

## Remuneration Committee Chair's Action (Approved 1 November 2021)



**Date Issued: 29 October 2021**

**Item: Senior Management Performance Award Scheme**

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**This paper will be published once the decision has been made.**

### **1 Summary**

- 1.1 Following a request from the Committee at its meeting on 7 July 2021, this paper sets out a proposal for the operation of Senior Management performance award schemes in TfL for the years 2021/22 and 2022/23, during the period that TfL is under 'extraordinary Government funding'. It seeks approval of the Committee to implement the performance award schemes according to the proposal outlined.
- 1.2 The use of Chair's Action is considered appropriate as we are already half-way through the performance year and need to provide staff with clarity on the operation of the schemes as soon as possible.
- 1.3 The members of the Committee are asked to consider the proposal and provide Ben Story, as Chair, with their views on or before 10am on 2 November 2021. The contents of this paper and the exercise of Chair's Action will be reported to the next meeting of the Committee.

### **2 Recommendation**

- 2.1 **The Chair of the Committee, in consultation with available Members, is asked to note the paper, and approve the implementation of performance award arrangements for 2021/22 and 2022/23 in accordance with the design outlined.**

### **3 Background**

- 3.1 Due to the very significant financial challenges faced by TfL, the ongoing discussions with Government about longer term funding requirements and future revenue risk, Committee members agreed at the meeting on 24 June 2020 that there was little option but to defer payout of all 2019/20 senior management performance awards for 12 months to June 2021.
- 3.2 It was agreed that all senior management performance award schemes would be suspended for the financial year 2020/21. This decision reflected the exceptional circumstances in which TfL found itself due to the impact of the coronavirus pandemic on its revenue, while it continued to run services to support key workers. At the time the Committee made it known that its decision was not a reflection on the hard work and commitment of staff, who the Committee recognised had made, and continue to make, an exceptional contribution to London, particularly in response to the coronavirus pandemic.

3.3 The pandemic has had a devastating impact on our finances as Londoners followed Government advice to stay home to save lives. We have successfully negotiated almost £5bn in extraordinary grant and additional borrowing authority, which enabled us to keep a near-full level of public transport service in operation throughout the pandemic. The Government support has come with many extremely challenging conditions – including massive savings targets – and we are committed to delivering these as part of reaching financial sustainability by April 2023. We continue to work with Government for a long-term financial deal after our current support ends in December 2021.

3.4 The short-term funding agreements TfL has secured from the Government have enabled TfL to play its part in keeping London moving safely throughout the pandemic. The terms of the current Extraordinary Funding & Financing Settlement operating for the period 1 June – 11 December 2021 state:

*‘Any bonus pay awards will not be paid for through extraordinary Government funding and TfL will have to demonstrate prudence in making any such payments.’*

In addition to the term concerning performance awards the Government expects TfL to freeze pay in line with the public sector pay pause it implemented in November 2020 while TfL is in receipt of Government funding.

3.5 At its meeting on 7 July 2021, the Committee considered what course of action should be taken for the performance years 2021/22 onwards and whether performance award schemes should be reinstated. The Committee recognised the value of TfL’s performance award arrangements in helping focus the organisation’s performance on its critical goals especially the immense challenge presented of achieving financial sustainability by April 2023.

3.6 Given that even prior to the pay freeze pay for Senior Management in TfL was generally lower than median levels in the external market; and that since the restart after the pandemic (along with many other sectors and businesses) we are starting to experience higher levels of staff turnover, the Committee also recognised that the operation of performance award schemes would be necessary to sustain a fair reward package as well as supporting retention of senior talent.

3.7 The Committee therefore asked TfL Management to form a proposal for a performance award scheme that could operate during the performance period that TfL is under the Government’s funding and remain consistent with the terms of that arrangement.

3.8 To form a compliant design proposal therefore required an adjustment to the existing scheme design (as set out in the proposal in point 5 below). The key change necessary was the need to accommodate the delivery of financial sustainability as a critical performance metric whilst also maintaining a balanced performance focus; and ensuring that payment of any awards due from the schemes would be contingent upon TfL’s delivery of financial sustainability and therefore not from the Government’s funding.

- 3.9 In addition to potential changes to scheme design brought about by the above considerations, TfL is refreshing its performance management processes. Central to this is a change to individual performance ratings and their reduction from 5 to 4 that also needed to be factored into any scheme design for 2021/22 onwards.

## **4 Financial Sustainability**

- 4.1 Prior to the coronavirus pandemic, our 2019 Business Plan targeted financial sustainability by April 2023, which meant breaking even and turning a surplus on our net cost of operations (total operating costs including maintenance and renewals).
- 4.2 This was through a combination of maximising fares income on London Underground and buses, full services running on the Elizabeth line, and reducing the buses deficit through additional roads income. This was a challenging ambition at the time, depending also on the realisation of TfL's £730m savings programme over a six-year period.
- 4.3 Since the pandemic, our income has plummeted – in 2020/21, our income was only £1.6bn, compared to the £5.1bn we had planned. Meanwhile our cost base has stayed fixed – at almost £9bn per annum whilst we protected core services for key workers.
- 4.4 Transport has a traditionally high fixed cost base, with heavy infrastructure and high upfront investment, which means it is difficult to cut cost out quickly without drastically changing the service proposition.
- 4.5 Government have made clear we must still achieve financial sustainability by April 2023.
- 4.6 TfL's main source of income is passenger revenue, and this underpinned the 2019 Business Plan assumptions for financial sustainability. With future passenger revenue so uncertain, TfL now faces a huge challenge to maintain the same date for financial sustainability.
- 4.7 This can only happen through significant savings and efficiencies programmes, identifying new revenue sources beyond passenger income, and astute commercial management.
- 4.8 The size of the gap we currently need to plug in our financial plan is around £2bn.
- 4.9 The huge change programmes needed to deliver this bring significant risk, and senior management will need to perform at the highest possible levels to overcome these challenges to deliver our goals.

