

# Notice of meeting and agenda

## Pensions Audit Sub-Committee

**2.00 pm Tuesday, 10th December, 2019**

Dunedin Room - City Chambers

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

### Contacts

Email: [lesley.birrell@edinburgh.gov.uk](mailto:lesley.birrell@edinburgh.gov.uk) / [natalie.le.couteur@edinburgh.gov.uk](mailto:natalie.le.couteur@edinburgh.gov.uk)

Tel: 0131 529 4240 / 0131 529 6160

### 1. Order of Business

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- 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**

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- 2.1 Members 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**

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- 3.1 If any

## **4. Minute**

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- 4.1 Minute of Pensions Audit Sub-Committee of 24 September 2019 – submitted for approval as a correct record 5 - 8

## **5. Reports**

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- 5.1 Agenda Planning – Report by the Executive Director of Resources 9 - 14
- 5.2 EU Tax Claims and Other Income Tax Recoveries – Report by the Executive Director of Resources 15 - 26
- 5.3 Investment Income Review Cross Border Withholding Tax – Report by the Executive Director of Resources 27 - 36
- 5.4 Global Custody Services Performance – Report by the Executive Director of Resources 37 - 44

## **6. Motions**

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- 6.1 If any

## **7. Resolution to Consider in Private**

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- 7.1 The Sub-Committee is requested under Section 50(A)(4) of the

Local Government (Scotland) Act 1973, to exclude the public from the meeting for the following items of business on the grounds that they would involve the disclosure of exempt information as defined in Paragraphs 6 and 9 of Part 1 of Schedule 7A of the Act.

## **8. Private Reports**

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|------------|---|---------|
| <b>8.1</b> | Lothian Pension Fund ICT Update – Report by the Executive Director of Resources | 45 - 50 |
| <b>8.2</b> | Risk Management In-Depth Review – Report by the Executive Director of Resources | 51 - 94 |

## **Laurence Rockey**

Head of Strategy and Communications

## **Committee Members**

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Councillor Cameron Rose (Convener) and Councillor Maureen Child; John Anzani

## **Information about the Pensions Audit Sub-Committee**

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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 Dunedin Room in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

## **Further information**

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If you have any questions about the agenda or meeting arrangements, please contact Lesley Birrell or Natalie Le Couteur, Committee Services, City of Edinburgh Council, Business Centre 2.1, Waverley Court, 4 East Market Street, Edinburgh EH8 8BG, Tel 0131 529 4240 / 0131 529 6160, email [lesley.birrell@edinburgh.gov.uk](mailto:lesley.birrell@edinburgh.gov.uk) / [natalie.le.couteur@edinburgh.gov.uk](mailto:natalie.le.couteur@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](http://www.edinburgh.gov.uk/cpol).

## Minutes

### Pensions Audit Sub-Committee of the Pensions Committee

**2.00pm, Tuesday 24 September 2019**

**Present:**

Councillors Rose (Convener) and Child; John Anzani.

**Pensions Board Members:**

Sharon Cowle and Brian Robertson

**Independent Professional Observer**

Andy McKinnell

#### 1. Minutes

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**Decision**

To approve the minute of the Pensions Audit Sub-Committee of the Pensions Committee of 25 June 2019 as a correct record.

#### 2. Agenda Planning

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An overview of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings for December 2019 and March 2020 was presented.

**Decision**

- 1) To note the agenda planning document.
- 2) To note that the Pension Board were invited to comment on agenda items during Committee meetings.

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

#### 3. Audited Annual Report 2019 of the Lothian Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

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The unaudited Annual Report for the year ended 31 March 2019 for the Lothian Pension Fund (LPF) and Scottish Homes Pension Fund (SHPF) had been considered by the external auditor, Scott-Moncrieff, and their findings presented.

It was concluded that that there were no matters which Scott-Moncrieff were required to report by exception.

## **Decision**

- 1) To note the report by Scott-Moncrieff “Lothian Pension Funds 2018/19 Annual Audit Report to Members and the Controller of Audit” (Appendix 1).
- 2) To note the audited Annual Report for the year ended 31 March 2019 for the LPF and the SHPF (Appendix 2).
- 3) To note that the audited financial statements, for the year ended 31 March 2019, of both the wholly-owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in May 2019. These statements were shown in full at Appendices 3 and 4.

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

## **4. Pensions Data Quality**

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The Sub-Committee was informed of the ongoing work to enhance the quality of pension administration membership record data.

In accordance with its Pension Administration Strategy, the Fund continued with its efforts to improve the flow of data from employers through regular reporting and liaison. Focus had been placed on bringing the receipt of monthly contribution (data) returns from employers to an up-to-date position together with the provision of a static pension record identifier.

Members discussed concerns regarding the ingathering of quality information from employers and whether everything was being done to resolve this. It was highlighted that there were reputational consequences for employer and fund that were used to incentivise compliance.

## **Decision**

To note the report.

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

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

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The Sub-Committee was advised of pension overpayments during the period 1 September 2018 to 31 August 2019, which had been deemed irrecoverable by the Executive Director of Resources, in accordance with the Council’s Scheme of Delegation to Officers.

## **Decision**

To note that the total value of pension overpayments written off between 1 September 2018 and 31 August 2019 was £7,888.00.

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

## 6. Fraud Prevention

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The work undertaken by the Lothian Pension Fund to prevent fraud was presented for review and scrutiny. The report provided details of participation in fraud prevention initiatives as an integral part of the control environment and the overall management of risk.

