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Dear Bernadette

TfL Pensions Review

I am writing in response to HM Government's (HMG) letter of 24 February 2023 (the 24 February letter), which provided HMG's high-level response to TfL's pensions related submissions required by the Funding and Financing Agreement dated 30 August 2022 (the Funding Agreement), including the pensions options paper of 14 October 2022[1] (the 14 October submission). I would like to confirm at the outset, that TfL remains committed to continuing to deliver the requirements of the Funding Agreement.

A copy of the 24 February letter is attached at Appendix 1 and a summary of the options contained in TfL's 14 October submission is included for reference at Appendix 2.

The 24 February letter set out which options HMG would and would not be willing to support. We understand from this letter that HMG would support an option to move from the TfL Pension Fund (the Scheme) to an existing funded public sector scheme for the provision of past and future service benefits - that is, a move to the Local Government Pension Scheme (LGPS), which we believe is the only relevant existing funded public sector scheme for these purposes. Conversely, the 24 February letter made clear that HMG would not support a new or existing unfunded public sector scheme or a new funded public sector scheme. HMG has also previously said it would not support the provision of a Crown guarantee.

[1] https://content.tfl.gov.uk/pensions-position-paper-14-october-2022.pdf

The 24 February letter also referred to HMG supporting a new or existing private sector scheme. We interpret this to mean a reform option in a private sector context, rather than a “Do Nothing” option, which you may wish to clarify. We do not believe that a private sector option is feasible on the basis that HMG has not expressed a willingness to provide the additional funding that would be required (and, as noted above, does not support the provision of a Crown guarantee) to address the significant financial risks inherent in this option. TfL has made clear in every submission it has made to date, the principal challenge facing the Scheme is the potential for large increases in costs in relation to past service liabilities owing to the potential risk and volatility in the Scheme funding position as the Scheme continues to grow, compounded by the unnecessary cost and risk resulting from private sector treatment and associated regulation. Reform in a private sector context would not address these risks. In fact, depending on how reform in a private sector arrangement is delivered, it may compound these risks further and lead to significant deterioration in the funding position of the Scheme (potentially leading to a deficit of up to £6bn based on a recent estimate). This risk was described in further detail in TfL’s 27 September 2022 submission[2].

It remains our firm view that private sector treatment of the Scheme is simply not appropriate for a public sector body like TfL, and we have been clear that we would be willing to consider approaches that allow these risks to be better managed in a public sector scheme, where a more reasonable approach to funding and investment could be applied and unnecessary cost and risk could therefore be avoided. The question then becomes how this might be best delivered, in a way that is both fair to members, fare-payers and taxpayers and delivers the best outcome for the public sector as a whole.

In considering this question, we have previously made clear that in any option, HMG support will be required. Therefore, given that reform in a new or existing private sector scheme is not feasible without HMG’s support for the associated risks, the only remaining option set out in the 24 February letter that HMG is willing to support is a move to the LGPS (HMG’s supported option). This effectively means that all other alternative approaches set out in the 14 October submission cannot be considered further because without HMG support, these simply cannot be delivered.

The next step, in accordance with the Funding Agreement (and the 24 February letter), is for TfL and the Mayor to agree with HMG a final detailed proposal and implementation plan by 17 March 2023 (extended by HMG from the original date of 31 January 2023). However, there are several fundamental outstanding practical and technical matters not addressed by the 24 February letter that will ultimately determine the deliverability, value for money and fairness of HMG’s supported option and will need to be resolved before any agreement can be reached. Before any further progress can be made, TfL will need assurances in relation to several critical matters as follows:

[2] https://content.tfl.gov.uk/tfl-response-to-pension-review-final-report.pdf

i. How members' past service benefits built to date will be protected on a mirror image basis without detriment (including maintaining the final salary link), as was the case for other public sector pensions reform that has been progressed. This is an absolutely essential requirement for any potential option and must be met;

ii. How future service benefits would be protected for those who HMG afforded statutory protected status as a result of the London Underground PPP arrangements[3]; and

iii. Noting that the LGPS does not currently appear to have any mechanisms to deliver (i) and (ii) above, confirmation that legislation will be made available to achieve these and also override the Scheme Rules where necessary (for example in relation to bulk transfers of past service assets and liabilities and closing the Scheme to the future build-up of benefits). This includes information and assurances regarding the type and scope (including the outline) of legislation needed along with the expected legislative timetable for HMG's supported option.

It is also the case that HMG's 24 February letter did not contain sufficient information to enable us to understand HMG's views of how the LGPS option compares to alternative potential approaches in relation to the assessment criteria set out by HMG in the Funding Agreement, including in relation to fairness. It will be important to have access to the detailed analysis that HMG has conducted in order to reach agreement on a final detailed proposal.

