ASSESSMENT OF AVIVA SMOOTH MANAGED FUND PROPOSITION

April 2018

Accessible – Comparative – Independent

Analysis by AKG Financial Analytics Ltd

CONTENTS

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 new Smooth Managed Fund (SMF) proposition.

1.2 AKG ASSIGNMENT

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

Review context

- **Market background** – Providing an overview of key pension/investment market and associated regulatory/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 and the unique requirements of drawdown investment strategies.
- **Risk and governance** – When considering engagement with managed investment solutions what should advisers/customers be looking for in terms of the investment approach, risk and governance structure and 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? Minimum investment, products/platforms where SMF can 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/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, processes etc?
- Investment objectives, performance and parameters – What are these for SMF and how can the adviser/customer judge successful outcomes, positive fund performance etc?
- Risk and governance – What are the Aviva risk management processes and governance structure which underpin the delivery of SMF?
- AKG observations/considerations – Independent comments on the proposition and associated considerations for advisers/customers engaging with the proposition.

1.3 INFORMATION SOURCES

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

- The Aviva Smooth Managed Fund, LF01102 11/2017
- Aviva – Smooth Managed Fund Research, YouGov
- Aviva SMF launch press release, 11/12/2017
- Key features of Pension Portfolio, LF01012 04/2017
- Fund governance at Aviva, IN50071 01/2018
- Aviva Investors Multi-asset Fund presentation, October 2017
- Dynamic Planner Risk Profile Certificate for SMF
- How would the Aviva Smooth Managed Fund have performed over the past five years?, LF10245 02/2018

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 market could have a significant impact upon the comments.

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2 MARKET BACKGROUND

2.1 ADVISER RESEARCH AND DUE DILIGENCE REQUIREMENTS

In February 2016, the FCA published TR16/1: Assessing suitability: Research and due diligence of products and services, a report which sets 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.

This would therefore incorporate the consideration, selection and suitability of investment solutions like Aviva L&P's SMF.

The general sentiment from the FCA in the paper is that research and due diligence processes need to be robust, repeatable and recordable. And crucially that the suitability of product/investment solutions for the end customer should be gauged at outset and reviewed on an ongoing basis.

2.2 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.

What is the management style? How do they select managers/stocks? What is their structure? What size are their 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 AKG 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.

2.3 THE GROWING IMPORTANCE OF DRAWDOWN

Following the introduction of the pension freedoms changes in April 2015 customers now have more flexibility in terms of how they withdraw money from their accumulated pension fund(s) at and during retirement. Industry statistics produced by the ABI and the FCA illustrate that drawdown has become the most popular product choice since the changes were implemented.

Advisers will now be dealing with a wider range of drawdown customers with differing planning requirements, each requiring support and guidance. The new flexibility is attracting more customers (to drawdown) who would previously have been likely candidates for an annuity and the average drawdown case size has reduced significantly in recent times.

Drawdown is a key area of focus for Aviva L&P, it can be facilitated via Pension Portfolio, and one of the key target customer segments for SMF is drawdown customers with a medium attitude to risk.

2.4 OUTCOME ORIENTED FOCUS

More flexible access to 'cash' has clearly been appealing to some, but two of the most enduring investment requirements for many customers considering their retirement strategies will 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, industry focus on targeting goals and outcomes for the customer when considering these retirement planning needs. Putting a target percentage on the amount of income required and/or the growth required on a capital sum feel like logical steps for the adviser and the customer.

When engaging with SMF, advisers might wish to consider the Smooth Growth Rate (the rate at which the Smoothed price will normally increase by) as a proxy for targeting outcomes with the customer. However, Aviva L&P states that SMF does not target the Smooth Growth Rate and may earn more or less than this.

There might need to be further clarity/explanation provided by Aviva L&P to advisers here in terms of targeting/expectations in order to avoid any confusion.

It is also worth underlining that charges will reduce the overall growth in the fund, i.e. the customer will receive the Smooth Growth Rate, less charges, before any income is taken.

2.5 TAKING THE BUMPS OUT OF THE DRAWDOWN RIDE

The impact of loss in the early years of an income drawdown investment portfolio can be irreparable and similarly the sequencing of returns in a drawdown portfolio can have a major impact on the sustainability of the fund. These will remain fundamental issues for financial advisers in their delivery of financial planning solutions to investors in the retirement income market.

These issues are well defined and described in Moshe A Milevsky's 2006 academic paper, Retirement Ruin and the Sequencing of Returns. Financial advisers can find further details at:

http://www.ifid.ca/pdf_newsletters/pfa_2006feb_sequencing.pdf

Hence drawdown investment solutions with some form of guarantee, volatility dampening techniques or smoothing mechanisms may appeal to more cautious investors, but historically the cost and perceived complexity involved in putting this type of solution together has often been a barrier to customer engagement.

Aviva L&P's smoothing mechanism is seeking to provide a solution for customers who wish to reduce the impact of normal, regular investment market shifts on their investments. It is important for advisers and customers to acknowledge that the SMF is not guaranteed and can go up and down in value.

