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**Pensions Review  
Stage 1 Call for Evidence, August 2021**

**Representations from TfL Trustee Company Limited  
as trustee of the TfL Pension Fund**

**17 September 2021**



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## Introduction

1. TfL Trustee Company Limited (“**Trustee**”) is the sole trustee of the TFL Pension Fund (“**Scheme**”). The Scheme is the primary pensions vehicle for Transport for London (“**TfL**”) and its operating subsidiaries.
2. Under the terms of TfL’s Funding Agreement dated 1 June 2021, TfL is required to conduct a review of the Scheme (“**Review**”). TfL decided that, rather than conduct the Review internally, it would invite an independent person to conduct the Review (“**Independent Lead**”). The Independent Lead of the Review has issued a paper, “*Pensions Review: Stage 1 Call for Evidence, August 2021*”.
3. The Independent Lead confirmed that he would be seeking the involvement of stakeholders throughout the Review process. The first stage of the Review is to seek the written submission of representations and evidence from various stakeholders, including the Trustee.
4. In particular, Appendix 4 of the paper states that the purpose of the first stage is “...to understand stakeholders’ views on the challenges (if any) currently facing the Scheme in light of the continuing funding pressures on TfL as well as any Scheme-specific challenges ...”. A number of specific questions are then set out.
5. The Trustee has considered which of the questions it is appropriate for it to respond to as trustee of the Scheme, both from its own perspective and from the viewpoint of the Scheme’s members and other beneficiaries. At this stage, the Trustee is submitting representations in response to questions 1, 2, 3, 6, 7 and 8.
6. Although it has decided not to respond to all of the questions, the Trustee may wish to do so at a later stage in the Review and reserves its position in that regard. For now, it simply wishes to record the following points in relation to questions 4 and 5:
7. Question 4 asks “*How should TfL’s pension arrangements compare with other pension arrangements elsewhere in the public sector?*”. The Trustee considers it important for the Review to take into account the Scheme’s unique history (see, by way of example, paragraphs 73 - 76 below) and the role that the Scheme’s benefits fulfils as part of TfL employees’ overall remuneration package (see paragraphs 12, 13 and 71 below). The Trustee therefore warns against any comparisons being drawn with other pension arrangements, particularly any over-simplified comparisons.
8. Question 5 asks “*What are your views on how TfL’s pension arrangements can be fair to all going forward, including different cohorts of members and the sharing of risk between the employer and the employee?*”. The Trustee notes that this question tends to suggest that TfL’s pensions arrangements are not currently fair to all, and warns against starting the Review from that premise. Furthermore, the Trustee again considers it important to note the Scheme’s unique history and its crucial role in TfL’s overall remuneration package for its employees. The Trustee also notes the benefits that TfL’s pensions arrangements provide by supporting its crucial role – not only to travellers on its network, but also to London and the UK more generally.
9. Please note that the responses to the questions contained in these representations are made on behalf of the Trustee in its capacity as trustee of the Scheme. They do not necessarily represent the personal views of individuals associated with the Scheme, who may also contribute to the Review in their personal capacity or through a different stakeholder.
10. The Trustee also notes that Appendix 4 of the paper states that “*engagement responses...will be summarised and published as part of Interim and Final reports to be produced by the Review*”. The Trustee requests that it have a reasonable opportunity to comment on the summary of these representations (and any additional comments made on behalf of the Trustee, whether orally or in writing) produced by the Review before it is published.
11. Finally, it should be noted that the Scheme has two sections – the Public Sector Section (which represents over 99% of the Scheme’s assets and liabilities) and the Composite Section. The Trustee’s representations are intended to apply primarily in relation to the Public Sector Section although, to the extent that they have general application, they also apply to the Composite Section.



**Question 1: How should long term sustainability be viewed and how does this look from the perspectives of members; the employer; taxpayers; farepayers; the Trustee and others? What are the key features of long-term sustainability for the pension arrangements of TfL?**

*Pensions are part of overall remuneration package*

12. As a preliminary point, the Trustee notes that it is widely understood that pensions are regarded as deferred pay and form part of employees' overall remuneration package. This is also reflected in TfL's Financial Sustainability Plan dated 11 January 2021 where it is noted that TfL's reward offering comprises as its key elements base pay (including performance awards), pensions and other discretionary benefits.
13. Further, the page headed "Rewarding You" on TfL's own website notes that, if TfL is to attract the right talent and retain the energy and commitment of its people, it "*must provide the rewards for that to happen*". The Scheme is highlighted as an important part of that package. It follows that, given the importance of pensions to the overall remuneration package, any adverse changes to pension benefits will jeopardise the ability of TfL to recruit, motivate and retain its employees. Therefore the long-term sustainability<sup>1</sup> of TfL's pension arrangements should be considered in that overall context; not in isolation.

