CPI and RPI – What is it all About?

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1 INTRODUCTION

Much has been made of the 2010 Emergency Budget announcement of linking benefit and public sector pension increases to CPI rather than RPI, and the financial implications to pensioners of this move. Also announced on 8 July 2010 was the intention that private sector schemes which refer to statutory increases, the Pensions Protection Fund (PPF) and Financial Assistance Scheme (FAS) would join the fold. This has been followed by further Government statements, consultations and legislation.

This briefing aims to cover the effect on public sector pensions, private sector defined benefit pensions, state pensions and the PPF and FAS. At the end there is also some background to the difference between CPI and RPI. It is based on our understanding of the Government's proposals at the current date and is subject to change in light of any clarification provided. You may wish to periodically check our website (www.gmb.org.uk/pensions) for updates.

Note that this briefing does not cover any defined contribution pension schemes. The rate at which your pension increases in these schemes is not subject to law, but rather is determined by the choice you make when you buy your pension on retirement.

2 OCCUPATIONAL PENSION SCHEMES

2.1 Guaranteed Minimum Pensions

Defined benefit schemes have been allowed to contract out of SERPS and the State Second Pension since 1978. This has meant that a refund of National Insurance contributions has been paid into schemes in respect of the scheme members (the Government has announced that from April 2012, the level of refund due to schemes is set to decrease). As a consequence, members have not built up any entitlement to either SERPS or State Second Pension. Defined benefit schemes that contracted out between 1978 and 1997 must have a provision to provide a Guaranteed Minimum Pension (GMP), as part of the benefits they pay to members who built up service in this period.

The complex terms under which GMPs are accrued and increased are specified by law and all schemes must comply with these.

2.1.1 GMPs in Payment

In applying increases to GMPs when they come into payment, the dates between which they were built up is important:

- For the period between April 1978 and March 1988 – a pension scheme does not have to apply any increases to GMPs in payment
- For the period between April 1988 and March 1997 – a pension scheme has to apply increases in line with price inflation up to 3% to GMPs in payment.

In recognition of the caps put on the inflationary increases paid by pension schemes, the state then pays the remainder of the increase to ensure that the whole GMP is increased by price inflation. Until now the measure has always been RPI, but this will change to be CPI from April 2011.

For example, if RPI was 5%, then a pension scheme would not increase the GMP built up before April 1988, but would increase the GMP built up after April 1988 by 3%. The state would pay the required amounts to ensure the whole GMP was increased by 5%, by applying an uplift to state benefits.

2.1.2 GMPs in Deferment

A member who leaves active service but does not draw on pension benefits is said to hold a deferred pension. Such deferred pensions are subject to increases for the period of deferment. The increase of deferred pensions is also known as revaluation.

GMPs are required to be increased whilst in deferment. Two different measures can be employed and each pension scheme will elect which measure they will apply. GMP revaluation can take one of the following forms:

- In line with increases to average earnings. Schemes were given the option to apply a cap to these increases of 5% pa for leavers before 6 April 1997
- In line with fixed revaluation amounts, dependent on the date of leaving. The following annual increases are applied:
  - Leavers before 6/4/1988 8.5%
  - Leavers between 6/4/1988 and 5/4/1993 7.5%

- Leavers between 6/4/1993 and 5/4/1997 7.0%
- Leavers between 6/4/1997 and 5/4/2002 6.25%
- Leavers between 6/4/2002 and 5/4/2007 4.5%
- Leavers after 5/4/2007 4.0%

These deferment increases of GMPs do not appear to be affected by the proposals to move towards CPI.

2.2 Revaluation of Pension in Excess of GMP

Defined benefit pension schemes (both in public and private sectors) have been required to increase (revalue) deferred pensions for many years.

The requirement to increase the pension above the Guaranteed Minimum Pension level applied in part for those who left active service of a pension scheme after 1 January 1986 and in full for those who left after 1 January 1991.

The law prescribed a minimal level of revaluation of the part of the pension that is not GMP. Individual pension schemes can choose to mirror this legislation or apply their own level of pension increases which are better than this legal minimum. Details of how defined benefit pensions are increased will be found in the trust deed and rules for a trust based pension scheme.

The statutory minimum level of increases that apply to pensions in payment is determined by the date in which the pension was accrued (i.e. when you build up the service on which your pension is calculated).

- For pensions that were built up before 6 April 2009, the current statutory requirement is that these are revalued by price increases up to a maximum of 5% per annum
- For pensions that were built up from 6 April 2009 onwards, the current statutory requirement is that these are revalued by price increases up to a maximum of 2.5% per annum.