Aviva L&P states that SMF's smoothing is designed to remove the impact of shorter term volatility, i.e. up and down by 6.5%. Anything sizeable could however be reflected in a Fund Price Adjustment - dampened to some extent by the fact the gap between is only closed to 1.5%.

2.6 TRANSPARENCY OF CHARGES/TERMS AND CUSTOMER OUTCOMES

There is now a concerted focus within the industry on ensuring that customers are treated fairly, 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?

The Regulator has now published the final findings of its Asset Management Market Study and announced the package of remedies it will take forward to address the concerns identified in its interim report into the sector. Advisers should be aware of this body of work, including key areas for further consideration and investigation.

Providers and asset managers will therefore continue to come under pressure in terms of making their objectives, terms, conditions and performance clearer to customers.

In launching a new investment proposition against the backdrop of this regulatory scrutiny on providers and asset managers, Aviva L&P and Aviva Investors will need to pay due consideration to the emerging requirements.

3 IMPORTANCE OF GOVERNANCE

3.1 WHAT DO WE MEAN BY GOVERNANCE?

There is no 'one-size-fits-all' definition of what constitutes good governance. AKG has therefore prepared the following overarching paragraph 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 its 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, 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.*

3.2 WHY GOVERNANCE IS IMPORTANT FOR 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.

3.3 ASSESSING GOVERNANCE FUNCTIONS

And so, when assessing governance functions and structures the reviewer should therefore have some of these key terms in mind and seek to monitor and appraise financial services governance functions against these core competencies and objectives.

Advisers will of course be told categorically that comprehensive risk management processes and governance structures are in place, but it is important for them to dig a bit deeper in their research and due diligence.

AKG's review of the approach to investment, risk and governance underpinning the delivery of SMF therefore seeks to test against some of these key competencies and objectives.

3.4 WHAT SHOULD THE INDUSTRY BE DOING ABOUT PRODUCT GOVERNANCE?

MiFID II has now arrived and has introduced significant product governance requirements. And hence, whether directly or indirectly impacted, companies across the UK financial services sector need to consider their approach and processes when designing and distributing products/funds. There is a range of considerations when reflecting on these governance requirements, including:

- Better acquisition and demonstration of knowledge and intelligence relating to a company's target customers and their requirements.
- When designing and testing appetite for new products/funds, companies should carry out quantitative and qualitative market research exercises to gauge customer objectives and requirements.
- Having established customer objectives and requirements, and launched a new product/fund, companies need to ensure that these solutions are going to the right customers. This will require detailed management information (MI) and reporting capability. Companies will need to investigate and report instances where their products/funds are not being used by the right customer.
- While much of the product/fund governance process might have previously focused on pre- and at-launch activities, there will be a greater requirement for this governance and associated reporting to follow the product lifecycle and to continue to test rationale relating to product/fund fit for customers.
- Companies will be held accountable for product governance processes and associated activities, reporting etc. Senior management teams need to ensure that governance is embedded in internal processes with relevant and appropriate levels of resource/expertise.

In launching a new investment proposition against the backdrop of this regulatory scrutiny on asset managers, Aviva L&P and Aviva Investors will need to pay due consideration to these emerging product governance requirements.

4 AKG OBSERVATIONS

Development and positioning

- The development of SMF has been a collaborative effort between different business units within Aviva L&P - including With Profits, Unit Pricing, Investments, Risk and Investment Compliance – and Aviva Investors. Advisers and customers should therefore stand to benefit from the combined knowledge and resources of these contributors/stakeholders when engaging with SMF.
- There is some good and practical insight contained in the findings of the consumer market research exercise carried out by Aviva L&P which they have been able to accommodate while finalising launch plans for SMF and also a number of points which they may wish to consider/accommodate as the SMF proposition evolves further during 2018/19.
- Aviva L&P openly references the fact that SMF is seeking to compete in the market with Prudential's established PruFund proposition. And by association of its core components, SMF will be competing with other funds/portfolios which seek to dampen volatility and more broadly with other multi-asset funds.
- Aviva L&P defines its target customer profile and describes its typical SMF customer. It is crucial for advisers to be across each of these characteristics as they assess the potential suitability of SMF for their customers, including potential time horizons for the investment in SMF.

Roles and responsibilities

- Ultimate responsibility for SMF 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 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 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.

Investment objectives, performance and parameters

- SMF was launched in December 2017 and hence there is no performance track record for advisers to review at this stage. Aviva L&P will have to work with advisers to keep them abreast of SMF behaviour and performance at key milestones post-launch.
- In terms of gauging the behaviour of SMF it is important for advisers to tie such assessment/review to the overarching investment objectives and target customer deliverables.
- At launch, Aviva L&P has endeavoured to illustrate how the asset classes contained in SMF might have performed over time when looking back at historical market data.
- Aviva L&P and Aviva Investors will need to ensure that the ongoing behaviour and performance of SMF is communicated to advisers on a regular basis. This work will be the responsibility of Aviva L&P as proposition owner but may be able to build on some of the regular communication activities already carried by the Aviva Investors Multi-asset Team in relation to the Multi-asset Fund (MAF) range.
- Advisers are able to get a sense of the past performance track record of the existing Aviva Investors MAF range. SMF is managed by the same team at Aviva Investors and shares some of the characteristics of the MAF range. Advisers can therefore take some confidence from the established investment approach, risk management and governance structure already in place here.