*Trustee's ability to pay beneficiaries' benefits*

14. The Trustee views the long-term sustainability of the Scheme as relating to its continued ability to pay members' and other beneficiaries' benefits as and when they fall due.
15. With the main purpose of the Scheme being the provision of retirement pensions and other benefits, the Trustee is primarily concerned with its ability to pay the Scheme's accrued benefits over the long-term. The time horizon over which the Trustee considers the Scheme's obligations is very long. The youngest members are around 20 years old, and their benefits might not start to become payable for some 45 years and might continue to be paid in 70 or more years' time.

*TfL's financial position*

16. TfL's financial position is an important factor in the Trustee fulfilling its role.
17. The Trustee is aware of TfL's position as a statutory body under the Greater London Authority Act 1999 ("GLA") and the regulation it must comply with under the Local Government finance rules. Collectively, these provide an element of statutory protection and a financial underpin. For example, as a statutory corporation, TfL is a functional body of the GLA so the corporate insolvency regime does not apply to it. Equally, unlike a commercial entity, TfL is legally required to produce a balanced budget each year.
18. The Trustee also notes the effective monopoly position of TfL as the operator of London's transport infrastructure. Government's support to TfL has also been demonstrated both during the pandemic in the face of a significant reduction in fare income and also in terms of the material increase in the cost of completing Crossrail.
19. These and other factors mean that the Trustee is able to place a high degree of reliance on the long-term commitment of TfL towards the financing and support it provides to the Scheme.
20. The Trustee notes that its view of the position of TfL is consistent with that taken by the rating agencies, who also take account of the direct and indirect support of Government in assessing the creditworthiness of TfL's financial position. Whilst they have recently downgraded TfL as a result of reduced certainty over longer-term government support, it still retains a strong investment grade rating.
21. From the Scheme's perspective, this means that, as long as TfL is in a position to pay the required level of contributions agreed at each actuarial valuation (as has always been the case), the Trustee can be confident that the Scheme will be able to weather any short-term adverse experience that could be reasonably expected and that TfL will continue to support the long-term approach to financing the Scheme and the benefits this will deliver.

<sup>1</sup> And "affordability", as referenced in Question 2



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### *Funding*

22. In viewing the long-term sustainability of the Scheme, the Trustee considers the statutory funding measure (i.e. that required by Part 3 of the Pensions Act 2004) to be the most appropriate financial metric. Under this approach, a prudent value is placed on the Scheme's accrued liabilities (known as the "Technical Provisions") and a prudent approach is taken to establishing contributions due from TfL and the other participating employers in respect of new accrual and the costs of ongoing administration. These representations refer to this as the Scheme's "**funding approach**".
23. The statutory requirement to be prudent in the funding approach means that it is expected to overstate the actual long-term cost of financing the Scheme, on the assumption that the Scheme remains in its current form. The Trustee notes that the underlying "best estimate" cost of running the Scheme is therefore expected to be somewhat lower than that reflected by the funding approach.
24. As required by applicable legislation, the Scheme's funding approach is agreed between the Trustee and TfL (subject to the supervision and regulation of the Pensions Regulator ("**TPR**")) as part of each actuarial valuation carried out for the Scheme (usually every three years).
25. The funding approach that was agreed in respect of the actuarial valuation as at 2018 ("**2018 Valuation**") is consistent with that which has been adopted by the Scheme since the current "scheme specific" funding regime came into force in 2005. As part of the 2018 Valuation, the Trustee and TfL entered into a legally binding agreement which provides additional security through an annual review of any excess of liabilities over assets. During the year ended 31 March 2021, additional deficit reduction contributions of £25.6m were paid by TfL to the Scheme under this agreement.
26. While there have been considerable fluctuations in the assessed funding level of the Scheme over this period, and the assessed cost of ongoing benefit accrual has been rising in recent years, this funding approach has resulted in the overall level of contributions paid to the Scheme by TfL remaining very stable at six to seven times the 5% level of contributions payable by contributing members. This supports the Trustee's view that, despite very significant changes in financial markets and the environment in which TfL is operating over the period from 2006 to 2018, the Scheme has remained sustainable.
27. Much of the increase in the value placed on the Scheme's liabilities and in the cost of ongoing benefit accrual over the last 10 years is a result of the reduction in interest rates and the consequent reduction in discount rates used to value future pension payments. If, as anticipated by many investment professionals, interest rates increase in the long term, then the value of the Scheme's liabilities and the assessed cost of benefit accrual would be expected to reduce compared with current levels. Long-term sustainability should therefore not be judged purely in terms of costs assessed based on current market conditions, not least because these conditions lie far from historical norms.
28. The Scheme is in the process of carrying out its next actuarial valuation as at 31 March 2021. Although it is premature to comment on its likely outcome, the Trustee notes that, using the approach and assumptions adopted for the 2018 Valuation updated to reflect prevailing market conditions and the Scheme's latest target asset allocation, the Scheme's funding level at 31 March 2021 is currently estimated to be around 100%. Therefore, if there is no change to the investment strategy or risk tolerance of the Trustee, the Scheme is expected to have sufficient capital to meet the payment of benefits that have accrued to date, without needing additional deficit contributions from TfL (above meeting the cost of further accrual).

