On point

UK pension schemes and 'productive finance' – a framework for effective intervention

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Contents

Executive Summary	3
1. Introduction	10
2. The current DC landscape	12
3. What is a 'productive' asset?	17
4. Potential barriers to investment in UK productive assets • Externalities • Information failures • Co-ordination failures • Regulatory failures	20
5. Barriers addressed: The role of scale • Scale in multi-employer schemes • Scale in single employer trusts • Contract based arrangements: GPPs	23
6. Barriers addressed: Government intervention assessed • DC Mega Funds • Subsidy of priority investments • Value-for-money framework • Long Term Asset Funds (LTAFs) • Voluntary compacts / mandation • Statutory over-ride for contract-based pensions	28
7. Conclusion	38
Appendix: If capital is global, does the level of investment in the UK by UK schemes matter?	40

Executive Summary

UK DC pension schemes and the 'productive' finance debate

In recent years, emphasis has been placed on promoting 'productive' investment in the UK.

The term has been used for different types of investment, including providing equity capital and finance for start-up and scaling UK businesses, domestic infrastructure projects, affordable housing and promoting longer-term and more illiquid investments.

Observing that other countries appear to have a higher level of their pension investments invested domestically, the UK Government has looked for ways to rebalance foreign investment towards domestic, shift cash savings to investments, and otherwise divert capital to more 'productive' uses. It sees this as a route to delivering greater economic growth, as well as providing potential benefits for individuals and businesses.

With the total UK workplace pension sector accounting for over £2 trillion in assets, successive Governments have become increasingly interested in these funds as an important source of capital for 'productive' redeployment, as described in the Pensions Investment Review (2025).[1]

In some of the public commentary on this issue, international comparisons are often cited as evidence that UK workplace pension schemes are under-investing domestically, e.g. compared to Australian and Canadian pension schemes.

But much of the policy debate lacks a clear and consistent framework through which to assess whether productive finance initiatives will be effective. In this paper we set out such a framework, describing the necessary conditions for productive finance policies to generate a net positive economic impact. We then apply this framework to assess various productive finance policies and describe the resulting implications for ongoing policy development.

When and where would greater UK investment from DC schemes be more 'productive'?

UK DC pension schemes currently invest less domestically, compared to equivalent schemes in other countries including Australia and Canada.

For example, in 2023, Australian schemes invested around 60% of their assets in the domestic economy compared with under 30% for UK schemes.

[1] https://assets.publishing.service.gov.uk/media/683971d8e0f10eed80aafb3a/27.05.2025_PM_-_final_report.pdf

However, this is driven by a range of factors including differing local context, tax treatment, incentives and – crucially – scale. For example, the combined assets of industry-wide Australian superannuation schemes are currently more than double those of their UK counterparts.

With mandatory saving into workplace DC schemes having started in Australia more than thirty years ago, it should not be surprising that this larger and more evolved system currently has a different investment mix to the UK.

Simplistic international comparisons of headline domestic investment rates explain little in themselves, and investment levels observed in other countries do not necessarily provide a sensible ‘target’ or a proxy for the ‘optimal’ level of domestic investment for UK DC Schemes.

It should also be noted that the Australian superannuation system is based on the principle that schemes should invest with the ‘sole purpose’ of providing retirement benefits for members, and that this means investing in the ‘best financial interests of members’ and not having regard to considerations such as the Government’s wider economic policy. Yet this ‘sole purpose’ rule has not prevented Australian schemes from having much larger allocations to ‘productive’ assets than is currently the case in the UK.

Similarly, comparisons between UK DC schemes and the Canadian ‘Maple 8’ large schemes are misleading. As a recent report by Pensions UK[2] pointed out, these large Canadian schemes are much closer in role to the UK local Government pension scheme (LGPS) rather than to industry-wide DC pension schemes.

Pensions UK noted:

> *“Like the LGPS, the retirement income elements of these Canadian funds collect member and employer contributions to provide a range of defined benefit (DB) pensions to their members” (p47).*

Once again, it makes little sense to compare (largely publicly owned) Canadian DB pension schemes with UK DC Master Trusts and expect the comparison to provide helpful insights, as the two types of schemes are trying to achieve different things against different regulatory backdrops. This is not the right lens through which to motivate or appraise productive finance policies.

Productive finance policies are a form of government intervention. As such, the design and appraisal of these policies should be assessed using the well-established cost benefit analysis framework used across Government, as described in detail in the Green Book[3] – guidance issued by HM Treasury on how to appraise policies, programmes and projects.

[2] Evaluating-Pensions-Models-The-Maple-8-and-the-LGPS-in-Focus-Sep-2025.pdf
[3] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government/the-green-book-2020

According to economic theory, in competitive markets, market forces deliver a market equilibrium that allocates resources efficiently (and ‘productively’), based on the products and services demanded by consumers and the productive capacity of the economy.

However, the ideal conditions are not always present; various ‘market failures’ can move markets away from this efficient equilibrium. Where this is the case, Government intervention can be justified to ‘correct’ for market failure and encourage or move markets back towards the competitive equilibrium. Interventions may also be justified on fairness grounds.

The rationale for any productive finance policy should be based on identifying what market failure is present (i.e. why pension scheme investment has failed to reach the socially optimal ‘productive’ outcome), how the proposed policy would correct for this, and why the chosen policy design is superior to the available alternatives.

It is plausible that a range of ‘market failures’ might apply in different asset classes and contexts, leading to a socially sub-optimal level of investment in UK productive assets. These market failures may include a mix of externalities (e.g. infrastructure investments may generate wider social returns above the narrow investor returns that accrue), information failures (e.g. a lack of available information can mean it is more difficult to appropriately assess the investment opportunity and/or the risk), and coordination failures (e.g. an investment case in a local area may be contingent on a larger critical mass of investments being made in the area overall).

Similarly, a focus on short-term returns may lead to investments taking place where the long-term social return is negative (once account is taken of adverse environmental impacts, for example).

At a high-level, the presence of one or more such market failures would mean that intervention to support greater investment in productive finance areas is needed.

However, it is not plausible that there is an overall shortage of capital available for productive use. Capital is internationally mobile, and private market investments are not restricted to any meaningful degree from deploying capital to productive assets if this is desired by investors. Equally, it is not plausible to suggest that the UK is a poor investment location internationally. But while capital may be ‘available’ it may not be optimally deployed as a result of the market failures mentioned above.

Some productive finance policies are more supportable than others

Using the cost benefit analysis framework to assess a selection of the Government’s current and proposed productive finance policies, there is variation in the degree to which these policies appear to be justified.

A range of policies appear broadly sensible

Larger DC pension schemes are better placed than smaller schemes to invest in ‘productive’ assets and make the most of opportunities to invest in domestic infrastructure and other unlisted assets.

Scale is important as larger schemes are better placed to maintain greater diversification across asset classes, take on a wider range of risks, and as larger schemes can better justify developing greater in-house knowledge and expertise, paving the way for a more diverse investment strategy. Larger schemes may also hold a greater degree of bargaining power when negotiating with providers of assets not available via public markets and may be able to operate at a more efficient scale ensuring that more of members’ money can be invested for growth rather than being taken up in the costs of running the scheme.

As the DC market continues to mature, over time average scheme size will increase through a combination of organic growth and consolidation.

Accordingly, it is highly likely that UK DC schemes will naturally move towards a greater level of investment in productive assets even without any Government intervention, though there is no doubt that Government actions to date have increased the focus on this type of investment. However, policies that accelerate these changes can deliver benefits sooner and may still be justified.

Government policies that actively support DC scaling and consolidation include setting a minimum £25bn figure for the ‘main scale default fund’ of multi-employer pension schemes. This may lead to an acceleration in market consolidation and therefore bring forward the benefits of this market restructuring. This would deliver a net benefit for the UK economy.

Similarly, the creation of new investment vehicles such as the FCA’s Long-Term Asset Fund (LTAF) to facilitate DC scheme investment in longer-term, more illiquid assets is expected to lead to greater and quicker investment in productive assets, by overcoming information barriers and other coordination failures. Although it is early days, more than two dozen funds have been set up to date, and this has the potential to help overcome some of the existing barriers to DC schemes investing in these types of assets.

Creation of a new ‘statutory over-ride’ to allow pension providers to move members with legacy Group Personal Pensions into better value and more productively invested funds, without needing to obtain individual member consent, also has the potential to benefit both individual savers, providers, and the wider UK economy.

The rationale for other policies is less clear cut

The Government's proposed value for money (VfM) framework is well-intentioned in principle, designed to encourage employers to consider 'value' over cost when selecting a workplace pension provider.

This may overcome information barriers that limit the appetite of DC schemes to invest in certain asset classes and could help to reduce any excessive focus on price amongst employers choosing a workplace provider.

However, crude VfM ratings (based largely on historic investment performance) and the expected league table environment could discourage schemes wanting to innovate when it comes to investment strategy and therefore could prove counter-productive in the long-run. Without careful design, such crude ratings could cause individuals to be too short-termist and move away from funds that could experience a period of relatively poor returns, thus disincentivising funds from higher-risk-but-higher-reward strategies. Even though the FCA has recently revised its proposal from a three tier (red/amber/green) rating to a four tier (red/amber/light green/dark green) rating, the fundamental issue remains.

Better policy design may be available and could better achieve the objectives of the VfM framework.

More direct Government intervention in how schemes invest needs to be approached with care.

To date the emphasis has largely been on voluntary agreements designed to overcome 'collective action' problems.

These arise where schemes would like to invest more into asset classes which potentially offer higher returns at a higher cost but are reluctant to be first or only movers. Industry-wide voluntary agreements reduce this risk.

However, the case for the Government's decision to take reserve powers in the Pension Schemes Bill to 'mandate' how schemes invest, apparently only to be used in the event that voluntary commitments are not met, is less clear. Trustees and fund managers are already required to make investment decisions in saver's best interests, and these judgments should not be over-ridden in pursuit of the Government's wider objectives.

A further issue with the use of top-down investment targets, whether as the basis for voluntary or mandatory allocations is that they can be too high-level and fail to focus on areas where market failures genuinely exist.