Investment approach/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 is a 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.

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.
- In launching a new investment proposition against the backdrop of regulatory scrutiny on asset managers, Aviva L&P and Aviva Investors will need to pay due consideration to these emerging factors, including product governance requirements.

Components/Features

- The smoothing mechanism is a key component of the 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 are able to deliver as smooth a return as possible with the minimum number of adjustments.
- It is important for advisers and customers to know that SMF is not guaranteed.
- The product and fund management charges for Pension Portfolio 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.

5 RATIONALE BEHIND SMF DEVELOPMENT

5.1 WHO/WHAT HAS IT BEEN DESIGNED FOR?

Aviva L&P states that SMF has been developed for customers who have a medium attitude to risk and particularly those approaching retirement and considering drawdown solutions.

Aviva L&P states that SMF…

"…is suitable for investors who are prepared to take a medium degree of risk and who understand the multi-asset approach to investing. It is for investors who are prepared to leave their money invested over the long term and take a medium degree of investment risk in order to increase the chance of achieving a positive return."

Source: Aviva L&P

5.2 TARGET CUSTOMER AGE/PROFILE

From a target customer age/profile perspective Aviva L&P suggests that SMF is most suitable for:

- Customers approaching retirement who wish to see more stability in final years, or
- Customers in retirement who wish to reduce the impact of sequencing risk when taking an income.

5.3 TYPICAL SMF CUSTOMER

Aviva L&P goes on to clarify that a typical SMF investor should:

- Be prepared to take a medium degree of risk with their investment in return for the prospect of improving longer term performance;
- Know that the value of an investment can go down as well as up and that they may get back less than they invested;
- 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;
- Accept that having a broad spread of assets may limit the potential returns but will also help to minimise the fluctuations;
- Be prepared to stay invested in SMF for at least 5 years.

It is crucial for advisers to be across each of these characteristics as they assess the potential suitability of SMF for their customers.

5.4 MARKET POSITIONING

Aviva L&P openly references the fact that SMF is seeking to compete in the market with the Prudential's established PruFund proposition.

And by association of its core components, SMF will also be competing with other funds/portfolios which seek to dampen volatility and more broadly with other multi-asset funds.

5.5 MARKET RESEARCH

As you might expect, Aviva L&P carried out a pre-launch market research exercise with a consumer panel in order to gauge/test appetite for the concept of SMF. This research was carried out on Aviva L&P's behalf by YouGov in September 2017.

The research assessed consumers' understanding of the SMF proposition, specifically in relation to the perceived benefits of the SMF, its charges, positioning, risks etc.

Aviva L&P's Customer Guide was also assessed to ensure that it communicated the SMF proposition clearly.

AKG has had access to the research findings and there is some good insight contained here for Aviva L&P which they have been able to accommodate while finalising launch plans for SMF and also a number of points which they may wish to consider/accommodate as the SMF proposition evolves further during 2018/19.

Aviva L&P should carry out further consumer market research exercises in future in order to continue to test understanding of, and appetite for, SMF.

From an ongoing research and governance perspective Aviva L&P should continue to monitor its MI to ensure that SMF is being used by the right customers.

5.6 WITH PROFITS OR NOT?

Aviva L&P states that SMF has not been designed as a with profits vehicle, it has been written as a unit linked product.

Aviva L&P describes the smoothing formula employed for SMF as formulaic, and 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 has designed SMF to be accessible via its adviser platform, and hence it felt that unit linked and collective investment funds would fit much 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.

5.7 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 are able to deliver as smooth a return as possible with the minimum number of adjustments.

6 SMF KEY FACTS

6.1 ACCESS TO SMF

At launch SMF is available exclusively via the Pension Portfolio on the Aviva adviser platform. Pension Portfolio is a flexible, online, self-invested personal pension, with access to a range of investment choices and income drawdown functionality.

Aviva L&P will monitor developments further during 2018 while considering whether to make SMF available through additional Aviva products.

6.2 DISTRIBUTION PLANS FOR SMF

At launch SMF is available solely via the intermediary distribution channel.

6.3 SMF CHARGING STRUCTURE

SMF has a 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 (outlined in the table below), where investment is made in Aviva's Insured Funds only, ranges from 0.10% to 0.35% depending on the customer's portfolio value.

AVIVA CHARGE FOR PORTFOLIO VALUE	CORE INVESTMENTS
Up to and including £29,999	0.35%
£30,000 to £249,999	0.30%
£250,000 to £399,999	0.20%
£400,000 and above	0.10%

Source: Aviva L&P

The total charge applicable for investing in SMF through Pension Portfolio is therefore a combination of the SMF fund management charge and Pension Portfolio product charge.

