

Annual Chairman's Report

Babloo Ramamurthy (IGC Chairman)

Scottish Widows Independent Governance Committee

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Contents

Statement from the Chairman 3

Full Report

1. What is the IGC and what does it do?	6
2. Who are the members of the IGC?	7
3. Which Scottish Widows products are covered by the IGC?	8
4. How does the IGC assess Value For Money?	9
5. What were the key insights from the customer research?	10
6. Our value assessment for the year ending March 2017	12
6.1 Investments	13
6.2 Administration	15
6.3 Engagement	16
6.4 Governance	17
6.5 Charges	18
7. What's next for the IGC?	19
8. What are the IGC's conclusions?	20

Statement from the Chairman



Babloo Ramamurthy,
Independent Chairman, Scottish Widows IGC

The role of the Independent Governance Committee Report (IGC) is to ensure that the workplace pensions provided by Scottish Widows and Clerical Medical offer good Value For Money (VFM) for customers.

The IGC review of 2016

Scottish Widows is a large and long-established pension provider and is now also responsible for pension products previously sold by Clerical Medical. In considering their products, it became clear to the IGC that older products (generally those established before 2001), which tended to be more complex in structure, and newer products, which were much simpler and qualified for auto-enrolment purposes, needed to be considered separately. The older products are often referred to in the pensions industry as “legacy products” and you will see this term used in this report.

Over the course of the year, the IGC has spent time examining the various aspects of Scottish Widows’ proposition that impacts the Value For Money (VFM) for customers.

The work of the IGC was also supplemented by a programme of independent research, which captured the views of Scottish Widows customers. Later in the year a separate programme of industry wide research was conducted at the request of the IGCs of most of the leading pension providers, which allowed us to see how the views of Scottish Widows customers compared with the views of other customers of workplace pension providers.

As a result of our work, we have determined that VFM should be assessed by examining five key “drivers of value”: Charges, Administration, Investments, Governance and Engagement.

Charges

The IGC recognises the impact of charges on VFM and the need to keep them under review. However, charges were consistently rated as the least important factor in the customer research. Many customers in the research did not even realise they were charged an annual fee for the administration of their pension.

The charges on all of Scottish Widows’ more modern pension contracts have been capped at 0.75% since April 2015, and have fallen from an average charge across that book of business of 0.75% in 2015 to an average of 0.59% in 2016. Statistics published by the Department for Work and Pensions in 2015 showed average charges for this type of pension ranging from 0.55% for Auto Enrolment Schemes to 0.81% for older schemes.

At the end of 2015, Scottish Widows also agreed with the IGC to cap the peaks in scheme charges applying to legacy products at 1% and to remove all exit penalties. The IGC can confirm that Scottish Widows made these changes for the benefit of the overwhelming majority of customers in legacy products from the start of 2017 and that the remaining customers will benefit from these changes during early 2017. These changes will have a substantial impact on improving the VFM for the majority of Scottish Widows’ legacy products.





Administration

We reported last year that during 2014 and through early 2015 Scottish Widows had failed to meet its own service standards for collecting and applying monthly premiums and also for settling claims when customers wanted to withdraw their money. We also noted in last year's report a recent improving trend. We are pleased to report that this improvement has continued through the last 12 months, with agreed service standards now being achieved consistently.

Customer research findings have told the IGC that whilst accuracy and timeliness were important, customers placed the greatest value on support and assistance and having their enquiries dealt with efficiently. As a result, Scottish Widows has agreed with the IGC various enhancements to its service model, including giving customers a single point of contact when dealing with their queries.

External ratings from customers and their advisers (known in the industry as Net Promoter Scores) have recognised the ongoing improvements to service levels and there has been a steady upward trend in these scores.



Investments

Through this past year's research customers have told the IGC that they regarded investment performance as being the most important factor in achieving a good outcome at retirement. The IGC reviewed the performance of the default investment funds (called "Pension Investment Approaches") commonly selected by employers for their workforce. These funds have delivered annualised returns of around 20% in 2016 and between 7% and 9% pa across the 3 years and 5 years time periods. The IGC believes these are good

levels of return relative to both other providers and long term expected returns more generally and have been an important factor in our VFM assessment.

However, the IGC would like to see more work done by Scottish Widows in assessing the performance of their Pension Investment Approaches relative to appropriate benchmarks, and across the industry more generally, to allow an objective comparison to be made by customers against similar options offered by other pension companies.



Governance

The results from the customer research indicate that 'Governance' isn't a term that is well understood. It covers a variety of areas such as: the steps taken to protect customer data and money from cyber crime; the internal processes required to ensure the fair treatment of their customers; and also the steps taken to manage the long term financial sustainability of the provider. However, once the term was explained to them, customers who agreed to take part in this year's research activity rated 'Governance' as being extremely important to them.