### *Investment strategy*

29. In the same way as it does in relation to the funding of the Scheme, the Trustee adopts a long-term view in relation to its investment strategy for the Scheme. This provides a competitive advantage versus other investors, including other private sector, 'defined benefit' pension schemes (which are typically closed to either new members or new accrual). In particular, as a long-term investor, the Trustee is able to invest in assets which have historically delivered higher returns and are expected to deliver higher returns over the long-term, within the constraints of an agreed risk budget. This, in turn, allows the funding strategy to be based on these long-term return expectations.
30. Whilst short-term "mark-to-market" volatility is an important consideration, the Trustee's primary focus is on the longer-term risk/return trade-off and the implications of alternative strategies on the ability to pay members' benefits and the balance between contributions and investment returns needed. The long-term outlook also presents a wider range of investment opportunities to achieve a higher return, such as a higher allocation to less liquid investments (investments which are expected to be more difficult or costly to sell). This leads to an efficient investment portfolio which supports the provision of the Scheme's benefits over the long-term.



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***Question 2: How should long term affordability be viewed, and how does this look from the perspective of members, the employer, taxpayers, farepayers, the Trustee and others? What are the key features of long-term affordability for the pension arrangements of TFL?***

31. The Trustee primarily assesses the “affordability” of TfL’s pension arrangements by reference to the amount of the contributions agreed at each actuarial valuation and whether TfL is in a position to pay those contributions when they become due.
32. The Trustee notes that, to date, the contributions have represented a relatively small proportion of TfL’s total income.



**Question 3: What do you consider to be the key risks and challenges in the short-, medium- and long-term in relation to the Scheme (for example, investment risk, salary risk, longevity risk) and how could these risks and challenges be mitigated?**

*Introduction*

33. As an institutional investor, and a large, 'open' pension scheme, the Scheme is exposed to a range of financial and non-financial risks as outlined below. Exposure to such risks is not necessarily a concern, if they are understood, measured, and monitored, and are appropriately sized in the context of the overall operations and strategy of the Scheme. In addition, a number of the financial risks (such as equity or illiquidity risks) are considered "rewarded risks" – that is, the Scheme's investments in this regard are expected to generate a higher level of long-term return as compensation for the short-term risks the Scheme is exposed to.
34. It is important to note that the open nature of the Scheme means that the 'long term' is much longer than for many other pension schemes. The Scheme is able to make investment and other decisions taking this into account, which can be a source of competitive advantage and operational efficiency gains compared with other pension schemes. Any material change to the open nature of the Scheme would lead to a fundamental reassessment of the funding and investment strategy, potentially leading to significantly increased costs and an increase in the level of contributions required from TfL and other participating employers in the Scheme.
35. Approaching the question more broadly, the Trustee is concerned that decisions could be made which have the potential to adversely impact members' benefits whilst the financial impact of the pandemic on TfL is still being keenly felt. It risks such decisions being based on short-term and/or potentially politically motivated grounds without proper regard to the longer term, and without taking into account the unique circumstances of the Scheme and the hugely positive benefits it provides to TfL as well as its employees and former employees.

