

Report from the Board of Aviva Life & Pensions UK Limited to the Secure Growth Fund Policyholders for 2019



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1. Introduction

Aviva manages approximately £48 billion of investments in its with-profits funds, on the behalf of around 1.4 million policyholders.

The Secure Growth Fund holds approximately £0.6 billion of investments on behalf of around 35,000 policyholders.

Rules for the management of the with-profits funds of Aviva Life & Pensions UK Limited are set out in our Principles and Practices of Financial Management (“PPFM”). These are available from aviva.co.uk/ppfm.

We also publish some simplified guides on how we manage the with-profits funds, and these are also available from the same website.

This Report from the Board, prepared in consultation with the With-Profits Committee, sets out how we managed our Secure Growth Fund in 2019.

A printed copy of this report can be obtained by sending a written request to: [Aviva UK Life With-Profits, Wellington Row, York YO90 1WR](#).

If you have any questions about your policy, please call us on the number shown on your annual statement.

2. Summary

In the opinion of the Board of Aviva Life & Pensions UK Limited, throughout 2019 our Secure Growth Fund has been managed in accordance with its PPFM.

The Board is also of the view that the decisions made in managing this with-profits fund were both appropriate and treated with-profits policyholders fairly.

3. Governance Arrangements – Making sure we comply with the Principles and Practices of Financial Management (“PPFM”)

The Board of Aviva Life & Pensions UK Limited has overall responsibility for the management of all of its with-profits funds and takes the key decisions that affect the funds.

Before making these decisions, the Board must seek and consider the advice of the funds’ With-Profits Actuary. The With-Profits Actuary provides advice to the Board on how discretion in the management of the with-profits funds should be applied. The With-Profits Actuary looks to balance the interests of Aviva’s policyholders and shareholders and to ensure that its with-profits policyholders are treated fairly.

The With-Profits Committee provides oversight of the management of the with-profits funds and the application of discretion. The majority of the Committee’s members are independent of Aviva and this helps the Committee provide robust challenge to Aviva on its management of the with-profits funds. The views of the Committee on the management of the funds are provided to the Board to help it make the key decisions for the with-profits funds.

Further information on the With-Profits Committee can be found at aviva.co.uk/wpcommittee.

The activity of the With-Profits Committee

During 2019, the With-Profits Committee considered a range of topics relevant to the Secure Growth Fund. These included;

- The investment strategy and performance of the fund (see section 4.2 below).
- Proposals for interest rates and final bonus to be added to policies (see section 4.3 and 4.4 below).
- The management of the Estate (see section 4.6).
- The review of policyholder communications and complaints.

- The ongoing plan to manage the fund as the volume of business in it reduces, known as the “run-off plan”.
- The risk appetite framework used to ensure the security of benefits and to manage the estate distributions.
- The proposals for changes to the PPFM to reflect a number of the above items (see section 6 below).

The With-Profits Committee, in reviewing management recommendations and actions, endeavours to ensure that all policyholders are treated fairly and that an appropriate balance is struck between the interests of different groups of policyholders and between policyholders and shareholders.

The With-Profits Committee is satisfied that it was consulted on the development of the Company’s proposals during 2019 and that the views of the With-Profits Committee have been taken into account in the proposals presented to the Board. The Committee is pleased that all concerns raised were resolved by this process. The Company values the input provided by the With-Profits Committee.

The With-Profits Committee has also provided a report to the Board on its views on whether or not Aviva complied with the PPFM in 2019. In its report, the Committee noted that the Company has complied with the PPFM in all material respects in 2019.

These governance arrangements, with their combination of Board level decision making, advice from the With-Profits Actuary and oversight and challenge from the With-Profits Committee, help ensure that Aviva manages its with-profits funds in accordance with its PPFM and treats its with-profits policyholders fairly.

The With-Profits Actuary’s report on the application of discretion during 2019 is attached at the end of this report.

4. Compliance with the Principles and Practices of Financial Management (“PPFM”) during 2019

4.1 Introduction

Background information on with-profits policies in the Fund

A unit fund is maintained for each policy in which policy premiums, less charges, are accumulated. Unit prices normally increase daily at the current rate of interest net of any annual management charge.

The amount paid on maturity or death for a policy in the Fund will normally be the value of the unit fund, increased by any final bonus, although in exceptional circumstances the amount may be lower (by applying a ‘Market Value Reduction’ or ‘Short Term Investment Charge’) or higher (if the policy has a ‘guaranteed minimum lifetime interest rate’).

Some policies have Guaranteed Annuity Rates (‘GARs’), which specify the minimum annual income that, subject to the policy conditions, can be bought from the Company by each pound of the policy’s unit fund value when the policyholder retires.

