

Non-Executive Report of the: Pensions Board 22 March 2021	 TOWER HAMLETS
Report of Kevin Bartle, Interim Corporate Director Resources	Classification: Unrestricted
Review of Internal Controls at Investment Managers and Custodian	

Originating Officer(s)	Miriam Adams, Interim Head of Pensions & Treasury
Wards affected	All wards

Summary

This report presents the finding of the review of the adequacy of internal control measures put in place by the fund managers that hold the Fund's assets in management. Officers have reviewed the available AAF 01/06 and SSAE3402 (which signifies that a service organization has had its control objectives and control activities examined by an independent accounting and auditing firm).

The review of these reports and bridging letters has identified no significant changes in the internal control environment for the period 1 April 2019 to 31 March 2020.

The Fund managers' internal control reports have been audited and approved by external auditors and from the reports issued they are satisfied that adequate controls are in place for managing and reporting of the Fund's assets.

Recommendations:

The Pensions Board is recommended to:

1. Note the report contents; and
2. Note the current position for London CIV

1. REASONS FOR THE DECISIONS

- 1.1 There are no alternative decisions to be made.

2. ALTERNATIVE OPTIONS

- 2.1 The review of fund managers' AAF 01/06 and ISAE 3402 reports should provide some assurance to the Pension Fund (Members and Trustees) that fund managers have adequate controls and safeguards in place for managing the Fund's assets. It is appropriate for the committee and Fund members to be kept abreast of any risks identified through this process and the likely impact of such risks to the Fund.

3. DETAILS OF REPORT

- 3.1 The Pensions Regulator Code of Practice 9 Internal Controls requires Trustees to review internal controls as part of risk management.
- 3.2 There are a range of internal control reports produced in different countries in response to local and regulatory pressures. The guidance allows service organisations to disclose their controls activities and processes to their clients and the auditors of their clients in a uniform reporting format.
- 3.3 The publication of a service auditor's report prepared in accordance with a country's authoritative guidance indicates that a service organisation has had its service control objectives and control activities examined by an independent accounting and auditing firm.

The importance of these assurance reports is that they are capable of providing appropriate audit evidence under ISA (UK & I) 402.

- 3.4 In December 2009, the IAASB published Internal Standard on Assurance Engagement 3402 (ISAE 3402), Assurance Reports on Controls at a Service Organization. This is effective for service auditors' reports covering periods ending on or after 15 June 2011 and replaces the previous AAF01/06 and SAS70 reports. This standard should now be the basis for all internal control reports, whichever country they have been issued in.
- 3.5 This authoritative guidance allows pension fund managers to disclose their control activities and processes in a universally recognised reporting format, which is updated annually.
- 3.6 The Fund has always required that fund managers prepare and provide internal control reports as part of their reporting requirement to the Fund. These reports provide some assurance to the Fund that fund managers' internal controls/safeguarding measures are adequate. These reports are subject to annual audits, and consequently officers also review the updated reports annually to ensure that any changes are acceptable to the Council and will not expose the Fund's assets to undue risk.

Review of Fund Managers' and Custodian Internal Control Reports

- 3.7 Each of the Fund's investment managers prepares an annual report having regard to ISAE 3402 and AAF 01/06. Under these protocols the directors/partners prepare a report focussing on key environmental business and process issues and make commitments along the following lines:
- The report describes fairly the control procedures that relate to their stated control objectives;
 - The control procedures are suitably designed such that there is reasonable assurance that the specified control objectives would be achieved if the described control procedures are complied with satisfactorily; and
 - The control procedures described are operating with sufficient effectiveness to provide assurance that the related control objectives were achieved during the period specified.
- 3.8 Each of the managers has engaged a leading firm of auditors to report on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives.
- 3.9 The internal controls report for the following fund managers have been received and reviewed:
- Schroders
 - LCIV
 - Legal & General
 - Goldman Sachs
 - Insight
- 3.10 This process has not identified any significant change in risk to the Fund. However, a report from the London CIV in their capacity as investment manager which complies to the Standard is currently being awaited.

