Dear Mr Field

Inquiry into the Defined Benefit White Paper

Thank you for your letter of 25 June 2018. I welcome the opportunity to respond on behalf of Clara-Pensions Limited (“Clara”). We expect a variety of consolidation models to emerge over time. I would therefore like to briefly outline what Clara is, and almost as importantly what Clara is not.

Clara – A Member First Solution

Clara is a member first solution for defined benefit pension schemes that is focused on securing the full pension promise for each individual member.

We agree with the view expressed by the Association of British Insurers and others in their evidence to the Committee¹ that insured buy-out is the “gold standard” outcome for members. We would go further than that. In Clara’s solution buy-out of full benefits is the only standard against which success is measured.

Clara is a bridge for members and sponsors to the insured market. Clara does not aim to be an alternative to pension insurance as the long-term solution for defined benefit pension benefits. Instead, Clara will lower the risk of the journey from the trust based to the insurance based environment:

- Clara will establish a new sectionalised occupational pension scheme governed by a board of fully independent trustees. We expect to be regulated by The Pensions Regulator (“TPR”) and to participate in the Pension Protection Fund’s (“PPF”) regime. Incoming schemes that become part of the Clara solution will each become a section within the Clara trust.

- Clara’s risk capital provides a permanent and funded covenant. For all but the strongest of schemes and sponsors (who are not our target market) this will immediately enhance members’ security.

- Clara’s solution gives sponsors and schemes, for whom buy-out is currently out of reach, the opportunity to accelerate the fulfilment of their pension promises.

- Clara’s funding position allows a de-risking of the investment strategy; therefore, members carry less risk on the journey to buy-out.

¹ Written evidence from the Association of British Insurers to the Work and Pensions Select Committee May 2018; and Oral evidence to the Work and Pensions Select Committee 6 June 2018 Q118 and Q119.
The scale benefits of consolidation provide Clara with the resources to embed strong governance. The economic value of better governance lies in reduced costs, improved risk adjusted returns and professionalised scheme management.

Although Clara has a commercial purpose, the interests of members, risk capital providers and Clara management are fully aligned around a single objective - delivering the most secure pension promise as early as possible.

Clara – What we are not

Clara is not a “superfund”. Unlike other consolidation structures that have become part of the debate both before and after the White Paper\(^2\), Clara is not a run-off entity.

In Clara’s journey, consolidation and its benefits are the vehicle not the destination. Our only destination is delivering the most secure pension promise to members.

Clara - Response to Questions

1) \textit{Who is backing Clara Pensions with investment capital, and to what amount?}

Providers of risk capital to Clara will meet the requirements that are intrinsic to the Clara structure.

Clara is a member first solution – Clara’s risk capital providers understand and accept that their economic returns are subordinated to the security of members’ benefits.

Clara’s risk capital is permanent, first in and last out – Clara’s risk capital providers are long-term investors who understand that their full capital and profit remain at risk until all members within a section have had their full benefits secured in the insured market.

We understand and respect the Committee’s policy of publishing both incoming and outgoing correspondence. Clara has and will continue to engage transparently with policy makers, regulators and all stakeholders. A specific response to this question, however, would cause us to expose commercially sensitive information. What I am free to say is that we are exploring investment with long-term investors of patient capital with an interest in innovative investments.

2) \textit{What sort of schemes are you seeking to absorb in terms of size and funding level?}

\textbf{Size}

Clara is relatively agnostic to scheme size and will deliver the advantage of good governance from our first transaction. We believe that the pattern of transactions and growth in the bulk purchase annuity (insured) market is likely to be a fair model for how the market for new consolidators - like Clara – develops. If you look back at the history of the insured market, the majority of transactions are below £500 million\(^3\). We therefore expect most of our opportunities to come from schemes in the range of £10 - 500 million but we are also able to execute larger transactions.

\textbf{Small Schemes}

It is well recognised that the majority of benefits of consolidation are the result of scale. It is also true that smaller schemes enjoy a relatively larger benefit by gaining access to that scale. As Clara grows, we want to provide a simple and low-cost route for smaller schemes to benefit from Clara’s solution.

\textbf{Funding}

Clara requires that all schemes will be fully funded based on our prudent technical provisions (i.e. meeting the statutory funding requirements of Part 3 of the Pensions Act...)

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\(^3\) Liabilities measured on a buy-out or solvency basis. LCP: “\textit{Pension de-risking steps up a gear}” January 2018.
2004) on entry. The question is therefore not what the schemes’ current funding levels are, but rather what are the existing sponsors’ ability and willingness to fund their schemes to the Clara entry level. Recent industry research suggests that scheme affordability has fluctuated. Our engagement with sponsors clearly suggests that with the certainty offered by the right solutions they have stronger reasons to accelerate the fulfilment of their obligations to members.

3) **Your website claims that Clara Pensions is a “member first solution”. What does this mean in practice?**

Simply put, members are at the core of everything we do. Members’ interests come first, before other stakeholders. This is reflected both in our focus on member security and in our vision for member engagement.

**Member Security**

In Clara’s solution buy-out of full benefits is the only standard against which success is measured. This is important for two reasons. It is a clear standard – either all member benefits have been secured or they have not. It is an objective standard – pricing in the insured market is provided by the bulk purchase annuity providers and is not based on assumptions set by us or our advisers.

