Written evidence from Clara-Pensions DBP0051

About Clara-Pensions, the member-first consolidator

Clara-Pensions ("Clara") is the member-first consolidator for defined benefit (DB) pension schemes. We act as a bridge for pension scheme members, from the company that currently supports their pension to a long-term insured future.

Clara is currently the only superfund to have successfully completed The Pension Regulator's (TPR) assessment process in late 2021. During 2022, we worked with a number of trustees and sponsors who saw the benefits for members of a transfer to Clara. Unfortunately, market volatility led to significant changes in Scheme funding levels which prevented these members transferring to Clara.

Clara is ready to transact and welcome our first members in 2023. We are in active discussions with many schemes considering their endgame options - predominantly with buyout funding levels of 85-95% for whom Clara can demonstrably improve member outcomes and allow sponsors to meet their historic obligations in full.

We operate under the interim regime for superfunds set out by TPR in June 2020 (the "Guidance"). We believe that some changes are required to this guidance to allow superfunds to provide sponsors and trustees with a way to improve member outcomes, and facilitate the injection of new capital to support members' benefits. We are engaging productively with TPR on some key changes to the Guidance.

Under our model, security of member benefits is improved as Clara injects our own capital and provides a robust oversight and governance environment. This allows sponsors to transfer the burden of their pension liabilities to Clara safe in the knowledge that their members will be looked after on their journey to buyout. By consolidating schemes there are multiple benefits of scale: resources to invest in the systems and controls to support strong trustee decision making; the ability to invest in longer-term illiquid assets which support the wider economy, and lower scheme costs.

Our model is based on core pillars which ensure that members and their benefits are our top priority on a highly secure journey to buyout:

- When a scheme transfers its assets and liabilities to Clara, those liabilities are supported by funded, permanent capital from our long-term capital providers. This provides greater security for schemes and members inside Clara.
- We operate a sectionalised model. A scheme's assets and liabilities are ring-fenced in Clara with their own dedicated capital buffer. This means sponsors and trustees have clarity on the security that Clara is offering their members and each section can travel on its own journey to buyout.
- Inside Clara, members will benefit from a high-quality experience. Our commitment to invest in technology and improving member data and communications coupled with a robust approach to governance including a professional, independent, and experienced trustee board.

Consolidation, and Clara, will not be right for every scheme. For many schemes, however, there is an urgent need for more affordable alternatives to the insurance market that provides security to members, increases the certainty of members achieving buyout and frees up sponsors to concentrate on their core businesses.

Many schemes today are underfunded and are reliant on weak corporate sponsors. Clara is ready to offer a solution for these members, allowing their sponsors to focus on strengthening their business. A transfer to Clara may avert a repeat of historic pension downfalls (for example, BHS). In some cases, a closed DB scheme can be a significant burden for the sponsoring employer, limiting their ability to focus on their core business, including investment in the future and the pay and pensions of current employees. Transferring to a superfund can relieve businesses of this burden, allowing them to focus on their business whilst safe in the knowledge that their scheme's members have had their benefits secured and are safely on the journey to an insured buyout.

Clara welcomes the Work and Pensions Committee inquiry. We would be happy to provide further detail on any of the responses below and we would welcome the opportunity to provide evidence to the Work and Pensions Committee on DB schemes and consolidation.

We are grateful for the engagement that the Department for Work & Pensions, HM Treasury, the Pensions Regulator and the Pension Protection Fund have shown on consolidation. This can only be in the interests of members and their sponsoring employers.

DB consolidation comes at a crucial time

DB pensions are a valuable benefit for members, but one which is available to fewer and fewer employees in the private sector. We welcome the continuing recognition by the Government of the benefits of consolidation and the role that superfunds can play in helping to secure the futures of DB members. Bringing schemes together with additional financial capital can improve outcomes for both members and employers – as the Pensions & Lifetime Savings Association's 'DB Task Force' said in their 'Case for Consolidation' report, this 'could transform the sector' for the better[1].