Legal and General (LGIM)

- 3.11 LGIM provided Assurance report on Internal Controls for the period 1 January 2019 to 31 December 2019. In respect of the Pension Fund accounts a bridging letter covering the period 1 January 2020 to 31 March 2020 was also received. The report is based on the framework set out in the technical releases International Standards for Assurance Engagements (ISAE) 3402, issued by the international Auditing and Assurance Standards Board (IAASB) and the Audit and Assurance Faculty (AAF) 01/06 on assurance reports on the internal controls of service organisations made available to third parties. Issued by the Institute of

The report received was in respect of 1 January 2019 to 31 December 2019. The manager provided bridging letter to cover the period 1 January 2020. There were no issues of material concerns flagged by KPMG who are the LGIM auditors.

London CIV (LCIV)

- 3.12 The London CIV report provided summarises the review of underlying manager controls. Data provided shows that the review conducted did not cover the reporting year of the Fund – 1 April 2019 to 31 March 2020. The LCIV has been contacted about this. The report did indicate that bridging letters had been requested for gap periods. As at the time of writing this report an updated version of the LCIV report had not been received.
- 3.13 The London CIV was also asked to provide a copy of the LCIV's AAF 01/06 ISAE 3402 in its capacity as fund manager for LCIV/Ruffer, LCIV BG Global Equity, LCIV MAC fund and LCIV BG DGF funds.

Goldman Sachs (GSAM)

- 3.14 The manager provided reports for the period 1 October 2018 to 30 September 2019 and a bridging letter for the period 1 October 2019 to 31 March 2020. There were no significant issues raised by PWC.

Schroders

- 3.15 Report provided by this manager covered Synthetic Equity, Equity protection and Real Estate mandates. Period covered was 1 January 2019 to 31 December 2019. The manager issued a bridging letter covering 1 January 2020 to 31 March 2020. EY the managers auditors reported no significant issues but acknowledges that their report did not cover security controls.

Insight Investments

- 3.16 The manager's report covered the period 1 October 2018 to 30 September 2019. A bridging letter was provided by the manager to cover period between 1 October 2019 to 31 March 2020. No material adverse changes to the control environment and/or objectives was reported by KPMG.

- 3.17 Northern Trust Corporation (NT)

NT provided reports in respect of the internal controls applicable to processing fund service transactions as custodian to the Fund. Reports were provided covering the 12 months to 31 March 2020 covering account coding, transaction events, authorisation, trade communication and settlements, vault security, tax withholding and reclamation, fund accounts, global subcustodian management and client and performance reporting all of which are key areas that affect their work for the Fund. It is understood from the report provided that the auditor also received control reports from NT's 3rd party processing centres and 3rd party data centres used however their audit did not include such.

No matters of significant reason was expressed by KPMG.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

- 4.1 Whilst the performance and effective controls of the investment manager and custodian is of paramount importance in the performance of the Pension Fund, there are no direct financial implications arising from this report.

5. LEGAL COMMENTS

- 5.1 All relevant implications are included in the report. It is important for the Pensions Committee to receive information on the performance of the Fund and internal control measures of the Fund managers. This assists the Administering Authority to meet its statutory and fiduciary duties.

6. ONE TOWER HAMLETS CONSIDERATIONS

- 6.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.
- 6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

- 7.1 The review arrangement of fund managers' internal control framework provides some assurance to the Committee that assets are being managed in a way that is congruent with the Fund Strategy and therefore more likely to yield returns/outcomes that reflect Fund objectives.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

- 9.1 The review of the AAF 01/06 and SSAE3402 internal control reports of third parties that manage Pension Fund assets ensures that fund managers are able to demonstrate that they are properly managing pension fund assets as stewards of the Fund and are following procedures that do not expose fund assets to any undue risks.
- 9.2 Pension Fund assets could be exposed to undue risk where AAF 01/06 and SSAE 3402 reports are not in place or adequate internal controls and safeguard measures are lacking in the management of Fund assets.
- 9.3 The risks arising from these investment performance are included in the Pension Fund risk register.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 10.1 There are no crime and disorder reduction implications arising from this report.
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Linked Reports, Appendices and Background Documents

Linked Report

- None

Appendices

- None

Local Government Act, 1972 Section 100D (As amended)

List of “Background Papers” used in the preparation of this report

Fund Managers AAF 01/06 and ISAE 3402 for Schroder’s, Legal & General, Insight, Goldman Sachs. In respect of LCIV a summary report covering all underlying managers was received.

(To be email if required)

Officer contact details for documents:

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