Clara’s structure is designed to provide members with a strong and well-funded covenant and to reduce the risk of the journey to buy-out. Clara’s capital providers share the belief that member security must come before their own economic interests.

It is not in Clara’s interests to hold members back from the “gold standard” of an insured long-term pension promise. Rather, it is our objective to ensure that members’ full benefits are secured in the insured market as early as possible. Clara’s capital providers are willing to invest to support members’ journeys to an insured outcome, and Clara management are committing themselves to delivering that journey.

**Member Engagement**

The economic value of consolidation does not only come from cutting costs, rather it allows trustees to lower marginal costs while simultaneously making better service affordable. This is particularly true for scheme administration where Clara intends to deliver a high quality service that is both engaging and valuable to members.

Clara will build member services that use modern technology to deliver the pension industry’s best practices.

4) **Under what criteria will investors be able to take a profit from the fund?**

The only circumstance in which risk capital providers can extract their original capital and any profit is once all the members in a section have had their full benefits secured in the insured market. Clara’s structure does not have a one-way release valve for dividends, coupons or profits before the clear end-point of buy-out is reached.

5) **If investment returns outperform the level needed to fund benefits, will scheme members be able to share in the upside?**

If Clara outperforms, members’ benefits will be secured in the insured market as promised and in full even sooner. We believe that providing security for the full benefits already promised is more important than offering the possibility of participating in a marginal upside, particularly if this means a riskier investment strategy.

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4 Hymans Robertson: “FTSE350 Pensions Analysis” 2017
6) **Will previously extracted profits be at risk in the event of a subsequent deterioration in the scheme funding position?**

In Clara’s model, there is no concept of “previously extracted profits”.

Please see our response to Question 4 above. In Clara’s structure, risk capital and profit remain available to support a section until all the members in that section have had their full benefits secured in the insured market.

7) **If in future it is proposed that Clara be sold off or merged with another firm, will the trustees be able to block this?**

Trustees and TPR already have powers and options available to them where a corporate change of control or other activity could cause detriment to a pension scheme. As you will be aware, the Department for Work and Pensions ("DWP") is currently consulting on strengthening this framework so that a broader range of events must be notified to TPR, and this will usually require early engagement with the scheme trustees. TPR’s powers, which are already extensive, are also to be strengthened in various respects.

We support this strengthening and will ensure that the trustees and Regulator are notified and consulted in advance of any potential change of control or other material and relevant corporate activity, should this arise.

Clara’s structure includes further defences:

- Risk capital is permanent and funded. There is no ability to extract either capital or profit until after all members within a section are fully secured in the insured market.
- Any changes to the investment strategy of the Clara scheme are controlled by a fully independent board of trustees.
- Clara management are a service provider. Like all other service providers, we are hired and can be fired by the independent trustees.

8) **What discussions have you had with the Pensions Regulator and the PPF about your venture?**

Clara is not a reaction to the government’s White Paper. We began work on our solution toward the end of 2016 and Clara itself was incorporated seven months prior to the White Paper’s publication. Over this time, we have worked with policy makers, regulators, potential clients, service providers and the wider pension industry. That said, we do not view ourselves as having formally launched and have sought engagement rather than publicity.

We first met TPR in January 2017 and again later last year. Following the publication of the White Paper, Clara submitted a detailed proposal document to the Regulator and met them together with our legal, actuarial and structuring advisers. Since then we have had regular and continuing engagement with the Regulator at all levels.

We met the PPF twice this year and have shared our proposal document with them.

We have also met twice with the DWP and look forward to participating in their planned consultation process in the autumn.

We have found all of these engagements to be very helpful, and we very much value the constructive dialogue.
9) The PPF has raised the issue of whether profit-making consolidators should be eligible for PPF protection and, if so, how the risks posed by consolidators should be reflected in the levy. How do you propose to shield the PPF against risk?

We recognise that consolidation has the potential to introduce additional concentration risk to the PPF, but believe that this small incremental risk is more than offset by the much higher funding and other benefits of Clara’s structure:

- Funding – Schemes entering Clara will be fully funded on a prudent technical provisions basis from the outset. The combination of sponsor contributions and Clara’s own risk capital will mean that the transferring schemes’ members will benefit from access to dedicated, permanent and funded capital well above their schemes’ current funding positions. This has two positive implications for the PPF. The higher funding level and stronger covenant within Clara creates a buffer for the PPF relative to their current position. Most importantly, however, Clara’s covenant is funded upfront.

- Governance, Risk Management and Professionalised Scheme Management - Clara’s role is to manage the scheme on a daily basis. Clara will be a leading manager of pension risk; and together with the independent trustees we are implementing a strong risk management framework to support decision making and governance. Scale and concentration also provide resources and focus to proactively identify and mitigate any deterioration in funding.

- Sectionalisation – The Clara solution will be within a sectionalised occupational pension scheme, which reduces concentration risk.

- s179 Buffer – Clara is working to ensure our solution always provides funding above PPF levels, which will ensure that the PPF is protected in all circumstances.

Clara has been nearly two years in design. My colleagues and I are incredibly proud to be delivering a true member first solution. I hope I have answered all your questions but if you or your Committee require further detail, please do not hesitate to contact me.

Your sincerely

Adam Saron
Chief Executive Officer