Building new norms

An update on our responsible investment activities 2018

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CIO foreword

Mark Fawcett

Our members are at the heart of everything we do at NEST, which is why we're pleased to reflect on their perspective in this year's report. Generating interest in pensions is hard at any time, engaging savers who haven't made an active choice to join a pension scheme is even harder. We, and others across the industry, are beginning to take a closer look at how we can better connect people to their pension savings. The research we present in this report shows that responsible investment, in all its forms, may be a way of achieving this.

Our findings show that we can build members' trust and confidence in saving by improving awareness and understanding of how we invest responsibly.

We're not the only ones reaching this conclusion. The House of Commons' Environmental Audit Committee, to which we gave evidence earlier this year, was particularly interested in understanding the information that reaches members about how pension schemes are addressing climate risk.

ShareAction, in their latest rankings of pension providers, also highlighted the issue. We were delighted to be top of the league for our responsible investment approach but agree with their assessment that there is a way to go, as a scheme and as an industry, in communicating our efforts effectively to members. We hope some of the plans we set out in this report will be helpful additions to the industry debate on how to do this.

Elsewhere, we're continuing to evolve our investment strategy at pace. We're fast approaching being one of the largest pension schemes in the country, which brings with it new challenges as well as many exciting opportunities.

From a responsible investment perspective, we're breaking new ground by integrating environmental, social and governance (ESG) concerns into alternative asset classes. Our new commodities mandate is a bespoke design that brings a responsible lens to an asset class that has traditionally had real challenges with ESG issues. Because of our approach, we can give members access to the benefits of these investments while managing ESG risks.

Having a larger asset base not only means we're able to require more from our investment mandates, we're also beginning to wield more influence in our engagement activities. This goes for our direct voting and engagement with individual companies, as well as our strategic engagements at the market and regulatory level. For example, this year we supported the 'Follow This' shareholder resolution calling for Shell to set business targets in line with its climate change commitments. By publicly signalling our intention to vote in favour of this resolution, our aim was to send a stronger signal to Shell of shareholder sentiment and to encourage others to do the same.

We're also pleased to see our engagements with fund managers bearing positive results.

This year we've been successful in achieving positive outcomes by collaborating with our fund managers on several key votes during the voting season. We believe this is due to our ongoing, proactive approach and persistence in engaging with our various stakeholders, as well as our growing presence as an asset owner.

Finally, we're lending our support to initiatives that seek to improve sustainability standards across the board and drive a more responsible capitalism throughout the global economy. These include the Taskforce for Climate Related Disclosure (TCFD), established by Mark Carney, Governor of the Bank of England.

"We, and others across the industry, are beginning to take a closer look at how we can better connect people to their pension savings."

We support the aim of establishing global climate reporting standards and have led by example by reporting against the framework for the first time in our annual report and accounts this year. We joined the Implementation Taskforce on Growing a Culture of Social Impact Investing in the UK, established by the prime minister. And we're looking into how we can begin using the UN Sustainable Development Goals as a framework for assessing and reporting on our responsible investment objectives.

As ever, we aim to achieve big results while keeping costs low for our members. We hope this third annual responsible investment report, which can only ever be a summary, provides an informative snapshot of all the work that has taken place over the last year and our ongoing commitment to delivering the best outcomes for members.

"Planning for retirement is about having a good view on your investments. It's important to know how those investments can be used to support your lifestyle."

Adrian Towers
General manager,
Guiseley football club

Introduction

What's covered in this report?

This year's report highlights our activities, key achievements and sets out our priorities for the coming year. We're committed to keeping our members, their employers and our stakeholders informed about our responsible investment activities. We want to share news about the impact we're having across our members' investments and the broader investment industry.

As always, our members are at the forefront of our decisions and the actions we take in our investment approach. Our ambition is to deliver the best financial outcomes for them and having a robust responsible investment approach is key to that. We also believe responsible investment is an excellent subject to get members engaged and interested in their pensions. It can help put what happens to their money into context.

A key focus of this report is to present our thinking on how we might communicate our responsible investment strategy to millions of members and think about channels for engagement and feedback. We also intend to use some of the information presented in this report to create a summary report specifically for members. We recognise the vast challenge of being able to communicate to and effectively engage with over 7 million members. However, with real commitment and the help of our stakeholders we hope this is a challenge we can successfully overcome.

This report covers five key topics:

- **Thinking about members** looks at the key findings from some of the research we've done with members over the year. We also present a snapshot of the member communications and engagement strategy we're starting to roll out (page 10).
- **ESG issues in our asset allocation** reports on how we're addressing specific environmental, social and governance (ESG) issues in our asset allocation, including the investment risks associated with tobacco stocks. We also provide an update on the performance of our climate aware fund and discuss how we are managing ESG risks in our new commodities mandate (page 13).
- **Creating better functioning markets** looks at how we've engaged with our stakeholders and industry bodies and the contribution we're making to help raise standards across the investment industry (page 23).
- **Active ownership highlights** provides a snapshot of key voting decisions and engagements we've undertaken with investee companies over the year (page 28).
- **Looking ahead** describes our priorities over the next year (page 33).

Executive summary

Key findings from our members

Pensions are becoming normal

Support for auto enrolment is high:

83%
of workers eligible for auto enrolment agree it's a good idea.

Only
4%
disagree today compared with **8%** in 2014

More workers are now considering the quality of an employer's pension when deciding where to work:

2014 **15%**

2017 **37%**

More workers now think saving in a pension is the normal thing for people like them:

2014 **25%**

2017 **46%**

But engagement in pensions is still low:

Across the working population,

17% of workers can't name their pension provider.

We see this at NEST too:

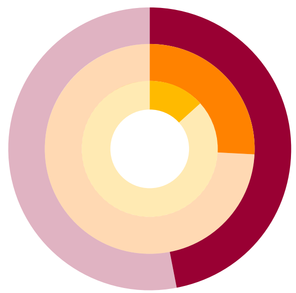
Only
17%
of our members logged onto their online account in 2017.

18%
of our members weren't certain or didn't know they had a NEST pension.

4%
didn't know they were saving in a pension at all.

People expect their pension provider to be investing responsibly:

We asked members how important it was to them that their pension scheme considers how the companies and markets they invest in are run, and how they treat people and the planet.



47%
Say it **matters a lot** to them.

26%
agree with this if it produces better returns.

Only
12%
say it doesn't really matter to them at all.

Responsible investment could build trust and confidence in pension saving too.

We asked members if information about what we do as a responsible investor would*:

improve their impression of NEST.

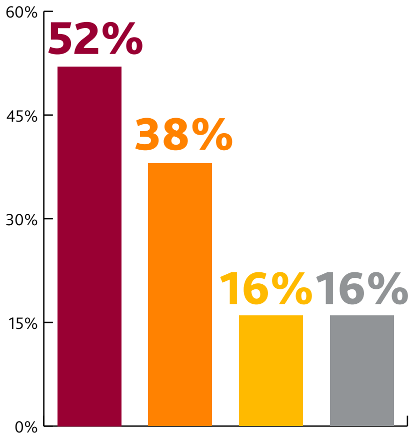
make them feel more confident about saving with NEST.

make them more interested in their pension.

- Agree (8-10)
- Neutral (5-7)
- Disagree (1-4)
- Don't know

* Percentages are approximations

Members told us this would give them a greater sense of trust in NEST:



- Knowing NEST's governance makes sure my money is safe.
- Knowing NEST holds the companies it invests with to account on things like executive pay, environmental damage and human rights.
- If I saw the media and organisations I trust rate NEST highly.
- If I felt NEST's website and communications were designed with people like me in mind.

