

Notice of meeting and agenda

Pensions Audit Sub-Committee

2.00pm, Monday 11 December 2017

Dunedin Room, City Chambers, High Street, Edinburgh

This is a public meeting and members of the public are welcome to attend

Contact

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1. Order of business

- 1.1 Including any notices of motion and any other items of business submitted as urgent for consideration at the meeting.

2. Declaration of interests

- 2.1 Members of the Committee and members of the Pensions Board should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

3. Deputations

- 3.1 None.

4. Minute

- 4.1 Minute of the Pensions Audit Sub-Committee of 26 September 2017 – Submitted for approval as a correct record (circulated)

5. Reports

- 5.1 Agenda Planning – report by the Executive Director of Resources (circulated)
- 5.2 Lothian Pension Fund Internal Audit Updates – 1 September 2016 to 31 October 2017 – report by the Chief Internal Auditor (circulated)
- 5.3 Pensions Administration Data Quality – report by the Executive Director of Resources (circulated)
- 5.4 EU Tax Claims and Income Recovery – report by the Executive Director of Resources (circulated)
- 5.5 Investment Income Review Cross Border Withholding Tax – report by the Executive Director of Resources (circulated)
- 5.6 Global Custody Services Performance – report by the Executive Director of Resources (circulated)

6. Motions

- 6.1 If any

Laurence Rockey

Head of Strategy and Insight

Committee Members

Councillors Rose (Convener), Child and John Anzani.

Information about the Pensions Audit Sub-Committee

The Pensions Audit Sub-Committee consists of 3 members of the Pensions Committee of which a minimum of two are City of Edinburgh Councillors and its membership is appointed by the Pensions Committee.

The Pensions Audit Sub-Committee usually meets in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

Further information

If you have any questions about the agenda or meeting arrangements, please contact Hannah King, Committee Services, City of Edinburgh Council, City Chambers, High Street, Edinburgh EH1 1YJ, Tel 0131 529 4121, e-mail hannah.king@edinburgh.gov.uk.

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the main reception office, City Chambers, High Street, Edinburgh.

The agenda, minutes and public reports for this meeting and all the main Council committees can be viewed online by going to www.edinburgh.gov.uk/cpol.

For remaining items of business, likely to be considered in private, see separate agenda.

Item 4.1 - Minutes

Pensions Audit Sub-Committee of the Pensions Committee

2.00pm, Tuesday 26 September 2017

Present

Councillors Rose (Convener) and Child; John Anzani

Pensions Board Members Present:

Catriona Warren and Alan Williamson

1. Minutes

Decision

To approve the minutes of the Pensions Audit Sub-Committee of the Pensions Committee of 5 December 2016 as a correct record.

2. Agenda Planning

An overview of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings for December 2017 and March 2018 were outlined.

Decision

To note the agenda planning document.

(Reference – report by the Executive Director of Resources, submitted.)

3. Audited Annual Report 2017 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

The Audited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund was provided. The unaudited Annual Report had been considered by the external auditor Scott-Moncrieff and their annual report to Members and the Controller of Audit was presented.

The audited financial statement for the wholly-owned companies LPFE Limited and LPFI Limited were also provided.

Representatives from Scott-Moncrieff were present for this item.

Decision

- 1) To note the report by Scott-Moncrieff “Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit” as detailed in Appendix 1 to the report by the Executive Director of Resources.
- 2) To note the audited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund as detailed in Appendix 2 to the report by the Executive Director of Resources.
- 3) To note that the audited financial statements, for the year ended 31 March 2017, of both the wholly-owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in June 2017 as detailed in Appendix 3 and Appendix 4 to the report by the Executive Director of Resources.
- 4) To note that Scott-Moncrieff had made no comment in respect of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance “Accounting for Local Government Pension Scheme Management Costs”, as revised in June 2016, and its failure to reflect full transparency of investment management fees, specifically through “fund of fund arrangements”.
- 5) To recommend to the Pensions Committee that the following wording was added to the decision “To note that the Pension Fund meets CIPFA guidance providing a level of transparency beyond what was required”.

(Reference – report by the Executive Director of Resources, submitted.)

4. Fraud Prevention

Information was provided of the work undertaken by the Lothian Pension Fund to prevent fraud. Details were given of participation in fraud prevention initiatives as part of the control environment and the overall management of risk.

Decision

To note the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

5. Irrecoverable Overpayment of Pensions – Decisions Made under Delegated Authority

Delegated authority had been granted to the Executive Director of Resources to write-off pension overpayments up to £3,000, in certain circumstances. Details were given of

pension overpayments that had been deemed irrecoverable during the period 1 September 2016 to 31 August 2017.

Decision

To note that the total value of pension overpayments written off between 1 September 2016 and 31 August 2017 was £8,128.39.

(Reference – report by the Executive Director of Resources, submitted.)

6. Overpayment of Pension

Authority was required from the Pensions Committee to write-off pension overpayments over £3,000. At its meeting on 27 September 2017, the Pensions Committee would be asked not to pursue recovery of overpayment of pensions totalling £34,563.21.

Decision

To note the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

7. Risk Management Summary

A summary was provided of the Lothian Pension Fund's risk management procedures, including details on the operational risk register and the Fund's action to mitigate these risks.

Decision

To note the Quarterly Risk Overview.

(Reference – report by the Executive Director of Resources, submitted.)

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

Agenda Planning

| | |
|---------------------|---|
| Item number | 5.1 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

This document provides Committee with an overview of the proposed agendas for future meetings of the Pensions Committee and Pensions Audit Sub Committee. It also provides a more general overview of the current cycle of papers for the Committees.

There will, of course, be specific matters and papers which need to be brought to the attention of the Pensions Committee and the Pensions Audit Sub Committee in addition to those set out herein.

Agenda Planning

1. Recommendations

Committee is requested to:

- 1.1 Note the agenda planning document; and
- 1.2 Note that the Pension Board are invited to comment on agenda items during Committee meetings.

2. Background

- 2.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, it was agreed that an agenda planning document be submitted each quarter and highlights any changes to the agenda over the last quarter.

3. Main report

- 3.1 In general, it is the Pension Board's preference to comment on each agenda item as it arises, rather than comment on all the papers at the start of Committee meeting. Therefore, following discussions with the Conveners of the Committees and the Chair of the Pension Board, the following changes have been made:
 - a. the agenda item 'Considerations and matters to be raised by the Pension Board regarding any items on the agenda' has been removed;
 - b. the agenda item 'Agenda Planning' will request Committee to note that the Pension Board are invited to comment on agenda items during Committee meetings; and
 - c. the Consultation & Engagement section within each paper now includes reference to the fact that the Pension Board are invited to comment on the relevant matters at Committee meetings.
- 3.2 Based on the Committee cycle and the current position, the proposed agendas for the next two meetings are set out below. The report on Cost Benchmarking which was due to be considered at the December meeting has been postponed to March 2018 due to delay in receipt of, and a number of outstanding queries on, the information received from the providers.

March 2018

Pensions Committee

- Audit plans and reports (internal and external) *
- Governance Update
- Actuarial Valuation: Lothian Pension Fund and Lothian Buses Pension Fund/Scottish Homes Pension
- Funding Strategy Statement
- Cost Benchmarking
- Revised Pension Administration Strategy (biennial from March 2016)
- Employers Participating in Lothian Pension Fund
- 2016 – 2018 Service Plan Update
- 2018 – 2021 Service Plan and Budget
- Risk management summary

*Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.

June 2018

Pensions Committee

- Referrals / recommendations from Pensions Audit-Sub Committee
- LPF Annual Report & Accounts Unaudited
- Statement of Investment Principles
- Investment Strategy Panel Activity
- Annual Investment Updates - Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund
- Risk management summary

Audit Sub Committee

- LPF Annual Report & Accounts Unaudited
- Risk Management summary

Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee

- Monday, 26 March 2018, 2pm, Dunedin Room, City Chambers
- Wednesday 27 June 2018, 2pm, Dunedin Room, City Chambers

Pensions Audit Sub Committee

- Tuesday 26 June 2018, 2pm, Dunedin Room, City Chambers

4. Measures of success

- 4.1 The Committee and Pension Board have greater clarity regarding the content of the Committee cycle.

5. Financial impact

5.1 None.

6. Risk, policy, compliance and governance impact

6.1 There is no direct impact as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds

7. Equalities impact

7.1 There are no adverse equalities impacts arising from this report.

8. Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 – Scheme of Committee Papers

| Frequency | Pensions Committee | Audit Sub Committee | Month |
|-----------|--|---|--------------------------------------|
| Annually | Audit plans and reports (internal and external) | N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee. | March |
| | Policies/Strategies/Training (including revised Pension Administration Strategy biennial from March 2016) | N/A | March |
| | Service Plan (every 2 years) | N/A | March |
| | Budget | N/A | March |
| | Governance Update (including Pension Audit Sub-Committee appointments) | N/A | March |
| | LPF Annual Report & Accounts Unaudited | LPF Annual Report & Accounts Unaudited | June |
| | Statement of Investment Principles | N/A | June |
| | Investment Strategy Panel Activity | N/A | June |
| | Annual Investment Updates - Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund | N/A | June |
| | LPFE limited and LPFI limited Annual Report | LPFE limited and LPFI limited Annual Report | September |
| | LPF Annual Report & Accounts Audited | LPF Annual Report & Accounts Audited | September |
| | ISA 260 Audit Report | ISA 260 Audit Report | September |
| | N/A | Pensions Data Quality | September |
| | N/A | Irrecoverable overpayment of pensions – decisions made under delegated authority | September |
| | N/A | Fraud Prevention | September |
| | Annual Report by External Auditor | Annual Report by External Auditor | December (or September if available) |
| | Benchmarking | N/A | December |
| | N/A | EU Tax Claims & Income Recovery | December |
| | N/A | Investment Income Review-Cross-Border withholding tax | December |
| | Stewardship and Engagement | N/A | December |
| N/A | Investment Controls & Compliance | December | |
| N/A | Global Custody Services Performance | December | |
| | Risk Management In-depth review | December | |

| Frequency | Pensions Committee | Audit Sub Committee | Month |
|------------------|--|-------------------------|-------------------------------------|
| Semi Annually | Employers Participating in Lothian Pension Fund | N/A | March & September |
| 3 Times per year | Service Plan Update | N/A | March, September & December |
| | Referrals / recommendations from Pensions Audit-Sub | N/A | June, September & December |
| Quarterly | Risk management summary | Risk management summary | March, June, September and December |
| Every 3 years | Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement | | December or March |
| As required | Delegated authorities (provider appointments) | N/A | |
| | Discretions (death grants etc.) | N/A | |
| | N/A | Internal Audit Reports | |
| | Regulatory Update | N/A | |
| | Investment Strategy Reviews (at least every 3 years) | N/A | |
| N/A | Risk management (in depth review) | | |

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

Lothian Pension Fund Internal Audit Update - 1st September 2016 to 31st October 2017

| | |
|---------------------|---|
| Item number | 5.2 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

The purpose of this report is to provide a summary of Internal Audit Activity for Lothian Pension Fund (LPF) during the period 1st September 2016 to 31st October 2017, and details of open and overdue Internal Audit recommendations as at 26th October 2017. Overdue recommendations are those that have not been closed by the agreed implementation date.

Of the three reviews included in the 2017/18 audit plan, one has been completed, with one at draft reporting stage and another in progress.

One further review was added to the 2017/18 Internal Audit plan (in September 2017) at the request of LPF management. This review assessed the design of the data security arrangements for a potential third party supplier who was being considered as an outsource provider for the LPF payroll. Given the commercially sensitive nature of this review, a progress update has been included in a separate B Agenda paper.

LPF had 3 open Internal Audit recommendations as at 26th October 2017. Of these, one had not been closed by the agreed implementation date and was reported as overdue to the City of Edinburgh Council's Corporate Leadership Team (CLT).

Lothian Pension Fund Internal Audit Update - 1st September 2016 to 31st October 2017

1. Recommendations

Committee is requested to:

- 1.1 Note Internal Audit activity and outcomes for period 1st April to 31st October 2017, and the status of LPF open and overdue Internal Audit recommendations as at 26th October 2017.

