Contents

1. Introduction................................................................................................................................................................................................. 1

1.1 Project background.................................................................................................................................................................................. 1
1.2 AKG assignment....................................................................................................................................................................................... 1
1.3 Source material and resources used by AKG........................................................................................................................................ 2
1.4 Reliances and limitations....................................................................................................................................................................... 2
1.5 Confidentiality....................................................................................................................................................................................... 2

2. Market Context.................................................................................................................................................................................................. 3

2.1 Why governance is important to managed investment solutions .................................................................................................. 3
2.2 Key governance considerations.......................................................................................................................................................... 3
2.3 MiFID II product governance............................................................................................................................................................ 4
2.4 Due diligence requirements................................................................................................................................................................. 4
2.5 Considering outsourced and managed investment solutions........................................................................................................ 5
2.6 Outcome oriented focus .................................................................................................................................................................... 5
2.7 Transparency of charges/terms and customer outcomes................................................................................................................ 5
2.8 Smoothed solutions............................................................................................................................................................................ 6

3. AKG Comments and Observations.......................................................................................................................................................... 7

3.1 Roles and responsibilities.................................................................................................................................................................... 7
3.2 Investment approach and methodology........................................................................................................................................... 7
3.3 Risk and governance.......................................................................................................................................................................... 7
3.4 Components and features................................................................................................................................................................... 7
3.5 Communications................................................................................................................................................................................ 8

4. SMF Key Facts .................................................................................................................................................................................................... 9

4.1 Background and availability................................................................................................................................................................. 9
4.2 Fund aim .............................................................................................................................................................................................. 9
4.3 Target market and client suitability.................................................................................................................................................. 9
4.4 Distribution.......................................................................................................................................................................................... 10
4.5 Charging structure (pension)............................................................................................................................................................ 10
4.6 Charging structure (investment bond)........................................................................................................................................ 10
4.7 Fund entrance/exit............................................................................................................................................................................. 11

5. Structure, roles & responsibilities - Aviva SMF.................................................................................................................................................. 12

5.1 The role of the adviser.......................................................................................................................................................................... 12
5.2 Key roles and responsibilities for SMF......................................................................................................................................... 12
5.3 Investment Management Agreement........................................................................................................................................... 12
5.4 Investment resource – Aviva Investors...................................................................................................................................... 13
5.5 Aviva Investors Multi-Asset Team – key personnel.................................................................................................................... 13

6. SMF Characteristics.................................................................................................................................................................................................. 14

6.1 Fund type.............................................................................................................................................................................................. 14
6.2 Active or passive? ............................................................................................................................................................................. 14
6.3 With profits or not?............................................................................................................................................................................ 14
6.4 Guaranteed or not? ........................................................................................................................................................................... 15
6.5 Type and number of underlying fund holdings ................................................................................................................................ 15

7. Risk Characteristics.................................................................................................................................................................................................. 16

7.1 Key risks............................................................................................................................................................................................ 16
7.2 Target risk parameters..................................................................................................................................................................... 16
7.3 Volatility range ................................................................................................................................................................................ 16
7.4 Aviva risk rating ............................................................................................................................................................................. 16
7.5 Risk warnings................................................................................................................................................................................ 16
7.6 Risk mapping................................................................................................................................................................................ 17

8. Aviva approach to smoothing................................................................................................................................................................. 18

8.1 Key smoothing components.......................................................................................................................................................... 18
8.2 Smooth price reset............................................................................................................................................................................. 18
1. Introduction

1.1 PROJECT BACKGROUND

Aviva Life & Pensions UK Ltd (Aviva L&P) has commissioned AKG Financial Analytics Ltd (AKG) to carry out an independent assessment and review of the investment management approach, risk management framework and governance structure which underpins the delivery of Aviva L&P’s Smooth Managed Fund (SMF) proposition. The role of Aviva Investors in the delivery of SMF is also considered.

1.2 AKG ASSIGNMENT

AKG’s assignment can be broadly summarised as carrying out an independent assessment of the proposition, considering and covering the following key themes and questions:

Review context

Market context – Providing an overview of key investment market and associated regulatory and legislative developments which are driving changes in adviser and provider approaches to the design and delivery of investment solutions for customers, including use of outsourced, managed investment solutions.

Risk and governance – When considering engagement with managed investment solutions, what should advisers and customers be looking for in terms of the investment approach, risk and governance structure and associated processes employed by the provider of the solution to underpin its delivery?

Proposition review

SMF overview – What is it, who is behind it and who/what has it been designed for?

SMF accessibility – How do advisers/customers access the proposition? What are the key terms and conditions and where (products/platforms) can SMF be held?

Roles and responsibilities – When engaging with SMF, where do the various roles and responsibilities reside for Aviva L&P, Aviva Investors and advisers?

Investment approach and methodology – What are the investment approaches and processes adopted by Aviva L&P and Aviva Investors in running SMF, including asset allocation strategy, multi-asset approach, investment beliefs and processes?

Investment objectives, performance and parameters – What are these for SMF and how can the adviser/customer judge successful outcomes and positive fund performance?

Risk and governance – What are the Aviva risk management processes and governance structure which underpin the delivery of SMF?

AKG comments and observations – Independent comments on the proposition and associated considerations for advisers/customers engaging with the SMF proposition.
1.3 SOURCE MATERIAL AND RESOURCES USED BY AKG

AKG has been supplied with and has utilised a wide range of material as a resource pool for this project, including the following:

- Aviva Smooth Managed Fund, Customer guide (LF01102 11/2019)
- Aviva – Smooth Managed Fund Research (pre-launch), YouGov
- Aviva SMF launch press release, 11/12/2017
- Key Features of the Pension Portfolio (LF01068 04/2019)
- Key Features of Select Investment, Growth & Income Option (IN88002 02/2019)
- Fund governance at Aviva (IN50071 09/2019)
- Aviva Investors Multi-asset Fund presentation, August 2019
- Aviva Pension Smooth Managed Fund – How would the fund have performed over the past five years? (LF10425 10/2019)
- Aviva Life Smooth Managed Fund – How would the fund have performed over the past five years? (IN88019 10/2019)
- Aviva Smooth Managed Fund - Q1 2019 performance review and outlook
- Aviva Smooth Managed Fund - Q2 2019 performance review and outlook
- Aviva Smooth Managed Fund – Q3 2019 performance review and outlook
- Dynamic Planner Risk Profile Certificate for SMF
- AKG Pension Freedoms Paper, May 2018

Access to key personnel

AKG has met with and had access to key members of the SMF proposition development and distribution team when carrying out this review. This has included representatives from Aviva L&P and Aviva Investors.

Additional material

Additional material from Aviva L&P and Aviva Investors has been considered in the compilation of this report and some of this material is referenced directly within the body of this report.

1.4 RELIANCES AND LIMITATIONS

Much of the information upon which AKG’s report and comments are based has been supplied directly by Aviva L&P and Aviva Investors.

AKG has made every effort to ensure the accuracy of the content of this report and to ensure that the information contained is as current as possible at the date of issue, but AKG (inclusive of its directors, officers, staff and shareholders and any affiliated third parties) cannot accept any liability to any party in respect of, or resulting from, errors or omissions. AKG personnel are available to expand upon the comments in this report, if required.

Whilst many aspects underlying AKG’s comments are likely to change only slowly, the financial services industry is a competitive and dynamic marketplace, with new products/funds and developments being announced regularly. As a result, AKG cannot guarantee that any particular comment will remain appropriate at any future date. Future developments in the product and investment markets could have a significant impact upon the comments.

AKG information, comments and opinion, as expressed in the form of its analysis and ratings, do not establish or seek to establish suitability in any individual regard and AKG does not provide, explicitly or implicitly, through this report and its content, or any other assessment, rating or commentary, any form of investment advice or fiduciary service.

1.5 CONFIDENTIALITY

This report has been produced for Aviva L&P’s consideration. AKG is happy for Aviva L&P to reproduce all or part of this report in any internal or external published material, subject to prior written agreement of the content, context, duration and volume of such reproduction and of any reference, explicit or implicit, to AKG’s involvement in producing this report.
2. Market Context

2.1 Why Governance is Important to Managed Investment Solutions

Governance functions and structures form an important element in the regular activity within AKG’s core company financial strength assessments and also when carrying out product/investment proposition assessment work.

From this perspective, AKG’s sense is that the importance of governance roles and functions will continue to increase over the next few years, particularly where these functions underpin the delivery of managed investment solutions.