For example, the total charge for a customer with a portfolio of £50,000 would be 0.98% (the first £30,000 is always charged at 0.35% and the next £20,000 will then be charged at 0.30%).

6.4 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. The maximum amount that can be invested in SMF is £1million.

Switches in and out of the 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 full switches in and out of the fund on a regular basis will not be allowed.

7 KEY ROLES AND RESPONSIBILITIES

7.1 THE ROLE OF THE ADVISER

The adviser remains responsible for assessing the customer's pension planning requirements and ascertaining their attitude to investment risk and capacity for loss. The adviser is also responsible for the suitability of the recommendation of SMF as an investment/pension solution for the customer.

In engaging with SMF, the adviser will effectively be outsourcing investment management duties and disciplines to Aviva L&P/Aviva Investors.

7.2 KEY ROLES AND RESPONSIBILITIES FOR SMF

The development of SMF has been a collaborative effort between different business units within Aviva L&P - including With Profits, Unit Pricing, Investments, Risk and Investment Compliance – and Aviva Investors. Advisers and customers should therefore stand to benefit from the combined knowledge and resources of these contributors/stakeholders when engaging with SMF.

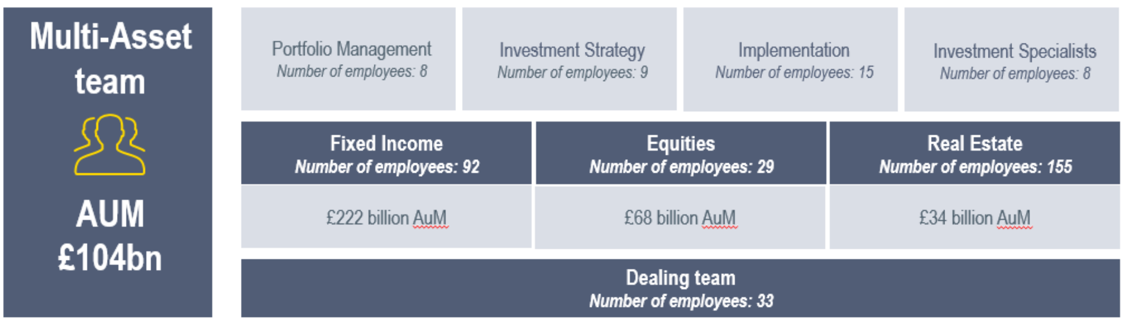
Ultimate responsibility for the SMF resides with Aviva L&P, while investment management duties for SMF are mandated to, and carried out by, the Multi-asset Team at Aviva Investors. Advisers can see the lines of responsibility drawn here and hence understand accountability for SMF behaviour and performance.

Within this structure the following core duties are carried out:

- Strategic asset allocation outlook, framework and implementation
- Tactical asset allocation positioning, review and implementation

7.3 RESOURCE – AVIVA INVESTORS MULTI-ASSET TEAM

The Aviva Investors Multi-asset Team has been operating in the market for a number of years, manages the established Aviva Investors MAF Range and has the following resources at its disposal.



Source: Aviva Investors

Aviva Investor's 50 strong Multi-asset Team 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.

7.4 AVIVA INVESTORS MULTI-ASSET TEAM – KEY PERSONNEL

Paul Parascandalo, CFA, part of the Aviva Multi-asset team at Aviva Investors, is named as the lead fund manager for SMF. Both Paul and Thomas Wells regularly present their views on the investment markets and asset classes/types within the trade press/media for advisers who wish to follow this commentary.

KEY PERSONNEL	
Peter Fitzgerald, CFA	Global Head of Multi-assets
Sunil Krishnan, CFA	Head of Multi-asset Funds
Thomas Wells, CFA	Fund Manager, Multi-assets
Paul Parascandalo, CFA	Fund Manager, Multi-assets
Kevin O'Nolan	Fund Manager, Multi-assets

Source: Aviva Investors

8 SMF CHARACTERISTICS

8.1 FUND TYPE

SMF is a daily priced, unit linked pension fund within Aviva L&P's insured fund range. SMF is a multi-asset fund.

8.2 ACTIVE OR PASSIVE?

Aviva Investors will make use of both investment disciplines in the construction and delivery of SMF.

Further information on this is provided in Section 9.8.

8.3 TYPE 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.

8.4 NUMBER OF UNDERLYING FUND HOLDINGS

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 11 funds invested in as at 1st March 2018 are confirmed below.

FUND NAME	FUND TYPE
Aviva UK Equity	Unit Linked
Aviva US Equity	Unit Linked
Aviva European Equity	Unit Linked
Aviva Japan Equity	Unit Linked
Aviva Pacific Equity	Unit Linked
Aviva UK L&P Emerging Markets	Unit Linked
Aviva UK L&P Emerging Markets Bonds	Unit Linked
Aviva Investors Global High Yield Bond Z Hedge GBP	SICAV
Aviva Investors Global Investment Grade Corporate Bond Fund	SICAV
Aviva Property	Unit Linked
Aviva Investors Multi Strategy Target Return Income Fund 8 G UK	OEIC

Source: Aviva L&P

8.5 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.