2. Background

- 2.1 The Internal Audit plan for the Lothian Pension Fund (LPF) was approved by the Pensions Committee on 20th March 2017 and includes the following three reviews.
 - Business Continuity - Review of the Fund's Business Continuity Plan including IT disaster recovery for systems hosted by the Council and third party system providers.
 - Information governance – Assessment of the processes and controls in place to ensure member data held by the Pension Fund is accurate, and is managed in compliance with Data Protection legislation.
 - Pensions tax lifetime and annual allowances - Review of arrangements in place to ensure that pensions tax legislation is applied accurately, and that members are informed of its impact on their future pension provision.
- 2.2 One further review was added to the 2017/18 Internal Audit plan (in September 2017) at the request of LPF management. This review assessed the design controls operated by a potential third-party supplier who was being considered as an outsource provider for the LPFE payroll. Given the commercially sensitive nature of this review, a separate update has been provided and will be considered as B agenda item.
- 2.3 Internal Audit recommendations and agreed management actions are tracked monthly, with details of overdue recommendations (those that have not been closed by the agreed implementation date) reported monthly to the City of Edinburgh Council's Corporate Leadership Team and quarterly to the Council's Governance, Risk, and Best Value Committee. Evidence provided by management to support closure will be reviewed, validated, and tested (where appropriate) by Internal Audit to confirm that agreed management actions have been effectively implemented and the risks identified in the original audit report effectively managed

3. Main report

- 3.1 The current status of the audits included in the LPF Internal Audit plan is as follows:
- Information Governance – completed. The final report was issued in October 2017. Refer section 3.2 below for further detail.
 - Payroll Outsourcing review - in progress. Further detail is included in a separate B agenda paper.
 - Business Continuity – draft report has been shared with LPF for management responses. Final report is expected to be issued by end November.
 - Pensions tax lifetime and annual allowances – in progress. Final report will be issued in December.

- 3.2 **Information Governance** - The scope of this review assessed the design and operating effectiveness of the controls in place to mitigate the risk that members' confidential data is lost or made public/breach of the Data Protection Act.

Our review confirmed that whilst no significant Data Protection Act breaches had been recorded by the Lothian Pension Fund (LPF) or were identified from our testing, some moderate weaknesses exist in the design and operating effectiveness of the key records management controls in place. These control weaknesses should be addressed to ensure full ongoing compliance with Data Protection requirements and ensure that the Fund is prepared for the new General Data Protection Legislation currently scheduled for implementation in May 2018.

Consequently, two 'Medium' and three 'Low' rated Findings were raised. For further details of the Findings raised, please refer to the full report which is included at Appendix 1.

4. Open and Overdue Internal Audit Recommendations

- 4.1 LPF had 3 open Internal Audit recommendations as at 26th October 2017. Of these, one had not been closed by the agreed implementation date and was reported as overdue to the Corporate Leadership Team (CLT). Details of open and overdue recommendations are included in the table below:

| Review and Recommendation | Rating | Status | Revised Date | Original Date |
|--|--------|---------|--------------|---------------|
| Disaster Recovery – CW1602 | Medium | Open | - | 30/11/17 |
| Service Level Agreements with Outside Entities – RES1605 | Low | Open | - | 30/11/17 |
| LPF Cyber Security – RES1614 | Medium | Overdue | 31/03/18 | 30/09/17 |

- 4.2 The Disaster Recovery and Service Level agreements recommendations were allocated across all Service Areas within the City of Edinburgh Council (following agreement by the CLT in September 2017) to enable identification of all shadow IT systems (systems, applications and websites historically procured and implemented by Services that are not managed corporately by the Council's ICT service) and

arm's length organisations that provide services to and receive services from the Council.

- 4.3 The LPF Chief Risk Officer has provided an update on the overdue LPF Cyber Security recommendation which confirms that progress is being made with development of an LPF supplier management framework to provide assurance over third party Cyber Security controls. This work is being combined with LPFs General Data Protection Requirements (GDPR) project and the Fund's existing risk and compliance controls framework, and LPF is now working to a revised date implementation date of 31st March 2018.

5. Measures of success

- 5.1 Provision of assurance over the key risks faced by the Fund and effective resolution of control weaknesses identified from audits.

6. Financial impact

- 6.1 There are no direct financial implications.

7. Risk, policy, compliance and governance impact

- 7.1 There are no adverse impacts arising from this report.

8. Equalities impact

- 8.1 There are no adverse equalities impacts arising from this report.

9. Sustainability impact

- 9.1 There are no adverse sustainability impacts arising from this report.

10. Consultation and engagement

- 10.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

11. Background reading / external references

11.1 None

Lesley Newdall, Chief Internal Auditor

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12. Appendices

12.1 Appendix 1 – Internal Audit report – Information Governance

The City of Edinburgh Council **Internal Audit**

Lothian Pension Fund - Information Governance

Final Report

13th October 2017

RES1705

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This internal audit review is conducted for the City of Edinburgh Council under the auspices of the 2017/18 internal audit plan approved by the Governance, Risk and Best Value Committee in March 2017. The review is designed to help the City of Edinburgh Council assess and refine its internal control environment. It is not designed or intended to be suitable for any other purpose and should not be relied upon for any other purpose. The City of Edinburgh Council accepts no responsibility for any such reliance and disclaims all liability in relation thereto.

The internal audit work and reporting has been performed in line with the requirements of the Public Sector Internal Audit Standards (PSIAS) and as a result is not designed or intended to comply with any other auditing standards.

Although there is a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the City of Edinburgh Council. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and elected members as appropriate.

1. Background and Scope

Background

Lothian Pension Fund ('the Fund') is the second largest local government pension fund in Scotland with over 70,000 members. The Fund holds both personal and sensitive personal data about its members and their next of kin which allows it to perform core functions such as collecting pension contributions and paying pension benefits. The Fund may share this data with employers and service providers for pensions administration and fraud prevention purposes.

This review was included in the 2017/18 Internal Audit Plan to assess the Fund's information governance maturity before the General Data Protection Regulations come into force in 2018, and in response to a number of minor data protection breaches in the past year.

Pensions records are maintained on the pensions administration system, Altair an employer data transfer portal; Pensions Web; the Fund's shared drive; and electronic mailboxes. Altair and Pensions Web are provided by third party suppliers Aquila Heywood and Civica respectively. A Lothian Pension Fund website links to My Pension Online, for members to administer their details and obtain information on the value of their fund.

Scope

The scope of this review assessed the design and operating effectiveness of the controls in place to mitigate the risk that members' confidential data is lost or made public/breach of the Data Protection Act.

Testing, where appropriate, was performed for the period 1 August 2016 to 31 July 2017. For the associated controls objectives and full terms of reference see appendix 2.

2. Executive summary

Total number of findings

| | |
|--------------|----------|
| Critical | 0 |
| High | 0 |
| Medium | 2 |
| Low | 3 |
| Advisory | 1 |
| Total | 6 |

Summary of findings

Whilst no significant Data Protection Act breaches had been recorded by the Lothian Pension Fund (LPF) or were identified from our testing, our review noted some moderate weaknesses in the design and operating effectiveness of the key records management controls in place. These control weaknesses should be addressed to ensure full ongoing compliance with Data Protection requirements and ensure that the Fund is prepared for the new General Data Protection Legislation currently scheduled for implementation in May 2018.

Consequently, two 'Medium' and three 'Low' Findings have been raised. One 'Advisory' Finding has also been raised reflecting best practice opportunities identified.


From the review the following areas of good practice were identified:

- The Lothian Pension Fund (LPF) website privacy & data protection policies outline the information that may be collected, how it will be used, and who it will be shared with;
- Information governance training has been undertaken by all staff;
- Regular compliance checklists are completed, linked to a breaches log and risk register, and supported by staff briefings, reminders and awareness communications;
- Data entry is automated via standard templates where possible, with manual data entry subject to peer reviews;
- Reconciliations of employers and retired members' data, and data matching for retired members are performed;
- Laptop security is enforced;
- Access to modules within the pensions administration system, Altair, are restricted by job role and connected people, with access change requests reviewed monthly by a Senior Manager;
- The shared drive is well structured and data is easily accessible;
- Contracts with third parties either reference data protection regulations or are supported by data sharing agreements; and
- Preparations for the 2018 General Data Protection Regulations (GDPR) are underway, and compliance with GDPR has been incorporated in the specification for the new pensions system.

Our detailed findings and recommendations are laid out within Section 3: Detailed Findings

3. Detailed findings

1. Records Retention and Disposal

| Finding | |
|---|---|
| <p>The Fund's records management framework and supporting processes require improvement to ensure that Fund records are effectively managed in line with Data Protection Act requirements. Our review identified the following control weaknesses:</p> <ul style="list-style-type: none"> • There is currently no formal records management plan and supporting processes; • Retention schedules and disposal logs are not used to record and action pre-determined disposal dates of Fund records; • Regular clear out days are not held to ensure that electronic and paper records are archived or scheduled for disposal; • Some records are duplicated between Pensions Web and the Fund's shared drive. • No documents have been archived in Pensions Web since its installation in 2013; and • The pensions mailbox is used to store correspondence that has not been attached to the Altair pensions administration system. | |
| Business Implication | Finding Rating |
| <p>Lack of formal governance supporting records management breaches the requirements of the Council's records management policy (sections 4.5 – 4.8)</p> <p>The lack of a records retention schedule, records management process and disposal log means that decisions are not being made regarding records, files and folders containing sensitive data that no longer requires to be held, or is being held in more than one location.</p> |  <p>Medium</p> |

| Action plans | |
|--|---|
| Recommendation | Responsible Officer |
| <p>Retention and Disposal</p> <p>It is recommended that a records management plan is prepared that sets out the proper arrangements for the management of the Lothian Pension Funds records that include personal data.</p> <p>A model records management plan developed by National Records of Scotland includes 14 elements for effective records management.</p> <p>Whilst there is no statutory requirement for this plan to be applied, it would be good practice to incorporate as many of these elements as possible into existing records management processes where they are not already applied by LPF.</p> <p>The 14 elements of the plan are noted below and further information can be found at:</p> <p>https://www.nrscotland.gov.uk/record-keeping/public-records-scotland-act-2011/resources/model-records-management-plan</p> <p>1. Senior management responsibility - <i>An individual at senior level who has overall strategic accountability for records management.</i></p> | <p>Chief Risk Officer, Lothian Pension Fund</p> |

2. Records manager responsibility - *An individual within the Fund to have day-to-day operational responsibility for records management.*
3. Records management policy statement - *To underpin the effective management of the Fund's records and information.*
4. Business Classification Scheme to organise records - *A scheme describing what business activities the Fund undertakes.*
5. Retention schedules - *A list of pensions records for which pre-determined disposal dates have been established.*
6. Destruction arrangements - *Disposal arrangements must ensure that all copies of a record – wherever stored – are identified and destroyed.*
7. Archiving and transfer arrangements - *Mechanism by which an authority transfers records of enduring value to an appropriate archive repository, specifying the timing of transfers and other terms and conditions.*
8. Information Security - *Process by which records are protected and ensures they remain available.*
9. Data Protection - *High level statement of public responsibility and fair processing.*
10. Business continuity and vital records plans; - *A business continuity and vital records plan serves as the main resource for the preparation for, response to, and recovery from, an emergency that might affect any number of crucial functions in an authority.*
11. Audit trail - *Sequence of steps documenting the movement and/or editing of a record resulting from activities by individuals, systems or other entities.*
12. Competency framework for records management staff - *lists the core competencies and the key knowledge and skills required by a records manager.*
13. Assessment and review - *To ensure that records management practices conform to the Records Management Plan.*
14. Shared information - *Reference to information sharing protocols in place that govern how the Fund exchanges information with others.*

When implementing these additional actions, reference should be made to governing legislation and advice available from the Council's Information Governance team.

A review should also be performed of existing records held in Altair, Pensions Web, mail boxes and the shared drive to ensure that multiple copies of records are not held, records are held in the most appropriate place, and storage capacity is minimised where possible.

Agreed Management Action

Estimated Implementation Date

Recommendations accepted – all actions recommended by Internal Audit will be fully implemented.

28/02/2018

2. System Access Controls

Finding

Altair Controls:

- The current user list for the pensions administration system, Altair, was tested to confirm that access levels in place aligned to job roles. Whilst no inappropriate access rights were identified for LPF staff, a small number of historic users were listed from East, Mid and West Lothian Councils. These Councils previously used the Altair system to access their information, but now use Pensions Web, therefore the Altair user accounts are no longer required.
- The Altair user access list was reviewed in July 2017 to identify leavers who should be removed. The outcomes of the review have been presented to management for approval.

Shared Drive Access:

- Some commercially sensitive records and LPF personnel folders within the LPF shared drive have access restricted to senior managers, however members' data held within the Pensions Admin folder can be viewed by all LPF staff, including those who do not require access to it.
- A list of employees who currently have access to the Pensions Admin folder was obtained from CGI. Of 70 individuals with access permission, seven should not have access to this folder, including individuals who have never worked within LPF. A list of exceptions was passed to the Systems Manager for review and resolution.

