defaqto

Nest Pension Scheme Q&A

April 2022

Sponsor

nest

For UK Financial Advisers only

Contents

Acronyms

The main acronyms used in this document are:

AMC	Annual management charge
ESG	Environmental, Social and Governance
HMRC	HM Revenue & Customs
Nest	National Employment Savings Trust
TPR	The Pensions Regulator
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
MVO	Mean variance optimisation
PAYE	Pay as you earn
UFPLS	Uncrystallised funds pension lump sum

Introduction

The National Employment Savings Trust is better known as Nest.

Nest has commissioned Defaqto to conduct an independent fact-based review of the Nest pension scheme. This is the UK's largest auto-enrolment compliant workplace pension scheme, which is used by 10 million savers and at the end of December 2021 had over £23bn invested on behalf of members.

The review has been done in the format of a Question and Answer (Q&A) report and is designed to help advisers better understand the proposition, while also considering the core elements required in a Value for Money assessment:

Scheme oversight and service + Performance and investment quality + Costs and charges = Value for money

The questions posed by Defaqto are:

1	How is the Nest Master Trust positioned in the market?
2	What are the key governance and due diligence points?
3	How do the Nest funds, in particular their investment strategy and process, work?
4	How have the Nest Default Funds performed?
5	What are the costs and charges?
6	What support does Nest provide to an employer when joining?
7	What additional support does Nest provide to employers?
8	What support does Nest provide to members?
9	What support does Nest provide to members at and in retirement?
10	What is Nest Insight and what do they do?

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Insight Analyst (Wealth)

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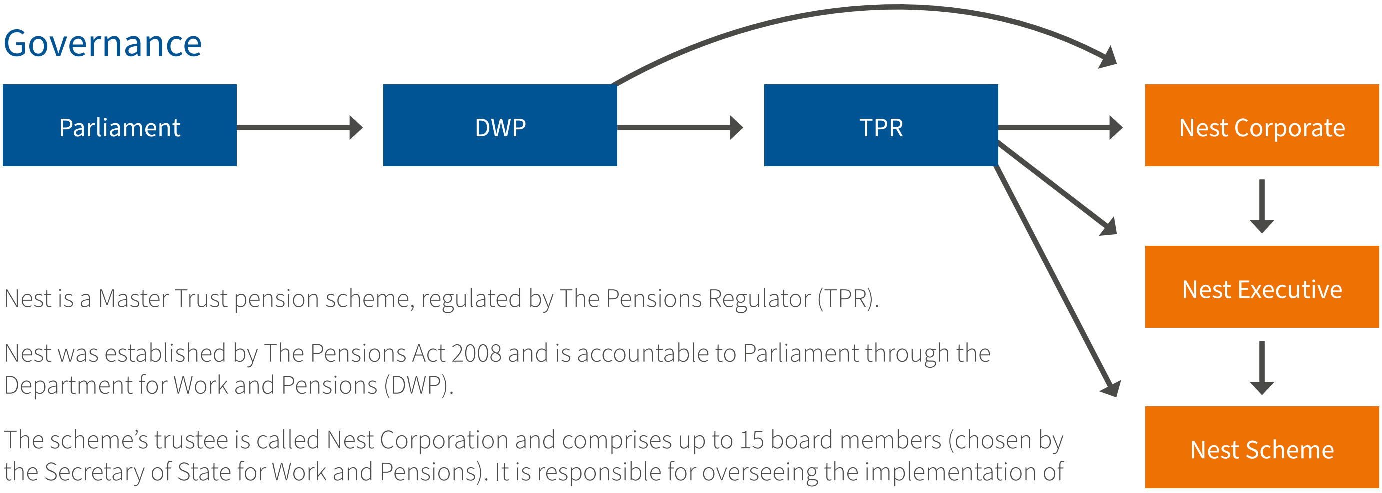
Q1. How is the Nest Master Trust positioned in the market?

Governance



Nest is a Master Trust pension scheme, regulated by The Pensions Regulator (TPR).

Nest was established by The Pensions Act 2008 and is accountable to Parliament through the Department for Work and Pensions (DWP).

The scheme's trustee is called Nest Corporation and comprises up to 15 board members (chosen by the Secretary of State for Work and Pensions). It is responsible for overseeing the implementation of the Nest strategy and the day-to-day operation of the Nest scheme.

Defaqto 5 Star Rating

As an impartial whole of market research company, we have researched and analysed the terms and conditions of every retail, open to new business, workplace pension on the market. This is over 60 schemes.

We have then rated each scheme on a scale of 1 to 5 based on the quality and comprehensiveness of the features and benefits it provides.

A 1 Star Rating indicates a basic product with a low level of features and benefits, while a 5 Star product provides one of the highest quality offerings in the market.

Nest is one of only four Master Trust based schemes to hold a Defaqto 5 Star Rating and has done so consistently for five years. To put this accolade into perspective, 87% of Master Trusts and 66% of all retail workplace pension schemes on the Defaqto database have a lower rating.

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2022

Created using facts, not opinion

Q2. What are the key governance and due diligence points?

Target market

Nest is the only workplace pension scheme that has a public service obligation to accept any employer wishing to comply with its auto-enrolment duties.

This becomes clear when Nest is subjected to the standard MIFiD II and PROD target market category assessments. These show that it is designed to meet the needs of a wide range of people looking for capital growth of pension savings.

Target client type	
Retail	✔
Professional	✔
Eligible counterparty	✔

Distribution channels	
Execution only	✔
Guided non-advised	✔
Advised	✔

Knowledge/experience	
Basic	✔
Informed	✔
Advanced	✔

Distribution channels		
Capital preservation	✔	In the consolidation phase
Capital growth	✔	
Income	✔	In the retirement phase

Financial strength

There is little point putting a scheme in place with a provider who is not going to be in business in the foreseeable future. Ascertaining and comparing the financial strength and capability of providers will go some way towards mitigating this risk.

Financial strength and credit ratings are widely used barometers when assessing schemes that use contract governance. When it comes to Master Trusts, this assessment used to be harder as they are not looking to make profits or pay shareholders.

However, in 2019, TPR introduced Master Trust Accreditation. Existing schemes had to reapply to remain authorised, while new schemes faced a much tougher assessment before they could start operating.

Accreditation was not a simple tick box process; indeed, over half of the Master Trusts exited the market at this time. Those that remain must meet ongoing requirements to remain authorised. Today, this means that advisers can recommend TPR authorised Master Trusts with confidence.

One unique element of Nest's proposition is that it was established to ensure auto-enrolment was an initial and ongoing success. Therefore, it is being funded by a loan provided by the government for the purposes of setting up and administering the scheme.

A list of all authorised Master Trusts, including Nest, can been viewed at:

www.thepensionsregulator.gov.uk

Nest has so far borrowed £884m from the DWP. This may seem like a lot; however, according to Nest's business plan, it expects to be able to cover its operating costs from 2026 and that the loan will be repaid by 2039.

