AVIVA INVESTORS

QUARTERLY UPDATE ON DRIVERS IN ILLIQUID ASSETS Q3 2018

In our regular update on alternative income assets:

- We explore opportunities for institutional investors in structured finance, as stringent capital requirements continue to rein in banks' activities in certain areas, including long-term lending and derivatives.
- We illustrate the spreads achievable across private assets of varying credit quality.

Key theme: Structured finance opportunities for institutional investors in the post-crisis world

STRUCTURED FINANCE: OPPORTUNITIES FOR INSTITUTIONAL INVESTORS IN THE POST-CRISIS WORLD

The post-global financial crisis period has seen large-scale deleveraging by banks to improve balance sheets and focus on core business. This led to a range of opportunities for investors to acquire attractive assets at a discount, as well as allowing them to step into activities that banks have retreated from.

Today, the deleveraging story is largely complete; however, as the regulatory environment has evolved, banks have been forced to contain their activities in less capital-intensive activities. As the type, scale, tenor, volume and format of their financing activities are now more constrained, opportunities have appeared in areas of the market they once dominated, including longer-dated lending and derivative transactions.

Comparison of lending appetite

	Banks	Institutional investors
Maturity	Up to 10 years	25 years plus
Nature of debt	Mainly loans	Mainly securities, increasingly loans
Interest rate term	Floating only (hedge via derivative)	Fixed, floating, index-linked (without swap)
Flexibility over drawdown, repayment	Flexible	Flexible, liability-matching investors may require prepayment penalties

For illustrative purposes only. Source: Aviva Investors

Structuring and participating in customised transactions:

a) Attractive return profile in fund financing

ATTRACTIVE RETURN PROFILE IN FUND FINANCING

A growing number of pooled funds lending to small and medium-sized enterprises (companies with EBITDA of around £20m to £50m) are seeking to raise finance to help enhance returns through fund leverage.

There are opportunities to offer term financing to vehicles holding senior debt, with similar security to the senior tranche of a collateralised loan obligation in a more bespoke transaction. There is also demand for bridge facilities, typically used to manage capital calls and optimise returns by delaying drawing on commitments.

It is possible to make sizeable investments in carefully selected transactions offering an attractive pick-up in spreads compared to equivalent public credit. In certain cases, covenants can be put in place to give structural protection that is not available in publicly-listed debt. The most attractive spreads tend to be in multi-currency transactions

b) Premia in swap repacks

PREMIA IN SWAP REPACKS

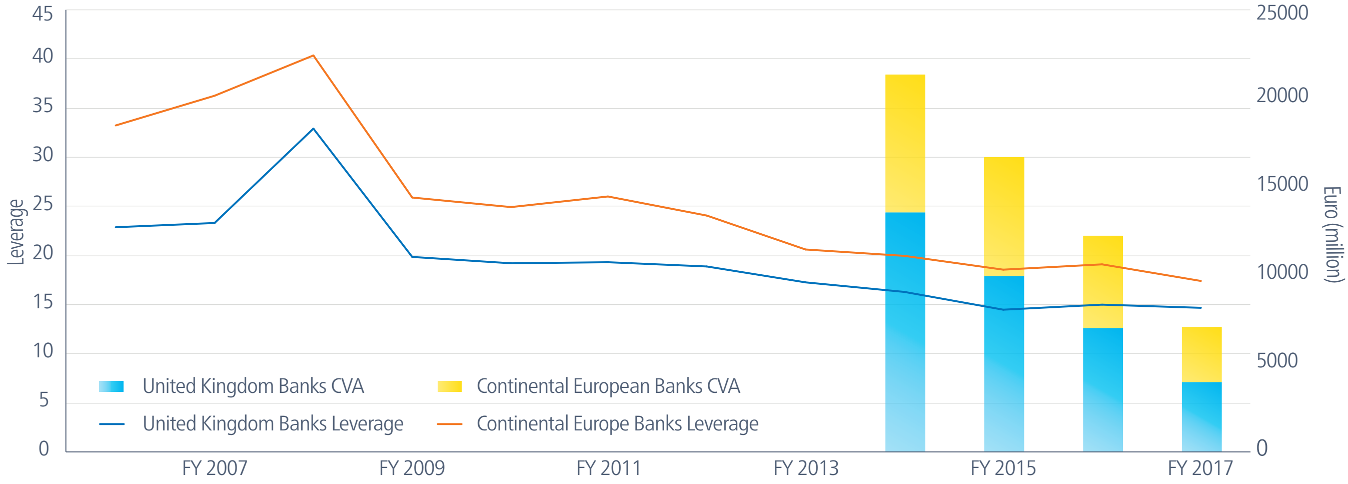
From an investors' perspective, investing in corporate credit through a debt or derivative structure should be broadly similar. In fact, the treatment by banking regulators results in pricing anomalies between the two structures. Banks hold loans in the banking book, while derivatives fall in the trading book, incurring materially higher capital charges for the credit risk component.