The market appears to be, once more, at a time of popularity for managed investment solutions. Some of this activity has been driven by an increase in adviser businesses seeking to outsource all, or elements of, their investment process/proposition to third parties.

But even where adviser businesses are retaining things in-house, managed investment solutions still seem to be in vogue.

More and more money is likely to continue to find its way into these solutions over the coming years and for reference, the generic term ‘managed investment solution’ could easily apply to a wide range of solutions in the market including with profits funds, multi-manager funds, multi-asset funds, managed funds, managed portfolios or default funds.

2.2 Key Governance Considerations

There is no ‘one-size-fits-all’ definition of what constitutes good governance. AKG has therefore prepared the following overarching paragraph over time to set the scene, having reviewed various sources from a number of different spheres of business and governmental activity.

In general terms, governance can be regarded as the combination of competent processes and structures within an organisation that ensures it meets its objectives in a legal, ethical and honest way. Most importantly, governance must be transparent. An organisation is accountable for its governance and must be able to demonstrate the same.

This overarching definition then needs to be interpreted further in the context of financial services in general, the specific role that the governance function in question is seeking to play and the associated roles of key market participants, including advisers, providers and asset managers.

In doing so, there are several key terms which then spring to mind when you consider what governance in financial services might stand for, including:

Accountability; Responsibility; Duty of care; Inquisitive; Challenging; Assessment; Demonstrable; Effective; Adaptable; Structure; Framework; Process; Connectivity; Communication; Recordable; Responsive; Participatory; Effective; Transparent; Auditable; Independent.

When assessing governance functions and structures the reviewer should therefore have these key terms in mind, specifically the end customer requirements, and seek to monitor and appraise financial services governance functions against these key competencies and objectives.

AKG’s review of the governance approach and framework adopted within the Aviva SMF proposition therefore seeks to assess against some of these key competencies and objectives.
2.3 MIFID II PRODUCT GOVERNANCE

Reason for better governance

MiFID II has introduced significant product governance requirements and hence, whether directly or indirectly affected, companies across the UK financial services sector now have cause to consider their approach and processes when designing, distributing and recommending products and funds in future.

Providers will need to demonstrate to distributors that they fully understand the product/fund and its features, so that advisers can explain these adequately to the end investor. The overarching aim for this work, as ever, should be to achieve best practice within these companies and to target positive outcomes for consumers in a transparent manner.

Range of considerations on governance

AKG has listed below various considerations for firms when it comes to MiFID II’s governance requirements:

- Better acquisition and demonstration of knowledge and intelligence relating to a company’s target customers and their requirements.
- Carry out quantitative and qualitative market research on consumer objectives when designing and testing appetite for new products and funds.
- Ensure solutions are going to the right customers through a detailed management information and reporting capability.
- Investigate and report instances where funds are not being used by the right customer.
- Enhance management information and reporting capability in relation to distributors. Improve the exchange and flow of data between companies, intermediaries and third parties to help each party meet their respective requirements.
- Realise there will be a greater requirement for governance and associated reporting to follow the product cycle. Be prepared to continue to test the rationale relating to product/fund fit for consumers.
- Senior management teams must ensure governance is embedded in internal processes, with relevant and appropriate levels of resource and expertise.

PROD rules

FCA PROD rules are outlined at: https://www.handbook.fca.org.uk/handbook/PROD/3/?view=chapter.

Distributors and manufactures need to pay close heed to these. If advisers haven’t digested and acknowledged these PROD rules they should do so.

Aviva L&P will also need to keep many of these product governance considerations in mind as it continues with the evolution of the SMF proposition, acting, where relevant, to establish commensurate processes and systems. This will include ongoing research to monitor the types of customer engaging with SMF and associated suitability testing.

2.4 DUE DILIGENCE REQUIREMENTS

In February 2016, the FCA published TR16/1: Assessing suitability: Research and due diligence of products and services, a report which set out the high-level findings of the FCA’s thematic review of the research and due diligence processes carried out by advisory firms on the products and services recommended by them to retail customers.

The review included, for example, exploring how:

- firms selected products, funds, platforms and discretionary investment management services
- created panels and centralised investment propositions (CIPs)
- considered options for individual clients.

The general sentiment from the FCA in the paper is that due diligence processes need to be robust, repeatable and recordable. And crucially that the suitability of solutions should be gauged at both a customer level and at an adviser business level. This certainly still carries relevance for advisers now.
2.5 CONSIDERING OUTSOURCED AND MANAGED INVESTMENT SOLUTIONS

With a proliferation of outsourced and managed investment solutions for advisers to select from in today’s market, and a regulatory focus on research and due diligence, there has inevitably been an increasing focus on how these solutions are operated.

Key considerations including:

- What is the management style?
- How do they select managers/stocks?
- What is their structure? What size are their resources and teams?
- Who is responsible for what?
- What processes do they have in place to underpin the delivery of the multi-asset funds or portfolios?

This review seeks to bring some clarity in relation to how Aviva Investors goes about some of these key investment disciplines with its management of SMF on behalf of Aviva L&P.

Performance and cost will continue to present themselves as differentiators for outsourced and managed investment solutions, although AKG believes that over time the ability of a fund or portfolio to meet its core, stated objectives and to operate within its stated parameters will be of ultimate importance to advisers and investors.

The quality of the underpinning governance structure and the risk management processes employed will also increase in importance and become a key differentiator.

2.6 OUTCOME ORIENTED FOCUS

Two of the most obvious and enduring investment requirements for many customers when considering their retirement strategies remain:

- The delivery of a sustainable income for life in retirement, and/or
- The preservation of capital sums accumulated.

There appears to be a greater, and welcome, focus on targeting goals and outcomes for the end investor when considering these retirement income planning needs as well as legacy/inheritance planning requirements.

Putting a target percentage on the amount of income required and/or the growth required on a capital sum are logical steps for the adviser and the customer.

Advisers might wish to align with Aviva’s SMF structure when setting outcome-oriented planning strategies for customers.

2.7 TRANSPARENCY OF CHARGES/TERMS AND CUSTOMER OUTCOMES

There is a concerted focus within the industry on ensuring that customers receive suitable recommendations and achieve good outcomes. Within this, the clarity and transparency of terms and conditions for investment and pension propositions will be key watchwords moving forward.

Items including the following will come under the microscope:

- Are the fund/portfolio objectives and parameters clearly explained for the investor?
- Is the company marketing the product, fund or portfolio solution doing enough to make the investment charges, methodology, terms and conditions clear and transparent?
- For example, is the total cost of investment made clear rather than just headline charges being displayed?
- What asset/fund types are being utilised within portfolios?
- Are associated investment risks adequately addressed?

Asset managers will continue to come under pressure in terms of making their objectives, terms, conditions and performance clearer to customers.
2.8 SMOOTHED SOLUTIONS

Given some of the concerns flagged by advisers about investment market volatility, AKG’s 2018 Pension Freedoms paper also sought to gauge adviser appetite for smoothed product/fund solutions.

The research showed that 17% of advisers surveyed were already utilising these solutions for clients while 32% were sometimes advising on these solutions.

A further 35% said that they would potentially use smoothed product/fund solutions with the caveat that such solutions need to improve/simplify further beforehand.

Providers of ’smoothed’ product/fund solutions in the retail wealth management market are acknowledged as being Prudential, LV= and Aviva.

These providers need to continue to evolve their propositions and ensure that they are marketed appropriately. Unless some form of guarantee is specifically in play, providers of ’smoothed’ product/fund solutions need to ensure that customers understand that the value of their units in the fund may go up as well as down. Customers must not have the perception that smoothing provides some form of implicit guarantee.

Continued improvements in the way in which smoothing techniques and functionality is described, to both advisers and customers, should also be targeted.

Providers and advisers both have responsibility in terms of best ensuring that customers understand the risk/reward profile of the funds and the likely investment performance characteristics.
3. AKG Comments and Observations

3.1 ROLES AND RESPONSIBILITIES

- Ultimate responsibility for the SMF proposition resides with Aviva L&P, while investment management duties for SMF are mandated to, and carried out by, the Multi-asset Team at Aviva Investors. Advisers can see the lines of responsibility drawn here and hence understand accountability for SMF behaviour and performance.
- While Aviva L&P and Aviva Investors both carry responsibilities in terms of the operation and management of SMF, advisers remain responsible for assessing the pension, investment and tax planning requirements of each customer and ascertaining the attitude to investment risk and appetite for loss for each customer.
- The adviser is also responsible for the suitability of the recommendation of SMF as an investment/pension solution for the customer.
- From a risk profiling perspective, advisers need to understand Aviva L&P's risk rating for SMF and consider how SMF is positioned in comparison to the output produced by third-party risk profiling tools. Advisers also need to be aware of any potential variance in the risk and risk profile descriptions used by Aviva L&P and third-party risk profiling tool providers.