For example, new investment in primary markets may deliver a materially different impact on the scale and pattern of real-world investment activity, compared to new investment in secondary markets. Rather than pursue top-down targets, policies should identify specific market failures and promote greater investments specifically where these occur.

Another risk of arbitrary ‘top-down’ targets, and especially a drive to get schemes to move at pace from current low allocations to private markets, is that schemes may lean towards the ‘easiest’ ways to hit the targets rather than the most productive from a social point of view. For example, there is growing evidence that signatories to recent industry-wide compacts are finding it easier to move towards their overall private market targets by focusing on infrastructure and other ‘real’ assets rather than the more painstaking process of identifying opportunities based on Venture Capital or private equity.

More granular targeting of additional investment to cases where market failures are present is likely to deliver greater benefits compared to arbitrary aggregate domestic investment targets.

There are Government policies that already attempt to achieve such targeting.

Public subsidies are delivered via organisations such as the British Business Bank, designed to overcome specific market failures as described above, and thereby better align the private and public cost/benefit of investing in ‘productive’ assets. One example is the ‘LIFTS’ initiative designed to encourage investment in science and technology.

However, in many cases these initiatives remain relatively small scale and are at an early stage of development. It may take some time before they attract new DC pension funding of sufficient scale to make a meaningful difference to the pattern of investment overall.

Conclusions

UK DC workplace pension schemes (particularly Master Trusts) are near the start of a decades-long growth journey. Significant increases in scale will emerge over the next 5-10 years, naturally leading to greater investment in productive assets.

This evolution in scale will be the most important single factor in changing the investment mix of UK DC schemes going forwards.

A large number of the Government’s productive finance initiatives target specific barriers to investment in certain areas, which could make it easier and more attractive for DC pension schemes to opt for investments in UK productive finance assets. However, as we describe, the success of such initiatives will rest on their design and execution. Top-down initiatives risk being too broad brush, and more tailoring and targeting would be preferable.

Government has an important role to play in boosting productive finance, to resolve market failures, and to ensure that legal and regulatory frameworks develop so as to minimise risk in investments in long-term and illiquid assets. Institutions already exist to identify and solve these types of market failures as described, but greater support may be required to accelerate progress and increase the scale of activities.

Finally, beyond pursuing productive finance policies to overcome specific market failures where these are identified, significant value can also be added by ensuring that the long-term investment environment offered by the UK is as attractive to investors as possible. DC schemes and other investors desire long-term stability. Risks are priced in and may scupper investment if these are too high. If other countries offer conditions that are perceived as lower risk, investor capital is free to move elsewhere and all else equal, it will do so.

For this reason, Government policies and behaviours that deliver macroeconomic and fiscal discipline and otherwise signal a healthy and stable long-term investment environment (e.g. via institutional stability, long-term health, education, and security policies etc.) are also highly important for attracting and retaining investment into the UK, and in ensuring that the UK invests as ‘productively’ as possible.

01. Introduction

"Britain needs to start investing in its own future again. UK Defined Contribution (DC) pension funds currently invest just 3% in infrastructure and only 0.5% in private equity. That's much lower than places like Canada (11% in infrastructure) or Australia (5% in private equity). Every percentage point matters, where this investment can deliver not only returns for savers, but also contribute to economic growth."

(Pensions Minister, Torsten Bell MP, March 2025)

With the UK government increasingly constrained in its ability to tax or borrow more, policy makers are focused on seeking other ways of generating additional revenue for the Government. Improving economic growth – described as the 'central mission' of the present Government – is seen as the best way to do this. And with the workplace pension sector accounting for over £2 trillion in assets, successive Governments have been especially interested in whether that money could be used 'more productively' to promote economic growth.

Definitions of what 'productive' finance means have evolved over time, but DWP says[4] it wants to promote:

"… investment that provides equity capital and finance for businesses in the UK including start-ups, infrastructure and private equity, as well as longer-term investments, typically in illiquid assets. This has been generically termed investing in "productive finance".

As we illustrate in this paper, there is some evidence that UK Defined Contribution (DC) pension schemes have relatively low allocations to these asset classes, particularly compared with their overseas peers.

But this prompts two key questions:

- If there are UK investments available which generate good risk-adjusted returns, why would UK pension schemes not invest in them?
- To the extent that there are barriers to such investments by UK pension schemes, what are they, and how far will current government initiatives help to overcome those barriers?

[4] See Ministerial Foreword: https://www.gov.uk/government/consultations/pensions-investment-review-unlocking-the-uk-pensions-market-for-growth

In this paper we start by providing some factual information about how UK DC pension schemes currently invest, including some context about the investment mix by the pension schemes in other countries.

We then consider the concept of a ‘productive’ asset and whether some asset classes might be more productive for the UK economy than others.

Next, we look at potential ‘market failures’ which could result in a socially sub-optimal level of domestic investment. This leads us to focus in more detail on the specific issue of scale, which appears to be a key determinant of the investment mix in UK DC pensions.

We then describe the main Government interventions designed to drive up ‘productive’ investment and assess how far each will address the market failures which have been identified. A concluding section offers some reflections on what further policy changes might be needed.

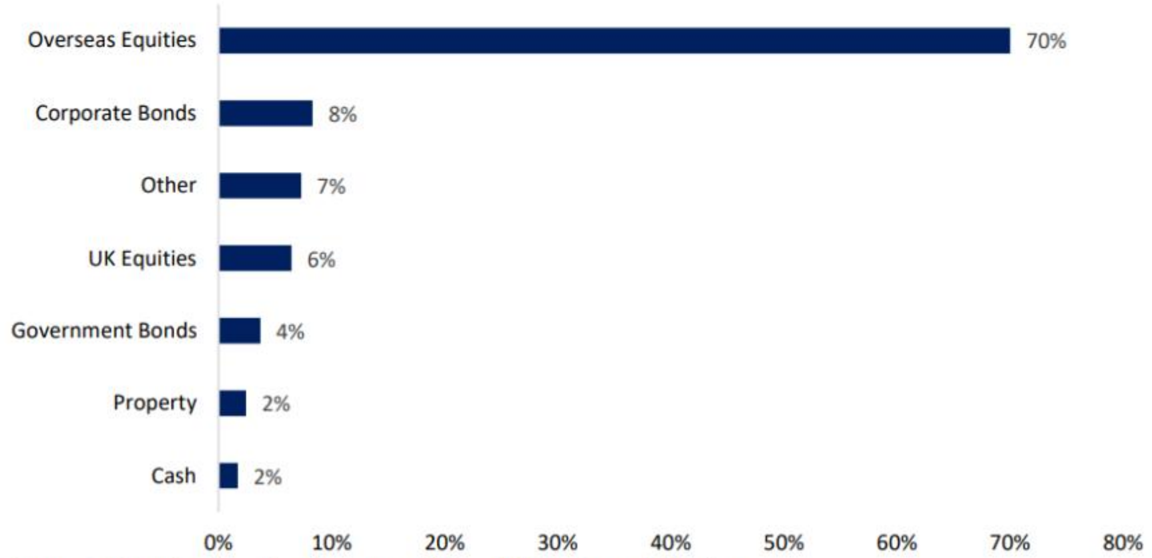
02. The current DC landscape

Private sector workplace pensions in the UK currently hold around £2 trillion in assets. Of this, just over half are in traditional Defined Benefit (DB) pension schemes, most of which are closed to new accrual. But future accrual in the private sector is overwhelmingly in DC pensions, with this type of provision growing rapidly. On current trends, the DC asset base is likely to overtake the scale of DB provision in the next five to 10 years and so for this reason, we focus in this paper on how DC schemes invest.

1. DC asset allocations in the UK

As part of its Pensions Investment Review, the Government published an evidence volume[5] with details of how UK DC pension schemes invest their money. Figure 1 from that report is reproduced below and shows how private sector UK DC workplace pension schemes invested in 2023.

Figure 1: Private sector workplace DC asset allocation (2023)



Source: DWP analysis based on Corporate Adviser MT/GPP Report 2024 data

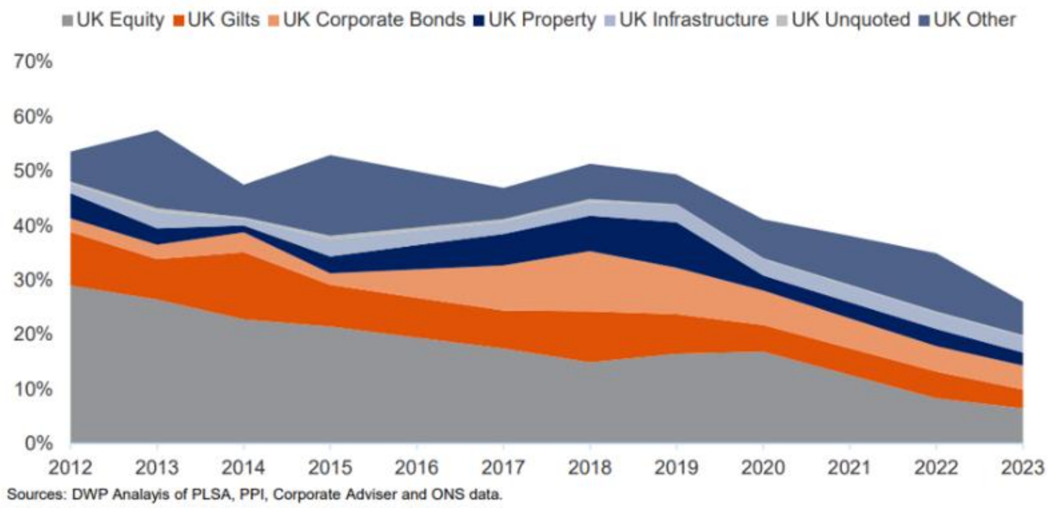
As Figure 1 makes clear, equities are the dominant form of investment for UK DC schemes, with around three quarters of all assets held in this form. However, this is overwhelmingly a matter of investing in overseas equities, with UK equities accounting for just 6% of total assets.

