy** is reviewed and approved by the investment committee every three years, and recently had some key updates:

- It reflects the revised Stewardship Code principle on conflicts of interest encouraging signatories to 'put the best interests of clients and beneficiaries first'.
- To avoid conflicts, the investment and responsible investment teams don't have access to a list of Nest's current or prospective clients, including both employers and members.
- A one-way system of information flow ensures that the responsible investment team doesn't become influenced or conflicted in its stewardship and investment activity.

We've developed a process to notify the Nest client relationship team ahead of each individual public engagement in the UK, but this is for their information only. Here's a recent example of how we handled a potential conflict of interest.

Issue

As part of our engagement with UK food retailers through ShareAction's Healthy Markets Initiative, we decided to publicly support a statement at a company's 2020 AGM. Our aim was to encourage the company to think more strategically about the issue of health and the potential impacts of government policy intervention and changing customer demand trends. The statement would have been accompanied by media activity.



The potential conflict

As a large workplace pension provider, Nest's customers include some of the UK's major employers, and there was a chance the company could have been a client. The public nature of the intervention could have strained the relationship if not managed appropriately.

How we dealt with it

We informed our designated representative, who communicated our intentions to the client relationship team ahead of the public intervention. This meant the client relationship team was in a better position to answer any queries from the client, and because of the clear and publicly available policy can make it clear that they have no influence on the responsible investment team's decision-making process.

Chapter 7

Our members

Our outlook is over years, if not decades. Our youngest member joined at just 16, and she – along with many other members – could be investing with us for more than 50 years. We therefore look to a long-term investment horizon rather than chasing immediate gains, believing it to be the best way to safeguard our members' interests.

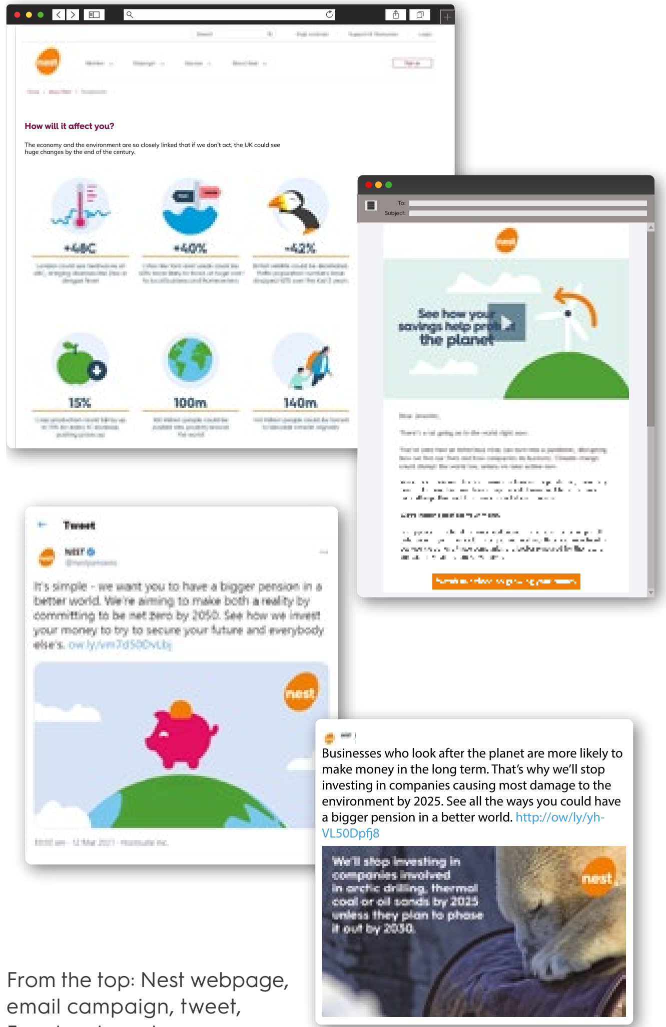
Communicating with our members

It's essential that we understand what our members need and expect from their pension savings, so that we can refine our investment beliefs and decisions to meet these requirements. That's why we run regular surveys that include questions on how our members feel about investment and ESG issues, as well as getting feedback from our Members' Panel.

