

TfL Pension Fund

Annual review 2006

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Notice for the visually impaired

Copies of this report in large type and in a text only format are available from the Fund Office. Please write to TfL Pension Fund, 4th Floor, Wing over Station, 55 Broadway, London SW1H 0BD, or call 020 7918 3733 for your copy.



A message from the Chairman

I am pleased to present my review of the year ended 31 March 2006 – another busy period for the Fund. During the year, the Trustees have spent much time and effort implementing the requirements of the recent Pensions and Finance Acts.

We have seen a year of strong investment performance, with the Fund's value increasing by 23%. Although global stock markets have fallen back since the end of March, our Fund is well positioned to ride out such short-term fluctuations. We have also continued to implement our new investment strategy. The aim of this is to improve returns without increasing risk unduly. The main changes have been to appoint Goldman Sachs to manage global bonds and Bridgewater Associates to manage the risks associated with holding assets denominated in currencies other than sterling. We also reviewed the management of the assets held in index-tracking or 'passive' funds. As a result we have decided to appoint Legal & General in place of Barclays Global Investors. The transfer of these assets took place during summer 2006.

Another change during the year was that we reviewed our legal advisers and have appointed Sacker & Partners, to replace Mayer, Brown, Rowe & Maw.

The latest three-yearly actuarial valuation has recently got underway. This is a complex and lengthy process so we will not have the final results until next year. However, the valuation will tell us how the Fund is doing and how much needs to be paid in to provide members' benefits over the coming years.

Finally, I would like to thank all the people who have worked to steer the Fund through the past year, the Trustees, our advisers, the Fund Office and the Fund Secretary.

Stephen Critchley

Myners update

You may remember us updating you about the principles set out in the Myners Review of Institutional Investment, which was published in 2001. The Government has said that it expects pension scheme Trustees to work towards complying with these principles. We have reported our progress towards compliance in the past three Annual Reviews and are now pleased to say that we are compliant.

The most recent changes we have made are:

- Focus on asset management – we have now appointed an active currency manager to manage the Fund's exposure to overseas currency risk on equities
- Activism – we have asked our investment managers to exercise their voting rights as shareholders in a manner which they believe to be consistent with best practice in relation to Corporate Governance and in accordance with the Institutional Shareholders' Committee's Statement of Principles on the Responsibilities of Institutional Shareholders and Agents

Full details are available on the Fund's website at www.tflpensionfund.co.uk

Pension reform – update

In our March 2006 edition of 'Pensionews', we updated you on the Government's pension changes and how they would affect Fund members from 6 April this year. At that time, there were a few areas where we needed further clarification or where we were in the process of implementation.

Tax-free cash

- Members can take up to 25% of the value of their benefits as a tax-free cash sum on retirement. The formula for calculating maximum cash is quite complicated, but we will be showing the amount you can take in retirement letters. You should remember that the more cash you take, the lower your pension from the Fund will be
- All members who have paid Additional Voluntary Contributions (AVCs) can take these as a tax-free cash sum on retirement, subject to overall limits

Trustee Knowledge and Understanding

The Pensions Act 2004 introduced new rules on Trustee Knowledge and Understanding

(TKU). From 6 April 2006 Trustees are required to be 'conversant with' their Fund's documents and have sufficient knowledge and understanding of pensions and trust law, pension scheme funding and investment to exercise their Trustee functions properly. The Operations Committee has been considering how to make sure these requirements are being met.

Trustee training has been included as part of the Trustees' activities during the year. New Trustees are invited to attend general Trustee training and, during the autumn, further training is organised for all Trustees and members of the Pension Consultative Council (PCC). In addition, we organise special investment related training sessions which are open to all Trustees.

The Board has also recently introduced training on topical matters that relate directly to the Fund. These sessions take place after quarterly Board meetings. Recent topics have included the Statement of Funding Principles and the Trustees' responsibilities in the new environment.

Summary Funding Statements and Statement of Funding Principles

In accordance with new legislation we are sending the first annual summary funding statements to all Fund members and beneficiaries. The purpose of this document is to give members information about the funding position of the Fund.

The 2006 statement is based on information from the most recent Fund valuation, which was carried out as at 31 March 2003. Once the 2006 actuarial review has been concluded its results will be used in preparing next year's Summary Funding Statements.

