Aviva Independent Governance Committee

2018 annual report

For members of Aviva's workplace pension schemes

AVIVA

Message from the Committee Chair

Welcome to the 2018 Independent Governance Committee (IGC) Annual Report, for members of Aviva's workplace pension schemes.

This is my third annual report as Chair of the Aviva Independent Governance Committee (IGC), and it has been a year of further change for the company. All Friends Life policies have now moved to the Aviva brand. The rebranding coincided with the transfer of the businesses of Friends Life to Aviva which was approved by the courts and became effective on 1 October 2017.

Aviva is a large and complex organisation, and the merger of the two companies has created the biggest provider of workplace pensions in the UK. Within the remit of the IGC are some three million workplace pension members across dozens of products, both actively marketed and no longer marketed. Many of these products also include a significant number of members who have now left their employer leaving the member with an individual pension policy with Aviva. The remit of the IGC includes these members, not just those still working for their employer.

Given the large and complex book of business we are pleased and grateful for the support, access and resource the company has provided to help us assess Value for Money (VfM).

Assessment against the (VfM) framework

The IGC has assessed overall Value for Money and concluded that most workplace pension customers are receiving a good offering from Aviva. The improvements we have seen in areas such as service and communications demonstrate that Aviva is committed to improving the overall member experience. We have had some excellent discussions with employers and advisers this year, and more is planned to engage directly with members. Further, we remain concerned that members in older products might be left behind and have asked Aviva to keep this under review. You can read more about how we have assessed VFM later in this report.

Regulatory Change

Transaction Costs disclosure

The Financial Conduct Authority (FCA) has now issued its guidance on the disclosure of transaction costs which will allow members to see all the costs they pay for their pension. The information is starting to be prepared by Investment Managers but is incomplete at present. Hence we have reported transaction costs on the same basis as previously. See later in the report for details.

Exit Charges

I promised to keep Aviva's position on exit charges under review – these are the charges some members pay for leaving Aviva early. They have continued to follow the required rules for people wanting access to their pension savings from age 55. All charges on exit for these members remain capped at 1% of the value of their fund (or a maximum of £100 for every £10,000 of investment). However, the presence of early exit charges for members wishing to access their funds remains a concern. Some other providers have removed these charges completely, in some cases for all members, not just those over age 55. We have asked Aviva to reconsider this and to keep us informed of any further developments.

Default Fund review

Following the merger of Friends Life and Aviva, the company has recognised the need to provide one, common default fund solution for all Aviva customers based on their needs. To this end, Aviva's investment team has been redesigning the existing default funds for all of their workplace customers. More detail about these changes is provided later in this report.

Progressing key items from our 2017 report

Charges

The Committee has once again spent a considerable amount of time understanding Aviva's position on charges, particularly for those members in older products. At the time of writing my report last year, around 100,000 customers were still awaiting a review to establish if their annual charge was higher than 1%. In 2017, we noted our disappointment at the pace of change relating to Aviva's book of older business. Some improvements have been made to address this, and we believe that further change is needed to ensure all customers receive fair value. We are continuing to review a number of issues with Aviva. While it is fair to say that many customers even in these older products are already paying less than 1% per annum in charges, we will continue to look at other areas of charging where there is potential unfairness between members in older and newer products being used to support auto-enrolment. Further detail of the challenges the IGC has set Aviva are covered later in this report.

Higher Charging funds

One of the commitments made to the IGC last year related to some ex-Friends Life members in higher charging, historical default funds. Whilst these members are paying the lower, charge-capped rate for any new contributions, money invested before their employer introduced their new default option remained invested in higher charging funds. We received a commitment from Aviva that these members would have these assets switched into their new default fund automatically, after giving sufficient notice of the proposed change.

This exercise was due to be completed in January 2018 following some changes to Aviva's systems to accommodate the automatic switch. At that time, Aviva was going through a period of significant transformation to enable all Friends Life customers to transfer over to Aviva. Due to the legal requirements of this change, a lot of development work, including this switch, was cancelled, and therefore this commitment was not met.

While disappointing, Aviva has agreed that the changes will be made as soon as possible and impacted members will be put back in the position they would have been in had the change been made in January.

Member Engagement

Over 90% of our workplace pension members are in modern "currently marketed" products. The remaining members are invested in older products which are no longer available for an employer to buy (although employers already using some older products could allow new members to join). Further, the majority of members in these older products are no longer contributing to their policy, having left employment some time ago. The IGC wanted to know how Aviva engages with these members, and we received some interesting and thought provoking findings, which are contained later in this report.

The other areas we assessed and which are worth noting include:

- the embedded procedures they have in place to support vulnerable customers
- the expansion of their advice service to members at retirement, and
- the effort they make on being responsible investors and taking non-financial factors into consideration such as Environmental, Social and Governance (ESG) when building investment portfolios.

We saw some examples of good practice and you can read more about these later in this report.

Priorities for 2018

Following the acquisition of Friends Life by Aviva, we have been pressing for a consistent set of Management Information across all of the firm's workplace pension products. We expect to see an improved regular report later in 2018. In addition, we feel that the IGC website provided by Aviva is not quite up to scratch, and we have asked them to make a number of improvements, including making access easier for you.

Members in modern products (those used to support auto-enrolment) are receiving Value for Money. Charges within these products are protected by the regulatory charge cap of 0.75%, and indeed many members are being charged less than this. In addition, the options available to them at retirement ensure they have full access to pension freedoms.

Members in older products have seen improvements in 2017. However, there remain features which lead to higher charges being applied to some of these older products, and we have asked Aviva to address this.

We will continue to challenge Aviva in areas where we believe that improvements to the member experience can be made. This is not just limited to charges – it means we want to see improvements in member communication and engagement, service and new product features which work for everybody, and not just those members who benefit from modern products.

We have asked Aviva to ensure that customers with older products are not forgotten when they consider improvements. These customers might represent a relatively small proportion of Aviva's workplace pension members but they are large in number. Our job as an IGC is to ensure value for money for everyone. We will remain focussed on ensuring an equitable outcome for all workplace pension customers – not just the majority.

In summary, the committee's view is that the vast majority of customers in Aviva's workplace pensions are receiving value for money. The improvements we have seen in areas such as service and communications demonstrate that Aviva is committed to improving the overall member experience. More needs to be done to ensure that customers in older products are not left behind.

Going forward our priorities will remain the same, namely to assess the ongoing VfM and to provide independent challenge and oversight in respect of Aviva's workplace pension policies. We will monitor the progress Aviva makes to improve outcomes for you in all areas of VfM and challenge them should we feel that more needs to be done.

Finally I want to thank you for taking the time to read this report. I hope you found it useful. Remember you can always contact us at IGC@aviva.com and we will responded to all queries. Any contact you have with us will be treated in strictest confidence. We would be very keen to hear your views.

Inderpreet Singh Dhingra
Independent Chair – Aviva IGC

Contents

Our assessment of Value for Money

We continuously assess Aviva's workplace pension products using a VfM framework which is applied to all of their products. The areas we assess are:

- **Product charges and costs** – what you pay each year for managing your workplace pension;
- **Service and administration** – the day-to-day administration and support provided to you as part of your workplace pension;
- **Communication and engagement** – the information Aviva sends to you as a workplace pension customer, and how this can help you to take action to improve your retirement outcomes;
- **Product design and suitability** – how your workplace pension is designed to provide you with options both during the life of your workplace pension and at the time you retire;
- **Investment choices and returns** – the range of investments Aviva makes available to you, how they manage these investments, and how they perform.

Throughout the year, we ask Aviva to tell us about their performance in all of these areas. We make our assessment of VfM based on how well they have performed in all of these areas.

Currently marketed and non-marketed workplace pensions

Aviva's workplace pensions can be split into two distinct groups:

- Currently marketed workplace pension products.
- Non-marketed workplace pension products.

Currently marketed workplace pensions are the products your employer would use today to meet their auto-enrolment duties. Non-marketed workplace pensions are older products which Aviva no longer provides for new business. They cannot be used for auto-enrolment.

