BlackRock.

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LGF Pensions Team
Department for Levelling Up, Housing and Communities
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Submitted via email to: LGPensions@levellingup.gov.uk

RE: Local Government Pension Scheme (England and Wales): Next steps on investments

BlackRock[1] is pleased to have the opportunity to respond to the Department for Levelling Up, Housing, and Communities (the "**DLUHC**") consultation on LGPS next steps on investment.

BlackRock manages the pension savings of over 12 million people in the UK and our investment approach is rooted in our fiduciary duty: we start with our client's objectives, we seek the best risk adjusted returns, and we underpin our work with research, data, and analytics.

At BlackRock, we are incredibly proud of the work we have done with the LGPS, having managed their assets for almost 50 years. We manage over £23 billion of assets for 62 LGPS and eight LGPS Pools. Our LGPS clients have allocated their assets across BlackRock's index, active and alternative investment strategies in addition to leveraging our transition capabilities as they transfer their assets to their Pools.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the DLUHC on this and other topics.

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While LGPS contribute a significant amount to the UK economy, it is worth noting from the outset that the purpose of the LGPS is to pay pensions in an affordable and sustainable manner. As such, any proposals addressing the future of the LGPS should focus on member outcomes and ensure that any potential benefits outweigh costs to members.

In line with this, we have a number of thoughts on the proposals and how they interact with member outcomes, which we have gone through in detail below.

Asset pooling in the LGPS

Scale can deliver significant benefits. It tends to be linked to more resources dedicated to governance, stronger negotiation power over fees, and greater investment expertise. In this respect, we believe that pooling has been a success story, as the consultation document notes, there are considerable examples of where pooling of assets has enhanced purchasing power, strengthened investment decisions, and benefitted member outcomes.

[1] BlackRock is a leading provider of investment, advisory and risk management solutions, and has been active in the UK for over 50 years. Our purpose is to help more and more people experience financial well-being.

However, the implementation of pooling is not without challenges, and we believe further consideration needs to be given to the possible unintended outcomes of these proposals.

Index Investments

While further pooling and timelines for completing pooling of assets are a matter for LGPS and the DHLUC, we would welcome further clarity on the treatment of index investments under these proposals.

The consultation document suggests that LGPS index investments would need to move to a pooled platform. However, we would raise questions about the proportionality in terms of member benefits of this change, given the frameworks already in place and the operational resource required to make this possible.

Index investments are typically already procured in large, liquid, and low-cost funds and these assets already receive oversight from their LGPS pool owners. This is the norm across industry, and we would highlight the work done on the National LGPS Framework for Passive Investment Management Services[2] to facilitate joint procurement done in the spirit of pooling. Given the impact that this type of procurement has had on pricing, there is no obvious value to moving this on to a pooled platform. It would introduce unnecessary operational and resource costs to members, potentially erasing the savings that have already been delivered.

It is worth noting some of the operational challenges that would be involved with this change. Index investments by LGPS are either made through Life Company or Authorised Contractual Scheme ("ACS") Fund structures. While the investments through ACS could operationally transition relatively easily to a pooled platform, the Life Company Funds could not. This change would thus have implications for those using Life vehicles and would involve transition costs resulting from a change in legal entity for those schemes, especially significant within Emerging Markets investments. These transition costs could include stamp duty or equivalent foreign transfer taxes on the underlying portfolios which would be borne by members.

There are also implications for portfolio construction, not all Life Company Funds will have an equivalent ACS vehicle available, therefore reducing investment options for the LGPS.

Taken together, the fact that the LGPS already benefit from pooled procurement, alongside the operational challenges involved, we believe that there are questions about the proportionality of this change and its overall benefit to members. We recommend, instead, that such investments can continue to be considered pooled assets ("assets under pool management") in the government's classification.

LGPS investments and levelling up

LGPS Funds have a long-standing relationship with their local community and, as the consultation document notes, there have been an increased number of LGPS investing locally and in projects which support levelling up.

In principle we agree that in support of levelling up objectives, funds should be able to invest through their own pool into another pool's investment vehicle, where a particular strategy or asset class that a fund wishes to allocate to is not available via its own pool.

[2] The National LGPS Framework for Passive Investment Management Services was the result of collaboration between the pension funds of Cambridgeshire, Essex, Hampshire, Kent, Norfolk, Northamptonshire and Suffolk County Councils. Pools and individual schemes have drawn off the national framework procurement process and fee level and it has contributed to lower fees across industry.

However, in permitting this there will be a number of practical issues for pools and funds to consider in relation to governance structures, balancing the needs of shareholder and external pool customers, cost modelling and managing demand. **We would support further consideration of these issues, through engagement with pools and LGPS Funds.**

Investment opportunities in private equity

While we are supportive of the work the UK Government has done to get further pension investment into productive finance, we have concerns about the proposed ambition for the LGPS to allocate 10% of its assets to private equity.

In order to protect member benefits, we recommend broadening the focus to a more diversified range of other private market investments. We also recommend avoiding strict geographical limitations to allow LGPS to apply appropriate risk and diversification standards. While we share the long-term goal of encouraging the growth of the UK's productive economy, hard geographical restrictions risk disrupting prudent portfolio allocation decisions.

It is worth stressing that there has been and continues to be great enthusiasm from LGPS to invest in private assets of all descriptions – private credit, private equity, infrastructure and real estate are no longer considered alternative but a core component of their investment portfolio.

There are many reasons for this investment in private markets, most notably the expected return premia. The diversity of asset classes within private markets are also a good match for open pensions schemes: a private market allocation should be more return seeking at younger ages and more focussed on providing yield and cashflow when paying out member benefits.

When thinking about diversification there are also clear benefits around risk mitigation - concentrating 10% of investment in one asset class, especially with a clear geographical tilt and higher risk profile, could store up a large amount of risk in LGPS portfolios.

Diversified private markets exhibit resilience through economic cycles, for example, in this current inflationary environment, the long-term inflation protection that can be obtained from infrastructure assets can help protect schemes. There is also a risk of creating asset price bubbles, if a large number of (LGPS) investors are seeking to invest in a relatively small pool of UK assets. This type of price inflation would not represent a good member outcome.

Diversification also has a role in smoothing returns, especially in the initial investment phase. In this respect, we would note that private credit is a natural partner to private equity investment, given its strong cash flows and stable attractive returns.[3]

We would highlight that, in the context of supporting UK growth, the majority of private credit lending activity takes place with exactly the type of business the consultation document points to as needing further support – small innovative companies who use this capital to grow their businesses. We hence see private credit as having an important role to play in supporting UK growth.

With all of this in mind, we believe that the DHLUC should consider broadening this ambition beyond private equity investment to include other private market assets. This will help mitigate risk, boost returns, and ultimately support the UK economy.

[3] Data provider Preqin predicts that private credit will be the world's second-largest private capital asset class in 2023, with an accelerating compound annual growth rate of 17.4 per cent, 2022 Preqin Global Private Debt Report, Preqin, January 2022

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We welcome the opportunity to continue our dialogue with the DLUHC on the issues raised by this consultation and will continue to contribute to the thinking on any issues that may assist in the outcome.

Yours faithfully,

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