Dear Madam/Sir,

The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £1 trillion of assets. Pension schemes are one of the largest institutional investors in government debt and UK shares. We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

The NAPF welcomes the opportunity to respond to this consultation and agree that the need for RPI as a statistical measure ought to be reviewed. We believe that RPI ought to be abandoned for the reasons put forward in Paul Johnson's review. We also recommend that a governance structure similar to that of the Financial Reporting Council and its' SORP-making bodies is set up to maintain and update consumer indices. We do not think that existing legislation provides a sufficiently flexible tool to respond to evolving demands on consumer indices.

RPI and pensions

RPI has clearly been shown to be based on an inferior methodology to CPI and we agree with the approach to abandon the measure. However such a move needs to come with parallel commitments to modernise both the legislation governing pension scheme indexation and government debt issuance, in a managed fashion. This cannot occur in isolation from other areas of Government policy as the RPI legacy has a number of consequences for pension schemes. We believe that DWP would need to legislate for a statutory override that enables Defined Benefit (DB) pension schemes to transition benefit indexation to CPI. In addition, the Debt Management Office (DMO) would need to manage the transition away from the issuance of RPI linked gilts; moving instead to CPI linked gilts.

Measures of inflation are important to pension schemes. DB pension schemes need to take into account salary indexation of accrued and contributed benefits and contributions respectively, inflation protection of benefits and inflation linked assets in liability matching and life-styling strategies. An individual's scheme pension is subject to both revaluation and indexation requirements that were historically linked to RPI but, for some schemes, moved to CPI in 2011. DC schemes often use CPI as a benchmark for their investment returns. For example, NEST, the pension scheme set up by Government to accept any employer under automatic enrolment into their pension scheme, has an investment strategy that targets a CPI+ measure.

In 2010, when CPI was formally adopted as the national statistic, the Government back-tracked on a commitment to allow pension schemes to alter inflexible scheme rules (by means of a statutory override).

This override would have allowed schemes to have the option of switching to CPI linked indexation of their liabilities. This resulted in schemes being subject to a 'drafting lottery', where those with more flexible scheme rules were able to adapt them to take into account indexation changes, with workers with protected rights (as former Government employees) particularly affected. At the time 61% of our membership indicated that the nature of their scheme rules meant they did not have the flexibility to switch. Since then, many schemes have engaged in lengthy and costly legal battles to alter their indexation method, often to no avail. We believe that if RPI is abandoned as an official inflation measure then DWP would need to legislate for a statutory override that enables Defined Benefit (DB) pension schemes to transition benefit indexation to CPI.

Inflation linked assets

Inflation linked assets are an attractive investment for both DB and DC pension schemes. Index linked gilts are typically used by DB pension schemes in liability matching strategies. Liability matching is a strategy that seeks return that approximately matches the growth of liabilities over time and an income stream that can match the future payments of those liabilities.

DB schemes with RPI-linked liabilities consider RPI-linked gilts a strategic asset - one of the few that offers hedging against RPI inflation. Recent reforms have resulted in an increased focus on liability matching strategies by schemes as a de-risking measure as DB schemes close to new members and mature. Indeed there is a pervading perception that liability matching and a switching from stocks to government bonds is the de-facto de-risking response and is encouraged by the Pensions Regulator. The EU's IORP Directive and Solvency Directive both put increased onus on capital matching of liabilities by institutional investors such as pension funds. Inflation linked assets, such as Government Index linked gilts, corporate bonds and infrastructure demonstrate many of these characteristics. For DC pension schemes, life-styling means that as members move closer to retirement age, schemes need to invest in long-term, low volatility assets that will at least meet inflation expectations, to give their members a decent chance of a good income replacement rate in retirement.

Despite pension scheme demand for long dated bonds and long dated linked gilts, there is a narrow pool of different assets that offer this return profile, and too narrow a supply in general. The introduction of CPI linked gilts could help reduce demand for RPI linked gilts, by providing an alternative asset of a similarly desirable profile for pension schemes to invest in. In recent years, despite negative yields, pension schemes have continued to be large holders of RPI linked gilts. This move to introduce CPI linked gilts could ease pressure on RPI linked gilts with a potential uplift to yield. After their 2011 consultation, the UK Debt Management Office (DMO) backed away from abolishing RPI for Index-linked gilt issuance and introducing CPI linked gilts. They consulted on potential issuance again in 2012, and maintained their position. With the move to CPI, DB schemes who were able to change their indexation are struggling to find assets that provide a direct match. The NAPF continues to urge the Government and the DMO to re-consider issuing CPI linked gilts.

A move by the ONS to abandon RPI would demand a corresponding move from the DMO to issue CPI linked gilts and potentially taper off the future issuance of RPI linked gilts in order that pension schemes and other investors can meet inflation-linked liabilities.

Finally, any national consumer index needs to be able to meet evolving needs, stay up to date with methodological advances, reflect international best practice and incorporate emerging goods and markets due to technological advances. At the same time, while RPI is still in use by pension schemes, the methodology for the index should not be frozen. Consequently, whatever powers are used to maintain the index ought to be sufficiently flexible to adapt on a timely basis. The model used for setting accounting and reporting standards is a strong example.