## **5 Proposed Annual Scheme Design for 2021/22 and 2022/23**

- 5.1 The Committee outlined some key design principles to guide the design:
- (a) The conditions set for the Extraordinary Government Funding are for 'revenue support' only and not the Government's financial support for TfL's capital projects. Achieving financial sustainability in the context of the

performance award schemes concerns this 'revenue support' from the Government only.

- (b) Any performance award arrangements agreed by the Committee will be within the spirit of the funding settlement as well as the specific conditions set in the letter from the Secretary of State for Transport. The key consideration therefore is for TfL to be financially sustainable before awards can be paid.
- (c) Despite the importance of achieving financial sustainability the underlying basis for the subsequent calculation of individual performance awards should not be on financial performance alone and a balanced scorecard approach should be maintained.
- (d) To be eligible to receive a performance award an individual will need to be continuously employed with TfL up to a date (yet to be determined) during 2023/24 in order to maximise the benefits derived from the scheme to include retention of senior talent in addition to supporting performance and reward.
- (e) The approach to performance awards must continue to demonstrate financial prudence.
- (f) The Committee will retain final discretion on the assessment of scheme performance metrics and the application of the business rules for the scheme to guard against any unintended consequences brought about by this redesign.
- (g) All performance award schemes will be aligned to standard TfL Performance Management processes and this includes the transition to the new model of 4 levels of individual performance rating for 2021/22 onwards.

## 5.2 Proposed Scheme Overview

- (a) TfL's annual performance award schemes will continue in their current format with performance award budgets assessed for a one-year performance period determined by annual business scorecard results and with individual awards calculated by linking performance ratings to a multiplier used against the calculated budget.
- (b) Individual performance awards will be calculated in line with the normal annual performance cycle and would be recorded for 2021/22 and 2022/23.
- (c) Payment of the recorded annual performance award amounts for 2021/22 and 2022/23 is then made further dependent upon achievement of a 'Financial Overlay Trigger' that also forms part of the metrics for each annual scheme.
- (d) The Financial Overlay Trigger will act as a separate overriding financial performance condition (independent of the annual scorecard and individual performance rating conditions) and will require TfL to deliver its business plan to become (operationally) financially sustainable, free of 'extraordinary

Government funding' by 1 April 2023. It will be evidenced by the annual budget and business plan that is set for 2023/24 financial year.

- (e) The Financial Overlay Trigger would have no bearing on the calculation of the quantum of the annual performance award budgets but will act as a necessary performance trigger only that ensures that by delivering the Financial Sustainability Plan any performance award payments will not be met from the Government's extraordinary funding.
- (f) Performance Awards can only become due at the point that financial sustainability is determined with the confirmation of the budget and business plan for 2023/24 so that it is important to note that there is no deferral of payments involved. Payments can only be considered as 'earned' when all performance conditions have been met including the critical Financial Overlay Trigger.
- (g) As is normal, the Remuneration Committee will hold final discretion on the assessment and application of both the Financial Overlay Trigger and overall operation of the performance award schemes to ensure that they only operate in the way that is intended.

## **6 Implementation**

- 6.1 The associated business rules for the annual schemes will be rewritten to incorporate the changes to the scheme design proposed and specifically the Financial Overlay Trigger.
- 6.2 The redesigned scheme performance conditions and business rules will be communicated to all Senior Management participants at the point of implementation.

## **7 Budget and Indicative Scheme Costs**

- 7.1 It is proposed that the performance award budgets for the annual schemes are continued to be calculated in accordance with the current scheme design.
- 7.2 Indicative total annual scheme costs for all Senior Management (inclusive of the Commercial Development scheme), modelled against the current headcount, total salary cost and anticipated individual performance rating distributions are set out below. Actual scheme costs will be dependent on the variable elements outlined. These costs are exclusive of Employer's National Insurance contributions.
  - (a) £9,354,36 at 75 per cent scorecard achievement which would represent an 'on target' level of performance;
  - (b) £10,615,016 at 85 per cent scorecard achievement which would represent a 'stretch' level of performance; and
  - (c) £12,155,315 at 100 per cent (maximum) scorecard achievement.

## **8 Other Performance Award Arrangements**

- 8.1 We also intend that all our other performance award arrangements including individual arrangements and performance awards for Payband 2 & 3 under the Pay for Performance framework (currently suspended) would recommence in line our senior schemes. To ensure consistency and compliance with the funding settlement conditions they would be made subject to the same Financial Overlay Trigger as per senior schemes.

### **List of appendices to this report:**

None

### **List of Background Papers:**

None

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