Obviously, communication is a two-way street. We also talk to our members, sharing the decisions we've made and the research that drove us. Over the last year we've created monthly email campaigns, and video, social and digital content on a variety of investment topics. Through our online member community, Your way, we ask their opinion on every sizeable campaign we work on. We'll then adapt the communication to address any concerns or feedback before we publish it, to help ensure our content is easy to understand, access and engage with. It's led us to create more effective communications that aim to break down the barriers and demystify the world of pensions.

We've been recognised for this work. In ShareAction's survey of the responsible investment policies of UK master trusts, Nest was the only scheme ranked as 'leading' in reporting on ESG in the scheme annual report and engagement with members. We'll keep striving to create and deliver memorable, effective investment content for our members.

Nest member communications



From the top: Nest webpage, email campaign, tweet, Facebook post.

Could ESG topics increase pensions engagement?

Our research unit, Nest Insight, joined forces with Legal & General Investment Management to see whether communicating with Nest members about the ESG impact of their investments make them more likely to engage with their pension. This included whether they were influenced to seek more information, change their contribution levels or make more active investment choices.

We found that:

- savers who care about ESG issues are more likely to engage with their pensions and trust pension providers when told about responsible investment
- members tended to prefer communications that focus on investments proactively doing good, talk about the collective impact, include specific examples and highlight local rather than global impact
- the term 'responsible investment' is more likely to engage savers than 'ESG'
- many savers don't know that their pension savings are invested, meaning providers and Trustees need to build this understanding before talking about responsible investment
- savers who have low levels of engagement with either ESG issues or pensions are more likely to read and act on communications that don't mention responsible investment[11]

The full paper, **Responsible investment as a motivator of pension engagement**, is available online.

11 A survey was conducted with 225 Nest members in addition to wider research. See Nest Insight, Responsible investment as a motivator of pension engagement (2020).

Chapter 8

More about Nest

How we're run

Nest was established by the UK government in 2010 to support the introduction of auto enrolment into workplace pensions. The Nest pension scheme is run as a Trust by Nest Corporation with the purpose of providing pensions and other benefits in relation to its members. It's accountable to Parliament through the DWP but is generally independent of government in its day-to-day decisions. Being a public body means that we have no owners or shareholders and the scheme is run for the benefit of its members.

From December 2019, Nest's investment and investment operations teams were seconded into Nest Invest Limited, the investment subsidiary of Nest Corporation, which is authorised and regulated by the FCA. The responsible investment team sits within Nest Invest.

Our rigorous governance mechanisms reflect our position as a publicly-accountable scheme, and our stewardship activities and processes are supported and overseen formally by our governing bodies.

We work hard to continuously improve the governance of our responsible investment activities. One way we do this is by furthering our Trustees' knowledge of responsible investment through training and workshops.

Role: **Trustee and Board members**

Responsibility

Nest Corporation is the Trustee of the Nest scheme. The Trustee is comprised of up to 15 Board members and the employees of Nest Corporation. The Board members are collectively referred to as the Board of Nest Corporation, or simply the Board. They're supported by an executive team and a range of specialists who aim to make sure Nest works in the way it should.

Board members are currently chosen by the Secretary of State for Work and Pensions in line with public appointments guidance that promotes selection on the basis of merit, fairness and openness. At some point in the future we'll be able to appoint our own Board members through a process that includes input from our Members' Panel. The Secretary of State will decide when that will be.

Role: **Members' and Employers' panel**

Responsibility

The Trustee gets the views of members and employers using Nest through the Members' Panel and Employers' Panel. These two groups provide member and employer perspectives on investment to the Trustee and have a statutory role in reviewing the SIP. These checks and balances provide Nest with a high level of oversight in its investment operations.