3.2 INVESTMENT APPROACH AND METHODOLOGY

- There is a clearly articulated set of three core investment disciplines and processes - strategic asset allocation, tactical asset allocation and implementation – which are already in play and proven within the operation of the Aviva Investors MAF range.
- The key difference for SMF being that Aviva L&P takes responsibility for strategic asset allocation, with input from Aviva Investors, while Aviva Investors has responsibility for delivering tactical asset allocation and implementation within this framework.
- While SMF itself remains a relatively new proposition, the investment team running the mandate for the fund and the processes underpinning the investment management approach are part of established practice within the Aviva Investors Multi-asset Team.
- The Aviva Investors Multi-asset Team has been operating in the market for a number of years, it also manages the Aviva Investors MAF Range and has wide-ranging investment resources at its disposal.

3.3 RISK AND GOVERNANCE

- AKG can see that there is a comprehensive risk and compliance structure behind SMF through adopted risk and governance procedures within both Aviva L&P and Aviva Investors, underpinned by the Group’s core three lines of defence framework.
- Advisers should understand that these risk and governance procedures need to fulfil a range of disciplines in relation to the operation of SMF, including items specific to the smoothing mechanism, the risk parameters of SMF, the performance of SMF against its investment mandate and the performance of SMF against its overarching investment objectives and target customer profile.
- Hence, Aviva L&P needs to ensure connectivity between the various moving parts and contributors to these risk and governance functions during the lifetime of SMF.

3.4 COMPONENTS AND FEATURES

- The smoothing mechanism is a key component of SMF, and it is vital that advisers and customers understand how this process works. Given that, to date, SMF is only available via the intermediated channel, there is a responsibility for advisers to be able to ‘translate’ the concept of smoothing and Aviva’s approach to smoothing to the end customer.
- But ultimately, given the proposed nature of a smoothed proposition, it is crucial that the framework and processes adopted by Aviva L&P to underpin SMF can deliver as smooth a return as possible with the minimum number of adjustments.
- It is important for advisers and customers to understand that SMF is not guaranteed.
• The product and fund management charges for Pension Portfolio/Investment Select Bond and SMF are presented in a clear manner so that the adviser and the customer can see the total charges that will apply to an investment.

• SMF is daily priced and so the customer’s money will buy units with effect from the end of the trading day closest to their investment being made. It is vital that advisers and customers understand that the value of their investment can be subject to a rise or fall from day one. There is no qualifying period for SMF investments.

3.5 COMMUNICATIONS

• It is vital for Aviva L&P to continue to develop the intermediary communication toolkit for the SMF proposition.

• The circulation of the quarterly performance review and outlook document is a good step forward in this regard.

• Given the established toolkit available to the Aviva Investors team in relation to the operation of the MAF range it would make sense to borrow from this but with specific application for SMF.

• Communication relating to positive or negative fund price adjustments, specifically the timeliness of these, and other informative material relating to the smoothing component of SMF is also crucial.

• Aviva L&P has stated that lessons were learnt from the way it responded to the first (negative) fund price adjustment for SMF from a communications activity perspective and that it has sought to address the feedback received from advisers at the time.

• It has subsequently had a chance to improve on this with the recent (positive) fund price adjustment and reports that new internal processes enabled a speedier update to be communicated to advisers using SMF.

• SMF is designed to deliver growth over the medium to long term and so ultimately its associated performance characteristics will emerge over time. It can be challenging for advisers to judge the performance of newer fund propositions in the early years. It will be helpful for advisers to be able to see the 24-month picture for SMF (pension) when it hits its two-year anniversary. Both pure investment performance against stated objectives should be assessed as well as being able to see ‘smoothing’ successfully applied.
4. SMF Key Facts

4.1 BACKGROUND AND AVAILABILITY

Aviva L&P announced the launch of SMF, available at the time through the Pension Portfolio on the Aviva adviser platform, in December 2017.

Subsequently SMF was added to Aviva’s investment bond, Select Investment, in February 2019.

SMF total fund size is £181m as at 31/10/2019

At a glance SMF key features

<table>
<thead>
<tr>
<th>Smooth Growth Rate</th>
<th>Pension share class</th>
<th>Investment Bond share class</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price adjustment</td>
<td>Bank of England Base Rate + 5%</td>
<td>Bank of England Base Rate + 4%</td>
</tr>
<tr>
<td></td>
<td>Occurs when the smoothed price is 6.5% higher or lower than the unsmoothed price</td>
<td></td>
</tr>
<tr>
<td>Cost</td>
<td>0.65%</td>
<td>0.46%</td>
</tr>
<tr>
<td>Availability</td>
<td>Aviva Platform Core Pension Portfolio</td>
<td>Aviva Investment Bonds (new and existing)</td>
</tr>
<tr>
<td>Launch date</td>
<td>December 2017</td>
<td>February 2019</td>
</tr>
<tr>
<td>AUM</td>
<td>£141m</td>
<td>£40m</td>
</tr>
</tbody>
</table>

Source: Aviva L&P as at 31/10/2019

4.2 FUND AIM

Quoted directly from the fund factsheet, the overarching fund aim for SMF is as follows:

The Smooth Managed Fund is designed to deliver growth over the medium to long term, employing a ‘smoothing’ process to shelter you from some of the impact of market movements. The fund invests in a broad range of global assets which changes over time as we aim to keep the investment risk in line with a moderately cautious risk profile.

4.3 TARGET MARKET AND CLIENT SUITABILITY

With the overarching fund aim in mind, who then might SMF be suitable for?

Aviva L&P suggests the following types of customer and customer circumstances:

- Customers who are prepared to take a medium degree of risk with their investment in return for the prospect of improving longer term performance.
- Customers who are comfortable that their investment may rise and fall in value over time and they may get back less than they invested.
- Customers who prefer to spread risk by investing in a wide range of assets and see their money typically be invested more in shares and/or property than fixed interest assets.
- Customers who accept that having a broad spread of assets may limit the potential returns but should help to minimise the fluctuations.
- Customers who would be prepared to stay invested in the fund for at least 5 years.

Advisers are responsible for appraising the suitability of SMF for their client and client circumstances and should therefore give close consideration to fund aim and target market considerations.
4.4 DISTRIBUTION
At the time of writing SMF remains available solely via the intermediary distribution channel. Intermediary sales and marketing activities are led by the Aviva L&P team, with support provided by the Aviva Investors sales and marketing teams.

4.5 CHARGING STRUCTURE (PENSION)
SMF, accessed via Pension Portfolio, has a headline fund management charge of 0.65% per annum (including allowance for a small shareholder cost in relation to smoothing, i.e. to cover the risk of extreme market events impacting SMF).

The charging structure for Aviva’s Pension Portfolio, where investment is made in Aviva’s Insured Funds only (Core option), ranges from 0.10% to 0.35% depending on the customer’s portfolio value.

<table>
<thead>
<tr>
<th>Aviva charge for portfolio value</th>
<th>Core option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to and including £30,000</td>
<td>0.35%</td>
</tr>
<tr>
<td>£30,000.01 to £250,000</td>
<td>0.30%</td>
</tr>
<tr>
<td>£250,000.01 to £400,000</td>
<td>0.20%</td>
</tr>
<tr>
<td>£400,000.01 and above</td>
<td>0.10%</td>
</tr>
</tbody>
</table>

Source: Aviva L&P

4.6 CHARGING STRUCTURE (INVESTMENT BOND)
SMF, accessed via Select Investment Bond, has a headline fund management charge of 0.46% per annum (including allowance for a small shareholder cost in relation to smoothing, i.e. to cover the risk of extreme market events impacting SMF).

The charging structure for Aviva’s Select Investment Bond ranges from 0.40% to 1.10% depending on the customer’s portfolio value.

<table>
<thead>
<tr>
<th>Portfolio value range</th>
<th>Fund Management Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>£10,000 - £24,999</td>
<td>1.10%</td>
</tr>
<tr>
<td>£25,000 - £49,999</td>
<td>0.75%</td>
</tr>
<tr>
<td>£50,000 - £99,999</td>
<td>0.60%</td>
</tr>
<tr>
<td>£100,000 - £249,999</td>
<td>0.50%</td>
</tr>
<tr>
<td>£250,000 - £499,999</td>
<td>0.45%</td>
</tr>
<tr>
<td>£500,000 plus</td>
<td>0.40%</td>
</tr>
</tbody>
</table>

Source: Aviva L&P
4.7 FUND ENTRANCE/EXIT

SMF is daily priced and so the customer’s money will buy units with effect from the end of the trading day closest to their investment being made.