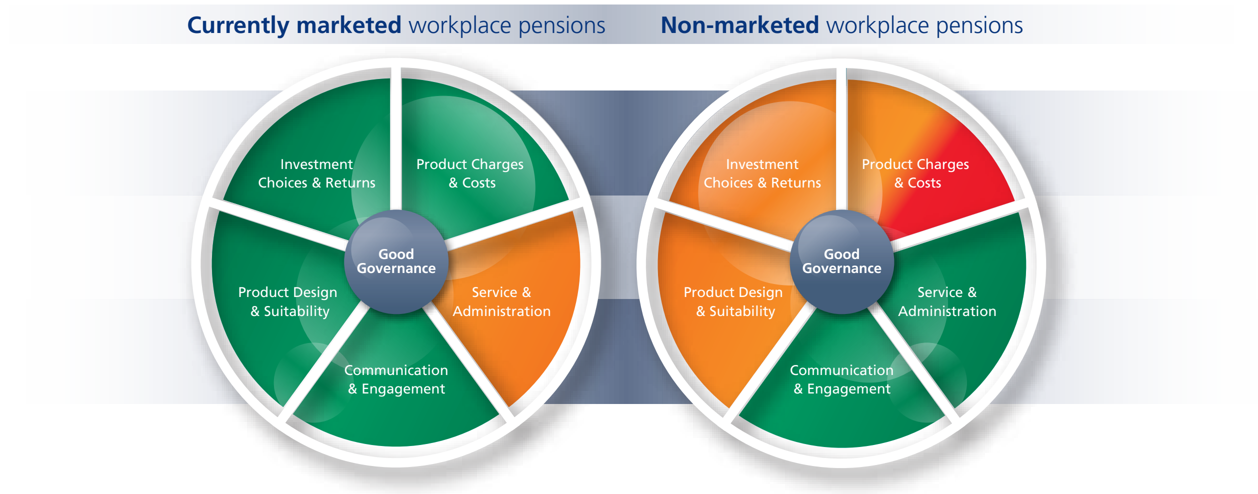
We assess both of these products separately and make the differences in our assessment clear to you. Most of you (over 90%) will be members of currently marketed products.

VfM assessment

It is the Committee's view that the vast majority of customers are receiving Value for Money. More needs to be done to ensure that customers in older products are not left behind.

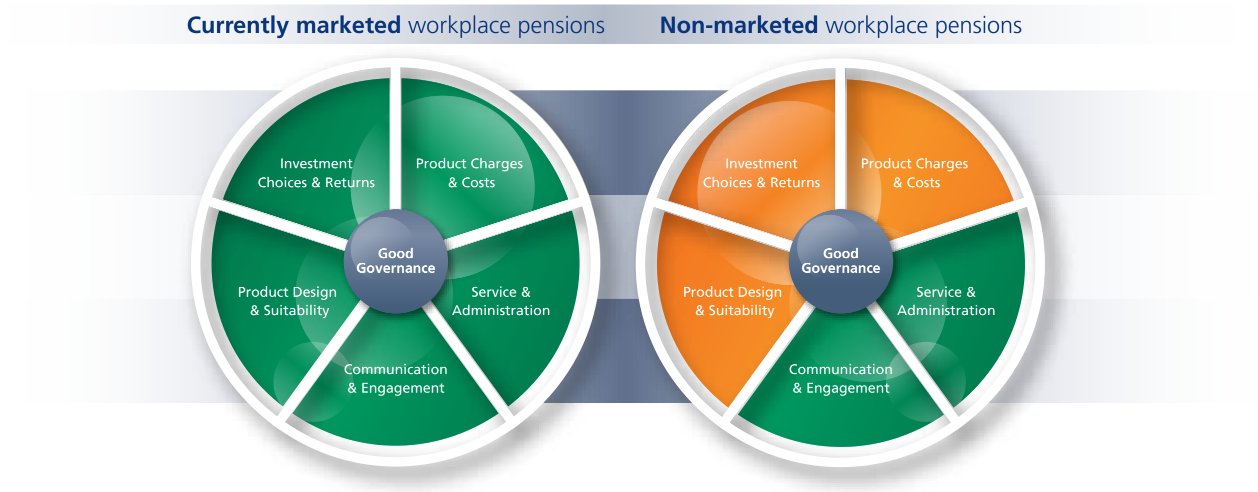
Last year’s assessment

Last year, our assessment looked like this:



This year’s assessment

This year, we have seen a couple of areas improve. Service under the currently marketed products has improved to “green”, and charges under the non-marketed products have improved to “amber”. This is pleasing. Our focus, going forward, will remain on helping to improve the experience for more members in older products.



Assessed as good – no areas of significant concern identified

Assessed as fair – some areas of concern identified, with action being taken

Assessed as poor – some areas of concern identified with actions not agreed or agreed but not yet delivered

Product charges and costs

We appreciate that Value for Money is not simply about the charges you pay to Aviva, but they are important. The charge you do pay each year is an amount of money which is then not available for investment. This is called a "Reduction in Yield", or RIY. The higher the charge you pay, the bigger the RIY, and so the bigger the impact on the size of your fund at retirement.

The following graph shows the impact of higher charges on a pension fund for two different members. It shows the value of their retirement pots based on various levels of monthly savings. The assumptions we have used are:

- both members are aged 40
- both are due to retire at age 65
- both members start with a pension fund of £20,000
- their investments grows at 4% per year

Source: Aviva

There are many factors which impact the return on your investment. For example, if you are paying 1% in charges each year and see your investments grow at a higher rate than someone paying a 0.5% charge, then that will go some way to offset the higher charge. The graph is for illustrative purposes only. It does, however, demonstrate the effect of charges.

We assess charges and costs to make sure that they are:

- Clear and fair;
- In line with market expectations; and
- Compliant with pension regulations.

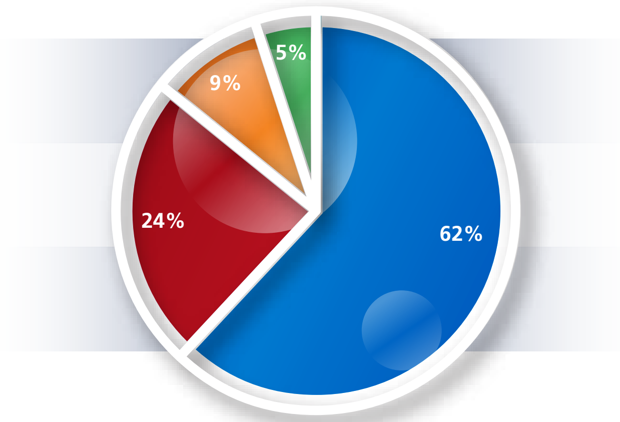
Aviva's currently marketed workplace pensions benefit from the new auto-enrolment regulations, where the maximum charge you can pay every year is 0.75% of your fund (or 75p for every £100 invested). Non-marketed workplace pensions do not benefit from these rules, and so some members could pay more than 0.75% each year in charges.

Areas we have assessed as good

Reduction in charges for older products – Aviva undertook all of the work they committed to in 2017 to remove charges in older products. This included reducing charges for members in older products to ensure that their RIY does not exceed 1% per year. 100,000 scheme leavers were reviewed in 2017, and many customers benefitted from a range of measures, mainly the removal of monthly policy fees where these were present. Other members could benefit from loyalty bonuses should they pay contributions continuously up to their selected retirement age. Aviva will re-assess these members should they leave Aviva to ensure that they are reimbursed for any charges they have paid above 1% at the point they leave or stop paying contributions. We receive regular updates to check that this process is working and we can confirm that we are satisfied with the situation as it stands. We will continue to monitor work in this area.

Since 2015 over 230,000 workplace pension policies have been reviewed (including the 100,000 policies reviewed in 2017) and the actions taken are shown below.