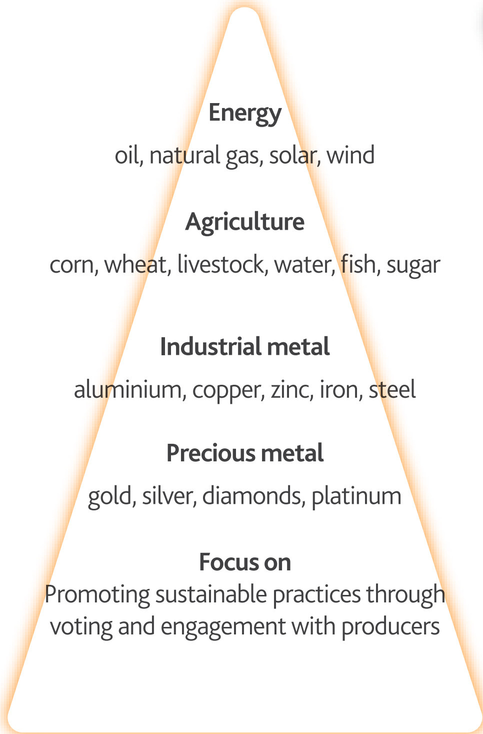
For more information see pages 10 to 12.

ESG in our asset allocation

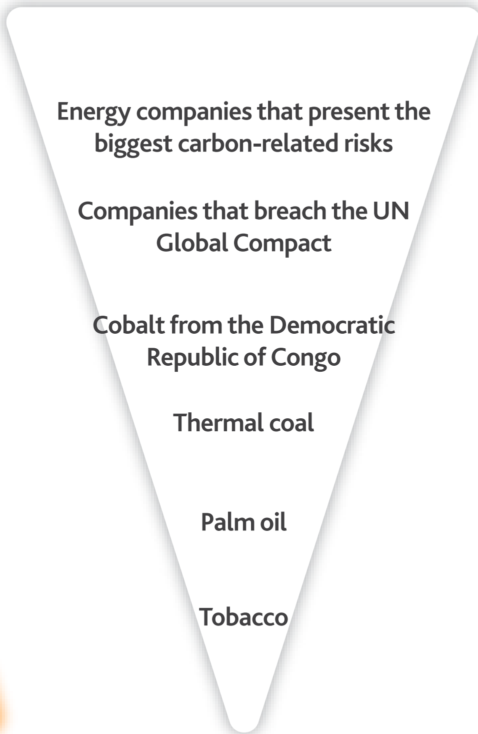
A responsible approach to commodities

We've introduced commodities to our members' investments, taking a unique approach to managing environmental, social and governance risks associated with the sector. See pages 14 to 16 for more detail.

What's in?



What's out?

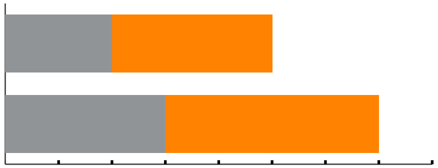


Mapping the impact of our climate aware fund

For members in our default funds, we've increased their climate-aware investments to:

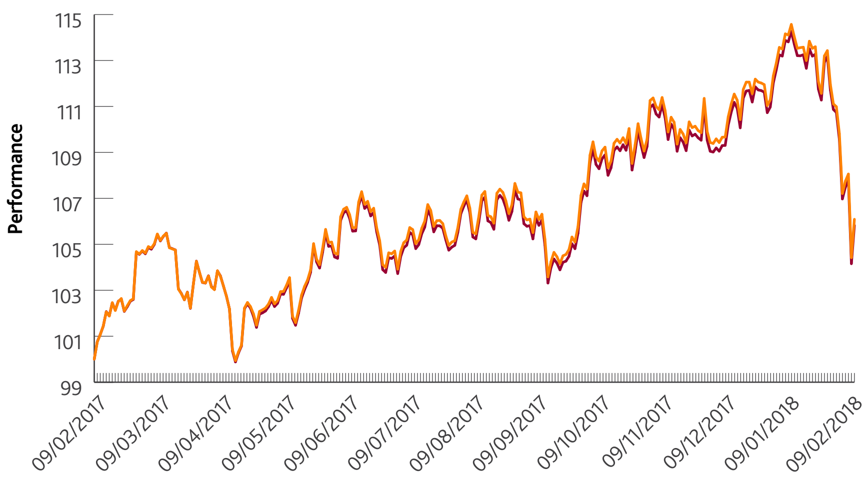
30% of global developed equities in the growth phase (up from **20%**)

40% of global developed equities in the foundation phase (up from **30%**)

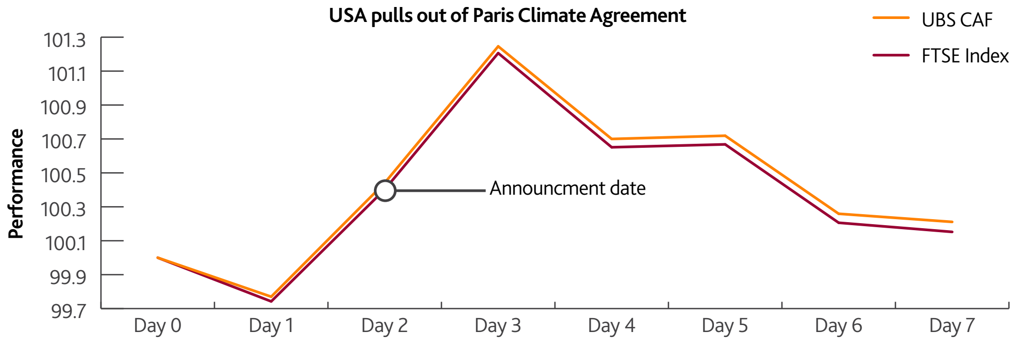


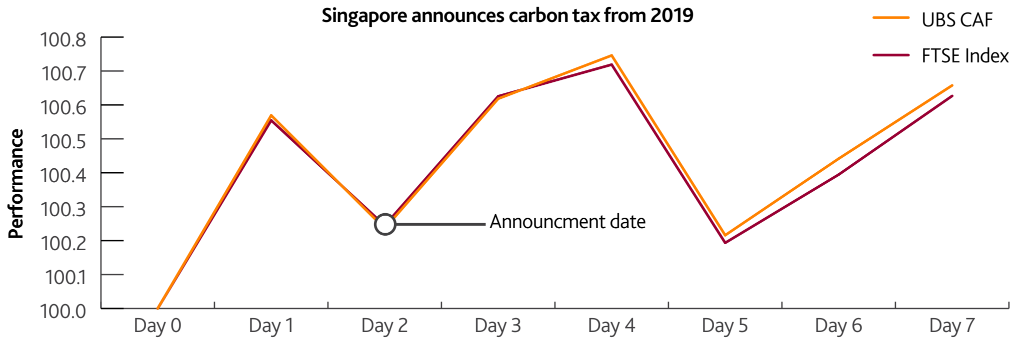
Investing money in our climate aware fund, we've calculated that our members' investments have avoided carbon emissions equivalent to taking **27,239** cars off the road each year, stopping **14,524** tonnes of waste going to landfill or powering **6,248** homes for a year.

We've also found that, in its first year, our climate aware fund had better investment returns and better risk characteristics than the FTSE World Index – the differences are small due to the design of the fund, but are statistically significant so far. The below graph shows how the climate aware fund's performance compared to the benchmark:



Our analysis found that one potential driver of this improved performance was how the share price of companies in the fund responded to negative climate-related news. Below you can see that the climate aware fund appears to respond better to these events than the benchmark, because it invests in more companies that are well-positioned for a low-carbon future and fewer that are contributors to climate change:





These small improvements in performance have added up over time and contribute to the overall outperformance of our climate aware fund. While this data represents only a very short time frame, we think it's encouraging and will be keeping a close eye on how the trend develops. See pages 19 to 20 for more detail.

Creating better functioning markets

Working with others to improve standards

Over the year, we've engaged with a range of key industry players, regulators and standard setters to help shape frameworks and standards that will improve outcomes for all. As a voice for over 7 million UK workers, we've lent our support and provided input to the following initiatives:

See pages 23 to 27 for more detail.

