TfL Pension Fund

Statement of Funding Principles

March 2019

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MAYOR OF LONDON

Transport for London

TfL Pension Fund – Public Sector Section

Statement of funding principles

This statement has been prepared by the Trustee of the TfL Pension Fund (the "Scheme") to satisfy the requirements of Section 223 of the Pensions Act 2004 (the "Act") and regulations made under the Act in relation to the Public Sector Section (the "Section") of the Scheme, after obtaining the advice of Gareth Oxtoby (the "Scheme Actuary"). The Trustee has discussed and agreed this statement with the Principal Employer, Transport for London ("TfL").

This statement covers the Section's statutory funding objective, the principles used to determine that objective and the Trustee's policy for securing that it is met. It contains other information required under the Act and relates to the actuarial valuation of the Section as at 31 March 2018.

Statutory funding objective

The statutory funding objective is that the Section must have sufficient and appropriate assets to cover its technical provisions. This statement sets out, among other things, the Trustee's policy for securing that this objective is met.

The Trustee will adopt a prudent approach when determining the assumptions used to calculate the technical provisions. Where appropriate it will consider whether, and to what degree, margins for adverse deviations should be taken into account when selecting this approach. The assumptions adopted will be chosen on the basis that the Section is not expected to be wound up in the foreseeable future.

TfL and the Trustee have agreed that, in relation to the matters covered in this statement, the Scheme Actuary will advise solely the Trustee. TfL will take advice from its own actuarial adviser.

Technical provisions

Method

The Section's "technical provisions" means the amount required, on an actuarial calculation, to make provision for the Section's liabilities. The method used in calculating the Section's technical provisions must be an accrued benefits funding method.

Having regard to the above, the Trustee and TfL have agreed that the Section's technical provisions at any given date are to be calculated as the capital value of the prospective benefits arising from service completed up to that date, including allowance for prospective salary increases for members in active service at that date and for prospective pension increases for all members. The regular contributions payable are at a level sufficient to provide for the accrual of technical provisions over the year following the effective date of the valuation and to meet expected regular non-investment expenses and Pension Protection Fund levies. Overall this method of determining the technical provisions is known as the projected unit credit method with a one-year control period.

Assumptions

The Trustee and TfL have further agreed that:

- prudent assumptions will be made regarding the future returns on the Section’s investments and future contributions, anticipating some of the additional returns expected to be obtained by holding investments other than gilts;
- the remaining financial assumptions, in particular future price inflation, will take into account information available in respect of economic conditions and bond markets at the effective date of the actuarial valuation;
- demographic assumptions will have regard to an analysis of recent changes in the Section’s and the Scheme’s membership as well as relevant statistics applicable to similar pension schemes and the Trustee’s and TfL’s views about how these may change in future.

Taken together, the assumptions adopted at a particular date will be prudent and consistent with the Trustee’s desired level of confidence that assets equal to the technical provisions will prove adequate to meet benefits already accrued as they fall due without the need for further contributions from TfL.

Discretionary benefits

There are a number of areas where the benefits payable are subject to some exercise of discretion on the part of the Trustee and/or TfL, the principal details of which are set out below:

- Pensions in deferment or in the course of payment are guaranteed under the Scheme rules to receive annual increases in line with price inflation (subject to a maximum of 5% in any one year in the case of New Members) (subject to statutory requirements). The Trustee, subject to the consent of TfL, has discretion to increase pensions above this level. For the purpose of calculating the technical provisions, the Trustee has agreed with TfL that no allowance will be made for any discretionary increases.
- At the request of any employer, and upon payment by that employer (and/or the member concerned) of any contributions that the Trustee (having consulted the Actuary) may decide, the Trustee may increase any benefit or provide additional benefits under the Section. The Trustee and TfL have agreed that such discretionary benefits will not be taken into account in the calculation of technical provisions, but that the capital value of any such benefits granted would be paid in full by the employer (and/or the member concerned) at the time the discretion is exercised.
- Members may commute pension for cash at retirement using commutation factors that are determined by the Trustee. The Trustee and TfL have agreed that an allowance should be made in the technical provisions to anticipate to some extent the financial effect of commutations.

