First Briefing, June 2025
Unlocking UK growth through DC megafunds

2025 wasn't shaping up to be a bumper year for pensions policy announcements, but that changed suddenly in late May when the Government published several consultation responses (and one report) all in one day.

Citing evidence from other countries showing that large pension funds can invest in major infrastructure projects and the private sector, the Government proposes requiring multi-employer Defined Contribution (DC) schemes to hold at least £25bn of assets by 2030 in a megafund, with the aim of investing pension savings in the UK economy.

To facilitate consolidation, there will be an override to allow transfers without consent from contract-based schemes.

The Government will have a reserve legal power to mandate investment in the UK, but doesn't plan on using it unless it sees insufficient progress from the pensions industry on this front.

These requirements are expected to be introduced by the Pension Schemes Bill, which was introduced to Parliament in early June.

The big idea – DC megafunds

The Government will legislate to require every multi-employer DC provider or master trust used for auto-enrolment to have at least one *main scale default arrangement*, with at least £25bn in assets under management, (AUM) by 2030.

Schemes will not be required to consolidate all their arrangements, nor will they be limited to a fixed number of arrangements.

The Government will also legislate to prevent new default arrangements from being set up, except in certain cases (which will need regulatory approval).

Who's exempt?

This requirement will not apply to:

- Single-employer trusts and collective DC schemes (for now).
- Schemes tied to specific professions or protected characteristics (e.g. religious beliefs).

Transition pathway for smaller schemes

Smaller schemes won't be left behind. Those aiming to hit £10bn in AUM by 2030 can apply for a special transition pathway, giving them extra time to meet the £25bn target.

To join the transition pathway, providers and master trusts will have to satisfy regulators that they have a *robust and deliverable plan* to reach £25bn in AUM by 2035.

They'll also have to show that they have, or are building, an investment capability commensurate with their scale. Further details of the transition pathway requirements will be in secondary legislation, which will be subject to a consultation.

Schemes that cannot either meet the minimum size requirement or join the transition pathway would cease to be auto-enrolment schemes. They would be expected to consider either winding-up or consolidating.

New entrants welcome – with conditions

The Government also proposes a pathway for new entrants. There will be additional authorisation criteria and threshold conditions for new entrants *with innovative products offering something significantly different.*

Three steps to address fragmentation

To reduce the number of smaller default funds giving poor value, the government has a three-step plan:

- **Step 1** – Providers and trustees will be expected to proactively consider consolidation and to do so unless it's not in members' best interests.
- **Step 2** – Once the proposed value for money (VFM) framework and contractual override regime are operational (expected in 2028), a minister-led review will consider why any default arrangements have not been consolidated into a main scale arrangement. A legislative underpin will *tackle any remaining fragmentation as needed*.
- **Step 3** - The findings of the review will be assessed (presumably by the government) to see if any further action is needed.

Proposed contractual override regime

At present, providers of contract-based schemes often need individual member consent to transfer members to another arrangement. This can be expensive and difficult to do – members may not be engaged and might ignore letters. This contrasts with trust-based schemes, where bulk transfers without consent are possible.

The Government considers that a contractual override power is needed to improve member outcomes (e.g. it might be in members' best interests to transfer from poor value legacy arrangements), to reduce fragmentation and to ensure a level-playing field with trust-based schemes.

Consequently, the Pension Schemes Bill will introduce a contractual override regime to enable transfers without consent from a contract-based arrangement to either trust-based or contract-based arrangements.

Initially the contractual override would only apply to workplace pensions, but non-workplace pensions could potentially be brought into scope later. As the override concerns contract-based schemes, the FCA will have regulatory oversight. It will make detailed rules for the proposed override.

Best interest test

Providers will be able to use an override where certain conditions are met, including that the transfer is in the best interests of members. There may be situations where a contractual override transfer is needed under other regulations or rules, e.g. the forthcoming VFM framework.

Providers would be required to obtain a positive assessment from an independent third party with sufficient expertise that the proposed transfer was in the best interest of members and that it complied with the relevant safeguards and processes. The Government will specify criteria that an independent expert must meet although it won't specify who may be one.

Active employers would have to be notified of any proposed use of the contractual override, although they would not have a specific role to play. They may have a right to be consulted on the proposed receiving scheme.

Individual's right to opt out

Individual members would be able to opt out of a proposed override transfer and pick an alternative receiving arrangement. However, it doesn't appear they would have the option of remaining in the transferring arrangement.

Mandating investment in the UK?

The Pension Schemes Bill will contain a reserve power which could, if necessary, allow the Government to set *quantitative baseline targets for pension schemes to invest in a broader range of private assets, including in the UK.*

The Government says that it does not anticipate using this power unless it thinks that the industry has failed to deliver change on its own through the recent Mansion House Accord, which saw a number of providers commit to investing in the UK.

Local Government Pension Scheme (LGPS)

The Government also announced plans to consolidate the 86 LGPS funds into six megafunds.

View from our employee benefits team

The Government's push for DC pension megafunds marks a notable shift in pension policy.

Although the Government highlights potential benefits for savers like higher returns and lower costs, concerns persist. There's a risk that mandated domestic investment could compromise fiduciary duties, reduce diversification, and lead to suboptimal returns if political motives outweigh financial ones.

Ultimately, the success of this initiative hinges on careful implementation, favourable market conditions, and the ability of megafunds to secure genuinely high-quality, long-term UK investment opportunities.