Active ownership highlights

Voting and engaging with companies

The 2018 voting season was significant, with rising levels of dissent from shareholders. We're particularly pleased to see our global developed equities fund manager UBS, taking a more proactive stance with companies we invest in on our members' behalf. They voted against management 2,825 times this year, including key votes at companies like Alphabet and Halliburton on poor board-level gender diversity, and supported 30 per cent more shareholder resolutions than last year:

Our developed equities fund manager voted against management

2,825

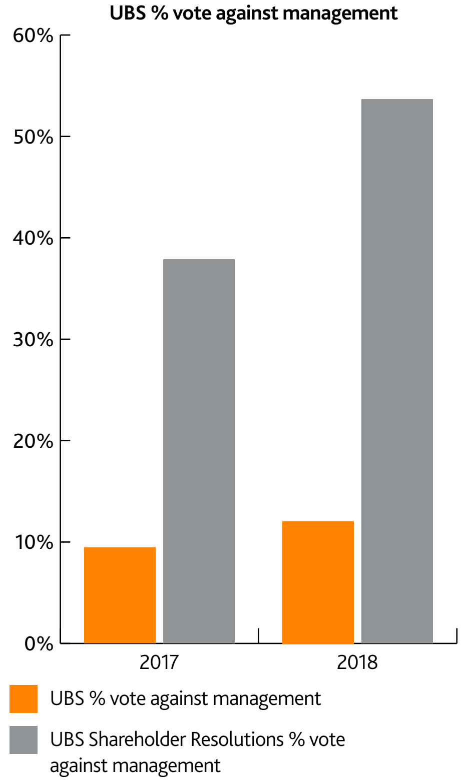
times this year

and supported

30% more

shareholder resolutions than last year

See pages 28 to 32 for more detail.



1. Thinking about members

Engaging with members

Engagement with pensions in the UK is generally very low, and NEST's experience is no different. Only 17 per cent of our members logged onto their online account in 2017. In our latest member survey, we found that nearly a fifth of our members weren't certain or didn't know they had a NEST pension. Indeed 4 per cent didn't know they were saving in a pension at all.

It's still early days of course, but as auto enrolment beds in here in the UK, the national debate is turning to how we can engage savers more to help them understand their options and take greater control over their retirement outcomes.

Evidence from Australia, where the defined contribution (DC) market is more mature, suggests that scheme members may begin to take notice and want to engage more with their pension pots when they reach a certain size. For example, having a pot big enough to buy a holiday or a car starts to mean something to people.

Over the next few years, many of our members will move from having a few hundred pounds in their pots to a few thousand. Having got through the initial set-up period of auto enrolment successfully, now is the right time to start thinking about how we can talk to our membership about their investments in a more meaningful way.

Responsible investment as an engagement tool

We invest responsibly because it leads to better long-term risk adjusted returns. We also believe that most savers want and expect their schemes to be taking a responsible approach to investing. Among our membership, nearly half of those surveyed (47 per cent) say they feel it's very important to them that NEST is making investment decisions that consider how companies and markets are run and how they treat people and the planet. A further 26 per cent agree with this if it produces better returns, while just 12 per cent of members said it doesn't really matter to them at all.

Before designing our investment strategy, we carried out extensive research among the UK population that would become eligible for auto enrolment to understand their needs, attitudes and behaviours when it comes to pension saving. As part of our ongoing commitment to providing a high-quality scheme in members' interests, we regularly conduct research with our membership and the wider population eligible for auto enrolment. We use this research to explore reactions to specific issues and to track how attitudes, behaviours and needs might be evolving over time. Attitudes to responsible investment are one of the topics we've started to explore within this programme of research. Referenced in this section are several quantitative online surveys of NEST's membership and the wider eligible population for auto enrolment. All survey results are weighted to be in line with the relevant population*.

* The surveys referenced in this section are:

- NEST member survey conducted online in November 2017 with 3543 members. Results are weighted to reflect NEST membership by age and gender.
- NEST member survey conducted online in September 2017 with 5481 members. Results are weighted to reflect NEST membership by age and gender.
- NEST consumer survey conducted online in November 2017 with 1030 individuals working in the private or third sector and eligible for automatic enrolment. Results are weighted to be reflective of this population.

Given this level of interest, it's frequently suggested that raising awareness of how a scheme is investing responsibly can help engender trust in pensions, improve engagement and provide members with a greater sense of ownership and appreciation of their pension.

When we tested this, we found that it rang true for our members. We gave a sample of our membership some information about what we do as a responsible investor. Half of those surveyed said this information improved their impression of NEST, while 44 per cent said it made them more interested in their pension. Nearly the same number (45 per cent) agreed it made them feel more confident about saving with NEST.

Improving trust in pensions

Pension saving seems to be becoming an accepted social norm. Support for the auto enrolment policy is high with the number of people disagreeing with the idea of auto enrolment halving between 2014 and 2017 from 8 to 4 per cent.

When deciding where to work, the quality of pension an employer offers is important to more than twice as many people today (37 per cent) as in 2014 (15 per cent). The proportion of workers agreeing it's normal for people like them to save in a pension has risen almost as much.

However, general levels of trust in pensions are still low and seem unchanging. 25 per cent of people still say they don't trust pension companies, showing little improvement over the last four years. 73 per cent of our members agree that saving in a workplace pension is a good idea, but fewer members are confident about the security of their pension saving with only 43 per cent agreeing that 'my money is safe with NEST'.

The question of safety and security of their money is paramount in members' minds. When asked to rank the things that would make them have greater trust in NEST, knowing that we were keeping their money safe was the top response. This chimes with much of our previous member research which consistently reveals a limited understanding of pensions but a sense that their pension savings are about prudence and security and therefore keeping their money safe is of paramount importance*.

Giving members information about where and how their money is invested, including how we're looking after it by being responsible stewards and owners of capital, should go some way to giving members the reassurance they seek.

25%
of people don't trust pension companies

73%
agree a workplace pension is a good idea

43%
agree that their money is safe with NEST

* See NEST's previous research, **Improving consumer confidence in saving for retirement**

This hypothesis is supported by our research. In the ranking of what would give members a greater sense of trust in NEST, knowing that we hold companies we invest in to account would positively influence a sense of trust in more than a third of our members. It was far more likely to influence their views than hearing that NEST was rated highly by the media or organisations they trust, for example, which just 16 per cent of members ranked in their top three. Almost two thirds of members also said it was important that NEST tell them about our responsible investment activities.

> "Knowing that we hold companies we invest in to account on things like executive pay, environmental damage and human rights would positively influence a sense of trust in more than a third of our members."

Developing our member engagement strategy

We believe the evidence therefore supports building a member engagement strategy that incorporates information about our responsible investment approach. While we always aim to be open and transparent about our activities there is more we could be doing to communicate, in an engaging way, to our membership.

We're already supporting the Cambridge Institute for Sustainability Leadership on a research project to understand how to best present information on social and environmental impact in investment fund fact sheets. We're also collaborating across industry on a project to improve the annual member benefit statement and plan to incorporate information on our responsible investment approach in future versions.

As part of our medium-term member engagement strategy we'll be looking to provide members with tailored and personalised videos and bulletins directly to their inboxes.

We'll also be further improving the information members can find about their investments via the website. In the longer term, we'll be exploring ways to have more of a two-way dialogue with members, over and above the member surveys and research we do. For example, the idea of annual general members' meetings, potentially held virtually, to overcome the logistical challenges of convening a broad-based membership, is one area we're planning to explore in future. Other activities will include producing member-facing videos, social media content and online information that we can direct members to, including member-facing versions of this report.

Giving members more insight into where their money goes and the impact it's having is engaging and helps bolster trust and confidence in pension savings. After all, responsibly managed pensions not only improve financial outcomes for members but can help improve the society and environment we all live and retire in. It's a great story that we're working hard towards sharing with over 7 million members.

2. ESG issues in our asset allocation

Environmental, social and governance (ESG) factors in alternative investments

Since auto enrolment came into effect, we've been building on the foundations of our investment approach by adding a range of fixed income, real estate and equity-based asset classes. We're now considering the next steps in the evolution of our investment approach.