Avoid recommending and/or introducing 'indirect discrimination'

The Pensions Act 2008 introduced auto-enrolment.

It specifies how employers can segment their employees into groups and treat them differently.

Tension

The Equality Act 2010 defines indirect discrimination as being 'when there is a practice, policy or rule which applies to everyone in the same way but has a worse effect on some'.

Therefore, those who follow the segmentation allowed by the Pensions Act may find their actions inadvertently introduce indirect discrimination into a workplace. This is especially true if the segmentation places people who share 'protected characteristics' at a disadvantage. Those characteristics are:

- Age
- Disability
- Gender reassignment
- Marriage or civil partnership
- Pregnancy and maternity
- Race
- Religion or belief
- Sex
- Sexual orientation

Using Nest can help employers avoid introducing indirect discrimination into their workplace

How Nest helps employers avoid introducing indirect discrimination (in tax year 2022/23)

Segmentation by age

The Pensions Act allows	Issue	Nest solution
Those employees aged below 22 and over 74 to be excluded.	Age is one of the protected characteristics defined by the Equality Act.	This rule can be ignored Nest accepts contributions from those aged between 16 and 74.

Segmentation by salary

The Pensions Act allows	Issue	Nest solution
Those who earn less than £10,000 per annum with the employer can be excluded	This can result in part-time employees being proportionately remunerated at a lower rate than their full-time colleagues. Part-time employees tend to share the protected characteristics of age, disability and/or sex (female).	This rule can be ignored. Nest does not require the earnings threshold trigger to be observed.
Qualifying earnings below £6,240 and above £50,270 are not automatically subject to auto-enrolment	This results in no employee receiving the headline 8% of salary. It also means those on the lowest and highest salaries receive much less than 8%. Low salary employees tend to share the protected characteristics of age, disability and/or sex (female), while high salary employees tend to share age and/or sex (male).	This rule can be ignored. Nest does not require lower or upper qualifying earning thresholds to be observed.
Allows workplace pension scheme operators to facilitate tax relief via the 'net pay' or 'relief-at-source' systems	Neither system is perfect, but the net-pay system results in non-taxpayers being treated differently. See below for explanation. Non-taxpaying employees tend to have the protected characteristics of age, disability and/or sex (female).	Nest facilitates pension contributions through the relief-at-source system. This ensures all employees receive the same tax-relief benefit.

The two tax systems explained and compared

Net pay	Relief at source
This system works by the employer taking the pension contribution from the employee's pay before it is taxed. This means the employee receives full tax relief, irrespective of whether they pay tax at the basic, higher, or additional rate. However, non-taxpayers receive no relief.	This system works by the employer taking the pension contribution from the employee's pay after deducting tax and national insurance. Then, irrespective of an employee's income, the pension provider adds tax relief to the employee's pension contribution at the basic rate (20%). This means non-taxpayers receive tax relief at 20% (to which they are entitled), while higher and additional rate income taxpayers can reclaim the difference above 20% through their tax return.

Therefore, the appropriateness of the tax-relief system is dependent upon the individual employee's tax rate.

<table>
<tr><th>Tax rate</th><th>Net-pay</th><th>Relief-at-source</th></tr>
<tr><td>Non-taxpayers</td><td>✗</td><td>✓</td></tr>
<tr><td>Standard</td><td>✓</td><td>✓</td></tr>
<tr><td>Non-taxpayers</td><td>✓</td><td rowspan="2">For equality 'Yes',
for personal admin 'No'</td></tr>
<tr><td>Additional</td><td>✓</td></tr>
</table>

Source: Defaqto, October 2021

Very few businesses employ only tax-paying individuals. It only takes one low paid employee to switch to part-time working and the net-pay system can cease to treat all employees equally.

Segmentation by beliefs

The Pensions Act	Issue	Nest solution
Makes no specific requirement to meet savers' religious or personal beliefs.	This can cause employees whose beliefs are not catered for to feel that a pension is not for them and opt out from saving. This could potentially leave an employer open to accusations of encouraging opt-outs, an offence under The Pensions Act.	Nest offers alternative funds to help meet the needs of those seeking: • Ethical investment • Sharia compliance • To avoid equities

Summary

From an adviser and an employer perspective, those looking to avoid indirect discrimination claims should consider using a pension scheme that meets two key criteria:

- ✓ Utilises the relief-at-source system
- ✓ Does not insist on the auto-enrolment exclusion allowances being observed

Q3. How do the Nest funds, in particular their investment strategy and process, work?

Nest's default strategies

Default strategies are the funds in which contributions to workplace pensions will automatically be invested without the employee making an investment decision.

In February 2020, TPR reported that more than 95% of workers are invested in the default fund, highlighting their importance in the retirement of millions of people. In the case of Nest, 99% of members are invested in default strategies.

The default option for Nest's members is one of the Nest Retirement Date Funds. There are nearly 50 of these funds in existence at any one time, with each corresponding to the year in which the member wishes to take out some of their money tax free and convert the remainder into retirement benefits eg if the member expects to take their money out in 2040, then they will save into the Nest 2040 Retirement Fund.

The member can, however, switch to a different fund, free of charge, if they later decide they want to save for longer or take their money out earlier. Most of Nest's peers use 'life styling' rather than this target date approach.

Nest offers other fund choices for members with certain beliefs or for those who want to take greater or less risk with their investments than the average. These are the:

- Nest Ethical Growth Fund
- Nest Sharia Fund
- Nest Higher Risk Fund
- Nest Lower Growth Fund
- Nest Guided Retirement Fund

Although Questions 3 and 4 focus primarily on Nest's Retirement Date Funds, and the 2040 Retirement Fund in particular, many of their attributes (eg the investment beliefs and team behind them) will also apply to Nest's other funds.

Investment strategy

Nest was able to start from a 'blank sheet of paper' when designing its investment process and governance structure. It carried out a consultation process, looking at how similar schemes operate around the world and learning from them. Nest has also attempted to make its solution scalable and is part of a network of large non-profit schemes, which also includes APG and the Ontario Teachers' Pension Plan.

Nest's investment beliefs, upon which its investment approach is based, are as follows (please see Annex 2 of Nest's SIP for the latest version of the 'beliefs'):

- Understanding scheme member characteristics, circumstances and attitudes is essential to developing and maintaining an appropriate investment strategy.
- Taking investment risk is usually rewarded in the long term.
- Diversification is the key tool for managing risk.
- Risk-based asset allocation is the biggest driver of long-term performance.
- Taking account of asset values and asset prices, economic conditions and long-term market developments enhances long-term performance and informs strategic decisions.
- Indexed management, where available, is often more efficient than active management.
- Good governance, including an appropriately resourced in-house investment function, is in the best interests of Nest members.
- As long-term investors, incorporating environmental, social and governance (ESG) factors is integral to the investment management process.