### Decision

To note the report.

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

## 7. Risk Management Summary

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The Lothian Pension Fund's risk management procedures required the fund to maintain a detailed operational risk register which set out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and the action taken to mitigate these risks

In line with the Pension Funds' ongoing risk management procedures, an overview was provided of the Fund's risk analysis for consideration by the Committee.

It was noted that risk was still high and that there were two significant critical around ICT and the office move where work was still to be done.

Members were advised that ICT risk had reduced due to three factors:

- A new strategy had been approved and put in place.
- The appointment of a new ICT and Governance manager.
- FCA-led governance improvements.

### Decision

- 1) To note the Quarterly Risk Overview.
- 2) To amend risk no. 9 from "elected members" to "members".

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

## 8. LPFE Limited and LPFI Limited Annual Report

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The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 6 and 9 of Schedule 7(A) of the Act.

An update was provided on the business and operation of the LPFE Limited (LPFE) and LPFI Limited (LPFI).

### Decision

As detailed in the Confidential Schedule, signed by the Convener, with reference to this minute.

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

## 9. Lothian Pension Fund ICT Update

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The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 6 and 9 of Schedule 7(A) of the Act.

Following approval by the Pensions Committee on 26 June 2019, an update was provided on the implementation of the LPF ICT pathway.

### **Decision**

As detailed in the Confidential Schedule, signed by the Convener, with reference to this minute.

(References – Pensions Committee 26 June 2019 (item 12); report by the Executive Director of Resources, submitted.)



## Pensions Audit Sub Committee

**2.00pm, Tuesday, 10 December 2019**

### Agenda Planning

Item number	5.1
Executive/routine	
Wards	All
Council Commitments	

#### 1. Recommendations

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The Pensions Audit Sub 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.

**Stephen S. Moir**

Executive Director of Resources

Contact: Struan Fairbairn, Chief Risk Officer, Lothian Pension Fund, Lothian Pension Fund

E-mail: [struan.fairbairn@edinburgh.gov.uk](mailto:struan.fairbairn@edinburgh.gov.uk) | Tel: 0131 529 4689

Susan Handyside, Customer Service & Compliance Officer, Lothian Pension Fund

E-mail: [susan.handyside@edinburgh.gov.uk](mailto:susan.handyside@edinburgh.gov.uk) | Tel: 07771 378238

# Report

## Agenda Planning

### 2. Executive Summary

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- 2.1 This report and the scheme of committee document (appendix 1 of this report) provides the 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 those committees.
- 2.2 There will, of course, be specific matters and papers which need to be brought to attention of the committees in addition to those set out herein.

### 3. Background

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- 3.1 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.
- 3.2 Committee meetings are held on a quarterly basis and the Audit Sub Committee meetings are generally held three times a year.

### 4. Main report

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- 4.1 The proposed agendas for the next two meetings are set out below, based on the usual Committee cycle plus any additional and intra-cycle requests.
- 4.2 An additional Audit Sub committee meeting may be held in March 2020 as agreed with the Convenor of the Audit Sub Committee, Councillor Cameron Rose to review and approve the Internal Audit Reports (should those be available at that time).
- 4.3 The scheme of committee schedule (appendix 1) has been updated with the following amendments:
- LPFE Limited (LPFE) and LPFI Limited (LPFI) Loan Financing Requirement paper, (which reports on the review and extension of the intra-group loan

arrangements from LPF to LPFI/E) has been included in the schedule and will be presented to the Pension Committee every three years.

- Investment Controls and Compliance will now be called LPF Group Controls and Compliance and will be presented annually to Committee in June instead of December.
- The Governance update will now be called Annual LPF Group Governance Update and will be presented in June. The report will include a strategic review of all LPF Group matters and will combine the LPFI and LPFE annual report which will be removed from September.

4.4 The additional quarterly Governance Updates, that provide updates on the LPF Group Governance review, will continue until all material outcomes of the review have been implemented.

## March 2020

### Pensions Committee

- Referrals / recommendations from Pensions Audit-Sub Committee
- Policies and Strategies Update
- Actuarial Valuation: Lothian Pension Fund/Scottish Homes Pension
- Employers Participating in Lothian Pension Fund
- Service Plan Update and Budget for 2020/21
- LPFI and LPFE Loan Financing Requirement
- Risk management summary
- LPF Group Governance Review Update
- Audit plans and reports (internal and external) \*

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

## June 2020

### Pensions Committee

- Referrals / recommendations from Pensions Audit-Sub Committee
- LPF Annual Report and Accounts (Unaudited)
- Statement of Investment Principles
- Joint Investment Strategy Panel Activity
- Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund
- Annual LPF Group Governance Update
- Risk management summary

### Audit Sub Committee

- LPF Annual Report and Accounts (Unaudited)
- Annual LPF Group Governance Update
- LPF Group Controls and Compliance
- Risk Management summary

## Future Pensions Committee and Audit Sub Committee dates:

Pensions Committee	Pensions Audit Sub Committee
<ul style="list-style-type: none"><li>Wednesday, 25 March 2020, 2.00pm, Dunedin Room, City Chambers.</li><li>Wednesday, 24 June 2020, 2.00pm, Dunedin Room, City Chambers.</li></ul>	<ul style="list-style-type: none"><li>Tuesday, 23 June 2020, 2.00pm, Dunedin Room, City Chambers.</li></ul>

## 5. Next Steps

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5.1 None.