Without HMG's detailed analysis, it remains our firm view that alternative potential approaches considered in the 14 October submission are likely to be capable of delivering better outcomes than moving to the LGPS when reviewed against all of the assessment criteria set out in the Funding Agreement and, therefore, should remain under consideration. For example, if a new funded public sector scheme were to be considered, this is likely to be far less complex to implement than moving to the LGPS (for past and future service benefits), particularly in relation to the matters set out in (i), (ii) and (iii) above and would offer greater flexibility to deliver outcomes that are fair to members, fare-payers and taxpayers.

To resolve this, and other important matters that will impact the ability to agree a final detailed proposal, please can you provide:

iv. HMG's rationale for the inclusion of support for a move to the LGPS and the exclusion of support for the other alternative options contained within the 14 October submission, in accordance with the assessment criteria set out in the Funding Agreement and more generally in relation to value for money on a whole of public sector basis;

[3] See Schedule 32 of the Greater London Authority Act 1999 and the London Transport Pension Arrangements Order 2000.

v. HMG's decision-making processes in relation to this matter, including the extent of any anticipated ministerial involvement and commitment given that, to date, discussions have been conducted at official level; and

vi. Confirmation of cross-Government support, which we note from the 24 February letter that HMG's support is subject to, including the process to ensure there is joint engagement with all relevant HMG departments, including the Department of Levelling Up, Housing and Communities (DLUHC), who hold responsibility for the LGPS.

The 24 February letter also refers to HMG's view that it is not appropriate to treat TfL differently to other schemes in a similar position, in terms of the support HMG is willing to provide. It is not clear which schemes HMG is specifically comparing the Scheme to. Nevertheless, we are aware that in all other cases of public sector pensions reform (including legislation that is currently being progressed in relation to the reform of the Nuclear Decommissioning Authority schemes[4]), that past service has been fully protected in the way we describe in (i) above and that it is Government policy for reform to apply to future accruals only[5]. We therefore assume that, in providing the assurances we require, HMG will support the same approach being applied to TfL, as a public sector body.

As set out above, TfL remains committed to reaching agreement on a way forward in accordance with the Funding Agreement. But until we have a clear and shared understanding that any potential proposal is deliverable (including in relation to protection of members' benefits built up to date and protected persons); is agreed across government; is fair, affordable and sustainable; and generates the best outcome for the public sector as a whole; it is not possible to agree a final detailed proposal.

It is also the case that TfL's ability to prepare for and meet the requirement of the Funding Agreement in relation to consultation progressing in May 2023, should that be appropriate, will be dependent on the timing of reaching agreement on a final detailed proposal and, on this basis, we do not believe that May 2023 is now achievable. This will also be affected by the detailed implications of the matters referred to in this letter and any further matters that may be identified as work progresses. Consequently, we should discuss and agree a revised date for any consultation that may be required once we have received the required information and assurances and have discussed this with you in detail.

It is important to be clear that the options discussed in this letter are not proposals for reform and, given the above considerations, "do nothing" remains an option. The implementation of anything else will remain subject to further detailed preparatory work, the availability of appropriate legislation, relevant

[4] See information at: https://www.gov.uk/government/publications/energy-security-bill-factsheets/energy-security-bill-factsheet-nuclear-decommissioning-authority-pensions-reform
[5] See final paragraph of page 8 in the HMG Response to NDA Pension Reform Consultation: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/762851/HMG_Response_to_NDA_Pension_Reform_Consultation.pdf

consultation with affected members and their representatives and TfL’s decision-making processes.

Yours sincerely

Andy Lord

Appendix 1 HMG 24 February Letter

See attached PDF

Appendix 2 Summary of Options in the 14 October Submission

Alongside a “Do Nothing” option, the 14 October submission discussed two broad categories of options for future service benefit provision as required by the Funding Agreement.

These were a form of final salary defined benefit arrangement and a form of a career average revalued earnings (CARE) defined benefit arrangement; both within the public sector given the unnecessary cost and risk caused by the current private sector status of the Scheme.

Two sub options for each of these broad categories were considered which looked at potential benefit design factors such as indexation, accrual rates, retirement age and so on (referred to as design options F1, F2, C1 and C2 in the 14 October submission).

Options for using the Local Government Pension Scheme (LGPS) or the Civil Service Pension Scheme (CSPS Alpha) for future service benefit provision were also considered.

In relation to the management of past service liabilities, options discussed included moving to a new or existing funded or unfunded public sector scheme or a Crown guarantee in respect of the Scheme.

These options for past and future service were considered against the assessment criteria of affordability, sustainability, fairness and deliverability as required by the Funding Agreement.

The 14 October submission also set out that it was essential that HMG confirm whether or not it will make available the legislative support that would be required in order to address both past service assets and liabilities and any potential future service benefit reform.

The 14 October submission also made clear that without such support, TfL will, in practice, be precluded from any further consideration of reform.