Investing responsibly

Responsible investment is at the heart of Nest's investment strategy. Nest believes that companies with good ESG practices will deliver better long-term investment results for members as well as help global efforts to tackle climate change and other issues.

They also work closely with current and prospective fund managers to ensure they fulfil their responsibilities in addressing material ESG factors in the investment process and stewardship on their behalf.

Nest announced their decision in 2019 to go tobacco-free across their investment portfolios. They also announced that year that they would start using the live databases of RepRisk and Sustainalytics to increase their ability to invest responsibly and further integrate ESG factors into their investment strategy, allowing them to spot ESG risks and screen out certain assets.

In July 2020 Nest launched its Climate Change Policy, including a commitment to making the entire Nest investment portfolio net-zero on carbon emissions by 2050, and the intention to halve emissions by 2030.

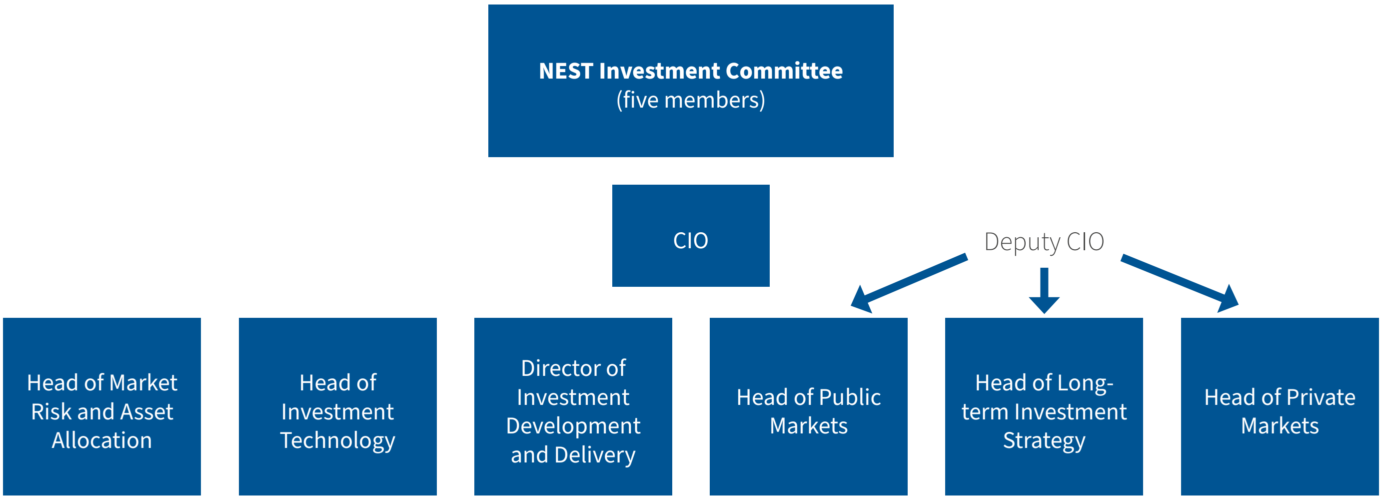
The Nest Retirement Date Funds hold a climate-aware global developed equities fund which over-weights companies making a positive contribution towards limiting climate change and reducing carbon, while under-weighting those which are least aligned to meeting industry carbon reduction targets. They also concentrate voting and engagement activities on improving companies that most need to adapt their business models to meet climate change goals.

The funds also hold: an ESG-screened emerging markets equities fund; two climate transition corporate bond strategies; a renewables infrastructure fund; an ESG-screened commodity fund; and an environmentally aware liquidity fund (alongside other funds – see Table 2 later in this report).

Investment team

Mark Fawcett is the Chief Investment Officer (CIO) of Nest. Figure 1 shows the other key members of Nest's Investment Directorate.

Figure 1: Key members of the Nest Investment Directorate



In addition, there is an Investment Operations team. Their main duties are to monitor the performance of the fund managers used by Nest, ensure portfolios are in line with targets, implement asset allocations and make recommendations for any changes.

All investment decisions are overseen by the Trustee through the Investment Committee (IC), a group of Trustee members and investment experts that meets quarterly to review investment decisions on a formal basis.

They decide on the recommendations of the CIO regarding several factors, including:

- Investment objectives
- Risk budgets
- Strategic asset allocations
- Fund manager selection
- Fund manager monitoring
- Investment costs

The IC also monitors fund performance and operations to make sure that the Trustee is fulfilling its legal duties. The IC consists of:

- Chris Hitchen (Chair and Trustee)
- Clive Elphick (Trustee)
- Jill Youlds (Trustee)
- Jennie Austin
- Jaap van Dam

Biographies of Mark Fawcett and the IC are published at www.nestpensions.org.uk

Investment approach

The life of each of the Retirement Date Funds is split into three different 'accumulation' phases (see Table 1 and Figure 2):

- Foundation
- Growth
- Consolidation

Table 1: The different phases of Nest's Retirement Date Funds

Phase	Rationale	Return target	Volatility target
Foundation	Get people into the habit of saving for their pension, therefore avoiding any large falls in value which could stop them from saving – only members joining in their twenties will save through this phase, usually for one to five years	Keep pace with CPI inflation after all scheme charges.	Long-term volatility average of 7%.
Growth	Where the main growth in the fund is expected to come from – members could spend up to 30 years in this phase.	CPI inflation plus 3% and cover all scheme charges over the long term.	Long-term volatility average of 11%.
Consolidation	Lock in gains that members have made over the previous phases by progressively switching out of higher risk assets – begins roughly 10 years before the fund matures.	Keep pace with CPI inflation after all scheme charges.	Reduce volatility as the fund gets closer to maturity.

Source: Nest

Following the Pension Freedoms reforms announced in 2014 and enacted a year later, Nest now targets an income drawdown at retirement instead of cash and bonds (to buy an annuity).

Nest's default path will automatically transition members with pots of over £10,000 into the Nest Guided Retirement Fund (NGRF), which aims to provide a consistent annual amount that can be withdrawn each year up to age 85. NGRF also allocates money to be accessed as emergency cash and to provide an annuity from age 85.

Figure 2: The glide path of the default fund strategy

Foundation phase	Growth phase	Consolidation phase
Objective = Keep pace with CPI (inflation) after all charges A low volatility approach designed to acclimatise younger savers to investing	**Objective** = CPI + 3% per annum after all charges over the long term Targeted use of asset classes expected to grow in value relative to CPI more than other investments.	**Objective** = Keep pace with CPI after all charges while progressively dampening volatility There is a progressive move from higher risk assets towards an income drawdown portfolio
Typically, the first 5 years for savers joining in their early to mid-20s	Main term	Typically, the 10 years before retirement

This lifecycle differs from that of the other main default funds in that none of them has a phase similar to Foundation; instead, they start with the main growth phase.

