Nest Corporation case study

1 Introduction

Nest Corporation is a Public Corporation of the Department for Work and Pensions (DWP) and the Trustee of the Nest pension scheme, a defined contribution pension scheme established by the government in 2010.

Nest was established following the 2002-2006 Pensions Commission, which was set up to consider the consequences of the UK's ageing society and declining participation in occupational pensions for the sustainability of the pension system. The Pensions Commission recommended a number of reforms to the pension system, including a fairer and more generous State Pension, an increase to the State Pension Age, and automatic enrolment, to increase participation in occupational pension saving.

Automatic enrolment mandated that all employers must enrol their employees into a pension scheme. Employees are able to opt-out if they wish to, but the default is that they are enrolled into a pension by their employer. Nest was set up as part of the automatic enrolment programme and has a legal obligation to accept any employer that wishes to use it to comply with its pension duties. This was to address a supply side failure potentially caused by auto enrolment: that existing pension providers may not want to provide a pension to employers if that business does not appear profitable. Nest receives grant income from DWP to cover the cost of this obligation and also has a government loan to cover set-up and operational costs, but is on a long-term path to repaying this and becoming self-sustaining.

Nest's primary legal duty is its fiduciary duty to its members, but as a Public Corporation it is also accountable to Parliament through DWP. Its Trustees are currently chosen by the Secretary of State for Work and Pensions. Nest also has a Members' Panel. The Panel allows Nest to take the views and considerations of members into account. It reviews the Nest Statement of Investment Principles and produces its own Annual Report. At some point Nest Trustees will be chosen through a process that includes the Members' Panel. Nest is regulated by The Pensions Regulator.

Since Nest was set up it has grown to become one of the largest pension schemes in the country, with 8.5 million members, 760,000 employers and £8.3 billion of assets under management (AUM). The 8.5 million members that Nest serves represent approximately a fifth of the working age population. It is thus one of the largest government behavioural interventions in any market, turning consumer inertia and defaults into a positive force to help people previously excluded from saving save for the future,

Due to Nest's scale, it operates a digital first, self-service approach to administration and customer service. This has enabled Nest to deliver quality whilst keeping operational costs down. The roll-out of auto enrolment was completed in a staged manner, with larger employers complying with pension duties first, followed by medium-sized employers and then small and micros. During the busiest periods of this over 1,800 employers were signing up to Nest in a single day. However due to the self-service design of Nest's administrative systems, 85% did so without having to contact the Nest call centre for assistance.

2 Nest's customers

Nest's members

Nest membership is predominantly made up of younger workers on low-to-moderate incomes. Nearly half of all members are below the age of 35 and more than half have annual earnings of less than £20,000. Each year around 4 in 10 of Nest members leave their jobs or choose to stop contributing to the Nest scheme. Around 7% decide to opt-out of saving into the Nest scheme.

Nest members work in a variety of industries, as described by the table below.

Top 10 industries	% Nest members
Employment	13%
Health and social care	11%
Catering and accommodation	9%
Retail, hire and repair	9%
Manufacturing	6%
Construction	4%
Administration and support services	3%
Education	3%
Charity	2%
Transportation and storage	2%

The majority (92%) of members saving into Nest have been automatically enrolled rather than having made an active choice to save. Those that have made an active choice to save (over 250,000 people) tend to be disproportionately female, earning less than £10,000, and under the age of 25.

Nest's employers

The employers using Nest tend to be smaller companies, with 98% of employers having fewer than 50 employees. However, a large percentage of its membership works for mid-sized and large firms. Although only 0.6% of Nest employers employ 250 or more workers, these firms account for 36% of Nest members.

Nest employers are located across the UK in major cities, suburban areas and rural communities. The highest concentrations of both Nest employers and their members (measured by number) are in the major metropolitan areas, including London, Cardiff, Birmingham and Manchester, along with the south of Scotland and Northern Ireland.

3 Investment approach

Given the profile of Nest's membership, and the differences between their demographic and financial characteristics and those of traditional pension scheme members, a significant body of research has been conducted into their risk capacity, preferences and investment choices, in order to inform the investment strategy.

This showed that compared to members of traditional pensions schemes, Nest's members are likely to have a lower capacity to take risk due to significantly lower incomes (around £10,000 lower than members of traditional schemes) and lack of experience with financial products and concepts. They are also likely to have a lower risk preferences, with a significant percentage of those surveyed (37%)

favouring taking no risk whatsoever with their retirement savings and displaying loss aversion when faced with investment losses.