Our assets under management are set to grow steeply from here as minimum contribution levels rise. Furthermore, all indications point to markets performing differently over the next decade to how they've done since NEST's inception. This means we need to evolve our asset allocation at a quicker pace, if we're to continue to meet our investment return objectives for members long into the future.

This year we've been researching a new range of alternative asset classes like commodities, infrastructure and private debt. For us, before including an investment mandate in a new asset class, we need to understand the ESG risks and opportunities involved. Our goal is to improve our understanding of the types of issues found in less traditional asset classes like private debt. This is so we can frame the right questions to prospective fund managers about their approach to identifying ESG opportunities and risk management and choose the right partners to deliver strong risk adjusted returns for our members.

We also want to help develop best practice in alternative asset classes, as we have done with traditional asset classes.

We'll continue pushing for higher standards across the fund management industry. However, as we continue to grow and build an investment approach that works for the future, we also want to have more direct control over how ESG issues are managed in our portfolio. Our new commodities investment mandate, which we added earlier this year, is an example of how we're setting about doing this.

> "We'll continue pushing for higher standards across the fund management industry."

What are Commodities?

Commodities are raw materials or primary agricultural products that can be bought and sold, such as copper, coffee or oil. Typically, commodities are expensive to store because they're perishable or unwieldy. Commodity producers generally have seasonal (e.g. farming) or undiversified (e.g. mining) business models and therefore rely on financial markets to mitigate the risk of producing a single product. For example, producers can guarantee they'll be able to secure a certain price for their goods by issuing 'futures' contracts. These are agreements to buy or sell a predetermined amount of a commodity at a specific price on a specific date in the future. This allows sellers to cover their production costs without risk, enabling them to concentrate on their core competency of producing the commodity. Buyers use such contracts to avoid the risks associated with fluctuations in price of the underlying product or raw material.

Case study 1- ESG aware commodities

We recently added a commodities mandate to our portfolio to enhance diversification and provide inflation protection for our members. As we highlighted last year, investing in commodities gives rise to various ESG risks and opportunities given the sectors that dominate this asset class, namely oil, mining and agriculture.

Over the past year, we carried out research to understand these factors and how best to manage and mitigate some of the risks involved. After an exhaustive selection process, we awarded the mandate to CoreCommodity Management, who were open to helping us design an appropriate ESG risk management strategy.

NEST's fund will be predominantly invested in commodity futures but will include a proportion of shares in companies involved in commodities production. Holding equities in the fund improves the overall return profile but also allows us to engage and vote on important issues affecting the sector.

The selection process

ESG considerations formed an integral part of our evaluation of available commodities funds.

In our request for proposals we asked questions and set out requirements on, for example, managing climate risks, or whether ESG opportunities in agriculture were identified and addressed. We asked about how fund managers dealt with social risks, such as child labour and health and safety issues, which can arise in sectors like mining.

We were also keen to understand the physical impacts of climate change on agriculture and how a fund's exposure to oil might interfere with the objectives of our climate aware fund. If a fund manager was unable to demonstrate a good understanding of these issues, it was reflected in their final score and they were unlikely to progress to the next stage.

NEST's first segregated mandate

We met with a range of fund managers, including some who demonstrated strong ESG credentials. However, we felt we needed to have tighter control and management of these various factors, given their importance to our investment principles. As a result, we decided to establish our first segregated account. This means the fund is solely for us and will have no other investors, giving us control of the design and direct oversight of the fund.

This structure allowed us to put in place a bespoke range of protective measures to manage the ESG risks involved in investing in commodities, in line with our members' needs and expectations.

Our ESG requirements

We worked with CoreCommodity Management to agree our voting, ESG screening and carbon risk management requirements, as follows:

- We want to manage the biggest carbon risks across NEST's portfolio as identified by our climate aware equity fund and not inadvertently allocate more money to those companies. We've therefore specified that our commodities fund not invest in companies we've identified as presenting significant carbon risks. This includes companies whose main operations are focussed on coal production. We'll still have exposure to some of these companies via the climate aware fund, so we can continue our engagement with them.
- The fund does not invest in what we regard as highly controversial and risky sectors, including cobalt mined in the Democratic Republic of Congo (DRC), thermal coal, palm oil, uranium or tobacco. Whilst exclusion is not a key feature of our management of ESG risks, engagement is difficult to undertake in commodity futures markets as the source of the commodity is often not known. Exclusion is therefore preferable in these circumstances. We believe that investment in these sectors represents poor value for our members over the long term.
- Some oil and mining companies operate in countries where there are weak regulatory regimes. It is up to individual companies to uphold high standards of conduct and treat the local environment and their workers decently. Unfortunately, this doesn't always happen. In limited circumstances, we want the discretion to remove companies from the portfolio that persistently contravene globally agreed principles like the UN Global Compact. We've set up and will manage the exclusion criteria and thresholds ourselves.
- We'll execute the voting of shares in the commodities fund via our proxy voting partner Minerva Analytics. This is the first time we'll be voting shares directly without the need to work with a fund manager. It's an exciting development for us as it means we can vote directly in accordance with NEST's voting policy and send clear signals to companies.
- The strategy will only invest in liquid commodity markets and does not 'short' futures or equities. This means the fund will not be creating pricing volatility that will potentially impact consumers. Furthermore, the fund will sell futures contracts before expiry and so will never take physical delivery of a commodity. This minimises ESG risks and price impacts on the market.

Cobalt in the Democratic Republic of the Congo

There are several commodities we've asked our fund manager to exclude due to ESG concerns, including cobalt mined in the Democratic Republic of the Congo (DRC). Cobalt is a material widely used in aerospace, machinery manufacturing, electrical, chemical and other industrial areas. It was historically sourced as a by-product of nickel and copper mining. But as the number of open cast nickel mines has decreased, so has the supply of cobalt. As a result, specialist cobalt mines have taken up the shortfall in supply. It is mined in several regions globally, but the bulk of supply originates in the DRC.

As cobalt prices have increased, so has unregulated cobalt mining. It is estimated that 20 per cent of DRC production is sourced from mines where serious social issues have been noted*. UNICEF has published reports highlighting the extensive use of child labour with little concern for human welfare or environmental standards. Children are subjected to unsafe working conditions, heavy metal dust inhalation and prevented from attending school.

Cobalt is not currently in the benchmark index for our fund and many fund managers we met with didn't think it was suitable for us due to liquidity and transparency issues. However, Glencore, which might have featured in the equity portion of our commodities portfolio, has extensive presence in the DRC. We've asked CoreCommodity to exclude the company given its cobalt mining operations in the DRC and other high-risk jurisdictions. We're still invested in Glencore via our passively managed developed equity portfolios. However, we'll use the knowledge we've gained here to continue our engagement and voting, pushing for change in their conduct.

* Source: Lazard Asset Management

Case Study 2: Our research on tobacco investments

In recent years, the question of investing in tobacco companies has gained attention. Campaigners have called on investors to sell tobacco holdings and several institutions have recently done so. As part of this discussion, we spent part of this year undertaking research and analysis to help establish our position on tobacco investments. As with all our investment research, our aim was to conduct an even-handed analysis.

There have long been concerns about the tobacco industry, which has the largest societal externalities. Externalities are costs borne by society that aren't included in the price of the product. Tobacco smoking has a societal burden equivalent to US$2 trillion, or 2.8 per cent of global GDP*. People's share of these costs varies a great deal across the world, reflecting differences in the role of government in providing health care. In the UK, for example, our taxes cover the cost of providing health care to counter tobacco related disease.

* *Better Business Better World. The report of the Business & Sustainable Development Commission, 2017.* Available at http://report.businesscommission.org/uploads/BetterBiz-BetterWorld_170215_012417.pdf

Tobacco use also causes unique harm with a large direct and indirect death toll. Tobacco related disease diminishes the quality of people's lives, and the addictive properties of nicotine makes stopping smoking particularly challenging. The testimony of ex-industry research scientists, the release of internal industry documents, and lawsuits filed by the US government against the tobacco industry to recover costs, show clearly that historically the conduct of the tobacco industry has been directly contradictory to human health. Moreover, the UK government is a signatory to the World Health Organisation (WHO) Framework Convention on Tobacco Control. The convention seeks 'to protect present and future generations from the devastating health, social, environmental and economic consequences of tobacco consumption and exposure to tobacco smoke by enacting a set of universal standards stating the dangers of tobacco and limiting its use in all forms worldwide.'