This creates opportunities for investors not subject to similar regulatory requirements. A derivative can be restructured (in a swap repack) to mirror a debt instrument that insurers and pension funds might already invest in, but provide better risk-adjusted returns. This is due to the pricing anomalies between the derivative and debt markets, and the greater complexity of derivative-based investments. Long-term borrowers, such as utilities or project finance companies, can particularly benefit from the greater flexibility institutional investors can offer to match their cash flow profiles through these structures.

European financials: deleveraging slowing; banks continue to shrink derivative exposure

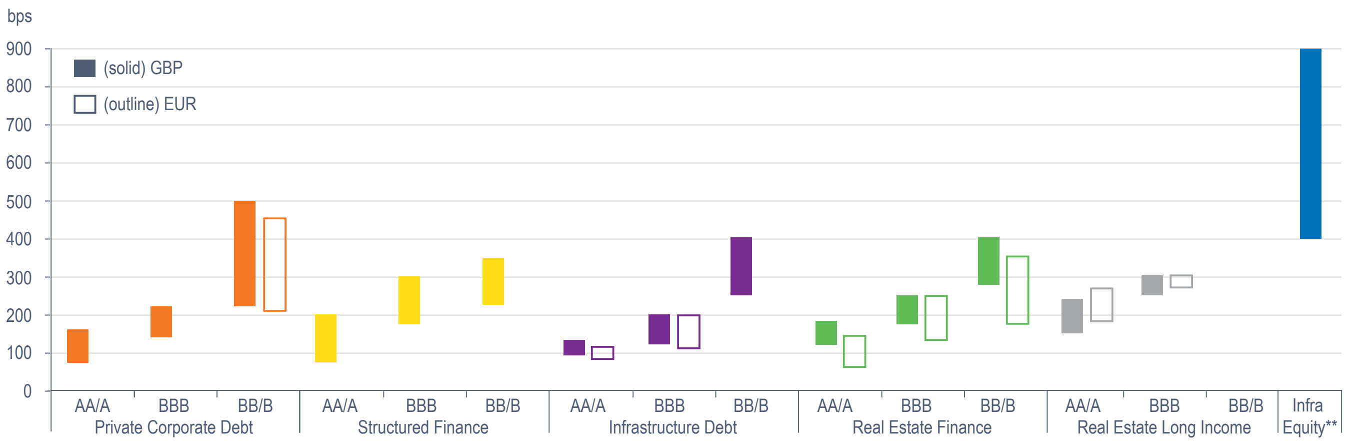
Leverage has been reducing since the global financial crisis.

The decline in CVAs highlights the reduction in bank appetite for credit risk in derivative form. This offers an opportunity for institutional investors to step in and provide financing in this format
to long term borrowers.



For illustrative purposes only. Source: Aviva Investors, as at 30 June 2018.

Indicative spreads p.a.*

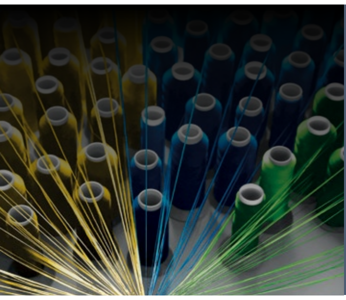


*Additional yield above comparable government bonds **High quality: unlevered infrastructure with largely predictable cash flow. Source: Aviva Investors (for illustrative purposes only). All data as at 30 June 2018. The future returns and opinions expressed are based on Aviva Investors internal forecasts and should not be relied upon as indicating any guarantee of return from an investment managed by Aviva Investors nor as advice of any nature.

RISKS

ILLIQUIDITY: Alternative Income assets are significantly less liquid than assets traded on public markets. Where funds are invested in infrastructure/real estate, investors may not be able to switch or cash in an investment when they want because infrastructure may not always be readily saleable. If this is the case, we may defer a request to redeem the investment.

VALUATION: Investors should bear in mind that the valuation of real estate/infrastructure is generally a matter of valuers' opinion rather than fact. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns.



FIND OUT MORE:

If you wish to know more about our Alternative Income, please contact your usual representative or our Global Client Solutions team:

Telephone:
0207 809 6000

Or visit us at:
www.avivainvestors.com

Important information

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