Interest is currently added to the Fund’s policies in one of two forms: regular interest, which is added throughout the policy term, and special interest, which may be added from time to time. Both take the form of an increase in the price of units.

The Fund has been invested in by policies from a range of different products over time. Different rates of interest may be paid to different types of policy. In particular, for some types of policy, the rate of regular interest may be reduced by an annual management charge whereas for other types of policy, the annual management charge may be collected by the cancellation of units.

Final bonus may be added when units in the Fund are cashed in order to distribute the surplus assets of the Fund to policyholders fairly over time.

Areas of Discretion

The principal areas of the management of the Secure Growth Fund where the Board has some flexibility or can exercise its discretion are:

- The Fund's investment policy.
- Setting interest rates.
- Setting the final bonus rate.
- Whether to apply a Market Value Reduction or Short Term Investment Charge
- The management of the Estate.

Whilst the Board can make choices or exercise its discretion in these areas, it must do so in accordance with the rules set out in the PPFM.

4.2 Investment Policy

Setting Investment Strategy – How it Works

The investment strategy for the Secure Growth Fund is set by the Board, and must observe the procedures and limits set out in the PPFM. The investment strategy reflects the Fund's capacity to take risk, which in turn is dictated by the value of its assets and the level of guarantees provided to its policyholders.

Should the Fund have the capacity to take risk then part can be invested in assets such as company shares, in the expectation that these assets will, in the longer term, provide superior returns. When setting investment strategy, the Board also takes into account current and expected future investment conditions, as well as the advice of our investment managers, Aviva Investors.

Investment Strategy in 2019

The mix of assets backing the Secure Growth Fund in 2019 is available in our 'With-Profits Summary' guide available from aviva.co.uk/ppfm.

During 2019, it was decided to reduce the investment risk in the fund by diversifying the equities held by geographical region and by reducing the holding in corporate bonds and increasing the holding in government bonds and cash. Implementation of this was completed in early 2020. The majority of the Fund's assets remain invested in corporate bonds.

The gross of tax returns achieved on the Fund's assets in 2018 and 2019 are shown in the table below.

	2019	2018
Secure Growth Fund	10.9%	-1.9%

The mix of assets is monitored closely throughout the year.

Conclusion

During 2019, the assets backing the Secure Growth Fund were managed in accordance with the requirements of the PPFM and the Board is satisfied that the investment strategy followed is appropriate for the Secure Growth Fund policyholders.

4.3 Interest rates and final bonus

Setting Interest Rates – How it Works

- We add your share of the returns which the Fund earns to your investment, through a system of interest rates and a final bonus.
- Interest rates and the final bonus rate cannot be negative, but they can be zero, and this flexibility provides policyholders with some protection from losses made by the Fund.
- There are two main types of Interest rate:
 - Regular interest rate – the price of units will increase on a daily basis (at a rate which over 12 months will amount to the declared rate) until the next interest declaration.

- Special interest rate - When special interest declarations are made, the price of units will increase by the special interest rate on a date we determine. Units encashed prior to this date are not entitled to receive any benefit from the special declaration.
- A final bonus may be added in order to improve the fair treatment of policyholders over time.

In the past, only regular and special interest rates were used to pass the returns of the fund to policyholders. We decided from 2018 to introduce paying a final bonus when units are cashed in. This was to enable a fairer sharing of the investment returns between policyholders that cash in their units in the short term compared to those that remain in the Fund for longer. Since the introduction of the final bonus, it is less likely that a special interest rate will be added in future.

Interest rates and the final bonus rate are set by the Board, having taken the advice of the With-Profits Actuary and having considered the views of the With-Profits Committee.

Interest Rates in 2019

A regular interest rate of 4.0% p.a. applied throughout 2019. This was reduced to 3.0% p.a. from the start of 2020.

For units cashed in from 1st January 2019, a final bonus rate of 15% was added. This rate of final bonus was increased to 20% from 1st January 2020.

The combination of these two actions will result in increased policy payouts in 2020.

The decisions made by the Board were consistent with the PPFM and with the advice of the With-Profits Actuary and the views of the With-Profits Committee.

4.4 Surrender Values and Market Value Reductions

Policyholders may choose to cash-in units or transfer the benefits under their pension policies to another provider.

The surrender value will normally be the value of units in the Fund, less any deductions described in policy conditions, and increased by any final bonus that may apply at the time.

We may also apply a Market Value Reduction (MVR) when the aggregate value of the reserves required to be held by the Fund exceeds the value of the assets of the Fund. An MVR will only be applied where it is not disallowed by policy conditions. The amount of any MVR will be proportionate to the shortfall of the value of assets in the Fund compared to the aggregate value of reserves. No MVRs were applied during 2019.

