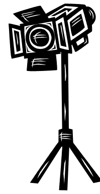
Spotlight



the pensions advisory service

THE CHANGE FROM RPI TO CPI

Introduction

This fact sheet outlines the Government's decision to use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) as the measure of inflation for pension increases in both public sector and private sector occupational pension schemes from 2011.

Differences between RPI and CPI

- RPI reflects the average spending pattern of most private households, excluding pensioner households and householders with the top 4% of income.

- CPI covers all private households, including the residents of institutional households such as student hostels, and also foreign visitors to the UK. This means that it covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.

- RPI includes mortgage interest payments. Thus changes in the interest rates affect the RPI. If interest rates are cut, it will reduce mortgage interest payments. Thus RPI will fall but CPI will not.

- RPI includes council tax and some other housing costs not included in CPI.

- CPI includes some financial services not included in RPI.

Historically, CPI has typically been around 0.7% lower than RPI. However, this has not always been the case, and in some instances, CPI has been higher than RPI.

Background

The Government announced as part of the 22 June 2010 Budget that it planned to use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) as the measure by which annual increases to certain state benefits and public sector pensions would be calculated, from April 2011. On 8 July 2010 the Government said that CPI would also apply to private sector occupational pensions from April 2011, where CPI will be used for statutory increases on pensions.

Compulsory increases prior to drawing a pension

Private sector

Before 1 January 1986, when a member of a private sector defined benefit occupational pension scheme left employment, the pension built up could remain frozen, i.e. the amount of pension did not increase between the date of leaving and retirement. There was an exception for contracted out pension schemes where a part of the pension has to be increased under contracting out rules.

Over the years since then, the government has gradually introduced compulsory increases to frozen pensions between your date of leaving and retirement based on price inflation. The level of increase broadly depends upon the regulations in force when you left service.

Pension schemes did not have to write these increases into their rules as the government's requirements had to be applied as a minimum, whether in the rules or not.

In practice some schemes have rules that refer to a specific level of increase; some refer to increasing pensions in accordance with the regulations that are in force; and some schemes have actually written RPI into their rules.

The impact of the change will therefore depend on how the scheme rules are written. Please see below for further details.

Public sector

Public sector pension schemes were already increasing pensions in line with inflation (using RPI). They will now use the CPI to increase these pension rights. Please see below for further details.

Compulsory increases when pensions are being paid

Private sector

Prior to 6 April 1997 private sector defined benefit occupational pension schemes were not required to increase pensions in payment. There was an exception for contracted-out pension schemes where a part of the pension had to be increased under contracting-out rules.

The government has since then introduced an element of compulsory increases for pensions that have come into payment. Increases only have to apply in respect of pension built up after the regulations were introduced. Pension schemes did not have to write these increases into their rules as the government's requirements had to be applied as a minimum, whether in the rules or not.

In practice some schemes have rules that refer to a specific level of increase; some refer to increasing pensions in accordance with the regulations that are in force; and some schemes have actually written RPI into their rules.

The impact of the change will therefore depend on how the scheme rules are written. Please see below for further details.

Public sector

Public sector pension schemes were already increasing pensions in line with inflation (using RPI). They will now use the CPI to increase these pension rights.

For fuller detail on how compulsory increases are given in practice, please see our website - www.pensionsadvisoryservice.org.uk/workplace-pension-schemes/final-salary-schemes/revaluation
And www.pensionsadvisoryservice.org.uk/workplace-pension-schemes/final-salary-schemes/annual-increases

The change to CPI

Public sector schemes

Public Sector schemes are governed by the Pensions (Increase) Act 1971 which refers to increases as announced by the Secretary of State from time to time. The Secretary of State has announced that CPI will replace RPI from 6 April 2011 as the rate used for the annual increases he sets. This therefore automatically changes the increases for public sector scheme members. This applies both to the increase to frozen pensions prior to drawing a pension and increases to pensions which are being paid.

The rate applied to public sector schemes was announced in the Pensions Increase (Review) Order 2011 - an annual increase of 3.1% which is the change in the CPI between October 2009 and September 2010.

The change to CPI is from 2011 onwards; increases announced in the past remain at RPI.

Private sector

The rules of the scheme will dictate how increases are to be applied. In addition, legislation imposes some requirements on pension schemes to make increases. Our website outlines the rates and when they have to be applied (see above).

The rate for these statutory increases is set by the government and where this relates to price inflation the rate is announced each year. The government has decided that the rate will now relate to CPI rather than RPI, which was used in the past.

Schemes may automatically switch to CPI if increases are not written into their rules or if the rules only refer to the statutory requirements. There is no change to the scheme rules as they are simply using the increases announced by the government.

The change to CPI is from 2011 onwards; increases announced in the past remain based on RPI.

However, many schemes actually wrote into the rules that increases would specifically be based on RPI. These schemes are likely to need to change their rules if they want to introduce CPI instead. This will be difficult – benefits are protected by restrictions in scheme rules and section 67 of the Pensions Act 1995 limits a scheme's ability to make changes that worsen benefits already built up. The government is not introducing legislation forcing schemes to change to CPI.

Changes can, generally speaking, be made to the rules in respect of benefits built up in the future (we believe the government is considering whether employers will be required to consult on changes to pension increases).

The government's intention does seem to be that schemes that continue to use RPI will not be required to also check whether CPI will provide a higher increase. But there still seems to be some uncertainty at the time of writing.

Spotlight on: The Change from RPI to CPI

How can TPAS help?

We are unable to provide a legal opinion as to whether a scheme is acting appropriately and in line with their rules. But we may look into private sector schemes that change their rules to apply increases using CPI, where RPI was previously written into the rules.

If you have complained that you have received scheme literature referring to RPI increases, and are now finding that CPI applies in the future, we expect the scheme rules and any requirements imposed by government to take precedence over leaflets from the scheme.

If you believe you have relied on letters or leaflets from your scheme that refer to RPI, and taken action or made decisions and are now worse off, you will need to provide evidence. You will need to show how it formed part of your decision making, and why you are subsequently worse off. However, we consider that it will be hard for a complaint about future pension increases to succeed.

About Us

The Pensions Advisory Service has been providing help and guidance to members of the public on pension matters since 1983 either by telephone or written advice. We can also help people who have a pension complaint or dispute.

Our service is free and sustained by a nationwide network of volunteer advisers, who are supported and augmented by technical and administrative staff based in our London office.

Contacting us

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We regret that we are unable to accept visitors at our office.

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