Drawing the new red lines

Supreme Court ruling puts pressure on LGPS ‘must do’ guidance
Covid-19 will have many effects on the Local Government Pension Scheme, but one that will receive particular attention is its likely impact on responsible investment.

Environmental, social and govern-ance (ESG) issues have been prevalent in risk and investment discussions ever since the formation of the London Collective Investment Vehicle, the LGPS pool for London local authorities. And our responsible investment policy reflects our focus on financial risks associated with people and diversity, regulation, climate change, economic stability and harmful goods.

Presently we are investing in extra people, developing new products such as a renewables mandate, an equity exclusion fund and an impact fund, as well as improving our governance through better reporting, enhanced proxy voting and better carbon footprinting.

So far, so good, but will any of this be affected by Covid-19? Yes – if anything it will add increasing impetus.

We are seeing increasing evidence that ESG investments have proved resilient amid current market turbulence; people are becoming even more alert to environmental and social issues, and both government and investors will focus on how companies address these in their recovery plans.

Recent research that examined 745 sustainable funds and compared them against 4,150 traditional funds found they matched or beat returns in all categories, whether bonds or shares and in the UK or abroad. Over 10 years the average return for a sustainable fund invested in large global companies has been 6.9% a year; a traditionally invested fund has made 6.3% a year.

To help us in our planning, we have formed a responsible investment investor reference group and will be asking whether our investors’ strategy will change as a result of Covid-19.

I don’t know if we will see major shifts – after all it’s rarely a good idea to quickly change well thought out strategies in times of market uncertainty – but it’s important to be sure they continue to be long term and sustainable. And indeed, there may well be new opportunities.

However, in terms of ESG I do wonder if we will see some immediate shifts in emphasis. Climate change has been the clearest and most pressing factor in sustainable investment, and that hasn’t changed, but might we see more attention paid to social and governance factors, such as how companies treat their workforce and responsibly manage their supplier chains?

The new ways of working are raising more interest in the use of technology; will this challenge investment in property and transport assets? And will the continued trend towards the integration of ESG factors into security selection and portfolio construction cause a rethink of the balance between active and indexed portfolio management?

Covid-19 will raise many issues for our funds to consider. Our job is to be part of that discussion and to identify the ways in which a collective approach will best deliver the pooled investments that will help the funds build sustainable portfolios in these challenging times.

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Learn how PIMCO can help you build resilience in volatile markets visit: pimco.co.uk
The pandemic gave urgency to investigating the causes of poverty in a borough hit particularly hard by Covid-19

Recent years have seen poverty grow as an outer London problem, and while we knew it impacted on people’s quality of life and that our services have to address its consequences, we decided we needed a thorough understanding of poverty in our borough.

Why are so many Brent residents poor? What does it mean to live in poverty? What works to address the issue—and to prevent it arising in the first place?

Although there was a wealth of knowledge within the council, we wanted to draw on wider expertise and experience, to learn lessons about what works elsewhere. And we wanted to hear things people might not like to tell the council.

It was to meet these challenges that Eleanor Southwood (Lab), our cabinet member for housing and welfare reform, commissioned the independent Brent Poverty Commission in January 2020. Chaired by the former chief executive of the Joseph Rowntree Foundation Lord Richard Best (Crossbench), it included experts and frontline practitioners with in-depth knowledge of the issues locally, across London and nationally.

It was deliberately non-partisan, with representation from the council’s minority party, and although the council provided support and set terms of reference, the commission decided its own programme. Its work started before the pandemic, but this gave the work greater urgency: Brent was hit particularly hard by Covid.

We wanted to make sure the commission’s recommendations were informed by the lived experience of what it means to be poor in Brent, and how it feels when things can be done to help people overcome poverty. To do this the commission has drawn on case studies in the published report.

The chair and commissioners focused their work on four areas agreed to be of fundamental importance: housing, economy and jobs, tackling financial exclusion, and local welfare. The work confirmed that these issues are frequently interrelated, that those in poverty often face challenges across all of them, and that solutions had to tackle each in as joined-up and tailored ways as possible.