Interestingly, the allocation to UK equities has not always been this low but has actually fallen over the last decade.

[5] Pension fund investment and the UK economy

Figure 2 from the same report shows total allocations to UK assets in DC schemes since 2012, broken down by asset class.

Figure 2: The proportion of private sector DC assets invested in various UK assets



Back in 2012, just over half of all assets in UK DC pension schemes were invested in the UK.

But this has fallen steadily since then and now stands at just over a quarter. This has been largely driven by a falling allocation to UK equities, down from nearly 30% of all DC assets a decade ago, to just 6% today. This is likely to have been driven both by the substantial outperformance of US and other overseas stock markets relative to the UK market (thereby automatically increasing the share of assets held overseas) as well as by active asset allocation decisions by trustees.

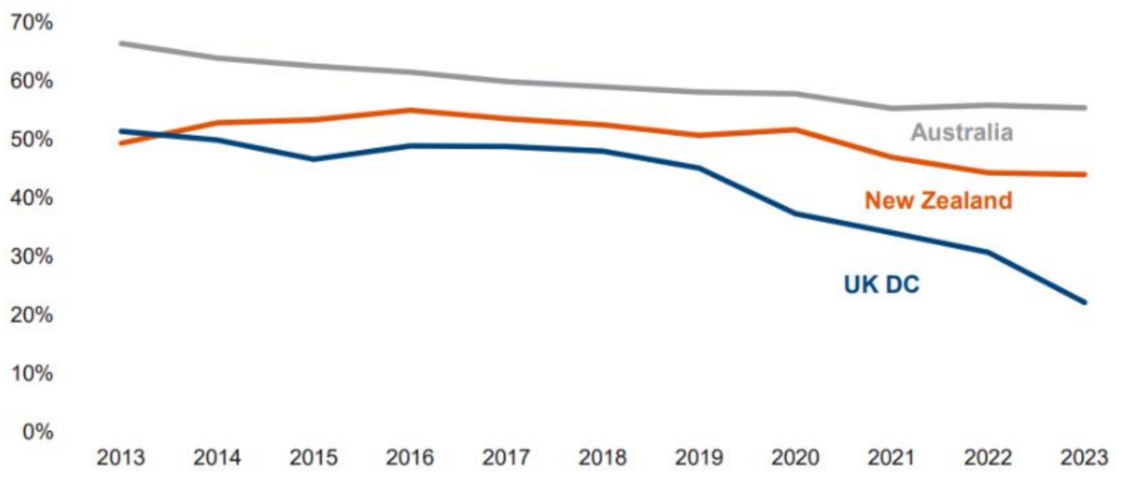
These charts show why ministers concerned about UK productive finance might feel that there is room for improvement. The large majority of DC assets are invested outside the UK and that share is, if anything, rising. Even those that are in the UK are not predominantly in categories such as long-term illiquids or private markets of the sort included in the Government’s definition of ‘productive’ investments. Indeed, allocations to ‘private equity’ have always been very small but have, if anything, fallen back over the last decade.

2. International comparisons

For context, we can see how far the (lack of) a domestic investment bias in UK DC schemes compares with other countries with large DC sectors.

This is shown in Figure 3.

Figure 3. Total domestic allocation of DC pension schemes in UK, Australia and New Zealand



Source: DWP Calculations as Figure 3. Australia: APRA Quarterly Superannuation Statistics; New Zealand: RBNZ Kiwisaver Assets

It is striking that both Australia and New Zealand have higher domestic allocations than the UK and that the gap has grown in the last decade.

In the case of Australia there is a strong tax incentive for equity holdings to be held on the Australian stock market, and this is likely to explain a significant part of the difference. There is also a tax incentive in New Zealand for investing in domestic equities compared with global equities, and there are also Foreign Investment Fund rules which further tilt the tax advantage in favour of domestic investment.

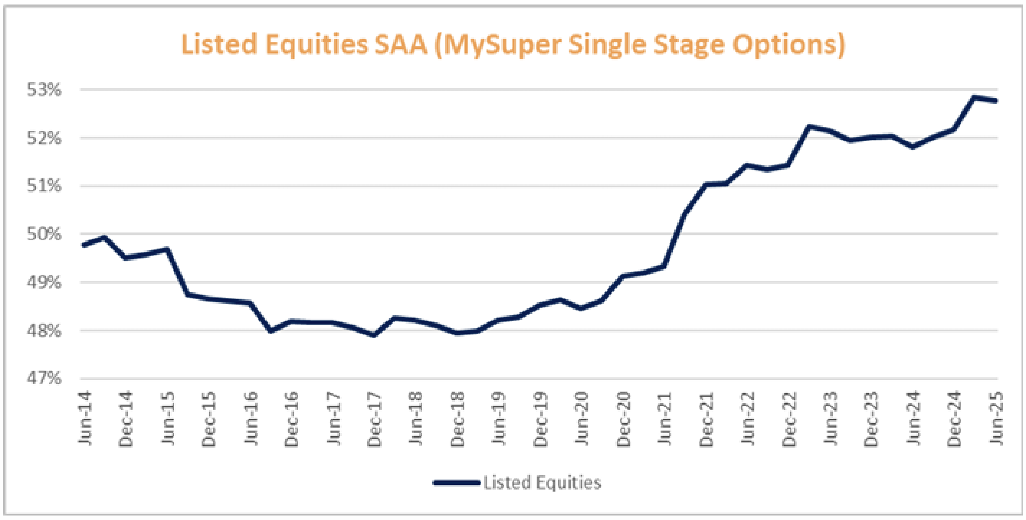
But the flip side of this chart is that a steadily rising share of assets in the large Australian Superannuation sector, is invested outside Australia. In part this reflects the fact that recent years have seen a growing allocation to equities and almost all of that growth has been in global equities as shown in the two charts below.

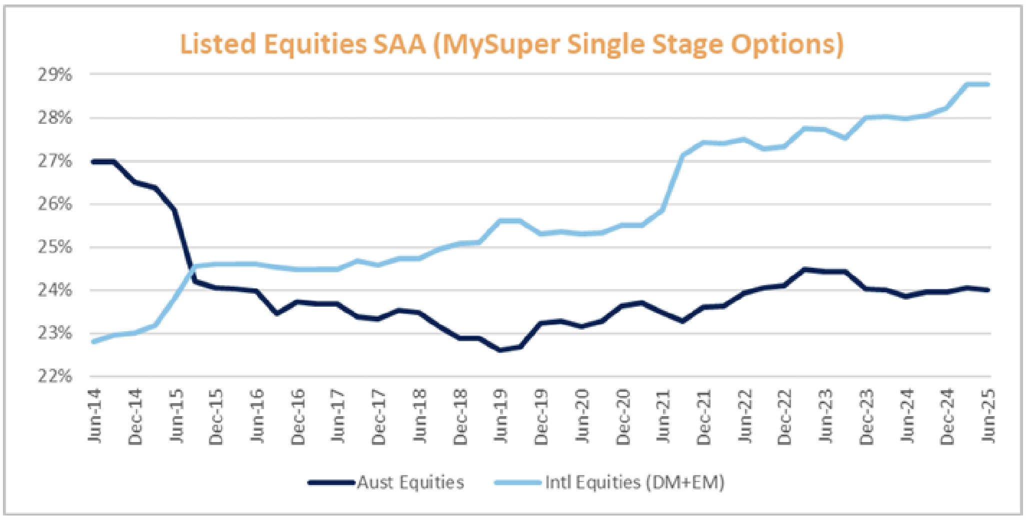
These charts show a) the overall 'strategic asset allocation' to listed equities, rising sharply over the last six years and b) the underlying allocations to split by Australian equities – roughly the same level as a decade earlier – and global equities, where allocations have risen steadily over the last decade. One reason for this is that the largest Super Funds have started to 'outgrow' their domestic market and need to look further afield to find homes for their equity allocations.[6]

But in terms of infrastructure investment, there remains a strong home bias within Australian schemes, primarily driven by large fee differentials between investing locally as against investing globally. Although collective industry initiatives have been undertaken to reduce some of the 'friction' in investing outside the country, it is still typically cheaper to invest at home and easier to

[6] AUD: Super fund's global push threatens the Australian Dollar, Deutsche Bank says

undertake due diligence on potential investments.





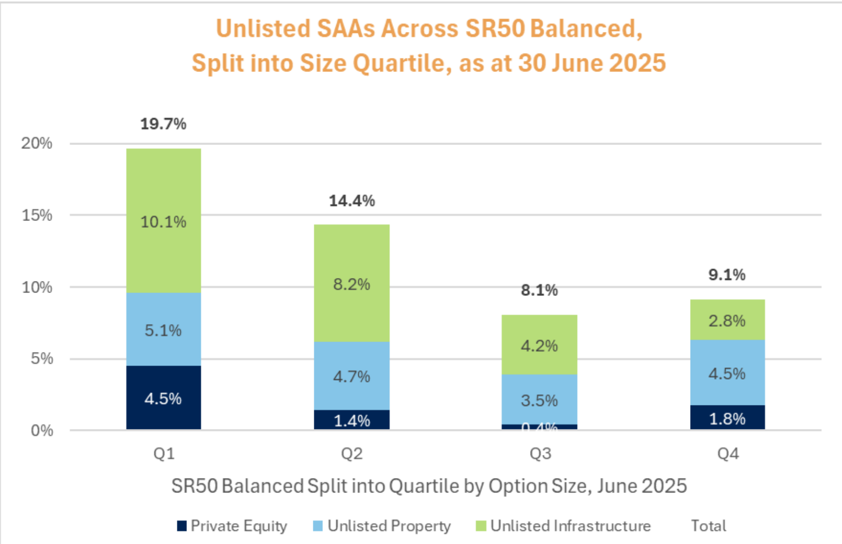
Still focusing on Australia, we see that the large industry-wide superannuation schemes are heavy investors in private markets, much more so than in the UK currently. The box opposite sets out how private market investment in Australia has evolved, overcoming some of the historic barriers to moving away from listed investments.

What has driven increased investment in private markets in Australia?