Eliminating a shortfall

The Trustee and TfL have agreed that any funding shortfalls identified at an actuarial valuation of the Section should be eliminated as quickly as the employers can reasonably afford by means of a one-off additional contribution shortly after the valuation has been completed and/or by the payment of specified additional annual contributions and/or additional multiples of member contributions over the recovery period.

When determining the recovery plan the Trustee may take into account factors such as the size of the shortfall, the employers' business plans, the Trustee's assessment of the strength of the covenants from the employers and any contingent security offered by the employers.

Frequency of actuarial valuations

The Section's fifth actuarial valuation under Part 3 of the Pensions Act 2004 is being carried out as at 31 March 2018. In the normal course of events the Trustee will request subsequent valuations three years after the preceding one. The Scheme Actuary will provide an estimate of the up-to-date financial position of the Section, relative to the statutory funding objective, as at each 31 March for which a full valuation is not requested.

The Trustee and TfL recognise that there is likely to be short-term volatility between the value of assets and the technical provisions. The Pensions Funding Agreement ("the Agreement") agreed by the Trustee and TfL in conjunction with the 2018 actuarial valuation and dated 22 March 2019 sets out certain circumstances in which the annual updates referred to above may lead to the payment of additional one-off lump sums to the Section by TfL. The updates provided by the Scheme Actuary will not normally lead to further changes in the required contributions ahead of the next valuation unless, after discussion, the Trustee and TfL agree that changes are required.

The Trustee may call for a formal funding valuation at any date if it is of the opinion that events have made it unsafe to rely on the results of the previous valuation for funding purposes. In reaching such a view, the Trustee will consider the advice of the Scheme Actuary and consult with TfL.

Actuarial valuation as at 31 March 2018

The Trustee (having taken the advice of the Scheme Actuary) and TfL have agreed assumptions for the valuation as at 31 March 2018, in line with the process described above. The Trustee has based the investment return assumptions on the Section's target asset allocation as at 31 March 2018 and has assumed this will continue unchanged.

Financial assumptions as at 31 March 2018

The financial assumptions made for the purpose of establishing the technical provisions, when assessing the contributions required to meet future service benefit accruals and in respect of meeting the funding shortfall, are set out below.

	% pa
Investment return for valuing accrued benefits	Term dependent discount rate trending from a nominal rate of 4.84% per annum to 4.54% over 10 years from 1 April 2018
Investment return for calculating cost of future accrual	5.16
Investment return assumed in recovery plan	5.31
RPI inflation	3.4
CPI inflation	2.4
Increases in Lower Earnings Limit	2.4
General increases in pensionable pay	3.65
Pension increases in payment	
- Pre-6.4.88 GMP	0.0
- Post-5.4.88 GMP	2.1
- Non-GMP	
- Existing Members	3.4
- New Members	3.2
Pension increases in deferment	
- GMP (section 148)	3.9
- Non-GMP	
- Existing Members	3.4
- New Members	3.2

Notes to table of financial assumptions

1. Investment returns are modelled using the 'yield reversion' parameterisation of the Willis Towers Watson investment model, over the average term of the Section's liabilities (18 years for the 2018 actuarial valuation), except as where noted below
2. Investment return for valuing accrued benefits calculated as a 65% confidence return as at 31 March 2018, tending to a 70% confidence return by 31 March 2028
3. Investment return for calculating cost of future accrual calculated as a 60% confidence return
4. Investment return for the purposes of the 2018 recovery plan calculated as a 60% confidence return assessed over 20 years
5. RPI inflation assumption reflects gilt yield-implied inflation at terms when the majority of accrued Scheme benefits are expected to be paid. CPI inflation assumed to equal RPI-1% pa, and general increases in pensionable pay assumed to equal RPI+0.25% pa
6. Pension increase assumptions reflect assumed inflation volatility of 1.9% pa for RPI and 1.5% pa for CPI.
7. Promotional increases in pensionable pay as set out in the Appendix apply in addition to the allowance for general increases in pensionable pay described above.

