Sackers

Reform of RPI

Alert | 26 November 2020

Introduction

On 25 November 2020, HMT and the UK Statistics Authority ("UKSA") published their response to this year's consultation on the reform of RPI.

Key points

- The earliest the methods and data resources of CPIH may be brought into RPI is February 2030. However, the UKSA does not specify a definitive date for implementation of the change.
- The government has decided not to offer compensation to the holders of index-linked gilts.
- Trustees of DB occupational pension schemes should discuss the effect this reform will have on their scheme, and the potential for mitigating its impact, with their advisers.

Background

RPI is the oldest measure of consumer prices in the UK and is used widely across the economy and in financial contracts. It has a number of acknowledged shortcomings, meaning that, at times, it has greatly overestimated, and at other times underestimated, the rate of inflation.

The UKSA is responsible for the production and publication of official statistics and National Statistics in the UK. It is required to compile and maintain RPI.

In certain circumstances, changes to RPI currently require the consent of the Chancellor of the Exchequer ("the Chancellor") before they can be implemented. The circumstances giving rise to this requirement expire in 2030.

How RPI will change

As proposed in the consultation, the methods and data resources of CPIH will be brought into RPI. (CPIH is currently the National Statistic and has been the ONS's lead measure of inflation since March 2017.)

RPI and CPIH will continue to be calculated separately, on an ongoing basis, and will be published as separate indices and growth rates.

The UKSA has also decided to discontinue the supplementary and lower level indices of RPI. It intends to provide their users with guidance to assist them in moving away from RPI-related indices.

Timing

Having considered the impact on the holders of index-linked gilts, the wider index-linked gilt market, and any consequent public finance implications, the Chancellor has concluded that he is unable to offer his consent to implementing the proposed change before the maturity of the final specific index-linked gilt in 2030.

It is the UKSA's policy to address the shortcomings of RPI, in full, at the earliest practical time. The Deputy Governor for Monetary Policy has confirmed that, from 2030, the proposed change should not have a materially detrimental impact on the interests of relevant index-linked gilt holders. By that point, the UKSA will not be required to seek the Chancellor's consent. As a result, the UKSA will be able to "legally and practically implement its proposal" in February 2030.

Impact

According to the response, the "vast majority of index-linked gilt holder respondents called for further mitigation for index-linked gilt holders in the form of compensation".

The contractual terms of all index-linked gilts state that RPI should be used to determine the index ratio, which is used to calculate interest and redemption payments. This will not be affected by the change to RPI methodology. As such, the government has decided not to offer compensation to the holders of index-linked gilts.

Although some DB pension scheme members will be affected by this reform, the response simply notes that the government "keeps the occupational pensions system under review and will continue to do so".

Action

Trustees should consider, with their advisers, the effect of this forthcoming change on their scheme and the actions which may need to be taken to mitigate its impact.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
E enquiries@sackers.com
www.sackers.com