Investing in private markets can involve specialist expertise and more due diligence than simply investing in listed equities. The fees involved can also be a barrier to schemes investing. So how has the Australian system overcome these barriers?

As Australian super funds have looked to expand into private markets, a key innovation was industry-wide co-operation to create assets managers such as ISPT and IFM who could acquire the necessary expertise and serve the industry as a whole.

As schemes grew, so did their desire to diversify, making private market investments more important. Even today, in Australia there is a strong link between scheme size and allocation to private markets. As the chart below shows, the largest quarter of schemes allocate roughly double the asset share to unlisted assets as the smallest schemes, and the difference is particularly notable in private equity and unlisted infrastructure.



Source: JANA Investments estimates based on SuperRatings AA data and APRA data

As well as increased scale, growing allocations to private markets have been driven by a range of factors including:

- The way in which scheme investment performance was 'benchmarked', with private market investments being compared with returns on listed equities
- The early success of some private market investments, leading other funds looking to make similar investments so as not to be left behind in performance rankings
- Venture Capital being seen increasingly as the main way in which schemes can invest in 'emerging' sectors of the economy and in 'disruptors'
- The availability of investments in public listed companies has fallen, with companies staying private for longer and some public companies de-listing
- Private equity not necessarily being seen as a 'high-risk' investment, but contributing to the range of risk/return mix being sought by schemes further down the risk spectrum

03. What is a 'productive' asset?

If pension funds did choose to divert investments into certain types of UK assets, will this achieve greater economic growth as a result? If this is plausible in theory, does this suggest that the types of assets classes typically targeted for 'productive finance' initiatives are the 'right' set of assets?

'Productive finance' initiatives target a wide variety of asset classes

The 2024 DWP paper quoted earlier[7] describes the links between a very wide range of asset classes and economic growth, and indeed other policymakers and market commentators have used different definitions of the scope of 'productive finance' depending on the context.

Broadly speaking, the types of assets that appear to be the most commonly cited targets for investment through 'productive finance' policies include:

- **Infrastructure** – UK infrastructure projects investing in large, often physical assets, with long-term asset life and payoffs eg road and rail infrastructure, energy production and distribution; this can also include 'natural' capital such as investing in forestry
- **Unlisted equities and debt** – either an ownership stake in private companies or debt finance for such companies
- **Venture capital / start-up funding** – funding for businesses with growth potential, usually aimed at start-up or scale-up stages of development

Many of these are illiquid assets, where there may be frictions in converting these to cash, often if there are limited buyers/sellers for the assets, or there are complexities in valuation of the assets eg certain real estate investments, private equity.

The distinction between these types of assets and listed equities is seemingly that these types of assets are under-invested in (for various reasons). If correct, the implication is that the expected returns for these assets should ideally be higher compared to returns from investing in listed equities with equivalent underlying risk profiles.

In recent policy debates, a focus has been on directing investment towards these types of assets where these are considered to be 'UK' assets ie where the assets and/or economic activity associated with these assets is located domestically within the UK.

The policy debates often conflate two issues: (1) the extent to which greater 'home bias' should be promoted i.e. directing more investment from UK investors towards UK activity; and (2) the extent to which capital (from any source) should be allocated towards 'productive finance'

[7] Pension fund investment and the UK economy - GOV.UK

activities. In this paper we comment on both of these issues separately.

The specific focus of this paper is on UK DC pension schemes as one (large) potential source of investible capital that could be deployed through productive finance initiatives.

However, it is noteworthy that similar policy attention has been placed on UK retail investors and individuals with cash savings balances, with the intention of promoting more 'productive finance' investment from these sources of funding too[8].

In addition to attempting to promote additional investment in domestic asset classes, other common features of 'productive finance' initiatives include aims to promote UK economic growth at regional level (as well as at national level), to promote innovation, and in support of long-term Government objectives including supporting the UK's transition to net zero and promoting sustainability, eg through a focus on 'green infrastructure'.

Assets can be more 'productive' than others in the presence of market failure

A well-functioning economy requires well-functioning capital markets that can direct investment to allow capital and labour assets to be created, developed, enhanced, and maintained over time.

An asset can be thought of as 'productive' when it is optimally utilised and used to either increase the overall output of the economy, or to reduce the resources needed to produce a given level of output (ie via efficiency improvements).

For individual investors, the level of risk that their capital is exposed to when it is used to finance an activity is very important. Investors are in general considered to be risk averse: for a given level of return, lower risk activities are preferred. To compensate investors for bearing risks, higher risk activities will need to pay investors a greater level of return to attract the investment and will therefore be subject to a higher cost of capital.

In theory, under the assumptions of perfect competition, full information, and no externalities, capital is directed across the economy in an ("allocatively") efficient manner to optimise the overall activity of the economy, and all assets yield returns equal to their marginal product of capital. In this stylised scenario, no particular asset or class of assets can be considered more 'productive' than another.

Importantly, this logic applies ex ante: at the time an investment is made, an assessment of risk is made based on the currently available information and based on the risks, an expected return is calculated.

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[8] For example, in the 2025 Budget, the Chancellor announced that working age investors would no longer be able to use their full £20,000 annual ISA limit to invest in Cash ISAs but could only invest the full £20,000 if at least £8,000 was invested in stocks and shares.

Some investments may offer higher absolute returns for investors, but this cost of capital is driven by the risk of the underlying activities – in the context of this paper it is not the case that higher returns reflect greater ‘productive’ output.

How the risks then play out for investors is uncertain: there may be significant levels of variation in the returns the investor actually achieves. This is the nature of bearing a risk, and this potential variation in returns is what investors are being compensated for. In hindsight some investments may have turned out better than others (and have been ‘more productive’ than others), but investment decisions cannot be based on hindsight views.

In reality, the assumptions upon which this stylised view of the economy is based do not typically hold. Like all economies, the UK economy is characterised by market conditions that can lead to sub-optimal outcomes: where there are ‘market failures’, this can lead to underinvestment in certain assets and asset classes, underinvestment in aggregate, and equally overinvestment in some other assets and asset classes (relative to the ‘optimal’ or allocatively efficient outcome).

In the next section we look in more detail at these market failures.

04. Potential barriers to investment in the UK 'productive' assets

The conditions under which private market outcomes may be sub-optimal from an economy-wide perspective are very well studied, and there is a standard taxonomy of 'market failures' in the economic literature – all of which in principle can lead to sub-optimal investment outcomes. In this section we consider each of the major types of market failure which may potentially lead to under-investment by UK DC pension schemes in UK productive assets.

1. Externalities

Externalities occur when the private costs and benefits of an activity differ from the wider societal costs and benefits. In the context of investment, there may be many activities whereby an economic activity that requires investment may generate significant positive societal benefits, which private investors are unable to fully appropriate. For example, infrastructure investments may improve logistics for a wider population in a given region which can generate positive spillovers for all individuals (and businesses) in that region. Similarly, green infrastructure and initiatives can significantly reduce environmental pollution and societal costs, to the wider benefit of the entire UK population. Research and development can generate positive knowledge spillovers that go beyond the specific individual or business that undertakes them.

2. Information failures

Information failures occur when all the relevant information relating to an economic activity is unavailable, or where one party in a transaction holds more information than another. In the context of productive finance, investors may have insufficient information to accurately assess the level of risk that their capital would be exposed to if invested in certain activities. This issue may be particularly acute for long-term infrastructure projects, for investment in early start-ups, or for R&D, and for investment in illiquid assets where the time to convert investments back to cash at any future point in time may be highly uncertain. There may also be issues in persuading employers, who are ultimately the commissioners of workplace pension arrangements, that private markets are a good area for schemes to focus on, particularly given the lack of track record of many of these investments.

3. Co-ordination failures

Co-ordination failures can occur in the presence of certain types of externality – whereby the derived private benefits from any individual activity are contingent on other related activities taking place at the same time.

In the absence of the ability of any one party to control all the activities in parallel and guarantee they will all take place; this can lead to none of the activities taking place. One example of this cited by the current Government is the challenge for any individual Master Trust in shifting its investment mix to a higher cost but potentially higher return strategy. A single Master Trust, acting in isolation, could lose market share because of the prominence of price in employer decision making. But if all Master Trusts act in tandem, the industry as a whole can move to a potentially preferable risk/return mix from a social point of view.

4. Regulatory failures

Regulatory failure may also contribute to underinvestment in certain assets if the regulatory environment that has developed in a market has created particular incentives that distort market outcomes. This is often cited in the case of DB pensions, where there has been a bias towards risk-averse regulation which has arguably resulted in excessive de-risking and increased cost for employers. But DC regulation could also result in perverse incentives such as 'investment herding' which has been witnessed in the Australian system. Regulatory requirements around liquidity may also hamper the ability of DC schemes to invest in longer-term and less liquid assets, even where these would otherwise be optimal. This can lead to a mismatch between types of assets needed by DC pension schemes and types of assets available.

Conclusions

Overall, the presence of these types of market failures will act to lower the expected return that a private investor will expect to achieve, were they to invest in the assets affected. Investors will seek to maximise the (risk adjusted) returns on their capital and have a range of investment options available to them. It therefore follows that the presence of market failures as described will lead to underinvestment in the asset classes affected, vs the optimal level and efficient allocation of investment for the economy. This may be driven by certain investments simply not happening, or via a pricing effect given these failures will tend to increase the effective cost of capital for the affected asset classes.

In summary, there appear to be two broad groupings of potential failures that apply to productive finance:

- circumstances where externalities or coordination failures mean that the levels of (under)investment currently observed are privately optimal for investors given market conditions, but where it could be socially optimal for this to change; and
- circumstances where it would be privately optimal for investors to invest differently, but they currently do not due to a lack of information, driven by forms of price-based competition which led to sub-optimal outcomes, or where the existing regulatory framework could be improved.

Given the asset classes targeted under “productive finance” initiatives have economic characteristics to which these various forms of market failure plausibly apply, it is entirely possible that the level of investment in certain asset classes is lower than optimal from the perspective of the UK economy. Initiatives that target the relevant market failures, or interventions to directly impact market outcomes (e.g. through dedicated Government investment) would then in principle improve allocative efficiency and thereby increase economic growth and the welfare of UK citizens overall. We describe these initiatives in Section 6, assessing how far each address one of the market failures we have identified. But first we consider the particular issue of scale, which appears to us to be key to explaining the investment differences between UK DC pension schemes and their overseas counterparts.