A key part of any decision about whether to continue investing in tobacco is the financial side of the argument. We found that on their own, the financial arguments tend to balance out. Long run historical performance of tobacco stocks has been strong, though the picture more recently is much less compelling. It's reasonable to argue that the financial future of the tobacco industry looks unappealing given a greater increase in regulatory pressure globally to reduce smoking worldwide. This has been especially strong in western countries and those that are signatories to the WHO framework. Barriers to tobacco advertising and promotion, declining cigarette sales in western countries, and divestment internationally among some large investors appears to be having a significant impact on tobacco sales and profits. This is certainly the case in developed countries.

However, we also found it entirely plausible that the future for tobacco companies isn't so gloomy. During the past 20 years tobacco industry investment returns have been strong despite setbacks in the courtroom, greater regulation and divestment by funds. Tobacco companies have merged to cut costs, and tobacco use continues to increase globally. While the tobacco industry is relatively easy to single out, we need to remember that tobacco products and smoking are legal globally.

For some people, an additional reason not to divest from tobacco stocks is the floodgates problem. According to this argument, NEST shouldn't divest because tobacco products are comparable to many other products with large externalities and because tobacco companies don't behave differently or identifiably worse than some other companies or industries. The concern is divesting from tobacco will set in motion a process that has no clear stopping point. Thermal coal stocks have large externalities and a product with minimal other purpose, for example. Gun stocks are arguably close by, as are nuclear weapons. Although divesting from tobacco stocks may have minimal effect on members' long-term investment returns, as more investments are excluded the impact is likely to grow, in one direction or the other.

With our tobacco stock research now complete and the evidence and arguments identified, we've developed a set of possible actions to take that we'll be considering over the coming months. Most importantly, any decision on tobacco investment or divestment will be consistent with our core goals and members' long-term interests. We'll report developments in our approach through our quarterly investment reports and in our next annual responsible investment report.

Climate aware fund study

In February 2017 we made our first climate aware investment. Having spent a significant amount of time developing the methodology behind our new climate aware fund, it was always our intention to monitor its performance and adjust the fund as new information and data came to light. With a year's worth of data, we were able to begin this analysis in spring 2018.

Firstly, we compared the one-year investment performance of our climate aware fund against a very similar fund from the same fund manager, as well as the FTSE benchmark index. These are two relevant comparators because they invest in the same companies as the climate aware fund, albeit in different proportions. Our analysis aimed to note any differences in risk and returns between the climate aware and the control funds. We found that over a year, the climate aware fund had better investment returns and better risk characteristics. It made more money and didn't fall as far when markets dropped. (See chart on page 8.)

So how can the result be explained? The improved performance could be a result of chance, or it could be a systematic result of the insights used to develop the fund's methodology.

In other words, we're improving investment performance by successfully identifying those companies in a better position to sustain their performance considering growing concern about climate change. To test what was driving the improved performance more closely, we designed a second study.

Our second test took all the important climate related news stories we could find in major media publications over a six-month period. We measured the investment performance of the climate aware fund and our two control funds for five days after each climate related news story was published. The findings showed that companies' share prices seem to react most in response to negative or alarmist news stories about climate change.

On average, each time a negative news story about climate change was published, the investment value of the control fund and benchmark lost more money – dropping a little more than the climate aware fund. This suggests that we've successfully identified more resilient companies, which even in the face of negative climate change news are maintaining their value better. Over a year, those little differences add up and explain the better investment performance we first observed in the climate aware fund.

> "We've successfully identified more resilient companies, which even in the face of negative climate change news are maintaining their value better."

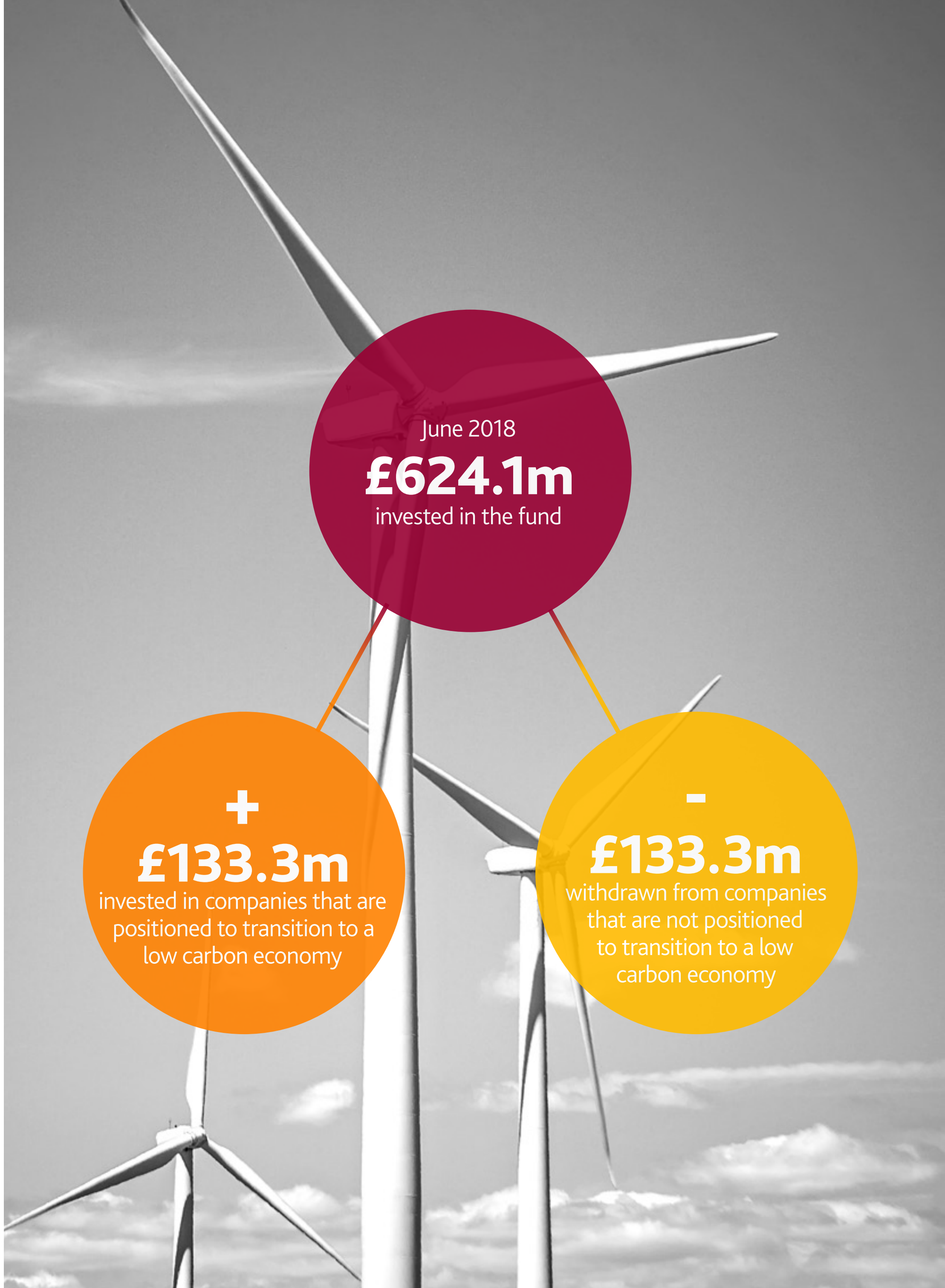
We'll continue testing these results as we gain more insight and have more performance data to analyse. But our preliminary findings, although tested over a very short period, are encouraging and confirm our confidence that climate change is a significant systemic risk that will materialise in financial markets.