Pension schemes are now subject to a Statutory Funding Objective, which is to have 'sufficient and appropriate assets' to meet their accrued pension obligations, as determined by the Fund Actuary. The Trustees will use the results of the 2006 valuation to prepare their Statement of Funding Principles. This will set out the policy for making sure that the Statutory Funding Objective is met.

The Pension Protection Fund (PPF)

The Trustees are still hoping to get the Public Sector section of the Fund reclassified so that we do not have to pay the PPF levy. To remind you, the PPF provides benefits for pension scheme members whose employers go out of business. We do not believe that Transport for London could go out of business and so feel that we should not have to pay towards the PPF.

Partial retirement

It is now legally possible for pension scheme members to take all or part of their pension while remaining in employment where employers decide to implement this. In consultation with Transport for London, we are considering how this flexibility might be introduced within the scope of the Fund's rules and without causing unnecessary additional administration.

Money in and out of the Fund

On 31 March 2006, the value of the Fund was £4,342.4m. This was an increase of £826.1m in the value at the end of the previous Fund year.

The table below shows the money coming into and going out of the Fund during the year.

| Money into the Fund | 2005/06 | 2004/05 |
|---|----------------|----------------|
| Employers' contributions | £174.0m | £170.1m |
| Investment income | £67.7m | £61.5m |
| Member's contributions | £33.0m | £32.8m |
| Transfers in from other pension schemes | £11.9m | £8.0m |
| Total income | £286.6m | £272.4m |

| Money out of the Fund | 2005/06 | 2004/05 |
|----------------------------------|----------------|----------------|
| Pensions and other benefits paid | £191.0m | £182.4m |
| Investment expenses | £4.4m | £4.7m |
| Administration expenses* | £4.6m | £3.5m |
| Payments to leavers | £2.8m | £2.5m |
| Total outgoings | £202.8m | £193.1m |

* For 2005/06 the Fund's administration expenses were as follows:

- Staff costs £1.9m
- Fund Office running costs £0.4m
- Professional fees (including PPF levy) £2.1m
- Communications £0.2m

Net movements in the Fund

| | |
|--|------------------|
| Fund at 1 April 2005 | £3,516.3m |
| Expenditure | £202.8m |
| Increase in market value of investments | £742.3m |
| Income | £286.6m |
| Fund at 31 March 2006 | £4,342.4m |

The Fund's accounts are audited each year by independent auditors, KPMG. They have confirmed that:

- The Fund's accounts show a true and fair view of the financial transactions during the 12 months to 31 March 2006
- Contributions were paid to the Fund in accordance with the schedules of contributions in force during the year
- The financial information in this Annual Review is a summary of the full audited accounts.

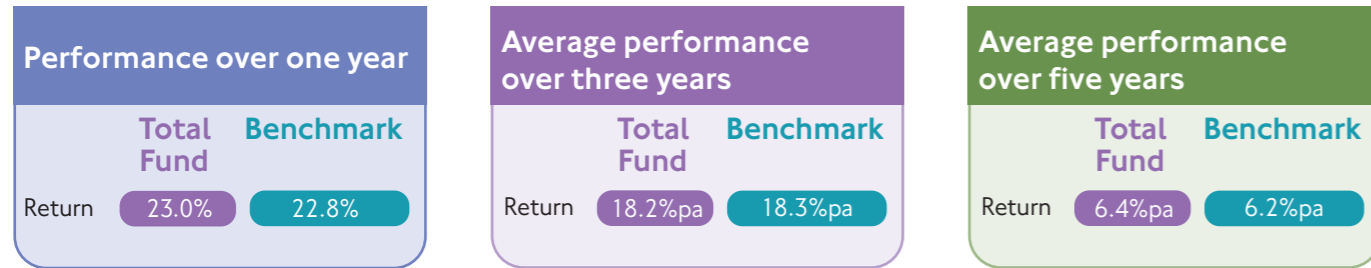
If you would like a copy of the full Report and Accounts, please contact:

Sue Timbrell
Director of Pensions & Fund Secretary
4th Floor, Wing over Station
55 Broadway
London SW1H 0BD

Alternatively you can download a copy from the Fund's website at www.tflpensionfund.co.uk