A Short Term Investment Charge (STIC) may also be applied in appropriate cases to prevent policyholders taking unfair advantage by investing and then encashing those units shortly afterward.

4.5 Charges and Expenses

The fees charged to policies during 2019 were in line with the policy terms and conditions.

The fund may make charges for the cost of regulatory capital and has done so in the past. However, no such charges were made during 2019, nor will such charges be made in future.

4.6 Management of the Estate

Management of the Estate – How it Works

The Estate is the assets held in the fund in excess of those required to pay guaranteed policy benefits and other liabilities.

The Estate provides protection for policyholders' benefits from adverse experience together with the freedom to manage the fund in the interests of policyholders.

In the past, special interest payments were made to prevent the Estate from becoming too large. The introduction of final bonus payments from 2018 means that the Estate may be distributed to policyholders in a fairer way going forward.

Management of the Estates in 2019

A final bonus rate of 15% was added to claim values in 2019.

Following a review in 2019, a Risk Appetite Framework was introduced for the Secure Growth Fund similar to those adopted in the other Aviva with-profits funds. A Risk Appetite Framework provides rules for how the risks taken in managing a with-profits fund are balanced against the size of its Estate. This will support the plan to distribute the Estate fairly over time.

Conclusion

Throughout 2019, the Estate was managed in accordance with the PPFM.

4.7 New With-Profits Business

The Secure Growth Fund is closed to new business other than a limited amount of increments to existing policies and the potential for some existing policies to switch investments into the Fund.

5. Potential Conflicts of Interest Between Policyholders and Shareholders

Given the level of discretion that can be applied by the Board in managing the Secure Growth Fund, there is a potential for conflicts between the interests of policyholders and shareholders to arise. Such potential conflicts include:

- Selecting a less risky investment strategy that reduces risk for shareholders, which might also reduce investment returns for policyholders.
- Encouraging policy exits or failing to point out the value of guarantees given up on exit, where it might be to the policyholder's benefit to retain the policy.
- Choosing to declare lower interest rates so that the cost of meeting guarantees is reduced.

Similarly, there is a potential for conflicts between the interests of different groups of policyholders. Such potential conflicts include:

- Following a riskier investment strategy that might be to the benefit of policyholders who intend to retain their policies for a long period but possibly to the detriment of policyholders expecting to exit the fund in the shorter term.
- Policyholders with policies that have high guarantees might be more relaxed about taking risks than policyholders that have policies with low guarantees.

Given these potential conflicts, it is vital that:

- There are clear rules and guidelines for the management of the Secure Growth Fund.
- Strong safeguards are in place to protect the interests of policyholders.

Rules for managing the Secure Growth Fund are set out in the PPFM, which are published. The Court Scheme also sets out a number of rules that must be followed by the Company in managing its with-profits funds. The rules in the PPFM and the Court Scheme address many of the potential conflicts of interest.

Compliance with these rules is monitored and the outcome of this monitoring is considered by the With-Profits Committee and the Board. Any breaches are corrected so as to ensure that no policyholders suffer any material detriment.

Discretion in relation to the management of the Secure Growth Fund is exercised by the Board, whose members include individuals who are independent of the Company and its executive management. Advice on the exercise of discretion is provided by the With-Profits Actuary, whose appointment must be approved by the Regulator and who must comply with regulatory requirements that are designed to ensure that policyholders are treated fairly. Oversight of the Company's management of the Secure Growth Fund and exercise of discretion is provided by the With-Profits Committee, the majority of the members of which are independent of the Company and its executive management.

The Board and the With-Profits Committee are of the view that the rules and safeguards set out in the PPFM and the Scheme, coupled with the protection provided by the input of the With-Profits Actuary and oversight from the With-Profits Committee are sufficient to avoid conflicts or ensure that they are dealt with fairly.

6. Changes to the PPFM in 2019

Some minor changes have been made that took effect from 1 January 2020, including to reflect the changes in investment strategy. Changes to the PPFM to reflect the introduction of the Risk Appetite Framework will be made in 2020.

Further information on changes to the PPFM for each fund is provided in the 'PPFM Summary of Change' documents, which can be found at [aviva.co.uk/ppfm](https://www.aviva.co.uk/ppfm).

Conclusion

The changes made were reviewed by the Board, the With-Profits Actuary and the With-Profits Committee and are considered to treat policyholders fairly.

Annex – With-Profits Actuary’s Report to Policyholders

I was appointed to the role of With-Profits Actuary to Aviva Life & Pensions UK Limited on 3 May 2018. In this role, I confirm that, in my opinion, the Board’s report and the discretion exercised by the Board during 2019 may be regarded as taking, or having taken, the interests of the company’s with-profits policyholders into account in a reasonable and proportionate manner.

