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Occupational pension increases

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Summary

Defined Benefit (DB) pension schemes provide pension benefits based on salary and length of service. There are statutory minimum requirements on them to:

- Index pensions in payment in line with inflation, capped at 5% for benefits accruing from service between April 1997 and April 2005, and at 2.5% for benefits accruing from April 2005 - known as Limited Price Indexation (LPI) (*Pensions Act 1995*, s51);

- Revalue the deferred pensions of early leavers in line with inflation capped at 5%, and at 2.5% for rights accrued on or after 6 April 2009 (*Pension Schemes Act 1993*).

Importantly, these are statutory minimum requirements -there is nothing to prevent schemes from making more generous arrangements through their scheme rules.

Reform of the Retail Prices Index (RPI)

As discussed below, in 2012 the Coalition Government switched from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) as the measure of prices used for setting the statutory minimum increase each year. However, many schemes had RPI written in their rules and could not change this.

Reforms to the methodology for calculating the RPI are planned to take effect from 2030. The aim is to address shortcomings acknowledged by the National Statistician in 2013.

In a statement on the future of the RPI in September 2019, UKSA said it intended to address the shortcomings of the RPI by bringing into it the methods of CPIH (Consumer Price Inflation including owner occupier housing costs). Until 2030, it requires consent of the Government to do this. In March 2020, UKSA and HM Treasury launched a consultation on the impact of the reform and when it should take place between 2025 and 2030. In their response to the consultation in November 2020, they acknowledged that there would be an impact on defined benefit (DB) pension schemes and members. For DB pension scheme members with RPI-linked benefits, the reform would result in a reduction in the lifetime benefits (para 95-7). For DB schemes, the impact would depend on the extent to which their investments and pension benefits were linked to the RPI. DB schemes with CPI linked pensions hedged with RPI-linked assets would see the total value of their assets fall while their liabilities remained unchanged. They would see a negative impact on their funding position (paras 65-76). Chancellor of the Exchequer, Rishi Sunak, said he could see the statistical arguments for the proposed approach but that in order to minimise the impact on the holders of index-linked gilts, he would be "unable to offer his consent to the implementation of such a proposal before the maturity of the final specific index-linked gilt in 2030." However, he would not offer compensation to holders of index-linked gilts (para 19-20).

The Pensions and Lifetime Savings Association expressed its disappointment that the Government had "chosen to disregard the detrimental impact this move will have on both savers' retirement incomes and on the assets of UK pension schemes." It would continue to press its case for solutions to mitigate the impact of the reform.

On 9 April 2021, the trustees of the BT Pension Scheme, Ford Pension Schemes and Marks and Spencer (M&S) Pension Schemes confirmed that they were seeking a judicial review of the decision effectively to replace RPI with CPIH from 2030.

Background: development of limited price indexation

Before April 1997 there was no general obligation on Defined Benefit schemes to increase pensions in payment (although there was a requirement on schemes that were contracted out of SERPS to provide indexation capped at 3% on rights accrued from 1988).[1] Despite the absence of a general obligation, it appears that many schemes did apply some form of inflation protection to pensions in payment *on a voluntary basis* and many applied LPI retrospectively to service before 1997 (Deregulatory Review, March 2007)

In 1993, the Pension Law Review Committee, chaired by Professor Roy Goode, recognised the importance of indexation from the individual's perspective:

> Most important is the uncertainty with regard to inflation. The individual is concerned not with money amounts but with what the pension will buy. (*Pension Law Reform. The report of the Pension Law Review Committee*, para 3.1.10)

Despite this, the Committee did not recommend making indexation requirements retrospective, because it:

> […] recognised that to require all earnings-related schemes to introduce LPI for pension rights accrued before the appointed date would place a considerable burden of costs on such schemes. (Ibid)

Limited Price Indexation (LPI) – a requirement to index pensions in payment in line with inflation capped at 5% - was introduced under the *Pensions Act 1995* (s51).

The Labour Government legislated to reduce the LPI cap to 2.5% for rights accrued from April 2005 in the *Pensions Act 2004* (s278-9). Following a consultation, it had decided that "mandating some level of protection from inflation remains desirable" but that lower inflation levels made a reduction in the cap appropriate:

> In 1995, when the legislation introducing LPI was passed, long-term expectations of inflation were significantly higher: the 5 per cent cap was only intended to provide for partial cover against inflation. But the Government's success in reducing inflation means that mandatory indexation has effectively become full inflation cover, something which is proving disproportionately expensive for some schemes to provide. (Cm 5835, p23).

In December 2006, an independent review looked at whether LPI should be removed. However, the reviewers – representing the employer and union sides - were unable to agree.[2] The Labour Government decided not to remove the requirement on the grounds that it was an important protection for members and there was no clear evidence that removing it would have a direct and significant effect on employer provision (Deregulatory Review, March 2007).

