BRITISH AIRWAYS PENSIONS

Reforming the Retail Prices Index: The outcome of the Government's Consultation

On 25 November 2020, the UK Government and UK Statistics Authority (UKSA) published the response to their joint Consultation about changing the Retail Prices Index (RPI) measure of inflation to be more closely aligned with the Consumer Prices Index including housing costs (CPIH).

The Office for National Statistics (ONS) currently uses three methods that measure inflation in the UK:

- The Retail Prices Index (RPI);
- The Consumer Prices Index (CPI); and
- Consumer Prices Index including housing costs (CPIH).

RPI has generally been about 1% higher than CPI and CPIH historically, although in recent years the gap has been somewhat smaller. These inflation measures are used throughout the UK economy and by the Government as the reference for yearly increases awarded to pensions in many UK pension schemes.

In 2020, the Government and the UKSA consulted on the date between 2025 and 2030 when RPI would be aligned with CPIH. The Consultation explains that, in HM Treasury and the UKSA's view, these dates were set because certain circumstances which give rise to the need to obtain the Chancellor's consent to changes in the RPI expire in 2030.

In recent years there has been substantial demand by UK pension schemes to invest in RPI-linked Government gilts issued by the UK Treasury. This is because RPI-linked gilts produce returns which generally match the benefits the schemes are required to pay out to members as they fall due. The holders of RPI-linked gilts, including many UK pension schemes, that mature after the proposed change will face reduced returns.

The NAPS Trustee responded to the Consultation and joined forces with several other large UK pension schemes to urge the Government to consider an alternative approach to redefining RPI that would lessen the impact of the proposed changes. The Association of British Airways Pensioners (ABAP) also ran a campaign to lobby the Government.

However, in November 2020, the Government and UKSA announced that the proposed change would apply from 2030. This means that RPI will effectively be aligned with CPIH from 2030.

Please read the Q&A below for more information about the Government's RPI reform Consultation and the impact on the income NAPS receives from its investments. Links to the full Consultation, Consultation outcome and additional reading are also included in the 'Useful links for further reading' at the end of this document.

From the Trustee of New Airways Pension Scheme

9 April 2021

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RPI reform Q&A

1. Who is the UK Statistics Authority (UKSA)?

The Statistics and Registration Service Act 2007 established the UKSA as an independent body which operates at arm's length from Government. The UKSA is responsible for the production and publication of official statistics and National Statistics in the UK.

It is the UKSA's role to compile and maintain the RPI, which is published and calculated by the ONS. In certain circumstances, changes to the RPI require the consent of, or a consultation by, the Chancellor of the Exchequer before they can be implemented.

2. What is the difference between CPI, CPIH and RPI?

The UK uses several ways to measure inflation, including RPI, CPI and CPIH. These measures are calculated in different ways. RPI is typically higher than both CPI and CPIH, which are generally more closely aligned.

CPI was introduced in 1997, and the Government has set CPI as the Bank of England's inflation target since 2003. CPI does not include a measure of owner-occupier's housing costs (the cost of living in and maintaining one's own home).

To address this, the ONS introduced CPIH in 2013, and it has used this as a measure of inflation since March 2017.

3. Why did the UKSA and the Government propose changes to RPI?

On 11 March 2020, the Government and the UKSA began a consultation on discrete methodological changes to the calculation of the RPI and the specific date between 2025 and 2030 at which the calculation of RPI would be aligned with CPIH (the Consultation). The Consultation notes that in 2013 the RPI lost its status as a National Statistic and details mathematical flaws in the RPI methodology. The Consultation did not ask whether the RPI should be continued in its current form.

The full Consultation document can be accessed here.

4. What were the responses to the Government's Consultation?

There were 831 responses to the Consultation, and 257 of those 831 responses were from individual members of BA pension schemes.

The NAPS Trustee, APS Trustee and ABAP responded to the Government's Consultation, demonstrating their opposition to bringing the methods and data sources of CPIH into RPI. They contended that the proposed change, which amounted to abolishing the RPI measure in favour of the CPIH measure of inflation, could lead to a worsening in the funding position for both Schemes.

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5. What was the outcome of the Consultation?

On 25 November 2020, the Government and UKSA responded to the Consultation, and the key outcomes, in effect, are that:

- from February 2030, the UKSA would cease to calculate RPI using the current principles and would instead calculate RPI by adopting the methodology for CPIH; and
- the Government will not offer compensation to the holders of RPI-linked Government gilts.

A link to the full response is included below.

6. What does this mean for my NAPS pension?

Under the NAPS rules, qualifying pensions receive increases each year according to the Government's Pensions Increase (Review) Order, which currently uses CPI. Future pension increases to NAPS pensions will not therefore be affected by the change. However the Scheme's investments are impacted by the change, see Q&A 7 below.

7. What does this mean for the Scheme's investments?

Following the guidance and best practice advice issued by The Pensions Regulator, the NAPS Trustee holds a proportion of the Scheme's investments in RPI-linked assets. The alignment of RPI to CPIH will therefore affect the income NAPS receives from its investments. The NAPS Trustee will continue to regularly review the investments of the Scheme and seek advice as appropriate.

8. Does this affect pension transfers paid by the Scheme?

After receiving advice from the Scheme Actuary, the NAPS Trustee has updated the calculations for pension transfers paid from the Scheme. A pension transfer from a defined benefit pension scheme such as NAPS means giving up any deferred pension benefits held in the Scheme (including any dependants' benefits) in return for a cash value, which is then invested in another pension scheme. At any time before it is drawn, a member can transfer the value of that deferred pension to another registered pension arrangement. This value is called a 'cash equivalent transfer value' or CETV.

Legislation requires pension scheme trustees to make sure that CETVs provide the best estimate of the cash equivalent of members' accrued benefits within the Scheme. The reduction in the value of some of the Scheme's investments means that CETVs may increase. CETV quotations available from NAPS since January 2021 are estimated to be on average 7% higher for all members, and up to 13% higher for members at younger ages. However, the calculations for CETVs must also include an allowance for current market conditions, which can vary significantly from month-to-month. It is therefore still possible for CETVs provided in the future to be lower than any values provided previously, rather than higher, once all factors are taken into account.

Useful links for further reading

1. Consultation: A Consultation on the Reform to Retail Prices Index Methodology, 11 March 2020

2. Consultation outcome: Responses to the Consultation

3. Office for National Statistics: Shortcomings of the Retail Prices Index as a measure of inflation

4. Lane Clarke & Peacock: RPI Reform: what does it mean for pension schemes and members