Role: **Investment committee**

Responsibility

All investment decisions are overseen by the Trustee through the investment committee, a group of Board members and independent experts that meets quarterly to formally review investment operations and decisions. They decide on the recommendations of Nest Invest on a range of investment-related matters including:

- investment objectives
- strategic asset allocations
- approach to responsible investment
- evolution of fund choices
- fund manager selection and monitoring
- investment communications for members and employers
- investment costs

This committee also monitors fund performance and operation to make sure that the Trustee is fulfilling its legal duties.

Role: **Nest Invest Limited (In-house investment team)**

Responsibility

Nest Invest Limited (referred to as Nest Invest) is the name of Nest's investment subsidiary, which was authorised by the FCA as an occupational pension scheme firm in January 2020. It can act on behalf of its client, Nest Corporation, to provide regulated advice, arrange deals and provide instructions to fund managers with regards to the investments in the scheme's portfolio. The investment team at Nest Invest manages the investment of our members' money from day to day. They monitor the performance of our fund managers, consider the opportunities available in different asset classes and assess and implement our responsible investment requirements.

Role: **Fund managers**

Responsibility

The day-to-day management of Nest's assets is performed by external professional fund managers and from time to time, Nest Invest. Fund managers are monitored on a regular basis and performance is reported to the investment committee quarterly. Their activities are defined and constrained by detailed agreements. Fund managers have discretion to buy and sell investments within the terms of their agreements. The most up-to-date list of fund managers and the assets they manage on our behalf can be found in our **quarterly investment reports**.

Case study:

How our governance process works

We aim to take a considered, responsible approach to our investments. Here's how our governance process worked when developing our securities lending policy, previously mentioned in **chapter 6**.

1 The need

As we moved our developed and emerging equities into segregated accounts, we felt it was necessary to review our securities lending policy. It was designed for pooled mandates, which allowed less control of responsible investment activity. However, we needed to understand if securities lending in segregated funds would meet our responsible investment objectives and policies.

2 What we did

Members of the responsible investment and fund administration teams conducted in-depth research on securities lending regulatory developments, best practice, and what our peers and asset managers were doing. We then carried out a cost-benefit analysis, presenting four different options for carrying out securities lending depending on the mandate, and ensured they were aligned to our responsible investment objectives. Our findings were presented in a discussion paper for review.

3 Governance process

The governance and oversight process was multi-layered, with an initial review and discussion by the investment leadership team, followed by a submission for the investment committee. The proposed new securities lending approach was approved, and a further update was provided to the Board.

4 Why it worked well

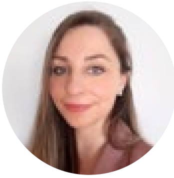
The collaboration across responsible investing and fund administration subject matter experts, as well as insights from external sources, academic and practical research, peers and our multidisciplinary team provided a holistic picture of the situation and the most appropriate options for a responsible securities lending approach. The investment committee and the Board could then put these options through rigorous discussion. This level of accountability meant we could confidently publish and implement our new approach.

Resourcing and support for responsible investment

Responsible investment expertise

Our responsible investment team is made up of five dedicated and experienced individuals who are supported by – and work collaboratively with – the entire investment team including the public and private markets, market risk and asset allocation teams to pursue our strategy. The combination of skill sets, diverse backgrounds and practical experience of team members is well suited to the development and execution of our responsible investment strategy and integration into Nest's wider investment approach.

Diandra Soobiah is the Head of Responsible Investment at Nest and has 18 years of investment experience. She joined Nest in 2010 and has helped build and develop Nest's responsible investment approach. She's responsible for its delivery and oversees the implementation and management of ESG factors across the scheme's assets. Diandra makes sure we fulfil our role as a responsible steward of our members' assets in order to deliver the best financial outcomes for our members. Diandra is certified under the FCA's Senior Managers and Certification Regime.