The IGC reviewed the various areas identified above as constituting good governance and concluded that the overall governance framework operated by Scottish Widows was both robust and incorporated an effective level of independent oversight to ensure that customers were at the centre of the governance process.



Engagement

Engagement, which is a term describing whether customers are interested and involved with their pensions, and the extent to which they feel informed, was also measured in our

research. This identified an 'engagement gap' not only in Scottish Widows but across the industry more generally. It is clear that there are significant knowledge gaps preventing customers from making the most of their pension products, and there are many misunderstandings which act as a barrier more generally to building trust in pensions. As a result, Scottish Widows has invested in a range of materials including tools and videos to help their customers better understand their pension.

At this point more work needs to be done to bring these materials to the attention of customers, but we believe there is now a growing library of tools on-line and on paper to help customers feel more confident in understanding how their pension works and the options available.

Last year the IGC highlighted a number of challenges which were specific to legacy customers. Towards the end of 2016, Scottish Widows established a dedicated division, specifically responsible for Long Standing Customers. Workplace savings customers in legacy products will now be managed within this area.

The Long Standing Customer team have shared their goals with the IGC which, in summary, is to give more focused and more fundamental consideration of VFM for customers in older products and on older systems. The IGC will be working with this new team to ensure that changes are made for the benefit of customers and to protect guarantees and other benefits provided under these contracts.



The IGC is encouraged by the progress and proposed improvement plans for the coming year. A key focus is the work being done to continue improving customer support especially for customers in older products

Overall view

Overall, the IGC has been encouraged by the progress made by Scottish Widows over the last year and also the direction of travel which they have signposted for the coming year. If customers in Scottish Widows' current, modern products can be encouraged to engage more fully with their pension, they will have access to options, performance and support which we believe, overall, represent good Value For Money.

The current lack of member engagement means that more work needs to be done by Scottish Widows, and the industry more generally, to build levels of trust and engagement which enables those customers who would like to become more engaged, to do so and to get more from their pension.

Customers saving through older "legacy products" can benefit from guarantees and other features which are not available today. The value of these benefits relative to some of the features commonly found in more modern products will depend on the personal circumstances of each customer. The IGC will be working closely with the new team responsible for Long Standing Customers as they consider various engagement and potential product and platform improvements during 2017 to ensure the VFM drivers of value are improved for the benefit of this group of customers.

Further detail is included in the annual statement which follows.

The IGC Members:

Joining me on the IGC there are 3 independent members; John Howard, a long-time consumer champion and former Chairman of the Financial Services Consumer Panel and former Board Member at the Financial Ombudsman Service; Tilly Ross, who was formerly Global Head of Pensions at the National Grid and is now a Non-Executive Director at The Pensions Regulator; Mark Stewart, who has considerable experience in pensions consultancy with a particular focus on defined contribution arrangements; and joining these independent Committee members are two senior members of the management team at Scottish Widows: Iain McGowan who is Head of Fund Development and Analysis and Ronnie Taylor who is Distribution Director. It was critical that the IGC had members who had expertise in the products and procedures operated by Scottish Widows so that we could be effective in assessing and improving the VFM of the provider's products for the benefit of customers.

If you have any comments, questions or concerns in relation to the work of the Scottish Widows IGC, please contact us through the following address: mailbox.contacttheigc@scottishwidows.co.uk



Babloo Ramamurthy,
Independent Chairman, Scottish Widows IGC

31 March 2017



1. What is the IGC and what does it do?

The IGC is a mainly independent body of experts and has been established under rules set out by the Financial Conduct Authority (FCA).

The IGC's primary role is to scrutinise the workplace pension products provided by Scottish Widows and to assess whether customers are getting Value For Money (VFM), i.e. the extent to which the services, benefits and safeguards put in place by Scottish Widows represent good value to customers relative to their cost.

A copy of the full Terms of Reference can be found [here](#).

The IGC oversees all contract-based workplace pensions (i.e. group personal pensions and group stakeholder pensions) operated by Scottish Widows. This includes customers who are currently contributing to their pension and also customers who have stopped contributing, but whose pension assets are still managed by Scottish Widows.

Scottish Widows is now also responsible for managing policies previously sold by Clerical Medical and the IGC therefore also oversees those group pension policies.

The remit of the IGC does **not** include:

- Trust-based schemes, where the Trustees of those schemes fulfil a similar duty to the IGC.
- Personal pensions purchased by individuals for their own use.
- Products used by customers to provide either a regular retirement income, known as annuities, or income drawdown products.