Workplace pensions reviewed



- No action required – charges were already at or below 1% per year
- Monthly or yearly policy fees have been removed to reduces charges to a maximum of 1%
- Policy fees have been removed, but will be reviewed on exit to ensure charges do not exceed 1%
- Currently paying less than 1%, but will be reviewed on exit to ensure charges do not exceed 1%

Source: Aviva

Charge cap – Many members pay charges in modern products well below the charge cap of 0.75% per year. All members are monitored by Aviva on a quarterly basis to ensure that their charge level has not increased above 0.75%. The cause of this might be an administration error, or an increase in the cost of their selected default investment. If an error has occurred, members are compensated in full and are put back into the position they would have been in had the error not occurred. We reviewed Aviva's process and safeguards around this area (together with sample tests) and are satisfied that this process is working effectively and that it creates a suitable safeguard for members. In 2017, Aviva compensated members in a number of schemes where the 0.75% charge cap had been exceeded.

Areas which require further attention

We have challenged Aviva to look at three key areas where we feel more should be done to benefit members who are in non-marketed workplace pension products:

Higher charging units – these units, sometimes called "Capital" or "Initial" units were commonplace in the pensions industry before 2001. They were designed to recoup charges such as the commission payments made to financial advisers. We do not believe these units should continue to be used and have asked Aviva to consider removing them.

Exit Charges – the presence of these "Capital" or "Initial" units also has an impact on the level of charge a member pays on transferring his pension away from Aviva early. We note that this early exit charge has been capped at 1% for members aged over 55 as required by regulations. However, members under the age of 55 receive no such protection, and we have asked Aviva to also consider extending their 1% cap to all members.

Commission – financial advisers are no longer allowed to receive commission payments from pension providers when auto-enrolling members into workplace pension schemes. Aviva's currently marketed products are therefore free of any commission payments. This rule, however, does not apply to members in older products not being used for auto-enrolment, and Aviva continues to pay commission on a "renewal" basis for some older products. Aviva is taking steps to establish if customers have an active relationship with a financial adviser or not. Where they do not, we have asked them to consider stopping paying commission and look to pass that saving back to customers.

We are conscious that some other providers have already taken steps to make these changes, and have asked that Aviva move quickly to conclude their investigation and confirm their proposed actions.

Service and administration

In our 2017 report, we mentioned that some members had received a very poor service experience following a transfer of the administration of their pensions to a new computer system. This issue was resolved and it is pleasing to report that service levels have been restored.

When assessing the quality of service and administration Aviva provides you, we consider:

- The feedback Aviva receives from you;
- Aviva's delivery against their key service measures; and
- What they are doing, or have done, to improve the service you receive

Overall, we have assessed service and administration as good, and have seen a number of improvements this year. This includes feedback from you about the service you receive from Aviva and the improvements they have made in the way they deal with your queries and requests for information.

Areas we have assessed as good

Client satisfaction – One of the ways Aviva measures how happy you are with the service is by asking you when you contact Aviva how they performed in areas such as service and "getting it right first time." Aviva has seen a marked improvement in customer satisfaction scores in 2017 compared to 2016 which is good news. It is also pleasing to see that they are not taking this improvement for granted and are implementing some further changes as to how they serve customers.

Service delivery – In September, we held one of our IGC meetings at Aviva's Sheffield office which looks after the servicing of around one million workplace pension customers. We were given a tour of the new business, servicing and specialist teams, and we walked through the changes being put in place to handle customer demands. Aviva staff now go through a period of accreditation to ensure they only receive items of work which they can handle without the need for referral to another team. This "One and Done" approach has led to a marked improvement, not only in the time taken to answer your query, but also in the quality of the response you receive. A good example of this is the pack they send you when you ask for full details about your policy which they have reduced from 22 pages to just 6. This makes it simpler for you to understand and deal with Aviva.

The changes in Sheffield, and the notable success in working this way, are now being rolled out across the rest of Aviva's workplace pension servicing areas. We look forward to seeing similar improvements in service delivery for all workplace pension customers.

Service Controls – In March, Aviva issued their first "AAF 01/06" report – an independent validation of their administration and IT controls. It is designed to give confidence that Aviva has in place a robust framework of controls to ensure they are getting things right. Aviva has shared this report with us. It includes controls around important areas such as safeguarding your money, making sure financial transactions are processed promptly and accurately, and that your details (the information Aviva holds about you) are kept safe and secure.

We see this as a very positive step and were pleased to note that the report had no adverse findings. This exercise will be undertaken again in 2018, and will give us more insight into how Aviva has performed in key areas of servicing and administration.

Areas which require further attention

Client satisfaction measures are a good way for Aviva to show us that you are happy with the service you receive. We want to see these scores continue to improve. The improvements Aviva has made are good, but we do not see this as an end point. The changes being made across all areas of the business will be reviewed this year to ensure that improvements can be seen by all customers.

Since the acquisition of Friends Life by Aviva, we have been reviewing the information we need to assess VfM. It has often been difficult to assess, because the information has not been in a consistent format across the various areas of the business where workplace pensions are administered. Aviva has shown us their plans for providing the IGC with consistent management information and we hope to see a significant improvement in the reports we receive this year.

Communication and engagement

Clear communication is key to making sure you understand how your pension is working, how you can improve your retirement outcomes, and what options are available to you. Too much information can be daunting, too little can leave you uninformed and complicated language can create confusion and disengagement. Getting the balance right is important.

Last year, we said we wanted to see the information Aviva gives you turn into engagement. We also said we wanted to see jargon reduced in the communications they send to you. Aviva has put in place a communication and engagement programme which they hope will lead to members taking more interest in their retirement planning. We shall see over time if this indeed has had the beneficial effect intended.

Items we have assessed as good

Communication improvements – Aviva is improving the communications they send to you, both paper and electronic. This follows feedback from you telling Aviva that documents are too long, and too complicated. Aviva will make their documents clearer and easier for you to understand. We have attended some of the customer listening sessions which Aviva uses to engage with customers on changes and improvements to their documents, and it was encouraging to note that customers found the new documents, particularly annual statements, much clearer and more useful than the previous versions. Improving these annual statements should help you understand more about the value of your pension and the charges you pay.

Pensions are a complicated area, and we believe that anything Aviva can do to make their communications simpler and easier to understand can only be a good thing.

Aviva is trialling a number of electronic communications including the use of videos. They are also improving their online tools so you will be able to view and manage your workplace pension online. We will be continuing to assess communications in 2018 including how electronic communications are being used.

Understanding the views of leavers – Aviva commissioned research into the views of people who have changed employment. They were keen to understand what these customers felt happened to their pension savings when they changed jobs. The views expressed were quite worrying. Some members believe that when they leave their employer, their pension is lost, and all of the money goes back to their employer. Others were concerned about the lack of information given to them about the options available to them when they changed jobs.

As a result of this research, Aviva will be delivering a number of solutions to help you understand more. These include:

- An online app which will help you decide if moving your pension is the right thing to do;
- Rewarding you if you continue to pay into your pension when you change jobs;
- Providing you with tools which help you understand if you are on track to meet your retirement goals;
- Help in moving all of your pensions into one place to make it easier for you to keep track of your retirement savings.

We will be monitoring these developments to ensure that they are providing leavers with clear and appropriate information about their workplace pension.

Understanding the views of employers – while we act only in the interest of members, we believe that employers can also play an important part in educating their employees. Last year, we invited one of Aviva's largest employer clients to meet with some members of the IGC and discuss member engagement. It was helpful to understand how some large employers engage with their staff to encourage them to take a more active interest in their pension. By doing this the employer had seen a significant increase in the number of their staff making higher contributions into their pension thus improving the chances of a better member outcome in retirement.