We believe there are four key benefits of DB consolidation that the Committee should consider during this inquiry:

- Providing a more affordable and secure option to the large proportion of DB pension schemes which cannot afford an insured buyout in the near future.
- Addressing a growing capacity crunch in the buyout market, caused by a surge of interest in this option, by providing a secure option for those schemes which can afford a buyout but cannot reach a deal due to lack of capacity.
- Alleviating the increasing regulatory and governance burden for smaller and medium-sized schemes and improving the member experience, whilst ensuring trustees have fulfilled their regulatory requirements.
- The economies of scale arising from consolidation, including reduced costs, improved governance, greater purchasing power in the insurance market thereby accelerating members' security of benefits, and the ability to invest in a wider pool of assets (eg, the Local Government Pension Scheme has created opportunities to access a wider range of longer-term opportunities that have economic or social benefit to the UK, such as infrastructure and climate-aligned assets).

To enable the benefits of consolidation to be realised, we believe there three key ways consolidation can be encouraged, which we encourage the Committee to consider as part of its inquiry:

1. **The introduction of superfunds legislation** to increase the confidence of trustees, sponsors, and providers of capital in the long term legislative framework.
2. **Increased education and awareness of the benefits of consolidation**, particularly among trustees and sponsors.
3. **The consideration of consolidation** to be actively encouraged as part of endgame planning.

Please find Clara's full response below. We only answer those questions relevant to our business and the subject of consolidation.

2. Is there sufficient capacity in the buy-out market to meet demand from DB schemes? If not, what are the alternatives?
A buyout with an insurer is the gold standard of de-risking for pension schemes. The economic volatility of 2022 has generally resulted in an improvement in scheme funding levels, and therefore the ability of more DB schemes to afford buyout. However, for those schemes who can now afford to reach buyout, accessing the insurance market is expected to become increasingly challenging due to a growing capacity crunch.

2023 looks set to be a record year for the risk transfer market (estimates of £25-40bn)[2] and there are questions over the ability of insurers to process the number of schemes which are now keen to transact.

Smaller schemes are less likely to be able to access the insurance market: capacity for providing quotations to smaller schemes is limited, with only four insurers active in the market for sub-£50m transactions. This narrows even further for sub-£20m transactions, with just two insurers undertaking these deals.[3] Only one of the eight insurers had an average transaction size of under £100m in 2022, with four having an average transaction size of over £200m.[4]

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[1] Pensions & Lifetime Savings Association, Defined Benefit Task Force, March 2017 'The Case for Consolidation', page 26.
[2] WTW De-risking report 2023, pg. 25

The potential to transact today should be seen against the potential backdrop that the change in market conditions may only be short-term[5] such that the insured option may move further away from schemes again. Transferring to a consolidator would enable trustees of these schemes to lock-in the recent improvements in funding, and deliver an efficient path to buyout.

The majority of schemes (a large proportion of which are small and medium sized schemes (under £250m)) still cannot afford to reach buyout in the near future. Many of these schemes need an alternative option that provides greater security for members. Consolidation offers that alternative.

Consolidation will not only help to alleviate the insurance buyout capacity crunch, it will also attract new capital to secure members' benefits, and propel members to an insured buyout more safely.

3. What should the Pensions Regulator (TPR) do to improve the quality of trustee boards?

TPR has provided a detailed and informative educational tool for trustees in the form of the Trustee Toolkit and provided additional materials within that Toolkit to adapt to the evolving pensions landscape e.g. pension scams. Clara would advocate for the development of these materials to include a module on end-game planning, de-risking and the full lifecycle of a pension including buy-out and consolidation options once the consolidation market is established.

We welcome the TPR requirement for trustee board members to keep training logs to demonstrate that they are keeping up to date with these changes via internal training and knowledge sharing from their advisers. This will give trustees the confidence that they can engage with new solutions as they have the base understanding to be able to critically engage with them.