*Investment risk*

36. As a result of the nature of the investment portfolio, the Scheme is exposed to mark-to-market investment volatility. This is the risk that the Scheme's assets experience large changes in value (either up or down); a material fall in market value as a result of adverse market events can result in a worsened funding position and a reduced surplus/increased deficit relative to the funding approach.
37. In certain circumstances, poor performance in investment markets may be offset by an increase in the future expected return of the asset class. This may increase the liability discount rate and provide an offsetting impact to the funding position. The size of the portfolio and a desire to ensure that the portfolio remains appropriately liquid means that the risks associated with investing in equity markets represent the most material element.
38. The Trustee has a number of risk mitigation measures already in place:
- (1) The Scheme has a highly diversified portfolio invested across a wide range of asset classes, including equities and bonds, invested in assets that are exposed to many countries and their economic growth, through many different investment strategies. The diversification this provides is intended to reduce the impact of a material downside event on the Scheme's funding position. In recent years, the Trustee has actively looked to increase the amount of diversification within the portfolio through disinvesting out of public equity and into a range of alternative asset classes, including hedge funds, alternative credit, and private markets. The Trustee is two years into a four-year "implementation roadmap" to facilitate additional disinvestment from equity markets and investment into a range of alternative asset classes to further increase the level of diversification and improve the investment efficiency of the portfolio;
  - (2) The Scheme has implemented an equity options protection strategy which provides some protection against a material downside event in equity markets;
  - (3) The Trustee undertakes a detailed review of the investment strategy at least every three years and monitors both the funding position and the level of risk being run on a quarterly basis (for example, with the use of Value at Risk metrics). A series of triggers for a review of the investment strategy are also monitored on a quarterly basis;



- (4) Whilst monitoring market conditions and the implications on the funding position on a quarterly basis, the Trustee is more focussed on the longer-term ability to pay members' and other beneficiaries' pensions and other benefits as they fall due. Consistently with this, the Trustee would typically expect to not sell assets following a material market event, but instead would look to hold the assets and take a long-term view and so be able to take advantage of market corrections as conditions improve – the most recent example of this is the impact of the fall in markets seen in the first quarter of 2020, followed by the swift rebound over the rest of 2020 and into 2021; and
  - (5) The Trustee recognises that climate change poses a clear and present risk, and in some cases an opportunity, to the future returns of a number of the asset classes within the Scheme's investment portfolio. The Trustee has taken a number of steps to reduce the carbon exposure of the portfolio including through restriction on investment in thermal coal, targeted engagement programmes with managers and underlying portfolio companies, and commitments to projects with a positive environmental impact. The Trustee is in the process of agreeing an ambitious "Carbon Neutral Journey Plan" to further manage the reduction of carbon emissions over time.
39. The risk mitigation measures outlined above have been demonstrated to mitigate against material falls in asset values, for example during the market volatility experienced in the first quarter of 2020 as a result of concerns about COVID-19. Over the quarter, the Scheme's return-seeking assets performed considerably better than global equity markets as a result of the diversification away from public equities and into liquid alternatives and private markets, and the protection provided by the Scheme's equity options protection strategy.
40. Additional possible risk mitigation measures which the Trustee keeps under review include:
- (1) Further reducing the level of risk within the investment portfolio;
  - (2) The use of additional insurance strategies (such as the existing equity options protection strategy) to reduce the impact of downside events; and
  - (3) Interest rate and/or inflation hedging strategies, as is often the case for typical 'defined benefit' pension schemes (which are closed to either new accrual or new members). However, the Trustee notes the Scheme is both open and very long-term in nature and the Scheme's current investment strategy reflects this.

#### *Liquidity risk*

41. The Scheme retains a relatively large allocation to listed equities and other highly liquid assets, which in total comprise over 75% of its total portfolio. The Scheme is also invested in a number of illiquid (or potentially illiquid in stressed market scenarios) investment strategies, which provide access to the illiquidity risk premium. In theory, the Scheme is exposed in respect of these illiquid or potentially illiquid assets to short-term liquidity risk, which is the risk that the Scheme has insufficient cash available to meet its short-term cash requirements, such as paying benefits and other expenses, meeting collateral calls from the investment portfolio, and meeting capital calls from private markets managers.
42. However, the Trustee has a number of risk mitigation measures in place in this regard:
- (1) The cashflow-positive nature of the Scheme reduces the likelihood of cash needing to be generated (either organically or through asset sales) to meet day-to-day cash requirements;
  - (2) The Scheme has a very large amount of liquidity which is far more than would ever be required for the day to day management of the Scheme's cashflows. For example, the Scheme could realise more than 66% of its total assets within five days, which is a far greater amount of liquidity than would ever be needed for the operation of the Scheme; and
  - (3) The expected and potential cash requirements of the Scheme outside of this are monitored on an ongoing basis, and periodic disinvestments are made from the Scheme's liquid assets to ensure a cost effective and orderly realisation of assets if ever needed.
43. In practice therefore the Trustee does not consider liquidity risk to be a material risk to the Scheme.

#### *Investment modelling risk*

44. At each actuarial valuation, a key actuarial assumption is the level of future anticipated investment returns (known as the "discount rate"). This is made using an investment model regarding future return expectations on the Scheme's actual investment strategy.