The research also suggested that Nest members are likely to have high levels of inertia once they have been automatically enrolled, with sizable majorities (between 7 in 10 and 9 in 10) of those auto enrolled in similar pension schemes in the US, Sweden and Chile remaining in the investment funds that they were defaulted in by their scheme.

Surveys of Nest's members also show preferences for an option for an ethical fund, with an appropriate stance on child labour, exploitation and human rights violations, and that Muslim members would opt-out of the Nest scheme if they informed that the fund invested in non-Sharia compliant investments, or would feel they ought to opt for a Sharia compliant alternative if they knew it was available.

These insights have formed the basis for the investment strategy, which offers high quality default investment options, on the basis that the majority of Nest members will remain in the default fund, supplemented with a limited number of choices to meet the needs of those with strong ethical or Sharia investment preferences.

There are almost 50 default investment options, one for each year members are expected to retire. The risk profile of these funds automatically adjusts throughout the working life of a member. When starting out members' assets are exposed to a limited amount of risk to avoid volatility, which given the risk capacity and preferences of members, may put them off pension saving and cause them to opt-out. When members have been established in pension saving, assets are exposed to a greater degree of risk to build up savings, followed by reducing risk gradually as they approach retirement to prevent losses in the lead up to reducing or stopping work.

Members can also choose from five investment options to suit specific preferences. These are:

- Higher Risk Fund
- Ethical Fund
- Sharia Fund
- Lower Growth Fund
- Pre-retirement Fund

As at 31 March 2019, 98% of members were invested in Nest's default investment strategy. Switching activity is low, with just 1% of members changing their investment options in the financial year 2018-19.

In 2014 the Government legislated to give pension savers more choice about how to access their retirement savings through the freedom and choice reforms, which removed the requirement to purchase an annuity. At the same time this created a disconnect between the behavioural forces at play during the saving and retirement phases of the pension system. Under automatic enrolment, members save predominantly through inertia, by being defaulted into a pension scheme by their employer. However following the freedom and choice reforms at retirement members now have to make a set of very active and involved decisions about how to access their pension savings.

Nest has conducted research into the attitudes and preferences of Nest members when it comes to this challenge. This shows that members (even those with small pension pots) want to use their savings to generate an income in retirement, and want to be nudged into a product that would give them a sustainable income by their pension scheme. These ideas are being taken forward by the pensions industry, with a number of providers developing products that have similar features.

4 Engaging and communicating with members

Alongside research to understand the risk and investment preferences of its members, Nest carried out research to understand how members are likely to think and feel about pension saving so that the scheme can communicate with members in an engaging and effective manner. This research was used to develop eight golden rules for communicating with members:

1. 'I keep it real' – pension communications should be as practical as possible and use examples people can relate to. Theoretical concepts are harder to grasp and should be avoided.
2. 'Rights not responsibility' – People respond more positively to language that focuses on their entitlements rather than what they should be doing
3. 'Out with the old' – Communications about the advantages of being in a pension shouldn't focus on the details of retirement. It's not an idea people like to think about. Many feel it's too far away to be relevant to them. That means it's important to engage with people as they are now and bring messages about pensions into their current working lives.
4. 'One for all' – Those people who have been affected by pension reform and automatic enrolment take comfort in numbers. For communications that means reassuring people that they're part of a wider group.
5. 'Tell it like it is' – We should present the facts and let people reach their conclusions. People don't want pensions information to be dressed up. They want information expressed in plain language so they can form any value judgements themselves.
6. 'Give people control (even if they don't use it) – Nest members want to feel in control, even if they do not exercise It.
7. 'Take people as you find them' – Communications should be designed to fit with where people are in their understanding. New savers might have quite different levels of understanding from each other and from existing scheme members.
8. 'Be constructive' – People respond well to the idea of being able to make a difference to their future. Even when they have worries about how financially prepared they are for retirement, they to focus on what can be done about it.

These eight principles flow throughout Nest's communications and narratives to members, both statutory and non-statutory, and have been accepted by the industry and wider pensions sector as best practice for communicating with the new generation of savers brought into pensions by automatic enrolment. It is provided by The Pensions Regulator as an example of how schemes should communicate with members in clear, plain English.

