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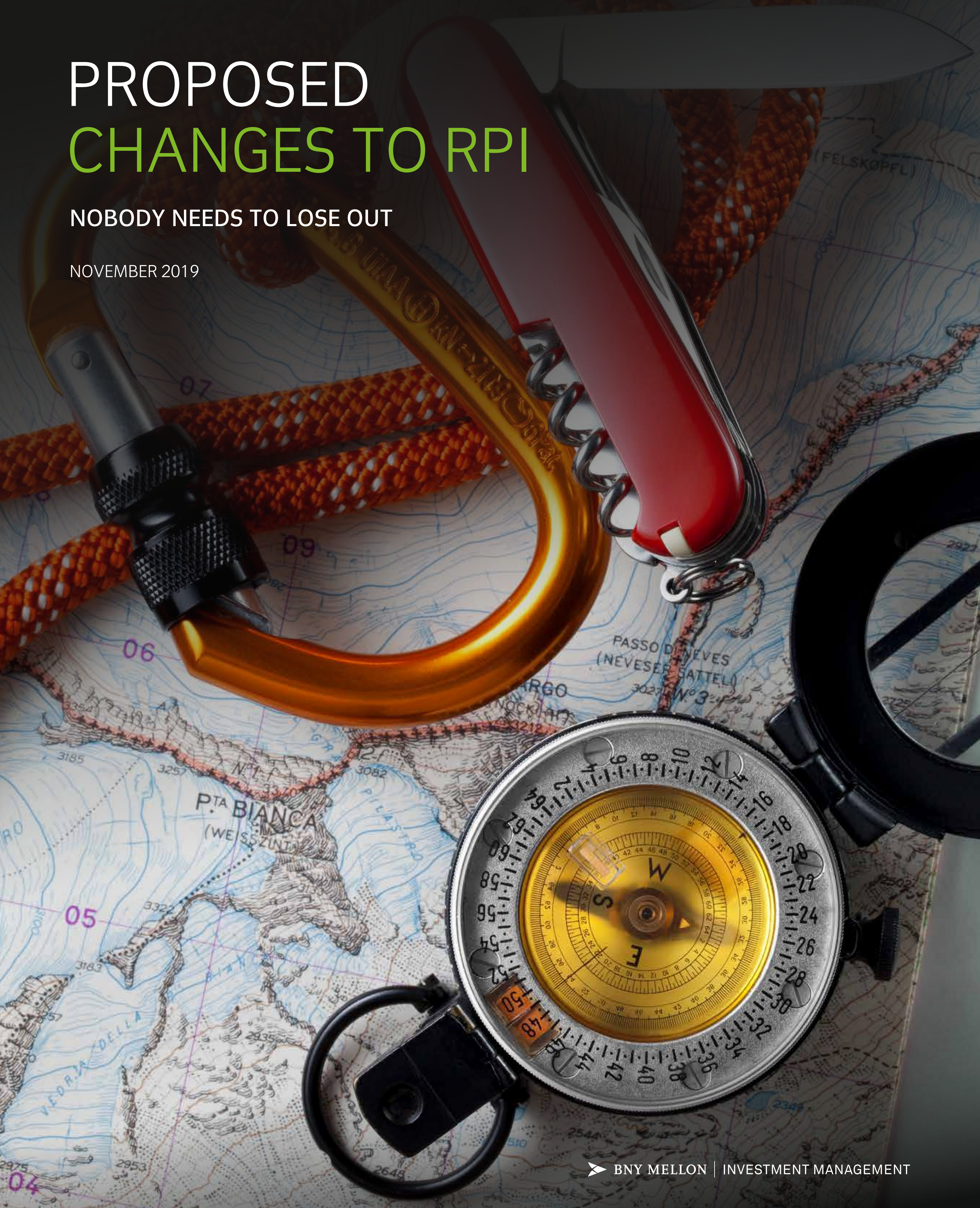
Insight INVESTMENT

PLEASE CONSIDER THE ENVIRONMENT BEFORE PRINTING.

PROPOSED CHANGES TO RPI

NOBODY NEEDS TO LOSE OUT

NOVEMBER 2019



BNY MELLON | INVESTMENT MANAGEMENT

ELIZABETH TRUSS MP

Chief Secretary to HM Treasury, oral evidence to the Select Committee on Economic Affairs enquiry on the use of RPI, 10 July 2018.[1]

People have invested in index-linked gilts or their pensions on the understanding that they would be uprated by RPI. They have entered into those arrangements with knowledge of the difference between RPI and CPI.

When people invest in RPI-related gilts, they are factoring in the fact that RPI is likely to rise more quickly than CPI. It is baked into the market.

[1] http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/economic-affairs-committee/the-use-of-rpi/oral/86754.html

INTRODUCTION

THE GOVERNMENT APPEARS TO BE ON A PATHWAY TO AMEND THE UNDERLYING CALCULATION OF THE RETAIL PRICE INDEX (RPI). THEY PLAN TO BRING THE MEASURE INTO LINE WITH THE CONSUMER PRICE INDEX INCLUDING OWNER OCCUPIERS' HOUSING COSTS (CPIH), REDUCING THE EXPECTED FUTURE CHANGE IN RPI BY AROUND 1% PER ANNUM.

