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Standard & Poor's View

Standard & Poor's Fund Services has assigned the Aviva Investors Direct Separately Managed Accounts (DSMA) offering an overall SMA Platform rating of 'STRONG'. This rating reflects our conviction that Aviva Investors Australia Ltd. (the portfolio manager or PM) has a strong ability to operate the SMA platform and deliver on its strategic objective of providing a highly cost-competitive SMA model portfolio offering.

DSMA is actually an SMA administration service, rather than a platform in the conventional sense. It provides the means by which retail investors can gain access to two SMA model portfolios managed internally by Aviva Investors.

In our view, the service delivers on the PM's objective of providing highly cost-competitive access to its model portfolios—Aviva Investors Core Opportunities and Aviva Investors Dividend Builder.

Additionally, the service is convenient for advisers, with direct data feeds into the largest adviser software applications, such as XPLAN and VisiPlan, with the expectation that COIN will be added shortly.

We believe the risk that the service will be discontinued at some future point is extremely remote based on the manager's financial position, the financial and strategic backing of its parent, the strategic importance of SMA-related growth, and the service's attractive fixed operating cost and limited ongoing capital expenditure (capex) business model.

The service is suitable only for investors seeking access to the two model portfolios. For such investors, both investment vehicles have the potential to be among the more cost- and tax-efficient investment vehicles on the market, including in comparison with exchange-traded funds (ETFs) and index-tracking managed funds.

Investor Suitability

- Investors seeking access to the two underlying model portfolios internally managed by Aviva Investors.
- Core Opportunities (4 Star S&P rating) is high conviction Australian equities investment mandate. Dividend Builder ((4 Star S&P rating) is designed to deliver a relatively high level of dividend income on a tax effective basis.
- Access to a highly efficient investment vehicle, both in relation to taxation efficiency and total investment costs (46 and 51 basis points, depending on the model portfolio selected) and.
- Investors seeking all the benefits of an SMA model portfolio, including transparency, tax-efficiency, low costs, and empowerment.

Key Strengths

- Low-cost offering, providing retail investors access to wholesale fees and wholesale brokerage rates. The service represents the lowest-cost overall SMA offering in the domestic market, partly due to the removal of a cost layer in the form of a third-party platform.
- The internal trading is a competitive advantage, improving the timeliness of trades and mitigating the transactional slippage issues that can be present in SMA portfolios.
- Direct data feeds into commonly used financial planning software, such as XPLAN, VisiPlan, and potentially COIN Office.
- On an after-tax-and-fees basis, the service provides access to one of the most efficient investment vehicles in the domestic market.
- A solid financial position, strategic backing, and attractive business model should ensure the offering's sustainability.

Key Weaknesses

- A limited service offering with access to only two internally managed funds. We acknowledge, however, that this is consistent with the manager's strategy of providing a low-cost solution.

Risks

- A discontinuation of the service. While platforms are legally separated from the platform provider, a discontinuation of the service would inconvenience investors.
- Poor performance of the underlying managed portfolios.

Platform Name:	Aviva Investors Direct SMA	Model Portfolio Options:	Two
Platform Operator:	Aviva Investors Australia Ltd.	Minimum Investment (A\$):	20,000
Responsible Entity:	Aviva Investors Australia Ltd.	Min Regular Investment (A\$):	2,000
Custodian:		Liquidity:	Daily
Inception Date:	Nov. 22, 2010	Release Authorised by:	Leanne Milton

Platform Overview

The service is a managed investment scheme operating on an investor-directed portfolio services (IDPS)-like platform. JP Morgan is the custodian. The investors' holdings are held under two separate holder identification numbers (HINs; one for each model portfolio) in omnibus accounts.

The service went live to the market in the latter part of 2010. The SMA model portfolio offering is restricted to the two internally managed model portfolios. While the number of internally managed products may expand, there are no definite plans to do so at this point.

The technology that underpins the service is provided by IRESS Market Technology under an outsourcing arrangement. An important aspect in the use of IRESS is that model portfolio performance data and information is fed directly into some of the major financial planner software applications, such as XPLAN and VisiPlan.

The PM's investment decisions are executed internally by the dealing team. This potentially provides a strong competitive advantage relative to most other SMA model portfolios. It assists in the timeliness of trade execution, mitigates potential performance variation risk (where the model portfolio mirrors a unit trust), and facilitates lower brokerage rates and access to institutional placements.

Cash will be held at a minimum of 1% (to cover costs) and a maximum of 10%. The service will always aim to have investors fully invested with cash generally not above 2.5%.

The strategic and (if required) financial backing of the service is strong. This is relevant to investors with regard to the offering's long-term sustainability and potential future developments.