Mais Callan is Senior Responsible Investment Manager and has 15 years of experience working in stewardship and ESG integration. Mais joined Nest in 2019 having previously worked for nearly a decade at Hermes EOS as an ESG analyst, engaging with senior management of European and emerging markets companies, and then moving to lead ESG integration at Hermes. She's also worked as an advisor to alternative asset managers on ESG. At Nest, Mais focuses on developing our stewardship approach and leads our human capital, food systems and cyber security engagements.

Katharina Lindmeier CFA is a Responsible Investment Manager with five years' investment experience. Katharina joined Nest in 2019 having previously worked in responsible investment roles at RPMI Railpen and Aberdeen Standard Investments. Katharina is focused on environmental issues and is primarily responsible for the development and delivery of Nest's climate change policy.

Louis Ryall is an ESG Research and Voting Analyst at Nest. Louis joined Nest in January 2021 and has just graduated from Imperial College Business School where he completed a master's degree in climate change management and finance. He will be leading Nest's proxy voting efforts as well as providing support on ESG research and engagement.

Dr Paul Cox is Head of Investment Development and Process. He advises on and inputs into Nest's delivery and strategic direction of the responsible investment approach. He's led research on the impact of extra-financial factors on Nest's investments and was instrumental in the design of the Nest Climate Aware Fund.

Responsible Investment Stakeholder Group

In early 2020, we established the Responsible Investment Stakeholder Group, which includes senior departmental leaders across Nest as well as our CEO. Ongoing responsible investment priorities and progress are discussed at a quarterly forum, and knowledge is shared so that activities and decisions are aligned.

Training and development

We strive to be thought leaders. It's important that we keep building and sharing our learnings both within the investment team and throughout the organisation to help embed responsible investment in all our decision-making and culture. We do this through:

- Trustee training: We've established a training programme for our Trustees, covering the fundamentals of responsible investment and key ESG themes.
- Responsible investment week: Every year, Nest holds a company-wide week-long event dedicated to responsible investment, where we run a series of presentations and webinars on topical ESG issues, drawing on the insights of both internal and external experts.

Performance and reward

Stewardship performance expectations go beyond the remit of the responsible investment team. The wider investment team and many of Nest's senior leaders, like our CEO and CIO, have objectives that include key performance indicators on delivering sustainable outcomes for our members.

Our stewardship commitments

We support and follow various codes of best practice, actively participating in initiatives and reporting requirements for the UN-backed Principles for Responsible Investment (PRI) and other groups. Acting as part of a coalition of like-minded investors gives us collective clout, and gives a clearer voice to the millions of members we act on behalf of.

Nest is currently a member of, signatory to, or supports, these global and local initiatives including:

- Principles for Responsible Investment
- FRC UK Stewardship Code
- FRC UK Corporate Governance Code
- Institutional Investor Group on Climate Change
- Workforce Disclosure Initiative
- Financial Stability Board's Task Force on Climate-related Financial Disclosure
- Pensions and Lifetime Savings Association Stewardship Advisory Group
- Transition Pathway Initiative
- Farm Animal Investment Risk and Return
- ShareAction's Healthy Markets Initiative
- ShareAction's Good Work Coalition
- 30% Club UK Investor Group
- UK Sustainable Investment and Finance Association

Nest's diversity and inclusion policy

In 2019/20, 26% of Nest's staff were from a Black, Asian or minority ethnic community and 50% were women. However, we want to do more.

We've set ambitious but achievable targets in our diversity and inclusion strategy, aiming for:

- at least 30% of our executive team to be women, and 50% of our leadership to be women, by 2025
- increasing Black, Asian and minority ethnic representation at leadership and Board level, including having at least 2 Black directors by 2025
- at least 13% of our executive team to be from a Black, Asian or minority ethnic community by 2025, in line with the UK's working-age population
- at least 12% of our leadership and executive team to be people with a disability by 2025, in line with the UK's working-age population

We benchmark ourselves against other organisations and take part in accreditation programmes such as the DWP's Disability Confident employer programme, HM Treasury's Women in Finance Charter, the Stonewall Workplace Equality Index, Healthy Workplace Charter and Timewise.