- This change would have significant and immediate financial consequences for individuals (e.g. people with RPI-linked pension benefits) and investors in RPI-linked assets, such as index-linked gilts.
- We estimate that the impact on the index-linked gilt market would be a loss of value of c.£90bn.
- It is critical that the January 2020 consultation on proposed changes to RPI allows respondents to express their view on the potential negative effects of the proposals.
- If the opportunity is provided in the consultation, Insight will recommend that RPI be amended to align with CPIH plus a margin. Nobody needs to lose out from this change.

RPI VERSUS CPIH: KEY FACTS

RPI

- Created in 1946, became the main measure of UK inflation in 1956
- Was the main measure of UK inflation until 2003, superseded by CPI
- Uses an arithmetic mean formula
- Includes mortgage interest payments and council tax

CPIH

- Published since 2013, with history to 2006
- The main measure of UK inflation from March 2017
- Uses a geometric mean formula
- Includes owner occupiers' housing costs and council tax

FOUR WAYS THE CHANGES COULD IMPACT YOU OR SOMEONE YOU KNOW

1

Pension scheme members with RPI-linked pensions will see the transfer value of their pensions fall and their future benefits will rise at a lower rate than previously expected.

2

Pensioners with RPI-linked annuities will see their future benefits rise at a lower rate than previously expected. They could have effectively overpaid for their annuities.

3

Investors in index-linked gilts and other RPI-linked assets such as pension funds will have lower returns – with the UK government the main beneficiary as the issuer of index-linked gilts.

4

Pension funds with CPI-linked liabilities that have used index-linked gilts to hedge liability risks will see their funding status deteriorate.

BACKGROUND

The government appears to be on a pathway to amend the underlying calculation of RPI to align the measure with CPIH. This conclusion has been drawn following the release of a letter on 4 September 2019 by Her Majesty's Treasury from the Chancellor of the Exchequer Sajid Javid to Sir David Norgrove, Chair of the UK Statistics Authority (UKSA), on proposed reforms to RPI. This was written in response to a letter dated 4 March 2019 from Sir David to former Chancellor Philip Hammond which was made public at the same time as the response. These create a new timeline for RPI reform, which we outline below, and follow a series of previous consultations.

Figure 1: Timeline for RPI reform

2011-13

- The Debt Management Office (DMO) consulted on issuing CPI-linked gilts in 2011 but decided against doing so
- Consultation on RPI was undertaken in 2012 and the decision of the National Statistician, widely supported by the respondents to the consultation, was to leave RPI unchanged as a legacy index

2014-19

- Office for National Statistics publishes analysis of shortcomings in RPI in 2014
- Johnson Review concludes that RPI should remain as a legacy index
- House of Lords Economic Affairs Committee report calls for UKSA to reconsider position on RPI
- National Statistician's Advisory Panel on Consumer Prices urges action on RPI

2020

- January 2020 consultation on:

  – whether a change to RPI be made before 2030, and if so, on what date between Feb 2025 and 2030

  – technical issues concerning proposed alignment of RPI with CPIH
- Response from government scheduled for March/April 2020

2025

- February 2025: Earliest date that changes can be made to RPI based on Chancellor's letter

2030

- Chancellor's consent is no longer needed to change RPI calculation after 2030 due to differing prospectus language for index-linked gilts maturing beyond this date

1 – Letter from UKSA, dated 4 March 2019 and released 4 September 2019

The UKSA made two recommendations:

(a) the publication of RPI should cease or

(b) the calculation of RPI should effectively change to CPIH

It was felt that announcing the end of RPI at an appropriate future date would give the government, markets and businesses time to agree to alternative arrangements. Alternatively, using the calculation methodology used in CPIH (consumer price index including owner-occupiers' housing costs) would mean that RPI would become CPIH by another name.

Given that these changes constituted a material change, consent was requested by the UKSA from the Chancellor to make the calculation change under section 21 of the Statistics and Registration Service Act 2007.

2 – Why did they need permission and why is 2030 an important date?

There are three index-linked gilts in issuance that have an explicit link to RPI in their prospectus. All three of these gilts will mature by 2030. The prospectus of these issues requires that, for any change in RPI that is considered fundamental by the Bank of England, permission is first required from the UK Chancellor. The Bank of England confirmed in a letter dated 4 March 2019 that the suggested change would be fundamental and would be "materially detrimental to the interests of the holders of relevant index-linked gilt-edged securities".

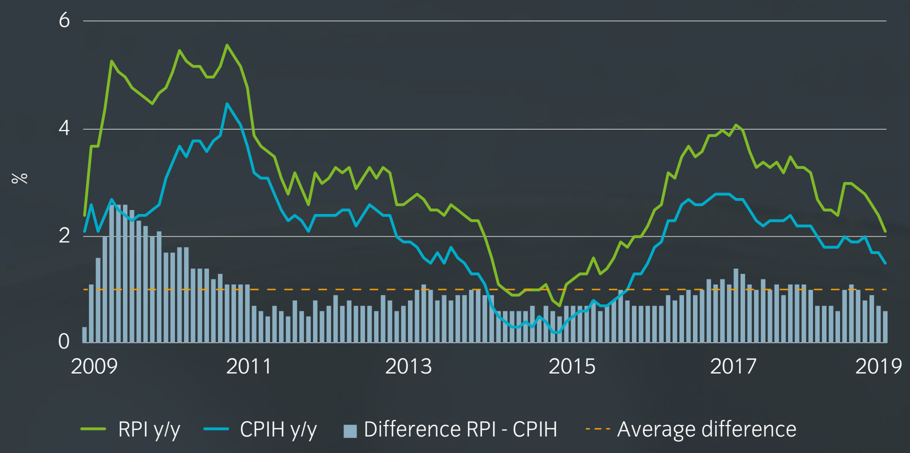
3 – The Chancellor's response (letter dated 4 September 2019)