45. There is the risk that this modelling process, which focuses on long-term returns relative to cash rates, generates changes in discount rates from time to time that diverge from short-term market returns. This translates to potential short-term volatility in the assessed funding position. The Trustee seeks to mitigate this risk through the flexibility in the contributions that have been agreed by TfL.
46. In the longer term, there is the risk that actual returns on the Fund's assets are lower than the prudent return assumptions made by the Trustee for funding purposes.
47. The Trustee seeks to mitigate this longer-term risk by diversifying the portfolio between a range of assets and reviewing the suitability of the portfolio on an ongoing basis. The Trustee also:
- (1) takes a prudent approach to the modelling, rather than best estimate expected returns, in determining the appropriate liability discount rate, which increases the likelihood of the return on the investment portfolio being sufficient to meet the liabilities; and
  - (2) monitors the development of the discount rate regularly, with full reviews at each actuarial valuation and otherwise through regular quarterly monitoring.
48. The modelling approach for the discount rate takes into account a range of sources, including not only market yields but also views of finance and investment experts (such as economists, central banks, fund managers and academics) regarding future return expectations. The focus is to generate a sensible, prudent view on the long-term return expectations, not one that is fixed relative to some arbitrary risk-free measure.
49. Poor returns relative to expectations may also arise from lower performance from individual asset classes or individual active investment managers not performing in line with expectations. The Scheme is also exposed to the risk that it is unable to source sufficient high-quality investment opportunities to meet the long-term expected return of the portfolio.
50. A key mitigating factor is that the Trustee ensures that the in-house investment team, which is responsible for the day-to-day management of the assets, is resourced as required, and makes appropriate use of external advisors to support the sourcing and monitoring of high-quality investment opportunities.
51. A detailed triennial review of the investment strategy also considers whether the portfolio should be evolved to reflect changes in market conditions, available opportunities or Trustee views. This looks to ensure that the Trustee is maximising the potential returns from the assets whilst keeping risk levels within the Trustee's risk appetite, whilst taking into account any changes to the Trustee's risk appetite as a result of changing market conditions, covenant strength, or other factors.
52. As part of the Trustee's investment process, the long-term sustainability of the investment portfolio is considered within the investment strategy, portfolio construction, and ongoing monitoring processes. This process helps to mitigate the risk of investment decisions having long-term detrimental effects to experienced investment returns. This includes consideration of environmental, social and governance risk and opportunities, and ensuring the Scheme's investment managers are making long-term decisions in line with the Scheme's time horizon.

#### *Inflation risk*

53. The Scheme is also exposed to inflation risk, through the risk that increased inflation (either experienced or expected) increases the liabilities to a greater extent than the assets. This is a component of the risk that the actual returns on the Scheme's assets are lower than the prudent discount rate assumption.
54. The Scheme has taken a number of mitigating actions through making investments to assets which either have an explicit link (such as index-linked gilts and secure income assets), or an implied link (such as gold or equities), to expected or experienced inflation.
55. Additional possible risk mitigation measures which the Trustee keeps under review include increasing the Scheme's exposure to assets with explicit inflation linkages, for example increasing the exposure to index-linked gilts and inflation swaps.

#### *Salary risk*

56. Following discussions with TfL in relation to each actuarial valuation, the Trustee agrees a prudent salary growth assumption for funding purposes. The Trustee notes that salary growth for pensions purposes is largely within the control of TfL. Specifically, under TfL's current remuneration structure, an increasing proportion of remuneration is provided in the form of non-consolidated lump sums rather than pay increases, thus limiting the risk to the Scheme of large increases in pensionable salary.



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*Longevity risk*

57. The Fund is exposed to what is known as longevity risk (i.e. the risk that members and other beneficiaries of the Scheme live longer than expected). However, the Trustee considers it has made prudent allowance for longevity in the funding approach.
58. At each actuarial valuation, the Trustee reviews in detail the actual mortality experience of the Scheme's membership. It has also periodically supplemented this with additional longevity modelling investigations, such as assessing longevity based on a number of risk factors known to influence mortality, such as pension size and pensioner location.
59. The Trustee is well aware of the improvements in longevity that have been seen generally in the wider population over recent decades. This knowledge has been built into the Trustee's longevity assumptions for many years, and the Trustee makes prudent allowance for future improvements in longevity for funding purposes.
60. The Trustee considers its approach to monitoring longevity and making periodic adjustments to its prudent longevity assumptions for funding purposes to be an appropriate way to manage the longevity risk. Longevity risk is also partially mitigated by its lack of correlation with investment risks.
61. It would be possible to mitigate some of the Scheme's longevity risk by transferring it to the insurance market via a longevity swap or bulk annuity. This market is well established for pension schemes of similar size to the Scheme, albeit to a lesser extent for non-pensioners. This option therefore exists for the Scheme, and is expected to remain so in the future.