Pensions Web Access:

- A Pensions Web LPF user list is not held locally, and is not regularly requested from the systems administrator, Civica, to enable completion of periodic user access checks.
- Designated LPF officers are systems administrators for Pensions Web employer users. The full population of current users is reviewed throughout the year, however, the process supporting this quarterly review has not yet been fully embedded, and no evidence of previous checks retained.

Business Implication

- Members personal data is available to all staff within the LPF which does not afford this data an appropriate degree of protection as required per Data Protection Act requirements.
- Access rights to key systems that hold member data has been retained for LPF staff and employers who no longer require access to it.

Finding Rating

Medium

Action plans

Recommendation

Responsible Officer

System Access Controls

Altair Controls

- The current user list requires to be reviewed to ensure that all active accounts have a legitimate business purpose.
- Any inactive accounts no longer required should be removed,
- The system should be updated immediately to reflect any team changes.
- An annual review of user Altair user access rights should be performed.

Shared Drive Access

- Access to shared drive folders containing members' data should be restricted to staff who require access to it.
- Access to the shared drive should be updated immediately to reflect any team changes, and should be subject to an annual review.
- Any inappropriate access rights identified should be raised with the Council ICT Security Manager as a security breach.

Pensions Web Access

- A revised list of current LPF users should be obtained from Civica to support each quarterly review performed throughout the year.
- Evidence of quarterly reviews performed should be retained together with confirmation that the full population of users has been reviewed during the year.

Chief Finance Officer,
Lothian Pension Fund

Agreed Management Action

Estimated Implementation Date

Altair Controls

Although user accounts existed, these could not be utilised to access the Altair system as the essential first stage log-in through Citrix receiver had been removed for all such users.

Following the notification by Internal Audit staff, the user access list was fully revised and deletions made for any users no longer required. Action on the recommendations is summarised as follows:

- The current user list requires to be reviewed to ensure that all active accounts have a legitimate business purpose.
 - Any inactive accounts no longer required should be removed,
 - The system should be updated immediately to reflect any team changes
- An annual review of user Altair user access rights should be performed.

31/10/2017

31/10/2017

31/10/2017

31/12/2017

Shared Drive Access

- Access to the Pensions Administration sub-folder will be restricted to appropriate staff. Request will be submitted to the Council's ICT provider, CGI. In every instance, access requests for new starts and terminations for leavers will be submitted to CGI without delay, e.g. legal trainees on temporary placement with Lothian Pension Fund.
- LPF will request CGI to provide shared drive user access details on an annual basis to enable them to perform a review and notify CGI of any inappropriate access rights as a security breach.

31/10/2017

31/10/2017

- Access to Altair and the shared drive will be incorporated into the LPF leavers process to ensure access is removed in a timely manner.

31/10/2017

Pensions Web Access

LPF recognises that, whilst control checks have been performed, processes and outcome reviews have not been formally documented. Accordingly, both recommendations are accepted and will be implemented.

- A revised list of current LPF users should be obtained from Civica to support each quarterly review performed throughout the year.
- Evidence of quarterly reviews performed should be retained together with confirmation that the full population of users has been reviewed during the year.

01/11/2017

01/11/2017

3. Fair Processing

Finding

The Pensions website privacy policy & data protection section states that the City of Edinburgh Council is the data controller in terms of the Data Protection Act 1998. This is contrary to the Information Commissioners Office Data Protection Register entry which notes that the data controller is the Lothian Pension Fund.

The welcome letter to new scheme members references the website, however it does not specifically draw attention to the privacy policy and data protection content outlined in the website.

The Pensions website privacy policy & data protection pages will require revision to comply with GDPR by May 2018, for example, opt outs should be opt ins.

Business Implication

- There is a lack of clarity as to who the Data Controller is; LPF or CEC
- There is a lack of transparency at the point of entry to the scheme as to how new members' data may be used.

Finding Rating

Low

Action plans

Recommendation

Fair Processing

- Agreement regarding data controller responsibilities between LPF and CEC should be clarified and the ICO registration and Pensions website updated accordingly.
- The welcome letter should be updated to include a reference to the privacy policy and data protection content outlined in the website.
- Website privacy policy & data protection pages should be reviewed to ensure compliance with GDPR requirements by May 2018.

Responsible Officer

Chief Risk Officer,
Lothian Pension Fund

Agreed Management Action

Estimated Implementation Date

Recommendations accepted – all actions recommended by Internal Audit will be fully implemented.

31/12/2017

4. Monthly Reconciliations

Finding

Automated monthly reconciliations are performed using pension reference numbers to ensure that employers contribution data uploaded by scheme members to Pensions Web is completely and accurately transferred across to the Altair pensions administration system. Exception reports are generated and reviewed to confirm that the full population of records and contribution data submitted has been accurately transferred to Altair.

City of Edinburgh Council (CEC) pension reference numbers are regularly changed in the Council payroll system and LPF is not notified. There was a batch change in November 2016 and old and new pension references were not provided, so completeness reconciliations could not be performed for City of Edinburgh Council employees.

It was noted that CEC are to provide a report of monthly changes, however the effectiveness of this automated reconciliation control will be reduced as manual intervention will be required.

Business Implication

Risk that CEC employee contribution data in the Altair system is incomplete and inaccurate with effect from November 2016.

Finding Rating

Low

Action plans

Recommendation

Monthly Reconciliations

- LPF should liaise with CEC to ensure that reports of monthly changes are produced and provided.
- Once reports are received from CEC, LPF should design and implement a revised contributions reconciliation process for CEC employees.

Responsible Officer

Chief Finance Officer,
Lothian Pension Fund

Agreed Management Action

At its meeting on 20 March 2017, Pensions Committee was advised of the following:

“City of Edinburgh Council – Pension Record Identifier - The Fund is also addressing data issues caused by the inherent but undesired variability in the City of Edinburgh Council’s payroll “position identifier” also being the identifier for pension records. This has caused significant issues as the Council is currently undergoing a review of their services and staff are being given a new identifier as part of this process.”

The Fund continues to liaise with the Council’s payroll staff, both to ensure monthly reports are received and reconciliation to member records is effective timeously.

Estimated Implementation Date

31/10/2017

5. Clear Desk Policy Compliance Breach

Finding

An after-hours walkabout to test compliance with the clear desk policy confirmed compliance in respect of individual workstations, however, sensitive data had been left in an in-tray in the business centre; payroll data and members statements marked 'returned to sender'. Additionally, LPF management have confirmed that office cupboards are not locked.

Whilst there is controlled access to the LPF offices, these documents could potentially be viewed by (for example) by cleaning and maintenance staff with access to the building.

Business Implication

- Inappropriate access to sensitive personal data and potential Data Protection Act breach.
- Non-compliance with LPF clear desk policy.

Finding Rating

Low

Action plans

Recommendation

After hours clear desk policy checks should be performed across all areas within LPF (including the business centre) to ensure that documents have been secured and cupboards lock with appropriate action taken where any exceptions have been identified.

Responsible Officer

Chief Executive Officer,
Lothian Pension Fund

Agreed Management Action

Recommendations accepted – all actions recommended by Internal Audit will be fully implemented.

Estimated Implementation Date

31/10/2017

6. Best Practice Improvement Opportunities

Finding

Two best practice improvement opportunities were noted during the audit:

1. There is no specific procedure or script for requests from Independent Financial Advisors (IFAs) to prompt the requirement for a signed and dated mandate from the member to be provided with any IFA requests. It was noted that most IFAs automatically provide this mandate.
2. The action taken for a data protection breach identified and recorded in the breaches log in relation to members' self-service on 07/12/16 was considered to be inappropriate: *'We have changed the process, and if the member has issues registering we send the activation code by post rather than by e-mail'*.

The decision to send activation codes by post appears to be excessive and would mean slower customer service. A more appropriate action would be to remind staff to take care when sending emails, and include a step in the process to delete links after posting / expiry of link after use.

Business Implication

Business processes not operating as efficiently as possible.

Finding Rating

Advisory

Action plans

Recommendation

Responsible Officer

Best Practice Improvement Opportunities

1. Process documentation should be updated to ensure that a signed and dated client mandate is requested and received before client information is provided to IFAs.
2. Employees will be permitted to send activation codes via e mail, and a reminder will be issued to ensure employees are aware of the requirement to delete links after posting / expiry of link after use.
3. Review of a sample of activation emails will be performed on an ongoing basis to ensure that activation links have been removed.

Chief Finance Officer,
Lothian Pension Fund

Agreed Management Action

Estimated Implementation Date

1. Where a request from an IFA is received on behalf of a member, if a signed mandate from the member is not provided with the request, the IFA is asked to provide one. A member's information would not be sent to an IFA without a current mandate.

In place

Our transfer out procedure is in the process of being reviewed and will incorporate IFA requests. The procedure will specify that a member's mandate is required where we get a request for information from an IFA, and that the mandate should be current (i.e. dated no older than a year from the request). If no mandate is provided, or it is out of date, then the IFA will be asked to provide a current one.

31/10/2017

2. This issue was caused by members not being able to locate the system generated email as it was being treated as spam by some email providers such as Hotmail and AOL. We have introduced a paragraph that is included in our email responses that are sent to members on

31/10/2017

how to trace the email and this has resulted in a resolution of most of the issues.

Appendix 1 - Basis of our classifications

| Finding rating | Assessment rationale |
|-----------------|---|
| Critical | <p>A finding that could have a:</p> <ul style="list-style-type: none"> • Critical impact on operational performance; or • Critical monetary or financial statement impact; or • Critical breach in laws and regulations that could result in material fines or consequences; or • Critical impact on the reputation or brand of the organisation which could threaten its future viability. |
| High | <p>A finding that could have a:</p> <ul style="list-style-type: none"> • Significant impact on operational performance; or • Significant monetary or financial statement impact; or • Significant breach in laws and regulations resulting in significant fines and consequences; or • Significant impact on the reputation or brand of the organisation. |
| Medium | <p>A finding that could have a:</p> <ul style="list-style-type: none"> • Moderate impact on operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations resulting in fines and consequences; or • Moderate impact on the reputation or brand of the organisation. |
| Low | <p>A finding that could have a:</p> <ul style="list-style-type: none"> • Minor impact on the organisation's operational performance ; or • Minor monetary or financial statement impact; or • Minor breach in laws and regulations with limited consequences; or • Minor impact on the reputation of the organisation. |
| Advisory | <p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p> |

Appendix 2 – Terms of Reference

Resources – Lothian Pension Fund

Terms of Reference – Information Governance

To: Clare Scott, Chief Executive Officer, LPF

From: Gemma Dalton, Principal Audit Manager

Date: 20 July 2017

Cc: Stephen Moir, Executive Director of Resources
John Burns, Chief Finance Officer, LPF
Struan Fairbairn, Chief Risk Officer, LPF
Diane Sinclair, Deputy Pensions Operations & Development Manager, LPF

This review is being undertaken as part of the 2017/18 internal audit plan approved by the Pensions Committee in March 2017.

Background

Lothian Pension Fund ('the Fund') is the second largest local government pension fund in Scotland with over 70,000 members. The Fund holds personal data about its members and their next of kin which allows it to perform core functions such as collecting pension contributions and paying pension benefits. The Fund may share this data with employers and service providers for pensions administration and fraud prevention purposes.

This review was included in the 2017/18 Internal Audit Plan to assess the Fund's information governance maturity before the General Data Protection Regulations come into force in 2018, and in response to a number of minor data protection breaches in the past year.

Scope

The scope of this review will be to assess the design and operating effectiveness of the controls in place to mitigate the following risk:

- Members' confidential data is lost or made public/breach of the Data Protection Act.

Our audit approach is as follows:

- Obtain an understanding of the Fund's information governance processes through discussions with key personnel, review of systems documentation and walkthrough tests;
- Identify the key risks around information governance;
- Evaluate the design of the controls in place to address the key risks; and
- Test the operating effectiveness of the key controls.

Testing, where appropriate, will be undertaken for the period 1 April 2017 to date.