Nest's workforce

25%

of Nest's workforce are from a Black, Asian or minority ethnic community

49%

of Nest's workforce are women

44%

of Nest's director-level roles and above are held by women, exceeding the 2019 HM Treasury Women in Finance Charter target of 30%

Disability Confident employer (level 2)

Nest fosters an environment where staff feel able to declare their disability status

An accredited Living Wage employer

Nest worked with Ambitious about Autism piloting work placements for people with autism

Figures as at March 2021

An industry-recognised approach

Awards

European Pensions Awards

European Pension Fund of the Year
Awarded for our risk management approach, in particular for ensuring responsible investment is an integrated part of our default strategy and risk analysis rather than an add-on.

Investment & Pensions Europe

Long-Term Investment Strategy
Investment & Pensions Europe said Nest's 'single-year target date funds, diversification and the funding of an innovative climate-aware fund make it one of the most innovative schemes in Europe'.

Corporate Adviser Awards

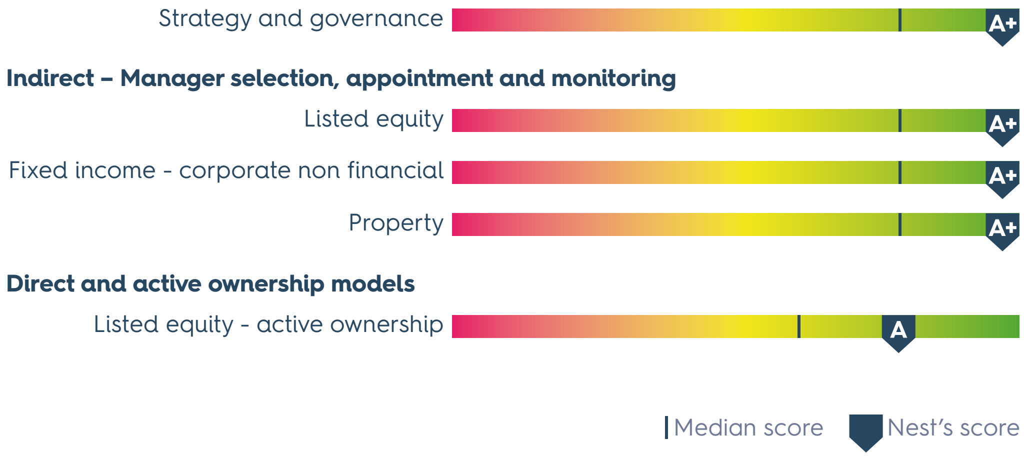
Best Default ESG Strategy
Recognised for reaching out to our members to understand their needs and our commitment to decarbonising our portfolios.

Pensions Age Awards

Best Investment Strategy
Praised for our clear understanding of the needs of an unengaged population and demonstrating that ESG is a clear and integral part of risk management, with our divestment from tobacco being one of many examples.

A top Principles for Responsible Investment rating

We're delighted that our hard work has been recognised. In 2020, we were awarded an A+ rating across the majority of the Principles for Responsible Investment's (PRI) assessment framework categories.