The advantage of the Nest lifecycle, as mentioned in Table 1, is that large market falls in the early years, which could dissuade people from continuing to save in the middle and later years, are less likely.

The disadvantage of this approach is that members miss out on any large market gains in the early years, or these would be at least restricted (although, as pots are small at this point, there may in fact be a negligible impact on outcomes).

The second main difference in lifecycle between Nest and most of the other default funds is that the latter will begin moving out of the main growth phase at a set number of years before the expected retirement date.

In the case of the Nest funds, however, the transition from one phase to another will be 'dynamically' managed rather than relying on a set rule. This means commencing the transition earlier or later, depending on prevailing economic and market conditions.

The asset allocation for each Retirement Date Fund will depend on its point in the lifecycle, together with prevailing economic and market conditions.

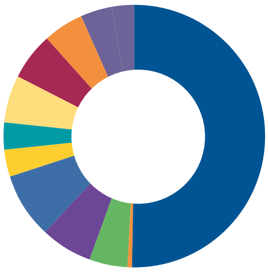
The policy (strategic) asset allocation is determined partly through mean variance optimisation (MVO). Nest, however, recognises the limitations of MVO, in particular the occurrence of corner solutions and its sensitivity to the inputs used; therefore, it combines this with risk-diversified optimisation. These policy asset allocations are typically adjusted once a year, when new capital market assumptions are produced. During the year the investment team monitors the implemented portfolio and adjusts active exposures if the risk-reward balance deviates significantly from the long-term expected returns.

Quarterly reviews take place in between the annual updates, where the in-house team looks at the macroeconomic background, financial markets, sentiment and latest asset class valuations, together with any tactical adjustments around the policy allocation that might be made.

In the first stage of the reviews, these inputs are discussed by the key members of the Investment Directorate. Any decisions are then made during the second stage at a meeting between just the CIO, Head of Asset Allocation and Head of Economics. These potential changes are analysed from a risk point of view before being implemented if appropriate.

The latest asset allocation for the 2040 Retirement Fund is shown in Figure 3.

Figure 3: 2040 Retirement Date Fund asset allocation at end December 2021



Climate aware global developed equities	50.5%	Commodities	3.3%
Global short duration investment grade bonds	0.5%	Hybrid property (UK direct and REITs)	5.8%
Private credit	4.6%	Emerging market debt	5.9%
Global investment grade bonds	6.4%	Global high yield bonds	5.1%
Climate aware global emerging market equities	8.2%	Sterling corporate bonds	3.7%
Global listed property	3.3%	Infrastructure equity	2.7%

Source: Nest

The Nest Retirement Date Funds hold more asset classes compared to many of the other default funds in the market, with several holding just equities and fixed income.

The advantages of 'alternative' asset classes are the greater potential for higher returns and diversification. However, they can also be more expensive, less liquid and less transparent.

Table 2 shows the different funds and fund managers used within the 2040 Retirement Fund (and other Retirement Date Funds).

Table 2: Retirement Date Funds – fund managers at end December 2021

Fund name	Investment approach
Amundi Funds Emerging Markets Blended Bond	Active
Amundi Global Commercial Real Estate Debt Fund	Active
BlackRock GBP Infrastructure Debt Fund	Active
BlackRock ICS Sterling Liquid Environmentally Aware Fund	Active
BNP Diversified Private Credit Fund	Active
CBRE Caledon Capital Management	Active
CoreCommodity / Nest Program	Active
JP Morgan Life High Yield Opportunities Fund	Active
LGIM Global Real Estate Equity Index Fund	Passive
LGIM Hybrid Property (70:30) Fund	Active
Northern Trust / Nest Climate Aware Emerging Market Equities Strategy	Systematic
Octopus Renewables Infrastructure	Active
Royal London UK Corporate Bond Fund	Active
UBS / Nest Climate Aware Global Developed Equities Strategy	Systematic
Wells Fargo / Nest Climate Transition Global Investment Grade Corporate Bond Strategy	Active
Wells Fargo / Nest Climate Transition Global Short Duration Investment Grade Credit Strategy	Active

Source: Nest

As can be seen, Nest uses external fund managers in all cases rather than the funds being managed in-house. One of the reasons for outsourcing to third-party managers is that no one manager can be the best across every single asset class. Instead, the pension fund sources a specialist manager for each different area. Other reasons for outsourcing include scale and resources/expertise within the provider.

The disadvantage of this method is that third-party managers are generally more expensive than managing the funds in-house. However, this may well be dependent on the available economies of scale and negotiating position. Also, in the case of workplace pension schemes, fund charges are capped.

As can also be seen, the majority of these funds are active. Active managers have the chance to outperform their respective index but also run the risk of underperforming it. Passive managers, meanwhile, simply track an index and generally cost less.

Many investment managers will use either an active or a passive manager, depending on the asset class. For example, if the asset class is believed to be 'efficient' – that the market is already highly researched and covered, leaving little scope left to outperform – then a passive manager may be used. If, however, a market is less researched and less efficient then an active manager is more likely to be able to outperform.

Nest's fund manager turnover has been low, and they (Nest) have said that they will tolerate short-term underperformance as long as the manager keeps to their stated process and style.

Risk framework

There are asset class ranges/limits and the Nest Investment Directorate would need permission from the IC if it wished to move outside these.

Nest uses Bloomberg PORT as its risk management tool.

Q4. How have the Nest Default Funds performed?

The reviewed population

When comparing the performance of Nest's default fund against the default strategies of other organisations, we look at the main growth phase and have used the funds shown in Table 3.

Table 3: Main default funds

Provider	Default fund
Aegon	Aegon Workplace Default (ARC)
Aon	Aon Managed Core Initial Growth Phase
Atlas Master Trust	Higher Equity Lifestyle (Multi Asset Portfolio 1)
Aviva	Aviva My Future Focus Growth S6
B&CE (The People's Pension)	TPP Global Investment (up to 85% Shares) Fund
Ensign	Aegon BlackRock LifePath Flexi
Evolve Pensions	Crystal Trust Growth
Hargreaves Lansdown	BlackRock Consensus 85 Fund
Intelligent Money	QWPS Default
Legal & General	LGIM PMC Multi-Asset 3
Lewis & Co	Lewis Default
Mercer Growth	Mercer Default Growth
National Pension Trust (NPT)	Life Stage Strategy (NPT Global Equity Fund)
Nest	Nest 2040 Retirement Fund
NOW: Pensions	Diversified Growth Fund
Royal London	Royal London Governed Portfolio 4
Scottish Widows	Scottish Widows Pension Portfolio Two
Smart Pension	Smart Growth Fund
Standard Life	Standard Life Active Plus III Pension Fund
Workers Pension Trust (WPT)	WPT Growth Fund

Source: Provider questionnaires, websites, and factsheets

Fund returns

It is generally agreed that longer-term numbers are more significant from a statistical point of view, and therefore we caution against decisions being made on a performance history of less than three years, especially so in the case of risk-adjusted performance. That said, auto-enrolment only started in 2012 so, at the moment, the majority of funds will only have a nine-year history at most.