It is vital that advisers and customers understand that the value of their investment can be subject to a rise or fall from day one. There is no qualifying period for SMF investments.

Trade press coverage at the time of Aviva’s downward unit price adjustment in December 2018 intimated that some advisers had expressed surprise at such a change to the fund price taking place so shortly after a client’s investment had been made.

There was also associated comment on the responsiveness of Aviva’s communications relating to the downward adjustment.

Evidently lessons to be learned by all parties here. For their part Aviva states that it has acknowledged the feedback received at the time and will endeavour to improve on quality and timeliness of future communications relating to changes made to the pricing of SMF.

AKG understands that a new internal communications process and group has been established at Aviva to deal with fund price adjustment announcements. This has been done to target quicker response times between a plus or minus adjustment being made to the fund pricing and associated contact being made to alert intermediary users of SMF.

Switches in and out of SMF are limited to 1 in each calendar quarter (1 January to 31 March; 1 April to 30 June; 1 July to 30 September; 1 October to 31 December). Switching activity is closely monitored by Aviva L&P as part of ongoing governance procedures for SMF, including managing any potential concerns on fund dilution.

Aviva L&P states that legitimate regular switching (e.g. re-balancing a portfolio) and regular cancellations to pay for income in drawdown are acceptable, but large switches in and out of the fund on a regular basis will not be allowed.

The maximum amount that can be invested in SMF is £1 million.
5. Structure, roles & responsibilities - Aviva SMF

5.1 THE ROLE OF THE ADVISER

The adviser remains responsible for assessing the customer’s pension, investment and tax planning requirements and ascertaining their attitude to investment risk and capacity for loss.

The adviser is also responsible for gauging and proving the suitability of the recommendation of SMF as an investment/pension solution for the customer.

Both of these activities need to be done at outset and on an ongoing basis moving forward.

From a pure investment perspective, in engaging with SMF, the adviser will effectively be outsourcing investment management duties and disciplines to Aviva L&P/Aviva Investors.

5.2 KEY ROLES AND RESPONSIBILITIES FOR SMF

The ongoing operation of the SMF proposition is a collaborative effort between different business units within Aviva L&P - including With Profits, Unit Pricing, Investments, Risk and Investment Compliance – and Aviva Investors.

Some of the key roles and responsibilities are outlined in the table below.

![Table of roles and responsibilities]

Source: Aviva Investors

Advisers and customers should therefore stand to benefit from the combined knowledge and resources of these contributors/stakeholders when engaging with SMF.

However, it is vital that the SMF solution equals the sum of its parts and that communications, deliverables and responsibilities remain clear across these different parties within Aviva. Also, vital that within this structure accountability is taken at both an individual and overarching level.

5.3 INVESTMENT MANAGEMENT AGREEMENT

There is a formal Investment Management Agreement (IMA) in place between Aviva Investors Global Services Limited and Aviva Life & Pensions UK Limited.

The IMA outlines the parameters for investment objective, investment strategy and permitted investments for SMF.

In this regard Aviva Investors is clearly accountable to Aviva L&P in relation to the terms of the delivery of the mandate and its associated investment terms, duties and responsibilities.
5.4 INVESTMENT RESOURCE – AVIVA INVESTORS

The Aviva Investors Multi-asset Team (responsible for the management of £88bn as at June 2019) has been operating in the market for several years, manages the established Aviva Investors MAF Range and has the following resources at its disposal.

Aviva Investor’s Multi-asset Team of over 50 individuals consists of experienced portfolio managers, economists, asset allocation specialists, manager researchers and portfolio implementers.

The team also draws on the skills of more than 400 investment professionals within specialist products, such as fixed income, equities, real estate, alternatives, cash and derivatives.

5.5 AVIVA INVESTORS MULTI-ASSET TEAM – KEY PERSONNEL

The names and roles of key personnel within Aviva Investors multi-asset team are confirmed below:

- Euan Munro - Chief Executive Officer
- Peter Fitzgerald - Chief Investment Officer, Multi-asset
- Sunil Krishnan, CFA - Head of Multi-asset funds
- Paul Parascandalo, CFA - Portfolio Manager, Multi-asset
6. SMF Characteristics

6.1 FUND TYPE

SMF is a daily priced, unit linked pension and life fund within Aviva L&P’s insured fund range. SMF is a multi-asset fund and is categorised in the ABI’s ‘Specialist’ fund sector (see below for sector definition).

33. Specialist

- Funds that have an investment universe that is not accommodated by any of the other ABI sectors.
- As funds in this sector do not meet any pre-set parameters, these should not be compared on a like-for-like basis.
- Performance ranking of funds within the sector as a whole is inappropriate given the diverse nature of its constituents.
- This sector is not monitored because universal methodologies to analyse the value or monitor the underlying assets are not available.

Source: ABI Sector Definitions, September 2017

The SMF factsheet (pension) can be accessed at:

https://www.fundslibrary.co.uk/flweb/FrameLogin/Transfer/DataOnline/PdfFactsheet/aviva.wrap/aviva_wrap/BF8KSW4?LoginSite=aviva.wrap&LoginUsername=avivawrap

6.2 ACTIVE OR PASSIVE?

Aviva Investors states that it will make use of both active and passive investment disciplines in the construction and delivery of SMF. Further information on this approach is provided in Section 10.4.3.

6.3 WITH PROFITS OR NOT?

While it may have some with profits characteristics, i.e. ‘smoothing’, Aviva L&P states that SMF has not been designed as a traditional with profits vehicle, rather it has been written as a unit linked product.

Aviva L&P describes the smoothing formula employed for SMF as formulaic and mechanistic. On the basis that the Smooth Growth Rate is linked to the Bank of England base rate, Aviva L&P states that the smoothing process will just be applied automatically, with no intervention from Aviva L&P, as and when circumstances dictate, i.e. there is no discretion applied on Aviva L&P’s behalf in the normal day-to-day running of the fund.

Aviva L&P designed SMF to be accessible via its adviser platform, and hence it felt that unit-linked and collective investment funds would fit better with the platform proposition than a with profits fund would have done.

Aviva L&P believes that on balance, for its target market, the unit-linked advantages of greater simplicity, improved transparency and more autonomous governance outweigh the benefit of additional discretion that might have been provided within a with profits fund structure.
6.4 GUARANTEED OR NOT?

SMF is not guaranteed. It is important for advisers and customers to understand this.

For clarity, and consideration when appraising the smoothing mechanics, Aviva L&P states that the smoothing will protect SMF customers from short term, normal levels of volatility but it cannot completely protect customers from a large fall in equity values.

Aviva L&P states that the value of an investment in SMF can go down as well as up and hence customers may get back less than they invested.

But ultimately, given the proposed nature of a smoothed proposition, it is crucial that the framework and processes adopted by Aviva L&P to underpin SMF can deliver as smooth a return as possible with the minimum number of adjustments.

6.5 TYPE AND NUMBER OF UNDERLYING FUND HOLDINGS

SMF provides exposure to a diverse range of global asset classes, using both active and passive funds and futures where appropriate.

These currently include equities, bonds, property/real estate and absolute return funds. The funds can also invest in commodities and convertible bond funds.

Aviva L&P states that SMF will typically hold between 10 and 15 holdings including collective investments and futures although this may vary over time. The fund breakdown and top 10 holdings as at 31st October 2019 are confirmed below.