For the purpose of determining the contributions required for the recovery plan and also for the purpose of determining whether or not the Scheme Actuary can certify the schedule of contributions, the Trustee and TfL may agree to make allowance for the Section's assets to earn an additional investment return above that assumed for the purposes of establishing the technical provisions and assessing the contributions required to meet future service benefit accruals. For the purposes of the recovery plan and schedule of contributions to be agreed in conjunction with the valuation of the Section as at 31 March 2018, a small additional allowance has been made in this regard as described in the table above.

Demographic assumptions as at 31 March 2018

Details (including sample rates) of the demographic assumptions are shown in the appendix to this statement.

Expenses

Investment management costs are assumed to be met out of future investment income and the assumed investment return is regarded as being net of such costs. Non-investment expenses payable by the Scheme and Pension Protection Fund (PPF) levies are met in full by the Section from its resources as they arise. An allowance of 0.4% of pensionable payroll (equivalent to 0.08 times member contributions) is included within the employer contribution rate to cover those non-investment expenses other than PPF levies. An allowance of 0.8% of pensionable payroll (equivalent to 0.16 times member contributions) is included to cover PPF levies.

GMP Equalisation

For the purposes of the 2018 actuarial valuation of the Scheme, the Trustee and TfL have agreed to include an allowance of 0.5% of the value of the accrued Section liabilities in the technical provisions as an estimate of the additional liabilities potentially arising from a requirement to equalise for the effect of Guaranteed Minimum Pensions (GMPs) in the Scheme. This reflects approximate calculations, taking into account the Section's membership characteristics and the Scheme Rules; the actual costs to the Section of implementing equalisation for the effect of GMPs in due course may be different.

Recovery plan

The Trustee has agreed with TfL that the shortfall of funds below the technical provisions revealed by the valuation as at 31 March 2018 should be made good over a period of seven years two months from 1 April 2019 by the payment for this period of additional employer contributions equivalent to £70m per annum, increased at the start of each Scheme Year commencing with effect from 1 April 2020 in line with the Agreed Index (as defined in the Schedule of Contributions dated 1 April 2019).

Full terms are set out in the recovery plan dated 22 March 2019.

The Agreement also contains provisions for the payment of additional deficit contributions in the event that future triennial valuations reveal a worsening of the Scheme's financial position.

Arrangements for other parties to contribute to the Section

There are no arrangements for a person other than the Participating Employers or a member of the Section to contribute to the funds held by the Section.

Payments of funding surpluses to the employers

The Scheme rules do not include provisions for the Trustee to make payments to the Participating Employers out of funds held for the purposes of the Section unless there exists a surplus following a winding up of the Section.

Cash equivalent transfer value calculations

The Trustee will from time to time consider whether or not to reduce cash equivalent transfer values in the light of the Section's financial position and the amount and volume of cash equivalent payments made from the Section. At the time of preparing this statement, the Trustee was not reducing cash equivalent transfer values.

Dates of review of this statement

This statement will be reviewed, and if necessary revised with the agreement of TfL, by the Trustee either:

- within 15 months after the effective date of each actuarial valuation; or
- within a reasonable period after any occasion on which the Regulator has used its powers to modify future accrual of the Section, directed as to the manner in which technical provisions are to be calculated or the period over which failure to meet the statutory funding objective is to be remedied, or imposed a schedule of contributions.

The Trustee may also elect to review, and if necessary revise with the agreement of TfL, the statement at other times.