*Other demographic risks*

62. Due to the range of benefit options available to members, and the possible path a member might take through his or her membership of the Scheme, there are a number of other demographic risks. Assumptions regarding these are made, and reassessed, at each actuarial valuation, such as the one currently underway as at 31 March 2021, to reflect emerging Scheme experience and wider population data. These assumptions include in-service experience (which in practice may vary between different employee groups) regarding such matters as early leavers, early/late/ill-health retirement, and also commutation, transfers and dependant statistics.
63. The Trustee does not consider, relative to the other risks addressed in this section, these other demographic risks to be significant. They are managed in a similar manner to longevity risk, by making and periodically reassessing prudent assumptions. Indeed, the funding position of the Scheme is not materially sensitive to a number of these options that are close to actuarially cost neutral (for example, early/late retirement terms).

*TfL's 'covenant' risk*

64. The TfL 'covenant' reflects TfL's legal obligation and its financial ability to support the Scheme both now and in the future, including any agreed deficit repair contributions. Consequently, any factor that materially impinges on this ability is a concern from the Trustee's perspective.
65. From this covenant perspective, the key risks relate to developments that could reduce TfL's income or increase its cost base. Examples of such risks include:
- (1) A slower than anticipated recovery in public transport usage as a result of COVID-19 thus negatively impacting income;
  - (2) A major health or security event incident or crisis;
  - (3) A failure to implement successfully TfL's longer-term projects (e.g. Crossrail, Bank Station capacity upgrade) and to invest at the required level to maintain TfL's infrastructure;
  - (4) An inability to continue to have access to financial markets as and when required;
  - (5) A reduction in the ability or willingness of the Government to provide financial support to TfL over and above existing funding requirements; and
  - (6) The impact of climate change on the operations of TfL over the medium term, resulting in interruptions in service and consequential major capital expenditure requirement.
66. These risks are monitored by the Trustee on a regular basis and discussed with TfL's management team. As a result, the Trustee believes these risks remain manageable, noting such factors as: the continued support from the UK Government during TfL's recent loss of revenue; the importance of the services that TfL provides; and the allowance made for deficit repair contributions within TfL's balanced budget framework.



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*Other risks and challenges*

67. As is the case for all other occupational pension schemes, the Scheme is subject to potential changes to the relevant legal environment, the tax regime, pension regulatory requirements/expectations, and changes to the regulatory investment landscape. The Trustee closely monitors these potential changes and, to the extent appropriate, takes steps to address their impact on the Scheme.

*Risk of short-term and/or inadequate decision-making*

68. The Trustee recognises the financial challenges that TfL is currently facing, and the extent of the financial support that Government has provided and will need to continue to provide for some time, given the impact of the Covid-19 pandemic and the Government's decisions in response to it on public transport travel in London.
69. Nonetheless, as noted at paragraph 35 above, the Trustee is concerned that decisions could be made which have the potential to adversely impact members' benefits whilst the financial impact of the pandemic on TfL is still being keenly felt. It risks such decisions being based on short-term and/or potentially politically motivated grounds without proper regard to the longer term, and without taking into account the unique circumstances of the Scheme and the hugely positive benefits it provides to TfL as well as its employees and former employees.



**Question 6: How are the current pension arrangements valued by TfL's staff? How important are the current pension arrangements in recruiting new staff and retaining existing staff?**

*Introduction*

70. In the Trustee's view, the Scheme provides members with a high degree of reassurance that they and their dependants will be able to enjoy an adequate retirement.
71. Furthermore, as is clear from TfL's own website, the provision by the Scheme of a range of high quality pension options for members (including ill-health and other benefits which may be particularly highly valued for a wide range of employees including those with physically and/or mentally demanding roles) is a key element in staff recruitment and retention, which in turn contributes to the continued safe and efficient running of London's critical transport infrastructure.
72. The value of the Scheme to TfL's current and former employees is also reflected in their engagement with the Scheme (both directly and through their representative organisations) stretching back to the establishment of the Scheme itself.