Aviva L&P has sought to have SMF mapped to the output produced by third-party risk profiling tools provided by FinaMetrica, Distribution Technology (DT) and Defaqto.

Aviva L&P provided details of the SMF's strategic and tactical asset allocations to DT and these were then mapped to DT's set of asset classes. This risk profiling analysis was carried out in November 2017 and SMF was subsequently ranked as '*5 – Low Medium Risk*' by DT's Dynamic Planner (risk rating scale of 1 to 10).

Post-launch Aviva L&P needs to continue to report strategic and tactical asset allocations to DT in order that the risk profile of the fund can continue to be monitored. 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.

Aviva L&P states that this DT Dynamic Planner risk rating is an initial rating and is based on the SMF's asset allocation model at launch. It anticipates that over time the performance of SMF and the application of its smoothing mechanism might impact on the future level of risk rating.

The risk rating profile of SMF, and any subsequent revision, is therefore something for advisers to monitor during 2018/19. 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.

8.6 GAUGING SMF BEHAVIOUR AND PERFORMANCE TRACK RECORD

Aviva L&P launched SMF in December 2017 and so SMF performance cannot be gauged sufficiently until it reaches significant milestones such as 1, 3 and 5 years.

Aviva L&P states that a typical SMF investor should be prepared to stay invested in SMF for at least 5 years.

Aviva L&P has produced and made available some simulated performance information which seeks to illustrate how the SMF might have performed over the past 5 years.

This simulated performance is based on the actual performance of the assets which the SMF invests in. However, it is only for example purposes and does not represent past performance of SMF.

In terms of gauging the behaviour of SMF it is important for advisers to tie such assessment/review to the overarching investment objectives and target customer deliverables.

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

Advisers are able to get a sense of the past performance of the existing Aviva Investors MAF range, by accessing the following resource:

https://www.avivainvestors.com/content/dam/aviva-investors/united-kingdom/images/campaigns/maf/tool/index.html#performance

SMF is managed by the same team at Aviva Investors and shares some of the characteristics of the MAF range. Advisers can therefore take some confidence from the established investment approach, risk management and governance structure already in place here.

9 INVESTMENT APPROACH/METHODOLOGY

9.1 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.

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.

9.2 TARGET RISK PARAMETERS FOR SMF

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.

9.3 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 DT's risk scale.

*DT risk definition

9.4 INVESTMENT STYLE FOR SMF

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.

9.5 STRATEGIC ASSET ALLOCATION FRAMEWORK FOR SMF

The overarching strategic asset allocation framework for SMF as at 1st March 2018 is confirmed in the table below. Advisers need to ensure that they understand and are comfortable with this asset allocation framework.

STRATEGIC ASSET ALLOCATION FRAMEWORK FOR SMF	
Overseas Equities	49.5%
Bonds	28.8%
Target Return	7.5%
Property	5%
Cash	5%
UK Equities	4.2%

Source: Aviva L&P

Aviva L&P can make more detailed asset class and portfolio holdings breakdown material available to advisers who want to see a deeper level of detail.

This type of material is already made available by Aviva Investors in respect of the Multi Asset Fund range and AKG anticipates that SMF resource material will evolve similarly moving forward.

9.6 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 your 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.

The asset allocation of SMF by Growth, Defensive and Uncorrelated assets is as follow:

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

9.7 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 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 in Section 12.2 illustrates the process flow for the SAA, TAA and Implementation stages. The diagram in Section 12.3 outlines the Implementation process.

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

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.

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. A diagram illustrating the make-up of the AAC is provided in Section 12.4. 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.

3. Implementation

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.

9.8 ACTIVE VS PASSIVE APPROACH AND STRATEGIES

In the Implementation Section above, 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 and stances:

- Passive in the developed market government bonds implemented through 10yr US Treasury futures.
- Passive in developed market equity space like the US where the equity market is informationally efficient and liquid - making active management incredibly challenging.
- A more active approach in emerging market and pacific equity markets as Aviva Investors believes that it pays to be active here.
- Active in the credit space, e.g. global high yield, global investment grade credit, and emerging market debt. 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.
- Aviva Investors also has a Euro Stoxx Bank future in the portfolio, to complement its current European equities holdings. Although technically this is a passive position, Aviva Investors is targeting a specific sector which they have conviction behind.

10 AVIVA APPROACH TO SMOOTHING

10.1 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.