The commission’s report, A Fairer Future – Ending Poverty in Brent, published in August, gives a comprehensive account of why so many of Brent’s residents live in poverty, what this means to them every day and what is already being done to help them.

It lays out the ways that rocketing housing costs, precarious employment and a welfare system which all too often puts process before people combine to drive people into poverty, and make it so hard to escape. Most importantly, it looks at what works and what doesn’t, and what could be done better, giving clear, practical and evidence-based recommendations to the council, the mayor of London and national government about how we can make a real difference.

The past six months have shown in the starkest way possible that sharp divides in our society endure and that poverty imposes huge costs in terms of health and wellbeing, community and cohesion, dignity and opportunity.

The novelist Winifred Holtby once noted that local government is the community’s first line of defence against poverty and that, even if the battle is not always faultlessly conducted, it is one worth fighting. The commission has given us a soundly based plan to continue the fight.●

For the full report visit www.brent.gov.uk
A fairer future – ending poverty in Brent

Objective
To explore the ways in which the council could do more to reduce the incidence of poverty, inequality and social exclusion among its citizens

Timescale
January-July 2020

Cost to authority
Within existing resources

Staff working on project
One (part of her time)

Outcomes
An independent report with key recommendations for the council to take forward

Contact
shazia.hussain@brent.gov.uk or jaqueline.barry-purssell@brent.gov.uk

POVERTY
A sound approach to eliminating poverty

Lord Richard Best
Chair, Poverty Commission

Our independent commission – set up by the council to see what more could be done to reduce poverty in the borough – heard what the poverty statistics really mean: interviews conducted for us revealed the misery of not having enough to cover food bills and heating costs, of struggling with debt, of facing eviction for rent arrears. And the position post-Covid looks set to be even more challenging.

Commissioners were hugely impressed by Brent’s efforts to combat poverty, particularly as the Covid story unfolded. Indeed, an overarching conclusion from our report is that Covid has not only revealed the gross inequalities in our society but has also demonstrated the centrality of local authorities in addressing them – the public health role, the housing of all homeless people sleeping rough, the emergency local welfare support, the convening, co-ordinating and funding of local voluntary and community organisations.

Brent is affected not just by low-paid employment but by high living costs – attributable to unaffordable rent levels, predominately in the private rented sector.

The proportion of children in poverty (using Office for National Statistics figures) stood at 22% before housing costs, but the proportion rose to 43% when housing costs were considered.

Our report therefore makes a series of recommendations for the council to pull out all the stops to increase the number of homes affordable to those on lower incomes, including borrowing to build council homes and maximising gains from planning. We predict opportunities post-Covid to do deals with developers finding sales more difficult and also to buy back ex-right-to-buy and other properties from landlords exiting the market in the months ahead.

But urgent measures must also be taken to increase incomes.

The commission commends the council’s efforts to boost employment, encourage apprenticeships and equip more young people for the jobs of tomorrow. Using its procurement powers and securing social value from the contracts it places, it can support the local economy and can see the London living wage paid to more workers.

Brent has seen circa 50,000 people furloughed and not all will return to full-time jobs. Of course, welfare support must come mostly from central government but we set out recommendations for enhancing local welfare assistance, both in this emergency and beyond. And we stress the value of the advice services so everyone gets the help to which they are entitled.

I hope the commission’s report shows there are real opportunities for all local authorities, despite financial constraints, to make a massive contribution to ending poverty.
McCloud

LGPS age discrimination remedy could cost £2.5bn

Martin George
Features editor

Government proposals to end unlawful age discrimination in the Local Government Pension Scheme could cost scheme employers £2.5bn, a government consultation has revealed.

The Ministry of Housing, Communities & Local Government has published its long awaited consultation on how to address a Court of Appeal judgement about reforms to public sector pension schemes in 2014 and 2015 that saw them move from a final salary to an average earnings basis.