The Chancellor rejected the proposal to cease the publication of RPI by the UKSA. Regarding changing the calculation methodology of RPI to CPIH, the Chancellor set February 2025 as the earliest date that a change could occur. A consultation was announced, to start in January 2020, aimed at gathering information about the potential impact of any change, whether the change should be made before 2030 and, if so, when between February 2025 and 2030 it should occur. The consultation will also include technical matters related to the implementation of the proposed alignment of RPI with CPIH, and UKSA will publish a response before the Spring Statement and end of the financial year (April 2020).

RPI VERSUS CPIH (THE WEDGE)

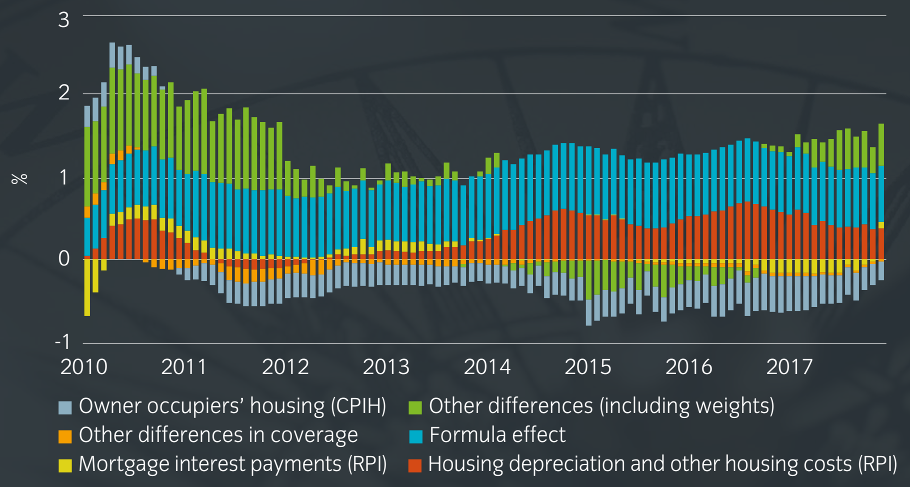
Since 2010, RPI has increased by an average of 1% more than CPIH per annum, with a high degree of consistency (see Chart 1).

Chart 1: RPI has averaged 1% above CPIH since 2010[2]



The difference between the two calculations was published until January 2018 and this data suggests that the 'formula effect' has been consistent over this period (see Chart 2). Between January 2010 and December 2017 the formula effect averaged 0.75% per annum.

Chart 2: Causes of the difference between RPI and CPIH 2010 to 2017[3]



The Wedge: The long standing difference between RPI and CPI/CPIH has become known as the 'wedge'. This concept has become so embedded that pension schemes with CPI-linked liabilities often embed assumptions regarding the wedge into their liability valuations and hedging triggers.

[2] Source: Bloomberg. Data as at 31 October 2019.
[3] Source: ONS.

THE IMPACT OF CHANGING RPI

RPI CONTINUES TO BE WIDELY USED AND IS WRITTEN INTO VARIOUS CONTRACTS. WE OUTLINE SOME OF THE MOST SIGNIFICANT IMPACTS OF CHANGING RPI BELOW.

INDEX-LINKED GILTS

The index-linked gilt market, a significant portion of which is held by pension funds, has coupon and principal payments linked to RPI, with the suggested change in RPI lowering the expected future returns of these assets. The calculation methodology in RPI was well known by market participants and, following previous consultations which concluded that RPI should continue to be published without change, investors in index-linked gilts will have invested in the reasonable expectation that RPI would continue to be largely unchanged over the life of their asset.

We estimate that the impact of the proposed RPI reform on the total value of the index-linked gilt market would be a reduction of c.£90bn. In addition, there are other RPI-linked bonds in issue, for example those issued by Network Rail.

A WORKED EXAMPLE FOR A SINGLE INDEX-LINKED GILT

Below is the estimated impact the proposed change would have on an individual index-linked gilt.

Maturity date	2055
Current value	£39bn
Impact of a 1% reduction in RPI from 2030	-£8bn
Impact of the proposed change on the gilt's value	-21%

INFLATION SWAPS

Inflation swaps are used by investors and pension funds to hedge long-term inflation-linked liabilities and can have maturities as long as 50 years. The purchaser pays a fixed return in exchange for an inflation-linked return. Most inflation swaps are linked to RPI, and in a similar way to index-linked gilts, the payments from A to B will drop, while the payment from B to A will remain unchanged.

PROPERTY AND INFRASTRUCTURE INVESTMENTS

RPI continues to be embedded within the property market, particularly for long-lease commercial property. Infrastructure investments can also have revenue streams which change with reference to RPI.

