24 October 2019

Rt Hon Frank Field MP
Chair of the Work and Pensions Committee
House of Commons
London
SW1A 0AA

Dear Mr Field

The Pension Schemes Bill and DB consolidation

Thank you for the invitation to give evidence to the Committee on Wednesday 30 October.

I thought it would be helpful to provide some background information for members of the Committee in advance of the session. We previously wrote to the Committee on 16 July 2018 and 24 May 2019 and I enclose copies of those letters. I also enclose two slides which summarise the challenges that DB pension schemes and their members face and provide a brief summary of our approach.

These hopefully provide suitable explanation of our model of consolidation and why we believe that it can offer many pension scheme members greater security than they currently have.

For us that is the key; consolidation can make pensions safer. Clara-Pensions is a real solution for real members who face not receiving their promised pensions if consolidation is not an option for them. We are confident that The Pensions Regulator can properly oversee consolidation and the transactions that can legally and safely take place under the current rules. However, we strongly support a specific authorisation regime being introduced through legislation at the earliest opportunity.

I look forward to answering the Committee’s questions on Wednesday.

Yours sincerely

Adam Saron
Chief Executive
Understanding the Problem
UK Private Defined Benefit Pension Schemes

Articulating the Problem

Uncertain time for Members
- Growing climate of corporate failures is undermining members’ confidence in a secure retirement
- Current position has too many risks: Sponsor failure, Growing deficits in the schemes, investment policy, to name a few
- Current safety net is the industry’s “lifeboat” scheme (PPF) but this will often result in lower benefits than promised

Challenge for Small Schemes
- Lack of scale is a major challenge
- Governance deficit is an increasing regulatory focus
- High relative costs prohibit adoption of many best practices
- Limited access to investment solutions and opportunities
- Limited risk management opportunities

Corporate Perspective
- Defined Benefit (‘DB’) pensions viewed as legacy liabilities
- DB is not part of compensation and retention policy going forward
- Closed DB schemes don’t support the current workforce
- DB scheme can be a barrier to growth via M&A, restructuring, management time and cash requirements

Key Figures

<table>
<thead>
<tr>
<th>Private DB Schemes</th>
<th>5,450</th>
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<tbody>
<tr>
<td>Open Schemes</td>
<td>661</td>
</tr>
<tr>
<td>% Schemes — &lt; 100 members</td>
<td>36%</td>
</tr>
<tr>
<td>% Schemes — &lt; 1,000 members</td>
<td>80%</td>
</tr>
<tr>
<td>Outstanding DB Pension Promises</td>
<td>£2,157bn</td>
</tr>
<tr>
<td>DB Pension Assets to pay promises</td>
<td>£1,573bn</td>
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<tr>
<td>UK Plc’s Pension Deficit</td>
<td>£584bn</td>
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<tr>
<td>All Bulk Annuities 2007-2018</td>
<td>£110bn</td>
</tr>
<tr>
<td>PPF Claims 2004-2018</td>
<td>£30bn</td>
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Sources: PPF Purple Book 2018, LCP Buy-out data

To find out more about Clara, the Member-First Consolidator, please contact us at team@clara-pensions.com or find out more at www.clara-pensions.com
Clara
The Member-First Consolidator for Defined Benefit Pension Schemes

Value Proposition

Member First
Secure members’ benefits by putting members and their interests at the heart of everything we do. A funded covenant, providing a secure journey to buy-out, removing the impact of sponsor insolvency.

Certainty for Sponsors
Clara allows the Sponsor to fulfil their legacy pension promises at a price below buy-out. A clean break is achieved and all future pension costs, risks and uncertainties are removed on day one.

Completion of existing Trustees’ Duty
Materially enhanced security of all promised benefits for all members on an accelerated path to a fully insured future.

Professional Management
Industry best practices on Trusteeship, Scheme Governance and Member Experience. Bringing schemes together creates efficiencies and benefits of scale.