05. Barriers addressed: The role of scale

Some of the market failures identified in the previous section may be particularly acute for smaller schemes.

This may be true for a number of reasons:

- Compared with investing in assets listed on global public markets, investing in private markets presents information challenges; there is simply less publicly available information about unlisted investments.
- In the case of start-up investments, venture capital etc., there is likely to be much less of a track record around the management of the businesses, undertaking due diligence is more costly and time-consuming.
- As schemes grow larger, the case for diversification across different asset classes grows; for a smaller scheme, the cost-benefit trade-off of overcoming the challenges in investing in less familiar areas can be unattractive.
- Whilst smaller schemes can use collective investment vehicles to invest in things like infrastructure or private markets, they are less likely to have the in-house knowledge and expertise needed; larger schemes can justify building up specialist expertise, paving the way for a more diverse investment strategy.

If scale is expected to be a significant barrier to investing in what the Government sees as more 'productive' assets, it is important to examine the scale of UK DC pension schemes, and how this is likely to evolve in the coming years, and to compare this with other markets at a different stage of their development.

We start by considering multi-employer Master Trusts, the closest UK parallel to the Australian 'Super' funds. Then we look at the remaining single employer trusts, some of which are multi-billion-pound funds and then consider scale issues in the non-trust based or 'contract-based' section of the market based around group personal pensions.

1. Scale in multi-employer schemes

A fundamental contrast between the UK and Australia, for example, is the relative maturity of the two systems, with Australia having at least a 20 year head start in mass market workplace DC pensions.

Mandatory superannuation saving in Australia started over 30 years ago, with an initial mandatory contribution rate of 3% which has risen in steps and to 12%.

By contrast, DC pensions in the UK were historically in the minority, before the introduction of Automatic Enrolment (AE). When AE was introduced in 2012, it initially applied only to the largest firms, with a minimum contribution rate of just 2% of a band of 'qualifying earnings'.

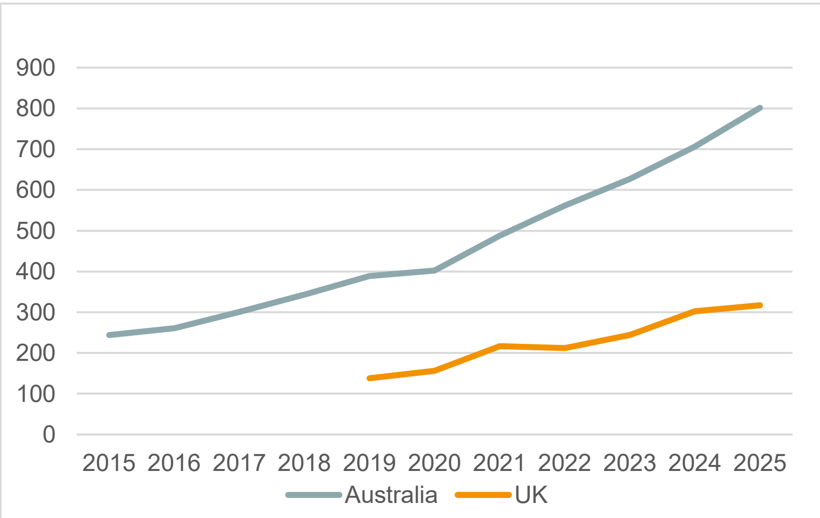
It was not until 2019 that the minimum contribution rate reached 8% of qualifying earnings and applied to all firms. Contributions are not expected to increase further in this Parliament.

Despite widespread closures of DB schemes, the majority of private sector workplace pension assets in the UK sit in Defined Benefit pension schemes, and the transition from DB to DC is still ongoing. UK DC workplace pensions therefore still in their infancy and cannot be directly compared with the much more mature Australian counterparts.

To give a very broad sense of the difference between the two countries, Figure 4 shows:

- Total assets held in Australian industry-wide superannuation funds and corporate pension funds over the last 10 years.[9]
- Total assets held in UK occupational (trust-based) DC pensions schemes[10], back to 2019, which was the year in which the first Master Trusts were authorised by the Pensions Regulator.

Figure 4. Assets (£bn) in a) Australian industry-wide super funds and b) UK Occupational DC Schemes[11]



As Figure 4 demonstrates, the Australian system has had a substantial head start in building a pool of DC assets.

[9] Note that this does not include 'Self-Managed Superannuation Funds', Retail Funds and Public Sector funds.
[10] The data is a combined total for multi-employer Master Trusts and single employer trusts. It does not include contract-based arrangements such as Group Personal Pensions, which are currently broadly equal in scale.
[11] Australian Prudential Regulation Authority (APRA), Annual superannuation bulletin | APRA; ONS Financial Survey of Pension Schemes, Funded occupational pension schemes in the UK: October 2024 to March 2025 - GOV.UK

By 2025, assets in Australian industry-wide Superannuation funds stood at around £0.8 trillion[12], compared with around £0.3 trillion in Uk occupational DC schemes. Even doubling that figure to account for contract-based schemes (Group Personal Pensions etc), the Australian system is clearly larger and has been so for much longer.

It is therefore unsurprising that investment allocations differ between the two countries.

At the individual scheme level, Australian superannuation schemes are also typically much larger than their UK equivalents.

The list below shows the largest three Australian Superannuation schemes and the largest three UK Master Trusts ranked by assets under management:

Table. Largest Australian Superannuation Schemes / UK Master Trusts by AUM[13]

Australia top 3 (at end of financial year 2025):

- AustralianSuper £195bn
- Australian Retirement Trust £175bn
- Aware Super £114bn

UK top 3 (latest annual accounts to March 2025):

- Nest £50bn
- L&G £33bn
- People's Pension £31bn

Again, we should not be surprised that a scheme of nearly £200bn might invest differently to one of £50bn.

It is worth noting however that the largest UK schemes are beginning to catch up with some of the mid-sized Australian schemes, particularly considering assets growth since March 2025.

For example, Nest reported in February 2026 that it had reached £60bn in assets[14], while the People's Pension recently reported that it had recently surpassed £40bn.

Larger UK schemes such as Nest are much less heavily invested in global equity trackers than the industry average and are moving into the type of 'productive' assets favoured by the Government. **Some of the difference between the UK and Australia may therefore reflect the relative immaturity of the UK DC landscape rather than a reluctance to invest in growth assets** – a gap expected to narrow quickly, even without Government intervention.

[12] For simplicity, all Australian data has been converted to £ Sterling at an exchange rate of Aus$1 = £0.50, as at 31st December 2025, rather than using year-by-year exchange rates.
[13] Source: State-of-Super-2026.pdf and annual reports of individual UK Master Trusts
[14] https://www.linkedin.com/posts/nestpensions_a-major-milestone-were-proud-to-have-activity-7427646426874085376-vmwe?utm_source=share&utm_medium=member_desktop&rcm=ACoAAC3nar0BLjOKt0Haxj_MCeVXXd9h7I57fGg

2. Scale in single employer trusts

In addition to multi-employer Master Trusts, the UK DC market still includes over 1,000 DC trusts of at least 12 members, sponsored by individual employers.

The number of such schemes has declined every year, and many of them are very small, though a minority are significant, multi-billion-pound schemes, often sponsored by high profile and relatively paternalistic employers.

Even the largest single employer trusts are typically much smaller than the £25bn minimum threshold proposed by the Government for multi-employer schemes in future. Nevertheless, many have much higher allocations to 'productive' assets than many Master Trusts.

The main reasons are likely to be:

- More paternalistic employers are willing to bear the increased costs of a more diverse investment strategy in the interests of generating better net returns for employees / members.

- Some of these schemes are sponsored by financial services firms with better access to the expertise required to invest successfully in illiquid and private markets.

This helps explain why the Government's rules for multi-employer schemes have not (so far) been extended to the typically smaller single employer trusts.

3. Contract-based arrangements: Group Personal Pensions

Over £300bn in UK DC workplace pension assets is held in contract-based Group Personal Pensions (GPPs) and similar arrangements rather than in trust-based occupational pensions. In some cases, the same provider operates a Master Trust, several single-employer Trusts and a GPP arrangement.

The issues for GPPs and productive finance differ due to the nature of the member-provider relationship, particularly for 'deferred' members.

A GPP consists of numerous individual insurance contracts between the members and the provider. While the provider can set a preferred investment strategy for all members, where a member is no longer active (eg has changed jobs and started a new pension), it cannot currently move the investments which are no longer active. This contrasts with Trusts, where trustees may change investments (including for deferred members) if it is in their best interests.

Consequently, tens of billions of pounds sit in 'legacy' funds with low allocations to the sorts of 'productive' assets now favoured by the Government. Legislative changes (discussed later) designed to address this issue could help the GPP sector to achieve greater scale and concentration than is currently possible.

06. Barriers addressed: Government intervention assessed

This section identifies six major Government interventions designed to increase domestic investment by DC pension schemes. Some initiatives were started by the previous Government and carried through by the present administration, while others reflect a change in emphasis following the 2024 General Election.

We describe the main features of each intervention and assess how they address the market failures identified earlier.

1. Drive to scale / consolidation – DC 'Mega Funds'

Policy: A requirement that, by 2030, the 'main scale default fund' in a Master Trust should be at least £25 bn (with limited exceptions)

Assessment:

The workplace DC market has been consolidating for many years, even before these latest measures are introduced. For example, in the single-employer space, the number of non-micro schemes (those with more than 12 members) decreased by 75%, from 3,660 in 2011 to 920 in 2024[15], and that trend is likely to continue as more employers shift to Master Trusts.

Within the multi-employer space, consolidation has also been happening at pace. When the Master Trust Authorisation Framework was first established, more than 100 Master Trusts were included on the Pensions Regulator's list of authorised schemes. That list now numbers only around 30, and the number is set to fall further.