## 6. Financial impact

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6.1 None.

## 7. Stakeholder/Community Impact

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- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

## 8. Background reading/external references

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8.1 None.

## 9. Appendices

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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 and Strategies Update (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan (every 2 years)	N/A	March
	Budget	N/A	March
	LPF Annual Report and Accounts (Unaudited)	LPF Annual Report & Accounts (Unaudited)	June
	Statement of Investment Principles	N/A	June
	Joint Investment Strategy Panel Activity	N/A	June
	Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund	N/A	June
	Annual LPF Group Governance Update	Annual LPF Group Governance Update LPF Group Controls and Compliance	June June
	Employer Covenant Review	N/A	September September
	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund, including the Annual Report by External Auditor.	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund, including the Annual Report by External Auditor.	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 and Other Income Tax Recoveries	December
	N/A	Investment Income Review-Cross-Border Withholding Tax	December
	Stewardship and Engagement	N/A	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 Lothian Pension Fund Contract Awards Report	N/A N/A	March & September March & September
3 Times per year	Service Plan Update  Referrals / recommendations from Pensions Audit-Sub	N/A  N/A	March, September & December  June, September & December
Quarterly	Risk management summary	Risk management summary	March, June, September and December
Every 3 years	Actuarial Valuation: LPF SHPF Funding Strategy Statement LPFI and LPFE Loan Financing Requirement		December or March  December or March
As required	Delegated authorities (provider appointments) Discretions (death grants etc.) N/A Regulatory Update Investment Strategy Reviews (at least every 3 years) N/A Contribution Stability Mechanism Review	N/A N/A Internal Audit Reports N/A N/A Particular items of risk management for greater scrutiny (as requested). N/A	

## Pensions Audit Sub Committee

2.00pm, Tuesday, 10 December 2019

### EU Tax Claims and Other Income Tax Recoveries

Item number	5. 2
Executive/routine	
Wards	All
Council Commitments	

#### 1. Recommendations

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The Pensions Audit Sub Committee is requested to:

- 1.1 note the report and highlight any points it would like to raise at the Pensions Committee on 11 December 2019.

**Stephen S. Moir**

Executive Director of Resources

Contact: Esmond Hamilton, Financial Controller, Lothian Pension Fund

E-mail: [esmond.hamilton@edinburgh.gov.uk](mailto:esmond.hamilton@edinburgh.gov.uk) | Tel: 0131 469 3521

## EU Tax Claims and Other Income Tax Recoveries

### 2. Executive Summary

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- 2.1 This report summarises activity on EU and other special tax claims made on behalf of Lothian Pension Fund. During the period since the last report, no additional claims have been paid and the amount recovered to date remains at £1.37m. Progress on outstanding claims is discussed in detail within the report. The main developments are:
- further legal progress with the Manninen and Manufactured Overseas Dividend claims; and
  - wtax has made additional Fokus claims in Germany and Denmark on a no win no fee basis.

### 3. Background

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- 3.1 EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt. The claims are based on a fundamental principle of EU law, that 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. The claims can be divided into three main types – Manninen / Foreign Income Dividends (FIDs), Manufactured Overseas Dividends (MODs) and Fokus.
- 3.2 Progress on claims to recover tax on Taiwanese dividends is now covered in the separate report on cross-border withholding tax.

### 4. Main report

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#### **Claims - Manninen / Foreign Income Dividends (FIDs)**

- 4.1 These claims are against the UK tax authorities. The FIDs claims are 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. Manninen claims concern whether the UK breached EU law in denying claims for tax credits on overseas dividend receipts.



- 4.2 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.
- 4.3 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.
- 4.4 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 Manninen claim. A cost benefit analysis concluded that a claim should be lodged, and this was done on 9 February 2006.
- 4.5 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.
- 4.6 A chronology of events to date is provided in Appendix 1. The contents of which have been approved by Pinsent Mason.
- 4.7 Since the last report to Committee in December 2018, work has continued towards litigation against HMRC in the High Court.
- 4.8 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £67.5k (£63.4k as at the last update to Committee in December 2018). 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 – Manufactured Overseas Dividends (MODs)**

- 4.9 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.
- 4.10 Note that manufactured dividends are dividends created when a security is out on loan at the time the company pays a dividend.
- 4.11 Claims in respect of manufactured dividends totalling £4,870.6k have been lodged with HMRC on behalf of Lothian Pension Fund.
- 4.12 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery.
- 4.13 A chronology of events to date is provided in Appendix 2. The contents of which have been approved by Pinsent Mason.
- 4.14 Since the last report to Committee in December 2018, the Court of Appeal decided in favour of the test claimant and refused HMRC permission to appeal to the Supreme Court. HMRC has indicated that it intends to apply for permission to

appeal this decision. Pinsent Masons plan to file a notice of objection to such a move by HMRC.

- 4.15 Fees incurred to date on these claims amount to £187.7k (£175.7k as at the meeting of December 2018). Potential subsequent referrals are estimated to cost £20k for each legal stage.

### **Claims – Fokus Bank**

- 4.16 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.
- 4.17 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £5.5m (£4.57m as at the meeting of December 2018) have been made. Progress on the claims is summarised in Appendix 3.
- 4.18 Since the last report in December 2018, Wtax have made additional claims of €1,192.6k in Germany and €34.4k in Denmark. Wtax operate on a no win no fee basis, so Lothian Pension Fund has not incurred any costs in making these additional claims. Since the initial success with claims in four EU countries there has been little apparent progress to the remaining substantial claims in France and Germany.
- 4.19 Fees incurred to date on these claims amount to £390.5k (£390.5k as at the meeting of December 2018). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

### **Claims – Taiwan**

- 4.20 Note that the financial impact of the Taiwan claims is now included in the separate report on cross-border withholding tax.