Table 4 shows the annualised returns for the default funds reviewed.

Table 4: Annualised returns

Provider	3 years	5 years
Average	8.5%	9.0%
Aegon	7.6%	8.3%
Aon	12.9%	13.9%
Atlas	9.6%	9.8%
Aviva	7.6%	8.2%
B&CE (The People's Pension)	8.8%	8.8%
Ensign	11.4%	11.6%
Evolve	12.3%	12.5%
Hargreaves Lansdown	7.2%	7.8%
Intelligent Money	7.1%	6.7%
Legal & General	7.5%	7.1%
Lewis & Co	6.9%	9.0%
Mercer	7.7%	8.8%
National Pension Trust (NPT)	12.8%	13.1%
Nest	9.0%	9.2%
NOW	8.2%	7.1%
Royal London	6.0%	7.3%
Scottish Widows	7.4%	8.3%
Smart Pension	7.3%	8.5%
Standard Life	4.8%	5.1%
Workers Pension Trust (WPT)	7.5%	9.3%

Source: Data from Morningstar and providers to end August 2021; calculations by Defaqto using monthly data, net of fees

As can be seen, Nest's returns are above the average over three and five years to the end of August 2021.

These figures are returns only, however, and take no account of the fund's volatility ie the risk taken in achieving these returns.

Sharpe ratios

The Sharpe ratio, which is fund return minus the risk-free rate divided by the volatility of these 'excess' returns, does take risk into account.

(Fund return − Risk-free rate) ÷ Volatility of returns = Sharpe ratio

This ratio has no units, but a higher number indicates better risk-adjusted performance. Table 5 shows the Sharpe ratios for the default funds reviewed.

Table 5: Sharpe ratios using 0.1% risk-free rate

Provider	3 years	5 years
Average	0.67	0.85
Aegon	0.65	0.84
Aon	0.87	1.13
Atlas	0.74	0.92
Aviva	0.71	0.90
B&CE (The People's Pension)	0.74	0.88
Ensign	0.72	0.92
Evolve	0.88	1.07
Hargreaves Lansdown	0.65	0.82
Intelligent Money	0.58	0.64
Legal & General	0.79	0.89
Lewis & Co	0.47	0.72
Mercer	0.65	0.90
National Pension Trust (NPT)	0.85	1.03
Nest	0.84	1.02
NOW	0.69	0.74
Royal London	0.52	0.76
Scottish Widows	0.53	0.70
Smart Pension	0.57	0.78
Standard Life	0.49	0.64
Workers Pension Trust (WPT)	0.50	0.74

Source: Data from Morningstar and providers to end August 2021; calculations by Defaqto using monthly data, net of fees

As can be seen, Nest's Sharpe ratio has been above that of the average over three and five years to the end of August 2021.

Nest's Sharpe ratio is also in the top quintile of the population over these time periods.

Sharpe ratios penalise upside and downside volatility equally. Most people would consider volatility caused by high returns to be acceptable and volatility due to low returns to be 'bad'; therefore, we next consider Sortino ratios.

Sortino ratios

Sortino ratios differentiate the 'bad' volatility of returns from total volatility by penalising only downside deviations and are an expression of the fund's return minus the risk-free rate divided by the downside volatility.

(Fund return − Risk-free rate) ÷ Downside volatility of returns = Sortino ratio

The Sortino ratios for the default funds are shown in Table 6 (again, these ratios have no units, but a higher number indicates better downside risk-adjusted performance).

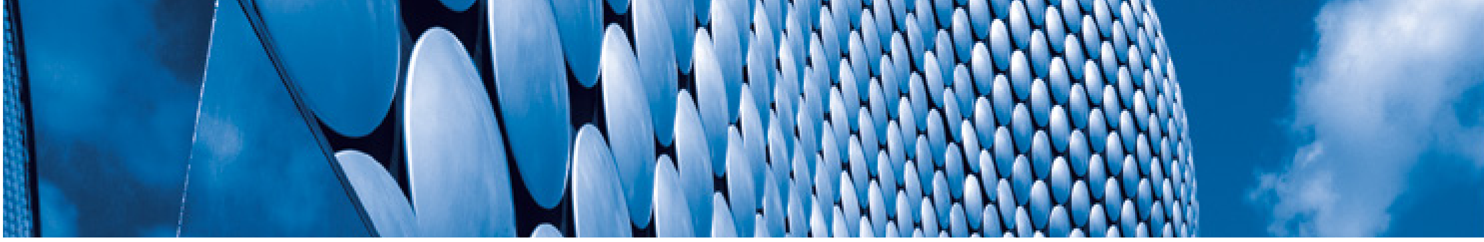
Table 6: Sortino ratios using 0% hurdle rate

Provider	3 years	5 years
Average	0.98	1.29
Aegon	0.99	1.34
Aon	1.38	1.84
Atlas Master Trust	1.08	1.39
Aviva	0.99	1.30
B&CE (The People's Pension)	1.07	1.33
Ensign	1.03	1.34
Evolve Pensions	1.37	1.74
Hargreaves Lansdown	0.99	1.30
Intelligent Money	0.84	0.96
Legal & General	1.13	1.31
Lewis & Co	0.69	1.12
Mercer Growth	0.87	1.27
National Pension Trust (NPT)	1.34	1.66
Nest	1.24	1.55
NOW: Pensions	0.93	1.01
Royal London	0.73	1.12
Scottish Widows	0.74	1.02
Smart Pension	0.84	1.21
Standard Life	0.68	0.91
Workers Pension Trust (WPT)	0.72	1.13

Source: Data from Morningstar and providers to end August 2021; calculations by Defaqto using monthly data, net of fees

As can be seen, Nest's Sortino ratio has been above that of the average over three and five years to end August 2021.

Nest's Sortino ratio has also been in the top quintile over these periods.



Q5. What are the costs and charges?

When it comes to workplace pensions there is a wide range of fees to be ascertained and compared. Another issue is whether the fees are to be paid by the employer and/or the employees.

Compared to some other workplace pension schemes, the Nest pricing structure is easy to understand as portrayed in Table 7.

Table 7: Nest pricing structure

Payer	Employer	Employee
Set up	Zero	Zero
Payroll or middleware	Zero	Zero
Initial charges	Zero	1.8% contribution charge
Ongoing charges	Zero	0.3% AMC*

Source: Defaqto October 2021

*AMC = Annual management charge.

For employers, the Nest solution is incredibly attractive because it is free. By way of comparison, 23% of schemes charge employers an initial fee, while 27% charge them an ongoing fee.

Usually when a scheme is free to the employer the employees pay a notable AMC. However, Nest charges its members one of the most competitive rates available in the retail market, at 0.3% per annum.

