



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Head of Audit and Inspection

Contact: Duncan Black Ext: 74053

Item 2

2nd September 2020

## INTERNAL AUDIT – REVIEW OF INVESTMENT INCOME

### Purpose of Report:

To present the results of the Internal Audit review of Investment Income within the Strathclyde Pension Fund Office.

### Note:

In most cases one of four opinions is expressed:

1. The control environment is satisfactory i.e. audit testing found no concerns with the control environment.
2. A reasonable level of assurance can be placed upon the control environment i.e. audit testing found no major weaknesses in the control environment but some improvements could be made.
3. A limited level of assurance can be placed upon the control environment i.e. improvements are necessary to ensure the control environment is fit for purpose.
4. The control environment is unsatisfactory i.e. significant improvements are required before any reliance can be placed upon the control environment.

### Recommendations:

The Committee is asked to note the contents of this report and **AGREE** the audit recommendation that the Head of Audit and Inspection submits a further report to Committee on the implementation of the actions contained in the Action Plan.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐

consulted: Yes ☐ No ☐

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# GLASGOW CITY COUNCIL INTERNAL AUDIT SECTION

## COMMITTEE SUMMARY

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**Title of the Audit:** Strathclyde Pension Fund – Investment Income

### 1. Introduction

1.1 As part of the agreed Internal Audit plan we have carried out a review of investment income within the Strathclyde Pension Fund Office.

1.2 The Strathclyde Pension Fund (SPF) Office are required, under statute, to provide retirement, death and other benefits for all eligible employees within the SPF local government pension scheme (LGPS). In order to do this, the SPF must ensure that assets and contributions are invested in such a manner that the benefits due to members and their beneficiaries can be paid from the fund as they arise. To help achieve this, the SPF has an Investment Strategy in place which broadly defines the types of investment to be held and the balance of the different types of investment (for example, equity, infrastructure etc.), the management of which is delegated to professional investment managers. Income from investments can either be realised or re-invested into existing investments. The SPF also participates in a securities lending programme managed by its global custodian, Northern Trust (NT).

1.3 The purpose of the audit was to gain assurance that appropriate controls are in place in relation to investment income. The scope of the audit included:

- Reviewing the arrangements that are in place to monitor and validate levels of income generated by investments;
- Reviewing the arrangements that are in place to monitor and validate levels of income reinvested within the investment portfolio;
- Reviewing the arrangements that are in place to take account of any potential changes in income realisation requirements of the fund; and
- Ensuring that appropriate reporting arrangements are in place in relation to investment income and the securities lending programme.

The scope also included reviewing the arrangements in place in relation to the lending of securities. However due to the current COVID – 19 pandemic, our audit testing was limited to assessing the adequacy of the control arrangements in place within this area. Sample testing could not be fully completed to confirm that the controls expected were being complied with.

1.4 The audit did not include a review of the following areas:

- The appropriateness of investments made.
- Investments made through the Direct Investment Portfolio (DIP).

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### 2. Audit Opinion

- 2.1 Based on the audit work carried out a reasonable level of assurance can be placed upon the control environment. The audit has identified some scope for improvement in the existing arrangements and one recommendation which management should address.

### 3. Main Findings

- 3.1 We are pleased to report that the key controls are in place and generally operating effectively. Investment Managers have delegated authority to decide on whether income arising from an investment will be realised or re-invested. This will primarily be based on the contractual arrangements in place and the type of investment being made. However, the SPF retain the ability to instruct the Investment Managers to reinvest or realise income as deemed necessary by the SPF Investment Strategy. We found that arrangements are in place to monitor and validate levels of income generated by investments, including property income, to provide assurance to the SPF that income levels being reported by the Investment Managers are accurate and complete. For a sample of five investments selected for review, we found evidence to show that the year-end income figures provided by the Investment Managers had been subject to a validation process by NT and Audit Scotland and no material issues had been identified.

- 3.2 A cash flow modelling process has been developed and is being monitored to ensure that income realisation from investments is sufficient to meet the future expected commitments of the pension fund. Arrangements are also in place to ensure that the SPFO Investment Strategy can be revised to facilitate access to cash generating investments. Evidence was in place to demonstrate this information being reported to the SPF committee. We found that the ongoing monitoring of these arrangements is undertaken by the Investment Advisory Panel (IAP), an advisory group which includes members of SPF senior management, the pension fund custodians and external investment consultants.
- 3.3 The main forum for discussions on investment income is through the IAP who provide support and advice to the SPF committee. We found that monitoring reports in relation to investment income is reported to the IAP on a regular basis, with a summary of this information reported to the SPF Committee.
- 3.4 Where securities are being loaned, the borrowing organisations are required to provide collateral at least equal to the market value of the securities being loaned to provide the SPF with protection in cases where the value of stocks transferred decrease, or the borrower becomes insolvent during the period of the loan. We reviewed 18 instances where securities had been

## GLASGOW CITY COUNCIL INTERNAL AUDIT SECTION COMMITTEE SUMMARY

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loaned and found evidence to demonstrate that the collateral held exceeded the market value of the loan in all cases.