INDIVIDUALS

The Institute and Faculty of Actuaries submitted a report[4] as evidence to the House of Lords Economic Affairs Committee on the use of RPI, in which it provided an overview of how a change to RPI could impact groups of consumers in practical terms. There are two areas which could potentially impact consumers significantly:

- **Pensioners:** Many defined benefit pension schemes pay pensions linked in some way to RPI. If RPI was to be aligned with CPIH, a 65-year-old man with benefits linked to RPI could expect his aggregate lifetime pension payments to reduce by between 10% and 15%. A reduction in future expected benefits would also be expected to negatively impact the transfer value of scheme assets linked to RPI.
- **Annuities/life insurance:** Many annuities have payments linked to RPI. If RPI was to be replaced by CPIH, then current annuitants could arguably have overpaid for the benefits they will receive. Future annuity prices could be expected to be lower to reflect the lower level of future benefits.

Perhaps more positive effects could emerge for student loans and rail fares.

Student loans in the UK have interest payments linked to RPI (for example, interest on student debt for those earning more than £41,000 per annum is set at RPI plus 3% pa). It is of course also possible for the government to change this calculation to be based on CPIH without needing to change the calculation of RPI itself.

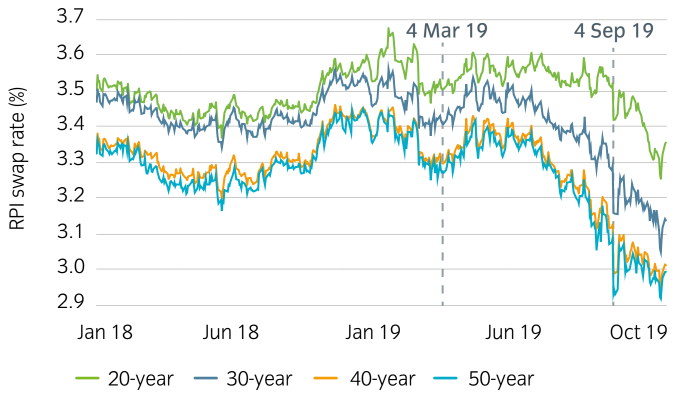
Rail fares are also linked to RPI. Although these could potentially be lower in future if RPI were to change, it is also important to note that the companies with whom the government have contracts will have priced these contracts based on RPI and may have language in them that would adjust the terms to reflect any change in RPI. As with student loans, it is of course also possible for the government to change these calculations to be based on CPIH without needing to change the calculation of RPI itself.

[4] Institute and Faculty of Actuaries response to House of Lords Economic Affairs Select Committee. As at 25 July 2018.

MARKET REACTION

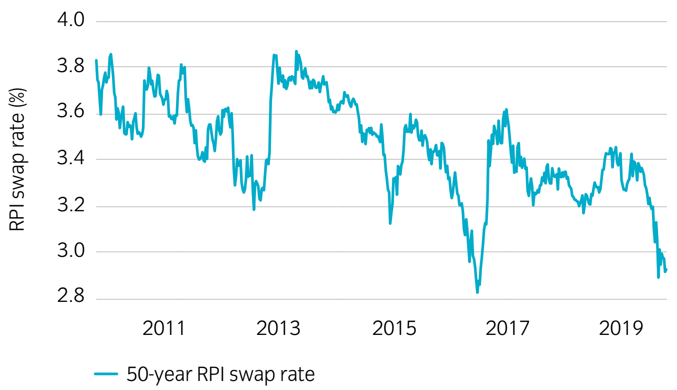
Markets reacted to the publication of the letters on 4 September by repricing the expected future level of UK inflation downwards. It is notable that the RPI swap market started to move well before the letters were published, with the market being surprisingly prescient.

Chart 4: Markets moved significantly before the September announcement[5]



Looking over a longer period, it is clear that there has been a notable decline in inflation expectations, especially for longer tenors such as the 50-year inflation swap.

Chart 5: Historically significant repricing of UK inflation markets[6]



[5] Source: Insight and Bloomberg. As at 31 October 2019.
[6] Source: Insight and Bloomberg. As at 31 October 2019.

UNDERSTANDING HOW THIS WILL IMPACT YOUR PENSION SCHEME AND POTENTIAL CONSIDERATIONS

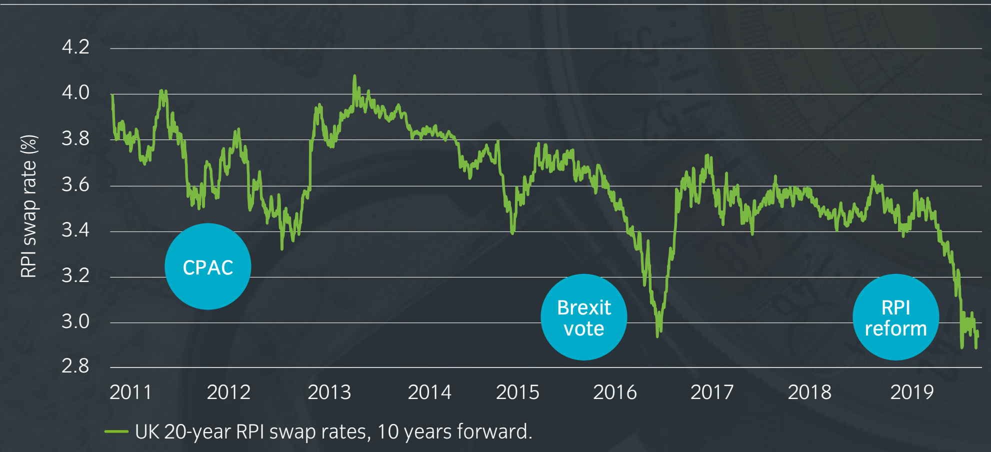
How the proposed change to RPI affects your pension scheme will depend on the type of assets the scheme holds and the nature of its liabilities. You should consult with your advisers and LDI manager to better understand how the proposed change is likely to impact your pension scheme. Below, we set out a simplistic version of the range of possible impacts on a pension scheme; in reality, most schemes are likely to experience different variations of these effects.