Further, I am satisfied that, during 2019, discretion in relation to with-profits policies has been exercised fairly and in accordance with the PPFM.

I have completed this report bearing in mind the requirements of the Financial Conduct Authority and the Prudential Regulation Authority, and the guidance and requirements of the actuarial profession and the Financial Reporting Council.

The Board of Aviva Life & Pensions UK Limited has provided me with the information and the resources I needed to enable me to make this statement.

Somerset Lowry

With-Profits Actuary for Aviva Life & Pensions UK Limited

13th March 2020

Note: This is a summary report, based on the conclusions of the report prepared by the With-Profits Actuary for the Board of Aviva Life & Pensions UK Limited in accordance with paragraph 4.3.16A(3) of the Supervision section of the FCA Handbook (SUP 4.3.16A(3)) and paragraph 4.3.16(3) of the Supervision section of the PRA Handbook. This report was considered to be compliant with the requirements of TAS 100 and the TAS 200 issued by the Financial Reporting Council and with APS X2 issued by the Institute and Faculty of Actuaries.

Appendix: Scheme Certificate

Aviva Life & Pensions UK Limited

Certificate by the Aviva Life & Pensions UK Board

Period 1st January 2019 to 31st December 2019

The Scheme for the transfer of the business of Friends Life Limited and Friends Life and Pensions Limited to Aviva Life & Pensions UK Limited (the “2017 Scheme”) was sanctioned by the High Court of Justice on 13th September 2017 and came into effect on 1st October 2017.

Aviva has, in accordance with Section 75 of the 2017 Scheme, undertaken a review of compliance with the requirements of the 2017 Scheme. The review covered the period from 1st January 2019 to 31st December 2019.

The Board of Aviva Life & Pensions UK Limited (the “Board”) has considered a report on the compliance review prepared by the With-Profits Actuary (which is considered to be appropriate actuarial advice as required under Section 75 of the 2017 Scheme). In addition, the Board has consulted the Aviva With-Profits Committee (as required under the With-Profits Committee’s Terms of Reference) on this matter.

A small number of issues have been identified as part of the 2019 compliance review.

- Section 33: An issue with the amounts charged to some of the with-profits funds for administration and investment services has been identified. This issue is relatively minor and has not led to any customer detriment, but if these funds have been over charged then this will be corrected.
- Section 44: During 2019 an issue with the historic accounting for the allocation of investment returns between FLC New WPSF and FLC Old WPSF was corrected. Compensation has been provided to the FLC New WPSF and will be provided to any affected customers in order to put the fund and customers back into the position they would have been in had the issue not occurred. The Board, the With-Profits Committee and With-Profits Actuary are satisfied that these actions are appropriate and that customers have been treated fairly.
- Section 73 and Schedule 1 Part 3 paragraph 4: These clauses permit changes to the methodology used for the annual investigations and calculations of the AAA Capital Thresholds, subject to certain governance. Changes have been made to the methodology, but the correct governance was not observed in that regulatory non-objection was not received. The Company is satisfied that the changes made were appropriate, and there has been no adverse impact on customers.
- Section 75: Whilst the certificate for 2018 highlighted that some issues had occurred, the certificate did not detail the respects in which the relevant provisions had not been complied with. These are set out in the appendix.

Where breaches have been identified, steps have been taken or are being taken, where appropriate and relevant, to improve processes and to make the required corrections.

Given this, the Board certifies that, other than as described above, the provisions of the 2017 Scheme have been complied with for the period between 1st January 2019 and 31st December 2019.



Angela Darlington
Chief Executive

1st April 2020

Appendix: Issues highlighted in the review for 2018

The following issues were identified in the review for 2018:

- Section 33: as described in the certificate for 2019.
- Section 44: as described in the certificate for 2019.
- Section 28: Incorrect Guaranteed Annuity Rates were used when setting up annuities for pension policyholders in the New With-Profits Sub-Fund and the Old With-Profits Sub-Fund. These errors have now been corrected.
- Section 50: The data for setting the assumptions relating to the Guaranteed Annuity Options for the FLAS With-Profits Sub-Fund and the FLC With-Profits Sub-Funds was identified to be inadequate. This has been corrected. There was no impact on payments made to policyholders.
- Section 51: Two errors were identified in the Provident Mutual Sub-Fund balance sheet. These have been corrected. There was no impact on payments made to policyholders.

Aviva Life & Pensions UK Limited. Registered in England No. 3253947. Aviva, Wellington Row, York, YO90 1WR.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
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[aviva.co.uk](https://www.aviva.co.uk)

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