Business Strategy And Financial Position

→ Business Profile

Aviva Investors Australia is 100% owned by Aviva Investors Holdings Ltd., a wholly owned subsidiary of Aviva PLC. Aviva PLC is listed on the London Stock Exchange. It is the world's fifth-largest insurance group and one of the largest asset managers, with A\$450 billion in assets under management.

In Australia, Aviva Investors specialises in the active management of Australian equities and listed property. It has approximately A\$5.2 billion in FUM across 10 investment strategies.

Aviva Investors Australia was founded in August 1994 under the business name Portfolio Partners Ltd. In 1998, Portfolio Partners was acquired by Norwich Union (now Aviva Australia). In September 2008, Portfolio Partners changed its name to Aviva Investors Australia.

In June 2009, National Australia Bank (NAB) agreed to buy Aviva Australia Holdings' wealth-management business, including its life insurance operations and investment platform, Navigator, for A\$825 million. The decision by Aviva PLC to sell Aviva Australia (life company) to NAB in June 2009 has resulted in the withdrawal of fixed-income money (approximately A\$3.5 billion) that Aviva Investors managed for Aviva Australia during 2010.

Following the divestment, Aviva Investors Australia solely comprises the investment-management operation. The SMA offering is seen as an important part of the company's overall growth strategy. The SMA offering currently comprises two internally managed model portfolios and the means of accessing those portfolios through DSMA.

→ SMA Service Strategy

We evaluate the quality and extent of an organisation's strategic planning and forecasting to assess the platform provider's business

focus and capabilities. Our key concern here relates to the ongoing support, development, and continuity of the platform service.

The manager views its SMA offering as a key component of its growth strategy. This is based on its belief that the uptake of low-cost investment solutions, such as SMAs and ETFs, will increase strongly, partly due to the prospective ban on commissions and volume-based payments from July 1, 2012. One of the major outcomes of this reform has been a shift in the market's view on SMAs, mainly driven by their potential to provide a lower-cost, more transparent solution for advisers already using a fee-for-service model.

The manager's SMA offering is based on a niche strategy—specifically a low-cost, simple, and convenient solution. The formulation of this was based on adviser feedback that low cost was their primary focus.

The manager's ability to deliver on its low-cost objective is based on a number of factors. By outsourcing the underlying technology to IRESS, the manager has limited operating costs and the degree of upfront and ongoing capital expenditure. By providing both the SMA model portfolios and the delivery vehicle, the manager has removed a layer of costs. The provision of what is seen as necessary functionality only is also consistent with facilitating a low-cost service. Finally, using its internal trading capability provides wholesale brokerage rates to retail investors.

The use of IRESS is critical to providing a convenient solution for advisers. It provides a direct feed into the XPLAN and VisiPlan advisor software planning applications. If an adviser chooses, their direct interaction with the manager's service can be limited to the application and redemption process, with all ongoing performance data and information accessible through their planning applications.

→ Financial Position

The platform provider's financial position is of fundamental importance to its ability to continue to effectively operate an SMA platform. While platforms are legally separated from the platform provider, either through a trust structure or custodial arrangement, financial difficulties faced by the provider could damage the ability to provide those services. If the provider is placed into administration or liquidation and the management of the platform is passed to another provider, investors in that platform will almost certainly suffer some degree of inconvenience.

Aviva Investors is budgeting a profit in the 2011 financial year after the repatriation of the bulk of the Aviva Australia FUM. The manager expects that the associated loss of revenue will be offset by a combination of local and cross-border sales. The business continues to have positive cash flow and is comfortably meeting its Australian financial services licence (AFSL) requirements. Currently, it has A\$5.2 billion in FUM.

According to the manager, its parent company, Aviva Investors Holdings (U.K.) is supportive of the Australian business and committed to its long-term development. It currently has A\$10.5 million of capital invested in the Australian business and has indicated that further capital will be available if required. Additionally, the manager states that the parent company sees the Australian business as crucial to the development and growth of the broader Asia-Pacific businesses.

The financial prospects of the SMA service are also clearly important to the manager's willingness and ability to sustain and develop the platform. The manager anticipates that, through the incremental FUM it delivers to the two model portfolios, the service will be cash flow-positive over the course of the first year of operation.

To its advantage, the SMA service is characterised by an attractive business model. Upfront and ongoing capex is limited and over the

foreseeable future largely related to marketing initiatives in the Q1 calendar year 2011 period.

The platform is characterised by a largely fixed operating cost model in which incremental revenues will mostly flow through to the bottom line. The manager's expectation is that variable costs will be limited to an additional staff member (customer services-related) and volume-related payments to IRESS.

→ Management

We believe the management team as well as the investment teams that managed the model portfolios are sufficiently experienced and adequately skilled to deliver on the strategic objectives of the service.

To Aviva's advantage, the company has now been directly engaged in the SMA space for for 1.5 years, first issuing SMA model portfolios in August 2009. We believe the portfolio managers of the two mandates has established suitable mandates for an SMA portfolio – concentrated and low turnover. The quality and depth of the investment teams are adequate and succession planning mitigates issues such as key person risk and ensures continuity.