We've since increased the allocation to our climate aware fund to 30 per cent of global developed equities in the growth phase of our default strategy, and 40 per cent in the foundation phase.

Over the year to the end of June 2018, total investments in the fund were £624.1m. Of this, the climate methodology means that we have:

- £133.3M (~21.4%) more invested in companies that are positioned to benefit from a global transition to a low carbon economy. This includes renewables companies PG&E, Iberdrola, EDP Renovaveis SA and green technology companies such as Vestas Wind Systems, Siemens Gamesa Renewable Energy and Xinyi Solar Holdings.
- £133.3M (~21.4%) withdrawn from companies that are not making progress on adapting for a low-carbon future and pose a risk to members' returns. This includes energy giants Southern Co, Duke Energy and RWE AG, fossil fuel extractor ExxonMobil and Royal Dutch Shell.

The next stage in the development of the fund will look at the impact of climate change on companies based on their physical location. We're going to start considering how the physical impacts of climate change, for example sea level rise, flooding, hurricanes, and droughts, may influence the value of the investments we've made. Impacts might include transport networks in extreme weather regions becoming unavailable, or heavy industry and refining close to the coast becoming unusable. We'll aim to report again on this in next year's responsible investment report, alongside updates to the performance analysis.



Looking ahead to future asset allocation decisions

Addressing ESG in factor-based or alternative indices

Traditional index funds* rank companies according to their market capitalisation, or the market value of a company's outstanding shares, and invest in them proportionally. An alternative index invests in companies based on different criteria. Some of the ways companies in an alternative index can be ranked include by their sales, income or earnings growth.

We're currently looking at a range of alternative indices. Adding an alternative index to our asset allocation would give us exposure to different elements that drive risk and return. This brings alternative forms of diversification, company-specific risk reduction, overall risk reduction and better expected returns.

We're exploring how ESG issues can feature in these types of indices. We've set out some of our possible approaches below:

1. **Incorporate ESG as a specific factor to track.** We'll look to see if ESG issues are, or can be, considered a 'factor' by which to rank companies in an index. This would be alongside traditional factors such as:
   - i the momentum of companies, short term or rapidly moving trends in company share price performance
   - ii quality, the underlying stability and transparency of company earnings
   - iii growth, the rate at which a company's earnings increase.
2. **Select traditional factors with positive ESG characteristics.** We're also looking into whether certain traditional factors can indicate strong or improving ESG performance. For example, is better ESG performance associated with certain factors like momentum, quality or growth? If we find compelling results, we may decide to allocate more money to index funds based on factors with the highest correlation to positive ESG performance.
3. **ESG tilt on a factor-based index.** The starting point here would be a factor-based index to which an ESG screen is applied, for example excluding certain companies due to poor ESG scores. One possible downside to this is that it could skew the factor-based methodology that we'd be trying to benefit from.

* Index funds, sometimes called passive investments, are funds that are designed to replicate the performance of a given market index, such as the FTSE 100. They generally invest in all the companies that appear in the benchmark index. The fees for these funds tend to be lower because once the rules for the fund have been designed and set, fund managers don't need to spend money on the research and analysis needed to actively buy and sell stocks.

Green bonds

We're already addressing climate-related risks and opportunities in our equity investments and now want to think about how to incorporate similar considerations in our bond holdings. One of the ways to tap into the potential for green investment and continue to be aligned with our risk and return expectations is through green bonds.

Green bonds are issued by companies, banks or governments to fund projects that have positive environmental, climate or social impacts. Green bond issuance is increasing, and liquidity is improving, resulting in more attractive investment opportunities. We're planning to add an investment grade credit mandate to our asset allocation and are researching how green bonds can play a part in our fixed income allocation in future.

In the market engagement we've done so far, fund managers have told us they're starting to see many good opportunities in green bonds, which provide similar risk and return profiles to conventional bonds. We'll be encouraging prospective managers to consider them as part of their conventional bond portfolios. At a market level, we'll continue to work with others and push for the adoption of green bond standards and the development of standardised reporting metrics.

3. Creating better functioning markets

One of our responsible investment objectives is to help ensure markets support long-term wealth creation for our members. To support this objective, we've continued our engagement with a range of key industry players and standard setters on various topics.

Our aim has been to help shape frameworks and raise standards, including via the following initiatives:

Consulting with the Financial Reporting Council (FRC) on the UK Corporate Governance and Stewardship Codes

- We welcomed the FRC's proposed Corporate Governance Code, particularly the renewed focus on companies' societal goals, the workforce, board diversity and the increased remit of remuneration committees. We argued that the remuneration committee should have a stronger role in monitoring wider workforce policies, practices, and pay and take these into account when setting the policy for director pay. We were disappointed not to have seen any policy changes on executive pay itself. We would like to have seen the proposed Governance Code encourage companies to show restraint in this area. Incentive packages should consider the long-term strategy rather than just the share price of the company.
- We also engaged with the FRC on the future viability of the Stewardship Code. In summary, while we're supportive of the Corporate Governance Code, we feel the Stewardship Code could be updated to better reflect stewardship in the UK. We suggested improvements based on the reality of how asset owners act as stewards of their members' money. For example, our stewardship activities are multi-dimensional and evolve as our investment approach does. The current Stewardship Code doesn't reflect this and isn't being used as a working tool by institutional investors.

Giving evidence to the Parliamentary Environmental Audit Committee

- We were invited to give evidence on green finance to the Environmental Audit Committee at the House of Commons in February 2018. The questions focused on how pension funds are tackling climate change in their investment approach, how they interpret their fiduciary duties and how they're planning on implementing the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.
- We described NEST's investment approach, including our commitment to ESG and responsible investment, how we developed our climate aware fund, and our work to collaborate with others.
- The Committee wanted to understand how we engage with members and whether we inform them of our responsible investment activities. The MPs were particularly interested in whether we currently do this in any member-wide communications, such as welcome packs or annual benefit statements, or give members any information on where their money is invested when they're first enrolled.
- We acknowledged that across our diverse membership, with over 7 million members, not everyone would want to engage. But we reiterated that we believe our responsible investment activities provide a rich source of stories that may capture the interest of some members and increase confidence and trust in the benefits of longer term saving for many more.

Reporting against the Taskforce on Climate-related Financial Disclosures (TCFD)

- TCFD is a climate reporting framework spearheaded by Financial Stability Board chairman and Bank of England Governor Mark Carney. It encourages all organisations, including financial-sector organisations, to publicly disclose climate-related financial information so that investors and stakeholders can better understand the climate-related risks and opportunities they face.
- We expressed our commitment to reporting against the TCFD framework at the Environmental Audit Committee hearing and have met that commitment already with a reporting statement in this year's *scheme annual report and accounts*. In line with the recommendations, we've made disclosures against the four thematic areas of the framework – governance, strategy, risk management, and metrics and targets.
- It's important to us that our stakeholders have transparency into how we're considering climate-related risks and opportunities. Furthermore, we're making a clear statement to encourage our investee companies, asset managers and other asset owners to follow suit. We're pushing for standards of reporting to be raised across the industry and for the TCFD to become a global standard for climate disclosure.

Contributing to the Implementation Taskforce: Growing a culture of social impact investing in the UK

- In March 2018 the prime minister established an implementation taskforce to take forward the recommendations in the *Growing a culture of social impact investing in the UK* report, which NEST was invited to join. We're part of a working group of the taskforce looking at how to make it easier to invest in social impact products. The aim is to contribute to stimulating the development of quality social impact investment products that are suitable for institutional investors, particularly DC pension schemes.
- NEST will also be part of the discussion on how the investment industry can begin to overcome structural and regulatory barriers to social impact investing. In our response to the DWP's consultation on clarifying and strengthening trustees' investment duties, we argued that trustees should be encouraged to consider social impact investments. Those investment opportunities can enhance risk-adjusted returns as well as meet social and environmental goals, so trustees shouldn't be deterred from considering them.
- We're also supporting the market in developing stronger definitions and labels for what constitutes 'impact' and encouraging robust measures for reporting impact in a consistent and comparable way.