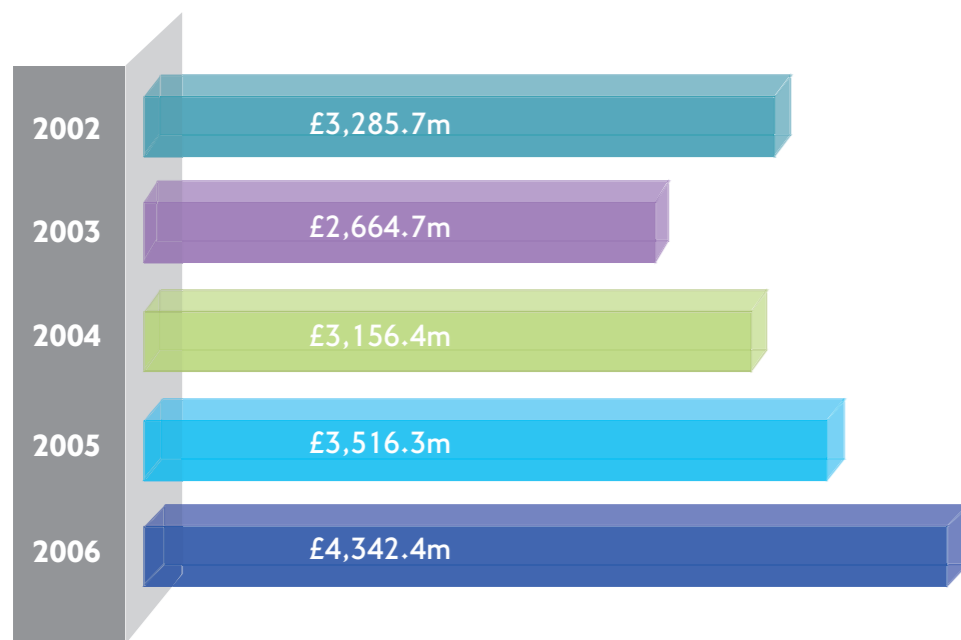
Investment review

As the table shows, the Fund's return for the Scheme year was 0.2% higher than the target (benchmark) set by the Trustees. When measured over three years, the Fund's investment performance was very slightly below this benchmark; measured over five years the performance was slightly ahead.



During the year the value of the Fund increased by 23% to over £4.3 billion.

How the value of the Fund has changed



How the Fund is invested

The Fund is held in a range of different investments (assets) in the UK and overseas. These tables show how the Fund was invested on 31 March 2006.

Who manages the Fund

Barclays Global Investors **49%**

Goldman Sachs **20%**

Alliance Capital **11%**

Baillie Gifford **11%**

Nomura **6.5%**

Bridgewater Associates **2.5%**



The Fund's assets

UK equities **39.6%**

Overseas equities **28.5%**

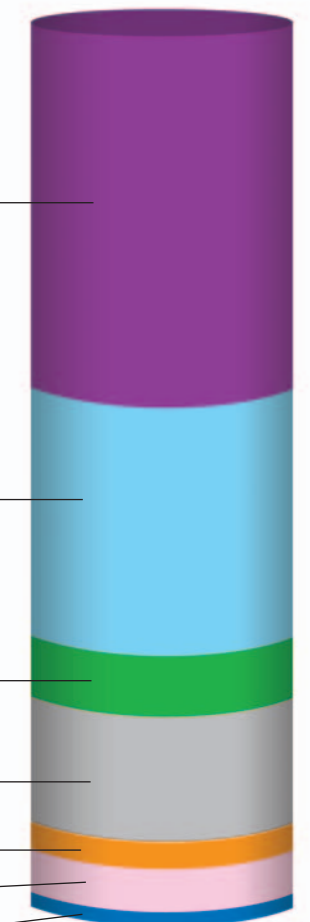
UK Government Bonds **8.4%**

UK Government Index-Linked Bonds **14%**

Overseas Bonds **2.7%**

Corporate Bonds **5.8%**

Cash and other investments **1%**



Top 10 shares

The Fund has significant holdings in the shares (equities) of a number of major UK companies. On 31 March 2006 the 10 largest holdings were:

| | | |
|----|------------------------|--------|
| 1 | BP | £67.5m |
| 2 | Royal Bank of Scotland | £65.9m |
| 3 | GlaxoSmithKline | £57.5m |
| 4 | Barclays Bank | £53.6m |
| 5 | Vodafone | £50.5m |
| 6 | Royal Dutch Shell | £46.6m |
| 7 | BG Group | £29.6m |
| 8 | BHP Billiton | £27.2m |
| 9 | HSBC | £26.6m |
| 10 | Rio Tinto | £25.7m |