<table>
<thead>
<tr>
<th><strong>Fund breakdown</strong></th>
<th><strong>Top 10 holdings</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong> 1.4%</td>
<td>Aviva Pensions US Equity Fund 21.5%</td>
</tr>
<tr>
<td><strong>Property</strong> 7.4%</td>
<td>Aviva Pensions European Equity Fund 12.0%</td>
</tr>
<tr>
<td><strong>Absolute Return</strong> 4.7%</td>
<td>Aviva Investors Global Investment Grade Corporate Bond Fund 10.3%</td>
</tr>
<tr>
<td><strong>Alternative Assets</strong> 4.7%</td>
<td>AUKLAP Emerging Markets 8.3%</td>
</tr>
<tr>
<td><strong>Emerging Market Debt</strong> 5.1%</td>
<td>US 10YR Note Dec 19 12/19/2019 10.2%</td>
</tr>
<tr>
<td><strong>Global Bonds</strong> 34.6%</td>
<td>Aviva Life &amp; Pensions Property Fund 7.4%</td>
</tr>
<tr>
<td><strong>Bonds</strong> 29.7%</td>
<td>Aviva Pensions Japan Equity Fund 6.2%</td>
</tr>
<tr>
<td><strong>Overseas Equities</strong> 52.9%</td>
<td>Aviva Investors Multi-Strategy Target Return Fund 4.7%</td>
</tr>
<tr>
<td><strong>UK Equities</strong> 3.9%</td>
<td>ALAP ULL Emerging Markets Bonds 5.1%</td>
</tr>
<tr>
<td><strong>Equities</strong> 56.8%</td>
<td>Aviva UK Equity Fund 4.3%</td>
</tr>
</tbody>
</table>

**Source:** SMF fund factsheet, November 2019
7. Risk Characteristics

7.1 KEY RISKS

It is crucial that advisers are comfortable with the key risks presented by engagement with any managed investment proposition and that these risks have been addressed with and been acknowledged by customers.

Aviva outlines the key risks for SMF as follows:

- The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates.
- Investors may not get back the original amount invested.
- The Fund uses derivatives, these can be complex and highly volatile. This means that in unusual market conditions the Fund may suffer significant losses.
- The Fund invests in emerging markets, these markets may be volatile and carry higher risk than more developed markets.

7.2 TARGET RISK PARAMETERS

Aviva L&P states that SMF aims to maximise investment returns per unit of risk while remaining appropriate for the customer's risk profile.

The fund seeks to generate returns through a combination of capital growth and income.

7.3 VOLATILITY RANGE

Aviva L&P states that the volatility range will be reviewed at least annually, and any changes will be communicated to the Aviva Investors Multi-asset Fund Manager to consider as part of the investment mandate for SMF.

The target volatility of the strategic asset allocation for SMF is set by Aviva L&P and is currently two-thirds of Global Equity volatility but can be between 58% and 72% after Aviva Investors’ tactical allocation decisions.

Aviva L&P states that this approach to volatility is in line with a 'low to medium'* customer risk profile and is currently rated as a 5 out of 10 on Dynamic Planner’s risk scale.

*Dynamic Planner risk definition

7.4 AVIVA RISK RATING

On the SMF factsheet Aviva L&P allocates a risk rating of 3 out of 7 for the fund, with this associated explanatory note:

*The historical performance of funds with this risk rating has typically experienced low to medium volatility compared with other funds Aviva has rated. This means that these funds have a low to medium potential for substantial changes in value compared with other Aviva funds. We regularly review the ratings we give to each investment fund. So, they might change from time to time.*

7.5 RISK WARNINGS

Risk warnings are highlighted in the SMF factsheet, in a high-level listing and with definitions of these risks defined later. Risk warnings are also highlighted and described in the Aviva SMF Customer guide.

Again, advisers need to ensure that they understand these risks and have discussed them with the client when considering attitude to risk and loss.
7.6 RISK MAPPING

Assessment of the customer’s attitude to risk and appetite for loss remains a key remit for advisers and some enlist the support of risk profiling tools when tackling this activity.

In addition to the provision of its own fund rating, Aviva L&P has also sought to have SMF mapped to the output produced by third-party risk profiling tools provided by Dynamic Planner, Defaqto and FinaMetrica.

Example: Prior to the launch of SMF, Aviva L&P provided details of SMF’s strategic and tactical asset allocations to Dynamic Planner and these were then mapped to Dynamic Planner’s set of asset classes. The original risk profiling analysis was carried out in November 2017 and SMF was subsequently ranked as ‘5 – Low Medium Risk’ by Dynamic Planner (risk rating scale of 1 to 10). AKG understands that this remains the case at the time of writing.

On an ongoing basis Aviva L&P needs to continue to report strategic and tactical asset allocations for SMF to Dynamic Planner in order that the risk profile of the fund can continue to be monitored.

Aviva L&P has now gone through similar processes with Defaqto and FinaMetrica. The risk ratings attributed to Aviva SMF by these third parties are confirmed in Aviva L&P’s quarterly performance review and outlook documents.

Aviva L&P and Aviva Investors need to ensure that their risk and governance framework supports this ongoing reporting to third party investment and risk analysts in relation to risk ratings and associated risk parameters and volatility ranges.

The risk rating profile of SMF, and any subsequent revision, is something for advisers to continue to monitor during 2020 and beyond.

Advisers also need to be aware of any potential variance in the risk rating methodologies and risk profile descriptions used by Aviva L&P and third-party risk profiling tool providers when matching solutions to risk profiling output.
8. Aviva approach to smoothing

The smoothing mechanism is a key component of the SMF proposition and so it is vital that advisers and customers understand how this process works. Getting to grips with definitions and terminology is therefore vital.

### 8.1 KEY SMOOTHING COMPONENTS

There are five key terms which form part of the smoothing mechanism employed by Aviva L&P within the SMF proposition and these need to be understood and given due consideration by advisers.

<table>
<thead>
<tr>
<th>Smooth Managed Fund</th>
<th>The fund’s assets, primarily equities and bonds. We value these regularly. You can find more information in our monthly fund factsheet.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unsmoothed price</td>
<td>The value of assets divided by the number of units in the Smooth Managed Fund.</td>
</tr>
<tr>
<td>Smoothed price</td>
<td>This is the price you pay to buy and sell units in the Aviva Smooth Managed Fund.</td>
</tr>
<tr>
<td>Smooth Growth Rate</td>
<td>This is the rate at which the Smoothed price will normally increase. For the Pension Fund, the Smooth Growth Rate is equal to the Bank of England Base Rate + 5% per year. For the Life Fund, the Smooth Growth Rate is equal to the Bank of England Base Rate + 4% per year.</td>
</tr>
<tr>
<td>Fund price adjustment</td>
<td>This is what happens when there is a 5.5% or more difference between the Smoothed price and the Unsmoothed price. We automatically adjust the Smoothed price so that the difference is only 1.5%.</td>
</tr>
</tbody>
</table>

Source: Aviva L&P

Aviva L&P also states the following important information relating to SMF and smoothing:

1. The fund does not target the Smooth Growth Rate and may earn more or less than this over any time period.
2. Fund Price Adjustments can be applied at any time and customers should understand that a negative or positive adjustment of 5% or more could be applied to their investment soon after investing, or before they take their money out of the fund.
3. For the Pension Fund, the Smooth Growth Rate will never be less than 5% or more than 10%. For the Life Fund, the Smooth Growth Rate will never be less than 4% or more than 9%. The return the customer gets from SMF may be more or less than these limits as Fund Price Adjustments also affect returns.

Given that, to date, SMF is only available via the intermediated channel, advisers will be partly responsible for ‘translating’ the concept of smoothing, and Aviva L&P’s approach to smoothing, to the end customer.

### 8.2 SMOOTH PRICE RESET

Aviva L&P states that in extreme circumstances it may have to protect customers invested in the SMF. This is likely to be when there is a large volume of money entering or leaving the fund. Aviva L&P states that it has done some back-testing to see how the smoothing might have performed in extreme market conditions. Advisers should enquire further about this material if they would like to know more about the back-testing and scenario modelling work.

When such an extreme event occurs, the Smoothed price of the fund will be immediately adjusted so that it is equal to the Unsmoothed price. After this has happened, the Smoothed price will continue to grow in line with the Smooth Growth Rate.
8.3 HOW THE SMOOTHING WORKS

A Smooth Growth Rate is set by Aviva L&P for the fund, which is the target rate at which the smoothed price will increase.

- For the Pension fund, Smooth Growth Rate is equal to the Bank of England Base Rate plus 5% per year.
- For the Life Fund, the Smooth Growth Rate is equal to the Bank of England Base Rate plus 4% Per year.

Advisers and their clients need to understand that the Smooth Growth Rate is not guaranteed.

The SMF price will usually increase daily in line with the Smooth Growth Rate – Aviva L&P calls this the smoothed price.

A core element of the smoothing proposition is the interaction between the smoothed price and the unsmoothed price, and subsequently the requirement for application of fund price adjustments.

Aviva L&P has sought to explain the smoothing process via graphs and examples within its Aviva Smooth Managed Fund brochure – with the same version of this being used for both adviser and customer audiences.

An example explanatory graph is included below and the production of further practical material like this is encouraged as the SMF proposition evolves during 2020 and beyond.