3.5 However, our audit testing found an area of non-compliance. Although a Securities Lending Agreement (SLA) is in place between NT and the SPF which details the role of both parties in relation to the lending of securities, we found that the SLA requires to be updated to reflect the current processes that have been adopted in relation to the lending of securities.

3.6 An action plan is provided at section four outlining our observations, risks and recommendations. We have made one recommendation for improvement. The priority of the recommendation is:

Priority	Definition	Total
High	Key controls absent, not being operated as designed or could be improved. Urgent attention required.	0
Medium	Less critically important controls absent, not being operated as designed or could be improved.	1
Low	Lower level controls absent, not being operated as designed or could be improved.	0
Service Improvement	Opportunities for business improvement and/or efficiencies have been identified.	0

3.7 The audit has been undertaken in accordance with the Public Sector Internal Audit Standards.

3.8 We would like to thank officers involved in this audit for their cooperation and assistance.

3.9 It is recommended that the Head of Audit and Inspection submits a further report to Committee on the implementation of the action contained in the attached Action Plan.

# GLASGOW CITY COUNCIL INTERNAL AUDIT SECTION COMMITTEE SUMMARY

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## 4. Action Plan

No.	Observation and Risk	Recommendation	Priority	Management Response
<b>Key Control:</b> Appropriate arrangements are in place to ensure that any lending of securities is appropriately controlled				
1	<p>All security lending is undertaken and administered by NT, the global custodian for the SPF. The role of NT and the SPF in the process is outlined in the SLA which acts as the legal document and governs the process. The current SLA in place was agreed in 1998 however, we were informed that there are plans in place to review the SLA as part of the upcoming tender exercise.</p> <p>Although the SLA suggests that different forms of assets are available to be loaned out by the SPF, we were informed that, in practice, only equities are now loaned.</p> <p>We were also informed that, following the financial crisis in 2008/09, a decision was made that collateral would not be re-invested but would be held in the form it was provided. However, we found that the SLA had</p>	As part of the custodian tender renewal process, SPF Management should review and update the Securities Lending Agreement to ensure that this reflects the current arrangements in place. Thereafter, the document should be signed by all relevant parties.	Medium	<p><b>Response:</b></p> <p>Accepted. Amendments to the original 1998 SLA have been reflected in various side letters. The Securities Lending Agreement will be reviewed as part of the custody tender process to ensure that it encompasses all arrangements.</p> <p><b>Officer Responsible for Implementation:</b></p> <p>Chief Investment Officer</p> <p><b>Timescale for Implementation:</b></p> <p>31 March 2021</p>

## GLASGOW CITY COUNCIL INTERNAL AUDIT SECTION COMMITTEE SUMMARY

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	<p>not been updated to reflect this and still suggested that NT should invest collateral.</p> <p>We also found that the current SLA does not include the arrangements in place for cases where the value of stocks increase over the period of the loan.</p> <p>This increases the risk that the correct processes in relation to the lending of securities are not followed or understood which could lead to financial implications for the SPF.</p>			
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## 5 Policy and Resource Implications

### Resource Implications:

*Financial:* Internal Audit services are included within the Central Support Services cost.

*Legal:* None

*Personnel:* None

*Procurement:* None

**Council Strategic Plan:** To provide assurance that appropriate controls are in place in relation to investment income.

### Equality and Socio-Economic Impacts:

*Does the proposal support the Council's Equality Outcomes 2017-22* Not applicable.

*What are the potential equality impacts as a result of this report?* No significant impact.

*Please highlight if the policy/proposal will help address socio economic disadvantage.* None

### Sustainability Impacts:

*Environmental:* None

*Social, including Article 20 opportunities:* None

*Economic:* None

**Privacy and Data** None

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## **Protection impacts:**

### **6 Recommendation**

- 6.1 The Committee is asked to note the contents of this report and **AGREE** the audit recommendation that the Head of Audit and Inspection submits a further report to Committee on the implementation of the actions contained in the Action Plan.