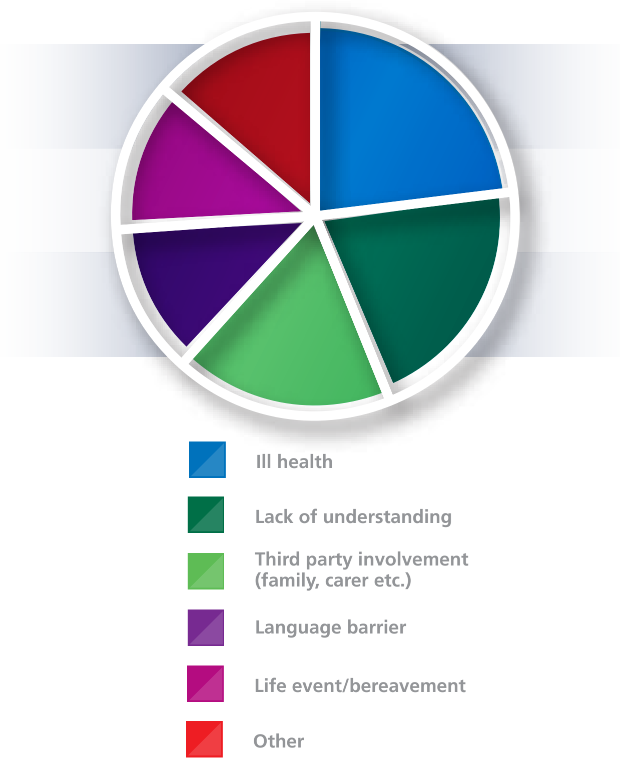
Employer forums – Aviva invited the IGC to attend their employer forums where we spoke to more employers about what we do, and shared more ideas about engagement. This provided the IGC with a very useful opportunity to hear first-hand any challenges or concerns some employers were experiencing. We will continue to attend these forums as we see it as an excellent opportunity for us to hear your views through the voice of your employer.

Aviva's advice service – In 2017, we invited Aviva's Client Advice Director to one of our meetings to tell us about their new advice service. Aviva is not the only provider to offer this service, but we see it as important that you have access to advice. Initially, the service can offer you advice at retirement, but there are plans to expand this to offer all customers advice throughout the life of their pension. We assessed the level of charges which Aviva has set for this service and it compares favourably against other providers. It is available to both existing Aviva customers and those customers considering a move to Aviva.

The service has proved popular, with over 2,000 customers contacting Aviva for advice. The number of advisers has increased to almost 100 in the last 12 months. The IGC members agreed that this was a positive proposition and have included it in their 2018 business plan to receive further updates.

Vulnerable customers – There are a number of reasons why a customer might be considered "vulnerable". A selection of these is shown below, and this represents the proportion of customers in the various groups who have contacted Aviva for help.

Vulnerable customers



Source: Aviva

Aviva has in place a good vulnerable customer policy and customer facing staff have been trained in how to recognise and respond to vulnerable customers. We have been provided with examples of how the policy is put into practice. We also noted that staff are encouraged to share their experiences to help continuously improve the policy.

Examples we have seen where customers have been supported include:

- Staff calling in emergency services where they feel there is a genuine risk to the wellbeing of the customer;
- Using "text speak" technology to support customers who are hard of hearing;
- Referring customers to charitable organisations in times of hardship.

We are pleased to see that Aviva is taking the needs of their vulnerable customers seriously. We see their work in this area as a real positive, and fully endorse it. We will continue to monitor their approach to ensure all customers receive the appropriate help when most needed.

Areas which require further attention

Communications – improving communications for members is clearly an important step in helping them understand their pension. We would like to see continued improvements in this area and more access to customer testing. Understanding what you think about the information being sent to you is important.

While mostly positive, the feedback Aviva received from you shows some areas where further improvement can be made. The use of larger fonts to highlight key messages, and clearer information about investment choices are a couple of areas where you have told Aviva they could do better. We shall continue to monitor the position to see how this feedback is factored into future improvement programmes.

We are advised that work is underway to improve communications to make them most appropriate for customers' needs, including braille and audio.

Direct member engagement – Aviva has three million workplace pension customers. It is impossible for us to speak individually with all of you. We will be considering further over the next 12 months how our thoughts can reach more of you.

Product design and suitability

The options you have when you take your benefits at retirement have changed considerably over the last few years. Previously you had little choice and had to take part of your fund as cash with the rest going to buy you an annuity. The government has now introduced "pension freedoms" which give you a range of more flexible options. Now, you have the choice to take an annuity, take all or part of your fund as cash, or to use flexible drawdown where you can take cash and an income when you want, rather than as a set monthly amount.

What Pension Freedoms mean for you

There are six ways you can take your defined contribution pension pot.

Leave your whole pot untouched	You don't have to start taking money from your pension pot when you reach your "selected retirement age" You can leave your money invested in your pot until you need it.
Guaranteed income (annuity)	You use your pot to buy an insurance policy that guarantees you an income for the rest of your life – no matter how long you live.
Adjustable income	Your pot is invested to give you a regular income. You decide how much to take out and when, and how long you want it to last.
Take cash in chunks	You can take smaller sums of money from your pot until you run out. Your 25% tax-free amount isn't paid in one lump sum – you get it over time.
Take your whole pot in one go	You can cash in your entire pot – 25% is tax free, the rest is taxable.
Mix your options	You can mix different options. Usually, you would need a bigger pot to do this.

Source: Pension wise https://www.pensionwise.gov.uk/en/pension-pot-options
https://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/

Areas we have assessed as good

Pension freedoms in currently marked workplace pensions – industry research has shown that the drawdown option is proving to be the preferred choice for most people taking their retirement benefits. Aviva has made this option available to all customers in currently marketed products along with the full range of alternative options.

Product governance – Aviva operates a robust Product Governance framework whereby all products, whether pension, protection or investment products, are assessed for suitability and value for money. We have been shown how this process works across Aviva, and are comfortable that the process provides an extra layer of protection to all customers when looking at product features and suitability. Where workplace pensions in particular are reviewed, we have asked Aviva to share findings, and should issues be identified which could affect you, we will ensure Aviva has a clear plan in place to resolve these.

Areas which require further attention

Pension freedoms in non-marketed workplace pensions – there remains a large group of customers who do not have access to the flexibility offered by recent pension freedoms.

This means that some of Aviva's workplace pension customers do not have access to a cash lump sum or flexible drawdown, and remain in products which essentially target an annuity at retirement. Customers wishing to access their pension in a more flexible manner would currently need to transfer to another product or provider, which could lead to the loss of any guarantees or bonuses which their Aviva pension gives them.

Aviva recognises that this is not an attractive option, and is working to make things better. In 2018 a number of customers will benefit from a change in their funds which will start to target a drawdown investment product rather than an annuity. They are also making the modern range of default funds available to more customers to ensure they have the same options at retirement as members in modern workplace pensions. This is a welcome development, but still leaves some customers without access to pensions freedoms and we have asked Aviva to address this.

Choice of investment funds – many members in older products do not benefit from any form of Lifestyle fund. A Lifestyle fund aims to provide you with growth in your investment in the earlier years, and will move your funds into "safer" investments as you approach your retirement date. This is called "de-risking." The IGC has set Aviva a challenge this year to come up with ways of ensuring all customers can be given suitable investment options including access to a lifestyle fund. This might be by way of a transfer to another product or a change to their existing product.

Investment choices and returns

The return on your investments is one of the most important considerations for you based on research conducted last year. We are pleased that both of Aviva's default funds have seen another year of growth in 2017, and the details are shown below.

While many of you will be invested in your employer's default fund, this might not be Aviva's standard default fund. It might be one chosen by your employer, or one which their adviser has designed for you. You can also choose to invest in a number of other funds which Aviva makes available to you. We receive regular updates from Aviva's investment team who tell us about the work they do to ensure that whichever funds you choose, they are subject to the same governance standards as Aviva's own funds.

Areas we have assessed as good

New Aviva default funds – if you are invested in either the "My Future" or "Future Focus" Aviva default funds chosen by your employer, you are likely to see changes this year. Aviva is redesigning these default funds for all of its workplace customers.

The asset allocation during the "growth" phase of the fund will continue to target a defined level of volatility (see below). This seeks to maximise growth while limiting risk. Aviva has agreed the revised mix of assets in the fund. They have increased the share of equities from 67% to 88%, and reduced the gilt and bond exposure to 12%. This is expected to achieve a superior growth while still meeting the risk tolerances.

The new default will also allow you to choose an option when you are closer to retirement to target either an annuity, drawdown or cash lump sum.