A brief summary of the IGC's purpose can be found [here](#).



2. Who are the members of the IGC?

The FCA requires that the IGC consists of at least five members, the majority of whom are independent, including the Chairman. The IGC Chairman is required to ensure that the IGC has access to the necessary expertise and to secure additional specialist expertise, whenever this is required.

The members of the IGC bring a wealth of experience at senior levels across the industry, including pension scheme governance, typical pensions practice, investment oversight, the work of the Financial Ombudsman Service and the Pensions Regulator, together with in-depth knowledge of Scottish Widows' products.

The Scottish Widows IGC is chaired by Babloo Ramamurthy, supported by three further independent members:



John Howard, long-time consumer champion and former Chairman of the Financial Services Consumer Panel and former Board Member at the Financial Ombudsman Service



Tilly Ross, formerly Global Head of Pensions at the National Grid and now a Non-Executive Director at The Pensions Regulator



Mark Stewart, pensions consultant with a particular focus on defined contribution arrangements

They are joined by two senior members of the management team at Scottish Widows:



Iain McGowan, Head of Fund Development and Analysis



Ronnie Taylor, Distribution Director

The inclusion of two members of the Scottish Widows management team brings considerable subject matter expertise to the Committee and ensures the right resources can be accessed quickly to support the IGC's work. More information about the members of the IGC can be found [here](#).



3. Which Scottish Widows products are covered by the IGC?

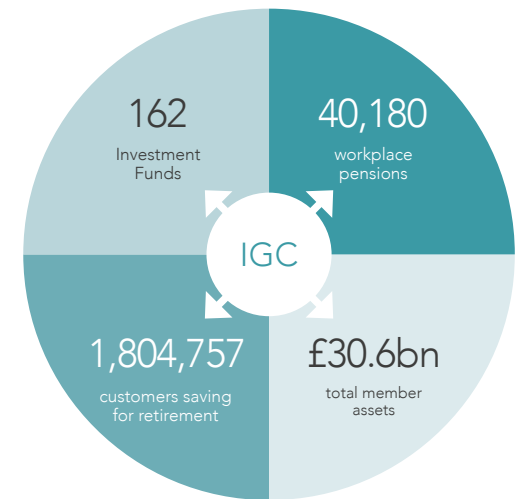
Scottish Widows is a long established pension provider managing a range of different products which customers have bought over a number of years.

The products overseen by the IGC are group pensions arranged by an employer for their employees, where each member has their own individual contract with Scottish Widows and their own personal pension account (or 'pot') over which they have control. These products differ from occupational pension plans established by employers under a trust-based arrangement, where members have no direct relationship with the pension provider.

Older products tend to be more complex, as was common across the pensions industry prior to 2001. These older, legacy products often have more complex charging structures, but can also contain valuable benefits which are no longer available today.

Most modern products are typically much simpler, with a single charge expressed as a percentage of the customer's fund, which is deducted annually. This is known as an Annual Management Charge (AMC). Also, they tend to have a more extensive range of investment options and more services available to customers on-line.

[Appendix 1](#) lists the Scottish Widows and Clerical Medical products which fall into each category.



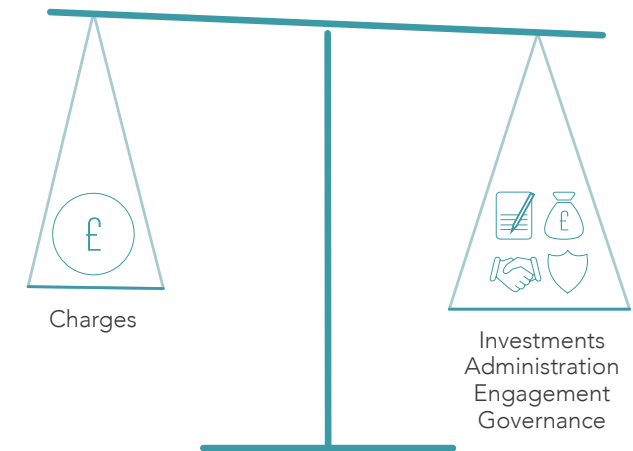
4. How does the IGC assess Value For Money?

The FCA did not specifically define Value For Money (VFM) when they established IGCs. Having assessed the various factors impacting the quality and outcome from pension products, the IGC has decided to assess VFM by considering each of five key drivers of value of the Scottish Widows proposition:

- Investments
- Administration
- Engagement
- Governance
- Charges

Over the course of the year, the IGC focuses on each of the above areas at their meetings and also spends 2 days on site with the operations team at Scottish Widows seeing things for themselves and speaking with customer facing staff. In addition to considering the views of end customers, the IGC spends time during the course of the year with Employee Benefit Consultants and sponsoring employers to understand their perspective.