The company had explored the option of rolling out its own SMA platform / administrative service for approximately one year prior to launching the service. S&P gained the impression that management have a good feel for the market and any associated risks that may impact the potential success of the service.

The areas of trading, compliance, and customer support for the SMA service also appeared adequately covered

Operational And IT Capability

→ Trading

The trading process largely determines the degree of transactional slippage that is an inherent risk and source of inefficiency in many SMA model portfolios. Relatively high brokerage costs and a delay in the execution of the portfolio manager's investment decision generates two performance risks in the case where a model portfolio mirrors a unit trust:—relative underperformance risk and portfolio variation risk (tracking error risk).

Aviva Investors has full control of trade execution. This is an important advantage relative to SMA model portfolios in general. It enables the manager to execute model portfolio trades alongside those of unit trusts and segregated mandates, thereby avoiding front running of the model portfolio. It provides wholesale brokerage rates to retail investors. In the case of the service, brokerage rates are among the lowest available for retail investors at around 10 basis points.

Additionally, direct execution gives the platform provider greater control over the execution price achieved by the broker. It also provides the SMA investor with access to institutional offers, such as placements.

Each model portfolio has a separate HIN and has the ability to net off trades. There is a full choice of broker selection, allowing for institutional brokerage rates and access to institutional placements.

The minimum trade size for DSMA is \$40. At the minimum investment of \$20,000, this represents 0.2% of the total portfolio. We regard this as a suitable balance between reducing small trades and limiting portfolio variance, and hence tracking error and relative performance risks.

Investor portfolios will not be rebalanced unless the difference between their portfolio and the model is at least 0.2% and that the trade will be greater than \$40.

Aviva Investors does not have minimum brokerage requirements for DSMA. Brokerage is charged on an ad valorem (according to value) basis, at a rate through an existing broker.

→ PM Interface

Where the model PM and the SMA platform provider are independent, the timeliness with which the PM communicates its investment decisions and the platform provider executes those decisions determines how true the model portfolio is to the PM's investment decisions. It is also important that the PM be able to review and audit performance and, if required, reconcile differences with a unit trust version or the PM's (non-executed) shadow portfolio.

The fact that Aviva Investors has full control of trade execution largely eliminates these risks. While there is no predefined trading or model update frequency, any stock changes in the unit trust versions are reflected in the model portfolios within two business days. The manager's administration systems allow for model portfolio changes to be executed alongside unit trusts and segregated mandates.

Additionally, performance measurement of an Aviva Investors-seeded SMA "header account" will provide an accurate means of performance audit versus unit trusts and expected returns.

→ Advisor Interface And Reporting

This is an assessment of the convenience, provision of support, and the quality of reporting the adviser receives.

We consider the reporting sufficient—it includes portfolio valuations, income and expense statements, capital gains reporting, and portfolio performance. Tax optimisation functionality is also sufficient.

Importantly, the service has direct data feeds daily into XPLAN and VisiPlan and is expected to have a direct data feed into COIN by Q1 2011. There is an EPI 4 feed available for all other planning software.

The latter means that advisers who so choose need have no direct interface with the manager's online service; they can simply access performance information through their existing planning software applications.

The service ticks the boxes in relation to tax lot management, enabling advisers to select the methodology with which to provide the desired tax outcome for investors.

→ General Support

We also consider general support mechanisms surrounding the IT platform that ensure the ongoing operation of the platform service.

As noted above, the IT platform/system is owned by IRESS and maintained according to service-level agreements. Where required, the manager's internal IT team provide general support, as do the client support team at IRESS.

IRESS Market Technology is a leading provider of share market information services, including adviser financial planning software applications XPLAN and VisiPlan. The manager has had an existing commercial relationship with IRESS since June 2000.

Product And Service Offerings

There are currently two model portfolios available both of which we rated as four stars as of the publication date of this report. We refer investors to the separate fund reports on both model portfolios, which can be accessed via our subscriber website at <http://www.fundsinsights.com>. Tables 1 and 2 below highlight some key characteristics of the two model portfolios.

Table 1: Aviva Investors Core Opportunities Model Portfolio

Investment objective	Outperform the S&P/ASX 200 Acc. Index by 3.5% p.a. over rolling five-year period
Investment strategy	Concentrated portfolio of 15 to 25 companies with significant capital growth potential
Benchmark	S&P/ASX 200 Accumulation Index
No. of shares	15 to 25
Cash weighting (%)	1-10
Management fee (%)	0.51
Inception date	22 November 2010

Table 2: Aviva Investors Dividend Builder Model Portfolio

Investment objective	Deliver higher dividend income on a tax-effective basis vs. the S&P/ASX 200 Industrials Acc. Index
Investment strategy	A diversified portfolio of high yielding Australian shares managed with an emphasis on tax efficiency
Benchmark	S&P/ASX 200 Industrials Accumulation Index
No. of shares	10 to 20
Cash weighting (%)	1-10
Management fee (%)	0.46
Inception date	22 November 2010

Fees And Costs

The manager's offering represents the lowest-cost SMA offering in the market, partly because it has eliminated a layer of costs by delivering the model portfolios directly to advisers.