*Member engagement throughout the history of the Scheme*

73. The Scheme was established in 1989 as a result of the merger of two pre-existing pension schemes for staff and wages grade employees of London Regional Transport ("LRT").
74. In the mid-1980s, LRT had wished to pursue a policy of amalgamating both pension schemes into a single pension scheme with one administrative body, comprising equal representation of management and staff, combining the current functions of the management committees and trustees. Discussions took place with a number of interested unions through a "joint working party on pensions" ("JWP") and that led to the Scheme's establishment.
75. Reflecting the importance of the Scheme to its members even shortly before its establishment, the initial proposal presented at the JWP provided that the Board of the intended LRT trustee company would be constituted with eight LRT nominated members including the Chairman, and eight from the members' side. (This principle of equal representation was subsequently established, and remains the position today.)
76. Furthermore, in a High Court case (known as *LRT v Hatt* (1993)), LRT was ordered to establish a "pensioners' forum" which would meet from time to time to discuss pension matters affecting pensioners and deferred pensioners. This was in addition to the Pensions Council for contributing members which already existed. This involvement of members in bodies associated with the Scheme continues today through the TfL Pension Consultative Council.
77. Perhaps in contrast to the members of many other defined benefit ("DB") pension schemes, the history of the Scheme demonstrates that its members have been engaged with the Scheme and the benefits it offers right from the outset.
78. This engagement has continued ever since through, for example, the online portal, the Scheme's website, and the regular communications that the Scheme provides such as annual pension statements, newsletters and the annual general meeting. And, with greater information and financial education in the public domain about the benefits of DB pensions, it is the Trustee's experience that members' awareness and appreciation of their benefits under the Scheme has also continued to grow.



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**Question 7: Are there any considerations or criteria the review should consider?***Relevant funding basis*

79. In the response to question 1, it is noted that the Trustee views the statutory funding basis to be an appropriate measure to view the long-term sustainability of the Scheme. Other valuation measures are routinely calculated either by the Trustee (such as those known as 'solvency', 'PPF / Section 179') or by TfL ('IAS19 accounting').
80. The Trustee does not consider those other measures as appropriate to assess the long-term viability of an ongoing pension scheme such as the Scheme. The solvency and PPF / Section 179 bases consider the scenario of the Scheme ceasing to have a sponsoring employer. The IAS19 accounting basis values liabilities using a discount rate set by reference to prevailing market yields on corporate debt, which bears no relation to the expected returns from the Scheme's actual investment strategy.

*Member expectations*

81. The Trustee notes that, as part of their overall remuneration package, active members of the Scheme (who contribute a percentage of their annual salary to the funding of the Scheme) may well have a genuine expectation to automatic enrolment in the Scheme on the current benefit and contribution structure that will continue in its current form for the duration of their careers with TfL.
82. The Trustee believes this to be an entirely appropriate consideration for the Review.

*Operational efficiencies*

83. The Trustee believes that the way the Scheme is administered and the associated cost of doing so are important factors to take into account in the Review. Through its Board (which includes an independent chair), the Trustee monitors and actively manages both closely to ensure that the service it provides through the Fund Office is first class whilst also being as cost efficient and cost effective as they can be.

*TfL's balanced budget obligation*

84. TfL is different from most businesses in that it is obliged to produce a balanced budget each year, does not seek to be profitable at the operating cash flow level, and makes no dividend or other payments to outside shareholders. The Trustee has taken these factors into account in coming to its assessment of the strength of the covenant.



**Question 8: Is there anything else you would like to add?**

85. When considering any reform options, the Independent Lead and TfL should ensure that they are fully aware of, and take into account, both the short-term costs and longer-term impact of any such changes on the Scheme.
86. Once the Independent Lead publishes a final list of the options under consideration, the Trustee will be in a position to provide further comments as appropriate. It is important to be aware that the costs of change – from long-term Scheme financing costs to short-term management time costs - could be very material.
87. The Scheme's funding level has improved significantly since the global financial crisis of 2008/09. It is the Trustee's position that from 2009 to the present date, the diversified investment strategy has produced positive results that have served to reduce the Scheme's reliance on the covenant over the longer term.
88. In addition to the responses to the questions set out above, the Trustee wishes to make the following comments in relation to Appendices 2 and 3 of the Call for Evidence. For this purpose, we have referred to the paragraphs in the applicable appendix to the Call for Evidence.