The sub-processes and related control objectives included in the review are:

| Sub-process | Control Objectives |
|-------------------------------------|---|
| Responsibilities & Compliance | <ul style="list-style-type: none"> • Staff are aware of their information governance responsibilities and what support there is for them. • Staff know how to report an information security or data protection breach. • Information risks and incidents are identified, recorded and managed through the Fund's Risk Management Framework. |
| Data Quality | <ul style="list-style-type: none"> • Member data held by the Fund is accurate and reliable. |
| Protection | <ul style="list-style-type: none"> • Staff have appropriate access permissions to personal data. • Data is stored, organised, and clearly identified according to the sensitivity of its content. • Data is appropriately protected if it is taken offsite. • Data is secured against theft, loss, and damage. • Any removable media and hosted services (e.g. Apps and websites) are authorised, managed, and reviewed. • Staff use secure Council devices for all tasks where personal data is used or accessed. • Privacy is actively considered and assessed when designing or changing processes. |
| Data Sharing | <ul style="list-style-type: none"> • There are data sharing agreements and protocols in place for any routine data sharing undertaken. • Appropriate authorisations are sought from members/powers of attorney in relation to using or sharing their personal data. • Staff know how and when to share information with third parties. • Ad hoc requests for personal data from other organisations are dealt with according to Council policy. |
| Availability | <ul style="list-style-type: none"> • Data is available to the right staff in the timeframe needed to meet business need and statutory obligations. |
| Retention & Disposal | <ul style="list-style-type: none"> • Records containing personal data are closed and retained or disposed of against the relevant Council retention rule. • Records are disposed of according to the sensitivity of their content. • Redundant, obsolete, and trivial information is routinely identified and cleared out. |
| General Data Protection Regulations | <ul style="list-style-type: none"> • Changes required to the Fund's records management processes in order to comply with the General Data Protection Regulations have been identified. • Any such changes identified will be implemented by 25 May 2018, when the General Data Protection Regulations come into effect. |

Limitations of Scope

The scope of our review is outlined above and is limited to members' personal data controlled and/or processed by Lothian Pension Fund.

Internal Audit Team

| Name | Role | Contact Details |
|----------------|-------------------------|-----------------|
| Lesley Newdall | Chief Internal Auditor | 0131 469 3216 |
| Gemma Dalton | Principal Audit Manager | 0131 469 3077 |
| Christine Shaw | Internal Auditor | 0131 469 3075 |

Key Contacts

| Name | Title | Role | Contact Details |
|------------------|--|----------------|-----------------|
| Clare Scott | Chief Executive Officer, LPF | Review Sponsor | 0131 469 3865 |
| John Burns | Chief Finance Officer, LPF | Key Contact | 0131 469 3711 |
| Struan Fairbairn | Chief Risk Officer, LPF | Key Contact | 0131 529 4689 |
| Diane Sinclair | Deputy Pensions Operations & Development Manager | Key Contact | 0131 529 4336 |

Timetable

| | |
|-------------------------|------------------------------|
| Fieldwork Start | 19 th July 2017 |
| Fieldwork Completed | 4 th August 2017 |
| Draft report to Auditee | 11 th August 2017 |
| Response from Auditee | 18 th August 2017 |
| Final Report to Auditee | 25 th August 2017 |

Follow Up Process

Where reportable audit findings are identified, the extent to which each recommendation has been implemented will be reviewed in accordance with estimated implementation dates outlined in the final report.

Evidence should be prepared and submitted to Audit in support of action taken to implement recommendations. Actions remain outstanding until suitable evidence is provided to close them down.

Monitoring of outstanding management actions is undertaken via monthly updates to the Chief Finance Officer. The Chief Finance Officer liaises with LPF officers to ensure that updates and appropriate evidence are provided when required.

Details of outstanding actions are reported to the Pensions Committee on a quarterly basis.

Appendix 1: Information Request

It would be helpful to have the following available prior to our audit or at the latest our first day of field work:

- Records Management Manual, and/or other guidance on data handling issued to the Pensions Administration team

This list is not intended to be exhaustive; we will require additional information during the audit which we will bring to your attention at the earliest opportunity.

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

Pensions Administration Data Quality

| | |
|---------------------|---|
| Item number | 5.3 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

The purpose of this report is to inform the Pensions Audit Sub-Committee of the ongoing work to enhance the quality of pension administration membership record data.

Aside from poorer service for members and additional costs in areas such as error correction, compensation claims from members and fines from regulators, poor record-keeping could potentially necessitate more conservative actuarial assumptions as well as causing reputational damage. Lothian Pension Fund, therefore, places a high importance on the quality of its pension administration data.

In accordance with its Pension Administration Strategy, the Fund continues with its efforts to improve the flow of data from employers through regular reporting and liaison.

Pensions Administration Data Quality

1. Recommendations

Committee is requested to:

- 1.1 Note and be assured by the report and highlight any points it would like to raise at the Pensions Committee on 12 December 2017.

2. Background

- 2.1 In previous years, Pensions Audit Sub-Committee has noted reports on the ongoing work to enhance the quality of pension administration membership record data. These have also emphasised the importance of good record-keeping, given the serious negative implications of inaccurate and missing information. The information demands of accurate record-keeping increased with the introduction of a scheme based on career average revalued earnings (CARE) in 2015.
- 2.2 As stated in the Lothian Pension Fund's Annual Report 2017, the pension funds are fully compliant with best practice as defined by the Pensions Regulator's guidance on record-keeping.
- 2.3 As Committee is aware, Lothian Pension Fund introduced a new employer on-line system in 2013/14. This portal facilitates secure electronic data transfer of member information from employers to the Fund, serving to increasing efficiency and reducing the risk of manual errors.
- 2.4 The Fund sets out standards for provision of data from employers in an agreed Pensions Administration Strategy (PAS). It includes scope for the Fund to levy charges to cover any resultant costs if an employer's performance continues to fall below acceptable tolerances. This provision ensures that the administrative costs of the Fund are borne equitably by all the employers. Criteria for passing on costs of poor performance by employers consist of any of the following;
 - Contributions received later than the regulatory standard;
 - Not regularly addressing membership data queries;
 - Consistently failing to meet service standards for new starts, leavers, retirements and deaths, and no clear commitment to improve; and
 - Not submitting monthly contributions for each member via the secure portal, or no clear commitment to implement such, before 1 April 2017.
- 2.5 Committee is reminded that, following the end of contracting-out of the Second State Pension (S2P) on 5 April 2017, HMRC will be sending a statement to all

individuals affected stating the amount of Guaranteed Minimum Pension (GMP) they will receive and who is responsible for paying it. As implied, GMP is the underpin that guarantees benefits will be no lower than the additional state pension a member would have accrued had their pension not contracted out. As different levels of indexation are applied to the GMP element of a member's pension compared to the balance, any incorrectly calculated GMPs can result in over or underpayment of benefits. Ahead of the UK Government's deadline of December 2018, pension schemes need to reconcile the GMP values they hold for members with those calculated by HMRC.

3. Main report

Pension Administration Strategy (PAS) performance 2017/18 to date

- 3.1 Fund-wide performance against PAS standards is reported each year in the Annual Report. Annual reports are issued to each employer outlining their own performance and comparing this to other employers of a similar size. Quarterly reports are also issued to the four councils and also on an exception basis to any employer whose performance merits specific intervention.
- 3.2 Overall employer performance for the first two quarters (cumulative) of 2017/18 is shown below, with 2016/17 shown for comparison purposes.

| Employer performance | | Quarters 1 and 2 ; 2017/18 | | | 2016/17 | | |
|----------------------|-----------------------|----------------------------|----------------------|-----------------|-----------------|----------------------|-----------------|
| Case type | Target (working days) | Number received | Number within target | % within target | Number received | Number within target | % within target |
| New Starts | 20 | 2,201 | 1,974 | 90% | 4,764 | 4,074 | 86% |
| Leavers | 20 | 889 | 433 | 49% | 3,425 | 1,421 | 42% |
| Retirements | 20 | 541 | 218 | 40% | 1,244 | 440 | 35% |
| Deaths in Service | 10 | 15 | 7 | 47% | 29 | 21 | 72% |

- 3.3 Overall, the results show a continuation of poor employer performance in the first half of this financial year, particularly for retirements and leavers. That said, there is a small improvement for both categories as compared to the year 2016/17.
- 3.4 The poor performance for leavers in 2016/17 and in the first two quarters of this year is primarily due to the voluntary staff release programme of the City of Edinburgh Council (CEC). Significant numbers of leavers were identified only through the year-end process, given the data matching difficulty arising from the lack of a stable "Unique Pension Record Identifier", as previously reported to Pensions Committee on 20 March 2017. Similar issues prevailed in respect of Midlothian Council. Excluding these two major employers, there were:
- 513 leavers, 59% of which were received within target;

- 306 retirements, of which 57% were received within target.
- 3.5 The receipt of new start information through the secure data transmission portal is generally good. Missing records were identified via the monthly contribution return process and details requested.
- 3.6 As in previous years, senior officers from the Fund will be holding annual meetings with large employers and these meetings will include discussion of the performance to highlight the key areas where improvement is required. Previous meetings have revealed that there is continued frustration over late notification of retirements and leavers by line managers to HR Payroll staff and the Fund has offered to help draft communications to attempt to increase awareness of the lead-in time required for retirements.

Monthly Contribution Return (MCR) position

- 3.7 As Committee is aware, the Fund's data transmission portal facilitates reconciliation of pension contribution payments by employers to member individual records on a monthly basis. By this means, any missing information, for example, new member, leaver, or mismatch of member working hours, can be identified promptly. The introduction of MCR is a significant step in improving data quality and improving the service to members.
- 3.8 At the start of the year, the Fund had 96 employers with active memberships. As at 30 September 2017, this had reduced to 92. Of these, 91 employers are submitting monthly returns and, for the first quarter, 93% of such returns were provided within the requisite timescale. The sole employer which does not yet not provide MCR is Scottish Fire and Rescue Service (SFRS). The Fund has been in regular contact with SFRS to expedite matters and has made known its frustration with the delay. This is particularly so given that the Fund originally advised employers of its MCR requirements in late 2015 and also the payroll system used by SFRS is supplied by the same provider as two of the Fund's largest Council employers. The Fund has received assurance that SFRS is engaged in dialogue with its payroll supplier to affect the necessary system amendments and a target date for completion by Christmas 2017 has been advised by SFRS.
- 3.9 In addition to SFRS, the "Pension Administration Data Quality" report, which was considered by Pensions Audit Sub Committee on 27 September 2016, identified two other employers which had yet to supply MCR. An update of progress is that:
- a. SEStran provided 12 returns for the 2016/17 year in April 2017. Since then, it has provided MCR within the requisite timescales.
 - b. Scottish Police Authority commenced providing monthly returns in September 2017 and to-date the Fund has received files for April to July 2017.
- 3.10 For the first half of 2017/18, to-date the Fund has posted member basic contributions of £18,696,914.03 (84.6% of total payment received) and recorded a Career Average Revalued Earnings (CARE) pensionable pay of £299,571,898.15 (84.2% of total CARE pay earned). Currently, the Fund has been unable to post

contributions (£2,558,126.51) and pay (£41,996,187.58) for The City of Edinburgh Council for August and September 2017. This reflects a residual issue with undesired volatility in the Unique Pensions Record Identifier in the recording of the backdated pay award in August's return. A revised file has been requested and is currently being actioned.

City of Edinburgh Council – pension record identifier and resulting backlog of data queries

- 3.11 As Pensions Committee is aware, a significant backlog of data queries has arisen owing to the inherent but undesired variability in the City of Edinburgh Council's payroll "position identifier" also being the identifier for pension records. To that end, the Head of Human Resources, City of Edinburgh Council, who has been assigned responsibility for the payroll function, has committed to secure suitable resources to address this as a priority. It is expected that the payroll system solution to provide requisite stability in the Unique Pension record Identifier should be delivered at pace. An oral update will be provided to Pensions Audit Sub-Committee.

Annual Benefit Statement 2017 – data returns from employers

- 3.12 As previously reported to Pensions Committee at its meeting on 27 September 2017, 49,051 annual benefit statements were produced by the statutory deadline of 31 August 2017, representing 99.9% of records where current member address details were held.

Pension Administration Strategy (PAS) – recovery of cost arising from unsatisfactory data transmission by employers

- 3.13 The PAS stipulates that failure by an employer to provide the Fund with a year-end return by 19th April each year shall incur a £200 initial fee plus 5p per active member per working day from 20 April to date return is received.
- 3.14 In accordance with the PAS, therefore, seven employers will be issued with fines due to late submission of their year-end data.
- 3.15 The PAS also provides for cost recovery by the Fund from an employer should it not submit Monthly Contribution Returns by the due date, the specific provision being "£50 fee per occurrence plus 5p per active member. Charges to be levied on an annual basis at the discretion of the Fund from April 2016." The two employers who have not done so (as at paragraphs 3.8 and 3.9 above) will be subject to this recovery of costs incurred.