The UK DC market is already much more concentrated than may appear to be the case. When Department for Work and Pensions (DWP) looked at the largest five and the largest ten DC providers in the UK and compared them with the equivalent schemes in Australia, they found that the UK market was actually more concentrated[16]. This is a reminder not to be distracted by the fact that there are large numbers of very small occupational DC pension schemes in the UK, as most of these have few members and relatively little in assets.

There is no doubt that the Government's consolidation agenda is leading a small number of Master Trusts that may struggle to reach the £25bn benchmark to consider their position. The

[15] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/occupational-defined-contribution-landscape-2024
[16] https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy

signal that such schemes may be forced to merge is already influencing the market, and the new legislation is likely to accelerate the process of scheme consolidation.

However, the overall impact may be relatively marginal given that the DC master trust market is already relatively concentrated.

Total funds under management in workplace DC are expected to roughly double between the mid-2020s and the early 2030s as more and more people start to build up DC pensions.

This legislation will probably result in this growing asset base to be concentrated in slightly fewer schemes, thereby improving the schemes' ability to overcome informational market failures and other barriers to investing in productive finance. However, many of the gains to scale were likely to come through in any case.

2. Subsidy/co-funding of priority investments e.g. via British Business Bank etc

Policy: Public funding to 'leverage in' private sector investment by pension schemes

Assessment:

A key strategy for overcoming externalities that may lead to socially sub-optimal levels of investment is the use of public money to 'leverage in' greater private investment in priority areas. This can involve a range of publicly funded bodies   using public funds to co-fund new projects or to restructure the risks associated with a project to make it more attractive to private investors. Such funding is typically linked to the Government's wider industrial strategy or to its commitment to net zero.

A helpful 'map' of the different organisations involved in the public investment landscape has recently been published by the Government and is shown below.

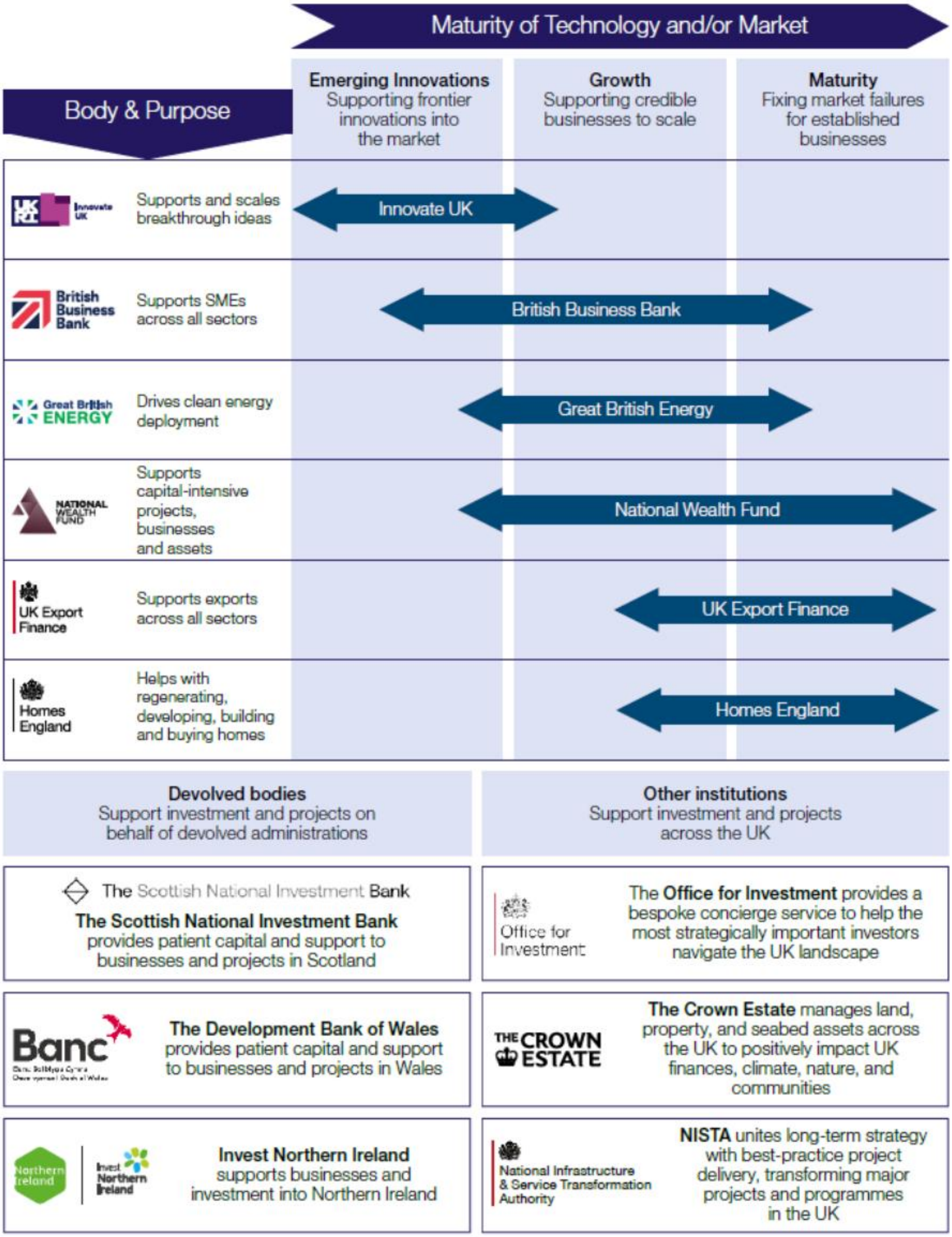
In terms of potential partnerships with pension schemes, the three organisations likely to be particularly relevant are:

A. The British Business Bank (BBB)

The British Business Bank (BBB) is the home of the 'British Growth Partnership', launched by the Government in October 2024. The Banks aim is:

> *"To encourage more UK pension fund investment into the UK's fastest growing, most innovative companies… we will seek to raise hundreds of millions of pounds from UK pension funds and other institutional investors to invest into UK venture capital, supported by a cornerstone Government investment. Investments from the fund will be made on a long term, fully commercial basis, independent of Government, drawing on the Bank's capability and market access to high potential companies across the UK."*

Map of the public investment landscape



[17]

[17] An introduction to the UK public investment landscape - GOV.UK

The BBB also oversees another initiative known as LIFTs – the Long-Term Investment for Technology and Science initiative[18]. The BBB says this initiative:

"…aims to establish new funds or investment structures to crowd in UK institutional investment, particularly Defined Contribution (DC) pension funds, to support the growth and ambitions of the UK's most innovative science and technology companies."

Its three objectives are:

- **Unlock UK institutional investment:** [we will] *"catalyse more investment from UK DC pension schemes into venture and growth equity in a sustainable manner, so as to increase the supply of domestic sources of capital for productive investment and increase access to potentially higher returning assets for UK savers."*

- **Catalyse investment into UK science and technology:** *"increase the supply of capital to UK science and technology scale-ups at the later stages…the Bank and others have identified a funding gap for R&D-intensive businesses seeking significant rounds of capital to scale up and accelerate their growth. We want to enable DC pension schemes to participate in these investments."*

- **Stimulate the UK VC ecosystem:** *"to sustainably increase deal flow, develop the domestic venture landscape and nurture investment and entrepreneurial talent, and attract the best international players to the UK to enable high-potential UK businesses to scale and stay here."*

The first investments were announced in early 2025. The BBB awarded £250m under the LIFTS initiative to Schroders Capital (£150m) and ICG plc (£100m).

It stated:

".. [this] will create two new investment vehicles that are accessible to pension fund and other institutional investment. This will be supported by £250m of pension investment from Phoenix Group, and together these investments are expected to generate over a billion pounds of investment into UK science and technology companies. UK savers will be able to benefit from the potential returns and investment diversification that these innovative sectors can provide, whilst also backing homegrown businesses."

The language used in this initiative explicitly targets market failures such as the lack of domestic 'scale-up' capital for UK science and technology investments.

B. The 'National Wealth Fund'[19](formerly the UK Infrastructure Bank)

The National Wealth Fund reports that it has an investment portfolio of over £6bn, of which £3bn was invested in the last 12 months. It also states that it has 'mobilised' over £14bn of private

[18] https://www.british-business-bank.co.uk/finance-options/equity-finance/long-term-investment-technology-and-science
[19] https://www.nationalwealthfund.org.uk/

investment. Its focus includes specific industrial sectors such as clean energy, advanced manufacturing, and green transport. It aims to 'mobilise' £3 of private finance for every £1 invested'.

The Fund identifies three stages at which its investments can 'crowd in' private capital:

- "when we make our initial investment".
- "where further finance is raised during the lifetime of the investment".
- "when we exit an investment".

There is explicit recognition that the Fund is designed to address market failures around access to capital for higher-risk projects and 'first-of-a-kind technologies', where information failures are likely to be greatest. This is achieved through the use of public subsidy.

They state:

"Our long-term return target is below that expected by a commercial bank. This allows us to prioritise transactions where there is an undersupply of private sector financing, take on risks the market is unable to take, or at a concentration the market would not. Economic capital represents our capacity to take risks. For every investment, we must set aside a certain amount of economic capital to reflect the credit risk. The riskier the investment, the more we must hold. Our economic capital limit has increased to £7 billion, giving us the capacity to take up to five times more risk than commercial banks. We can have impact across the risk spectrum, from high-risk investments in first-of-a-kind technologies and nascent sectors, through to supporting investment-grade projects experiencing market capacity limits. The majority of assets in our portfolio are sub-investment grade, unlike commercial banks."

C. The National Housing Bank, a subsidiary of Home England

The National Housing Bank announced[20] in 2025 that it would provide "£16bn of new public investment [which] will help build over 500,000 new homes, unlocking over £53bn of private investment."

Notably, it says that it will "... [issue] Government guarantees directly and have greater autonomy and flexibility to make the long-term investments that are needed to reform the housing market …"

In all of these cases, Government intervention is designed to deal with externalities, where the societal benefit of things like low-carbon investments or new technologies are greater than the private return to individual investors. They also seek to improve the functioning of the capital market to make it easier for investors to find suitable ways of investing in things like private markets.