The McCloud and Sargeant cases saw judges rule that transitional arrangements put in place to protect older active members of the judicial and firefighters’ pension schemes directly discriminated against younger members of the schemes.

Last year, after being refused permission to appeal to the Supreme Court, the government confirmed that the ruling also applied to the other main public sector pension schemes, including the LGPS.

In April 2014, the LGPS became a career average earnings scheme, but the government introduced transitional protection for members nearing retirement age to ensure they would not be worse off.

This statutory ‘underpin’ meant LGPS members who were within 10 years of their final salary scheme normal pension age on 1 April 2012 would receive a pension at least as high as they would have received had the scheme not been reformed.

Now, the MHCLG has outlined plans to remove the age requirements for the underpin qualification criteria.

The document says: “At a high-level, our proposal for removing the difference in treatment from the LGPS is to extend government introduced transitional protection for members nearing retirement age to ensure they would not be worse off.

Phasing out underpin protection is an important step to achieving the full benefits of a career average scheme”

Regulation

Contractor seeks judicial review of new

Martin George
Features editor

A contractor involved in a £6.5m dispute with a council pension fund is mounting a legal challenge to new government regulations on Local Government Pension Scheme exit credits.

The Ministry of Housing, Communities & Local Government announced new rules in February that gave LGPS funds discretion over payments to companies that leave the scheme. They reformed regulations dating from 2018 that introduced exit credits for employers that had a surplus when they left the LGPS.

The changes aimed to address concerns that some outsourced employers were receiving large exit credits when they left the LGPS, despite having had agreements which removed some or all of their risk during their time in the scheme.

Enterprise Managed Services, which is now part of Amey, provided a range of environmental services for Daventry DC and Northampton BC from 2011 to 2018, with council staff who transferred to EMS remaining in the LGPS.

A report to Daventry’s strategy group in May 2019 said the contract “transferred almost all pension risk” from EMS to the councils, including liability for any exit payment EMS might have needed to pay.

Although the EMS account was assessed as being in deficit through most of the life of the contract, which resulted in the councils paying higher employer pension contributions, it was assessed as having a surplus of about £6.5m by the time the contract ended.

Last year EMS launched legal action seeking a £6.5m payment from Northamptonshire Pension Fund under the 2018 regulations.

The Daventry DC report says: “Such an exit credit would have been a wholly unjustified windfall to EMS, which prior to the 2018 regulations would have had no expectation of such a payment and would not have priced the [contract] in anticipation of it.”

The legal dispute has yet to be resolved, but during the government’s consultation on its revisions to the exit credit rules, Daventry said the changes “would be likely to resolve the situation DDC and NBC face”, adding that “£6.5m of funds would be retained for the benefit of the residents of Daventry District and Northampton rather than forming an unjustified windfall to EMS”.

In February, the MHCLG said it would amend the 2018 regulations “so that administering authorities may determine, at their absolute discretion, the amount of any exit credit payment due, having regard to any relevant considerations”.

Now, Amey has applied to challenge the new rules in the High Court. A spokesperson told LGC: “We remain committed during this time to working collaboratively with the MHCLG to reach a proportionate and fair outcome.”
underpin protection to... those who were not old enough to receive underpin protection when it was originally introduced.”

It adds that this should ensure LGPS members who were not originally eligible for the underpin under the 2014 reforms will be “treated equally for benefits accrued from April 2014 onwards”.

The LGPS consultation also proposes that from 1 April 2022 all service in the LGPS will be on a career average basis, with no underpin, adding: “We believe that the move from a final salary to a career average pension scheme design in April 2014 created a fairer structure for LGPS members.

“Under the 2014 scheme, those public servants who see considerable increases in earnings over their career – particularly towards the end of their career – are no longer likely to be relatively favoured compared with their colleagues who did not.

“Phasing out underpin protection is an important step to achieving the full benefits of a career average scheme design.”