THE POTENTIAL IMPACT ON YOUR PENSION SCHEME

	FULLY INFLATION HEDGED	NOT INFLATION HEDGED
RPI LIABILITIES Pension payments that increase in line with RPI inflation	• Both asset and liabilities will fall so your scheme's funding and hedging level remains broadly unchanged	• Liabilities would fall so your scheme's funding level would increase
CPI LIABILITIES Pension payments that increase in line with CPI inflation	• Assets will fall so your scheme's funding and hedging level would reduce	• Both assets and liabilities would be unchanged so your scheme's funding and hedging level remains broadly unchanged • Hedging could be more attractive as RPI-linked assets become a closer match for CPI liabilities

Whether your pension scheme's liabilities are RPI or CPI-linked will depend on your scheme rules. For many schemes that have hedged CPI exposure pre-2030 (e.g. to cover increases in deferment), the impact may be less significant than it might seem at first glance. It is therefore important to look at your pension scheme's inflation exposure after the date the potential change is implemented, i.e. 2030.

Chart 6: Markets priced in the proposed change to RPI rates beyond 2030[7]



[7] Source: Insight and Bloomberg. As at 31 October 2019. CPAC is the investigation by the National Statistician's Consumer Prices Advisory Committee (see page 10)

THINGS TO CONSIDER AS A RESULT

In light of the potential change to RPI, there are a number of factors to consider and potential actions to take:

1 ENGAGE WITH POLICYMAKERS AND RESPOND TO THE CONSULTATION

Now is a good time to engage policymakers to ensure the consultation allows you to express your views and to help get more clarity on what the financial consequences of the change will be. Once the consultation opens in January 2020, it will be important to respond to it to ensure your views are heard.

2 REVIEW THE SIZE AND SHAPE OF YOUR INFLATION HEDGE

As the proposed change is likely to come into force from 2030, only RPI-linked assets maturing after this date will be affected. You could consider changing the size of your hedge to reduce your overall exposure to these assets or the shape of your hedge to make it less sensitive to RPI after 2030. However, any change in the inflation hedge could expose the scheme to inflation risk. The potential negative consequences of such a change should be carefully considered. In addition, any adjustment could crystallise the impact of market movements.

3 SEEK TO INVEST IN CPI-LINKED ASSETS

As RPI inflation is likely to move closer to the current level of CPI inflation, you could consider investing in CPI-linked assets. However, CPI-linked assets are in short supply; the total value of CPI-linked assets available is less than £10bn compared to the total value of RPI-linked bonds in issuance of c.£700bn. In addition, CPI-linked assets are currently relatively expensive and markets have already priced in the expected reduction in the difference between RPI and CPI inflation expectations from 2030. The implied forward RPI-CPI wedge is now below 0.5% pa[8] at some maturities and, if you were to transact, there would be additional dealing costs of up to 0.1% pa, which would reduce the wedge differential further. This compares to historical assumptions regarding the wedge of closer to 1% pa.

4 REVIEW YOUR DE-RISKING TRIGGERS

Given the change in the level of RPI pricing, care needs to be taken when valuing CPI-based liabilities or setting market-based triggers. Many schemes still use RPI market levels and adjust this using a fixed estimate of the wedge for the purpose of valuing CPI liabilities. Given the fall in RPI market levels due to the proposed change, you may need to re-consider your wedge assumption and trigger levels.

5 ENGAGE WITH YOUR ASSET MANAGERS OF RPI-LINKED ASSETS

In addition to index-linked gilts, other asset classes such as property and infrastructure often have RPI-linked income streams. You should talk to your asset manager if you hold such investments to understand how the change may impact the income you receive.

Table 1: Historical estimates of the wedge have been considerably higher than current levels[9]

	Wedge (%)
2014 BoE inflation report	1.3
2015 OBR estimate	1.0
Average since 2010	1.0
Market-implied expectation as at 31 October 2019	0.5

Please note that the above market-implied level is derived from the swap market. The CPI swap market has limited liquidity and it is therefore difficult to place too much reliance on this, however, it is evident that the market has already reacted to price in the potential change in RPI.

[8] Source: Bloomberg. As at 31 October 2019.
[9] Source: Insight and Bloomberg. As at 31 October 2019.