The price increases referred to here have been RPI up to now, but will be CPI from April 2011.

Note again that your scheme may have in-built rules that provide better levels of increase than the statutory minimum. The Government has confirmed that at this stage they do not intend to override any scheme rules that provide more than the statutory minimum level of pension increases[1].

2.3 Public Sector Pension Increases in Payment

The Government announced that the move from RPI to CPI will be applied for the indexation of public sector pensions that are being paid.

This applies to any pension in excess of Guaranteed Minimum Pension. The increases and revaluation applied to Guaranteed Minimum Pensions are as described above.

[1] http://www.publications.parliament.uk/pa/ld201011/ldhansrd/text/100728w0001.htm#10072823000767

Under existing law, public sector pensions increases in payment, which are subject to the Pensions (Increase) Act 1971 and the Social Security Pensions Act 1975, are increased by the general level of prices. No reference to any particular index is made.

The Government has estimated that the saving to the Treasury of the move to CPI across all public sector schemes (excluding the Local Government Pension Scheme) will exceed £3bn by 2015[2]. The move to CPI would also apply to the Local Government Pension Scheme, so this would generate an extra reduction in the cost of this scheme.

Confirmation that public sector pensions would be uprated in line with CPI (3.1% in September 2010) rather than RPI (4.6%) was formally given on 3 February 2011[3].

As an example, for someone receiving a pension of £2,000pa in 2010/11, the move to CPI means that their pension would increase to £2,062pa in April 2011, rather than increase to £2,092pa if RPI increases had been retained.

2.4 Private Sector/Trust Based Defined Benefit Pension Increases in Payment

Legislation has required a minimal level of increases of the part of the pension that is not covered by GMP. Individual pension schemes can choose to mirror this legislation or apply their own level of pension increases which exceed the statutory minimum level of increases. Details of how defined benefit pensions are increased will be found in the trust deed and rules for the pension scheme.

The statutory minimum level of increases that apply to pensions in payment is determined by the date in which the pension was accrued (i.e. when you build up the service on which your pension is calculated).

- For pensions that were built up before 6 April 1997, there is no current statutory requirement for this to be increased when in payment
- For pensions that were built up between 6 April 1997 and 5 April 2005, the current statutory requirement is that these are increased by price increases up to a maximum of 5% per annum
- For pensions that were built up from 6 April 2005 onwards, the current statutory requirement is that these are increased by price increases up to a maximum of 2.5% per annum.

The price increases referred to here have been RPI up to now, but will be CPI from April 2011.

So for example, if you built up a pension between 6 April 1993 and 6 April 2009 in a scheme providing statutory minimum increases in payment, you would have 16 years of service. The pension from your first four years (i.e. one-quarter of your pension) would not be increased. The pension from your subsequent eight years (i.e. one-half of your pension) would be increased by price increases up to 5% pa. The pension from your

[2] http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100727/text/100727w0012.htm#10072820007969

[3] http://www.dodsmonitoring.com/downloads/WMS/WMS_2011/February_3_2011/WMSPSP3211.pdf

final four years (i.e. one-quarter of your pension) would be increased by price increases up to 2.5% pa.

Note again that your scheme may have rules that provide better levels of increase than the statutory minimum and again the Government have not yet proposed any statutory override of any scheme's rules. Pension scheme rules can be changed to reduce the level of increases that applies for pension that accrues in the future. The Government intends to include any such change on the list of changes which employers must consult with their workforce about.

3 FINANCIAL ASSISTANCE SCHEME AND PENSION PROTECTION FUND

The Pension Protection Fund (PPF) and Financial Assistance Scheme (FAS) pay a pension to members of schemes whose sponsoring employer has gone insolvent and whose scheme reserves are insufficient to pay a pension in line with the level of protection offered by the PPF.

PPF protection currently ensures that members will receive no less than 90% of their accrued benefits up to a cap of about £29,750pa. FAS provides a similar level of protection.

Both bodies apply increases to deferred pensions and pensions in payment. Up to now these increases have been based on the RPI but from 2011 they will be linked the CPI.

The Government has estimated that the move to CPI will save £4.6m[4] from pensions in payment from the Financial Assistance Scheme by 2015 (FAS currently pays pensions to 14,500 individuals).