Actuarial Valuation as at 31 March 2017

- 3.16 A detailed report on the assessment of the quality of the pension member record data provided for the Actuarial Valuation 2017 for each of the three pension funds, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund is expected shortly. An oral update will be provided to Pensions Audit Sub-Committee.
- 3.17 The Actuary, however, commented at the Fund's annual employer seminar on 2 November 2017, that the data submission was of very good quality and compared

most favourably to other Funds within the Local Government Pension Scheme (LGPS). None of the serious data concerns, evident from the Actuarial Valuation as at 31 March 2016 for the LGPS funds in England and Wales, were encountered.

Guaranteed Minimum Pension (GMP) reconciliation

- 3.18 Data analyses to reconcile the GMP records held by the Fund to those of HMRC is now well underway. The current position being that 64% of relevant records align, within acceptable tolerance, to those held by HMRC. This progress is considered satisfactory, in the context of a deadline for full reconciliation by December 2018, although much work remains to be done.
- 3.19 The UK Government has not yet responded to its public consultation on the indexation of GMPs for members who reach State Pension Age after 5 December 2018.

Other data quality initiatives, including mortality screening and tracing

- 3.20 Matching our records to the General Registrar's Office for Scotland, Disclosure of Death Information (Scottish GRO) and also the National Fraud Initiative (NFI) were covered separately in the report "Fraud Prevention", which was considered by the Pensions Audit Sub-Committee, at its meeting on 26 September 2017. In this context, it should be noted that the quarterly GRO mortality validation has been postponed, pending establishment of an enhanced secure data transfer portal. The "Fraud Prevention" report also encompassed the Local Government (LGA) National Insurance number database and the "Tell Us Once" death notification service. In addition, the Fund continues to use mortality screening and address tracing services.

Longevity monitoring and data quality assurance - "Club Vita"

- 3.21 Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund participate in "Club Vita", which is a specialist company providing longevity monitoring and experience analyses. Various data quality assurance checks are undertaken on an annual basis. In this respect, it is particularly important for data to be clean in a number of key areas for example 'lifetime' dates such as dates of birth and death, and information which may distinguish between those with significantly different life expectancies ('longevity predictors'), such as pension amounts or postcodes.
- 3.22 As at the recent annual report in October 2017, data quality compared very favourably with other funds. Club Vita's commercial confidentiality constraints, however, do not permit more detailed disclosure.

Management information and data quality monitoring

- 3.23 The Fund intends to enhance its management information and facilitate greater transparency as to its data quality provision. This will include regular use of the actuarial valuation portal and also analyses of compliance with the Pension Regulator's standards, through a similar tool being developed by suppliers of pension administration software systems. Given the focus on resolution of data

issues referred to elsewhere in this report, progress on improved statistical reporting has been delayed.

4. Measures of success

- 4.1 Data quality performance standards are measured against best practice guidance from the Pensions Regulator and included in the Annual Report of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

5. Financial impact

- 5.1 There are no direct financial implications as a result of this report.

6. Risk, policy, compliance and governance impact

- 6.1 There are no adverse risk, policy, compliance or governance impacts arising from this report. Poor data quality of member records, of course, does represent an inherent risk. This report advises of measures taken to mitigate this risk and ensure compliance with guidance from the Pensions Regulator.

7. Equalities impact

- 7.1 There are no equalities implications as a result of this report.

8. Sustainability impact

- 8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

- 10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: John Burns, Chief Finance Officer, Lothian Pension Fund

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

11. Appendices

None.

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

EU Tax Claims and Income Recovery

| | |
|---------------------|---|
| Item number | 5.4 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

This report summarises activity on EU and other tax claims made on behalf of the Lothian Pension Fund. During the period since the last report, no additional claims have been received and the amount recovered to date remains at £1.3million. Progress on the remaining claims is discussed in detail within the report.

EU Tax Claims and Income Recovery

1. Recommendations

Committee is requested to:

- 1.1 Note the report and highlight any points it would like to raise at the Pensions Committee on 12 December 2017; and
- 1.2 Note the decision by Officers not to refresh the older Fokus Bank claims in Italy. This was based on an assessment of the cost and the perceived remote likelihood of the claims ultimately being paid. See the table at 3.10 below.

2. Background

- 2.1 EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt or payable tax credits thereon. They relate to a fundamental principle of EU law, that all member states should not discriminate in the application of national taxes between home tax payers and those in other member states in a way that is likely to hinder the free movement of capital.
- 2.2 The claims can be divided into three main types – Manninen / Foreign Income Dividends (FIDS), Fokus and Manufactured Dividends.

3. Main report

Claims - Manninen / Foreign Income Dividends (FIDS)

- 3.1 These claims are against the UK tax authorities. The FIDs claim is based on the UK providing for the repayment of tax credits on UK dividends but not on Foreign Income Dividends ("FIDs") paid by UK companies. The Manninen claim is based upon the non-availability of payable tax credits in relation to foreign dividends.
- 3.2 The European Court of Justice's ruling in the Manninen tax case in September 2004 opened an avenue for claims for tax credits on EU dividends. Pensions Committee has previously agreed to pursue potential claims.
- 3.3 Based on the decision in the Manninen case, KPMG's EU Tax Group is undertaking statutory claims on behalf of UK pension funds to claim a repayment of tax credits on FIDs and overseas dividend income in respect of periods 1990/91 to 1997/98. Pension funds have also pursued parallel claims in the High Court.
- 3.4 The claims are for tax credits and are based on the rate of advance corporation tax in place in respect of the overseas dividends. While the UK tax authorities are

disputing the validity of such claims, the estimates show that Lothian Pension Fund could benefit by up to £2.6m from a successful claim. A cost benefit analysis concluded that a claim should be lodged, and this was done on 9 February 2006.

3.5 HMRC has rejected all claims of this nature. As a result, KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery by way of a test case brought with the BT Pension Scheme as the test claimant.

3.6 A chronology of events to date is provided in the table below:

| Date | Event |
|---------------|---|
| March 2011 | First-tier Tribunal (FTT) published its judgement on the test case: <ul style="list-style-type: none"> • Withholding of tax credits on foreign income dividends and overseas dividends (Manninen) was a breach of EU law – the substantive issues. • All but one of the claims were out of time because they were made more than six years after the end of the tax year in which the relevant dividends were received - the out of time issue. |
| July 2012 | Appeal against the FTT judgement was heard by the Upper Tribunal. |
| February 2013 | Upper Tribunal published its judgement on the appeal and supports judgement of the FTT. |
| April 2013 | Upper Tribunal refuses HMRC’s request for leave to appeal on the substantive issue and claimants’ request on the out of time issue. |
| June 2013 | Court of Appeal approves direct requests to appeal from HMRC and claimants. |
| November 2013 | Court of Appeal advises that a preliminary hearing will be held in December 2013 to decide if any questions related to the case should be referred to the Court of Justice of the European Union (CJEU). |
| January 2014 | Court of Appeal rejects the claimants’ appeal on the out of time issue (based on UK domestic law). A further hearing by the Court of Appeal was set for February 2015 to consider HMRC’s appeal on the substantive issue and the out of time issue (based on European law). It is possible that the Court of Appeal will refer certain issues to the CJEU at this hearing. |
| June 2015 | The second Court of Appeal hearing took place in June 2015 concerning EU law based “out of time” arguments and the substantive issues. |

| | |
|----------------|--|
| July 2015 | <p>The Court of Appeal handed down its judgement:</p> <ol style="list-style-type: none"> 1. The original decision on the out of time issue is upheld. 2. On the substantive FIDs issue the Court has decided to refer this to the CJEU. 3. The Court did not determine the substantive Manninen issue because it was found not to be relevant as the claims were out of time. <p>On the FIDs substantive issue the parties agreed the specific questions that will be referred to the CJEU.</p> |
| August 2015 | On the out of time issue an application for permission to appeal was submitted to the Supreme Court directly. |
| January 2016 | <p>The Supreme Court refuses to grant permission to appeal on out of time issue.</p> <p>CJEU acknowledge start of legal process on the substantive issue. Hearing should take place late in 2016 with the judgement likely to be issued within six months afterwards.</p> |
| November 2016 | CJEU hearing was held on 9 November 2016. |
| December 2016 | The Opinion of the Advocate General was released, which recommended that the CJEU should conclude that the denial of payable tax credits on FIDs was an unjustifiable breach of EU law. |
| September 2017 | CJEU full judgement released on 14 September 2017. This is a positive outcome with a clear finding of a breach of EU law in denying tax credits on FIDS. |

3.7 The above wording on progress with this claim has been reviewed by Pinsent Masons.

3.8 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £63.4k (£63.4k as at the last update to Committee in December 2016). Assuming that the case is pursued to a final conclusion, total costs for the Fund are capped at £90k. This compares with the claim for £2.6m.

Claims – Fokus Bank

3.9 These claims are against the tax authorities of the EU member states (and Norway) in which the Fund has invested. The basis of the claims is that the tax authorities have applied favourable tax treatment to domestic pension funds that they have denied to pension funds in other member states.

3.10 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £3.7m have been made. Progress on the claims is summarised in the table below.

| Country | Claim Period From / To | Estimated Amount Claimed | Amount Received | Notes |
|-------------------------|------------------------|--------------------------|-----------------|---|
| Completed Claims | | | | |
| Austria | 2006 2010 | £83.0k | £83.0k | Claim paid in September 2012. |
| Netherlands | 2003 2006 | £440.0k | £440.0k | Claim paid in 2009. |
| Norway | 2004 2010 | £278.9k | £278.9k | All claims paid - final instalment received in February 2013 (£73k) |
| Spain | 2004 2009 | £568.2k | £568.2k | All claims paid - final instalment received in March 2015 (£102k) |
| Active Claims | | | | |
| France | 2005 2009 | £692.0 [€776.7k] | - | <p>15% tax imposed on all pension funds from 1 January 2009 – so no further claims can be made after that date. In May 2012, the EU Court ruled in the Santander test case that refunds must be paid to investment funds.</p> <p>In February 2016 KPMG submitted a comparability analysis demonstrating that Lothian Pension Fund is in a similar situation to the test claimant. For efficiency purposes our claim is being included in a batch with similar claimants. This has delayed the filing of the documentation with the French Tax Authorities (FTA).</p> <p>To date KPMG have not received any response from the FTA. KPMG will contact the FTA in 2018 if they do not start to hear from them in respect of any clients and consider whether any other action should be taken. The FTA's willingness to resolve the cases is highly influenced by political developments in France and there have been elections in 2017.</p> <p>Significant interest accrues on any refunds from France and it is paid automatically.</p> |

| Country | Claim Period From / To | Estimated Amount Claimed | Amount Received | Notes |
|---------|---|---|-----------------|---|
| Germany | <p>KPMG 2003 2010</p> <p>Deloitte 2011 2014</p> | <p>£958.5k [€1,076.0k]</p> <p>£120.7k [€135.5k]</p> | - | <p>In August 2015, following a competitive tender, Deloitte LLP was appointed to make additional claims in respect of the calendar years 2011 to 2014 inclusive.</p> <p>The ability to progress the claims has been made considerably more difficult due to fact that there are a number of forms of German pension fund and none are exactly the same as a UK pension fund. They tend to operate in a more commercial manner and benefits are based on returns rather than defined benefit.</p> <p>It would appear that the optimal comparable German pension fund form from a discrimination perspective is subject to tax but able to deduct technical provisions for future pension payment. This means that the test claimant needs to demonstrate that if they calculated their taxable profits according to German tax law there would be no (or less) German tax to pay than the WHT suffered. ("net tax calculation"). In these circumstances, the calculation/proof of discrimination is complex and the burden of proof required to establish discrimination is unclear.</p> <p>There have been a number of net tax cases decided by the CJEU with conflicting results. Some positive and some negative. Some of the conflict stems from what is considered an allowable expense for calculating the level of discrimination and amount of "direct linkage" to the collection of the dividend income that is necessary. It also seems that one negative decision was based on incorrect interpretation of the earlier CJEU ruling in Commission v Germany.</p> |

| Country | Claim Period From / To | Estimated Amount Claimed | Amount Received | Notes |
|--------------|------------------------|--------------------------|------------------|--|
| | | | | <p>The German tax authority are of the view that there is no case to answer for pension funds due to this unsuccessful case against them but they ignore the fact that the EU Commission chose not to look at the whole picture (and they also ignore the positive outcome in Commission v Finland which specifically addressed in principle the deductibility of provisions in the net tax comparison for pension funds).</p> <p>Whilst getting litigation in Germany underway is very slow the chances of getting the positive result will be greater with the insights KPMG have from other cases (rather than being the "guinea pig").</p> |
| Italy | 2004 2010 | £535.1k [€600.5k] | - | <p>The Italian Tax Authority (ITA) has taken no action in respect of claims and it seems litigation will be required for a resolution. There has been little appetite amongst claimants to date, to fund a test case. KPMG believe claimants prefer to concentrate efforts on France and Germany before considering Italy.</p> <p>If the ITA ignore claims for a period of 10 years then the claimant must refresh the claim in order to keep the claim alive.</p> <p>Officers have considered the cost of refreshing the claim and the potential for the claims being paid and decided not to pursue this option. This means that €329k of the claim will lapse reducing the value of the remaining claim to £240k.</p> |
| TOTAL | | £3,676.4k | £1,370.1k | |