In the past year the IGC has also benefited from reviewing the results of comprehensive research into customer views. In early 2016, external research specific to Scottish Widows customers was commissioned using ORC International, an independent research firm. This provided the IGC with comprehensive and quite material insights. Later in 2016, 11 leading product providers participated in a broader research programme which allowed IGCs to assess their own customer views relative to the customers of other pension providers. The IGC has assessed the insights obtained from this customer research, alongside the information which the IGC obtains directly from Scottish Widows, to assign a status of red, amber or green, in relation to each of the five drivers of value identified above. Where a component is rated as anything other than 'green', an action plan is agreed between Scottish Widows and the IGC which would achieve a 'green' rating in the future.



5. What were the key insights from the customer research?

In the spring of 2016 ORC International conducted research with the Scottish Widows customer base to understand the extent to which they valued the proposition from Scottish Widows and whether they felt they were getting Value For Money.

Customers were initially asked for their views based on their existing level of knowledge. In a later part of the research, customers were given some additional factual information about their pension product to allow them to offer opinions equipped with more detailed information.



Investment

Throughout the research, customers consistently ranked Investment as the most important driver of value, recognising the importance of satisfactory investment returns to good outcomes at retirement. However, customers tended to think results were somewhat in the hands of fate, not appreciating the role which Scottish Widows plays in setting the investment strategy and ongoing asset allocation of default funds and in designing the de-risking process towards retirement. Customers also had little appreciation of the role which they could play in terms of matching investments to their

attitude to risk and tailoring the investments in later years to better match their own retirement plans, once these are known.



Administration

Second in terms of importance was Administration. Although accuracy and timeliness were considered important, customers placed the highest value on being provided with adequate help and support when making decisions or if things went wrong.



Engagement

The importance of Engagement varied depending on the status of the customer. Typically, new customers were engaged to the extent that they wanted to ensure things were set up correctly. Subsequently, customers tended to be far less engaged until about the age of 50 when they became more engaged again through trigger events such as the death of a colleague or loved one, for example. The later life engagement is more intense as customers start thinking through the important choices ahead of them at retirement.



Governance

Initially, customers seemed to place little importance on Governance,

probably because it is not a term that seems to be widely understood by customers. However, when the governance structure and the role of the Independent Governance Committee was explained to them, customers rated this far more highly and regarded it as a very important aspect.



Charges

Charges were consistently rated as the least important factor. Many customers in the research did not even realise they were charged an annual fee for the administration of their pension. Where customers were aware of fees, they over-estimated the level of fee, believing charges to range between 2.5% and 4.7%.

In the autumn of 2016, the IGC's of 11 leading product providers came together with the support of their respective product provider to shape and commission a programme of industry-wide research using an independent research firm, NMG. This broader programme explored similar areas to the research commissioned by Scottish Widows earlier in the year, but also allowed the IGC to assess the views of Scottish Widows customers relative to the views of the customers of other providers.

Customers believe investment returns will have greatest bearing on the size of their pension pot but have little understanding of charges

The key qualitative research findings were:

- The views of participants generally echoed the views of the Scottish Widows customer base, including areas such as the high importance assigned to Investments and an almost identical (lack of) understanding and perception of Charges.
- Pension savers appear to have a number of misunderstandings about their pension products which are likely to contribute to a generally low level of trust in the industry and, perhaps, also contributing to a general under-saving through pensions. For example, some customers thought they would lose their pension pot if their employer ceased trading, or even when they changed job. More generally they did not identify their pension pot as being their own money – despite these being personal pension arrangements where each customer has their own contract and has sole control and access to their pension account.
- Following the initial qualitative research phase, a subsequent quantitative phase of the research was shaped under four key headings which were proposed by the independent research firm based on the feedback received from customers in the earlier phase. 'Service' and 'Engagement' were combined under the heading of 'Support'. 'Governance' was re-badged as 'Security'. 'Charges' remained as 'Charges' and 'Investments' was merged within the wider category of 'Product'.

The key quantitative research findings were:

- Investment performance was identified as the most important factor contributing to good outcomes at retirement.
- Of the 23 attributes assessed, 4 of the 7 attributes which were of the most importance to customers related to 'Security' including security of their money and data, and also the financial security of their product provider.
- Once again, customers were largely unaware of 'Charges', but when this was explored further, they expected their charges to be broadly in line with industry averages.
- Customers using Scottish Widows' products assessed the Value For Money provided as being marginally ahead of the overall industry average. These customers felt that their pension savings were more secure than the average for the industry as a whole, but had a relatively lower opinion of Scottish Widows' digital capabilities, including e-mail communications, compared with the rest of the industry. Customers in Scottish Widows' products assessed felt that the range of investment funds available was more restricted than for customers more generally.