4 STATE PENSIONS

The State Pension in the UK is made up of two main components – the Basic State Pension and the State Second Pension (formerly known as SERPS). A long running GMB campaign called for the indexation of state pensions to be the better of the growth in annual earnings and in prices, thereby reversing the damage done by the Conservative Government, when they broke the link with earnings in 1980.

The Government has recently announced its "triple lock" guarantee, which they claimed would take effect from April 2011, meaning that the Basic State Pension would increase in line with the best of:

- Consumer Prices Inflation (3.1% in September 2010)
- Average Weekly Earnings Index (2.2% in September 2010)
- 2.5%.

[4] http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100727/text/100727w0010.htm#10072820007835

However, the Emergency Budget states that in April 2011, the Basic State Pension will increase by the measure of RPI in September 2010 (4.6%). Clearly the Government anticipated this measure to exceed any of the three measures listed in the triple lock as they have quoted that the cost of the triple lock in 2011 will be exactly £0[5].

Whilst the triple lock applies to the Basic State Pension, the other components of state pension (i.e. State Second Pension and SERPS) will continue to remain linked to one measure of increase. However, rather than this being RPI, as has been the case up to now, the Emergency Budget indicated that this will change to CPI from April 2011. The Emergency Budget also confirmed that the Pension Credit, the means tested benefit payable to low-income pensioners, will rise in line with the cash increase (NB not the proportionate increase) to the Basic State Pension in 2011. From April 2011 the Pension Credit will guarantee a weekly income of £137.35. Beyond 2011, the Pension Credit appears to be linked to CPI indexation.

4.1 The Future of the Basic State Pension

The full Basic State Pension in 2010/11 amounts to £97.65 per week, and will increase to £102.15pw in April 2011. How might this increase in the future? The Office for Budget Responsibility's own projections will be helpful in assessing this[6]. The Emergency Budget Report contains estimates of future RPI, CPI and earnings growth:

Year		2010	2011	2012	2013	2014	2015	Cumulative
Increase in Quarter 4	CPI	2.7%	2.4%	1.9%	2.0%	2.0%	2.0%	13.7%
	RPI	3.7%	3.2%	3.2%	3.3%	3.4%	3.5%	22.1%
	Earnings	2.1%	1.9%	2.3%	3.8%	4.4%	4.4%	20.4%

For the Basic State Pension, these estimated projections, applied to the current value and the proposed triple lock policy would result in a weekly amount of £120.36 pw being paid from April 2016.

If the CPI measure of inflation was not implemented, but rather the RPI measure used in the triple lock, the equivalent amount of Basic State Pension from April 2016 would be £122.01pw. This is roughly a reduction in annual Basic State Pension of £86 in five years time.

[5] p41, http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf
[6] p84, http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf

5 SUMMARY OF INCREASES

The table below summarises the current increases that are applied to various different pensions, as well as the potential position under the proposal to move to CPI. These increases are explained in full in relevant sections of this briefing.

Benefit	Position before April 2011	Position from April 2011
GMP in payment	RPI (increases split between pension scheme and state)	CPI (increases split between pension scheme and state)
GMP in deferment	Fixed or National Average Earnings	No Change
Public Sector Pensions in payment	RPI	CPI
Public and Private Sector Pensions in deferment	Statutory minimum of RPI up to caps (caps determined by date of accrual)	Statutory minimum of CPI up to caps (as determined by date of accrual) – schemes can retain RPI if it is referred to in their rules
Private Sector Pensions in payment	Statutory minimum of 0% (accrued before April 1997) and RPI up to caps thereafter (caps determined by date of accrual)	Statutory minimum of 0% (accrued before April 1997) and CPI up to caps thereafter (caps determined by date of accrual) – schemes can retain RPI if it is referred to in their rules
PPF Pension in deferment	In line with the statutory minimum applied to occupational schemes (caps determined by date of accrual)	In line with the revised statutory minimum applied to occupational schemes (caps determined by date of accrual)
PPF Pension in payment	0% (accrued before April 1997) and RPI up to 2.5%pa thereafter	0% (accrued before April 1997) and CPI up to 2.5%pa thereafter
FAS Pension in deferment	RPI up to 5%pa (where scheme rules apply revaluation)	CPI up to 5% pa (where scheme rules apply revaluation)
FAS pension in payment	0% (accrued before April 1997) and RPI up to 2.5%pa thereafter	0% (accrued before April 1997) and CPI up to 2.5%pa thereafter
Basic State Pension in payment	RPI (with 2.5% minimum increase applied in recent years)	From 2012 onwards, best of CPI, Earnings and 2.5% (RPI used in 2011)
SERPS/State Second Pension in payment	RPI	CPI
Pension Credit	RPI	CPI from 2012 onwards

6 WHAT CAN I DO?

GMB members in private sector pension schemes are advised to request and inspect their scheme rules and write to their trustees. Copies of a scheme's Trust Deed and Rules should be made available to a member or recognised trade union on request.