Often when a low AMC is charged, there is an additional fee to pay and with Nest this is also true. Nest charges a 1.8% contribution fee. This means that for each £100 invested a £1.80 fee is incurred.

By way of comparison, only three schemes charge a contribution fee, of which one is slightly cheaper at 1.7%. Looking at the wider market, other providers tend to charge for items like administration and access to computer platforms. Some charge a percentage rate, while others charge a fixed monthly fee.

While these fees tend to be much smaller in value than the contribution charge, they are an ongoing, repeating cost. This is a critical fact because the impact of one-off fees is diluted over time, whereas repeating fees are a constant drain on performance. This is illustrated in the next section.

One final word on fixed monthly fees. They can be extremely expensive (and damaging) when the member has a small balance saved and/or is making small contributions. While they are not legally chargeable (from April 2022) on values below £100, they still impact on those with the smallest balances saved.

For example, a £1.75 monthly fee on an unchanging value of £110 equates to the saver paying more than 20% in fees for the year. With indirect discrimination in mind, fixed fees are easily avoided as fewer than 10% of schemes charge them.

Nest charges and Value for Money

Here we compare the Nest charging structure against generic rates that are commonly charged across the industry. We have also included two benchmarks, shown in grey, as reference points. These are:

- 0.48% as, according to TPR, this was the average fee paid by members in 2020
- 0.75% as this is the maximum charge allowable under the charge cap

We examine the effect of the different charging structures by illustrating the value of a pension pot over 10, 20, 30, 40 and 50 years. These calculations assume:

Salary at start of illustration pa	£25,000
Salary growth and inflation rate pa	2.0%
Total contribution rate pa	8.0%
Investment growth rate pa	6.0%

Charge	Value after				
	10 years	20 years	30 years	40 years	50 years
Nest 0.30% pa+ 1.8% contribution charge	£28,765	£85,861	£194,364	£395,328	£761,052
0.30% pa + monthly fee*	£28,985	£86,517	£195,848	£398,347	£766,858
0.40% pa	£29,137	£86,461	£194,464	£392,777	£750,490
0.48% pa	£29,013	£85,692	£191,747	£385,144	£731,532
0.50% pa	£28,983	£85,501	£191,075	£383,263	£726,880
0.60% pa	£28,829	£84,554	£187,758	£374,024	£704,136
0.75% pa	£28,601	£83,158	£182,914	£360,662	£671,569

Source: Defaqto October 2021

*£1.75 per month, increasing by 2% per annum to reflect inflation.

Observations

Nest's 1.8% contribution charge is a one-off charge and therefore its impact is diluted over time.

As you can be seen, the effect of the charge over 20 years means Nest members pay less than the market average of 0.48%. The cross-over point is at 19 years and 3 months.

When we compare Nest against the price capped fee of 0.75% pa, we see that Nest members are paying less in fees overall after 8 years and 9 months.

Over most time frames, the Nest solution is either the second or third cheapest solution. This evidences that for members with a comfortable investment time horizon, the Nest charging structure represents good value for money, a situation that only improves as the timeframe increases.

Costs reduce returns, but cheap does not equal value for money

Q6. What support does Nest provide to an employer when joining?

Nest is an online, paperless solution. It is purpose built, with a decade of evolution based on real feedback and testing.

Employers certainly do not need to be online experts to use it. The website contains clear step-by-step instructions for employers to follow to set up an account and then keep it up to date.

Stage 1

Create own personal login including a username and password.

Accept Nest's terms and conditions.

Stage 2

Load organisation's details:

- name
- PAYE number(s)
- number of workers
- staging date or duty start date
- primary contact details

Stage 3

Add delegates.

- individual delegate – a person inside your business nominated to manage Nest for you
- organisation delegate – a third party authorised to help set up or manage Nest for you ie an accountant or financial adviser

Stage 4

Add contribution (payment) method.

This tells Nest how you are going to pay contributions for your workers and where you would like any refund payments to go.

Best practice is to set up a direct debit payment.

Stage 5

Add worker group(s) and for each group you will need to report:

- pay periods
- contribution rates
- the part of your workers' earnings that contributions will be based upon

Stage 6

Add workers.

This involves assigning each enrolled worker to both a payment source and a group.

Stage 7

Tell the workers.

There are statutory communications that must be issued to members at specific times.

Nest has these available online for employers to use freely as and when required.

Contact

Nest offers guidance to both employers and advisers via:

- PDF guidance
- online
- telephone

Q7. What additional support does Nest provide to employers?

One of the hidden aspects of auto-enrolment is the amount of paperwork employers must undertake.

The Nest system works for any size employer; however, it is especially efficient for smaller employers.

For smaller employers

Nest allows employers to log into the Nest system and manually input the monthly payroll and contribution information.

This avoids the need for them to invest in a payroll system and/or middleware (and the training that goes with them) to input the required data each time payroll is run.

For larger employers

Nest can accept payroll data uploads via Excel, CSV, payroll systems and provider middleware solutions.

It is worth noting that some pension schemes charge extra to facilitate these solutions; Nest does not.

Nest also provides additional support to employers through:

Employer's pension duties toolkit

Everything an employer needs to keep eligible employees informed about their rights.

The triennial process to follow and communications to give to those who have opted out and need to be re-enrolled.

Can include communications via payroll

Employee engagement toolkit

For new employees, a pack explaining how the Nest scheme works and how to make the most of it.

For all employees, information on how to log into their Nest account to see how their savings are invested and to make any changes they see fit.

At re-enrolment, information for eligible workers about auto-enrolment and re-enrolment.

Posters
Flyers
Templates

Q8. What support does Nest provide to members?

The Nest website is a thorough source of information for members. Compared to some other providers it is easy to navigate and understand.

The home page contains six headline subject areas, each of which opens a door to well-written, easy-to-understand information and guidance.

About pensions	My Nest pension	Saving for my future	Retirement	Support	Log in

It also provides a depth of guidance that we simply have not found elsewhere. For example, in the section entitled, 'Why save in a workplace pension', it not only provides answers to the key questions and concerns members may have but also provides guidance on:

- pensions versus other investments
- balancing pensions and mortgages
- balancing pensions and debt

The Nest website also contains information and guidance on those transactions members most commonly wish to undertake, including:

Checking contributions	Changing contributions	Viewing an up-to-date valuation
Fund switching	Consolidating pensions together	Assigning death benefits

One thing that particularly impressed us was the pension consolidation guidance, which is not only impartial but also goes to great lengths to make sure members consider all the facts, including the loss of any guaranteed or protected rights.

Additional engaging support and functionality looking at pension consolidation includes:

- ✔ Investment guidance
- ✔ Explanation of risk and volatility, and how funds compare
- ✔ Fund factsheets
- ✔ Online valuations
- ✔ Online free fund switching

It is worth noting that Nest does not charge the 1.8% contribution charge on the value of pots transferred into them. So even though the standard 0.30% AMC applies, pension consolidation with Nest can be a very cost-effective solution for many members.