6. Our value assessment for the year ending March 2017

In considering VFM the IGC assesses a number of the key components which make up the overall proposition for customers. Having considered each area, the IGC assigns a status of 'red', 'amber' or 'green'.

Where a status other than 'green' has been assigned, the IGC will agree with Scottish Widows an action plan to move the assessment to 'green' in the future.

As a result of our work analysing the products provided by Scottish Widows, and reviewing the feedback from the customer research, we determined that VFM should be assessed by examining five key "drivers of value": Charges, Administration, Investments, Governance and Engagement.



RED

This aspect of the proposition is performing at a level below which the IGC feels is appropriate, or below alternatives available in the market more generally.



AMBER

There may be a sub-set of customers for whom improvements are required or some quite specific areas that require attention.



GREEN

The IGC has observed no material issues and performance is in line with expectations.

We provide our current assessment of each of these areas below:

6.1 Investments



In 2015, the IGC focused primarily on the governance and performance of the Pension Investment Approaches (PIAs), which are the small group of investment options used as default funds in workplace pension schemes used for auto enrolment. This year the IGC again assessed the governance and performance of those funds, but also considered the wider range of funds available to customers through Scottish Widows' products.

Customers' long term growth projections are currently set by the FCA, who require pension companies to illustrate the rates at which investments might be expected to grow each year. Growth rates are illustrated between a low of 2% and a high of 8% per annum. The IGC found that the PIA defaults continued to perform well with annualised returns of around 20% in 2016 and between 7% and 9% pa across the 3 years and 5 years time periods.

The 2016 returns in particular reflect the particular circumstances of a strong equity market, the benefit of overseas investments during a period of falling sterling exchange rates and falling yields on corporate bonds.

The IGC has challenged Scottish Widows to review whether it is appropriate for the PIA returns to be so strongly linked to currency movements going forward. Scottish Widows tend to hold a higher proportion of equities than other providers when customers are younger which means that performance could be more volatile. However, Scottish Widows also start to de-risk client portfolios 15 years from retirement, which is somewhat earlier than other providers. The IGC has considered the overall level of risk from the PIAs, alongside the returns they have produced. We believe, overall, that the level of risk to which Scottish Widows' customers are exposed over the lifetime of a typical policy is broadly in line with the market and in line with Scottish Widows' description of the PIAs to members.

The IGC also considered the wider range of investment funds available to those customers who wish to make their own active investment choices. Whilst the IGC is comfortable with most aspects of the internal governance processes which now oversee this portfolio of funds on behalf of customers, it was concerned that the range of funds offered had not been refreshed for some time. Scottish Widows has now undertaken a thorough review during 2016 and, as a result, has added 21 new funds to their fund range and will be removing around 40 funds over the next 6 months. The IGC sees this as the first iteration of a more active governance of the fund range.

Good levels
of investment
returns



However, the IGC continues to have concerns in the following areas:

- Although the absolute performance of the PIAs (which are most often used as default funds) in recent years is to be welcomed, the IGC would like to see Scottish Widows do further work to explain more clearly the operation of the PIAs to members. It would also like to see further progress with the framework for comparing funds and their investment outcomes against similar funds offered by other providers. Scottish Widows has agreed to undertake this work.
- Scottish Widows has made some progress in gathering information in relation to transaction charges within its various funds. These transaction charges are costs that relate to the buying and selling of assets held in the fund, and hence reduces the net investment return received by the customer. At present there is no agreed and consistent basis across asset managers for the disclosure and comparison of this information. The IGC is supportive of the work currently sponsored by the FCA to agree a standard basis of disclosure, and Scottish Widows has confirmed to the IGC that they are also supportive of this initiative and is working with asset managers in preparation for additional disclosure once a common format is agreed.

- In the meantime, Scottish Widows analysed the transaction costs during the year for 29 of the largest equity funds used in the PIAs and other Scottish Widows funds offered to customers. Across all of these funds the aggregate impact of transaction costs was to reduce returns by less than 0.05% pa, with no individual fund's transaction costs reducing returns by more than 0.15% pa.
- The IGC will be working with the new team responsible for long standing customers as they consider how to engage more effectively with those in legacy products to help them make more informed choices around their long term savings including their investment options where appropriate. Various engagement products and platform improvements are scheduled for 2017 and the IGC is keen to ensure that customers are made aware of the choices available to them.
- On 4 March 2017, Aberdeen Asset Management and Standard Life announced their intention to merge their two businesses. Just over one-third of Scottish Widows' workplace pension investments are managed by Aberdeen within specific funds designed by Scottish Widows. While the proposed merger should have no direct impact on the services that customers will receive, the IGC has asked Scottish Widows to be kept informed of their intentions in dealing with the merged business and to highlight any concerns in relation to future customer outcomes.