Smooth Managed Fund	The fund's assets, primarily in equities and bonds. These are valued on a regular basis. Advisers can find more information in the monthly SMF factsheet.
Unsmoothed price	The value of assets divided by the number of units in the SMF.
Smoothed price	This is the price paid by the customer to buy and sell units in the SMF.
Smooth Growth Rate	This is the rate at which the smoothed price will normally increase by. The Smooth Growth Rate is equal to the Bank of England Base Rate +5%. This may change in the future.
Fund price adjustment	This is what happens when there is a 6.5% or more difference between the value of the assets in the SMF and the smoothed price. Aviva L&P automatically adjusts the smoothed price so that the difference is only 1.5%.

Source: Aviva L&P

Regardless of definitions and terminology, the smoothing mechanism is a key component of the SMF and it is vital that advisers and customers understand how this process works. 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 the Bank of England base rate +5% per year.
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 the money out of the fund.
3. The Smooth Growth Rate will never be less than 5% or more than 10%. 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.

10.2 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.

When this happens, 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.

10.3 APPROACH TO SMOOTHING

With profits is covered briefly in Section 5.6 in terms of underlining that Aviva L&P has designed and delivered SMF in a unit linked format. This was their preferred approach but Aviva L&P acknowledges that writing the SMF as a unit linked product, rather than a more discretionary with profits product, has its advantages and disadvantages.

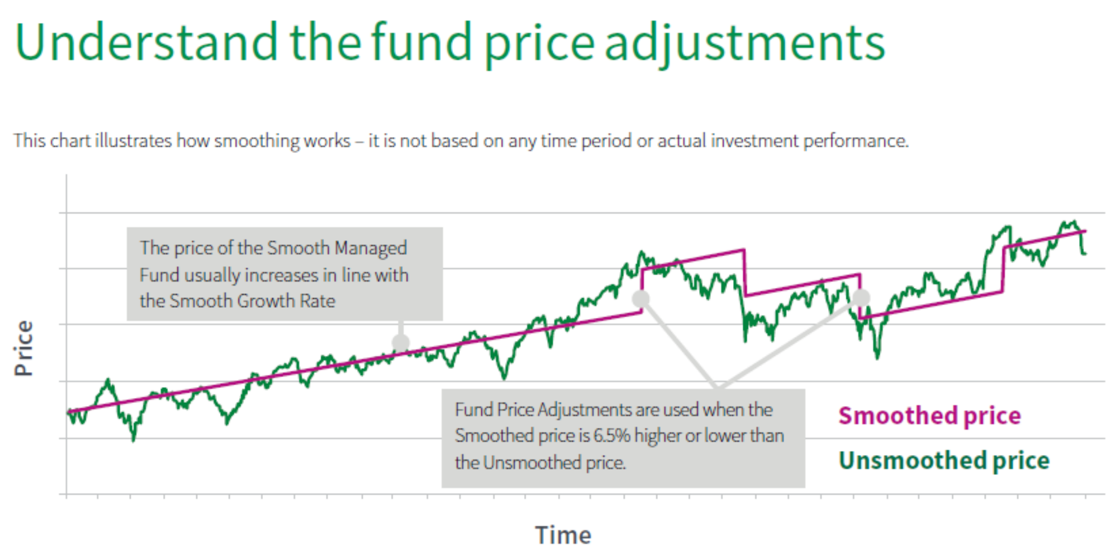
Here Aviva L&P considers the benefits of discretion in relation to some of the core fund and smoothing components:

- **Smooth Growth Rate** - Given that Aviva L&P's target clients will be long term investors, and will potentially receive one-off advice, it feels that taking a longer-term assumption versus cash is more appropriate rather than a more cyclical expectation based on an in-house view of long-term returns which can vary from quarter to quarter.
- **Fund price adjustment** – Aviva L&P states that it has back-tested a number of parameter options in various investment market conditions in order to balance the number and magnitude of the adjustments. Given the experience of this modelling, Aviva L&P states that it would not expect to have to make any changes to its parameters.
- **Fund price reset** – Aviva L&P's mechanism manages an acceptable level of dilution across short and medium terms in line with market practice for similar funds. Unit linked terms and conditions enable Aviva L&P some additional discretion to delay prices and redemptions where appropriate. This applies to all insured funds and can be applied where Aviva L&P believes it is in remaining customers interests.

10.4 UNDERSTANDING FUND PRICE ADJUSTMENTS

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 2018 and beyond.



Source: Aviva L&P

11 RISK AND GOVERNANCE

11.1 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.

11.2 OVERARCHING RISK AND GOVERNANCE

At an overarching level, Aviva L&P and Aviva Investors' approach to risk management and governance adopts the Aviva Risk Management Framework which has been implemented across the Group. A diagram which illustrates this Risk Management Framework is included in Section 12.1.

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.

11.3 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 providing independent challenge to ensure the level of risk taken is appropriate. The team ensures that each portfolio's risk profile is consistent with the portfolios 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 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 on a daily basis, 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.