We welcome the move towards professional or experienced trustees, as they benefit from the experience of multiple situations, and in particular the complexity of de-risking transactions.

4. What, if any, further steps should be taken to encourage DB scheme consolidation?

The lack of legislative framework for superfunds is a potential barrier for trustees, sponsors, and providers of capital. The future legislative framework should ensure that superfunds are able to continuously provide an alternative option to schemes that are unable to afford an insurance buyout (e.g. any minimum funding requirements should move in parallel with that of insurers throughout the credit cycle).

Alongside legislation, we believe there are further measures that would encourage consolidation and enable more sponsors and trustees to transfer their schemes' members to superfunds:

- **Education on consolidation:** More should be done to publicise the wider benefits of consolidation, including educating trustees and sponsors about its potential long-term advantages. This is necessary to counter a lack of trustee or sponsor awareness. Clara has advocated for the development of the Trustee Toolkit to include a module on end-game planning, de-risking and the full lifecycle of a pension including buy-out and consolidation options.

- **Consolidation as part of endgame planning:** TPR and the PPF should encourage trustees and sponsors to explicitly consider consolidation in endgame planning. These issues are more pronounced as more DB pension schemes enter the 'end-game' where issues with pension schemes often become more pronounced. Scheme liabilities are maturing, schemes are becoming cashflow negative and with many schemes closed, the link to the employer is weaker. As schemes plan for their future, and that of their members, simply continuing on, falling into the PPF safety net or struggling toward an unobtainable buy-out provide too narrow a set of choices. Self-sufficiency and buyout should not be considered viable funding strategies where the time to achieve them is inconsistent with covenant strength or

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[3] 2019 and 2020 saw a hive of activity amongst large schemes seeking to transfer risk to the insurance market, with 15 buy-ins and buy-outs making up c. 60% of 2019 and 2020 combined volume - Hymans Risk Transfer Report 2023
[4] Hymans Risk Transfer Report
[5] A decrease in market surplus is already showing (https://www.ppf.co.uk/ppf-7800-index) and the IMG is predicting that interest rates will return to pre-pandemic levels: https://www.imf.org/en/Blogs/Articles/2023/04/10/interest-rates-likely-to-return-towards-pre-pandemic-levels-when-inflation-is-tamed

horizon. If consolidation is affordable, trustees should have to justify why they have not considered consolidation as an option.

Interest in consolidation within the market is high. Trustees and sponsors want to make sure they are making the right decision for their scheme members. Members, trustees and sponsors should be able to take comfort from the fact that Clara has completed TPR's rigorous and robust assessment process.

Both DWP and TPR are supportive of consolidation and we are grateful for the positive engagement we have had so far and would like to continue to build on this.

5. Are there any circumstances in which consolidation should be mandatory?

We do not consider that consolidation should be mandatory as to do so would restrict trustees' decision-making power to do what is in the best interests of scheme members. Trustees should, however, be required to consider consolidation as part of their endgame planning and seek a consolidation solution if demonstrably in members' interests.

9. Should changes be made to the Pension Protection Fund (PPF), Financial Assistance Scheme (FAS) or Fraud Compensation Fund (FCF) to improve outcomes for members?

In so-called 'PPF+' cases, members' benefits can be insured with an insurance policy that provides a greater level of benefit than they would receive in the PPF but which represents a reduction (often a significant one) to their full benefit entitlement.

In these situations, superfunds may have the ability to offer a higher level of benefit to these members than insurers. Frustratingly, superfunds, necessarily legally instantiated as pension funds, do not have a legal mechanism to take on these members at anything less than their full benefit entitlement (without individual member consent). The result of this is a gap in the market in which members whose sponsors have failed may end up receiving 90% of their pension from an insurer but could have received 95% or more from a superfund if this had been legally possible.

We therefore suggest that there is legislation to allow superfunds to provide "haircuts" to pension benefits that would be smaller than those provided by the insurance market, enabling members to benefit from a higher percentage of pension benefits.

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