Overall, the IGC has assessed a RAG status of 'Amber' for Investments.

More work to be done on benchmarking performance



6.2 Administration



In last year's report, the IGC highlighted the considerable issues which Scottish Widows had faced in relation to the administration of contributions received from some of their auto enrolment arrangements, and also the deterioration in some service standards following the introduction of pension freedoms in April 2015. The IGC noted the steps being taken by Scottish Widows to recover the service position and, at the time of writing last year's report, the improving trend of internal and external metrics in these areas.

The focus of Scottish Widows has been on accuracy and timeliness. Whilst the customer research findings confirmed to us that these were important, customers placed more importance on the help and support which was available to them when they needed to make an important decision or to help deal with problems when something goes wrong.

Following discussion of the research findings with the IGC, Scottish Widows proposed some significant changes within its customer service model, which

involved moving from a structure focused on transactional efficiency to one of greater multi-skilling and individual case ownership.

Over the course of 2016, Scottish Widows has seen complaint levels fall by 58%, with significant improvements in external Net Promoter Scores (which is an ongoing independent external measure of customer satisfaction). More recently, Scottish Widows was awarded a 5 star rating for customer service at the 'Financial Adviser Awards' and also the award for 'The Most Improved Company', having been awarded only 1 star the previous year. These external measures of improvement in overall service standards has reassured the IGC and we will continue to focus on this area to make sure this significant improvement in service levels is sustained in the future.

Scottish Widows has shared with the IGC details of the further investment it is intending to make in its service proposition, including making greater use of digital technology to meet the needs of customers.

The IGC has assessed a RAG Status of 'Green' for service. However, retaining this assessment over the coming year will be dependent on continued improvements in the various independent measures and the number of complaints continuing to reduce.

Scottish Widows
complaint levels
down 58%



6.3 Engagement



Last year, Scottish Widows agreed to invest £45m in new digital services to help customers engage more effectively in relation to their pension and with retirement planning more generally. The IGC also noted the advances made through the new 'Retirement Hub' designed specifically to help customers who needed support in understanding the new pension freedoms.

Both the research of the Scottish Widows customer base and the wider industry research conducted during the year show considerable knowledge gaps and misunderstandings, which if left unaddressed will mean that customers do not fully understand or trust pensions. The IGC believes that customers are likely to save more in a pension and achieve outcomes which better match their own goals and aspirations, if levels of trust and knowledge are increased. To this extent the IGC has pressed Scottish Widows to do more to inform customers and make it easier for them to engage.

Currently, Scottish Widows has 700 clients on the Employer Hub, with an ambition to have 12,000 on it by the end of the year. A new Employee Hub is currently being tested with pilot customers and will be formally launched this year, including a new 'App' for smart phones and tablets.

In addition to the 'Retirement Hub', Scottish Widows has relaunched its consumer site structured around the way customers perceive themselves in their savings journey, and has produced a series of thirty-one, 30 second videos, addressing the most common pension and retirement related questions from customers in a very simple way. Scottish Widows has also produced a new on-line, non-advised transfer service to make it easier for customers to consolidate or transfer historic pension pots to more modern products.

The research conducted for the IGC told us that more than 50% of Scottish Widows customers engage with their pension at least once a year and the IGC believes that these customers are the most likely to benefit from the new services being developed. Although Scottish Widows is experimenting with technology, behavioural economics and other methods to encourage more customers to become better engaged, the view of the IGC is that the present knowledge gap and misunderstandings held by many customers remains a significant area of concern for the industry as a whole.

The IGC would like to see the innovations being piloted and introduced by Scottish Widows evolved into a comprehensive and fully inclusive plan, giving Scottish Widows customers the opportunity to make informed decisions about their pension in a timely manner.

The IGC would also like to see Scottish Widows play a wider active role in industry initiatives to address the misunderstandings which exist in relation to pensions more generally. Scottish Widows has confirmed that they are supportive of this approach and are keen to play a prominent role.

Although Scottish Widows has developed a number of innovative new services and is showing determination in closing the engagement gap, the fact remains that Scottish Widows customers have the same low levels of understanding as pension customers more generally and for that reason the IGC has assigned an 'Amber' status for engagement.