11.4 RESPONSIBILITY FOR SMF PERFORMANCE

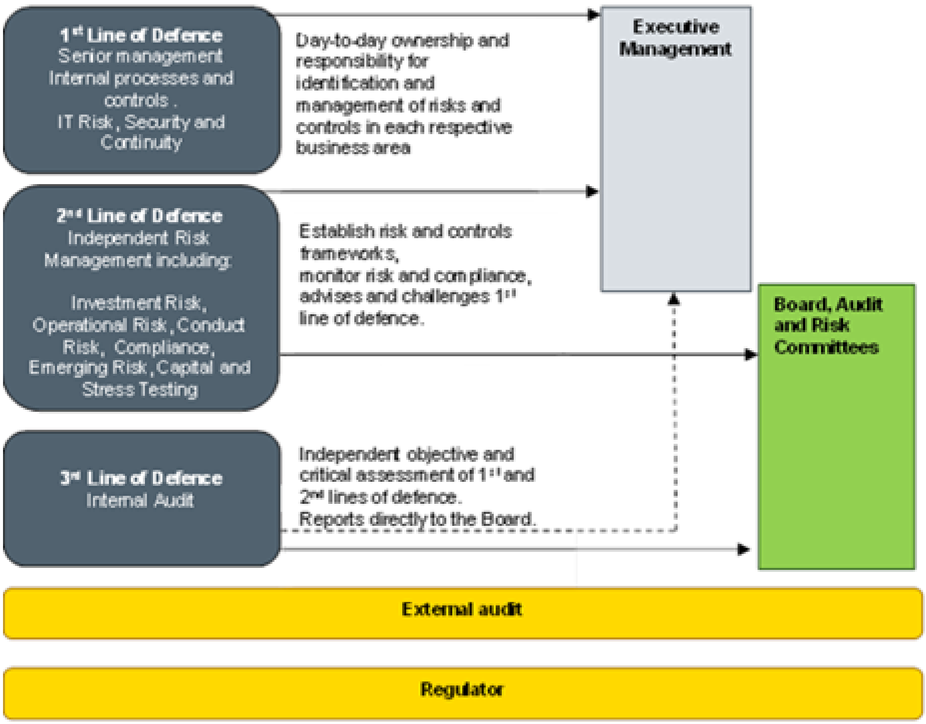
Aviva L&P states that it manages the performance of internal funds managed by Aviva Investors, including SMF, through the Aviva Customer Investments Forum which is chaired by Aviva's Chief Investments Officer.

This group meets each month to carry out the following duties/disciplines:

- 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's Handbook
- Ensure compliance with Aviva Group investment policy
- Question and challenge the fund managers.