Scheme rules may refer to the statutory minimum level of increases to pensions in deferment and payment, but they need not necessarily do so – some schemes will specifically grant RPI increases to pensions and have rules that are worded accordingly. Any changes to such rules must be consulted upon and would only be allowed to apply for pensions that are accrued in the future (i.e. the increases applied to your past service pension would be protected).

Trustees should be asked to prepare a schedule of the increases that are applied to different scheme benefits. This would include pension in payment, pension in deferment, revaluation of earnings (in a career average scheme or final salary scheme that uses average earnings over a period).

GMB is considering the legal implications of this policy. We have been clear in calling for a full review of pensioner inflation in the UK and the establishment of a pensioners price index, and we will continue to campaign for this.

7 BACKGROUND: CPI and RPI – A DIFFERENT MEASURE OF THE SAME THING?

The Consumer Prices Index (CPI) and the Retail Prices Index (RPI) may sound like exactly the same thing. In many respects that is true, they measure the rate at which the cost of living is increasing; but the differences that do exist can result in the indices being significantly different.

Both measure a basket of goods, but give different weightings to different goods. Also the RPI index includes a number of items not included in the CPI index, such as mortgage interest and trade union subscriptions[7]. The general housing boom in the UK has led to RPI being significantly higher than CPI over the long term.

There is another implicit reason why RPI is usually greater than CPI. This relates to the method of calculation – and the difference between the averaging applied[8]. This difference in methodology alone would cause the CPI to be 0.5% lower than an RPI equivalent.

The table below shows the RPI and CPI measures in September for each year since 1996. The official reason that the September measure is used is that this is the most up to date figure that can be included in the Pre-Budget Report which outlines increases to apply in the following April.

[7] http://www.statistics.gov.uk/articles/nojournal/CPI_and_RPI_The_2010_Basket_of_Goods_and_Services.pdf

[8] p84, http://www.statistics.gov.uk/downloads/theme_economy/CPI_Technical_Manual.pdf

Year		2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Inflation In September	RPI	4.6%	-1.4%	5.0%	3.9%	3.6%	2.7%	3.1%	2.8%	1.7%	1.7%	3.3%	1.1%	3.2%	3.6%	2.1%
	CPI	3.1%	1.1%	5.2%	1.8%	2.4%	2.5%	1.1%	1.4%	1.0%	1.3%	1.0%	1.2%	1.4%	1.8%	2.3%

This shows that with a few exceptions, RPI tends to be the higher measure of price inflation. On average, and over the long term, RPI is roughly 0.75% higher than CPI.

8 SO HOW WOULD THE MOVE TO CPI AFFECT MY PENSION?

It is impossible to predict the future impact of the migration to CPI for future pension increases, although the Government's projections have allowed us to analyse their assessment of increases to the Basic State Pension.

It is useful to look at how pensions might have increased in the past had CPI been applied rather than RPI. The table below shows the pension a pensioner might be receiving had they retired in the year shown, compared with a pension of £4,000pa. The bottom row shows how much their current pension would be lower as a percentage if CPI had been used rather than RPI.

Year of Retirement	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Current Pension with CPI increases	£4,000.00	£4,044.00	£4,051.70	£3,969.81	£3,923.83	£3,916.19	£3,840.22	£3,787.92	£3,761.85	£3,747.05	£3,663.62
Reduction in pension	0.0%	-1.1% (£44.00 better off)	-1.3% (£51.70 better off)	0.8% (£30.19 worse off)	1.9% (£76.17 worse off)	2.1% (£83.81 worse off)	4.0% (£159.78 worse off)	5.3% (£212.08 worse off)	6.% (£238.15 worse off)	6.3% (£252.95 worse off)	8.4% (£336.38 worse off)

For example a member retiring in 2000 would currently be receiving a pension of £3,663.62 rather than £4,000 if CPI had been applied rather than RPI. Note that as CPI exceeded RPI in September 2008 and 2009, this measure would have resulted in people retiring in these years being on a larger pension now. However the above shows that over the longer term, CPI linked increases tend to produce lower rates of pension.