Deliverable
Clara is a DB pension scheme, regulated by the UK Pensions Regulator. Clara’s member-first solution can operate under the current regime.

Key Features

Bridge to Buy-out
Insured pension provision is the ‘gold standard’ outcome for members. Clara lowers the risk of the journey from the trust-based to the insurance-based environment — Clara is a bridge to buy-out.

Permanent Ringfenced Capital
Capital provided to underpin members’ benefits is permanent and ringfenced to each section with no cross-subsidy risk with other sections.

Aligned Interests
Clara’s permanent capital travels the full journey to buy-out with members in each section. Clara truly is THE member-first consolidator.

Sectionalisation
The assets and liabilities of each pension scheme that are consolidated into Clara will become their own section supported by its own ring-fenced and funded capital.
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 Committee\(^1\) 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.

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\(^1\) 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) **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) **What sort of schemes are you seeking to absorb in terms of size and funding level?**

**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.

**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.

**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: “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[^4][^5] 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.

[^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
Dear Sir

An Update on Clara-Pensions and Defined Benefit Consolidation

I am grateful for the opportunity to update the Committee on Clara-Pensions and the development of consolidation for defined benefit pension schemes. I previously wrote to the Chairman, at his request, on 16 July 2018 to provide an overview of how Clara brings pension schemes together, our wider model and what 'Member-First' means in practice.

Clara has developed significantly since last summer. The next stage of our journey is to bring our first transactions to The Pensions Regulator (“TPR”) and to work through the clearance process with them. We believe that consolidation, and Clara, continue to offer a significantly improved likelihood of pension scheme members receiving their promised benefits in full.

Safer Pensions

The consultation launched by the Department for Work and Pensions in December on “The Consolidation of Defined Benefit Pension Schemes” rightly triggered a debate on the appropriate authorisation and regulatory regime for defined benefit (“DB”) consolidators. Clara is strongly in favour of robust authorisation criteria and a strong pensions regulatory framework. Clara’s full Consultation response is available on our website and we have included a copy with this letter for your reference.

Consolidation will bring benefits to members, but new policy should be subject to scrutiny and careful consideration. The Government is currently considering the Consultation; and their own response will be an important element in realizing the full promise of DB consolidation. DB consolidation is Government policy. It has, however, been unfortunate that the Government’s support for consolidation has faced criticism from outside of pensions. We recognise the need for debate of genuine issues but are also concerned it has caused disproportionate delay to a pressing matter.

I would like to summarise the key principles underlying consolidation.
1. **Safer Pensions** – Consolidation is about delivering better pension outcomes for members than they could hope to be achieved by their current sponsor. If consolidation does not offer a safer pension today and better outcomes going forward, it follows from their existing duties of care and governance structures that transferring trustees would not, and should not, be able to give their consent.

2. **Consolidation is Good Policy** – It is common ground that bringing multiple DB schemes together should result in the better use of resources and stronger governance. It is clear across UK pensions that the Government’s policy is to encourage both pooling and professionalisation. Consolidation will create economic value, but there is a valid policy question as to both when and how that value is shared between stakeholders.

3. **Consolidators are Pension Schemes** – The legal position is clear. Consolidators are pension schemes and consolidation is deliverable today under the current legislative and regulatory framework governing occupational pensions. The Pensions Regulator is already responsible for the pension schemes that will transfer into consolidators. It is logical that they should continue to regulate going forward.

4. **Consolidators should be subject to Authorisation and Regulation** – There needs to be a strong and clear authorisation and pension-based regulatory regime for consolidators. This is Clara’s firm position. If consolidation is about delivering safer pensions for members first, strong regulation is in the best interests of all.

**The Clara Model**

Clara formally launched in September 2018 with a unique answer to the challenges of consolidation and based on the clear principle of putting members first.