## **5. Next Steps**

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- 5.1 Officers will continue to monitor progress with the remaining claims with the assistance of the appointed professional advisers.

## **6. Financial impact**

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- 6.1 Tax claims totalling of £13.0m (£12.8m as at the meeting of December 2018) have now been lodged with the relevant tax authorities. Professional fees amounting to £645.7k (£629.6k as at the meeting of December 2018) 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.

- 6.2 Currently, claims paid to date exceed the costs incurred by £724.4k (£740.5k as at the meeting of December 2018). So irrespective of the outcome of the remaining claims, Lothian Pension Fund will accrue a financial benefit. The financial position can be summarised as follows:

<b>Claim Type</b>	<b>Total Claims £'000</b>	<b>Claims Settled £'000</b>	<b>Claims Outstanding £'000</b>	<b>Costs to Date £'000</b>
Manninen	2,626.7	Nil	2,626.7	67.5
Manufactured Dividends	4,870.6	Nil	4,870.6	187.7
Fokus Bank	5,498.0	1,370.1	4,127.9	390.5
	<b>12,995.3</b>	<b>1,370.1</b>	<b>11,625.2</b>	<b>645.7</b>

- 6.3 Because of the uncertainty associated with the tax claims, amounts are only recognised in Lothian Pension Fund's accounts when funds are received.
- 6.4 Note that the financial impact of the Taiwan claims is now included in the separate report on cross-border withholding tax.

## 7. Stakeholder/Community Impact

- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

## 8. Background reading/external references

- 8.1 None.

## 9. Appendices

- Appendix 1 Chronology - Manninen / Foreign Income Dividends (FIDs)
- Appendix 2 Chronology - Manufactured Overseas Dividends (MODs)
- Appendix 3 Fokus Bank – Claims Summary

## Appendix 1

### Events Since Last Report to Committee - Manninen / Foreign Income Dividends (FIDs)

Date	Event
October 2018	<p>Based on the current timetable, HMRC are likely to file their amended defences by 26 October 2018. The deadline for BTPS (the test claimant) to serve a reply, if this is considered necessary, was 17 December 2018.</p> <p>Once both parties have served their amended or fully pleaded statements of case, Pinsent Masons expect the Court to list a Case Management Conference in due course.</p>
December 2018	HMRC filed their defences as expected on 26 October 2018 and BTPS (the test claimant) served their replies on 17 December 2018.
January 2019	On behalf of the test claimant, Pinsent Masons wrote to HMRC regarding the steps the parties needed to take in advance of the Case Management Conference (CMC). Pinsent Masons commenced work on these aspects. One of the steps was for the parties to attempt to agree the issues for disclosure in the case.
February 2019	<p>HMRC wrote back to the test claimant with their comments on the issues for disclosure.</p> <p>BTPS (the test claimant) confirmed instructions to seek a short form prospects of success opinion from Counsel in respect of the High Court litigation in the early part of 2019.</p> <p>The Court notified the parties that the case had been allocated to Mrs Justice Falk and requested a short written summary of the issues for disclosure.</p>
March 2019	Pinsent Masons wrote back to HMRC on behalf of BTPS regarding the issues for disclosure.
April 2019	Both parties agreed a short written summary and submitted this to the Court.
July 2019	On behalf of BTPS (the test claimant), Pinsent Masons wrote to HMRC regarding listing a Case Management Conference (CMC)

Date	Event
	hearing.
August 2019	<p>A summary of Counsel's opinion on the prospects of success for the High Court action for both the FIDs and Manninen claims was sent to all group claimants. This update also set out the options claimants have in pursuing their FIDs and Manninen claims.</p> <p>The parties wrote a joint letter to the Court regarding listing a Case Management Conference.</p>
September 2019	<p>HMRC wrote to BTPS (the test claimant) seeking a stay of the High Court proceedings behind the case "Test Claimants in the Franked Investment Income Group Litigation v HMRC (FII)". In response Pinsent Masons wrote to HMRC to request further information and clarification of their stay proposal.</p>
October 2019	<p>HMRC have provided further information in respect of their stay proposal. Pinsent Masons are currently in the process of considering the implications of this on the High Court proceedings with Counsel and the test claimant.</p>

## Appendix 2

### Events Since Last Report to Committee - Manufactured Overseas Dividends (MODs)

Date	Event
October 2018	To date, the parties have exchanged skeleton arguments and the Court of Appeal has recently listed the substantive hearing for 25 – 27 June 2019.
June 2019	The Court of Appeal hearing was heard on 25 – 27 June 2019 by Lord Justice Newey, Lady Justice Asplin and Lady Justice Rose at the Royal Courts of Justice. Judgement was reserved in the normal way at the end of the hearing.
October 2019	<p>The Court of Appeal handed down its judgment on 3 October 2019 and the test claimant was again successful before the Court of Appeal.</p> <p>Further, the Court of Appeal refused HMRC permission to appeal to the Supreme Court. HMRC have indicated that they intend to apply for permission to appeal the Court of Appeal's decision directly to the Supreme Court. If HMRC do apply for permission directly to the Supreme Court, Pinsent Masons will have an opportunity to file a notice of objection. The Supreme Court will review the notice of objection in deciding whether or not to grant HMRC permission to appeal.</p>