Trustees' managers and advisers at 31 March 2006

Investment Managers

- Alliance Capital Ltd
- Baillie Gifford & Co
- Barclays Global Investors Ltd
- Bridgewater Associates, Inc
- Goldman Sachs Asset Management
- Nomura Asset Management UK Limited

Custodian

JP Morgan Chase Bank

Administration Services

Transport for London

Investment Adviser

Mercer Investment Consulting

Scheme Actuary

RV Williams, Watson Wyatt Limited

Legal Advisers

Sacker & Partners LLP

Auditors

KPMG LLP

Bankers

The Royal Bank of Scotland plc

Communications Adviser

GR Communications

Medical Adviser

Professor K Holland-Elliott

AVC Providers

Clerical Medical
Equitable Life
Standard Life

Membership review

Between 1 April 2005 and 31 March 2006, the total membership of the Fund decreased by 56 to 82,257.

The table shows how the membership is split between contributing members, deferred members, pensioners and dependants. As you can see, Transport for London continues to demonstrate its support for the Fund by offering membership to its new employees.

| | As at 31 March 2006 | As at 31 March 2005 |
|-------------------------|---------------------|---------------------|
| Contributing members | 22,174 | 22,367 |
| Deferred pensioners | 18,941 | 18,779 |
| Pensioners | 30,345 | 30,273 |
| Dependants and children | 10,797 | 10,894 |

The table below shows how the contributing members are spread across the Participating Employers.

| | As at 31 March 2006 | As at 31 March 2005 |
|---------------------------|---------------------|---------------------|
| Transport for London | 16,632 | 16,341 |
| Metronet Rail BCV Ltd | 1,950 | 2,144 |
| Metronet Rail SSL Ltd | 1,835 | 2,029 |
| Tube Lines Ltd | 1,522 | 1,599 |
| PFI and other contractors | 235 | 254 |

Reminder about new member numbers

Please remember to use your new member number in all correspondence with the Fund Office. If you are a contributing member you will find this on your benefit statement. If you have a deferred pension you will also find this on your benefit statement, which you will receive shortly. If you are receiving a pension from the Fund, you will find your member number on your annual pension payslip.

The Pension Fund website

Whether you are a contributing member, a pensioner or have a deferred pension, you can find plenty of relevant information about the Fund on our website at www.tflpensionfund.co.uk

We hope that you will take the opportunity to visit the site – we always welcome your comments and ideas, which you can send to us by filling in the online feedback form.

Actuarial valuations – history and purpose

The Trustees' Actuary is working on the three-yearly valuation of the Fund. This is being calculated as at 31 March 2006 and we expect to have final results early next year. In the meantime, we thought you might find it helpful to know a bit more about why we need a regular valuation and what it tells us.

All funded pension schemes (schemes where contributions are invested in advance to pay for benefits at a future date) are required to value their funds at least every three years. The main purpose of this valuation is to check that the Fund is on track to pay out benefits to members as entitlements arise. There are two parts to this:

- A past service valuation – to work out whether the assets already held in the Fund are sufficient to provide the benefits that members have earned up to the valuation date
- A future service valuation – to work out how much should be paid into the Fund to cover the benefits that members will earn going forward.

There are many factors that need to be taken into account, most of which can only be predicted at best, based on the Fund's past experience. These include:

- How many members will retire early and how many will die or leave before they take their pension
- How long members will live after their pension starts
- How much salaries will increase by
- How investments will perform

The valuation will show whether the Fund is in deficit or surplus. If a pension fund is in deficit, this means that at the date of the valuation the scheme's assets (the investments) were worth less than the past service liabilities (the value of members' benefits already built up). The Trustees are required to draw up plans to make good any deficit so this will need to be taken into account when setting the future contribution rate. A surplus arises where there is more money in a pension fund than is required to meet the past service liabilities and this could mean that future contributions can be reduced.