6.4 Governance



Governance at Scottish Widows falls into three broad areas, all of which were examined by the IGC during the year:

- Corporate Governance
- Product Governance
- Cyber Security

The Scottish Widows executive management team is overseen by a Board, which includes independent non-executive directors. Amongst other duties, the executive management team and the Board have a responsibility to ensure the fair treatment of customers and these individuals are personally accountable for the way in which they execute their duties.

The Board is supported by a number of committees which are made up partly of independent experts.

Product governance is an ongoing process, continually checking that pensions are performing the way in which customers expected and also checking that products continue to be appropriate as the market develops over time. 'Treating Customers Fairly' (TCF) is a framework developed by the FCA to guide providers in their ongoing evaluation of both new products in development and existing products which customers hold. TCF compliance is monitored through this process.

When product governance identifies an issue, a project will be undertaken to rectify the issue. If the issue was found to be historic in nature, Scottish Widows has a framework, which it has agreed with the FCA, to put customers back into the position they should have been in. This process also extends to customers who have since transferred their assets away from Scottish Widows.

Cyber security is an area of increasing importance. The IGC sees this as a critically important area from the perspective of both data security and in terms of the custody of customer assets. As part of the Lloyds Banking Group, the security of IT systems and customer data sits within the wider Lloyds Banking Group security framework. The IGC was reassured by the work being done in this area and also noted that Lloyds Banking Group were the first financial services group to achieve the Bank of England's CBEST standard. However, this is a fast changing and dynamic challenge and Scottish Widows, within Lloyds Banking Group, will need to remain focused and agile in continuing to respond to this challenge.

The IGC found the design and operation of the governance processes at Scottish Widows to be robust and has assessed a RAG status of 'Green'.

Governance isn't well understood by customers despite its important role



6.5 Charges



During 2016, the IGC has continued to assess charges separately for those customers in modern, qualifying (i.e. eligible for auto enrolment) workplace savings contracts and those customers in older “legacy products”.

For modern products, Scottish Widows applies a single charge, known as an Annual Management Charge. This is a percentage of each customer’s pension pot taken by Scottish Widows as a charge. The average charge across the book of business of such products has decreased from 0.75% in 2015 to 0.59% in 2016. Statistics published by the Department for Work and Pensions in 2015, showed average charges for this type of pension ranging from 0.55% for Auto Enrolment Schemes to 0.81% for older schemes. We expect a more up to date view of average charges across the industry to be published by the Department for Work and Pensions in the summer and we will conduct a further review of Scottish Widows charges against those statistics when they are published. When asked about charges during the VFM research work undertaken in 2016 customers felt that their charges should be in line with the national average.

The charging structure in older products is more complex, where the overall level of charge can rise and fall over time as the various charges interact with each other and as changes occur within the customer’s policy. Last year Scottish Widows agreed to cap the ‘peaks’ in these fluctuating charges at 1%, thereby reducing the overall average charge over time. Scottish Widows also agreed to remove all exit penalties, so that customers who wish to transfer to a more modern product (with Scottish Widows or with an alternative provider) can do so without penalty.

The IGC can confirm that the project established to make these changes has proceeded in line with the time-frames agreed between Scottish Widows and the IGC, and is pleased to note that all customers will benefit from these changes from early 2017.

The IGC has assessed a RAG status of ‘Green’ for Charges but will continue to compare average charges paid by customers of Scottish Widows against national averages to ensure VFM continues to be provided.

Average charges on modern products reduced from 0.75% to 0.59% in 2016



7. What's next for the IGC?

Over the course of the coming year the IGC will again scrutinise the various aspects of the Scottish Widows proposition. Where the IGC has assessed a RAG status other than 'Green' the IGC will work with Scottish Widows to oversee an action plan which will achieve a 'Green' status at the earliest opportunity.

The IGC will review the output from the latest survey of pension scheme charges being conducted by the Department for Work and Pensions, including a comparison of Scottish Widows' charges relative to the latest national averages.

The IGC will be scrutinising the plans which Scottish Widows has to improve service and facilities for customers in older products and ensuring that the execution of any changes are in the interests of customers.

The IGC will also be working with Scottish Widows to agree plans to better engage with customers in older products including helping them to better understand both their existing products and the options available to them.

The IGC will be working with Scottish Widows to develop a framework for better benchmarking of investment performance to include transaction charges as these become available.

The IGC will work with Scottish Widows to understand the extent to which a broader benchmarking across products offered by the various pension companies could help the IGC better assess Value For Money.