## Fokus Bank – Claims Summary

Country	Claim Period From / To	Estimated Amount Claimed	Notes
France	2005 2009	£671.1k [€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>KPMG's update of July 2019 states:</p> <p>"A summary of the questionnaire has been filed with the FTA on behalf of UK pension funds to evidence their comparability. Meetings with the FTA are expected in the coming months to discuss next steps."</p>
Germany	KPMG 2003 2010  Deloitte 2011 2014  WTax 2015 2018	£928.9k [€1,076.0k]  £117.1k [€135.5k]  £2,020.6k [€2,338.4k]	<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>After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make additional claims in Germany</p> <p>Since the last report to Committee WTax has made a further claim in respect of the 2018 calendar year of €1,192.6k.</p> <p>KPMG's update of July 2019 states:</p>

Country	Claim Period From / To	Estimated Amount Claimed	Notes
			<p>"In KPMG's view all claimants that have filed claims with local tax authorities [which LPF has done] should be in a good position to receive refunds."</p> <p>"German Law has been amended so that all German portfolio dividends paid post 1 March 2013 are taxable income for German corporations. By this action Germany has reacted to the CJEU decision C-284/09 and abolished discriminatory treatment in the fact pattern underlying this decision. The amendment of the law only covers corporations; however it is a strong sign for other claimants (such as pension funds, investment funds and life companies) that discrimination existed."</p>
Italy	2007 2010	£65.1k [€75.4k]	<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>Under Italian law, claims must be renewed after a period of 10 years. In 2017, Officers 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 €525.1k of the original claims have lapsed, reducing the value of the remaining claim to the £65.1k stated above.</p> <p>WTax, which operates on a no win no fee basis, has decided not to pursue claims in Italy.</p>
Denmark	2016 2017	£94.7k [€109.6k]	<p>After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make some claims in Denmark.</p> <p>Since the last report to Committee WTax has made a further claim in respect of the 2018 calendar year of €34.4k.</p>



<b>Country</b>	<b>Claim Period From / To</b>	<b>Estimated Amount Claimed</b>	<b>Notes</b>
			Previous providers did not consider it economic to make claims in this country.
Sweden	2013 2017	£229.5k [€265.6k]	<p>After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make some claims in Sweden.</p> <p>Previous providers did not consider it economic to make claims in this country.</p>
<b>TOTAL</b>		<b>£5,498.0k</b>	

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## Pensions Audit Sub Committee

2.00pm, Tuesday, 10 December 2019

### Investment Income Review Cross Border Withholding Tax

Item number	5.3
Executive/routine	
Wards	All
Council Commitments	

#### 1. Recommendations

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The Pensions Audit Sub Committee is requested to:

- 1.1 note the report and highlight any points it would like to raise at the Pensions Committee on 11 December 2019.

**Stephen S. Moir**

Executive Director of Resources

Contact: Jason Koumides, Senior Finance Manager, Lothian Pension Fund

E-mail: [jason.koumides@edinburgh.gov.uk](mailto:jason.koumides@edinburgh.gov.uk) | Tel: 0131 529 6245

## Investment Income Review Cross Border Withholding Tax

### 2. Executive Summary

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- 2.1 This report provides information on a benchmarking assurance review, prepared by Deloitte, into the effectiveness of the procedures in place to manage the tax exposure on the investment income of the Lothian Pension Fund and the Scottish Homes Pension Fund.
- 2.2 The review shows that Northern Trust is generally applying the correct withholding tax rates on investment income. Recovery claims are being processed and reclaims received, but Deloitte advise that the time taken seems to be longer than the market standard for refunds (particularly for Switzerland and Germany). A summary of the opportunities and issues identified is provided.

### 3. Background

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- 3.1 Lothian Pension Fund (LPF) and Scottish Homes Pension Fund (SHPF) 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 2018/19 financial year the funds earned income from companies in 37 different countries.
- 3.2 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.
- 3.3 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.
- 3.4 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.

- 3.5 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.
- 3.6 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**

- 3.7 The custodian appointed for the two 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**

- 3.8 The tables below show the movement in the reclaimable tax balances during the 2018/19 and 2017/18 financial years for LPF and SHPF.

<b>Lothian Pension Fund</b>	<b>2018/19 £</b>		<b>2017/18 £</b>
Brought Forward 1 April	7,659,745.17		4,609,963.36
Recoverable tax accrued during year	4,525,904.62		4,258,212.07
Claims paid during year	(3,119,995.53)		(1,208,430.26)
Carried Forward 31 March	9,065,654.26		7,659,745.17

<b>Scottish Homes Pension Fund</b>	<b>2018/19 £</b>		<b>2017/18 £</b>
Brought Forward 1 April	44,822.84		-
Recoverable tax accrued during year	306.41		46,229.12
Claims paid during year	(14,252.54)		(1,406.28)
Carried Forward 31 March	30,876.71		44,822.84

- 3.9 The balance carried forward increased by £1,406k for LPF and decreased by £14k for SHPF.
- 3.10 The year-end recoverable tax balances at 31 March 2019 and 31 March 2018, broken-down by country, are provided for each of the Funds in the tables below.

