

Outcome of the consultation on the reform to Retail Prices Index Methodology

On Wednesday 25 November 2020 HM Treasury and the UK Statistics Authority published a joint response to the consultation on the reform to the Retail Prices Index ('RPI') Methodology. This update provides a brief summary of what has been announced and Cartwright's initial thoughts on the implications for UK pension schemes.

What has been announced?

The key takeaways from the joint announcement from HM Treasury and the UK Statistics Authority are:

- The UK Statistics Authority has reaffirmed its preference for RPI is to align it with CPIH (as noted in the original consultation document);
- The Chancellor will not consent to RPI being reformed before 2030 (when the final 'relevant' index-linked gilt matures);
- Consequently, **RPI will be aligned with CPIH from 2030;**
- The UK government will **not offer compensation to holders of index-linked gilts.**

How have markets reacted?

The immediate market reaction following Wednesday's announcement was fairly muted with only a slight fall in index-linked gilt yields and not much movement in long-dated inflation, possibly because this news was largely anticipated.

As the announcement removes some uncertainty, we may see an increase in trading activity that has been put on hold pending publication of the response to the consultation on RPI reform. However, as the change is not due to take effect until 2030, this may not be the end of the matter and we could see further twists and turns before then.

What are the implications for UK pension schemes?

As CPIH has been lower than RPI by c. 1% per annum due to the different formulas used and coverage of these indices, this is not good news for pensioners with RPI-linked benefits, as the uplifts will be lower in the future. Similarly, schemes with a large proportion of CPI-linked benefits that have hedged a significant amount of their inflation risk (with RPI-linked assets) are likely to see a fall in their funding ratio, with hedging assets falling relative to their liabilities.

Of course, as we (and others) pointed out in our response to the consultation, this change will result in a significant transfer of wealth and the impact will be felt well beyond the index-linked gilt market and UK pension schemes. We will therefore continue to monitor developments closely.

Please get in touch with your usual contact at Cartwright if you have any questions or would like to discuss this.

27 November 2020

Mill Pool House
Mill Lane
Godalming
Surrey GU7 1EY

T: 01483 860201

E: enquiries@cartwright.co.uk

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP

T: 01252 894883

E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN

T: 01245 293300

E: enquiries@cartwright.co.uk

The Mansley Business Centre
Timothys Bridge Road
Stratford Enterprise Park
Stratford-upon-Avon
CV37 9NQ

T: 01245 293300

E: enquiries@cartwright.co.uk