3.11 Exchange rate movements have had the effect of increasing the value of the unpaid claims since last year's report. Reducing the estimated total amount claimed from £3,707.9k to £3,676.4

- 3.12 Fees incurred to date on these claims amount to £389.7k (£389.7k as at the meeting of December 2016). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Claims – Manufactured Dividends (MODs)

- 3.13 This claim is against the UK tax authorities. It is based on the fact that manufactured dividend receipts relating to UK shares were not subject to any UK withholding tax but receipts relating to manufactured overseas dividends suffered a UK withholding tax.
- 3.14 Note that manufactured dividends are dividends created when a security is out on loan at the time the company pays a dividend.
- 3.15 Claims in respect of manufactured dividends totalling £4,870.6k have been lodged with HMRC on behalf of Lothian Pension Fund.
- 3.16 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery. A brief chronology of events to date is provided in the table below:

| Date | Event |
|---------------|---|
| March 2013 | An initial hearing of the First-tier Tribunal (FTT) took place. |
| During 2014 | Pinsent Masons were in correspondence with HMRC through the course of 2014 and have agreed a statement of facts in order to minimise the fact-finding undertaken by the Tax Tribunal at the hearing itself. |
| November 2015 | The case was heard by the FTT (sitting in London between 2 and 5 November 2015). A decision was reserved by the Tribunal to be handed down at a later date. |
| July 2016 | The FTT concluded that there was a movement of capital, but that the MODs rules applied by HMRC did not amount to a restriction on the movement of capital. |
| August 2016 | The FTT granted the test claimant permission to appeal its decision to the Upper Tribunal. |
| October 2016 | The Upper Tribunal (UT) stage commenced. |
| March 2017 | UT rejected immediate reference to CJEU. Reference was requested as it was deemed beneficial to make the reference as early as possible in view of the UK's scheduled exit from the European Union. |
| July 2017 | Substantive UT appeal has been listed for a hearing in February 2018. |

- 3.17 The above wording on progress with this claim has been reviewed by Pinsent Masons.
- 3.18 Fees incurred to date on these claims amount to £162.3k (£146.3k as at the meeting of December 2016). Potential subsequent referrals are estimated to cost £20k for each legal stage.

4. Measures of success

- 4.1 Success is measured by the amount of tax recovered exceeding the cost of pursuing the claims.

5. Financial impact

- 5.1 Tax claims totalling of £11.2m have now been lodged with the relevant tax authorities. Professional fees amounting to £615.4k have been paid to date. As previously agreed by Pensions Committee, it is likely that further legal costs will be incurred in pursuing the claims. However, any legal costs are shared across a pool of fellow claimants and Lothian Pension Fund has the right to cease participation without incurring further costs.
- 5.2 Currently, claims paid to date exceed the costs incurred by £754.7k. So irrespective of the outcome of the remaining claims Lothian Pension will have accrued a financial benefit. The financial position can be summarised as follows:

| Claim Type | Total Claims £'000 | Claims Settled £'000 | Claims Outstanding £'000 | Costs to Date £'000 |
|------------------------|-------------------------------|---------------------------------|-------------------------------------|--------------------------------|
| Manninen | 2,626.7 | Nil | 2,626.7 | 63.4 |
| Fokus Bank | 3,676.4 | 1,370.1 | 2,306.3 | 389.7 |
| Manufactured Dividends | 4,870.6 | Nil | 4,870.6 | 162.3 |
| | 11,173.7 | 1,370.1 | 9,803.6 | 615.4 |

6. Risk, policy, compliance and governance impact

- 6.1 There are no risk, policy, compliance and governance impacts arising from this report.

7. Equalities impact

- 7.1 There are no equalities implications as a result of this report.

8. Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

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11. Appendices

None.

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

Investment Income Review Cross Border Withholding Tax

| | |
|---------------------|---|
| Item number | 5.5 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

This report provides information on a benchmarking study prepared by EY into the effectiveness of the procedures in place to manage the tax exposure on the investment income of Lothian Pension Fund and Lothian Buses Pension Fund.

The benchmarking report prepared by EY shows that Northern Trust is generally applying the correct withholding tax rates on investment income. Recovery claims are being processed and reclaims received but EY advise that the time taken seems to be longer than the market standard for refunds. A summary of the opportunities and issues identified is provided.

Investment Income Review Cross Border Withholding Tax

1. Recommendations

Committee is requested to:

- 1.1 Note the report and highlight any points it would like to raise at the Pensions Committee on 12 December 2017.

2. Background

The Taxation Environment

- 2.1 Lothian Pension Fund (LPF) and Lothian Buses Pension Fund (LBPF) invest directly in stock markets across the globe. These investments generate income that is potentially liable to income tax in the country of tax domicile. During the 2016/17 financial year the Pension Funds earned income from companies in 33 different countries.
- 2.2 UK pension funds are usually able to benefit from beneficial tax rates. These rates are normally determined by separate tax treaties established between the UK Government and most foreign countries. Tax on dividends varies between 0% and 35%. In contrast, income on fixed interest stocks is usually free from tax.
- 2.3 In virtually all countries income is subject to taxation at source, so the owner of the investments receives the income net of the appropriate amount of tax. Taxation deducted in this way is called withholding tax or WHT for short.
- 2.4 In some countries, the preferential rate for UK pension funds is subject to providing the tax authorities of the country concerned with an application and supporting paperwork. The exact requirements vary from country to country and in some cases, can be quite onerous. Failure to have preferential rate approval in place means that income will be subject to a higher rate of tax than is necessary.
- 2.5 The preferential rate may be applied at source, meaning that there is no tax to reclaim from the foreign tax authority. Alternatively, the rules of the country may require tax to be deducted at the full rate with a subsequent claim having to be made to the tax authority to get repayment of the difference between the full rate and the preferential rate.
- 2.6 The requirements to make a valid repayment claim and the time it takes for the claim to be paid vary considerably from country to country.

The Role of the Custodian

- 2.7 The custodian appointed for the three pension funds is Northern Trust (NT). In addition to the vital role of holding title to investments on behalf of the investor, the global investment custodian is responsible for the management of the procedures and processes that relate to the taxation of investment income.

The Scale of Activity – Lothian Pension Fund and Lothian Buses Pension Fund

- 2.8 The tables below show the movement in the reclaimable tax balances during the 2016/17 and 2015/16 financial years for both Lothian Pension Fund and Lothian Buses Pension Fund.

| Lothian Pension Fund | 2016/17 £ | 2015/16 £ |
|-------------------------------------|----------------------|----------------------|
| Brought Forward 1 April | 3,998,673.01 | 3,937,409.41 |
| Recoverable tax accrued during year | 3,975,760.09 | 2,113,859.80 |
| Claims paid during year | (3,771,744.82) | (2,052,596.20) |
| Carried Forward 31 March | 4,202,688.28 | 3,998,673.01 |

| Lothian Buses Pension Fund | 2016/17 £ | 2015/16 £ |
|-------------------------------------|----------------------|----------------------|
| Brought Forward 1 April | 433,978.69 | 476,181.59 |
| Recoverable tax accrued during year | 326,214.98 | 202,692.33 |
| Claims paid during year | (352,918.59) | (244,895.23) |
| Carried Forward 31 March | 407,275.08 | 433,978.69 |

- 2.9 The balance carried forward increased by £204k for Lothian Pension Fund and fell by £27k for Lothian Buses Pension Fund.
- 2.10 The year-end recoverable tax balances at 31 March 2017 and 31 March 2016, broken-down by country for both Lothian Pension Fund and Lothian Buses Pension Fund are provided in the tables below.

| Lothian Pension Fund | Reclaim Amount 31/3/17 £ | Number of Dividends 31/3/17 | Reclaim Amount 31/3/16 £ | Number of Dividends 31/3/16 |
|-----------------------------|---|--|---|--|
| Austria | 54,505.28 | 18 | 38,001.16 | 16 |
| Belgium | - | - | 33.37 | 1 |
| Canada | - | - | 4,526.36 | 2 |
| Denmark | 28,431.85 | 9 | 8,280.04 | 5 |
| France | 64,130.39 | 47 | 37,744.04 | 25 |
| Germany | 723,567.24 | 16 | 138,136.59 | 21 |
| Israel | - | - | 12,598.08 | 3 |
| Japan | - | - | - | - |
| Netherlands | 175,751.82 | 20 | 178,050.13 | 22 |
| Norway | 443,846.94 | 24 | 445,730.33 | 26 |
| Poland | - | - | 14,250.66 | 2 |
| Russian Federation | - | - | - | - |
| South Africa | - | - | - | - |
| Spain | 18,513.24 | 4 | 15,090.80 | 4 |
| Sweden | 340.54 | 1 | 326.30 | 1 |
| Switzerland | 2,583,416.00 | 28 | 2,918,336.47 | 46 |
| United Kingdom | 110,181.98 | 4 | 187,568.68 | 11 |
| United States | - | - | - | - |
| Grand Total | 4,202,688.28 | 171 | 3,998,673.01 | 185 |

| Lothian Buses Pension Fund | Reclaim Amount 31/3/17 £ | Number of Dividends 31/3/17 | Reclaim Amount 31/3/16 £ | Number of Dividends 31/3/16 |
|-----------------------------------|---|--|---|--|
| Denmark | 6,607.61 | 4 | 2,414.66 | 3 |
| France | 36,396.33 | 11 | 7,190.49 | 2 |
| Germany | 91,675.58 | 7 | 19,568.27 | 4 |
| Italy | - | - | 885.75 | 1 |
| Japan | - | - | - | - |
| Netherlands | 13,414.91 | 5 | 14,499.30 | 5 |
| Norway | 60,039.98 | 15 | 61,318.63 | 14 |
| South Africa | 1,118.65 | 1 | - | - |
| Spain | 2,584.93 | 1 | 2,396.08 | 1 |
| Switzerland | 178,232.03 | 7 | 305,725.80 | 15 |
| United Kingdom | 17,205.06 | 4 | 19,979.71 | 5 |
| Grand Total | 407,275.08 | 55 | 433,978.69 | 50 |

2.11 For Lothian Pension Fund, Switzerland accounts for 61% (73% at 31 March 2016) for the total amount receivable and for Lothian Buses Pension Fund the percentage for Switzerland is 44% (70% at 31 March 2016). The reason why the Swiss total claim value is so large is that 35% tax is deducted on all dividends and the 0% rate

relief is obtained by claiming the tax paid back. There are few other countries where the tax deducted at source is so high.

- 2.12 The Swiss, German, Dutch and Norwegian claims are discussed in more detail later in this report.

Scottish Homes Pension Fund

- 2.13 The Scottish Homes Pension Fund is mainly invested in pooled funds, so there is no requirement to recover income tax as this is organised by the pooled fund manager. However, with the change in investment strategy, the Scottish Homes Pension Fund now has direct holdings in equity investments. As a result, the Fund's WHT experience will be included in next year's version of this report.

3. Main report

Benchmarking Study

- 3.1 Given the complexity and scale of the taxation of investment income, it is important that the Funds' custodian, Northern Trust (NT), provides an efficient service. Failure to ensure that the correct tax rates are being applied would result in a direct loss of income. Poor management of the tax reclaim process could mean that recoverable tax is never recovered or delayed.
- 3.2 In order to assess the effectiveness of NT's work, Ernst & Young (EY) has been commissioned to prepare a benchmarking report. EY's remit was:
- Review the withholding tax rates applied by NT and verify these with a database of rates prepared by EY;
 - Identify areas where there is opportunity for greater relief from withholding tax than that currently being applied;
 - Quantify the amount of withholding tax that could potentially be reclaimed for the chosen study period (12 months to 31 August 2017);
 - Review the withholding tax reclaims that have been processed by NT and assess their timeliness.

Findings – WHT Rates Applied

- 3.3 The study concluded that generally NT has been applying the appropriate withholding tax rates for a UK pension fund. However, they have identified a number of potential opportunities and issues. These are summarised in the Appendix to this report. NT has responded to the points raised and the responses have been incorporated in the Appendix.