Source: Aviva L&P

8.4 FUND PRICE ADJUSTMENT – PLUS AND MINUS

The price of the SMF increases daily by the Smooth Growth Rate, which for pensions business with Aviva L&P is equal to the Bank of England Base Rate plus 5% per annum net of fees.

Each day, the price of the SMF is compared to the value of the underlying assets, i.e. the Unsmoothed price. If the difference between the two prices is greater than 6.5% a Fund Price Adjustment is made to bring the Smooth Managed Fund to 1.5% of the Unsmoothed price.

Therefore, when markets perform poorly the underlying assets may lose value, which can trigger a downward Fund Price Adjustment. Equally, in an environment where markets are performing well, an upward Fund Price Adjustment may be seen.

This means that over a long-term time horizon, investors will receive similar performance to the underlying holdings. Crucially, however, the client’s investment journey is in principle designed to be much smoother because they are not exposed to daily price movements.
8.5 FUND PRICE ADJUSTMENT HISTORY SINCE LAUNCH

**Minus adjustment** - On the 19/12/2018 the price of the Pension SMF was adjusted by -5% to be 99.75p.

Aviva L&P has said that it will continue to look at ways of being more proactive with communications when adjustments are applied following feedback from advisers in December 2018.

**Positive adjustment** - On the 30/07/2019 the price of the Pension SMF was adjusted by +5.4% taking it to just over 108p.

Putting the Fund Price Adjustment into context, Aviva L&P commented:

> “Following a challenging 2018, markets have performed exceptionally well so far this year, primarily due to the more dovish stance adopted by the Fed and ECB. This has created a positive environment for equities and bonds alike, which has helped the Smooth Managed Fund’s globally diverse asset allocation to deliver strong positive returns.”

To date there have been no adjustments made to the price of the Bond SMF.

8.6 SMOOTH MANAGED HISTORIC GROWTH RATES

<table>
<thead>
<tr>
<th>Smooth Managed Historic Growth Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond</td>
</tr>
<tr>
<td><strong>Date</strong></td>
</tr>
<tr>
<td><strong>Historic Expected Growth Rate</strong></td>
</tr>
<tr>
<td>11 Feb 2019</td>
</tr>
<tr>
<td>11 Dec 2017</td>
</tr>
<tr>
<td>02 Aug 2018</td>
</tr>
</tbody>
</table>

**Source:** Aviva L&P
9. Gauging SMF behaviour and performance track record

Aviva L&P launched SMF in December 2017 and so SMF performance can now be gauged over a 22-month period.

### 9.1 SMF (PENSION) PERFORMANCE SINCE LAUNCH

The graph below illustrates the investment performance of SMF (Pension) since launch up to and including the end of October 2019.

In this example SMF performance is compared to the performance of the ABI Mixed Investment 40%-85% Shares Sector and the MSCI World over the corresponding period for illustrative purposes.

![Smooth Managed Performance Since Inception](image)

**Source:** Morningstar Direct

The impact of the negative and positive fund price adjustments since launch can be clearly seen in the performance chart.

Advisers with clients invested in SMF and/or those advisers considering investment in SMF for clients will need to keep abreast of this performance story on an ongoing basis.

In its marketing material for SMF Aviva L&P states that a typical SMF investor should be prepared to stay invested in SMF for at least 5 years.
9.2 EXAMPLE HISTORIC PERFORMANCE MODELLING

Aviva has done some illustrative work to show advisers how SMF might have performed historically by producing some simulated performance graphs using representative data from the Aviva Investors Multi-asset Fund range.

Examples have been produced for Pension and Bond variants of SMF.


9.3 REGULAR ADVISER COMMUNICATIONS

Aviva now produces quarterly performance review and outlook bulletins for advisers.

The bulletins include commentary on SMF performance during the corresponding periods, provide an update on Aviva Investors’ market outlook and outline any significant portfolio adjustments made.


Representatives from Aviva Investors regularly discuss investment market trends and themes with the intermediary channel via a range of media.
10. Investment approach and methodology

10.1 OBJECTIVE FOR SMF

Aviva L&P states that the SMF is designed to deliver growth over the medium to long term, employing a ‘smoothing’ process to shelter customers from some of the impact of adverse market movements.

In order to achieve these objectives SMF invests in a broad range of global assets which can change over time as Aviva L&P/Aviva Investors aims to keep the investment risk in line with a medium degree of risk.

10.2 INVESTMENT STYLE FOR SMF

The Aviva Investors Multi-asset Team is the fund manager for SMF. The Aviva SMF has many similar characteristics to the Aviva Investors Multi-Asset Fund range. It is important for advisers to understand the approach taken by Aviva Investors.

Aviva Investors describes its investment style for the SMF mandate as follows:

- Actively managed portfolios to deliver capital growth.
- Portfolio construction process that aims to deliver the optimal investment outcome for level of risk undertaken.
- Globally unconstrained approach towards asset allocation, with no bias towards UK equities or fixed income.
- Collaborative approach to management, acting as a single team and seeking to bring together the breadth and depth of Aviva’s global resources with its local market knowledge and experience.
- Blended approach of active and passive underlying investments, seeking to provide scope for the most effective way of implementing investment ideas.

10.3 ACHIEVING MULTI-ASSET DIVERSITY

SMF is a multi-asset fund. While it does not form part of the Aviva Investors MAF range, SMF has some similar characteristics with three broad categories of assets defined by Aviva Investors.

- **Growth assets** - Growth assets have the potential to drive each portfolio’s capital growth. Typical assets include equity but also riskier forms of fixed income.
- **Defensive assets** - Aims to protect the value of investments and manage risk. This includes cash, government bonds and lower-risk corporate bonds.
- **Uncorrelated assets** - Have the potential to perform in all conditions or in low correlation to traditional asset classes. This includes absolute return funds.

This is the typical asset allocation of SMF:

- Growth assets - 62%
- Defensive assets - 25.5%
- Uncorrelated assets - 12.5%

*Source: Aviva L&P*
10.4 MULTI-ASSET INVESTMENT PROCESS

The multi-asset investment process behind SMF is very similar to that employed by Aviva Investors with the operation and management of the MAF range.

But for SMF it is important for advisers to understand that roles and responsibilities are slightly different given Aviva L&P’s ownership of the SMF proposition.

There are three core elements in the asset allocation process for SMF:

1. Strategic asset allocation,
2. Tactical asset allocation, and
3. Implementation.

Aviva L&P sets the strategic asset allocation framework for SMF, incorporating input from Aviva Investors in the construction of this framework, and then Aviva Investors is tasked with tactical asset allocation and implementation of the investment portfolio for SMF under the terms of the mandate issued by Aviva L&P.

Aviva Investors makes a range of material available to advisers who are keen to know more about their approach to these core investment elements.

The diagram below provides an illustration of the process flow for these strategic asset allocation, tactical asset allocation and implementation stages.

![Diagram showing process flow for strategic asset allocation, tactical asset allocation, and implementation]

Source: Aviva Investors

Each component part of the investment process is further described by Aviva L&P and Aviva Investors as follows.
10.4.1 Strategic asset allocation

Aviva L&P and Aviva Investors agree the strategic asset allocation framework on a collaborative basis for SMF. Strategic asset allocation is used to create a long-term portfolio that is aligned to the target client’s risk profile. In constructing it, Aviva L&P and Aviva Investors uses long-term volatility and correlation measures which it believes are more stable than those focused on the shorter-term.

Aviva L&P/Aviva Investors do not currently outsource any asset allocation decisions to third parties, preferring to manage this in-house with the control and freedom to make asset allocation changes for SMF as and when they are required.

Aviva Investors states that empirical studies have shown that investing globally can enhance risk-adjusted returns and help to diversify portfolios. The SMF is fully unconstrained and invests on a global basis; and so, if Aviva Investors does not like an asset class it does not have to hold it.

Asset allocation – high level core assets

High level core holding asset allocation model for SMF.

Source: Aviva L&P

Aviva Investors is quick to point out its preference for global equity exposure, something which is clearly illustrated here by overseas equity holdings versus UK equity holdings.

10.4.2 Tactical asset allocation

In order to generate additional returns, or protect the portfolio, Aviva Investors states that it will deviate from the strategic asset allocation, whilst ensuring that the SMF remains appropriate from a risk perspective.

The Aviva Investors House View defines the global macro framework it believes will drive markets over the coming years, serving as a starting point for investment experts across the firm to generate ideas. It defines the following:

- The central case across global markets and asset classes
- The key risks to the House View to explore potential alternative macro scenarios to the central case.