Key focus areas include transaction charges, product and investment benchmarking and long standing customer servicing and support



8. What are the IGC's conclusions?

The IGC considers that where customers hold workplace pension products with Scottish Widows, which they actively engage with, they will have access to options, investment performance and support which represents good Value For Money.

However, more needs to be done at Scottish Widows, and across the industry more generally, to interact more effectively with customers to encourage them to become actively engaged.

Babloo Ramamurthy, John Howard,
Iain McGowan, Tilly Ross,
Mark Stewart, Ronnie Taylor
Scottish Widows IGC, 31 March 2017

If you have any comments, questions or concerns in relation to the work of the Scottish Widows IGC, please contact us through the following address:
mailbox.contacttheigc@scottishwidows.co.uk

The challenge is
to make it easier
for the customer
to engage



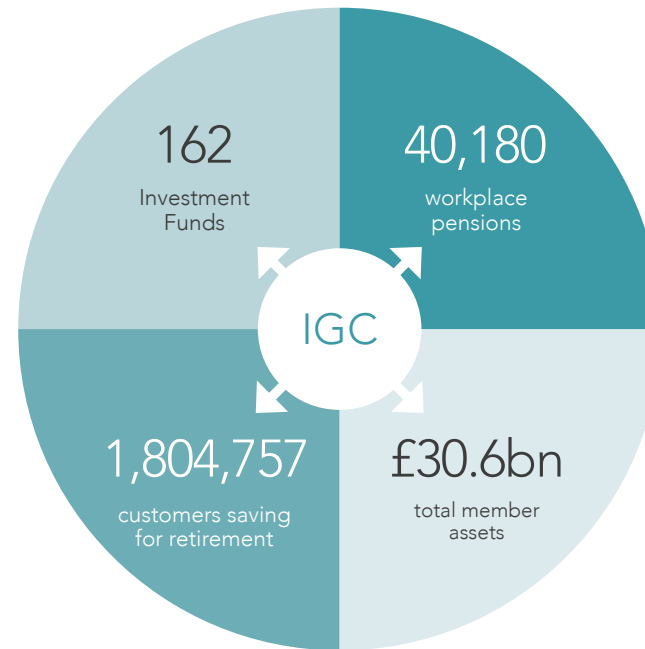
Appendix 1

Categorisation of Scottish Widows Legacy Products

Prior to 2001 it was common for pension products to have a more complex range of charges. These older products, often referred to across the industry as 'legacy' products can also contain some valuable benefits which are no longer available today.

The arrival of Stakeholder Pensions with a simple charging structure, set a Government led benchmark for the industry. Scottish Widows launched a new Stakeholder Pension in July 2000 and at the same time, simplified the charging structure on some of the other products offered by the company.

Scottish Widows has 1,804,757 customers saving for retirement through 40,180 workplace savings schemes. At present (as at end 2016), total member assets are £30.6bn.



Products	Categorisation	Comments
Scottish Widows Pensionbuilder	Legacy Product	<ul style="list-style-type: none"> • Wholly invested in the Scottish Widows 'Unitised With Profits' (UWP) fund. • Minimum growth rate applies to units bought pre 1 July 1994. • Additional death benefits available. • A range of different types of charges have applied to these products. • Charging structure will be simplified during 2016 and 2017 as outlined in this report. • Not available as a 'Qualifying Scheme' for Auto Enrolment.
Scottish Widows New Unitised Pension Contracts (Schemes established prior to July 2000)	Legacy Product	<ul style="list-style-type: none"> • Customers can invest in a range of 'unit linked' investment options, as well as Scottish Widows UWP fund. • Waiver of premium and additional death benefits available. • A range of different types of charges have applied to these products. • Charging structures will be simplified during 2016 and 2017 as outlined in this report. • Not available as a 'Qualifying Scheme' for Auto Enrolment.
Scottish Widows New Unitised Pension Contracts (Schemes established after July 2000)	Modern Product	<ul style="list-style-type: none"> • Customers can invest in a range of 'unit linked' investment options. Some products can also invest in Scottish Widows UWP fund. • Scottish Widows Pension Investment Approaches typically used by employers as a default fund. • Simple charging structures. • Available as a 'Qualifying Scheme' for Auto Enrolment.
Clerical Medical Products	Legacy Products	<ul style="list-style-type: none"> • Customers can invest in a range of 'unit linked' investment options, as well as Clerical Medical UWP fund. • Waiver of premium and death benefits available on some products. • A range of different types of charges have applied to these products. • Charging structures will be simplified during 2016 and 2017 as outlined in this report. • Not available as a 'Qualifying Scheme' for Auto Enrolment.