[20] https://www.gov.uk/government/news/over-500000-homes-to-be-built-through-new-national-housing-bank

At this stage it is too early to say whether these various initiatives will have the desired effect of leveraging in substantial private capital and helping to overcome externalities of the sort we have described. Government activities to 'pick winners' in certain industrial sectors have had a chequered past, and the use of billions of pounds of public money to direct private investment to places it would not otherwise have gone, needs to be closely scrutinised and assessed for cost-effectiveness.

3. Value-for-Money framework to drive focus on 'quality, not cost'

Policy: The Pension Schemes Bill (and related FCA regulation) will create a 'value for money' metric which assesses schemes in terms of investment returns net of costs, and not just 'price'. This information will be publicly available and trustees, employers and the public will be able to compare the performance of schemes.

Assessment:

The thinking behind this approach was summarised by the Pensions Minister, in his foreword to the May 2025 Government consultation response on the Pensions Investment Review:

> "we need to see a more cultural shift – from an excessively narrow focus on cost onto what matters most for savers: returns, and the eventual size of their pension pots" (p7)

The rationale for this intervention is that asset classes regarded by the Government as more productive may tend to be associated with higher costs. If employers, in choosing a workplace pension provider, focus primarily on returns net of costs, this might not be a problem, as such assets might provide better net returns. But if employers focus excessively on price, providers will be discouraged from diversifying in this way.

This is an example of the 'collective action' market failure described earlier. For pensions providers as a whole, it may make sense to include assets which are more expensive, but which will contribute overall to improved risk-adjusted returns (net of charges), but it is difficult for an individual scheme to do so in isolation for fear of being less competitive in a highly price-sensitive market.

To help overcome this potential disincentive, the Government is creating a VFM framework, designed to encourage employers to choose workplace pension providers on the basis of 'quality' rather than price alone. This involves extensive data collection and reporting, including detailed figures on historic rates of return[21] (net of fees), and a red/amber/light green/dark green ratings system to drive out under-performers. Following consultation, the FCA now proposes that expected future investment returns should also be considered.

[21] Economic theory would suggest that just because a scheme has achieved the best returns in the past, it does not follow that it will do so in the future. However, the Government is seeking to change the incentives of schemes so that investing in higher risk / higher return assets is not penalised in the way that may currently be the case because of the excessive focus on price alone.

By making it easier to compare schemes on a wider range of metrics than purely member charges, it is hoped that schemes which grow member pensions by achieving better returns from a wider range of assets will in future benefit by doing so rather than potentially losing out as at present where that strategy involves higher up-front charges.

One risk of the new approach, including the creation of league tables, is that the remaining schemes may actually become more risk averse.

Being ‘in the pack’ of a league table and scoring a comfortable ‘green’ rating for VFM is probably a safe place to be. Having a riskier investment strategy (which could be the result of investing in the kind of assets that the Government favours) increases the risk of being an outlier in terms of net investment returns.

Whilst being ‘top of the league’ is attractive, the rewards for this may be marginal.

By contrast, being ‘bottom of the league’ and potentially at risk of losing a ‘green rating’ could be an existential threat, as poorly rated schemes may ultimately have to close to new business or, at the very least, suffer reputational damage. The result – which has been seen in Australia where performance league tables are longer established – could be ‘herding’ of investment strategy and a reluctance to take on too much risk.

In response to this critique, the Government has refined its proposed red/amber/green ratings and has now suggested that there will be more of a ‘spectrum’ of ratings, with less of a cliff edge between each. Nonetheless, there remains an asymmetry of incentives in this new regime where a scheme would far prefer a series of steady if unspectacular years over an outcome where they are top the league one year but end up bottom the next because of the greater volatility of returns of certain asset classes.

There are other reasons why the proposed regulatory framework might fail to deliver the desired outcome:

- Although regulators are exploring the potential for ‘forward-looking’ metrics of potential future returns, without such information all returns data will be backward looking; if the time period over which the data is collected pre-dates any revised investment strategy, they may get no ‘reward’ for a strategy, which could in future give a better cost-adjusted return.

- A linked risk of the new framework is that the historic performance data is based on outcomes in the past one, three and five years (and longer if available); when the data is updated – potentially each year – the only *new* information will be performance in the last 12 months; if there is commentary on each set of VFM league tables this could include a focus on who has improved their relative position and who has gone down; these changes could be strongly influenced by very short-term investment performance and would make investments with a ‘J-curve’ profile of returns look very unattractive;

It is, though, important to note that it is very hard, if not impossible, to determine ex ante what strategy will in fact maximise future returns. The move to low cost, passive tracking arose from accumulated evidence that this strategy does, on average, provide better returns to the investor than the higher cost managed funds. While there are funds and strategies which, over a period of time, provide better returns net of costs there are plenty that do worse. Hence the problem of knowing ex ante which will be better, and why low-cost trackers provide good value on average.

4. New ‘Long-term asset funds’ to address liquidity / daily dealing issues in DC

Policy: The Long-Term Asset Fund (LTAF) is a UK fund authorisation which was established with the specific purpose of enabling more UK defined contribution schemes to invest in private markets. This includes less liquid investments such as private equity, infrastructure and private debt. It was also designed to overcome ‘permitted links’ rules which had acted as a barrier in the past.

Assessment: Holders of DC pensions are entitled to know the value of their pension pot on a daily basis and are generally entitled to transfer their savings to another pension provider if they wish. Once they are over Normal Minimum Pension Age (NMPA) – currently 55 – they can draw all of their funds.

All of these features of the DC pension system require DC funds to have a high level of liquidity and up-to-the-minute valuation. But some of the asset classes which the Government regards as more productive may not sit well with these regulatory requirements. In particular, investments in infrastructure can be highly illiquid and may not lend themselves to daily valuation. In this case, a by-product of the regulatory regime can be a socially sub-optimal set of asset allocations.

To reduce the risk that liquidity concerns are discouraging DC schemes from investing in infrastructure and other illiquid assets, the Government and the FCA has created ‘Long-term Asset Funds’ (LTAFs) which provide a way for schemes to invest in long-term assets in a way which helps to overcome issues around liquidity and daily valuations.

Since the first LTAF launch in early 2023, there have been a total of 25 individual LTAFs authorised as well as further LTAF umbrella arrangements. These have, in the main, been either manager multi-asset solutions for investors, or providers setting up their own LTAFs through which they can invest in either internal or external private markets as part of their own investment strategy proposition.

Investor commitments across these investments have been mixed, with some successes with bespoke client solutions and provider offerings, whereas pooled solutions have taken time to progress across the industry. The largest LTAF to date, has c.£2bn invested.

The next fund launches are expected to be feeder funds, where investors can access the LTAF to invest in existing global private market funds. We have also had the first LTAF for retail investors authorised.

Investing and trading in LTAFs tends to be either monthly or quarterly, with at least 90-day notice periods, which creates funding and liquidity considerations. There is also the challenge of less frequent pricing, meaning a lag to overall pricing for members, which creates member fairness considerations.

It is also worth noting that many of these funds have performance fees incorporated, at either the top or underlying level. This is a new area for DC schemes which is seeing further interest and growth but comes with additional member fairness and value considerations.

5. Voluntary compacts on investment in private markets (with reserve power to mandate)

Policy: Successive Governments have worked with the pensions industry to produce voluntary 'compacts' regarding future investments. The most recent 'Mansion House Accord' involves a pledge that, by 2030, 10% of default funds will be invested in private markets, with at least half of this in the UK.

Assessment:

A separate approach to the potential 'collective action' problem in this space has been to support the industry in coming up with voluntary agreements whereby (almost) all the major players agree together to reach certain targets for investment in priority areas.

In 2023, pension providers signed up to the Mansion House Compact, in which they pledged to hit a target of 5% of their assets being invested in unlisted equities by 2030, though with no specific UK allocation.

This has been followed up by the 2025 Mansion House Accord[22], where a longer list of schemes agreed to a 10% allocation to private markets, at least half of which would be in the UK. This commitment was conditional on the Government and others bringing forward suitable projects for investment and also on trustees believing this remained in the best interests of members.

It should be noted that many of the signatories to the Accord start from a very low current allocation to private markets and will need to 'ramp up' their expertise and investments over a relatively short timetable to meet these targets. This is much easier to do in schemes (and countries) which have a much longer track record of this type of investment.

This need to ramp up quickly means that the 'easier' assets which satisfy the targets – such as property and infrastructure – are getting more attention than more challenging areas such as

[22] https://www.pensionsuk.org.uk/Policy-and-Research/Document-library/Mansion-House-Accord

private equity, private debt and venture capital.

The Government has also taken a ‘reserve power’ in the Pension Schemes Bill to mandate Master Trusts as to how they should invest. This is a power which the Government says it hopes not to use but is designed to focus minds in the industry on the need to deliver on existing voluntary commitments. Part of the reason for the inclusion of this measure is Government frustration with the perceived slow pace of progress against the original (2023) Mansion House pledges.

But in our view, the potential move from voluntary to mandatory investment strategies is not supported. Trustees seek to act in the best interests of members, and the Government should not force a different asset allocation on them in pursuit of other policy objectives.

A particular issue with mandating is the use of high-level ‘top-down’ targets for investment allocation which represents a blunt instrument for tackling quite specific and often nuanced market failures. For example, it may be that market failures mean that the current mix between investment in ‘primary’ markets and ‘secondary’ markets is suboptimal from a social point of view, but proposed Government targets make no distinction between the two. Such a top-down intervention would therefore be unlikely to tackle underlying distortions between the two categories.

6. Statutory over-ride to address legacy Group Personal Pension issues

Policy: Money held in ‘legacy’ Group Personal Pensions may be held in relatively high-cost products and not invested in line with modern best practice. But because GPPs are a large number of individual insurance contracts, the provider cannot unilaterally move the member to a more modern default. Subject to certain conditions, new legislation will make this possible.