The ministry also proposes making a number of changes to the underpin regulations that would apply retrospectively from 1 April 2014. The document acknowledges that “retroactive application of the proposed draft regulations will lead to significant administrative complexity”.

The consultation estimates the cost of the proposals will be £2.5bn to LGPS employers in the coming decades, based on annual future long-term pay growing by CPI plus 2.2%. This was the assumption used by the Government Actuary’s Department for the 2016 valuation of public service pension schemes.

However, the document notes that it is “not possible to say precisely how the proposals may impact on any individual employer’s contribution rate”.

The proposed remedy for the LGPS differs from those for other public service pension schemes, which include an element of member choice, because the transitional protection arrangements for those schemes were different to those for the LGPS.

The Royal Courts of Justice

The Royal Courts of Justice

In this section: 51 Chris Bilsland on environmental, social and governance issues 54 Phil Triggs on the future of pooling

**Oversight**

**Concerns as pension board meetings cancelled**

**Martin George** Features editor

Pension boards have been told there is no legal barrier to holding their meetings virtually after it emerged that some have been cancelled during the coronavirus pandemic.

Councils have moved to remote, online meetings since the onset of the coronavirus crisis. However, the Local Government Pension Scheme’s advisory board (SAB) has warned that “a number of administering authorities have cancelled meetings of their local pension boards during the Covid-19 emergency.”

Early in the pandemic, the government introduced regulations to allow local authorities to hold meetings remotely, and allow members of the public and press to access meetings and meeting documents in a similar way.

The advisory board said local pension boards are not usually classed as local authority committees under the Local Government Act 1972, and suggested that decisions to cancel pension board meetings may have been taken on the grounds that they did not fall within the new regulations, and there was therefore no legal basis for meeting remotely.

However, the advisory board said regulation 106(8) of the LGPS Regulations states that “a local pension board shall have the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions”.

It added: “Having taken legal advice, SAB is satisfied that arranging a virtual meeting of a local pension board would facilitate the discharge of its duty to conduct business during the emergency.”

The advisory board said: “During the emergency it is essential that both pension committees and local pension boards find ways of exercising their statutory functions. SAB is clear that there is no legal barrier to either the committee or board meeting on a virtual basis including public and/or press access through remote means if considered necessary.”

It also recommended that local pension boards amend their terms of reference to give them the flexibility to hold virtual meetings, if they did not already allow this, “even if this is only to cover emergency situations where boards should not be meeting in person.”

**LGPS exit credit rules**

*The Royal Courts of Justice*
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The resilience of ESG investments and growing awareness might drive changes in emphasis.
Real estate: an undervalued tool in sustainable investing

The built environment contributes significantly to carbon emissions, so addressing this by investing responsibly in the sector can be a major driver for change.

An intractable problem?
Society is increasingly coming to grips with the scale of the environmental challenges facing the planet and the urgent need for change. This is prompting increasing focus from consumers, companies and governments on environmental, social and governance (ESG) factors in every facet of public and private life. But the very scale of the challenge can make it difficult to know where to start in tackling such a vast issue.

One overlooked lever for ESG impact is real estate. From the homes we live in to the factories that produce our goods and the offices that house workers, the built environment contributes 40% of carbon emissions. Given that people can spend between 80-90% of their time indoors, the built environment also has an enormous impact on the health and wellbeing of our communities.

The ability to make a positive contribution to ESG factors through property ownership can be underestimated. ESG factors can have a profound effect on the investment performance of an asset. At CBRE Global Investors, we take a different approach to ESG, seeing it not as a compliance issue to avoid. Instead, it’s a central tenet of how we add value across every stage of the investment lifecycle, creating a shared advantage for clients while contributing to society as a whole.

Shared responsibility
There are many ways real estate investors can contribute to sustainability through the management of their properties. It is possible to upgrade buildings to minimise their environmental footprint in simple ways, such as installing smart meters and energy-efficient lightbulbs or implementing waste management programmes. Meanwhile, improving facilities to provide gyms or cycle stores, or renovating to improve the light and space, can have a huge impact on wellbeing and social factors.