Q9. What support does Nest provide to members at and in retirement?

Nest Guided Retirement Fund

The Nest Guided Retirement Fund is a solution for members who desire a regular income in retirement but do not want to be tied to one option.

It provides members with a similar amount that can be withdrawn every year through to age 85. The fund also sets money aside to purchase an annuity from age 85 and access to additional short-term funds should the need arise.

It is available to members who meet the following criteria:

Aged between 60 and 70	With over £10,000 in their Nest retirement pot

For those members who do not have £10,000, Nest is able to receive balances from other pension savings and/or lump sums to be invested.

How it works

The value of the Nest pension savings pot is split into three parts, each of which has a predefined purpose.

Nest pension savings

My Nest Wallet	My Nest Vault	My Nest Safe
Cash available to withdraw to spend Nest will move money from the Nest Vault into My Nest Wallet every year up until age 85	Designed to provide money in future years by: • Topping up My Nest Wallet • Putting money into the 'Nest Later Life Pot' to buy a guaranteed lifetime income from age 85 if desired	This an emergency cash fund Nest will put a one-off balance into the Nest Safe when the member enters the Nest Guided Retirement Fund

Withdrawals

The minimum withdrawal value is £20.

Up to one withdrawal can be requested each calendar month through the Nest website.

Charges

The standard 0.30% AMC is applied, but the 1.8% contribution charge is waived for both funds already in Nest and those transferred in from a third-party pension scheme.

Taxation

Nest is not permitted to operate FAD (flexi access drawdown) so uses UFPLS (uncrystallised funds pension lump sum) rules to make withdrawal payments.

UFPLS is designed to meet the needs of those without complicated planning and taxation needs.

It is therefore good to see Nest utilising UFPLS for its members.

For clarity, UFPLS works by treating each income payment the same:

25%	Tax free
75%	Subject to income tax

Nest deducts the tax payable using the Pay As You Earn (PAYE) income tax system. This uses the member's personal tax code. For most members, this removes the need to complete an annual tax return.

Members not eligible for NGRF will move into Nest's Post Retirement Fund, which is a low-risk fund from which withdrawals can be made. Members may also transfer to other providers if they wish.

Q10. What is Nest Insight and what do they do?

Nest Insight is a public-benefit research and innovation centre. It aims to find ways to support low and moderate income workers to be financially secure, both today and into retirement.

Through its research programmes, Nest Insight works collaboratively to understand the needs and behaviours of the new generation of savers created by the UK's pensions auto enrolment system, as well as the self-employed and others at risk of missing out on saving. Using this information, they identify and test practical, real-world solutions.

Nest Insight's findings are shared freely to help inform industry, policymakers, and academics so that savers around the globe can benefit from their work.

To illustrate the activities Nest Insight undertakes we have summarised two of their trials currently underway. They are a) the sidecar savings trial, and b) an opt-out payroll savings trial.

1 in 4 working age adults have less than £100 in savings to hand*

Employees' money worries are a concern for employers because^:

- 40% felt stressed within the last year
- 25% have lost sleep over money worries
- Around half of adults with a debt problem have a mental health issue*

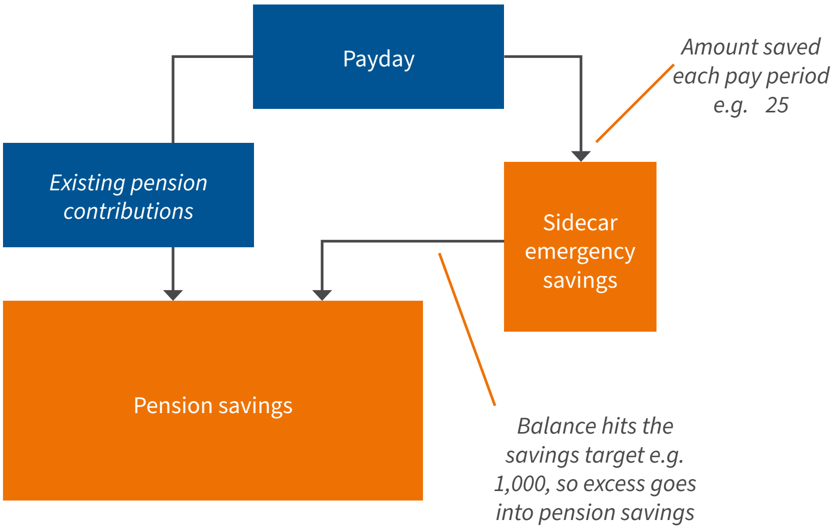
Sources:
*Money and Pensions Service
^Analysis by Salary Finance
Both published by Nest, Nov 2019

a) The sidecar savings trial

Many low- and moderate-income savers in the UK are now building up meaningful retirement savings through auto enrolment, but a significant proportion of these workers have little or no money put aside for today's emergencies. When an unexpected cost occurs, people without accessible savings may find themselves left with little choice but to seek money from elsewhere, which could mean taking on costly debt to cope.

Towards the end of 2018, Nest Insight officially launched a UK research trial to test the impact of a combined savings tool, often referred to as the 'sidecar savings model', where a liquid 'emergency savings' account is linked to a defined contribution pension pot. The trial is supported by BlackRock Charitable Trust, the Money and Pensions Service (MaPS) and JPMorgan Chase. The research is being led by Nest Insight, working with academics Sarah Holmes Berk, John Beshears, and David Laibson from Harvard University, James Choi from Yale University, and Brigitte Madrian from Brigham Young University, as well as MaPS.

This hybrid savings tool is currently being trialled in UK workplaces: BT, ITV, StepChange, Timpson and the University of Glasgow. Salary Finance is the trial's savings technology partner, providing the savings tool known as 'Jars'. Jars allows employees to set up regular payroll deductions to save money into their emergency savings jar, provided by Yorkshire Building Society, and, when they reach their savings target, to save more into their existing workplace pension. The saver can take money out of their emergency savings jar as often as they want. Whenever the balance drops below the savings target, contributions start going into the emergency jar again.



This is designed to give the saver the **peace of mind** that:

- They are building up instant access cash savings
- They have an instant access emergency fund available when they need it
- Once their emergency savings target has been reached (e.g. 1,000), the additional salary deduction will be automatically redirected into their pension, on top of their normal pension contributions, so they are saving more for later in life
- If they use all or some of their emergency savings the additional salary deduction will start going back into the emergency savings jar until their target (e.g. 1,000) is reached, all without them needing to do anything.

b) Opt-out payroll saving trial

This is a research trial to test the effectiveness of making savings through payroll the default. Employees who do not wish to save, need to opt-out. It is believed that the automatic nature of this approach will reduce barriers to saving such as sign-up friction and overcoming inertia; the tendency to do nothing when faced with a decision.