There is a number of other reasons for carrying out a valuation and these all require different calculation methods. For example, pension funds receive valuable tax benefits and must confirm that they continue to comply with the rules associated with these. In addition, pension funds must certify that they meet a Minimum Funding Requirement, though this is being replaced by a scheme-specific funding standard which looks at funds individually. Pension funds also need to be valued to find out how much they will be required to pay towards the new Pension Protection Fund.

To understand the purpose of these valuations, it helps to think of them as a pension fund healthcheck – they make sure, as far as is possible, that members' benefits are secure and will continue to be so in the future.

The Fund's Trustees

The Fund is run by a board of directors, known as the Trustees. Individual Trustees are nominated by Transport for London (as Principal Employer), the trade unions and the Tfl Pension Consultative Council (PCC), which is itself elected by the membership.

On 31 March 2006, the Trustees were as listed below. The nominating bodies are shown in brackets.

Stephen Critchley (Chairman), Chief Finance Officer, Transport for London (Tfl)

Marina Ainsworth, Head of Business Planning & Support, Surface Transport, Transport for London (Tfl)

Steve Allen, Director of Corporate Finance, Transport for London (Tfl)

Nicky Belben, Director of Human Resources, Tube Lines Limited (Tfl)

Gerry Duffy, Director of Employee Relations, London Underground Limited (Tfl)

Chris Godbold, Director, Transport Benevolent Fund (PCC)

Steve Grant, District Organiser, ASLEF (ASLEF)

Jennifer Hamilton, Station Assistant Multi Functional, London Underground Limited (TSSA)

Jane Hart, Principal Lawyer, Tfl Legal, Transport for London (Tfl)

Hugh Hood, Director of Group Human Resources, Transport for London (Tfl)

Chris Miller, pensioner (PCC)

John Robson, Train Operator, Arnos Grove, London Underground Limited (PCC)

Tom Scanlon, Regional Industrial Organiser, T&GWU (T&GWU)

Pat Sikorski, Assistant General Secretary, RMT (RMT)

Michael Swiggs, pensioner (PCC)

John Timbrell, Project Engineer, Metronet Rail, Trains Division (LTJTC)

Philip Worthington, VP, Reward and HR Systems, Metronet Rail Limited (Tfl)

There was a vacancy at 31 March 2006 which was subsequently filled by the appointment by Tfl of Howard Collins, SSR Service Director, London Underground Limited

Key

ASLEF – Associated Society of Locomotive Engineers and Firemen

LTJTC – London Transport Joint Trades Committee

PCC – Tfl Pension Consultative Council

RMT – National Union of Rail, Maritime and Transport Workers

T&GWU – Transport and General Workers' Union

Tfl – Transport for London

TSSA – Transport Salaried Staffs' Association

Annual Members' Meeting (AMM) and Exhibition

This year's TfL Pension Fund Annual Members' Meeting (AMM) and exhibition will be at 11.00am on Tuesday 3 October. **We have a new venue this year – One Great George Street, Westminster, London SW1P 3AA.** The meeting and exhibition are open to all Fund members – contributing members, members in receipt of a pension (including dependants and children) and those who have left with a deferred pension.

You will be able to ask questions on the day, but if you cannot attend, you can submit a question to the Trustees by writing to Sue Timbrell, Director of Pensions & Fund Secretary, 4th Floor, Wing over Station, 55 Broadway, London SW1H 0BD. She will respond as soon as possible after the AMM.

Please remember, we can only answer general questions about the Fund at the meeting, not those relating to your own benefits.

The programme for the day is:

- Introduction by the Chairman
- Keynote speech by Peter Hendy, Commissioner of Transport for London
- Review of the Annual Report & Accounts to 31 March 2006 by the Fund Secretary
- Legislative changes
- Questions and answers

For the exhibition, we have invited a number of external organisations to bring along information of interest to all our members. The exhibition will run throughout the meeting so, if you cannot attend the whole event, please feel free to pop in and find out what's going on.

For members who have mobility considerations or are wheelchair users access to the building is via the lift at the rear entrance in Little Sanctuary. If you require further information please contact the Fund Office on 020 7918 3733.

Please note that, for security reasons, you may be asked for some form of identification on arrival.