<b>Lothian Pension Fund</b>	<b>Reclaim Amount 31/3/19 £</b>	<b>Number of Dividends 31/3/19</b>		<b>Reclaim Amount 31/3/18 £</b>	<b>Number of Dividends 31/3/18</b>
Austria	53,428.52	12		55,867.68	18
Denmark	95,714.69	30		70,191.73	21
France	3,556.67	5		154,186.04	16
Germany	2,920,338.37	74		1,821,509.69	47
Israel	16,408.26	4		-	-
Netherlands	165,944.30	14		291,839.23	24
Norway	430,879.15	28		343,270.30	22
Portugal	44,252.27	1		-	-
Spain	-	-		2,048.54	1
Switzerland	5,147,938.86	61		4,712,958.99	61
United Kingdom*	187,193.17	10		207,872.97	12
<b>Grand Total</b>	<b>9,065,654.26</b>	<b>239</b>		<b>7,659,745.17</b>	<b>222</b>

<b>Scottish Homes Pension Fund</b>	<b>Reclaim Amount 31/3/19 £</b>	<b>Number of Dividends 31/3/19</b>		<b>Reclaim Amount 31/3/18 £</b>	<b>Number of Dividends 31/3/18</b>
Canada	1,010.82	2		3,702.48	8
France	-	-		9,580.77	3
Germany	11,916.81	4		12,124.28	4
Japan	1,427.77	1		1,380.31	1
Netherlands	1,547.36	4		2,361.45	4
Norway	4,548.94	6		4,634.87	6
Switzerland	8,697.30	2		8,401.98	2
United Kingdom*	1,727.71	4		2,636.70	4
<b>Grand Total</b>	<b>30,876.71</b>	<b>23</b>		<b>44,822.84</b>	<b>32</b>

\* Relates to UK listed overseas companies dividends.

- 3.11 SHPF had direct holdings in equity investments during the period March 2017 to March 2018. An Index Linked Gilts strategy was adopted in March 2018. As a result, SHPF had some outstanding withholding tax claims at 31 March 2019 relating to this period of equity investment.
- 3.12 For LPF, Switzerland accounts for 56% (62% at 31 March 2018) for the total amount receivable, and for the Scottish Homes Pension Fund 28%. The reason 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.
- 3.13 The Swiss, German, Dutch and Norwegian claims are analysed in more detail later in this report.

## 4. Main report

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### **Benchmarking (Assurance) Review**

- 4.1 Given the complexity and scale of the taxation of investment income, it is important that LPF's 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.
- 4.2 In order to assess the effectiveness of NT's work, Deloitte has been commissioned to prepare a benchmarking assurance report. The remit was to carry out a review of the WHT suffered for the period 1 August 2018 to 31 July 2019. Deloitte have also been asked to review the timeliness of the WHT reclaims made by the custodian in respect of this period.

### **Findings – WHT Rates Applied**

- 4.3 The Deloitte study found that in general optimal WHT rates appear to have been achieved by the Fund for the majority of dividend distributions received. However, they have identified a number of potential opportunities and issues. These are summarised in the Appendix to this report. NT has been asked to respond to the points raised and these responses have been included in the Appendix.
- 4.4 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.
- 4.5 The Deloitte report highlights “the vast majority of pending claims are just waiting for the 2019 year to end in order for them to be processed in 2020”. However, examples have been identified of NT's claims processing being slower than the market standard for such work with the most material of these being for the Swiss and German markets. The responses of NT to various matters identified have been summarised below. We will continue to work with NT to ensure that our claims are processed as quickly as possible.
- 4.6 Swiss claims accounted for 56% (£5,148k) of the value of Lothian Pension Fund claims. The amounts due can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	<b>31/10/19</b> £	<b>31/3/19</b> £	<b>31/3/18</b> £	
2016	-	-	1,602k	Paid in 2018/19
2017	2,244k	2,208k	2,133k	NT status at 31 October 2019: "Agreed with Sub Custodian". Awaiting confirmation of when reclaim will be made.
2018	2,145k	2,110k	978k	NT status at 31 October 2019: "Reclaim Submitted to Sub Custodian". There is no requirement for action from LPF.
2019	2,214k	830k	-	Claim cannot be made until the end of the calendar year.
<b>Total</b>	<b>6,603k</b>	<b>5,148k</b>	<b>4,713k</b>	

4.7 The reason for the increase in the balance for the Swiss claims is the 2017 claim not being paid until the 2018/19 financial year. The factors accounting for the delay have been queried with NT.

4.8 NT has stated that the 2017 reclaims were submitted in 2018 and although repayment has been agreed funds have yet to be received.

4.9 For Germany, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	<b>31/10/19</b> £	<b>31/3/19</b> £	<b>31/3/18</b> £	
2016	702k	702k	714k	NT status at 31 October 2019: Agreed with Sub Custodian". Awaiting confirmation of when reclaim will be made.
2017	955k	954k	971k	NT status at 31 October 2019: "Market Issue"
2018	1,126k	1,125k	137k	NT status at 31 October 2019: "Market Issue"
2019	1,418k	139k	-	NT status at 31 October 2019: "Market Issue"
<b>Total</b>	<b>4,201k</b>	<b>2,920k</b>	<b>1,822k</b>	

4.10 The German claims relating to the 2016 period have been accepted by the sub custodian, the Fund now awaits payment of these claims. For claims 2017 onwards the Germany Tax Authorities have introduced a holding period requirement where claimants must have not traded 45 days prior to and after the dividend ex-date where the reclaim is greater than 15%. UK pension funds are caught under this bracket. This is why all reclaims from 2017 onwards have been assigned a "Market Issue" status as NT review its operations to be able to capture this new requirement.