Whichever option you choose, at your retirement date the exposure to equities is reduced as follows:

- The "universal" option (the fund you will invest in until your retirement age if you do not choose an annuity, cash or drawdown) will give you a final asset allocation of 25% equities and 75% bonds (gilts and corporate bonds);
- If you choose to target an annuity, you will be moved into the new annuity fund which looks to track annuity prices;
- Should you choose to target withdrawing your pension savings as cash, your assets will be moved into funds which look to preserve the value of your pension against the impact of market falls and inflation;
- The drawdown option will give you an allocation at retirement of 60% equities and 40% bonds.

Aviva has chosen BlackRock to manage the new default funds with the exception of the annuity fund. The transition is expected to take place in mid-2018.

Target Volatility

Volatility is the risk that your investment will fluctuate in value. An investment which has high levels of volatility will fluctuate more in value than an investment with low levels of volatility. Investments with high volatility are typically said to offer higher levels of return over the long-term. The default solutions offered by Aviva are designed to try and manage the level of volatility experienced by your investment, while seeking to maximise the level of return generated.

We have reviewed the investment solution Aviva is proposing and their analysis and proposed changes make sense to us.

Adviser designed default funds – not all of you will be invested in Aviva's own funds. Some of you will be in funds which your employer's adviser has designed. We were keen to understand how advisers designed their defaults, and how they ensured they were appropriate for members. Last year, we invited one of the largest advisers to speak to us about their investment governance. It was pleasing to note that the good investment governance we see at Aviva is also put into practice by that particular adviser.

Adviser designed defaults require approval from Aviva before implementation. In 2017, Aviva added 86 adviser or employer designed defaults. Many of these were added to give members access to the pension freedom options, and replaced older funds targeting an annuity.

When considering the suitability of these funds, Aviva's governance review specifically covers:

- Whether any of the funds proposed for use within the default are:
  - on the Aviva watchlist of funds where performance or management is a concern
  - subject to an outstanding fund event or corporate action
  - pending removal
  - With Profits funds, as these cannot be used
- Whether the suggested name of the default strategy provides a fair reflection of its risk/reward profile and uses terminology appropriate for the scheme members.
- The number of funds within any one stage. Further rationale is sought from the adviser for any proposals including more than five funds in any phase, as this may be deemed too complex.

- Whether the default is compliant with the regulatory charge cap.
- Whether the approach includes at least one growth phase and at least one de-risking/consolidation phase.
- Whether the de-risking/consolidation phase features a smooth glide path aiming to either reduce volatility or help preserve the level of income in the run-up to retirement.

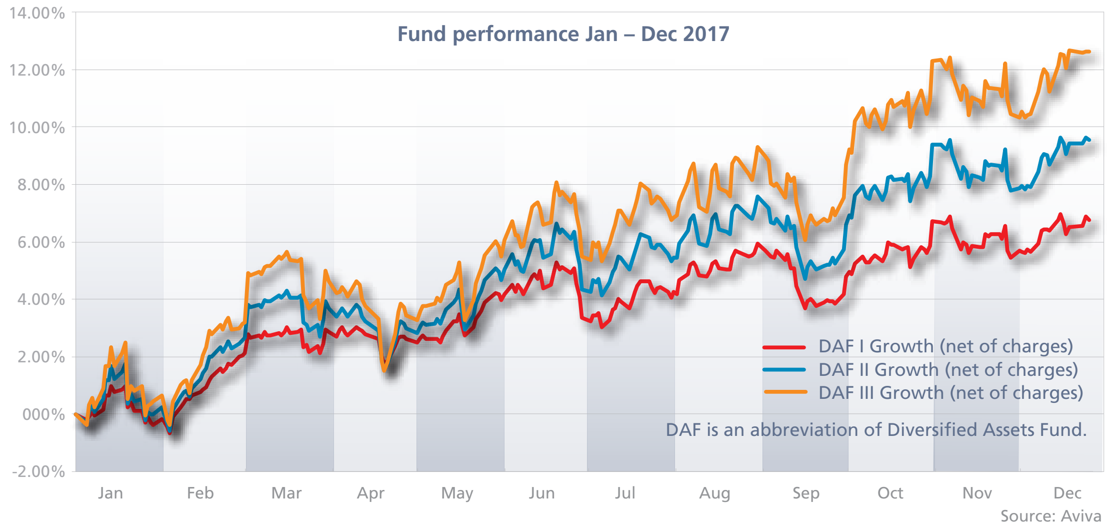
Once an adviser-created default has been accepted and implemented, Aviva will undertake a governance review at least once every two years.

Investment Governance – We are regularly informed of how Aviva monitors the range of investments they make available to you. This includes understanding what they do when funds are not performing as they should, and the actions they take as a result of this. In 2017 they removed 54 funds from their investment range where they failed their governance checks. If you were invested in one of these funds, you will have had your savings moved to a fund Aviva felt matched the objective of the old fund. You will have been informed about this change.

Investment Returns – graphs A and B below show the investment performance of the Aviva default funds – Future Focus and My Future – over the 12 months to 31 December 2017.

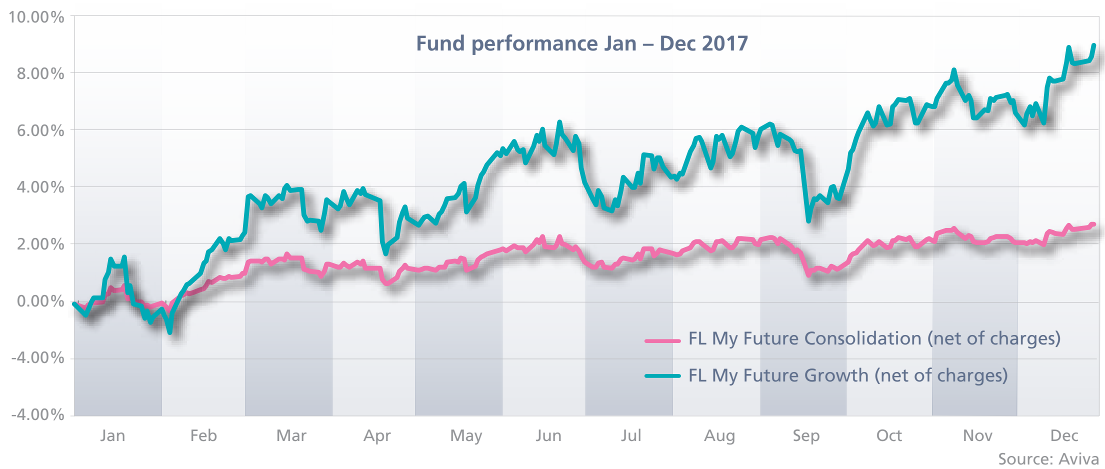
When looking at any of the graphs included in this report please be aware that past performance is not a guide to future performance. The value of the fund is not guaranteed and may fall as well as rise. You may not get back the original amount invested.