Active asset allocation views are then discussed and debated at Aviva Investors’ Asset Allocation Committee (AAC) meetings. This forum brings together the Multi-asset Fund Managers, key representatives of the Investment Strategy Team and Fund Managers from across the wider Aviva Investors investment floor.

The aim is to determine asset allocation views that will enable the funds run by the Multi-asset Team to generate excess returns over a one to two-year time horizon. Whilst positioning is set with this period in mind, the AAC is cognisant of shorter-term risks and longer-term trends.
10.4.3 Implementation

The diagram below outlines this Implementation process.

By harnessing the breadth and depth of its global investment resources, Aviva Investors feels that it can continually adapt to market conditions, and hence keep its portfolios aligned to investors’ risk profile. Aviva Investors recognises that identifying the right investment ideas does not in itself guarantee good investment performance and how these ideas are put together is crucial. Aviva Investors believes that portfolio construction is equally important as idea generation to ensure robust, efficient investment performance.

This step of the Aviva Investors investment process determines how the asset allocation positioning and sizing is decided in the context of each individual fund’s objective and portfolio guidelines, including risk budgets and restrictions. Potential positioning changes are debated at a weekly meeting at which the fund managers, as well as members of the Investment Strategy team are present, and reflect changes in market conditions.

The Multi-asset Fund Manager, with assistance from Implementation Managers and the Multi-manager Research Team, selects the most appropriate vehicle to access each asset class. A blended approach of active and passive underlying investments provides scope for the most effective ways of implementing an idea.

The Aviva Investors Multi-asset Fund Manager also selects what he or she believes to be the most appropriate vehicles to populate the asset allocation. This will determine whether Aviva Investors believes the exposure can benefit from an active stock-picking approach in the context of the multi-asset mandate or whether a passive exposure, be it through a passive index mutual or ETF fund, or a derivative future, is better suited.

Whilst Aviva Investors has a significant internal capability, both active and passive, the funds do have the flexibility to invest in external managers if required. The Multi-asset Team works closely with the Multi-manager Research Team in order to select from ‘best of breed’ external managers in individual asset classes should this be required.

Aviva Investors describes how active and passive investment strategies are utilised and blended in the construction and implementation of the SMF portfolio. Furthermore, Aviva Investors confirms that based on the strategic asset allocation (the neutral allocation model excluding any tactical positioning) the split between active and passive strategies is approximately 50/50.
Aviva Investors believes that a blended approach is sensible, given that there are some asset classes where it pays to be active and others where a passive approach is more than adequate.

For example, Aviva Investors currently has the following active vs passive beliefs when managing multi-asset solutions:

- Wholly passive exposure to developed market government bonds.
- A bias towards more passive exposure in developed market equities, which are typically informationally efficient and liquid; making active management incredibly challenging. However, they take a more active to emerging market equities, given the additional risks associated with that asset class.
- Wholly active approach to credit e.g. global high yield and investment grade credit. A feature of being passive in the credit space would mean that the portfolio would get more exposure to the most indebted companies which is not attractive.
11. Risk and governance

11.1 Fund Governance

The ongoing performance of internal funds, including SMF, is managed through the Aviva Customer Investments Forum, chaired by the Chief Investment Officer. Aviva states that this Forum meets each quarter to:

- Review investment policy and strategy, taking into account changes in markets
- Monitor and review investment benchmarks
- Approve changes to fund objectives and risk controls
- Review and evaluate investment performance
- Look at any changes to the investment process which aim to meet performance objectives
- Ensure compliance with the FCA Handbook
- Ensure compliance with Aviva Group investment policy (including derivative policy and counterparty risk exposure)
- Question and challenge the fund manager(s).

11.2 How is the Fund’s Adherence to its Investment Style Monitored?

Performance positioning and tactical asset allocation changes are discussed and debated in weekly meetings with fund managers and members of the Investment Strategy team.

Independent oversight and challenge to these processes is provided by the second line investment risk team. Whilst the portfolio managers retain responsibility for the management of the assets, the investment risk team works with them to enhance the investment decision making process and provide independent challenge to ensure the level of risk taken is appropriate. The team ensures that each portfolio’s risk profile is consistent with the portfolio’s objectives and the stated investment process.

Aviva Investors believes that effective and robust risk analysis, leading to an enhanced understanding of investment risk will, over time, deliver superior investment performance that is consistent with the stated investment objectives.

The Investment Risk Team analyses risk from security level through asset classes and at a total fund level and provides risk analysis to the Portfolio Managers using externally provided software, such as BlackRock Solution’s Aladdin platform and internally developed risk tools. Risk statistics are calculated daily, which include VaR, concentrations, exposures, sensitivities, stress and scenario testing among others. The Investment Risk Team’s process includes regular Risk and Performance Review (RPR) meetings with the Portfolio Management Team and Global Performance Services Team, chaired by the head of the relevant investment area.

The role of the RPR meetings is to monitor that Aviva Investors portfolio risk is consistent with investment objectives, funds are aligned to the ‘House view’, to monitor Aviva Investors performance against targets and to approve appropriate actions to re-align the portfolio’s risk profile when required. This formal reporting structure supplements and compliments the daily risk management engagement which occurs between the portfolio management teams and the independent Investment Risk function.

11.3 Risk and Governance Measures in Place to Support Smoothing

Responsibility for SMF resides with Aviva UK Life’s Investment Solutions business unit. Some of the key SMF principles, processes and mechanisms require specific risk and governance monitoring.

The Smooth Growth Rate of the Fund is linked to the Bank of England Base Rate and asset flows need to be monitored in case the smoothed price needs to be reset by Aviva L&P. There are also limits around the number of switches and the amount that can be invested in SMF that require daily monitoring by Aviva L&P. Aviva L&P’s internal risk and governance processes for SMF therefore need to facilitate the following disciplines:

- Updating the Smooth Growth Rate when Bank of England Base Rate changes
- Monitoring the number of switches per customer
- Monitoring investments against maximum limits
- Resetting the Smooth Price when asset flows reach certain triggers.
11.4 OVERARCHING RISK AND GOVERNANCE

The Aviva Group’s overarching risk and governance structure is also relevant to the operation of Aviva L&P and Aviva Investors. The information provided here is referenced from the Aviva corporate site.

The Aviva Board’s role

The Aviva Board’s role is to provide entrepreneurial leadership of Aviva, within a framework of prudent and effective controls to assess and manage risk. It believes that a strong system of governance throughout the Group is essential to:

- ensure the business runs smoothly
- aid effective decision making
- support the achievement of our objectives.

The Board is responsible for promoting Aviva’s long-term success for the benefit of shareholders and for:

- setting Aviva’s strategic aims
- ensuring an appropriate system of governance is in place
- setting Aviva’s risk appetite
- making sure Aviva is adequately resourced
- making sure Aviva has effective controls in place
- setting Aviva’s values and supporting its culture.

To discharge its responsibilities, Aviva’s Board has established frameworks for risk management and internal control using a ‘three lines of defence’ model and reserves to itself the setting of the Group’s risk appetite.

The Board retains ultimate responsibility for internal control and risk management, and their effectiveness, and carries out a review of the systems on an annual basis. In-depth monitoring of the establishment and operation of prudent and effective controls in order to assess and manage risks associated with the Group’s operations is delegated to the Audit, Risk and Governance Committees which report regularly to Aviva’s Board.

Source: Aviva Group

Aviva’s frameworks are important to help the business manage risks that could stop the Board achieving its objectives. They are designed to identify and manage, rather than eliminate, the risk of failure to achieve business objectives. They can only provide reasonable and not absolute assurance against material misstatement or losses.

Aviva states that it regularly reviews these frameworks and complies with the Financial Reporting Council’s Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.
Aviva’s Risk management framework

At an overarching level, Aviva L&P and Aviva Investors’ approach to risk management and governance adopts the Aviva Risk Management Framework (RMF) which has been implemented across the Group. Aviva states that rigorous and consistent risk management is embedded across the Group through its RMF, comprising systems of governance, risk management processes and risk appetite framework.

Source: Aviva Group

Aviva’s RMF is designed to identify, measure, manage, monitor and report the significant risks to the achievement of Aviva’s business objectives. It is embedded throughout the Group, and is codified through Aviva’s risk policies and business standards, which set out the risk strategy, appetite, framework and minimum requirements for the Group’s worldwide operations.