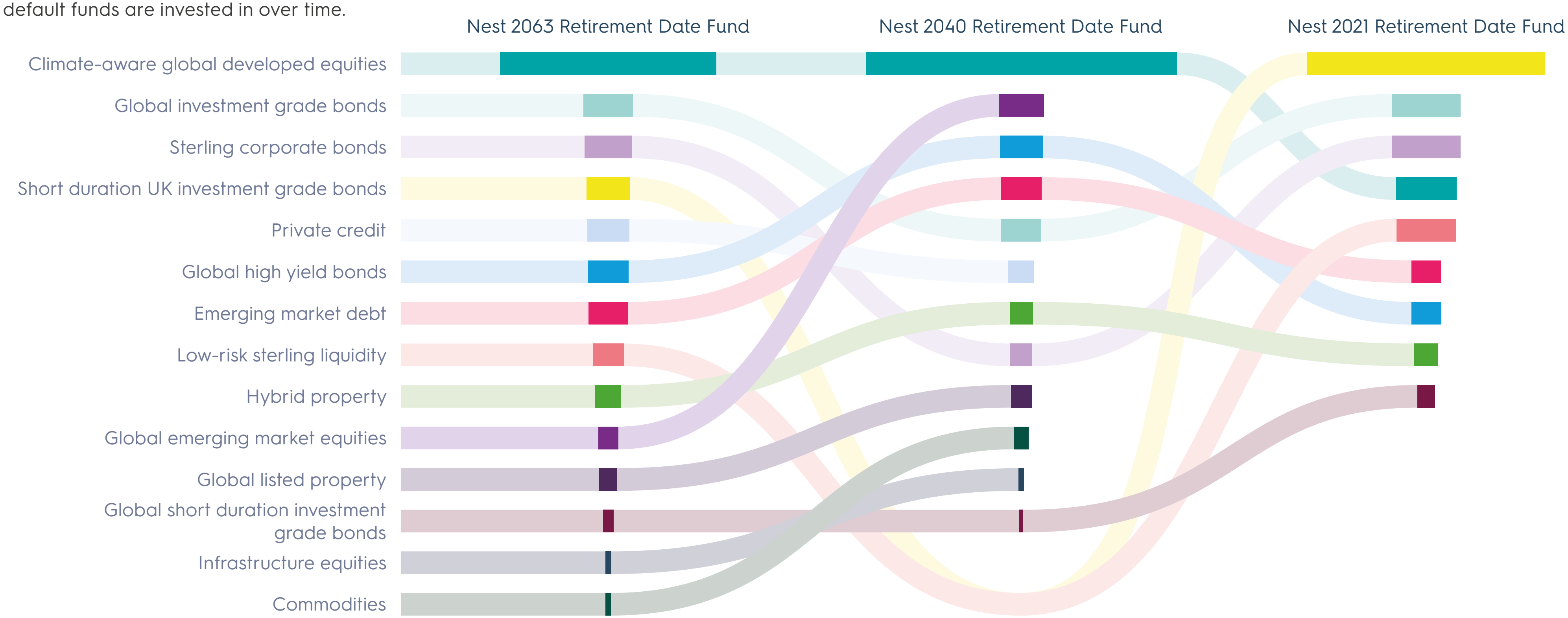


Principles for Responsible Investment, Nest Assessment Report 2020

Our asset allocation over time

Our investment strategy flexes depending on how close a member is to retirement. This helps us invest in appropriate asset classes and mandates over a long timeframe. We invest in higher risk, higher growth assets when a member needs to grow their savings, and begin shifting to less volatile assets a decade before they retire.

This visualisation shows you what our default funds are invested in over time.



Chapter 9

Meeting the FRC's Stewardship Code

The information in this report is intended to meet the reporting expectations against the FRC Stewardship Code's 12 principles.

Stewardship code principle	Page reference
Principle 1: Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.	7, 8, 38
Principle 2: Signatories' governance, resources and incentives support stewardship.	25, 29, 34-37
Principle 3: Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.	31
Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.	9, 10, 13, 26, 38
Principle 5: Signatories review their policies, assure their processes and assess the effectiveness of their activities.	24, 28, 29, 32
Principle 6: Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.	5, 26, 32-35, 40
Principle 7: Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.	22-28
Principle 8: Signatories monitor and hold to account managers and/or service providers.	10, 25, 28

Stewardship code principle	Page reference
Principle 9: Signatories engage with issuers to maintain or enhance the value of assets.	6, 9-11, 16-21, 23, 24, 26
Principle 10: Signatories, where necessary, participate in collaborative engagement to influence issuers.	16-21, 26, 38
Principle 11: Signatories, where necessary, escalate stewardship activities to influence issuers.	6, 16, 30
Principle 12: Signatories actively exercise their rights and responsibilities.	6, 15, 24, 29

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