Graph A – Fund performance of the main funds used in the Future Focus Default fund

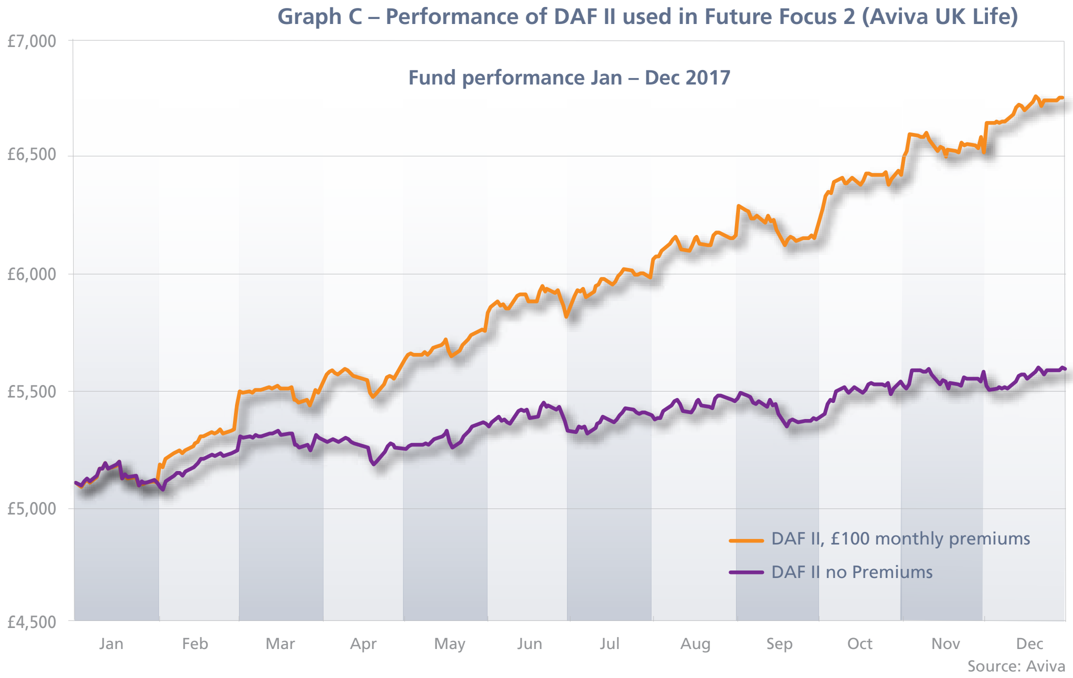


The above graph shows the annual performance of the DAF funds listed in the key for the period 01/01/2017 to 31/12/2017. The performance quoted is an illustration of the fund performance with a scheme charge of 0.6% applied (the average charge for members investing in this fund). Please be aware that past performance is not a guide to future returns..

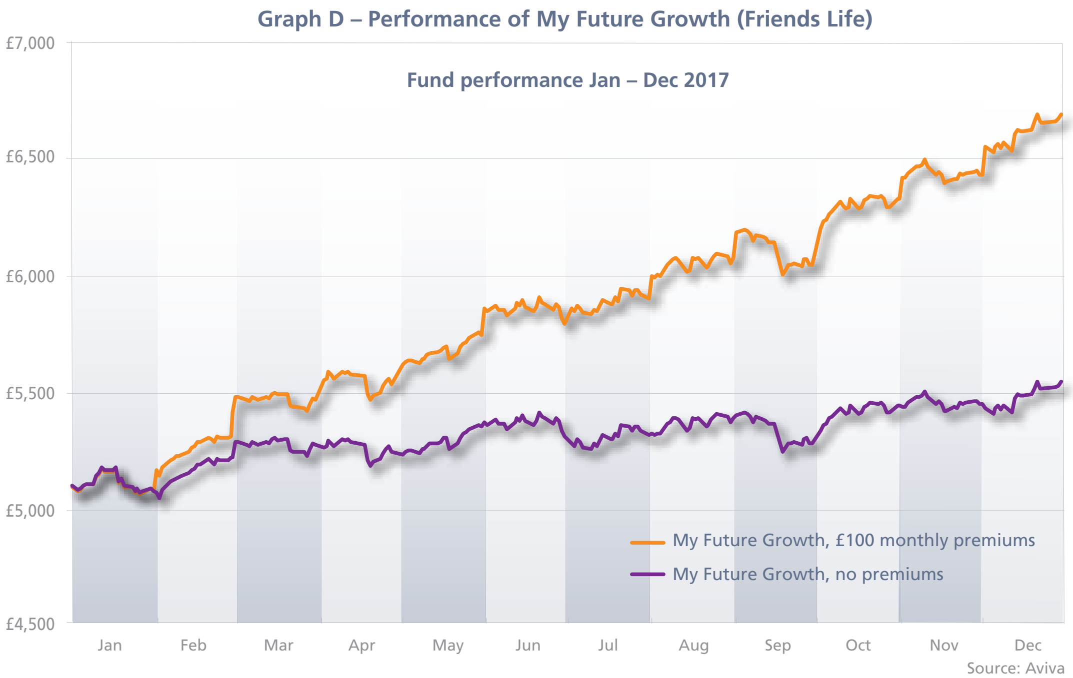
Graph B – Fund performance of the main funds used in the My Future Default Fund



The above graph shows the annual performance of the My Future funds listed in the key for the period 01/01/2017 to 31/12/2017. The performance quoted is an illustration of the fund performance with a scheme charge of 0.4% applied (the average charge for members investing in this fund). Please be aware that past performance is not a guide to future returns.



So, if you started the year with a fund of £5,100 invested in DAF II, and paid no premiums in 2017, your fund value would be £5588 after charges (9.57% growth in the year).



If you paid no premiums in 2017 and were invested in My Future Growth at the start of the year, your £5,100 would be worth £5,550 after charges (8.84% growth in the year).

Of course, many of you will not be invested in Aviva's defaults. Below is the performance figures for the top ten funds for workplace pension customers by the size of assets held.

To 31 December 2017	1 year	3 year annualised	5 year annualised
Av Balanced Index Fund Of Funds	9.6%	10.3%	10.1%
Av BlackRock (50:50) Global Equity Index Tracker	14.1%	12.9%	12.8%
Av BlackRock (60:40) Global Equity Index Tracker	13.6%	12.3%	12.2%
Av Managed	10.8%	7.9%	9.1%
Aviva Mixed Investment (0-35% Shares)	6.2%	6.7%	7.1%
Aviva Mixed Investment (20-60% Shares)	8.4%	8.0%	8.3%
Aviva Mixed Investment (40-85% Shares)	10.8%	10.0%	10.3%
Aviva UK Equity	12.9%	9.2%	10.1%
Av BlackRock Consensus	9.1%	10.5%	10.7%
Aviva Global Equity	12.9%	13.6%	14.0%

Environmental, Social & Governance factors (ESG) – We understand that Value for Money may have wider implications for many scheme members. ESG measures the non-financial or sustainability impact of investments in a company or a business. Aviva takes this very seriously, and believes that they have a role to play in both influencing those companies, and protecting customers' long term savings leading to better financial outcomes at retirement. We have seen evidence of their work in areas such as climate risk. This includes investments by Aviva Investors in sustainable energy such as wind, solar and biomass energy, and active engagement and voting; over the last year they advise that they have voted for 52.3% of resolutions on climate change. We welcome the fact that management of the Stewardship funds have been brought in-house and will be available to schemes as an option. Aviva currently holds around £4bn of assets on behalf of all of their customers in ethical/sustainability funds.

Over the last year, we have also been aware of the increased external interest on ESG issues from regulators and policymakers and how these are reflected in pension investment strategies. The Law Commission, European Commission Action Plan on Sustainable Finance, Pensions Lifetimes Saving Association, the Environmental Audit Committee and the FCA have held discussions, carried out surveys and created recommendations in this area, many of which Aviva has contributed to.

Following the Government's and FCA's published response to the Law Commissions recommendations in the summer, we will discuss the implications with Aviva in our future meetings.

In 2017 Aviva, in its role as a pension provider, was contacted along with 11 other pension providers by ClientEarth – a non-profit environmental law firm with a particular interest in the physical and financial implications of climate change. A copy of their letter was sent to the IGC and we were subsequently invited to meet with them and Aviva to discuss their concerns. These centred on the work Aviva is doing in workplace pensions to consider sustainable investments for workplace pension customers.

Aviva regularly commissions Consumer Attitude surveys from IPSOS MORI (one of the largest independent market research organisations in the UK). In the November 2017 survey of 1,000 adults from the UK they found that:

- **31%** of those surveyed advised that it is important to them that their pension money is invested in projects that will help build a better future
- **45%** advised that they would like their pension provider to inform them on where their money goes/ is invested
- **34%** said it is important to them that the company they purchase products from/invest money in has a strong social purpose:

We will use this and other results to build a picture, monitor and help inform the pace and focus of our work going forward.

Last year Aviva decided to divest from tobacco manufacturing companies. The scope chosen was in respect of where they do not want to take active positions on their own account as they felt that holding investments in tobacco stocks was inconsistent with their product offering as a health insurer. We have engaged with the team within Aviva regarding this debate, and ultimately it was decided that this should not be applied to the auto-enrolment pension funds. As a Committee we intend to keep this, and indeed any other ESG related exclusions, under review as surveys would indicate that customers consider them important.