Date of statement (for reference purposes): 22 March 2019

Signed on behalf of Transport for London

Signed

Print name S Kilonback

Position Chief Finance Officer

Signed on behalf of TfL Trustee Company Limited
acting as the Trustee of the Scheme

Signed

Print name M Antoniou

Position Chair

Date 22 March 2019 Date 22 March 2019

The demographic assumptions to be adopted for the purposes of the 2018 actuarial valuation of the Section are summarised below. The demographic assumptions to be adopted for future actuarial valuations will be agreed by the Trustee and TfL at the time, taking into account relevant Scheme experience as well as relevant statistics applicable to similar pension schemes and the Trustee's and TfL's views about how these may change in future.

In-service – specimen decrement rates per 10,000 members at each age and salary scale

	Withdrawal rates		Mortality rates		Ill-health retirement rates		Other early retirement rates		Salary scale	
Age	**males**	**females**	**males**	**females**	**males**	**females**	**males**	**females**	**males**	**females**
25	572	778	2	2	2	1	-	-	904	1,002
30	457	584	2	2	2	5	-	-	1,087	1,230
35	343	389	2	3	8	11	-	-	1,190	1,365
40	248	292	5	4	19	17	-	-	1,270	1,465
45	152	195	6	5	27	23	-	-	1,337	1,465
50	57	117	13	9	38	46	-	-	1,337	1,465
55	4	19	22	14	68	84	500	500	1,337	1,465
60	-	-	30	20	122	139	1,500	1,500	1,337	1,465

The table above shows, for each gender and for specimen ages, the rate at which members are assumed to leave service each year by the various means of exit. For example, for every 10,000 males aged 50, within a one-year period 57 are assumed to withdraw, 13 are assumed to die, 38 are assumed to retire on ill health and none are assumed to retire early in normal health.

The salary scale shows how salary is assumed to increase at each age due to merit increases. For example, for a male, salary is assumed to increase from age 40 to 45 by 5.3% (= 1,337 ÷ 1,270 - 1). General inflationary increases are assumed to apply in addition.

Mortality rates in deferment/retirement

Current mortality in deferment and payment is assumed to be in line with the following tables, projected to 2018 in line with the CMI_2015 1.6% model for the appropriate gender:

male members who retire on grounds of ill health	S2IMA	x 116%
female members who retire on grounds of ill health	S2IFA	x 109%
other male members	S2NMA	x 122%
other female members	S2NFA	x 122%
male dependants	S2NMAH	x 113%
female dependants	S2DFA	x 124%

Allowance is made for mortality improvements after 2018 in line with the CMI_2017 1.5% model for the appropriate gender.

Family statistics

The proportion of members assumed to have dependants varies with age and reaches a maximum of 80% for males and 60% for females at age 60. Members are assumed to be of the opposite gender to their dependants. The age difference (male member – dependant) or (dependant – female member) ranges from 2 to 3.5 years, depending on age.

Allowance for option of members to commute pension for cash at retirement

It is assumed that members will commute 24% of pension at retirement, on the commutation terms in force at the valuation date (adjusted to reflect assumed future mortality improvements appropriate to each member's year of birth).

Allowance for retirement of deferred pensioners before vesting age

It is assumed that each deferred pensioner retires at his or her vesting age (60 in most cases, but 62 for males who left service before 1 April 1989).

Allowance for deferred pensioners to take cash equivalent transfer values

It is assumed that no cash equivalent transfer values will be paid.

Allowance for late retirement

It is assumed that:

- all active members who are under age 65 at the valuation date retire by age 65;
- all active members who are age 65 or over at the valuation date retire immediately;
- all deferred pensioners who are below vesting age at the valuation date retire at vesting age ;
- all deferred pensioners who are at or over vesting age at the valuation date retire immediately.

A 2% loading is added to the total deferred pensioner liabilities for the strains arising on late retirement.

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For further help or information

Please contact the Fund Office if you have any questions about this document.
Contact details are shown below.

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