**Member-First**

Clara’s solution gives corporate sponsors a compelling reason to fund their pension schemes today. By exchanging the existing, unfunded sponsor covenant for Clara’s fixed, funded and transparent financial covenant members get a safer pension today. In exchange for fulfilling their pension promises, sponsors get certainty and the freedom to focus on the future of their businesses with confidence.

Clara’s solution has three features which set it apart from competing models and distinguishes Clara as the member-first consolidator for defined benefit pension schemes:

1. **Bridge to Buy-out** – Insured pension provision is the “gold standard” outcome for members. Clara lowers the risk of the journey from the trust-based to the insurance-based environment. Rather than holding members back in a run-off vehicle, Clara is a bridge to insured buy-out.

2. **Shareholder returns subordinate to Members’ Interests** – Clara’s permanent and funded capital travels the full journey to buy-out with the members of each section. Clara is the member-first consolidator; therefore, capital and profit can only be returned after members have had their full benefits secured. In the unlikely event a section of Clara faces difficulties, capital faces losses before there is a risk to members.

3. **Sectionalisation** – The assets and liabilities of each pension scheme that are consolidated into Clara will become their own section supported by its own ring-fenced...
and funded capital. Sectionalisation provides certainty that the capital and assets available to secure members' benefits within Clara are not exposed to contagion risk from past or future transactions. Expressed differently, although Clara’s covenant is fixed, it is always clear.

Member-first also means aspiring to deliver an engaging and accessible member experience and Clara is committed to delivering a member service that meets this standard as we scale. Clara is strongly supportive of the Pensions Dashboard initiative. Clara believes that digital-first is member-first.

People
At its heart, Clara is a well-run, well-funded pension scheme, overseen by independent trustees with a clear duty to members. Meaningful governance is essential to unlock the full promise of consolidation; and Clara’s board of trustees is comprised of three professional, independent trustees from three separate trustee firms. On 12 September 2018 we were honoured to announce1 Alan Pickering CBE as our inaugural chair of trustees together with Michael Chatterton and Frank Oldham.

Governance is not just a pension matter. Clara’s management team is well supported at the corporate level by our chairman, Lawrence Churchill CBE2, and our experienced non-executive directors: Steve Groves3 and Gill Tait.

Capital
DB consolidation holds out the promise of safer pensions for members and a clearer future for their current corporate sponsors. Although DB pension liabilities have been a barrier to investment in UK plc, consolidation can attract capital to invest in the UK - and in UK pensions in particular.

In my previous letter to the Chairman of the Committee, I was not able to fully answer the Chairman’s questions in relation to Clara’s source of capital.

On 19 December 2018 Clara announced4 that TPG Sixth Street Partners (TSSP), the global credit investment firm, became Clara’s provider of long-term capital. This announcement was not just a vote of confidence in the Clara team, but more importantly in Clara’s solution. Capital is available to support the right consolidation model.

Interest from Trustees, Sponsors and Advisers
A significant development over the past year for both Clara and DB consolidation is the rising level of acceptance within the pension sector. While consolidation is not a panacea, it can certainly be a real solution for a large number of schemes and their members.

Both Lincoln Pensions\(^5\) and Hymans Robertson\(^6\) have published surveys to illustrate this point, but Clara experiences this directly in our interactions with potential clients.

Since the beginning of 2018 Clara has had discussions with trustees and/or sponsors of 80 schemes (69 remain ongoing) and which together represent £17.5 billion of liabilities. These schemes represent a wide range of sizes (£5 million to £1 billion) and a wide spread of buy-out funding levels (41% to 95%).

Clearly not all opportunities will progress to transactions, but these figures are much higher than our most optimistic estimates of 12 months ago. The meaningful conclusion is that schemes and sponsors want and need new solutions that deliver safer pensions to members where an insured outcome is not possible in the foreseeable future.

If the Committee, the Chairman or any individual member requires further detail, please do not hesitate to contact me.

Your sincerely

Adam Saron
Chief Executive Officer

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