Aviva has sought to engage with workplace pension employers, and held their first Thought Leadership lunch on "Creating a Sustainable Future" in January 2018. The 17 companies represented at the meeting have over 85,000 workplace pension members and assets under management of over £1.4 bn. The discussion generated a great deal of interest and similar events are being planned. We will be watching this with interest and look to see how Aviva incorporate such feedback into their product designs going forward.

Areas which require further attention

Investment transaction costs – Transaction Costs is the term used to describe a number of costs, such as buying and selling shares, which you can incur when you invest in a fund or funds. These costs are important because they impact the overall return you receive on your investment.

As mentioned in last year's report the Financial Conduct Authority (FCA) was undertaking a consultation exercise on the most appropriate way of making this information available. Towards the end of last year the FCA published the conclusions of this exercise. They have confirmed the way in which these transaction costs should be calculated and placed a requirement on pension providers to disclose these from 2018 onwards.

We have asked Aviva how they are progressing in implementing these new transaction cost reporting requirements.

They have confirmed that they've engaged with fund managers to understand their plans to provide Aviva with the information required to enable them to do the calculations. They have also confirmed that a solution is in place to enable them to collect and eventually provide us with transaction costs in line with the methodology as set out by the FCA. We hope that the transaction costs information based on the new FCA methodology will be available from the second quarter of 2018 onwards.

As a result we have asked Aviva to provide us with an estimate of the transaction costs which apply to their most commonly used default funds, or the funds used in their defaults. These costs are shown below and are based on figures provided to Aviva by the fund managers. The transaction costs shown are a combination of explicit and implicit costs. The explicit costs include transaction commissions (e.g. commission paid to an equity broker – an institution that facilitates the buying and selling of equities or shares) and transaction taxes (e.g. stamp duty reserve tax – a tax that is payable when buying the shares of companies listed in the UK) that were charged to each fund. Other costs are estimated figures, based on the asset classes used within each of the funds. These estimates are derived from trade cost analysis figures provided by third party providers. The calculation method used does not reflect the method introduced by the FCA.

Fund	Transaction Costs
Diversified Assets Fund I	0.04%
Diversified Assets Fund II	0.05%
Diversified Assets Fund III	0.05%

Fund	Transaction Costs
My Future Growth	0.01%
My Future Consolidation	0.01%
My Future Annuity	0.01%
My Future Drawdown	0.02%
My Future Cash Lump Sum	0.02%

Source: Aviva.

The estimated transaction costs for the Diversified Assets funds are for the period 1st January to 31st December 2016.

The estimated transaction costs for the My Future funds are for the period 1st January to 31st December 2017.

This means that, if you are investing in DAF II, you will have paid 4p per year in transaction costs for every £100 you have invested. Furthermore it is worth noting that these transaction costs are already deducted from the performance figures described earlier.

We have asked Aviva to re-calculate these costs using the FCA methodology from the second quarter of 2018 onwards.

Industry benchmarking

Along with a selection of other providers, Aviva, with full support of the IGC, participated in an exercise to compare certain VfM attributes of their workplace pensions. The benchmarking was undertaken by Redington Limited, who are a firm of independent consultants.

All the key areas of our VfM framework were considered as part of the exercise. At this stage quantitative rather than qualitative factors were considered (so for example the length of communications rather than the quality of the content).

The research shows that Aviva is performing well when compared to a number of its peers in some of the key areas of VfM which we monitor. It is fair to say that there is room for improvement in some other areas, although the research was undertaken at a point before many of the service and communication improvements mentioned in this report were put in place.

We have not had time to fully consider whether Aviva needs to take any further action as a result of the report. When we do consider the findings more fully, we may identify areas where we think they could or should improve. If that is the case we will ask Aviva and provide an update in future reports.

We are grateful to Redington for taking the time to run through the results of this exercise with us. We believe that having a comparison against other providers is a valuable way of assessing VfM.

Priorities for 2018

Members in modern products (those used to support auto-enrolment) are receiving Value for Money. Charges within these products are protected by the regulatory charge cap of 0.75%, and indeed many members are being charged less than this. In addition, the options available to them at retirement ensure they have full access to pension freedoms.

Members in older products have seen improvements in 2017. However there remain features which lead to higher charges being applied to some of these older products, and we have asked Aviva to address this.

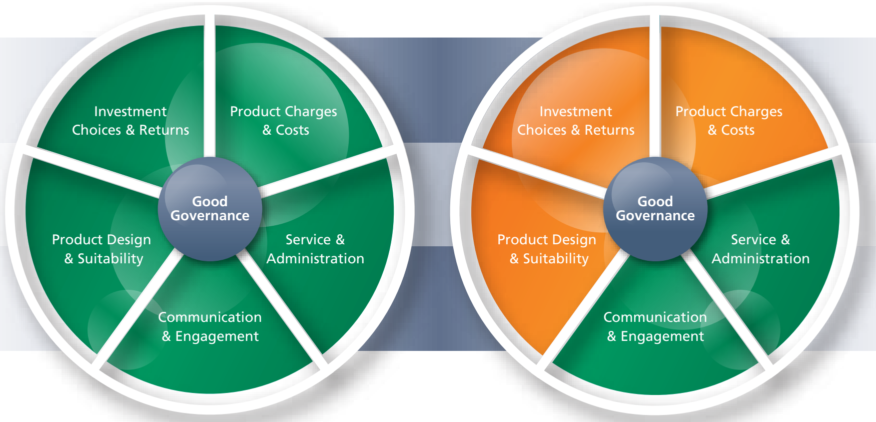
We have highlighted in this report some of the areas where the IGC want to see progress from Aviva in the next 12 months. These include

- **A review of commission being paid to advisers** from older workplace pension products not being used for auto-enrolment.
- **A review of members invested in higher charging "Capital" or "Initial" units.**
- **A review of exit charges** to establish if the 1% cap for over 55s only is fair to under 55s and to those who do not exit.
- **Implementation of the new default fund** and a move to this fund for members in higher charging funds, taking into account Aviva's commitment to put impacted members into the position they would have been had the exercise been completed on schedule.
- **The availability of Pension Freedoms** and a review of those members in older products who do not have access to these options in retirement including those members with no Lifestyle option.
- **Disclosure of transaction costs** and confirmation from Aviva that the new regulations around the disclosure of transaction costs have been fully implemented, and that we will be able to report more fully on this.

In our next report, we will tell you how Aviva has progressed in all of these areas.

Overall summary and conclusions

Overall it is the Committee's view that the vast majority of customers are receiving Value for Money. More needs to be done to ensure that customers in older products are not left behind.



Assessed as good – no areas of significant concern identified

Assessed as fair – some areas of concern identified, with action being taken

Assessed as poor – some areas of concern identified with actions not agreed or agreed but not yet delivered

This year, we have seen a couple of areas improve. Service under the currently marketed products has improved to "green", and charges under the non-marketed products have improved to "amber". This is pleasing. Our focus, going forward, will remain on helping to improve the experience for more members in older products.

While we were disappointed that some of our initiatives were delayed by the regulatory process of the merger of Aviva and Friends Life, we are encouraged that Aviva is now focussed on delivering these changes in 2018.

We have set Aviva a number of challenges this year, and hope to see further improvements in a number of areas to ensure you continue to receive VfM.

Your views

We would very much like to hear your views, thoughts or concerns. You can contact us to tell us what you think about the pension you have with Aviva, whether you think you are getting value for money, or simply to talk to us about the work we do. We are here to act in your interests, and welcome any feedback you have. You can contact us at IGC@aviva.com. This mailbox is permanently monitored, and we will reply to any of your questions. Your contact with us will be treated in the strictest of confidence.