However, ESG issues can sometimes be pushed to the bottom of the agenda in real estate due to confusion over whose responsibility they are. Landlords can feel it’s not appropriate to pry into their tenants’ operations, while some tenants deflect responsibility of a building’s ESG performance to their landlords. Green leases can help address this confusion by including clauses that define the responsibilities of the owner and tenant with regard to sustainability. They formalise a collaborative approach to monitoring, managing and improving the environmental impact of a building. With very long lease terms prevalent in some real estate sectors, landlords may believe their next opportunity to include green lease clauses is many years away, but often proactive engagement with tenants leads to an agreement on common sustainability goals.

A growing urgency to act
Unfortunately, delays in addressing ESG matters pose a significant, and imminent, risk to the investment performance of a property. Just as investors face pressure to meet tightening government regulations around ESG issues, their tenants face that same pressure. In coming years, buildings that underperform on ESG factors will
Real estate: an undervalued investing responsibly in the sector can be a major driver for change

The built environment contributes significantly to carbon emissions, so addressing this by environmental, social and governance (ESG) factors in every facet of consumption, companies and society as a whole.

An intractable problem?

Investors, we take a different approach to property ownership can be contribution to ESG factors through wellbeing of our communities. The ability to make a positive environmental impact of a building. With accountability board structure bribery & corruption and compliance procurement transparency, leading in ESG at CBRE Global Investors, we put ESG at the centre of our investment process. We live and breathe it every day. We believe that understanding and managing ESG factors at every stage of the property lifecycle is one of the drivers of investment’s outperformance.

Our proactive approach ensures we work closely with tenants and landlords to help them reach their ESG objectives. Through green leases, on-site sustainability workshops, tenant fitout guidance and b2b collaboration, we help futureproof property investments and build mutually beneficial relationships with tenants over the long term. We can also provide look-through reporting for our clients, to monitor progress against bespoke ESG targets.

For LGPS organisations looking to demonstrate their commitment to ESG values, property investment provides an effective way to make a tangible, measurable contribution to sustainability.

“...All ESG factors are set to become more influential as we transition to a green economy...”

Modern, smart buildings rather than traditional office space offer more for tenants and investors...
Looking again at the government’s pension pooling red lines

A landmark Supreme Court ruling on ethical investments in the LGPS has wide ranging implications

The red line, or “to cross the red line”, is a phrase used to mean a line in the sand, or a limit which should not be crossed. The phrase is derived from the Red Line Agreement in 1928 between the largest oil companies of Britain, the USA and France at the time of the end of the Ottoman Empire when the borders of the former empire were not clear. To remedy the problem a red pencil was used on a chart to make clear the borders. The phrase stuck, although in France one would not cross the yellow line: franchir la ligne jaune.

In the world of Local Government Pension Scheme asset pooling, the Ministry of Housing, Communities & Local Government attempted to set its own red lines to indicate the ‘musts’ to be achieved by the LGPS administering authorities in setting up the eight pools. The January 2019 draft pooling guidance, issued by the MHCLG under an informal consultation process, clearly set out the ‘musts’, providing an indication of the extent to which funds should adhere to MHCLG’s guidance. For the record the ‘musts’ were:

- The assets must be pooled
- A pool company must be appointed to implement investment strategies
- The pool company must decide which managers are used for pool vehicles
- The pool company must be regulated by the Financial Conduct Authority
- A governance body must be established and maintained to set the direction of the pool and “hold the pool company to account”.

The assumed mandatory position then became somewhat clouded when the then local government minister Rishi Sunak clarified in May 2019 that this consultation paper had informal status only, saying a further formal consultation would be issued in due course. This formal consultation should have been in the summer of 2019, with draft guidance in place in early 2020, but was not published at that time for a good reason: the pending Supreme Court Palestine Solidarity Campaign judgment, which was issued in April 2020.

