Scottish Widows response to the Financial Reporting Council Exposure Draft AS TM1: Statutory Purchase Money Illustrations

Scottish Widows, which is part of Lloyds Banking Group, welcomes the opportunity to provide input into this consultation. When combined with the heritage brands of Clerical Medical and Halifax Life we are the UK's largest investment, pensions and savings provider.

We support the principles behind the proposals for statutory money purchase illustrations, but believe the changes required for 6 April 2014 should be limited to permissive changes only. We also believe that there should be complete consistency with illustrations provided under FCA COBS rules and on that basis there should be alignment between the respective approaches for calculating annuities. Our response covers these and other points in more detail.

If you have any questions or would like us to expand on any aspect, please do not hesitate to contact me.

Ian Naismith
Senior Manager - Market Development
Scottish Widows
69 Morrison Street
Edinburgh
EH3 8YF

Telephone 0131 655 3407
e-mail ian.naismith@scottishwidows.co.uk

Key points from Scottish Widows

1. We are supportive of the principles behind the proposed changes to statutory money purchase illustrations and support many of the changes.

2. However, the changes required for 6 April 2014 should be limited to the permissive changes arising from the revisions to the disclosure legislation effected by the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013. This will give providers time to consider if and how they wish to react to these changes and make the necssary amendments to their IT systems.

3. The proposed mandatory change to show projection rates in inflation-adjusted terms will also require providers to amend their IT systems and the scale of ch\ange is not feasible for mandatory compliance by 6 April 2014.

4. We do not see any benefit to the customer in FRC and FCA maintaining different approaches for the calculation of the annuity. We urge FRC and FCA to work together to agree a harmonised approach to the calculation and seek to require future changes to be made at the same time.

Responses to specific questions

1) Do respondents agree with the proposed approach to the allowance for cash in the calculation of the statutory illustration (paragraph 3.3)?

We support the proposal to allow for a cash lump sum in the calculation of the statutory illustration. However we do not feel that the proposed amendments are sufficient to implement this clearly and suggest the following additional amendments:

- Where a provider wishes to take account of the cash lump sum in the calculation, TM1 should specify that the amount of the lump sum must be shown on the statutory illustration (the proposed amendments to C3.1 do not mandate this).
- Given the current requirement to show the projected pension in inflation-adjusted terms and the proposal within this consultation to similarly express the projection rates in inflation-adjusted terms, the cash sum should also be shown in inflation-adjusted terms. TM1 should specify this and how the calculation is to be performed (i.e. the calculation of the cash lump sum is to be applied to the projected fund after discounting by the inflation rate for the relevant term).

2) What are respondents' views on the proposed approach to the cash assumption (paragraphs 3.6 to 3.8)?

Currently providers are not required to show the projected fund value on the statutory illustration (only the projected pension). As such, where a provider has chosen not to show the projected fund value, simply stating the assumption used for the calculation of the cash lump sum as a percentage of the fund (e.g. 25%) will not help the customer understand what *amount* has been calculated. We therefore suggest that TM1 be amended to require that, where the cash lump sum is taken into account in the calculation, the amount must be expressed as a monetary amount.

We would also suggest that C3.1 is amended to state that the cash lump sum assumed to be paid at retirement date should not normally exceed the maximum tax-free amount, with discretion for providers to exceed this up to the maximum permitted by the scheme rules or legislation provided that the rationale for exceeding the tax-free amount is disclosed in the statutory illustration.

3) Do respondents agree with the proposed approach to the spouse's or civil partner's pension (paragraphs 3.10 to 3.12)?

We understand the rationale behind the proposal to relax the mandatory spouse's pension percentage specified in TM1. However we suggest that the requirement at C3.13 is worded to specify a 50% spouse's pension, with discretion for the provider to use another percentage as long as this does not exceed the amount permitted under the scheme rules or legislation.