Unlike most other SMA platforms, investors are not charged a platform administration fee (typically around 30 to 50 basis points) or custody fees (typically 5 basis points). Furthermore, brokerage rates are among the most competitive in the market and the management expense ratio (MER) on the underlying portfolios, at an average of 48 basis points, is below that of the unit trust versions (70 basis points).

Table 3: Fees And Costs

Type	Amount
Establishment fee	None
Contribution fee	None
Withdrawal fee	None
Termination fee	None
Securities transfer fee	Nil
Adviser commission	Subject to commercial terms between investor and advisor

Compliance And Legal Capability

The service is a managed investment scheme operating on an IDPS-like platform. A scheme constitution and a compliance plan have both been lodged with the Australian Securities and Investments Commission (ASIC). The manager's AFSL was varied to allow the manager to operate an IDPS-like scheme.

JP Morgan is the custodian. The investors' holdings are held under two separate HINs (one for each model portfolio) in omnibus accounts.

SMA Platform Rating Philosophy

The SMA rating criteria is intended to provide an assessment of an organisation's capabilities as a provider of an SMA platform. To some extent, all SMA platforms vary, either in terms of the investment choices available, the quality of the services provided, or the cost of using the platform. The SMA rating is designed to address each of these issues and will specifically assess: platform features, product and services, trade execution, fee structure, adviser interface, business profile, and information technology systems.

SMA Platform Rating Definitions

SMA PLATFORM RATING VERY STRONG	S&P has assigned a 'Very Strong' rating to the product based on its conviction that the manager can meet its objectives over the stated time period. The product has scored exceptionally in a number of categories but may not be suitable for all investors.
SMA PLATFORM RATING STRONG	S&P has assigned a 'Strong' rating to the product based on its conviction that the manager can meet its objectives over the stated time period. The product has scored strongly in a number of categories but may not be suitable for all investors.
SMA PLATFORM RATING SOUND	S&P has assigned a 'Sound' rating to the product based on its conviction that manager can meet its objectives over the stated time period. The product has scored satisfactorily in a number of categories but may not be suitable for all investors.
SMA PLATFORM RATING PASS	S&P has assigned a 'Pass' rating to the product based on its conviction that the manager can meet its objectives over the stated time period. The product has passed a number of categories but may not be suitable for all investors.
SMA PLATFORM RATING WEAK	S&P has assigned a 'Weak' rating to the product based on its conviction that the manager cannot meet its objectives over the stated time period. The product has scored weakly in a number of categories and may not be suitable for most investors.
SMA PLATFORM RATING ON HOLD	S&P has placed the SMA platform product 'On Hold' due to issues that have emerged that may affect the characteristics of the SMA platform. The rating is temporarily suspended, pending clarification.

SMA Platform Rating Process

The SMA rating is designed to address the various features and costs and will specifically assess the following: platform features, product and services, trade execution, fee structure, adviser interface, business profile, and information technology systems. The SMA rating does not address, and does not provide comments on the performance of the underlying investments available on an SMA platform.

SMA Rating Scales Notes

Very Strong	For an SMA platform to receive a 'Very Strong' rating, the platform has scored highly overall and particularly in the more important categories of fees and brokerage, investment options, trade execution, and adviser interface. The platform is viewed as a very strong platform offering.
Strong	For an SMA platform to receive a 'Strong' rating, the platform has scored above average overall but has scored highly in the more important categories of fees and brokerage, investment options, trade execution, and adviser interface. The platform is viewed as superior to the majority of platform offerings.
Sound	For an SMA platform to receive a 'Sound' rating, the platform has scored above average on the majority of criteria but is characterised by some inconsistency across scoring categories. The platform is viewed as in line with the majority of platform offerings.
Pass	For an SMA platform to receive a 'Pass' rating, the SMA platform has scored average overall but is characterised by poor scores on a number of categories. The platform is viewed as inferior to the majority of platform offerings.
Weak	For an SMA platform to receive a 'Weak' rating, the SMA platform has scored below average in the majority of criteria and, in particular, the more important categories of fees and brokerage, investment options, trade execution, and adviser interface. The rating may also partly or wholly reflect concerns about the financial sustainability of the platform provider.
On Hold	For an SMA platform to receive an 'On Hold' rating, the SMA platform must have issues that may affect the provision of the SMA service. The SMA product rating is temporarily suspended, pending clarification.

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