14 July 2010

Review

Pensions

RPI to CPI - All change?

Hot on the heels of controversial announcements that public sector pension schemes will be increased in line with the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI), Steve Webb, the Minister of State for Pensions, issued a written ministerial statement last week confirming the Government's intention to use the CPI in place of the RPI when setting increases for all occupational pensions. Further information has since been provided in a press release issued by the Department for Work and Pensions (see http://www.dwp.gov.uk/newsroom/press-releases/2010/july-2010/cpi-measure.shtml).

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Here are the key points for trustees and employers of private sector occupational pension schemes:

- It is expected that the proposed switch from the RPI to the CPI will impact upon the minimum statutory increases which are designed to ensure both pensions in payment and deferred pension rights keep pace with inflation (otherwise known as indexation and revaluation). These increases are set by the Secretary of State for Work and Pensions each year and are currently based on the RPI. The recent announcements indicate that, when setting minimum indexation and revaluation rates in future, the Secretary of State will use the CPI instead. Controversially, it appears that the new rates will be applied to future increases of pensions currently in payment and the revaluation of pensions already accrued by scheme members still to retire, as well as pension rights accrued going forward.

- The CPI is calculated differently to the RPI, for example, it excludes most housing costs. In the past RPI inflation has typically been higher than CPI inflation. As such, assuming this trend continues, the adoption of statutory minimum indexation and revaluation rates based on the CPI could present a real cost saving opportunity for hard pressed defined benefit occupational pension schemes, but result in members being paid lower benefits on (and after) retirement than they were expecting to receive.

- The extent to which a defined benefit pension scheme will be able to take advantage of this cost saving opportunity is likely to depend on its scheme rules. Where the rules set indexation and revaluation rates solely by reference to the relevant legislation, we anticipate that the switch from the RPI to the CPI will automatically be reflected in scheme benefit calculations. Where the scheme rules specifically refer to the RPI or a fixed rate of increase, then amendments to the scheme rules are likely to be required. The ability of the trustees/employers to amend the scheme may be restricted by legislation and scheme amendment powers which protect pension rights that members have already accrued.

- Legislation will also be amended to enable the CPI to be used for relevant increases in respect of Pension Protection Fund compensation and Financial Assistance Scheme payments.

FURTHER INFORMATION

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