4.11 For Norway, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	31/10/19 £	31/3/19 £	31/3/18 £	
2016	-	101k	103k	Paid 2019/20
2017	-	216k	221k	Paid 2019/20
2018	-	114k	20k	Paid 2019/20
<b>Total</b>	-	<b>431k</b>	<b>344k</b>	

4.12 All Norwegian claims were settled in October 2019

4.13 For the Netherlands, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	31/10/19 £	31/3/19 £	31/3/18 £	
2017	-	36k	255k	<b>Paid 2019/20</b>
2018	54k	92k	36k	Partial payment Paid 2019/20
2019	297k	38k	-	Too early to claim
<b>Total</b>	<b>351k</b>	<b>166k</b>	<b>291k</b>	

4.14 It is worth noting that Netherlands tax periods are calculated on a calendar year basis. This is the reason why a partial payment of withheld tax was received for the 2018/19 period.

### Taiwanese Claims

- 4.15 Previous years cross border withholding tax reviews had identified the opportunity to make additional claims to recover tax deducted on dividends from Taiwanese companies.
- 4.16 After reviewing a number of quotations, Deloitte has been appointed to make claims for three calendar years (2016, 2017 and 2018).
- 4.17 All reclaims submitted for these periods have been successful. As at 31<sup>st</sup> October 2019 £693k of withheld income has been returned to the Fund while approximately an additional £250k is expected by the end of the year.

## 5. Next Steps

- 5.1 LPF will continue to monitor the withheld tax on the pension funds' investments and ensure it maximises the income it receives, expediting the recovery of tax when required.

## **6. Financial impact**

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- 6.1 The financial impact of the withholding tax claims is described in section 3.8 of this report.

## **7. Stakeholder/Community Impact**

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- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

## **8. Background reading/external references**

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- 8.1 None.

## **9. Appendices**

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

10 December 2019

## 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
Israel	<p>Summary:</p> <p>Approximately £93k may be reclaimable through double tax treaty relief. In the first instance, we would recommend discussing this point with NT to determine if they are able to reclaim this amount through their standard procedures. The completion of some tax documentation may be necessary. Deloitte would be happy to assist if needed.</p>	<p><b>LPF comment:</b></p> <p>NT has been contacted on this point and we await their comments.</p> <p><b>NT response:</b></p> <p>Dividends originated from revenues generated abroad would be subject to 25%.</p> <p><b>LPF Conclusion:</b></p> <p>The matter seems to be resolved. However, we have asked for confirmation.</p>
United States	<p>Summary:</p> <p>Approximately £58k may be reclaimable through double tax treaty relief. This appears to relate to a single position where full UK pension fund relief has not been applied. In the first instance, we would recommend discussing this point with NT to determine if they are able to reclaim this amount through their standard procedures. The completion of some tax documentation may be necessary. Deloitte would be happy to assist if needed.</p>	<p><b>LPF comment:</b></p> <p>NT has been contacted on this point and we await their comments.</p> <p><b>NT response:</b></p> <p>The withholding related to a UK ADR which was subject to the 21% withholding tax rate.</p> <p><b>LPF Conclusion:</b></p> <p>The matter seems to be resolved. However, we have asked for confirmation.</p>
Italy	<p>Summary:</p> <p>Approximately £112k may be reclaimable through EU law reclaims. Deloitte can provide support in this regard if needed. However, we would note this may be a very long process, as Italy are not currently processing claims. As such, the cost/benefit may not warrant such a claim.</p>	<p><b>LPF comment:</b></p> <p>WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian.</p> <p>The Italian reclaim process can be time consuming with the average time to process reclaims being 8 years. There is also no guarantee of success. To date WTax have shown no interest in participating in this market.</p> <p><b>LPF Conclusion:</b></p> <p>The Fund is inclined not to pursue these reclaims.</p>

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## Pensions Audit Sub Committee

**2.00pm, Tuesday, 10 December 2019**

### Global Custody Services Performance

Item number	5.4
Executive/routine	
Wards	All
Council Commitments	

#### 1. Recommendations

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The Pensions Audit Sub Committee is requested to:

- 1.1 note the report and highlight any points it would like to raise at the Pensions Committee on 11 December 2019.

**Stephen S. Moir**

Executive Director of Resources

Contact: Jason Koumides, Senior Finance Manager, Lothian Pension Fund

E-mail: [jason.koumides@edinburgh.gov.uk](mailto:jason.koumides@edinburgh.gov.uk) | Tel: 0131 529 6245

## Global Custody Services Performance

### 2. Executive Summary

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- 2.1 This report presents the Key Performance Indicator Report for the 12 months ended 30 September 2019 provided by the Lothian Pension Funds (LPF) 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 two pension funds;
- 2.2 The report highlights that the indicator for Corporate Actions elected within deadline has remained Red for the year. As per previous years, a majority of late responses related to an external investment manager (79% of late responses). From investigation, LPF has comfort that these responses have not been late and the issue relates to how “default” corporate actions are being picked up between the manager and Northern Trusts system;
- 2.3 The conclusion is that Northern Trust’s services are currently meeting the needs of the two pension funds.

