



PENSIONS COMMITTEE

Monday, 2 November 2020

REPORT TITLE:	RETAIL PRICES INDEX REFORM
REPORT OF:	DIRECTOR OF PENSIONS

REPORT SUMMARY

This report informs members of the government's consultation on reform of the Retail Prices Index (RPI index) and the Fund's response.

RECOMMENDATION

That Members note the report and the Fund's response to the consultation.

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION

- 1.1 There is a requirement for Members of Pension Committee to be kept informed of pension fund and market developments.

2.0 OTHER OPTIONS CONSIDERED

- 2.1 No other options have been considered.

3.0 BACKGROUND INFORMATION

- 3.1 The government announced that it was launching a consultation on changes to the RPI index. <https://www.gov.uk/government/consultations/a-consultation-on-the-reform-to-retail-prices-index-rpi-methodology>
- 3.2 The RPI was formally introduced in 1956, and, as such, is the oldest measure of inflation still published by the ONS. But it has significant shortcomings, including in:
- the index formulae it uses to aggregate some price changes,
 - the treatment of housing costs,
 - population coverage,
 - weights,
 - classification, and
 - geographic coverage.

Reflecting the problems with its construction, the RPI lost its National Statistic status in 2013. At this time, the Authority judged that the RPI did not comply with the Code of Practice for Statistics (the Code).

This view was based primarily on:

- the finding that the methods used to produce the RPI (notably the use of the Carli index formula) did not meet current international statistical standards, and;
- the decision in 2013 effectively to freeze the methods used to produce the RPI, and only to consider 'routine' changes, was inconsistent with the requirement in the Code to seek to achieve continuous improvement.

One major use of the RPI by government is in its issuance of index-linked gilts which use the RPI to adjust their coupon payments and in the repayment of the principal. There is substantial demand from defined benefit pension funds seeking to match RPI-linked liabilities.

The CPI was introduced in 1997, and has been a National Statistic since the introduction of the Code. The CPI does not suffer from the same shortcomings as the RPI and in 2003, the government set the CPI as the basis for the Bank of England's inflation target.

However, the CPI does not include a measure of owner-occupiers' housing costs, that is, the cost of living in and maintaining one's own home. The ONS introduced the CPIH in 2013 to address this.

Since 2010, the measured rate of RPI annual inflation has been on average one percentage point per annum above the CPIH.

There has been an exchange of letters between the UK Statistics Agency (UKSA) and the Chancellor on RPI. A letter from the UKSA to the Chancellor in March 2019 made two recommendations:

- The publication of RPI should cease or
- The publication of RPI should effectively change to CPIH

The Chancellor rejected the proposal to cease the publication of RPI by the UKSA but, regarding the potential change to the calculation methodology of RPI, February 2025 was set as the earliest date that a change could occur.

A consultation was announced aimed at gathering information about the potential impact of any change, whether the change should be made before 2030 and, if so, when between 2025 and 2030 the change should occur.

4.0 FINANCIAL IMPLICATIONS

- 4.1 As set out in the Fund's response, the Fund has substantial investments in assets with RPI linked cash flows and any uncompensated change to the calculation of RPI would have a detrimental effect on the value of those assets resulting in a deterioration in the funding position.

5.0 LEGAL IMPLICATIONS

- 5.1 There are none arising from this report.

6.0 RESOURCE IMPLICATIONS: STAFFING, ICT AND ASSETS

- 6.1 There are none arising directly from this report.

7.0 RELEVANT RISKS

- 7.1 As set out in the Fund's response, the Fund has substantial investments in assets with RPI linked cash flows for risk management purposes. Any uncompensated change to the calculation of RPI would have a detrimental effect on the value of those assets.

8.0 ENGAGEMENT/CONSULTATION

- 8.1 Not relevant for this report.

9.0 EQUALITY IMPLICATIONS

9.1 No equality issues arising from this report.

10.0 ENVIRONMENT AND CLIMATE IMPLICATIONS

10.1 There are no carbon usage implications, nor any other relevant environmental issues arising from this report.

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APPENDICES

Appendix 1 Response to RPI consultation

BACKGROUND PAPERS

<https://www.gov.uk/government/consultations/a-consultation-on-the-reform-to-retail-prices-index-rpi-methodology>

SUBJECT HISTORY (last 3 years)

Council Meeting	Date