This approach, similar to that used for auto enrolment, preserves employees' choice to decide what to do with their money, whilst removing the need for them to do anything if they wish to save.

Employees will be able to make changes to the amount they save, quickly withdraw their money if they need it, and they can stop saving at any time.

The trial is being conducted with employees of SUEZ a recycling and waste management company. Around 600 new-joiners are being provided with payroll saving with Transave on an opt-out basis and will be compared to a control group who will continue to be offered payroll saving on an opt-in basis.

Research will be conducted for one year to assess participation rates, savings behaviours, and the impact on employee financial wellbeing. The effectiveness of the approach will be assessed by Nest Insight along with academics from Harvard and Yale Universities.

Nest pension scheme – Summary

Defaqto has impartially reviewed the Nest pension scheme and we encourage you to read the full question and answer report. At the start Defaqto lays out a Value for Money assessment and the key findings are summarised below.

Scheme oversight and service + Performance and investment quality + Costs and charges = Value for money

Scheme oversight and service

The combination of the Nest Executive being overseen by Nest Corporation, who in turn are answerable ultimately to Parliament, means oversight is very strong.

The Nest pension scheme is an online solution. It uses proven technology and has had ten years of enhancements to finely tune the employer and consumer experience. This has resulted in it becoming a very user-friendly experience.

The website uses education and guidance combined with comprehensive functionality to make the users' experience memorable for all the right reasons.

We like the innovations coming out of Nest Insight designed to empower consumers to build an instant access cash balance for those rainy days we all worry about.

For those wanting to start taking an income, Nest's UFPLS based solution is rather clever and we suspect it will meet the needs of the majority of consumers when they come to start taking an income.

Performance and investment quality

Nest's returns are above the average over the 3- and 5-year periods reviewed; this is including and excluding adjustment for volatility (Sharpe and Sortino ratios).

Nest is one of the few providers that can signpost its members to examples of how ESG has informed its investment decisions.

Nest is also a pioneer in the use of 'alternative' asset classes, which have the potential to create higher returns and diversification, albeit they can also be more expensive, less liquid and less transparent.

Costs and charges

For employers, Nest is free.

For employees, Nest has one of the lowest retail AMCs at 0.30% per annum.

To this is added a contribution charge of 1.8%. A one-off fee is levied on the contribution received and therefore its impact is diluted over time. This means that the Nest solution becomes increasingly more cost effective, making it one of the cheapest providers for those with a longer time until retirement.

Nest pension – Key facts

Public service obligation to accept any employer wishing to comply with its auto-enrolment duties	Authorised Master Trust	Regulated by The Pensions Regulator (TPR)
Can help employers avoid introducing 'Indirect Discrimination' into their business, as defined by the Equality Act 2010	A low annual management fee and a charging structure that becomes more cost effective as time goes on	Above average performance over 3 and 5 years
A pioneer of ESG investing and utilising alternative assets	A great online solution for those looking to take an income from their savings at retirement	Nest website for employers is thoughtfully laid out with everything needed to run a successful auto-enrolment campaign and for easy ongoing management

Nest website for employees is full of guidance designed to educate and help users make well-informed decisions.

It also empowers them to manage their savings and make free fund switches at their discretion

The Nest Insight initiatives are saving schemes designed to help members gain financial peace of mind by building up an instant access cash reserve for rainy days.

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Defaqto is a financial information, ratings and fintech business.

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Your feedback is extremely important to us and we would be grateful if, after completing this publication, you would take a few minutes to complete a short survey. Your answers will be treated in the strictest confidence and the results of this will help the development of future publications.

The survey can be accessed at:

https://www.snapsurveys.com/wh/s.asp?k=144610976149

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Defaqto is a leading financial information, ratings and fintech business, helping financial institutions and consumers make better informed decisions.

Our experts research, collect and continuously assess over 43,000 financial products. Our process is extremely robust and is driven by over 60 specialist analysts who have unparalleled knowledge of financial products, services and funds in the market. Our independent fund and product information helps banks, insurers and fund managers with designing and promoting their propositions.

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Diamond Ratings help segment the funds and portfolios available in each sector because they indicate, at a glance, where funds, fund families and DFMs sit in the market, based on both performance and a range of key attributes, including competitiveness in areas such as cost, scale and manager longevity. You can use them as a filter criterion or use them for fund or DFM comparison.

Service Ratings provide advisers with a simple and unbiased assessment of provider service. Based on advisers' perceptions of the service they receive, providers are rated Gold and Silver.

Risk Ratings use the projected volatility of a fund using asset allocation and historic volatility, based on observed standard deviations, to map a fund to a Defaqto Risk Profile. Risk Profile 10 indicates highest risk and Risk Profile 1 represents lowest risk.

Income Risk Ratings are unique to the market, comparing fund objectives, asset allocations, income and capital volatilities, and maximum drawdown. The Ratings are mapped to four Income Risk Profiles based on the income required and the level of risk. They are: capital preservation, low income volatility, medium income volatility, high income volatility.

Income Drawdown Ratings use the fund's asset allocation and historic returns to assess the levels of sustainable income it can deliver over a given duration, and the likely residual value at the end of the agreed term.

Defaqto Reviews

In response to the growing requirement for advisers to have access to ESG data and fund/DFM research, Defaqto ESG Reviews provide an invaluable resource to assist in assessing funds and DFM MPS from an ESG point of view. With a mixture of qualitative and quantitative data provided in a standard format in Defaqto Engage, advisers can cut through the complexity of ESG to ensure suitable advice.

Also available to advisers through Defaqto's end-to-end financial planning tool, Engage, Defaqto Fund Reviews combine detailed quantitative and qualitative data to produce an in-depth report on not just fund families but also single funds. These can also be used by fund managers to provide more information to advisers beyond the fund factsheet or KIID.

Expert financial planning with no loose ends

defaqto engage

Defaqto Engage

Defaqto Engage is our financial planning software solution enabling advisers to manage their financial planning processes all in one place.

Our software contains a wealth of product and proposition information to help advisers select a product that is suitable for their clients' needs and evidence their due diligence for compliance purposes.

The satisfaction results, by category, are available within Engage. Advisers can use the individual category satisfaction scores (for example, new business servicing, existing business administration, online servicing) during the research process as one of a number of selection criteria. They can also be added to comparison tables.

Advisers should note that not all providers are rated. To qualify for a Service Rating, providers must receive a minimum number of responses from advisers. So, using any service results in the filtering process may exclude providers offering potentially suitable client solutions from the research output.

Benefits

- **Save time** – consistent use of client data and profiling saves time doing research, suitability reports and client reviews
- **Save money** – one vs multiple systems check
- **Better client outcomes** – from a robust and consistent methodology
- **More robust compliance** – demonstrate a consistent, repeatable advice process

Additional modules available

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