Assessment: A surprisingly large amount of current DC workplace funds (running into tens of billions of pounds) is held in ‘legacy’ contract-based arrangements. Even where a provider (such as an insurance company) thinks it could do better for members, both in terms of charges and in terms of investment strategy, it cannot unilaterally move member funds. And obtaining consent one-by-one can be prohibitively expensive. This means both that members can lose out and that the opportunity for this money to be more productively invested is being missed. The proposed statutory over-ride (with suitable member protection) has been widely welcomed and could provide a material boost to the level of ‘productive’ investment in the UK.

07. Conclusion

By international standards, UK DC workplace pension schemes currently have relatively low allocations to domestic assets. In particular, UK schemes tend to have especially low allocations to private markets and illiquid investments.

But comparisons with other countries such as Australia need to be made with care for two main reasons:

- The Australian workplace DC market is far bigger and far more mature than that in the UK; for reasons set out in this paper, as the UK market matures and individual scheme size increases, this is highly likely to lead to greater allocation to private markets and more illiquid investments;
- The incentives provided in different countries for home investment can vary; in particular, Australian Super funds benefit from a dividend tax credit when they invest in their domestic stock market, and this has led to a high (though declining) home bias in the investments of such schemes

Even though allocations to productive assets are likely to rise as scheme size increases – and as a result of voluntary industry-wide commitments – we have shown that there are still potential 'market failures' which might lead to a socially sub-optimal level of investment in such assets.

These include:

- Externalities, where the market return to a potential investor is lower than the wider return to society as a whole.
- Information failures, such as the challenge in investing in less familiar assets classes or those where it is harder to establish how much risk is involved.
- Co-ordination failures, where potentially beneficial outcomes are only achieved if all / most market participants act at the same time, but where individual participants do not want to risk going it alone.

The Government (and its predecessor) has put in place a series of market interventions designed to overcome some of these barriers.

These include:

- Driving greater scale, including through setting a minimum £25bn figure for the 'main scale default fund' of multi-employer pension schemes; however, we find that market consolidation was already happening, in both the multi-employer and single-employer space; new rules may lead to a modest acceleration in this consolidation, but probably nothing more.

- Public subsidy, via organisations such as the British Business Bank, designed to make the private cost / benefit of investing in particular sectors closer to the public cost / benefit; in many cases these initiatives are still at a relatively early stage, and so it may take time before we see how far they achieve their stated objective of ‘leveraging in’ significant amounts of DC pension funds.

- A VFM framework designed to encourage employers to consider ‘quality’ and not just cost when selecting a workplace pension provider; whilst this may encourage Master Trusts to offer slightly more expensive products, which invest more heavily in productive assets, we have highlighted a number of other concerns about the new ‘league table’ based approach to VFM which could prove counter-productive in the long-run.

- The creation of a new investment vehicle – the Long-Term Asset Fund (LTAF) – to facilitate DC scheme investment in longer-term, more illiquid assets. Although it is early days, the new framework has seen more than two dozen such funds set up, and this has the potential to help overcome some of the existing barriers (around liquidity and daily valuation) to schemes investing in this way.

- Support for industry-wide, voluntary agreements to increase allocations to productive assets; in many cases schemes are committing to do something which they would have done in any case, but the fact that others are signing up at the same time reduces the risk to them of being an outlier if/when they do so.

- Creation of a new ‘statutory over-ride’ to allow pension providers to move members with legacy Group Personal Pensions into better value and more productively invested funds, without needing to obtain individual member consent; this is a welcome change, which could benefit both individual savers, providers and the wider UK economy.

In summary, having considered the main barriers to DC schemes investing in ‘productive’ assets, a number of the Government’s initiatives are likely to target these barriers and could make it easier and more attractive to DC pension scheme investors to opt for investments in UK productive finance. But in many cases, this shift in investment mix will happen in any case as the UK DC sector gradually matures. In some cases there is a risk of over-regulation (notably in the threat to mandate schemes in how to invest) or inefficient use of public funds (to incentivise investments in favoured sectors which would have happened in any case) which means that the Government’s actions in this space need to be subject to rigorous evaluation to ensure that they are not distorting the market or creating unwelcome deadweight costs for the taxpayer.

Appendix: If capital is global, does the level of investment in the UK by UK schemes matter?

UK DC pension schemes currently invest the majority of their assets overseas, meaning only a small fraction of UK pension money is held in domestic equities or the kinds of illiquid, long-term investments that typically make up the target asset classes of productive finance initiatives. At the same time, global investors have become major owners of UK assets, from airports and energy networks to high-growth companies and housing developments.

This prompts two questions:

- in theory, does it matter whether an investor is located in the same country as the economic activity the capital is used for?

- under the specific types of productive finance initiatives described, does it make sense to try and fill any identified investment 'gaps' through UK investors, as opposed to non-UK investors? In other words, in a world of open, global capital markets, does it actually matter who owns and finances the UK's 'productive' assets?

Under perfect conditions, capital is neutral and the location of investors is irrelevant

In standard macroeconomic models, capital is often assumed to be perfectly mobile across national borders[23]. In other words, whether an infrastructure project in the UK is financed by a British pension scheme or a Canadian superannuation fund makes no difference to the total investment made or the associated impacts of the investment: the same bridge gets built, employment rises, and economic welfare improves.

But in practice, the conditions for perfect capital neutrality do not typically hold

The neutrality result depends on strong assumptions that rarely hold in practice. Information asymmetries, institutional frictions, and differing perceptions of risk mean that capital does not always flow to the most productive use.

There may be many reasons for these information failures[24][25], including:

- investors may continue to prefer investing in domestic assets because they hold better local information and more familiarity with local laws and governance, which may reduce the perceived investment risk for them;

- the costs of entry and due diligence in smaller or less-liquid markets may deter foreign investors, leaving gaps in sectors such as early-stage venture capital or regional

[23] https://www.elibrary.imf.org/downloadpdf/display/book/9781557757777/ch03.pdf
[24] https://www.sciencedirect.com/science/article/pii/S0014292123002131
[25] https://oxfordre.com/economics/oso/viewentry/10.1093%24002facrefore%24002f9780190625979.001.0001%24002facrefore-9780190625979-e-311

infrastructure, meaning domestic institutional investors may have comparative advantages, such as local knowledge, or greater regulatory familiarity; and

- some barriers reflect ecosystem-level issues that affect all investors (both domestic and foreign) – such as limited pipelines of investable opportunities, weaker innovation networks, or less-developed mechanisms for discovering and scaling start-ups compared with other markets (e.g. the US).

Beyond information failures, there are a wide range of other factors that may point to the failure of the capital neutrality hypothesis in practice. Other failures of neutrality may arise from a range of public policy and governance considerations.

Dispersed global ownership can create a collective-action problem: when no single shareholder holds a sufficiently large stake or has strong incentives to monitor management, firms may under-invest in long-term assets. Academic studies of institutional ownership suggest that concentrated, long-horizon investors are associated with stronger governance and higher firm valuations[26]. Likewise, research on short-termism, ownership and implications for investor stewardship finds that dispersed ownership structures can weaken incentives for oversight, leading to a free-rider problem where no investor finds it worthwhile to engage in monitoring management for the long-term[27]. Reflecting these concerns, DWP argues that rebuilding domestic institutional ownership could *"reintroduce long-term stewardship to UK capital markets, improving corporate decision-making and, over time, productivity"*[28].

Another dimension often highlighted in the literature is the potential contribution of domestic institutional investors to financial stability. Large, patient investors such as pension funds may act as counter-cyclical stabilisers, buying assets when prices fall and by being more likely to hold them through periods of volatility[29]. However, this role may apply more to DB schemes or actively managed mandates than too much of the existing UK DC landscape, where default strategies tend to follow passive global allocations.

The nationality of capital can also hold implications for strategic autonomy and national policy alignment. Decisions about infrastructure maintenance, technology transfer, or corporate restructuring ultimately rest with investors. When key assets for an economy (e.g. energy grids, ports, data infrastructure) are owned predominantly by foreign entities, the ability to steer investment toward national priorities can be constrained.[30]

In other words, domestic pension funds, answerable to UK beneficiaries and regulators, can act as strategic investors, supporting projects that advance shared national objectives such as the net-zero transition, energy security, and regional development. The Government's Mansion House Accord and the creation of the National Wealth Fund reflect a desire to combine public and private domestic capital in this way. While foreign partners remain vital for scale and expertise, a core domestic investor base provides strategic reassurance and ensures that decisions about the UK's productive assets are made primarily with domestic interests in mind.

[26] https://www.sciencedirect.com/science/article/abs/pii/S1042444X22000044
[27] https://eprints.bournemouth.ac.uk/23743/1/ShorttermismOwnershipStewardship%20BAM2016.pdf
[28] https://assets.publishing.service.gov.uk/media/673f3ca459aab43310b95a8d/pension-fund-investment-uk-economy.pdf
[29] https://www.oecd.org/content/dam/iops/en/working-papers/WP-31-Are-pension-funds-a-stablising-factor-in-financial-markets.pdf
[30]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652505/2017_10_16_NSII_Green_Paper_final.pdf

Conclusions

In theory, it does not matter whether an investor is located in the same country as the economic activity the capital is used for, but in the real world there are several factors that suggest promoting greater home bias would deliver economic benefits.

But the empirical evidence on the broader economic effects of domestic ownership is mixed. Some studies find that global capital markets are not perfectly frictionless – investors around the world exhibit a persistent “home bias” in their portfolios. Yet equally, the aggregate macroeconomic gains of redirecting more capital into domestic projects have not been decisively demonstrated in empirical research.

Moreover, many of the frictions cited are likely to affect both domestic and foreign investors alike or may even be more acute for the latter. If the constraint lies in the broader investment ecosystem rather than the origin of the capital being deployed, focusing on domestic investment may have limited impact unless those underlying channels are improved.

Therefore, any case for promoting greater UK domestic investment rests on the belief that market conditions are such that there is significant and meaningful divergence from optimal global investment patterns, driven by some failure of capital neutrality. Ultimately, it remains uncertain whether encouraging UK DC pension funds to invest more at home would deliver significant net welfare gains for the UK overall.

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