Members of some occupational pension schemes – such as the Hewlett Packard Pension Association – have called on the Government to require indexation of pre-1997 rights. However, the Government has said it has no plans to do this, on the basis that it would mean "significant additional expenditure for any scheme and its sponsoring employer" see Library Debate Pack CDP- 2017-0016, September 2017.

Switch to the CPI – April 2011

From April 2011, the Coalition Government changed the measure of inflation used for determining the annual minimum increases from the Retail Price Index (RPI) to the Consumer Prices Index (CPI) (HC Deb, 8 July 2010, c14-16 WS).The change was controversial because the CPI inflation tends to be lower than RPI inflation. The impact of

1 SN-04956 Guaranteed Minimum Pension – annual increases (2015)
2 Lewin and Sweeney, Deregulatory Review of Private Pensions. A Consultation Paper, March 2007

the legislative change on individual schemes would depend on what their rules said (DWP, Impact assessment, 12 July 2011).

The Government considered introducing a 'statutory override' to allow schemes to change their rules where they might otherwise be prevented from doing so. (DWP, The impact of using CPI etc – consultation on Government proposals, December 2010). However, it decided against on grounds that trust in pensions was important and that government justification demanded strong justification. Where a scheme did intend to change its rules for future accruals, employers would be required to consult (Government response to consultation, June 2011, para 18 and 34).

On 7 November 2018, the Supreme Court ruled that the wording of the rules of the Barnardo's pension scheme did not permit it to switch from the RPI to another index that it considered more appropriate unless the RPI had been officially withdrawn and replaced, which it had not.

Consultation on ability to change scheme rules

In its December 2016 report on Defined Benefit pension schemes, the Work and Pensions Select Committee said schemes that had latitude in their rules to switch to the CPI had tended to do so. It recommended that the Government consult on "permitting trustees to propose changes to scheme indexation rules in the interests of members":

> Pension promises are just that. Any change to the terms of them should not be taken lightly. In circumstances where an adjustment to the scheme rules would make the scheme substantially more sustainable, however, a reduction in benefits could well be in the interests of members.[3]

In its February 2017 Green Paper, the Government asked for views on whether:

- There was evidence to suggest an affordability crisis that would warrant permitting schemes to reduce indexation to the statutory minimum;
- The Government should consider a statutory over-ride to allow schemes to move to a different index, provided protection against inflation was maintained;
- The Government should consider allowing schemes to suspend indexation in some circumstances. (DWP, Security and Sustainability in Defined Benefit Pension Schemes, CM 9412, Feb 2017).

The March 2018 White Paper ruled out changes to override scheme rules:

> 212. We are committed to protecting members' pension benefits, and are presently ruling out measures which would override provisions in scheme rules and allow employers, or schemes, to change the measure of inflation used to calculate annual increases. However, we will continue to monitor developments in the use of inflation indices. (Cm 9591, March 2018).

[3] Ibid, para 110-11

1. Introduction

There are two main types of occupational pension schemes:

- Defined Benefit (DB) schemes, that typically promise to pay a pension linked to salary and length of service.
- Defined Contribution (DC) schemes, that typically pay out a sum based on the value of a member's fund on retirement.

For DB schemes, there are statutory minimum requirements regarding the indexation of pensions in payment and the revaluation of the deferred pension rights of early leavers:

- Under the *Pensions Act 1995* pensions in payment must be increased annually in line with prices, capped at 5%, was required for rights accrued from 1997.[4] Under the *Pensions Act 2004*, the cap was reduced to 2.5% for rights accrued from 2005 onwards.[5]
- Under the *Pension Schemes Act 1993* deferred pension rights must be revalued in line with prices, capped at 5% for service to 5 April 2009, and at 2.5% for service thereafter.[6]

The minimum annual increases are provided for in an annual order.[7]

Separate requirements applying to Guaranteed Minimum Pensions (which schemes are required to provide as a condition of being used to contract-out of the State Earnings Related Pension Scheme between 1978 and 1997). Occupational pension schemes are required to index-link GMP rights accrued between 1988 and 1997 subject to a cap of 3%.[8] This, and the interaction of GMPs with the State Pension system which also provides some indexation, is discussed in Library Briefing Paper SN-04956 GMP annual increase order (June 2015)

This legislation does not apply to DC schemes, where inflation-protection will depend on what an individual does with their funds at retirement - for example, whether they buy an index-linked or fixed annuity.[9] The requirement to index-link DC scheme pensions or lifetime annuities was removed for pensions coming into payment from April 2005.[10]

4 Section 51
5 Section 278
6 *Pension Schemes Act 1993,* Part IV, Chapter II
7 See for example, The Occupational Pension (Revaluation) Order 2015 (SI 2015/1916)
8 *Pension Schemes Act 1993,* s109
9 HC Deb, 2 March 2011, c478W
10 HL Deb 13 October 2004 c91GC; *Pensions Act 2004*, s278-9

2. Reform of RPI methodology

This section looks at plans to reform methodology for calculating the RPI, to bring it into line with that for CPIH (Consumer Prices Index, including housing costs) from 2030.