The case involved a challenge to two passages in guidance issued by the secretary of state in 2016 to assist administering authorities in the formulation of their investment strategies. They prohibited the use of pension investment policies to pursue boycotts and similar activities against nations which were not the subject of formal UK government sanctions or similar steps. The Supreme Court quashed these two passages, upholding by a three-to-two majority an earlier decision of the High Court, and overturning a subsequent ruling of the Court of Appeal.

Since the 2000s, successive governments have preferred the use of guidance rather than a method of arriving at implementation. Governments have been reluctant to break with the principle that red lines are better left to broad-brush guidance was sufficient for entirely extraneous reasons. What the courts have said is that the ‘musts’ are significant constraints to be observed by the pools.”
The Supreme Court considered that the secretary of state had the power to direct how administering authorities should take decisions but not what those decisions should be.

Lord Wilson’s leading judgment said: “Irrespective of whether the misconception to which I have referred played a part in leading the secretary of state to include in the guidance the two passages under challenge, I conclude that his inclusion of them went beyond his powers. HOW [Lord Wilson’s capital letters] does not include WHAT. Power to direct HOW administrators should approach the making of investment decisions by reference to non-financial considerations does not include power to direct (in this case for entirely extraneous reasons) WHAT investments they should not make.”

This particular coup de grâce would appear to be a game changer when it comes to the setting out of red lines in a government statutory guidance paper. One must wonder if the MHCLG is now trawling its new, unpublished consultation paper and draft guidance in a search for directions as to what to invest in or not to invest in, as opposed to how LGPS funds should invest. Special attention should be paid to the word ‘must’ because it would be difficult for government to specify a particular outcome, at least in guidance, rather than a method of arriving at implementing a particular investment strategy. If the government had particular red lines about any aspects of the asset pooling policy, then the means by which this would be achieved must now be considered very carefully.

Since the 2000s, successive governments have preferred the use of guidance and a broad framework for local authorities rather than the imposition of prescriptive solutions. In the case of LGPS pooling, prescriptive approaches could have stirred a hornets’ nest. The government therefore deliberately left important decisions to local authorities on how to form their own asset pools and devise their own pooling solutions: hence the formation of eight LGPS pools with various investment approaches and varying results which were established by local authorities (not by government). Asset pooling was the desired outcome for the government and the broad-brush guidance was sufficient to make it happen.

The Supreme Court decision clarifies that where an outcome or red line is required, legislation, not guidance, must be the means by which it is achieved. But where a process is required, guidance will suffice. Interestingly, early on in the LGPS pooling formation, senior civil servants took advice from the pension pools in Australia, which said the UK should legislate for the pooling outcome that the government desired. This advice was not taken. Accordingly, the government will need to decide its red lines on pooling and, if it wants to push through the policy directions of the abandoned draft pooling guidance from 2019, it appears that all the ‘must’ provisions will need to be lifted out of that draft statutory guidance and dropped into secondary legislation, while making sure that decisions on the process of how to deliver pooling are left to the administering authorities and the pools.

The Supreme Court did not comment on or even look at the 2019 draft pooling guidance although, if it had, it appears the judges would have had a field day.

Covid-19 has possibly slowed asset pooling transitions, so now might be a window of opportunity for local authorities to shape the potential outcome of the government’s review of both the existing regulations and the latest draft guidance. Revised consultation documents might be published by the end of 2020 but given the possible impact of a fresh outbreak of Covid-19, combined with the logistics of the UK’s departure from the EU, this seems ambitious and unlikely. It is therefore open for local authorities to take the opportunity to lobby government now about which aspects of the draft guidance work and which do not.

In the ‘musts’ outlined above, we see the government’s insistence of having an FCA-regulated entity at the heart of each pool. The government has failed to articulate the need for the pools to be FCA-regulated and such a requirement could be considered a distractor where it is now recognised that the relevant question should be whether an entity is carrying on an activity which needs to be regulated by the FCA or not.

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