*Appendix 2*

89. Paragraphs 5.6 and 5.7: The Trustee notes the reduction in demand brought about by the Covid-19 pandemic for TfL's services, as has been illustrated on Appendix 2 - Chart 5. However, it also notes that this is unlikely to be permanent with demand expected to return to 90% of pre-pandemic levels by 2022/23 and to 2018/19 levels (i.e. pre Covid-19 levels) by 2024 under Management's 'Decarbonise by 2030' case.
90. The Trustee notes the current funding discussions between Government and TfL are taking place against a protracted decline in passenger numbers due to the Covid-19 pandemic. Although the timing of the recovery continues to be uncertain, as the number of people working from home reduces, the Trustee understand that TfL expects its revenue to recover. From the Scheme's perspective, the Trustee expects the underlying financial position of TfL (which will also include the beginning of commercial operations for Crossrail) to improve before the next actuarial valuation for the Scheme in 2024.
91. The support provided by Government to TfL in response to the Covid-19 pandemic has reinforced the Trustee's view that the network represents an essential element of London's infrastructure, benefitting not only the travelling public directly but also the wider commercial and hospitality sectors. This view in turn allows the Trustee to take a long-term view of TfL's financial position.
92. However, the Trustee does note that the fact that the Government's funding support has, to date, been short-term in nature and has prompted an examination of whether there has been any weakening of TfL's covenant over the longer term, which in turn is relevant to the level of risk that it is appropriate to take. In this respect, a longer-term funding solution will assist not only the financial position of TfL but also the longer-term viability of the Scheme.
93. More broadly, the Trustee believes TfL's wider role should be considered from a sustainability perspective:
- (1) It is essential as part of UK Government's target to achieve environmental sustainability; whilst this may require further government investment this will generate significant additional revenues and environmental long-term benefits (see TfL's Decarbonise by 2030 case).
  - (2) Its historically reliant on government support (Appendix 2 – Chart 1) and consequently its sustainability should be viewed more broadly than whether it requires medium term government support. For instance, it plays a crucial role in supporting the hospitality and tourism sector in London, providing jobs, income and tax support for the UK economy as a whole. This in turn has generated business rates revenue that has been used to fund Crossrail and other TfL investments.
  - (3) The nature of government support also plays an important role from a sustainability perspective with the current short-term funding agreement potentially weakening the sponsor employer covenant and thereby increasing the cost of the Scheme. Longer term government support would therefore be beneficial; this is in addition to the greater investment certainty it would provide from a wider TfL perspective.

*Appendix 3*

94. Paragraph 7.1: The Trustee agrees that the nature of the Scheme, as a private sector scheme sponsored by a public sector body, does not fit neatly within the current regulatory framework. The Trustee's view is that its unique circumstances should be recognised and more expressly taken into account within the regulatory framework.



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95. Paragraphs 7.2 and 7.3: For the avoidance of any doubt, the Trustee notes that Part 3 of the Pensions Act 2004 does not require “*increased levels of prudence and contributions in order to reduce risk over time*”. The Trustee also does not accept that it is TPR’s focus for the Scheme. Although the Trustee acknowledges that, speaking generally, it may be correct to describe this as the focus of TPR, it should also be noted that the reason for this general focus is because the majority of private sector defined benefit schemes are, unlike the Scheme, closed to new entrants and/or future accrual.
96. Paragraph 7.4: It is the Trustee and TfL who are responsible for ensuring that the Scheme is being funded in accordance with legal requirements. TPR has significant powers available to it in this regard, but the examples provided have never been exercised to date in relation to any pension scheme, let alone in relation to the Scheme. In addition, it should be noted that the governing documentation for the Scheme supplements the statutory funding regime (e.g. the Rules of the Scheme require TfL to pay a certain minimum level of contributions to the Scheme).
97. Paragraph 8.8: The Trustee notes that if the increase in value of Scheme assets keeps pace with the increase in Scheme liabilities resulting from lower expected future investment returns, then it is not ‘inevitable’ that a funding gap will arise. The experience of the Scheme over the period since 2006 has shown that it has been possible to maintain a relatively stable level of cash contributions expressed as a percentage of pensionable salary from TfL despite the significant reduction in expected returns over that period.
98. Paragraph 8.13: The Trustee does not disagree that population life expectancy has increased significantly since 1980. However, the Scheme has been able to incorporate this within the funding arrangements. In presenting a more balanced view on the topic, the Trustee would highlight the slow-down in improvements in life expectancy in the last 10 years, and the potential for COVID-19 to further exacerbate and even reverse that trend.
99. Paragraph 9.4: Chart 8 reflects the quarterly funding updates provided for the Trustee by the Scheme Actuary. Between actuarial valuations, these reflect a mechanistic update of the previously agreed valuation methodology, and it does not follow that the same assumptions would have been used had a full valuation been carried out at those interim dates. As evidenced above, the Scheme has been able to withstand such volatility by taking a long-term view and has maintained the overall cash cost of the Scheme to TfL within a stable range for many years. The Trustee does not believe that the extreme market volatility experienced in the first half of 2020 should form the basis for making decisions about the long-term future of the Scheme.
100. In addition, if Chart 8 was extended to show a longer period of history more consistent with the long-term context in which the Trustee believes the Scheme should be viewed, it would show actuarial valuations which revealed a funding surplus (e.g. in 2000).



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