THE HISTORY OF RPI

1946 In **1946**, the UK government created the Cost of Living Advisory Committee, tasked with creating an "adequate measure of changes in the cost of living" to replace the simpler measures used before World War II. In 1947, the Committee recommended that a new index be created, based on a broad range of goods and with weights updated to reflect the findings of a household expenditure survey which was carried out through 1937 and 1938. This index, which was initiated in June 1947, was known as **the Interim Index of Retail Prices**.

1956 In **January 1956**, the index was adopted as the official measure of UK inflation, and its name was changed to the **Retail Price Index**. The index continued to evolve over time, incorporating changes in spending habits and more sophisticated data collection techniques.

2010 RPI was highly regarded until **2010**, when the index started to unexpectedly diverge from the **Harmonised Index of Consumer Prices** (HICP), which was a measure of UK inflation created in 1996 by the European Union in preparation for the launch of the euro.

2011 An investigation into this divergence was announced in **2011** by the National Statistician's Consumer Prices Advisory Committee (CPAC), and was finalised in 2012. This investigation highlighted a problem stemming from a change made in 2010 to the way the Office for National Statistics (ONS) collected clothing prices. It concluded that the use of the Carli formula in certain subcomponents of RPI created an upward bias in the index. This impact has become known as the 'formula effect'.

2012 With the calculation of RPI in question, Jil Matheson, the UK National Statistician announced a consultation on options for improving RPI[10], which launched on **8 October 2012**. The consultation was conducted over eight weeks, and 332 of the 406 respondents supported keeping the calculation of RPI unchanged.

Feb 2013	In **February 2013**, the ONS published a response to the consultation[11], in which it concluded that RPI did not meet international standards. The ONS announced that a new index would be published from March 2013, using the Jevons formula and known as RPIJ. RPI would continue to be published, but no longer be classified as a national statistic. **Despite this, RPI continued to be widely used by both the government and private sector**.
May 2013	In **May 2013**, Sir Andrew Dilnot, Chair of the UK Statistics Authority, invited Paul Johnson, Director of the Institute for Fiscal Studies, to conduct a review of UK price indices.
Jan 2015	In **January 2015**[12], the Johnson Report was published, concluding that RPI should remain as a legacy index.
Jun 2018	In **June 2018**, the House of Lords Economic Affairs Select Committee launched an inquiry into the use of RPI[13], including a consultation in which Insight participated.
Sep 2019	In **September 2019**, Her Majesty's Treasury released a letter from the Chancellor of the Exchequer, Sajid Javid, on proposed reforms of RPI, which suggested that RPI could be replaced by CPIH between 2025 and 2030.

[10] https://www.ons.gov.uk/ons/about-ons/user-engagement/consultations-and-surveys/national-statistician-s-consultation-on-options-for-improving-the-retail-prices-index/options-for-improving-rpi-consultation-document.pdf

[11] https://www.ons.gov.uk/ons/about-ons/get-involved/consultations/archived-consultations/2012/national-statistician-s-consultation-on-options-for-improving-the-retail-prices-index/national-statisticians-response.pdf

[12] https://www.statisticsauthority.gov.uk/wp-content/uploads/2015/12/images-ukconsumerpricestatisticsarevie_tcm97-44345.pdf

[13] https://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-committee/inquiries/parliament-2017/the-use-of-rpi/

[14] Adapted from an illustration offered in the House of Lords Economic Affairs Committee report on Measuring Inflation, available here: https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/246/24605.htm

Table 2: An illustration of the formula effect

CARLI FORMULA (used in RPI)	JEVONS FORMULA (used in CPIH)
Developed in 1764 by Italian economist Gian Rinaldo Carli, the Carli formula is an arithmetic mean.	Developed in 1863 by English economist William Stanley Jevons, the Jevons formula is a geometric average.

Illustrating the upward bias in the Carli formula[14]

Under the Carli formula, if a price rises then falls back to the its starting point, an increase in price may be recorded even though the price is unchanged over the period.

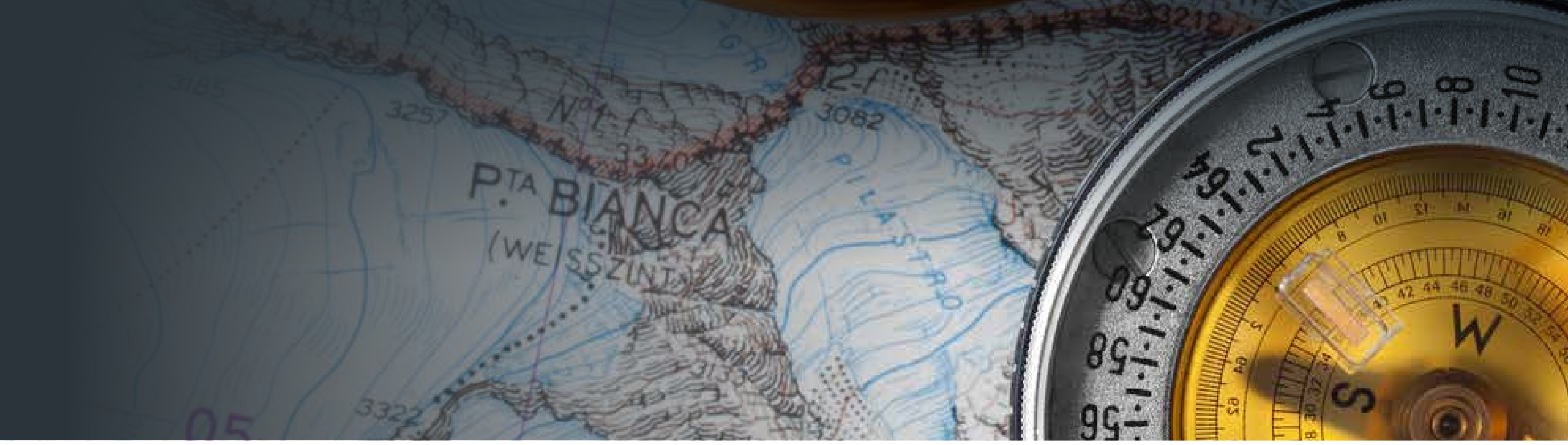
For example:

- In January 2016, two shirts each cost £20.
- In January 2017, the price of shirt X rises to £30 while the price of shirt Y remains at £20.
- In January 2018, the price of shirt X drops back to £20 while the price of shirt Y remains at £20.
- Under the Carli formula:
  – the average price change in the first year would be 25%: one shirt's price increases by 50% while the other's remains unchanged.
  – in the second year, the average price change under the Carli formula would be minus 17%: one shirt's price falls by a third, while the other's remains.
  – when these price change ratios are multiplied together, the increase in price recorded by the Carli formula over the two years is 3.8%, even though both shirts cost £20 at the beginning and end of the period.

INVESTORS HAD GOOD REASON TO BELIEVE RPI WOULD BE MAINTAINED

In this section we highlight key text from various consultations and documents. The message was clear – RPI would not be changed. This reinforces the argument that any change should only be made if compensation is provided to prevent wealth transfer effects.

Publication	Extracts
2012 Consumer Prices Advisory Committee	In developing her recommendations the National Statistician also noted that there is significant value to users in maintaining the continuity of the existing RPI's long time series without major change, so that it may continue to be used for long-term indexation and for index-linked gilts and bonds in accordance with user expectations. Therefore, while the arithmetic formulation would not be chosen were ONS constructing a new price index, the National Statistician recommended that the formulae used at the elementary aggregate level in the RPI should remain unchanged. https://webarchive.nationalarchives.gov.uk/20160108030655/http://www.ons.gov.uk/ons/rel/mro/news-release/rpirecommendations/rpinewsrelease.html
2013 Consumer Prices Advisory Committee	Therefore, ONS recommends: i. That while the Carli would not be chosen were ONS constructing a new price index, the formulae used at the elementary aggregate level in the RPI should remain unchanged. ii. That ONS develops a new RPI-based series (called RPIJ), using the Jevons formula in place of the Carli at the elementary aggregate level. iii. That the basic formulation of the RPI is accepted as currently defined and that any future changes should be limited to issues such as the annual update of the basket and weights, improvements to data validation and quality assurance etc. http://www.ons.gov.uk/ons/guide-method/development-programmes/other-development-work/consumer-prices-advisory-committee/cpac-papers/cpac-papers---january-2013-meeting.pdf
2013 ONS on removing national statistic designation	**Decision concerning continued designation as National Statistics** The Statistics Authority judges that the RPI, including the sub-indices and variants listed in section 1.1.2 does not comply with Principle 4 and specifically with Principle 4, Practice 5 of the Code. This view is based primarily on: i. The finding that the methods used to produce the RPI are not consistent with internationally recognised best practices (para 3.4); and ii. The decision to freeze the methods used to produce the RPI, and only to contemplate 'routine' changes (para 3.5). The Statistics Authority notes and supports the decision by the National Statistician that, to meet the needs of existing users of the RPI in its current form, ONS will not amend its basic formulation. This has the effect that the RPI is inconsistent with the Code of Practice (see paras 3.4 and 3.5). As required by Section 14 of the Statistics and Regulation Service Act 2007, and in line with its statement on criteria for not awarding the National Statistics designation, the Statistics Authority has cancelled the designation of the RPI, including the sub-indices and variants listed in section 1.1.2, as National Statistics. http://www.ons.gov.uk/ons/guide-method/development-programmes/other-development-work/consumer-prices-advisory-committee/cpac-papers/cpac-papers---january-2013-meeting.pdf