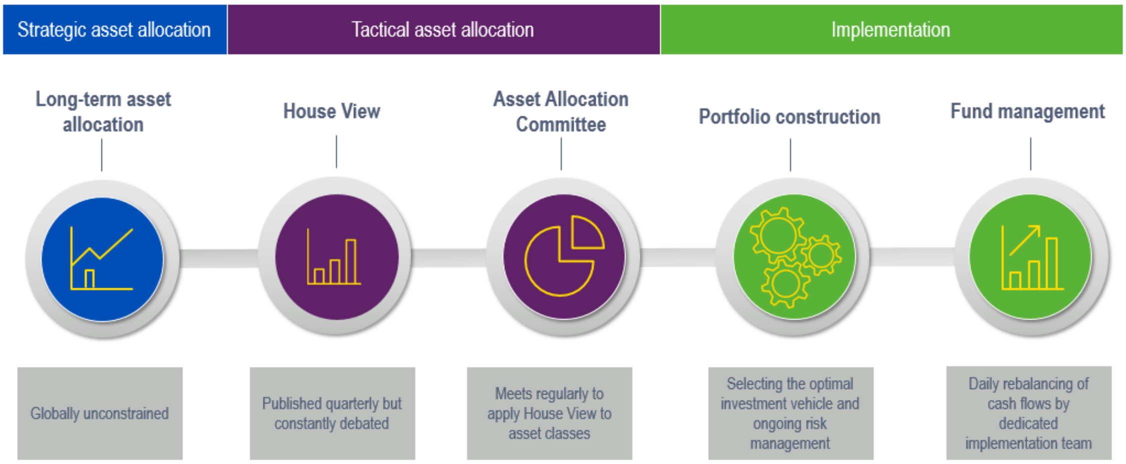
12 ADDITIONAL DETAILS FROM AVIVA

12.1 AVIVA – RISK MANAGEMENT FRAMEWORK



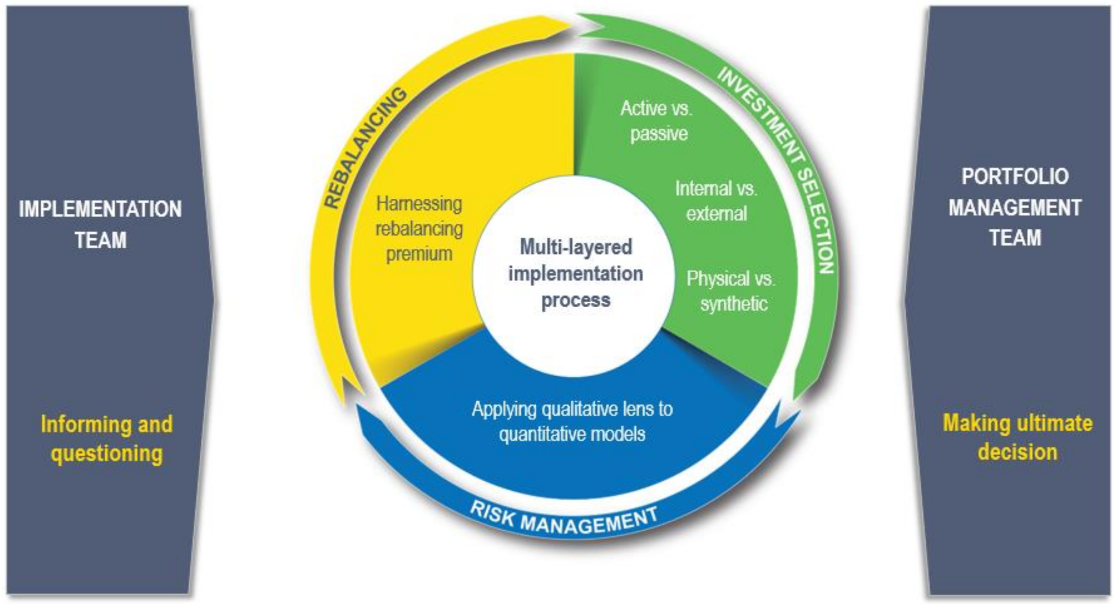
Source: Aviva L&P

12.2 AVIVA INVESTORS – OVERARCHING INVESTMENT PROCESS



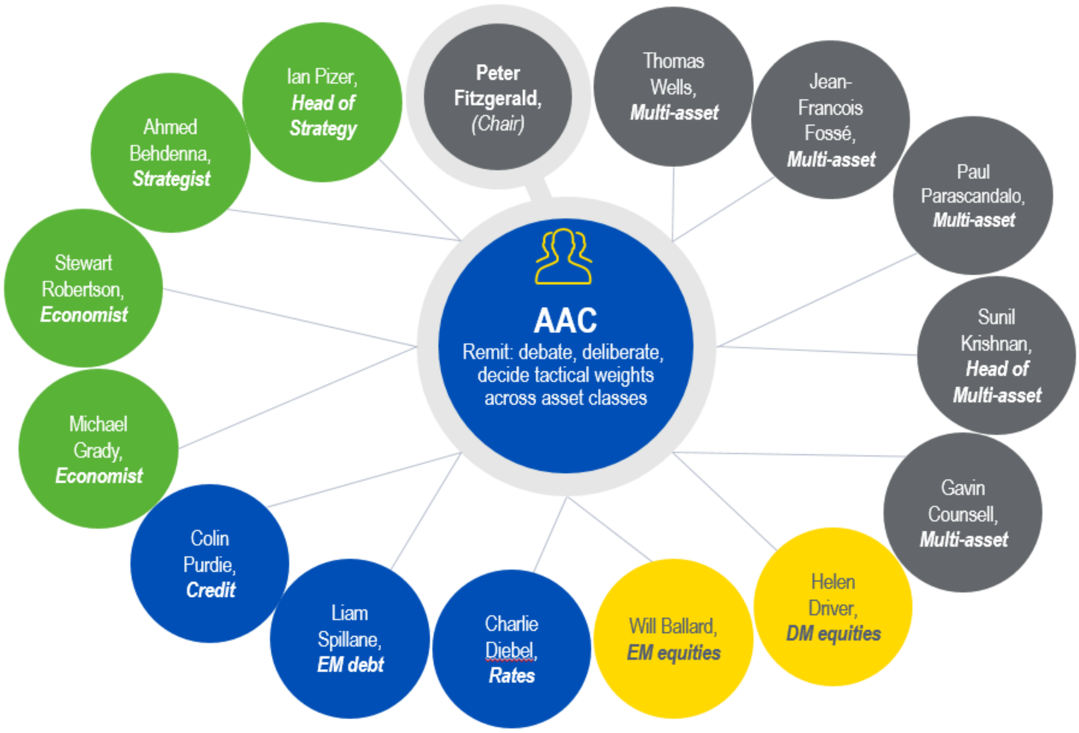
Source: Aviva Investors

12.3 AVIVA INVESTORS – INVESTMENT IMPLEMENTATION PROCESS



Source: Aviva Investors

12.4 AVIVA INVESTORS – ASSET ALLOCATION COMMITTEE



Source: Aviva Investors

INFORMATION ABOUT AKG

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Within a specialist focus on the financial services industry, AKG has developed a broad, complementary range of clients including: Intermediaries (Financial Advisers and EBCs), Life Companies, Friendly Societies, Adviser Networks, Regulators, Fund Managers, Trade Bodies, Service Providers, Banks, and Building Societies.

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  (Providing further depth in the assessment of with profits funds)

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