Findings – WHT Claims

- 3.4 The reclaim process consists of the custodian preparing an application in the required format for the country concerned. Once the application has been lodged with the tax authorities of the country, it will take the authority an amount of time to process the claim and pay the refund. This processing time varies from country to country – some take a matter of months and others will take a number of years.

- 3.5 The EY report identified examples of NT's claims processing being slower than the market standard for such work. However, with the exception of the Swiss, German, Dutch and Norwegian claims the amounts involved were relatively low. We will continue to work with NT to ensure that our claims are processed as quickly as possible.
- 3.6 Swiss claims accounted for 61% (£2,583k) of the value of Lothian Pension Fund claims. The amounts due can be summarised as follows:

| Year | Lothian Pension Fund | Lothian Pension Fund | Comment |
|--------------|----------------------|----------------------|---|
| | 31/3/17 £ | 31/3/16 £ | |
| 2014 | - | 1,040k | Paid in 2016/17 |
| 2015 | - | 1,153k | Paid in 2016/17 |
| 2016 | 1,630k | 725k | Outstanding at 31 October 2017 – Claim submitted to sub custodian |
| 2017 | 953k | - | Claim cannot be made until the end of the calendar year |
| Total | 2,583k | 2,918k | |

3.7 The oldest claim outstanding as at 31 March 2017 has been reduced by a complete year's claim compared to 31 March 2016.

3.8 For Germany, the position for the Lothian Pension Fund claims can be summarised as follows:

| Year | Lothian Pension Fund | Lothian Pension Fund | Comment |
|--------------|----------------------|----------------------|--|
| | 31/3/16 £ | 31/3/16 £ | |
| 2014 | - | 15k | Paid in 2016/17 |
| 2015 | - | 30k | Paid in 2016/17 |
| 2016 | 621k | 93k | Outstanding at 31 October 2017 – Claim submitted to sub custodian. Increase in exposure to German market has increased the amount to claim. |
| 2017 | 103k | - | Current NT status: Market issue. Awaiting further comment from NT. |
| Total | 724k | 138k | |

3.9 For the Netherlands, the position for the Lothian Pension Fund claims can be summarised as follows:

| Year | Lothian Pension Fund | Lothian Pension Fund | Comment |
|------|----------------------|----------------------|---------|
| | 31/3/17 | 31/3/16 | |

| Year | Lothian Pension Fund | Lothian Pension Fund | Comment |
|--------------|----------------------|----------------------|---|
| | £ | £ | |
| 2013 | 5k | 5k | Paid 2017/18 |
| 2015 | - | 145k | Paid 2016/17. |
| 2016 | 143k | 28k | Paid 2017/18 |
| 2017 | 28k | - | NT Status: Reclaim submitted to sub custodian |
| Total | 176k | 178k | |

3.10 For Norway, the position for the Lothian Pension Fund claims can be summarised as follows:

| Year | Lothian Pension Fund | Lothian Pension Fund | Comment |
|--------------|----------------------|----------------------|----------------------------|
| | 31/3/17 £ | 31/3/16 £ | |
| 2014 | - | 224k | Paid 2016/17 |
| 2015 | 223k | 201k | Paid 2017/18 |
| 2016 | 221k | 21k | £131k paid 2017/18 to date |
| Total | 444k | 446k | |

4. Measures of success

- 4.1 Minimising exposure to tax on investment income.
- 4.2 Obtaining prompt recovery of reclaimable income tax deducted at source.

5. Financial impact

- 5.1 The recoverable tax accrued during 2016/17 on Lothian Pension Fund was £3,976k (£2,114k 2015/16); claims paid were £3,772k (£2,053k 2015/16), leaving a balance to be recovered of £4,203k at 31 March 2017 (£3,999k at 31 March 2016).
- 5.2 For Lothian Buses Pension Fund, recoverable tax accrued during 2016/17 was £326k (£203k 2015/16); claims paid were £353k (£245k 2015/16), with the balance of £407k at 31 March 2017 (£434k at 31 March 2016).

6. Risk, policy, compliance and governance impact

- 6.1 There are no risk, policy, compliance and governance impacts arising from this report.

7. Equalities impact

7.1 There are no equalities implications as a result of this report.

8. Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

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11. Appendices

Appendix 1 – Summary of the findings of the withholding tax benchmarking report

11 December 2017

Summary of the Findings of the Withholding Tax Benchmarking Report

| Country | Findings | Conclusions as at Date of Preparation of Report to Pensions Audit Sub-Committee |
|---------|---|--|
| Canada | <p>Summary: Potential claim for £41,415 identified.</p> <p>Detail: 24 dividends have been subject to a 25% withholding tax, whilst a further 11 dividends have been subject to a 15% withholding tax. Those subject to 25%, are held at the dividend headline rate, and those subject to 15% are held at the treaty rate. However, pension funds should be tax-exempt with respect to their investment income and therefore a full reclaim may be possible.</p> <p>Northern Trust have advised that in 2016, your documentation did not cover Trust Income, which would explain why there have been amounts withheld. As the total amount available for reclaim is CAD 68,875 (£41,415), it may be worth considering applying for this. As this has been flagged by Northern Trust as not processed due to Lothian's documentation not covering Trust Income.</p> | <p>LPF comment: Trust income refers to the income from the Canadian form of unit trusts.</p> <p>NT comment: After reviewing the case further, and taking into consideration our experience in the market (NT is a withholding tax agent in Canada), it is NT's view that UK Pension Funds are not able to obtain the full withholding tax on Canadian TRUST INCOME.</p> <p>If EY believes that the full exemption can be applied to LPF on Canadian TRUST INCOME, NT can provide the necessary tax vouchers to allow EY to lodge the tax reclaims or NT could investigate further on the reclaim possibility provided that EY shares the necessary information to sustain their comments around the eligibility.</p> <p>Please also note that Canadian income not referring to TRUST INCOME was correctly paid at pay date.</p> <p>LPF Conclusion: EY have now confirmed that they agree with NT's second response that the correct withholding has been applied in this case based on the type of income. No further action is now required.</p> |
| Germany | <p>Summary: Confirmation needed on claim for £996,710</p> <p>Detail: 26 dividends have been subject to a 26.375% withholding tax rate. This is the dividend headline rate. The treaty rate is 10%. Northern Trust are not treating any of these as recoverable.</p> | <p>LPF comment: We have checked the data and confirm the finding. However, a review of the NT claim status report would appear to show that claims have been lodged.</p> <p>Query has been raised with NT to confirm that the claims have been made.</p> |

| Country | Findings | Conclusions as at Date of Preparation of Report to Pensions Audit Sub-Committee |
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| | <p>We would have expected Northern Trust to access the treaty rate on the 26 dividends. As Lothian has suffered a higher rate, the total tax leakage that could have been avoided is EUR 1,119,145 (£996,710). From our discussions with Northern Trust so far, it is not clear if these are being recovered and this should be monitored.</p> | <p>NT comment: Germany is a reclaim market so the market statutory rate (26.375%) will always be reflected at pay date. NT is accruing all these payments and processing the claims with our sub-custodian. For 2016 pay dates, the claims have been lodged or are being reviewed with our sub-custodian. For 2017 pay dates, the claims are currently on hold due to new requirements but NT expects to start lodging it in 2018. For pay dates between 2011 and 2015, all the claims have paid.</p> <p>LPF Conclusion: Correct treatment has been applied.</p> |
| Italy | <p>Summary: Confirmation needed on claim for £113,294</p> <p>Detail: Eight dividends have been subject to a 26% withholding tax, whilst a further 4 dividends have been subject to an 11% withholding tax. Those subject to 26%, are withheld at the dividend headline rate, and those subject to 11% are withheld at the treaty rate. Northern Trust are not treating any of these as recoverable.</p> <p>We would have expected Northern Trust to access the treaty rate on the eight dividends that have suffered 26% withholding tax. As Lothian has suffered a higher rate, the total tax leakage that could have been avoided is EUR 127,211 (£113,294).</p> | <p>LPF comment: We have checked the data and confirm the finding. A check of the NT claim status report has not confirmed the status of the claims. Query has been raised with NT to confirm that the claims have been made.</p> <p>NT comment: Italy is a relief at source (RAS) market and the reclaim process is quite difficult (in terms of requirements and also the fact that the Italian Tax Authorities usually take more than 10 years to issue the refunds). For this reason, NT does not offer a reclaim service in the market.</p> <p>Nevertheless, the RAS service is offered and LPF obtains the treaty rates (11%) at pay date.</p> <p>In case RAS is missed, NT is able to offer a quick adjustment process (we have 4 months to receive the documents and request the tax adjustments). All the payments that EY are referring as outstanding were actually subject to this procedure and were already paid to LPF.</p> <p>LPF Conclusion: Correct treatment has been applied.</p> |
| Netherlands | <p>Summary: Confirmation needed on claim for £254,150</p> <p>Detail:</p> | <p>LPF comment: We have checked the data and confirm the finding. However, a check of the NT claim status report would appear to show that claims have been made.</p> |

| Country | Findings | Conclusions as at Date of Preparation of Report to Pensions Audit Sub-Committee |
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| | <p>41 dividends have suffered a 15% withholding tax, which is the headline dividend rate. There is a domestic provision exempting tax for non-resident tax-exempt pension funds. Northern Trust are only treating ten of these withholdings as recoverable.</p> <p>We would have expected Northern Trust to access the treaty exemption on the remaining 31 dividends. The total tax leakage that could have been avoided is EUR 285,369 (£254,150).</p> | <p>Query has been raised with NT to confirm that the claims have been made.</p> <p>NT comment: Netherlands is a reclaim market so the market statutory rate (15 %) will always be reflected at pay date. NT is accruing all these payments and processing the claims with our sub-custodian, for the full withholding tax exemption.</p> <p>For pay dates between 2011 and 2016, all the claims have been paid. For 2017 payments, 3 claims have been paid and 19 are being lodged.</p> <p>LPF Conclusion: Correct treatment has been applied.</p> |
| Taiwan WHT Rate | <p>Summary: Opportunity for a tax claim of £758,322.</p> <p>Detail: The statutory rate in Taiwan is 20%, however a UK pension fund should be able to obtain a full reclaim as they are generally tax exempt. 8 dividends have been held at the statutory rate and are eligible for a reclaim of TWD 30,114,864.77 (£758,322).</p> <p>Due to the complexities of the Taiwanese market, Northern Trust will not offer a reclaim service. EY is able to support this and to assist the funds in obtaining treaty relief at source going forward.</p> | <p>LPF comment: A claim was submitted to reclaim the WHT suffered in excess of the UK-Taiwan Double Tax Treaty in August 2010 for the years 2005 to 2009 for 23,821,000 TWD. A top up claim was submitted in 2013 for 9,742,000 TWD. These claims have now concluded. Therefore, it should be possible to make claims from 2013 onwards. Under procurement regulations it will be necessary to conduct a competitive tender for this reclaim work.</p> |
| Sundry EU Countries | <p>Summary: EY have suggested that there is the possibility of making additional Fokus Bank type claims in respect of the following countries.</p> <p>Detail: Denmark We note that UK pension funds should be exempt from tax on Danish dividends under European Court of Justice (ECJ) principals) and therefore should be able to make a full reclaim DKK 333,544 (£39,892).</p> <p>France We note that UK pension funds should be exempt from tax on French dividends under European Court of Justice (ECJ) principals) and</p> | <p>LPF comment: The status of previous Fokus Bank type claims is the subject of a separate report to the Pensions Audit Sub Committee.</p> <p>The additional claims suggested opposite, have been discussed with EY. Even without considering the likelihood of claims be paid, EY have agreed that it would not be cost effective to progress claims for Denmark, Portugal and Sweden.</p> <p>Italy, has been discounted as the prospect of payment is viewed as remote.</p> |

| Country | Findings | Conclusions as at Date of Preparation of Report to Pensions Audit Sub-Committee |
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| | <p>therefore should be able to make a full reclaim EUR 251,994 (£224,425) (this is exclusive of the 30% withholding rates not already recovered). We are aware that we have discussed this with you since the last report, and that you may not choose to pursue this path, although it may be worth discussing further still.</p> <p>Germany We note that UK pension funds should be exempt from tax on French dividends under European Court of Justice (ECJ) principals) and therefore should be able to make a full reclaim EUR 683,447 (£619,646).</p> <p>Italy We note that UK pension funds are tax-exempt with respect to their investment income and therefore should be able to make a full reclaim EUR 150,553 (£135,772).</p> <p>Portugal We note that UK pension funds should be exempt from tax on Portugal dividends under European Court of Justice (ECJ) principals) and therefore should be able to make a full reclaim EUR 52,180 (£56,760).</p> <p>Spain We note that UK pension funds should be exempt from tax on Spanish dividends under European Court of Justice (ECJ) principals) and therefore should be able to make a full reclaim EUR 122,731 (£109,280).</p> <p>Sweden We note that UK pension funds should be exempt from tax on Swedish dividends under European Court of Justice (ECJ) principals) and therefore should be able to make a full reclaim SEK 445,951 (£40,983).</p> | <p>NT's comment on Spain is that LFP is already receiving the full withholding tax refunds via NT.</p> <p>As a result of last year's report from EY we discussed the possibility of additional claims in respect of Germany and France with EY and other potential providers. Only EY was prepared to make additional claims in France and on that basis LFP has not progressed that option.</p> <p>There was more general support for German claims and on that basis a Quick Quote procurement was undertaken with 3 potential providers. EY had the winning bid. However, Officers have decided that, based on an assessment of the cost and the perceived likelihood of the claims ultimately being paid, these additional claims should not be made.</p> |

Pensions Audit Sub Committee

2.00pm, Monday, 11 December 2017

Global Custody Services Performance

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|---------------------|---|
| Item number | 5.6 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

This report presents the Key Performance Indicator Report for the 12 months ended 30 September 2017 provided by the Funds' custodian, Northern Trust. The purpose of this report is to demonstrate that the performance of the custodian is regularly monitored to ensure that the services provided meet the needs of the three Pension Funds.