Joining the Company Reporting & Auditing Group (CRAG)

- NEST has joined CRAG, convened by the Investment Association. This is made up of investment management firms and asset owners, with the aim of helping ensure corporate reporting and large company audits meet investors' needs. The group meets with regulators, standard setters, and accounting and audit firms.
- Being a member also allows us to help shape conversations about less traditional performance data such as climate data. Improving assurance of this type of data can help develop models to monitor responsible investment practices effectively.

> "To support our responsible investment objectives, we've continued our engagement with a range of key industry players and government departments on various topics."

Thematic engagement

Last year we reported in detail on several of our strategic engagement projects. These included improving culture and conduct in banks and reward and progression in the workforce. Over this reporting year our focus has shifted from research and evidence gathering at a company level to conversations to help drive change at a regulatory level. Our objective is to achieve better functioning markets through collaborating with standard setters and helping drive policy improvement from the top.

Banking culture and conduct

The next phase of our engagement on banking culture and conduct was around encouraging membership of the Banking Standards Board (BSB). The BSB is now well established and has gradually grown in membership. There's no statutory requirement to join the BSB, membership is voluntary. It implies a commitment to high standards of behaviour, competence and professionalism at an individual, organisational and sector level.

Membership of the BSB matters for several reasons:

- The financial crisis, which prompted new conduct, culture and trust programmes across the sector, is a decade ago.
- Now is the right time to renew focus on culture and not let it slip.
- Several high profile BSB members are improving their track record on conduct, governance, social and environmental topics compared to some non-member banks.

Over the last year we've written to relevant investee banks and fund managers to question why they aren't members of the BSB and to ask them to explain their decision to us. We also wrote to encourage those that are already members, by expressing our support.

> "Our focus has shifted from research and evidence gathering at a company level to conversations to help drive change at a regulatory level."

Workforce and Human Capital

NEST is a founding signatory of the Workforce Disclosure Initiative (WDI). The WDI survey, run by **ShareAction**, asks companies for workforce information about them and their suppliers, ranging from pay and workers' rights through to health and safety practices. Companies that respond to the survey and give their permission to publish their information help stakeholders and investors like us to better understand them and have constructive conversations. The WDI is at an early stage of development so by lending our support we hope we'll be helping it to succeed. As part of this we're writing to companies to ask them to consider reporting on and disclosing WDI information.

On a related theme, in January we partnered with the Financial Reporting Council's (FRC) Financial Reporting Lab to host a roundtable about company reporting on workforce and human capital. The FRC is the UK's company financial reporting regulator. Ours and the FRC's aim is to understand why companies report so little on their workforce and human capital even though UK company reporting standards ask for this information and encourage companies to report much more. The roundtable led to suggestions about how company reporting on workforce and human capital can be improved. In the **roundtable discussion paper** that we've published we look at some of the main metrics, measures, and narratives that investors would find most meaningful. In doing so, we hope to create a solid foundation for the FRC to take forward into corporate reporting.

Finally, we have long thought that one of the clearest alignments between the investments that NEST makes, and our members' wider interests, is likely to lie in this area. Most of our members are working for employers in the UK, so the human-interest angle is one that millions of savers can relate to. We've started researching how we could construct an investment portfolio that puts more money into companies that promote high quality workforce development and less into other companies, while remaining confident of delivering strong investment performance. We've some way to go on this, in part because the information is not as good as we'd like, which is why the WDI and FRC are important pieces in the overall picture.

4. Active ownership highlights

The UK voting season 2018 shaped up to be quite significant, with many UK companies facing dissent from investors at their annual general meetings (AGMs). The number of votes against individual directors doubled from 2017 and some contentious votes on executive pay received a lot of attention, including that at UK housebuilder Persimmon. While the issue of executive pay dominated discussions in the lead up to Persimmon's AGM, NEST was keen to highlight the stark disparity between pay at the top and the bottom of the company. We added our **public support** to ShareAction's petition calling on the employer to pay all staff the Living Wage.

We had already written to Persimmon three years ago to question their position on the Living Wage, so this was an opportunity for us to escalate that engagement. Supporting Living Wage accreditation is part of our broader work on workforce and human capital. We aim to encourage our investee companies to be fair employers and to treat their staff decently, not only because it leads to more sustainable and profitable businesses. It's also in the best interests of many of our members, who make up a large part of the UK workforce.

> "We aim to encourage our investee companies to be fair employers and to treat their staff decently."

Pooled fund investment and voting

NEST generally invests via pooled funds, which means the fund manager has responsibility on behalf of numerous investors for any voting rights associated with the shares held in the fund. Most of the votes associated with our shareholdings are therefore not voted directly by us. So, it's even more important for us to make our voice heard during voting season and express our views publicly on important issues. We do this to gather wider support for particular votes, publicly represent the interests of our members and to send direct signals to companies about changing their approach.

We also engage with our fund managers ahead of key votes to understand their voting intentions and discuss any differences of views. Our fund managers have been forthcoming in providing thoughtful explanations around their decisions, which has been positive and led to constructive dialogue.

We've been approaching our fund managers in this way since the beginning, and this year we've achieved some positive outcomes. For example, we engaged with UBS about a vote on executive pay at Lloyds Banking Group PLC. Our view was that there was a lack of transparency around bonus decisions at the company. This was supported by UBS and led to a vote against the bank's executive remuneration report. We also encouraged UBS to support a shareholder resolution at Walmart, requesting that the board prepare a report to shareholders on racial or ethnic pay gaps. We made the point that Walmart has had many labour rights issues over the years and had introduced a diversity goals program in 2015.

The shareholder resolution aimed to help investors track Walmart's progress towards this goal and assess whether they're sticking to their strategy.

We also voted directly on issues including the following, using our voting override option:

- We voted FOR the shareholder resolution at Shell asking that the company set carbon reduction targets in line with the Paris Agreement.
- We voted AGAINST the re-election of the CEO at Barclays due to fines from the FCA for trying to identify a whistle blower on two separate occasions.
- We voted AGAINST the re-election of the Chair of the Nominations Committee at Prudential as only 12 per cent of the board is female.
- We voted FOR a shareholder proposal at Altria Group requesting the Board to report to shareholders on reducing and disclosing nicotine levels in its cigarette brands.

We continued to expand our active vote monitoring subset this year. This now includes more Japanese companies that have proven charges of fraud against them. There has been a wave of negative reports around corporate governance and culture in Japan. Several companies we hold shares in have been involved in corporate scandals regarding falsifying and/or fabricating inspection data for products that fall short of public standards or customer specifications. The emergence of a new Corporate Governance Code in Japan means there is a recognition of poor behaviour and the need for change.

Shareholder resolution at Shell

NEST voted in favour of the '**Follow This**' shareholder resolution at Shell's AGM this year. The resolution, which was filed by activist investor group 'Follow This' and ShareAction, asked Shell to set and publish targets in line with the Paris Agreement to limit global warming to below two degrees.

While we recognise and commend the leadership Shell has shown in setting a net carbon footprint ambition that covers all emissions, we believe the company should transform these into targets. The investment industry is pushing for targets across the oil and gas sector, so we can better assess and compare progress companies are making in transitioning to a low carbon economy. The terms of the 'Follow This' resolution should be achievable by an industry-leading company like Shell, which has already reported and estimated its carbon emissions.

It's important to signal that setting long-term targets and intermediate objectives in line with the Paris Agreement provides, rather than hinders, the flexibility for companies to adapt and change their business in a staged and progressive way towards meeting those goals. This is a key objective of our climate aware fund.

We publicly pre-declared our support for the resolution and engaged with our fund managers and responsible investment networks ahead of the AGM to generate support. We also co-signed a Principles for Responsible Investment (PRI) letter to all oil and gas companies on the importance of transitioning to a low carbon economy.

The shares in our climate aware fund were voted in support of the resolution. Prior to the vote we had open discussions with UBS about their voting position in their global equity fund, in which NEST invests. UBS abstained and will be engaging with Shell about the requests of the shareholder resolution and how they can begin to meet them.