Since the launch of Nest, approximately a quarter of active members have registered to access their account via the website. Nest is increasingly focussed on testing methods of communicating with members, so that where it is in their interests, Nest can increase engagement amongst the membership and drive up member registrations. As Mark Rowland's, Nest's Chief Customer Officer, describes in this **video**, this focuses on developing personalised content to overcome the challenges of engaging with a membership who are overwhelmingly saving through auto enrolment and have many competing demands for their attention.

Engagement is tested through A/B testing (randomised experiments with two variants) and developed iteratively, refining the content and the target audience over time to increase engagement. Nest also conducts annual research into its membership and customer base, the 'Voice of the Customer' to understand how its administration, service levels and brand is perceived by members and employers, as well as ad hoc research into specific subjects to better how to engage with its membership.

This is used to develop the communications approach, in particular non-statutory communications which aim to increase engagement and the percentage of members with registered accounts. Nest recently launched a series of animated videos to provide information about its responsible investment approach to members. This was in response to a survey commissioned to better understand how to engage with members. Almost two thirds of those surveyed (63 per cent) said they want to know more about the pension scheme's status as a responsible investor. Women (68 per cent) were more likely than men (59 per cent) to want to know more about how their funds are being responsibly invested, and almost half savers surveyed (45 per cent) felt more confident about saving with Nest when they heard about responsible investment.

5 Regulation

Nest complies with a number of regulatory frameworks to provide assurance that it operates effectively. These include The Pensions Regulator's Master Trust Authorisation framework, which was introduced in 2017 to ensure that all Master Trust schemes operate to rigorous minimum standards. It was developed to provide a strong regulatory regime for the Master Trust sector, as employers increasingly used them to fulfil their pension duties under auto enrolment. It is not possible for a Master Trust to trade without receiving authorisation from The Pensions Regulator.

The Master Trust Authorisation regime set out criteria for schemes to meet in order to be authorised. These include:

- Fit and proper - All individuals being assessed must be able to satisfy the Pensions Regulator that they are fit and proper and meet the standard of honesty, integrity and knowledge appropriate to their role.
- Systems and processes - Master trusts must have sufficient IT systems and processes in place to run efficiently and have robust systems and processes to effectively govern the scheme and comply with all the relevant requirements.
- Continuity strategy - Sufficient contingency planning is crucial to the effective running of a master trust. The Pensions Regulator assesses the scheme's strategy for responding to a triggering even and how a master trust may be closed down or how the triggering event will be resolved.
- Scheme funder - Any scheme funder must be a body corporate or partnership and only carry out activities relating directly to master trusts. The Pensions Regulator assesses whether the scheme funder is able to financially support the master trust.
- Financial sustainability - The master trust needs to have enough financial support to ensure it can set up and operate on a day-to-day basis and to cover the costs subsequent to a triggering event without increasing the cost to members. A key part of demonstrating that the authorisation criteria are met is by having a business plan in place setting out the expected activities and growth of the master trust and how they will be funded.

Nest has gone through the Master Trust Authorisation regime and received authorisation in September 2019. The regime formalises many standards and processes that were already in place for Nest and ensures that proper scrutiny is in place across the Master Trust sector. It provides a minimum standard, however as a trust-based scheme with a duty to act in the best interests of its members, Nest acts to deliver standards over and above those set out in the Master Trust Authorisation framework.

6 Conclusions

From a standing start Nest has grown to become one of the largest pension schemes in the UK, serving a significant proportion of the UK's working age population.

Many of the people that Nest serves are low income, saving into a pension for the first time, and disengaged with the act of pension saving. To ensure that Nest serves these people effectively and fulfils its duty to act in their best interests, it has had to consider the design of a pension scheme from first principles, conducting a significant body of research into its membership to design an investment strategy, administration services and communications materials to meet the specific needs of its membership. In the process it has had a wider positive impact on the pensions industry, influencing other schemes to change their own approaches to member communications and investments.

Nest aims to continue to influence the industry to improve standards. It has established Nest Insight, an in-house research unit, which conducts multi-disciplinary research into the financial challenges of auto enrolment and low income savers, drawing from its mass membership. Nest Insight makes its research freely available for industry, government and public policy communities. Over the next three years Nest Insight is planning a wide-ranging programme of research including testing how access to emergency savings affects people's short and long-term financial resilience, exploring interventions to increase pension saving amongst the self-employed, and assessing the phased increase in the statutory minimum level of pension contributions affects savers' behaviours and attitudes. For more information please see nestinsight.org.uk.