4) Do respondents agree with the proposed approach for the interest rate used for annuity rates when providers illustrate a non-increasing pension (paragraph 3.19 to 3.23)?

No, we disagree with the proposed approach.

Whilst appreciating the rationale detailed in paragraphs 3.19 to 3.23, the FCA have previously presented equally compelling rationale for their basis. We feel that having different approaches by FRC and FSA to the same issue is not helpful to customer understanding.

We would like to see FRC and FCA seeking to agree a harmonised approach to their respective projection bases wherever possible as this will improve consistency in the message given to customers in the projections that they receive from point of sale through the lifetime of their policy.

Within this context we would suggest that FRC and FCA work together to agree and adopt a unified basis for the interest rate to be used for annuity rate calculations, with both regulators reviewing the basis together going forward and making any changes to both sets of rules at the same time.

We would also make the following comments with regard to the proposed changes to TM1 paragraphs C3.4 and C3.7:

- Currently TM1 requires that providers do not take account of any guaranteed annuity rates (GAR) in the calculation of the annuity. In many cases a GAR would not apply to inflation-linked annuities, so not taking it into account has been reasonable. However, if TM1 allows providers to illustrate annuities on a level or fixed increase basis, a GAR may apply to the form of annuity used.

  Taking the numerous legacy GAR approaches into account within the SMPI calculations would have a *huge* impact on providers' calculation complexity and IT build costs. It could also build false expectations if the customer retired on a different date or chose a different form of pension. We therefore do not believe that use of GARs should be required, but suggest that it should be permissible for providers to illustrate using GARs if they apply to the form of annuity shown and an appropriate explanation is included.

- It should be noted that the 'yield on the FTSE Actuaries' Government 15 year Fixed Interest Index' doesn't actually exist. TM1 either needs to refer to 'the FTSE Actuaries' Government 15 year Fixed Interest Yield Index' or 'the yield on the FTSE Actuaries' Government over 15 year Fixed Interest Index'.

5) Do respondents agree with the proposed approach for the interest rate used for annuity rates when providers illustrate a pension that increases at other rates (paragraph 3.25)?

See response to Q4 above.

6) Should AS TM1 suggest that providers should disclose the accumulation rate used net of inflation (paragraphs 3.28 to 3.29 and 3.36)?

We agree that it makes sense to show the projection rates used in inflation-adjusted terms given the move to this approach by the FCA for point of sale and existing business illustrations.

However we DO NOT agree with an effective date of 6 April 2014 for this change. It will require changes to cross-heritage IT systems and appropriate testing. All our IT changes are subject to strict release governance, with release slots being planned and filled many months ahead. An effective date of 6 April 2014 is simply not achievable.

7) Do respondents agree with our proposal not to amend the price inflation assumption (paragraph 3.32)?

Yes.

8) Do respondents agree with our proposal not to amend the earnings inflation assumption (paragraphs 3.33 to 3.34)?

We agree that the earnings inflation assumption should not be amended as part of the changes required for 6 April 2014 – in view of the proposed effective date, these should be permissive only.

However see response to next question.

9) What other aspects of AS TM1 do respondents suggest should be considered in our review of AS TM1 next year?

Whilst accepting the rationale expressed in the first three bullet points in paragraph 3.33, we do not agree that the earnings inflation assumption should be maintained at the same level as the price inflation assumption.

We would support FRC moving to a 4% earnings inflation assumption to align with the current FCA intermediate rate assumption for point of sale and existing business projections. We do not believe that this will overcomplicate the calculation, nor materially increase the likelihood of overstatement of the illustrated results.

FRC and FCA should review the basis together going forward, with any changes made to both sets of rules at the same time.

10) Do respondents agree that the changes to AS TM1 should be effective for statutory illustrations issued on or after 6 April 2014?

We agree with the proposed effective date for the permissive changes. However we DO NOT agree with the proposed effective date for the non-permissive requirement that projection rates are shown in inflation adjusted terms (see response to Q7 above).