Publication	Extracts
2014 Consumer Price Indices technical manual	The RPI is the most long-standing measure of inflation in the United Kingdom. It is currently used for the revalorisation of excise duties and for index-linked gilts. In the past, it has been used for a variety of other purposes; these included the Government's inflation target, uprating tax allowances, state benefits, and pensions, as well as deflating consumer expenditure in the National Accounts. The RPI was assessed against the Code of Practice for Official Statistics in early 2013 and the UK Statistics Authority cancelled its designation as a National Statistic because of the finds that: i. The methods used to produce the RPI are not consistent with internationally recognised best practices and ii. The decision to freeze the methods used to produce the RPI, and only to contemplate 'routine' changes. http://doc.ukdataservice.ac.uk/doc/7022/mrdoc/pdf/7222technical_manual_2014.pdf
2015 Johnson review	This reliance on the RPI, as already discussed, led to the National Statistician to commit to not changing its coverage or basic calculation. This commitment leaves considerable room for interpretation. When withdrawing the RPI's National Statistics status, the Authority referenced a paper prepared by ONS for the January 2013 Consumer Prices Advisory Committee meeting. This paper clarifies what no change to coverage or basic calculation means: That the basic formulation of the RPI is accepted as currently defined and that any future changes should be limited to issues such as the annual update of the basket and weights, improvements to data validation and quality assurance etc. (ONS (2013), paragraph 5 iii). By not changing the calculation of the RPI to make it a more "correct" measure of inflation in the face of evidence that the current methodology is flawed, the Authority has set a clear precedent. The RPI should not be improved except for those changes that ensure its continued production. Changes that are within the scope of this recommendation need to be clarified. For example, a new approach to adjusting the differences in quality between items might be considered a change in the basic formulation and so not allowed. On the other hand, updating the basket each year in the RPI is necessary to keep the selection of goods and services relevant and is therefore allowed. https://www.statisticsauthority.gov.uk/archive/reports---correspondence/current-reviews/uk-consumer-price-statistics---a-review.pdf
2019 Letter from UKSA in response to the House of Lords	As your report made clear, the question faced by the Authority in 2012 was whether to make substantive changes to the construction of the Retail Price Index (RPI). The decision made by the then National Statistician, one widely supported in the consultation at the time, was to leave the RPI unchanged. This decision gave rise in turn to the conclusion that the RPI should be treated as a legacy measure, with no future substantive changes to its construction and methods. That position was endorsed by an independent review of consumer prices led by Paul Johnson, which reported in 2015. In the period since, the Office for National Statistics (ONS) has developed alternative measures of inflation, and the Authority has urged users to move away from RPI. https://www.statisticsauthority.gov.uk/wp-content/uploads/2025/09/20190904_Response_to_LEAC.pdf
2019 House of Lords, Measuring Inflation report	Paul Johnson's review, published in January 2015, described the existing situation: "By not changing its calculation to make it a more 'correct' measure of inflation in the face of clear evidence that the current methodology is flawed, the [UK Statistics] Authority has set a clear precedent. The National Statistician recognised that by stating that the methodology of the RPI would remain unchanged. This means that improvements to the methodology of the CPI and CPIH will not be carried over to the RPI." The review recommended that the RPI should be considered a 'legacy measure' only; no further changes should be made to it and it should stop being used: "ONS and the UK Statistics Authority should re-state its position that the RPI is a flawed statistical measure of inflation which should not be used for new purposes and whose use should be discontinued for all purposes unless there are contractual commitments at stake." https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/246/246.pdf

A FAIR SOLUTION AVOIDS UNINTENDED WEALTH TRANSFER

Changing RPI to simply mirror CPIH would have far-reaching consequences throughout the UK economy, with significant transfers of wealth, primarily from pension beneficiaries and asset holders, such as pension schemes, to the government. This would impact millions of people who have pension benefits or annuities linked to RPI.

We are also concerned that any such decision could have consequences for some pension funds who have hedged CPI-linked liabilities with the most liquid option to do so – RPI-linked assets.

Additionally, if markets were to perceive that any change would effectively renege on contractual obligations, or lead to a redistribution away from investors to the government, it could have implications for the government's perceived creditworthiness, and could be subject to legal challenge.

One way to minimise the impact of the change would be to amend RPI to align with CPIH plus a margin, where the margin was an agreed and transparently calculated adjustment to reflect the expected long-term average premium of RPI over the new inflation measure. We believe that this should be established via a market-wide public and impartial consultation. If managed transparently, simply amending the RPI calculation to align with CPIH plus a margin would ensure the transition away from RPI occurs in a way which all parties perceive as fair.

CONCLUSION

Changing RPI could have significant consequences and Insight has created this document to raise awareness of the issue.

We urge all UK pension funds, advisers and asset managers to engage with policymakers now to shape the upcoming consultation and to participate, once published, to ensure that it:

a) provides an opportunity for all the relevant stakeholders to debate whether the change should proceed; and

b) encourages debate on a compensation formula for recipients of contractual RPI-linked payments such as pension fund members and index-linked investors, to achieve an outcome which avoids an unintentional wealth transfer.

Insight will be responding to the consultation and we will recommend that RPI be amended to align with CPIH plus a margin. This is consistent with our response to the House of Lords Economic Affairs Committee consultation in 2018. Insight was quoted in the consultation report as stating that any changes to RPI "should only be undertaken after considerable consultation and planning, with any redistributive effect minimised". We also raised the issue of compensation, saying:

> "To remove RPI from use in the gilt market, one method could be to compensate investors through enhanced terms to reflect the change in methodology. Compensation could take various forms, including adjusting the terms of index-linked bonds from RPI to CPI/CPIH +X, where X was an agreed and transparently calculated adjustment to reflect the expected long term average premium of RPI over the new inflation measure (estimated to be 1.3% over CPI by the Bank of England – February 2014 Inflation Report p34). By changing both the payments on index-linked gilts and the payments to pensioners in the same equitable way, RPI could be discontinued without creating winners and losers."[15]

Together, through active engagement on this important topic, we aim to protect the asset values of UK pension schemes and the retirement income that millions of people depend on now and for decades to come. Nobody needs to lose out from this change.

[15] http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/economic-affairs-committee/the-use-of-rpi/written/87085.html

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