11/2019

XPS Express for Employers

Bringing you the latest pensions news for employers

Potential changes to RPI inflation are impacting schemes now

At a glance

The Chancellor recently announced that he is planning to consult in early 2020 on changing RPI inflation to align it with CPIH inflation at some point between 2025 and 2030

CPIH is generally 1% lower than RPI. As this is a change to RPI itself, it would directly impact any benefits linked to RPI and RPI related assets

But even now, the announcement is impacting pension schemes' assets and liabilities since market expectations of RPI are reacting to the news

The impact of the announcement on your scheme will depend on whether your benefits are linked to inflation and how much inflation hedging your scheme has

Any exercise that places a value on scheme benefits needs to consider the RPI and CPI assumptions used carefully, particularly accounting disclosures, member options and any funding discussions or agreements

Potential impact on your scheme

The impact depends on whether scheme benefits are linked to RPI or CPI and how much inflation hedging your scheme has.

	Liabilities	Assets
RPI benefits	Future realised RPI is now more likely to be different from market expectations depending on if, when and how a change is made	To the extent hedging is in place, hedging is expected to successfully match RPI liability movements
CPI benefits	CPI assumptions typically set as a deduction to RPI. Current deductions may end up understating CPI linked liabilities	If hedged with RPI instruments, assets may be impacted differently to liabilities, introducing significant deficit risk

Impact on member options

Member option	Potential impact
Early and late retirement	Relatively insensitive to financial assumptions
Cash at retirement	Conversion terms typically kept relatively stable
Trivial commutation	Typically not material, unless undertaking a bulk exercise
Transfer value (full and partial)	Value is typically market related. Review CPI wedge
Pension increase exchange	Review terms carefully for inflation increases

Actions employers can take

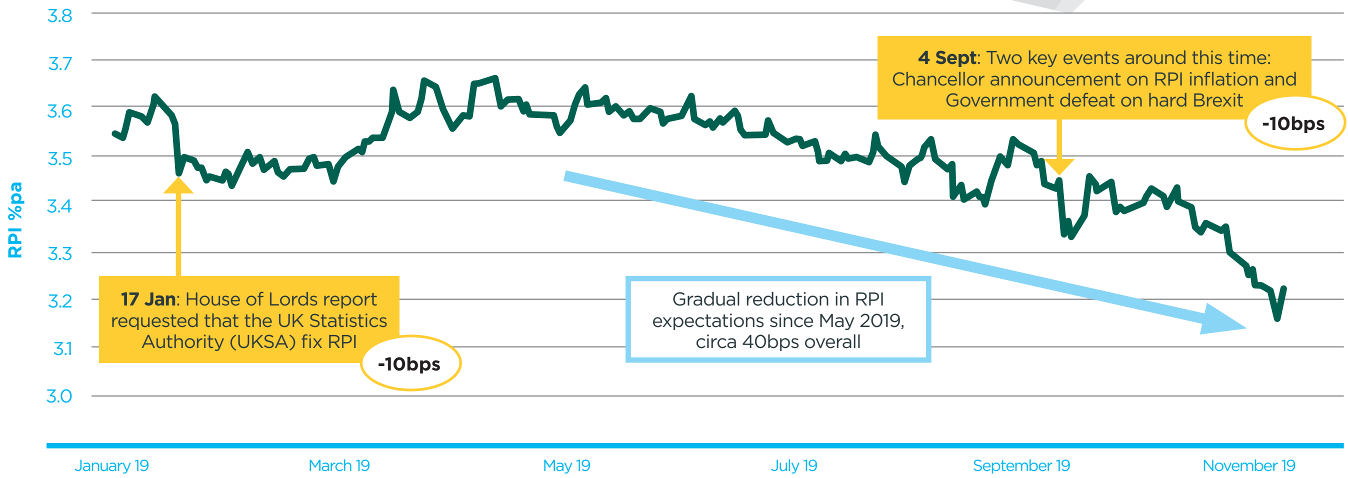
1. **Consider your RPI and CPI assumptions carefully for accounting. Auditors are expecting this to be considered so we recommend proactively engaging with them ahead of year-end to avoid delays.**
2. **Review your approach to member options, in particular pension increase exchange and transfer values, to ensure you are paying fair value and not creating additional risk.**
3. **Understand the options for managing the risk to your scheme's funding level and any additional liability. Make sure you are not funding something that might not come to pass – a notional reserve could be held to cover the potential risks.**

What are the different measures of inflation?

RPI	CPI	CPIH
- Statutory measure of inflation until 2010	- Statutory measure of inflation since 2010	- Same construction as CPI
- Generally accepted as having a flawed formula	- Different construction to RPI and excludes housing costs	- Includes housing costs

Market expectations of RPI inflation

RPI expectations are influenced by a large range of market and political factors, making it difficult to conclusively say how the market has reacted to the news. There is a consensus view that some change has been priced in but not all.



Source: 20 year breakeven spot RPI rate %pa, Bank of England.

Given the apparent market reaction, it is important to reconsider RPI and CPI assumptions.

Auditors have told us that year-end accounting assumptions will need to take account of the potential change to RPI, however assumptions should still reflect market pricing with appropriate adjustments, so they are not expecting radical changes.

For further information, please get in touch with Vicky Mullins or Heidi Webster or speak to your usual XPS Pensions contact.

t 020 3725 7017

e vicky.mullins@xpsgroup.com

t 0118 918 5483

e heidi.webster@xpsgroup.com

@xpsgroup

company/xpsgroup

XPS Pensions Group