The framework is based on the ‘three lines of defence’ model, where:

1. the first line is responsible for (Business) ownership of risk-based decision making,
2. the second line (Risk and Compliance) reviews and challenges, and
3. the third line (Internal Audit) provides assurance that processes and controls are well designed and operating effectively.

The Group Framework uses an Identify, Measure, Manage, Monitor and Report (IMMMR) Methodology to facilitate a continuous cycle of operational risk management. The two main processes used to identify risks are the Risk and Control Self-Assessment (RCSA) and Top Down Risk Assessment (TDRA). The processes are implemented by the first and second lines of defence respectively but should be seen as complementary and with a consistent aim of producing high quality risk data on which business decisions and management actions can be based.

This framework is based on the FCA’s risk model and utilises a range of risk categories and risk appetite qualitative statements and quantitative tolerances to monitor and control the risks faced by the business. The appetite for certain risks is specified at the Aviva Group level and cascaded to business units.
Aviva’s risk appetite framework

The Group’s risk appetite framework comprises:

- Overarching risk appetites: Quantitative expressions of the level of risk Aviva can support (e.g. capital Aviva is prepared to put at risk).
- Risk preferences: Qualitative statements on the risks Aviva believes it is capable of managing, risks it can support but need to be controlled, and risks it seeks to avoid or minimise.
- Operating risk limits and tolerances: Quantify Aviva’s specific boundaries (e.g. limits on specific risks).

Aviva’s Board has approved two risk appetite statements:

- Solvency II capital: Based on Solvency II eligible own funds at risk in an extreme loss event over a one-year period.
- Liquidity: Based on stressing forecast central liquid assets and cash inflows and outflows over a specified time horizon (covering Group centre costs, debt costs and dividends).

Aviva’s risk appetites are clearly defined – in aggregate and by risk type – and are refreshed on a regular basis as part of Aviva’s planning process.

Aviva’s long-term sustainability depends on the protection of franchise value and good relationships with customers and other stakeholders. As such, Aviva’s Board has made an overarching risk preference statement that it won’t accept risks that materially impair its reputation and Aviva requires that its customers are always treated with integrity.

Risk management processes and controls

Aviva governs risk through group-wide risk policies and business standards, risk oversight committees and clear roles, responsibilities and delegated authorities. The Aviva Board is responsible for setting the Group’s risk appetite and establishing and operating controls to assess and manage the risks.

The Board delegates day-to-day risk management to the Group CEO, who delegates operational aspects to executives within the Group through delegated authority letters.

Line management in the business is accountable for risk management, which together with the risk function and internal audit form Aviva’s ‘three lines of defence’ of risk management.

Internal controls

Aviva’s internal controls facilitate:

- effective and efficient business operations
- the development of robust and reliable internal reporting
- compliance with laws and regulations.

Aviva assesses its operational risks, and the adequacy and operating effectiveness of the controls implemented to manage and mitigate them, through operational risk and control self-assessments, an integral part of the Group’s Operational Risk & Control Management (ORCM) framework.

Aviva has a Group-wide reporting manual in relation to International Financial Reporting Standards (IFRS), Solvency II reporting requirements and a Financial Reporting Control Framework (FRCF). FRCF relates to the preparation of reliable financial reporting, covering both IFRS and Solvency II reporting activity.

The FRCF process follows a risk-based approach, with management identification, assessment (documentation and testing), remediation (as required), reporting and certification over key financial reporting-related controls.

Management regularly undertake quality assurance procedures over the application of the FRCF process and FRCF controls.
Aviva’s Board delegates day-to-day management of its company and approval of specific issues up to set financial limits to the Group CEO. This includes limits on revenue and capital expenditure, reinsurance spend, and the settlement of claims. In turn the Group CEO delegates some of his authority to his direct reports. Aviva has a similar delegated authority framework in place throughout the Group.

Management as the first line of defence

Management are responsible for:

- the application of Aviva’s risk management framework
- implementing and monitoring the operation of Aviva’s system of internal control
- providing assurance to the Audit Committee, the Risk Committee, the Governance Committee and the Board.

Aviva Leadership Team members and each business unit Chief Executive Officer are responsible for:

- implementing Group strategies, plans and policies
- monitoring operational and financial performance
- assessing and controlling financial, business and operational risks
- the maintenance and ongoing development of a robust control framework and environment in their areas of responsibility.

There are three group-level management committees designed to assist members of the Aviva Leadership Team in the discharge of their delegated authorities:

- Aviva’s Asset Liability Committee (ALCO) is chaired by the Chief Capital Officer (CCO). It helps the CFO meet his responsibility to manage the Group’s Balance Sheet and liquidity within risk appetite. It also provides financial and insurance risk management oversight.
- Aviva’s Operational Risk Committee is chaired by the Chief Risk Officer (CRO). It supports the first line owners of key operations in overseeing the Group’s operational risk profile, monitor specific operational and conduct risks and the risks impacting the Group’s reputation and take appropriate action as and when required.
- Aviva’s Disclosure Committee is chaired by the CFO. Its role is to support the Group CEO and Group CFO in ensuring timely and accurate disclosures and announcements are made by the group to its security holders and the investment community.

Each business unit must establish a local ALCO and a local ORC in line with the overall scope of the group-level committees, although recognising different group and business unit requirements. Aviva’s Business Unit Chief Executive Officers and Chief Financial Officers sign off the results of the FRCF process, and report compliance with FRCF to the Disclosure and the Audit Committees.

The Risk function as the second line of defence

The Risk function is accountable for the quantitative and qualitative oversight and challenge of the identification, measurement, monitoring and reporting of significant risks and for developing the Risk Management Framework (RMF).

As Aviva responds to changing market conditions and customer needs, the Risk function regularly monitors the appropriateness of the Group’s risk policies and the RMF to keep them up to date. This helps to provide assurance to risk oversight committees that Aviva has appropriate controls for all core business activities, and its processes for managing risk are understood and followed consistently across the Group.

The second line Risk function also includes Compliance and Actuarial functions.

Aviva’s Actuarial function is accountable for Group-wide actuarial methodology. It reports to the relevant governing body on the adequacy of Aviva’s reserves and capital requirements, and on the adequacy of Aviva’s underwriting and reinsurance arrangements.
Aviva’s Compliance function supports and advises the business on the identification, measurement and management of its regulatory, financial crime and conduct risks. It is accountable for maintaining Aviva’s compliance standards and framework, and monitoring and reporting on its compliance risk profile.

**Internal Audit as the third line of defence**

The Internal Audit function gives independent and objective assessment on:

- the robustness of Aviva’s RMF
- the appropriateness and effectiveness of Aviva’s internal control
- the adequacy of these systems to manage business risks and safeguard assets and resources.

It reports to Aviva’s Group Audit, Governance and Risk Committees, business unit Audit Committees and the Board.

The Internal Audit function has an Internal Audit Charter and Business Standard. The Charter sets out the function’s purpose, scope and responsibilities and how it maintains independence from the first and second line management of the Group.

The four main functions of Internal Audit are to:

- assess and report on the effectiveness of the design and operation of Aviva’s framework of controls to assess and manage risk
- assess and report on the effectiveness of Aviva’s management actions to address deficiencies in the framework of controls
- investigate and report on cases of suspected financial crime and employee fraud and malpractice
- undertake designated advisory projects for management provided that they do not threaten the function’s actual or perceived independence from management.

The Internal Audit Business Standard sets out how Aviva’s managers support Internal Audit to achieve its objectives. It requires businesses to design and operate processes and controls to satisfy their mandatory requirements in the Standard based on the size and complexity of their business, and nature of the risks and challenges it faces. Any breaches of the Standard must be reported to the Chief Audit Officer (CAO) and others as appropriate.

**Board oversight**

Aviva’s Risk Committee helps the Board oversee risk and risk management across the Group and makes recommendations on risk appetite to the Board.

Aviva’s Governance Committee works closely with the Risk Committee helping the Board oversee operational risk across the Group, particularly in respect of the risk of not delivering good customer outcomes.

Aviva’s Audit Committee, working closely with the Risk Committee, is responsible for assisting the Board to meet its responsibilities for:

- the integrity of Aviva’s financial statements
- the effectiveness of Aviva’s system of internal financial controls
- monitoring the effectiveness, performance and objectivity of Aviva’s internal and external auditors.

The responsibilities and activities of the Risk, Governance and Audit Committees are set out in their respective Committee Reports in the Annual Report and Accounts.
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For further details on any of the above please contact AKG:

+44 (0) 1306 876439
akg@akg.co.uk
www.akg.co.uk