About the IGC

The purpose of the Independent Governance Committee

Simply put the purpose of the Committee is to:

- Create a strong voice to act solely in the interests of scheme members
- Provide independent challenge to, and oversight of Aviva, in respect of their workplace pensions
- Assess the ongoing value for money provided by workplace pension policies
- Publish an annual report of our work for the year
- Act on any concerns relating to value for money

Acting solely in your interests

The IGC was designed to be independent of the workplace pensions provider (Aviva in this case). We have powers and processes in place to ensure this:

- Clear and public Terms of Reference for the committee requiring us to act solely in the interests of scheme members.
- A committee composed of a majority of independent members.
- Independent members who are not remunerated or incentivised to act other than impartially.
- A requirement to monitor and report any conflicts of interest.
- The power to escalate matters to the Board of Aviva Life and Pensions UK Limited, if required.
- The power to escalate and report matters directly to the Financial Conduct Authority, if required.
- An Annual report summarising our work and judgements.

How the Committee is, and remains, independent of Aviva

The IGC consists of five members with the majority, including myself as Chair, being independent of Aviva. I'm satisfied we fulfil the definition of being independent as specified by the Financial Conduct Authority and I confirm that I, and my fellow independent members:

- Are not currently employees of Aviva and are not paid for other roles in the Company
- Have not been employees of Aviva within the previous five years
- Have not had a material business relationship with Aviva within the previous five years

The committee structure

Inderpreet S Dhingra (Independent Chair) – Inder is a non-executive director, independent pension trustee and an experienced senior executive from the financial services industry. He serves as director of Law Debenture, representing them on the trustee boards of a number of large pension schemes including as chair of investment committees. His expertise includes strong governance, investment strategy and risk management across both DB and DC schemes.

Inder's career has spanned financial services, business, academia and engineering. Before joining Law Debenture he spent two decades working in banking covering treasury, finance, risk management, pensions and insurance. His last role at Lloyds Banking Group was as Senior Executive with group-wide responsibility for market and liquidity risk and prior to that as Managing Director at Nomura International plc.

Inder lives in Surrey with his wife and four children. He is on the Boards of two charities and also helps look after his elderly parents. When time permits he likes to dabble in psychology with a particular interest in communications and decision making.

Steve Carrodus (Independent member) – Steve is a Client Director with PTL Governance Ltd. He has over 40 years' experience dealing with employers and trustees in connection with workplace pensions. After 1988 this included advising employers on contract-based pension arrangements. Through his professional trustee role Steve has extensive experience of governance responsibility relating to pensions and has recent experience with DC Master Trusts and one other IGC.

Steve is married and lives in Surrey and enjoys country walks and spending time with his grandchildren.

Marcia Campbell (Independent Member) – Marcia is an independent non-executive director with over 30 years' experience in the financial services industry, with roles covering pensions administration, strategy, IT and operations. She is currently on a range of Financial Services company Boards spanning banking, asset management and insurance. The main part of her executive career was with Standard Life.

Marcia lives in Edinburgh with her family and is actively involved in the local Women in Banking and Finance group, mentoring young executives and small businesses.

Robert Talbut (Independent Member) – Robert served as Executive Director and Chief Investment Officer for Royal London for ten years between 2004 and 2014, developing an investment team which delivered outstanding investment performance during his time there.

He has worked in an executive capacity within the insurance and asset management industries for over 30 years, and has directly managed various client portfolios covering unit trusts, pensions and insurance funds together with overseeing the management of whole asset management businesses. Robert has a particular interest in how investment managers demonstrate added value and also how through good quality corporate governance processes they can hold corporate management to account. For the last few years he has developed a portfolio of non-executive and advisory roles covering asset management, insurance and charities.

Robert is married with four children, two of whom now live away and two who are at university, allowing him more time to enjoy his interests which include travel, most sports and the theatre.

Colin Williams (Aviva appointed member) – Colin has worked in Life and Pensions, predominantly in the Corporate arena for over 20 years. Starting as a graduate at the Pru, he held a number of roles including head of strategy for Corporate Pensions, before leaving to join a small consulting firm at the beginning of the tech boom in the late 1990s. In 2000, he returned to Financial Services with Fidelity Investments to lead their internal management consulting practice working internationally across the business before finally taking a role leading Fidelity International's Defined Contribution pensions business which he did for seven years.

Colin left Fidelity to take a six month career break to sail a yacht across the Atlantic before returning to take a role as Director of Sales & Marketing at AXA UK. After Resolution's purchase of AXA's savings and investments businesses, he took the role of Managing Director Corporate Pensions at Friends Life during which time he served on the Group Executive and the UK Executive. On the sale of Friends Life to Aviva, he continued in the role of MD Workplace Savings and now leads the UK's largest Corporate Pensions business responsible for defining, developing and managing the sales and marketing strategy and creating innovative and market leading propositions to respond to the changing corporate savings market.

Colin lives in a village just outside Oxford with his wife and two daughters.

Jargon buster

Auto-enrolment/Auto-enrolled
Starting from October 2012, all employers were required to offer a workplace pension scheme and automatically enrol eligible workers into it. This is known as auto-enrolment.

Allocation rate
This is a term which describes the amount of your pension contribution invested in to your pension. For example if you pay £100 each month and your allocation rate is 95% this means that £95 is invested in your pension and £5 is taken in charges. The allocation rate you received depends on the age of the pension product you have and how long you have been paying into it. The majority of currently-marketed pensions have allocation rates of 100%.

Charges
Are levied on scheme members with the most common charge often referred to as the "annual management charge" (AMC). This is the price you pay for holding the product and is usually expressed as a % per year. E.g. if you are invested in a fund with an AMC of 0.75% then this means that you'll pay 75p a year for every £100 invested in it. Other types of charges may also apply, especially on older products

Charge cap
Is the maximum charge that can be applied to a default fund. A charge-cap of 0.75% per year was introduced in from April 2015.

Commission
Means payments (sales commission) that are deducted from your pension plan and paid to financial advisers.

Costs
Are typically related to investment related activities carried out by fund managers. These costs are not explicitly levied on you (i.e. they are not included in the AMC) but they are included in the net returns achieved by fund managers.

Customer Satisfaction (CSAT)
This is one of the measures Aviva uses to gauge customer satisfaction. The question used to help determine this is "How satisfied are you with the service you received from Aviva?" The scoring uses a 0-10 scale. All customers scoring between 0-6 are classed as detractors and 7-10 are classed as promoter. The CSAT score is calculated by subtracting detractors from promoters.

Default fund(s)
Scheme members who do not choose a particular investment fund or funds have their money invested in a default fund. The default fund will usually consist of a small number of funds which in combination, are sometimes referred to as a strategy.

Deferred members (scheme leavers, leavers)
This is where a scheme member has left their employer and their pension plan is no longer part of their former employer's workplace pension scheme.

Financial Conduct Authority (FCA)
The FCA regulates financial firms providing services to consumers and maintains the integrity of the UK's financial markets. It focuses on the regulations of conduct by both retail and wholesale financial services firms.

Loyalty Bonuses
These can take many forms and depend on the type of pension you have. Loyalty bonuses are usually paid upon your pension maturity date and provide you with some additional benefit which increases the value of your pension pot.

Pension Freedoms
Pension freedoms, sometimes referred to as "pension flexibilities" were introduced by the Chancellor in his 2015 Spring Budget and give you more choice over how you take an income from your pension.

Policy fees
This described a charge which may be taken from your pension each month to cover the cost of administration.

Reduction in Yield (RIY)
Put simply, it's a way of expressing the effect the total charges on a pension policy will have on its potential rate of growth. It's a handy tool for comparing the cost of one policy with another. Here's an example: Let's say that your pension policy has a projected investment return (or "yield") of 4% a year. If all the charges on that policy brought its projected return down to 3%, it would have a "reduction in yield" of 1%.

Scheme member
Essentially this is you, as you are a member of the workplace pension scheme.

Transaction Costs
This is the term used to describe a number of costs which can occur when you invest in a fund or funds. These costs are important because the level of them impacts the overall return you receive on your investment.

Workplace pension scheme
This is the type of pension which your employer, or if you are a deferred member, your previous employer, has set up and which you are a member of.

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