During the year, the Fund exercised its option to extend its custody contract by three years to February 2020.

The report highlights that the indicator for Corporate Actions elected within deadline has remained Red for the year. On review of the data this was due to one of the Fund's external investment manager's failing to respond in time to 47% of their corporate actions in the year. After investigation, the issue relates to how "default" corporate actions are being picked up between the manager and Northern Trusts system.

During the period, there was also a deterioration in the timeliness of receipt for the monthly asset valuation and financial reporting of the Fund. In all cases the reporting was delayed due to queries raised by Fund staff.

The conclusion is that Northern Trust's services are currently meeting the needs of the three Pension Funds.

Global Custody Services Performance

1. Recommendations

Committee is requested to:

- 1.1 Note the report and highlight any points it would like to raise at the Pensions Committee on 12 December 2017.

2. Background

- 2.1 Following a competitive tender process, Northern Trust has provided investment custody services since early in 2011 for the three Pension Funds. Provision of these services is vital to the management of the Funds' investments. The range of services includes:
 - Safe custody of investment assets.
 - Reconciling investment valuations and accounts.
 - Ensuring that investment transactions are processed within market requirements.
 - Collecting investment income.
 - Providing notification of all corporate actions and passing responses to the companies concerned.
- 2.2 In order to assess the services provided a number of key performance indicators have been agreed with Northern Trust. These indicators are subject of a report from Northern Trust, the latest of which is for the 12 months ended 30 September 2017. The indicators cover the services listed above.
- 2.3 In addition, Northern Trust provides foreign exchange conversion and investment income tax services. The performance of these services is assessed in separate annual reports, with the former being considered by the Investment Strategy Panel. The only other significant service provided is securities lending, this revenue item being included in the budget and outturn figures which are also presented to Committee.
- 2.4 In February 2014's external consultancy review of the Funds' investment arrangements it was recommended that the Fund should conduct regular operational reviews of key outsourced providers and incorporate onsite visits with face to face meetings. Following this review the Fund has undertaken an annual site visit to Northern Trusts' offices in London for the past three years.

3. Main report

3.1 Information about all of the performance indicators is summarised below:

Month End Valuation Reporting

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| Description of Indicator | Month end valuation reports of investments completed and reviewed by Northern Trust and available to client within the target number of business days of end of the previous month. |
| Performance Traffic Lights | Green – Completed by business day 14 Amber – Completed by business day 15 Red – Completed by business day 16 or later |
| Service Rating Over 12 Months to 30/9/17 | Amber (Previous Report: Green) |
| Comments | <p>Unreviewed valuations are available on business day one; these are accurate for quoted investments. Portfolios that contain unquoted investments take longer for valuation information to be obtained.</p> <p>Month end valuations provided by Northern Trust are reconciled with records maintained by the external or internal investment manager. In addition, checks are made on the prices used by Northern Trust and the prices used by the external or internal investment manager.</p> <p>On three occasions during the year our accounts were signed off after the 14-day target (March, May and August 2017). On all occasions, the delay in sign off was as a result of queries submitted by the Funds' staff over asset valuations. Queries are regularly raised to improve the accuracy of the monthly valuations and are an essential part of quality assurance role played by the Funds' staff.</p> <p>Working proactively with Northern Trust helps to minimise future problems.</p> |

Financial Reporting

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| Description of Indicator | Since April 2012, Northern Trust has been responsible for providing investment accounts for all three Pension Funds. This includes a month end trial balance and summary accounts and at the year end additional information for inclusion in the annual accounts. |
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| | Month end investment accounting packs should be completed and sent to the Fund within the target number of business days of end of the previous month. |
| Performance Traffic Lights | Green – Completed by business day 18 Amber – Completed by business day 19 Red – Completed by business day 20 or later |
| Service Rating Over 12 Months to 30/9/17 | Amber (Previous Report: Green) |
| Comments | More time is allowed at the year end for the preparation of the additional information required for the annual accounts. The month end accounts are checked by the Fund for accuracy. Any delays in month end valuation reporting have a knock-on effect in completion of the monthly financial reporting. Due to the three occasions of late sign off for the month end reporting this indicator has also been downgrading to Amber for the year. |

Trade Settlement Statistics

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| Description of Indicator | Each investment market around the world has a set of requirements that must be followed regarding the settlement of trades (purchases and sales). These requirements include a fixed number of business days for a trade to be settled. For example, shares trade in the UK must be settled in a three-day period. Within that period each side must “deliver” either the shares or the cash as appropriate. The indicator is the percentage of trades that have settled on time. |
| Performance Traffic Lights | Green – 94% or higher Amber – 92% to 94% Red – 91% or lower |
| Service Rating Over 12 Months to 30/9/17 | Green (Previous Report: Green 95.35%) 97.06% |
| Comments | During the period, there were a total of 5,509 trades of which 5,347 (97.06%) were settled on time. Of the 162 trades settled late, 153 were purchases and 9 were sales. This is due to a common market issue where the selling |

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| | <p>broker does not initially have sufficient shares to settle the purchase trade.</p> <p>Northern Trust provides a range of reports on settlement statistics; this includes one that provides information by broker. This is particularly useful for identifying the source of settlement problems.</p> <p>Northern Trust provides contractual settlement on all trades. For sales, Northern Trust will credit the Fund with the cash proceeds on the contractual settlement date of the underlying trade regardless of whether it settles on time in the market. Northern Trust would then seek compensation by issuing a market claim against the purchasing broker.</p> |
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Income Collection Statistics

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| Description of Indicator | <p>It is the responsibility of the custodian to account for all dividend income when it becomes due and to receive the money into the bank when the dividend is actually paid.</p> <p>The indicator is the percentage of the number of income payments received on pay day.</p> |
| Performance Traffic Lights | <p>Green – 95% to 100%</p> <p>Amber – 90% to 95%</p> <p>Red – 90% or lower</p> |
| Service Rating Over 12 Months to 30/9/17 | <p>Green (Previous Report: Green 98.65%)</p> <p>98.34%</p> |
| Comments | <p>The performance indicator is based on the number of income collections rather than their value. During the period, there were a total of 2,355 income collections, 2,316 (99.40%) of which were received on the correct pay day.</p> <p>Northern Trust provides a range of reports on income receipts including one that provides information by country. This report is useful to identify any problems at the market, rather than individual company, level.</p> <p>Northern Trust provides contractual income in around 46 countries. This means that Northern Trust endeavours to credit the Fund's bank account with the income on its pay date irrespective of the actual date of receipt.</p> |

Corporate Actions

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| <p>Description of Indicator</p> | <p>Corporate actions are events announced by companies that give shareholders the opportunity to make a decision on two or more potential choices. For example:</p> <ul style="list-style-type: none"> • Rights issue to buy additional shares • Dividend reinvestment in additional shares • Receive dividend in GBP, USD or EUR <p>It is the responsibility of the custodian to collate responses from its clients to corporate actions and communicate the results to the company. The Fund has the responsibility of responding to corporate actions on a timely basis.</p> <p>The indicator is the percentage of responses made by the client with the deadline date set by the company for a response.</p> <p>The Fund has the responsibility of responding to corporate actions on a timely basis. Responses are made by external and internal investment managers for the portfolios that they are responsible for.</p> |
| <p>Performance Traffic Lights</p> | <p>Green – 100%</p> <p>Amber – 95% to 99%</p> <p>Red – 94% or lower</p> |
| <p>Service Rating Over 12 Months to 30/9/17</p> | <p>Red</p> <p>94.86% (Previous Report: Red 94.32%)</p> |
| <p>Comments</p> | <p>During the period, there were 467 corporate actions, 443 (94.86%) of which are recorded as having been responded to within the time limit.</p> <p>Northern Trust provide an online system to advise clients of all upcoming corporate actions. The same system is used by the client to record decisions. As the deadline for an action approaches and no response has yet been recorded, Northern Trust staff will attempt to contact the client for a response. Contact is initially made by e-mail and on the day prior to the deadline contact by phone is attempted. If a client response cannot be obtained Northern Trust will elect the default option for the action.</p> <p>Of the 24 late items 22 related to one of the Fund’s external managers. After investigation, it was discovered that the issue relates to how certain default corporate actions are</p> |

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| | <p>being captured between the manager and Northern Trust systems rather than late action.</p> <p>On assessment, the late corporate actions did not represent the potential for financial loss to the Fund.</p> |
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3.2 On 9th November 2017 the Fund conducted its annual site visit to Northern Trust's London office. Areas covered included –

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| LGPS Asset Pooling | Discussion on the current developments in England and Wales following the creation of asset pools and the implications for Northern Trust. |
| Lothian future developments | Discussions on the potential to automate the current trading process and future considerations for any collaborative arrangements. |
| Regulatory overview | <p>Focus of discussion on MiFID II and EMIR requirements coming into force 3rd January 2018. Also touched on upcoming changes in relation to GDPR, IORP II and Brexit.</p> <p>Work is ongoing to ensure the Fund provides policy consents to Northern Trust/Brokers, ensure collateral arrangements are in place for its currency forwards and that the unbundling of broker costs is complete in advance of January's deadline.</p> |
| Sub Custodian Monitoring | <p>Review of the processes and procedures in place to ensure that standards set by Northern Trust are met in various markets in which they do not directly participate, rather reliance is placed on its network of sub custodians. Key finding were -</p> <ul style="list-style-type: none"> • Sub custodian reviews are completed on a regional basis and then reviewed by a global oversight committee which ensures consistency of standards across all areas. • External legal opinion is sought to ensure client assets are sufficiently ring fenced and recoverable. • Due diligence reports are completed annually which are then followed by site visits. • Feedback is sought from all sections that interact with the sub custodian within Northern Trust when reviewing their performance. |
| Cybersecurity | Provided with an overview of the Information Security Structure in place at Northern Trust, the types of threats faced and controls in place. |

4. Measures of success

- 4.1 Performance is measured against the indicators that have been set for the main services provided by Northern Trust.

5. Financial impact

- 5.1 The budget set for the provision of custody services for 2017/18 is £352k. This report has no impact on the cost of custody provision.
- 5.2 Poor performance of the custodian could have a financial impact on the three Pension Funds. For example: from delays in, or failure to, collect investment income or failure in the system to notify companies of decisions made in response to corporate actions. However, staff monitor service provision and corrective action are taken if any issues arise.
- 5.3 The cost and quality of custody services are assessed as part of a rigorous competitive procurement exercise. Northern Trust was the winner of the last exercise and the initial contract was set for five years ending in February 2017, with the Fund choosing to take up its option to extend for a further three years to February 2020. Northern Trust has a strong presence in the LGPS market and has retained a high credit rating (AA-) for many years and has not been involved in high profile litigation cases with clients (in contrast to some other global custodians).

6. Risk, policy, compliance and governance impact

- 6.1 There are no risk, policy, compliance and governance impacts arising from this report.

7. Equalities impact

- 7.1 There are no equalities implications as a result of this report.

8. Sustainability impact

- 8.1 There are no sustainability impacts arising from this report.

9. Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None.

Stephen S. Moir

Executive Director of Resources

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11. Appendices

None