### 3. Background

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- 3.1 Following a competitive tender process, Northern Trust has provided investment custody services since early in 2011 for the pension funds. Provision of these services is vital to the management of LPF’s investments. The range of services includes:
- safe custody of investment asset;
  - reconciling investment valuations and accounts;
  - ensuring that investment transactions are processed within market requirements;
  - collecting investment income; and
  - providing notification of all corporate actions and passing responses to the companies concerned.
- 3.2 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 2019. The indicators cover the services listed above.

- 3.3 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.
- 3.4 In February 2014's external consultancy review of LPF's investment arrangements it was recommended that LPF should conduct regular operational reviews of key outsourced providers and incorporate onsite visits with face to face meetings. Following this review, LPF has undertaken an annual site visit to Northern Trusts' offices in London.
- 3.5 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 LPF taking up its option to extend for a further three years to February 2020. Pensions Committee has also approved the additional extension of this contract to February 2022 whilst Scottish Government consultation on the structure of the LGPS continues. 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).
- 3.6 Internal audits scope of work for 2019/20 includes the review of key controls used to support the custodial services provided by Northern Trust to LPF. The findings of this will be reported to Committee in due course.

## 4. Main report

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- 4.1 Information about all of the performance indicators is summarised below:

### Month End Valuation Reporting

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 30/9/19	Green (Previous Report: Green 14 days) 13 days
Comments	Unreviewed valuations are available on business day one, accurate for quoted investments. Portfolios that contain unquoted investments take longer for valuation information to be obtained. Month end valuations provided by Northern Trust are reconciled with records maintained by the external or

	<p>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 two occasion during the year, our accounts were signed off after the 14-day target (October 2018 and March 2019). The delay in sign off was as a result of queries submitted by LPF's 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 LPF's staff. Working proactively with Northern Trust helps to minimise future problems.</p>
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### Financial Reporting

Description of Indicator	<p>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.</p> <p>Month end investment accounting packs should be completed and sent to LPF within the target number of business days of end of the previous month.</p>
Performance Traffic Lights	<p>Green – Completed by business day 18</p> <p>Amber – Completed by business day 19</p> <p>Red – Completed by business day 20 or later</p>
Service Rating Over 12 Months to 30/9/19	Green (Previous Report: Green 16 days) 17 days
Comments	<p>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 LPF for accuracy. Any delays in month end valuation reporting have a knock-on effect in completion of the monthly financial reporting.</p>

### Trade Settlement Statistics

Description of Indicator	<p>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.</p>
Performance Traffic Lights	<p>Green – 94% or higher</p> <p>Amber – 92% to 94%</p> <p>Red – lower than 92%</p>
Service Rating Over 12 Months to 30/9/19	Green (Previous Report: Green 95.58%) 95.79%



Comments	<p>During the period, there were a total of 4,999 trades of which 4,783 (95.79%) were settled on time. Of the 216 trades settled late, 184 were purchases and 32 were sales. This is due to a common market issue where the selling 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 LPF 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

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. 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 – lower than 90%</p>
Service Rating Over 12 Months to 30/9/19	<p><b>Green (Previous Report: Green 98.50%)</b> 98.48%</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 2,305 income collections, 2,271 (98.48%) 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 LPF's bank account with the income on its pay date irrespective of the actual date of receipt.</p>

### Corporate Actions

Description of Indicator	<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"> <li>• rights issue to buy additional shares;</li> <li>• dividend reinvestment in additional shares; and</li> <li>• receipt of dividend in GBP, USD or EUR.</li> </ul>
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	<p>It is the responsibility of the custodian to collate responses from its clients to corporate actions and communicate the results to the company. LPF has the responsibility of responding to corporate actions on a timely basis. The indicator is the percentage of responses made by the client with the deadline date set by the company for a response.</p> <p>LPF 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>
Performance Traffic Lights	<p>Green – 100%</p> <p>Amber – 95% to 99%</p> <p>Red – lower than 95%</p>
Service Rating Over 12 Months to 30/9/19	<p><b>Red</b></p> <p><b>91.20 % (Previous Report: Red 93.52%)</b></p>
Comments	<p>During the period, there were 443 corporate actions, 404 (91.20%) 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 39 late items 31 related to one of LPF's external managers. After investigation, it was discovered that the issue relates to how certain default corporate actions are being captured between the manager and Northern Trust systems rather than late action.</p> <p>On assessment, the late corporate actions did not represent potential for financial loss to the pension funds.</p>

### Due Diligence Annual Review

- 4.2 LPF visited Northern Trust's office in London on 8 November 2019 to undertake requisite detailed review of the banking operations and control environment. A comprehensive report covering LPF's findings for this year's due diligence will be provided to Committee at its next meeting in March 2020.

## 5. Next Steps

- 5.1 Service provision by Northern Trust, as global custody services provider, is subject to ongoing monitoring by LPF.
- 5.2 As stated above, a further assurance report will be provided to Committee in March 2020. In future, it is intended that the timing of the site visit should be brought

forward so that a single report on due diligence and performance review of global custodian services could be provided.

- 5.3 Internal Audit's findings on the Northern Trust controls for supporting LPF's custodial services will be presented to Committee in due course.

## **6. Financial impact**

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- 6.1 The budget set for the provision of custody services for 2019/20 is £427k. This report has no impact on the cost of custody provision.
- 6.2 Poor performance of the custodian could have a financial impact on the underlying 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.

## **7. Stakeholder/Community Impact**

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- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

## **8. Background reading/external references**

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- 8.1 None.

## **9. Appendices**

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- 9.1 None.

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