Voting-led engagement

After the voting season last year, we wrote to companies we voted against to explain our decisions. We took a collaborative approach and reached out to other investors who opposed management on the same issues, asking them to support our letters. Co-signatories to our letters included the West Midlands Pension Fund, Environment Agency Pension Fund, South Yorkshire Pension Fund and various members of the 30% Club Investor Group, which campaigns for greater gender diversity on boards and senior management teams. Combining investor voices creates a higher impact and we believe improves the likelihood for change.

We wrote to the following six companies, explaining our voting rationale and setting out future expectations for change on various ESG issues:

- **Glencore** – we wrote to highlight our concern about the poor gender balance on Glencore's board. This led investors to vote against the Chair and Chair of the nominations committee.
- **British American Tobacco (BAT)** – we wrote to explain that we had voted against their annual report and accounts because of political donations made by BAT to jurisdictions outside the EU without shareholder approval. We used the opportunity to encourage them to cease making political donations altogether in all jurisdictions. We also flagged our concern in relation to the Serious Fraud Office's formal investigation into acts of bribery at BAT.

- **Chevron** – we wrote to explain our decision to support two shareholder resolutions. One asked Chevron to report on how it can transition to a low carbon economy. The other requested the appointment of an independent director with environmental expertise. We emphasised that improved disclosure on how Chevron is preparing and adapting its business model under different climate scenarios would reassure investors. A board member with responsibility for overseeing the company's transition to a low-carbon model would give investors further assurance. We'd like Chevron to be clear about who is responsible for the climate transition strategy and what makes them appropriate for the role.
- **ExxonMobil** – we wrote to explain why we voted in support of a shareholder resolution requesting Exxon to report annually to shareholders (at reasonable cost, omitting proprietary information) on its plans to minimise methane emissions, particularly leakage, from the company's hydraulic fracturing operations. Reducing methane emissions from upstream oil and gas production is one of four key global greenhouse gas mitigation opportunities identified by the International Energy Agency to keep global warming below two degrees.
- **BlackRock** – we wrote to express our concern about the current structure and independence of the board. We voted against the re-election of Larry Fink, who holds the combined CEO and Chair roles at the organisation, and non-executive Murray Gerber, who was appointed as lead independent director despite serving on the board for over 17 years. We highlighted that it is our policy not to support boards that have joint Chair and CEO roles, unless they have good reason. We also do not support boards where we have doubts over lead directors' independence.
- **Shell** – we wrote in relation to our decision to vote against Shell's executive remuneration policy. We signalled that the policy could be better aligned to a corporate strategy consistent with the Paris Agreement. The policy is currently too heavily weighted towards carbon project delivery and contains cash flow targets that could encourage executives to focus on maintaining carbon volumes.

Engagement outcomes

Four out of the six companies responded to our letters and we held a follow-up call with BlackRock to discuss their response in further detail. They were keen to illustrate the effectiveness of the board and how it promotes open challenge and good decision making. They also took investor feedback on board with regards to the combined CEO/Chair role and will consider this in their succession planning.

Our letter to Glencore was replicated by Canadian investor British Columbia Investment, which they used to engage with the company on the board's poor gender balance. After mounting investor pressure and collective engagement activity, we were pleased to see Glencore recruit a second woman to its board in December 2017. We'll continue monitoring progress at the company and encourage them to disclose an aspirational target or strategy for electing more women to the board.

Voting on sustainability issues

The most effective way to raise concerns about companies' environmental and social practices is to engage with them. However, we also feel that fund managers could do more to use their voting rights to put these issues on companies' agendas.

Embedding long term sustainability factors as key criteria when deciding how to vote on company shares would lend more weight to engagement activity in this area. It would also give investors and shareholders more confidence that these issues are being addressed. An increasing number of shareholder resolutions are already being filed to raise awareness and send a public signal to companies about a variety of issues. We're pleased to see some of our fund managers support a broad range of these resolutions and start to embed sustainability concerns in their voting on some management resolutions.

For example, HSBC voted to support shareholder resolutions at:

- Pfizer, Chevron, ExxonMobil, and Alphabet, requesting the board to prepare a report to shareholders on lobbying
- Home Depot, requesting the board to prepare a report to shareholders on the company's political donations
- Chevron, requesting the board to prepare a report to shareholders on the feasibility of a policy of not doing business with governments that are complicit in conflicts
- Alphabet, requesting the Board reports to shareholders on sustainability metrics in incentive pay.

UBS also voted against management proposals to re-elect the Chair of the nominations committees at Alphabet and Halliburton because of poor progress on board gender diversity. This sends an important message to the company that they're taking the issue of gender diversity seriously and are signalling expectations for change.

We would like to see this trend continue and be adopted more broadly. We'll be engaging with our fund managers and wider stakeholders to encourage this.

5. Looking ahead

Cyber and data security

This year we want to investigate cyber and data security and the potential impact the issue could have on our investments. Our aim is to develop a corporate position and suitable strategy with regards to the associated investment risks and opportunities.

Cyber security risk is systemic in nature and can affect global companies in many different sectors. It can even impact national economies. NEST, a global investor with stakes in thousands of companies across many sectors, is likely to be highly exposed to the risk of cybercrime and the implications of data breaches. That said, the systemic and wide-scale nature of cyber security risk can be difficult to address and monitor effectively. We feel it's important to understand what, if anything, we should do about the issue as an investor and how we could approach addressing it.

To develop a deeper understanding from an investor standpoint, our research project will include meeting with a range of experts from various industries. This will include our in-house cyber and information security team. Through research and conversations, we'll be able to gain a better understanding of the issues surrounding cyber and data security, whilst potentially unearthing investable opportunities.

From these meetings we want to learn:

- what our starting position on the issue should be
- whether there's anything we can do as an investor to influence companies on this issue
- who in an organisation is responsible for the issue and who we should be talking to
- whether there are specific policies and practices companies should be employing to mitigate the risk and enhance opportunities
- what kind of disclosure investors should be expecting from companies.

Audit of ESG standards at NEST and its suppliers

Our voting and engagement policy sets out our ESG expectations of the companies we invest in. We believe this is crucial to the long-term performance of our underlying investments as it promotes good risk-management and forward-looking, sustainable practices.

Although NEST is not a publicly listed company, it's important we also understand and seek to manage similar issues as an organisation and in our supply chain as we would expect companies we invest in to be doing. These include, for example, workforce management, governance, fitness to operate and any regulatory or wider supply chain risks that may be a factor.

As a public corporation, NEST has robust governance standards and processes in place. These have been verified and validated by third parties referencing frameworks issued by the Institute for Chartered Accountants in England and Wales, the Pensions Regulator and the Pensions and Lifetime Savings Association. However, as we grow and evolve we're looking for ways to continually improve.

To test and strengthen our existing practices, we'll be setting out a policy on the standards we expect as an investor for managing ESG issues and where these are relevant to NEST and our suppliers. We'll audit our current practices against this framework and look to make improvements if needed. We see this as a helpful exercise to support us as we look ahead to the renewal of our scheme administration contract and other major procurement projects we'll undertake in coming years.

UN Sustainable Development Goals (SDGs)

In September 2015, the United Nations set seventeen goals to end poverty, protect the planet and ensure prosperity for all. Each sustainable development goal, or SDG, as they became known, was designed with specific fifteen year targets. As part of our responsible investment approach, NEST already has many initiatives aligned with the SDGs. We're aiming to start reporting against these, internally to our trustees initially, with a view to sharing this in future responsible investment reports. We want to ensure we're producing meaningful analysis that shows how far our activities contribute towards globally agreed sustainability standards. We've therefore identified a select number of SDGs that are most relevant to our work and researched the methodology behind quantitative metrics we can adopt. We'll target a few meaningful metrics for these areas rather than aim to report against the full list of SDGs.

We hope this has been a useful summary of our activities throughout the year and our focus for the future. If you're interested in finding out more about our responsible investment approach and areas of work, visit the **responsible investment** section of our website.

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