2.1 Background

January 2013

The then National Statistician, Jil Matheson, decided to leave the way RPI is calculated unchanged following a consultation on altering the construction of the measure.[11] However, RPI lost its designation as a 'National Statistic' as the formula used to produce it "does not meet international standards".[12] The result of this decision was to downgrade the status of RPI as a measure of inflation, without changing the way it was calculated. This meant it continued to be used for a variety of purposes including for index-linked government bonds.

March 2013

In November 2012, the Office for National Statistics (ONS) announced that an additional measure consumer price inflation would be launched which included owner-occupiers' housing costs – this would be known as CPIH. Statistics for CPIH were first published in March 2013.[13] (The headline CPI measure does not include owner-occupiers' housing costs, while RPI does.)

CPIH was initially awarded National Statistic status, but this was subsequently taken away due to concerns with the source data it used to estimate owner-occupiers' housing costs.[14] To do this, CPIH includes a so-called rental equivalence measure. This uses private rent costs to estimate the hypothetical rental value of an owner-occupier living in their own house.[15]

January 2015

An official wide-ranging review of consumer price statistics was commissioned by the UK Statistics Authority in May 2013.[16] This was led

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[11] ONS, National Statistician announces outcome of consultation on RPI, 10 January 2013; a summary of events leading up to the consultation are covered in OBR, *Economic and fiscal outlook*, Box 3.7 ONS methodological developments on consumer prices, December 2012

[12] A separate measure of RPI inflation, called RPIJ, was also created. This corrected for the most obvious statistical problem with RPI (by using the 'Jevons' rather than 'Carli' index formula), although this measure was discontinued a few years later.

[13] UK Statistics Authority, Assessment of compliance with the Code of Practice for Official Statistics: Statistics on Consumer Price Inflation, July 2013, pp1-2

[14] Summarised in Resolution Foundation, The going rate: Moving from CPI to CPIH and the inflation, March 2017

[15] Rental equivalence is used in an effort to isolate the cost of owning your own house that directly relates to the benefit of living there ('imputed rent'), rather than any element related to owning an asset. However, this means it cannot be directly observed and measured.

[16] UK Statistics Authority, Statistics Authority launches reviews of price indices, 16 May 2013

by Paul Johnson, Director of the Institute for Fiscal Studies, and reported in January 2015.[17] It recommended that:

- The ONS should move towards making the CPIH its main measure of inflation. Until then CPI should be used.
- ONS and the UK Statistics Authority should reiterate that RPI is a flawed statistical measure and shouldn't be used unless "there are contractual commitments at stake".[18]
- RPI should be considered a "legacy measure" and no further changes should be made to it.
- Government and regulators should work towards "ending the use of RPI as soon as practicable".[19]

In response, the then national statistician, John Pullinger, agreed to make CPIH the main measure of consumer prices from March 2017 by which time he said all planned improvements to the measure would be implemented.[20] This involved including council tax in CPIH for the first time, as well as other technical changes.

March 2017

The CPIH became the ONS' main measure of inflation in March 2017 (although it would not gain its National Statistic status until July 2017).[21] In practice, this meant the ONS would prioritise CPIH statistics in its monthly bulletin of consumer prices and downgrade the prominence of CPI figures. The use of CPIH in the wider economics and policy community has been more limited, with the more established CPI measure still preferred. For example, the Bank of England's inflation target – set by government –is still based on the CPI measure.

October 2018

In Budget 2018, the Government announced that it would not introduce new uses of RPI. In addition, the Government said its objective was that CPIH becomes its headline measure "over time" and that it will "reduce the use of RPI when and where practicable".[22] Nevertheless, it noted that moving away from RPI was complex given its extensive use in the public and private sectors.

January 2019

The House of Lords Economic Affairs Committee published a report, *Measuring Inflation*, which considered the future use of RPI and alternative measures by the government.[23]

The Committee concluded that the UK Statistics Authority (UKSA) should correct a specific error in the RPI – related to a 2010 change in

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[17] UK Consumer Price Statistics: A Review, Paul Johnson, UKSA, January 2015
[18] Ibid. recommendation 4
[19] Ibid. recommendation 5
[20] Statement on future of consumer price inflation statistics in the UK, John Pullinger, ONS, 10 November 2016
[21] ONS, Consumer price inflation, UK: February 2017, 21 March 2017; Letter from Ed Humpherson, Director General for Regulation, UKSA to John Pullinger, 31 July 2017
[22] HM Treasury, Budget 2018, HC 1629, October 2018, p12, Box 1.A
[23] House of Lords Economic Affairs Committee, Measuring Inflation, HL paper 246, Jan 2019

the way clothing prices are measured – which has led to it being 0.3 percentage points higher since 2010 (from being 0.5 percentage points higher than CPI before 2010 to around 0.8 percentage points since). It also called on UKSA to make subsequent improvements to RPI.

> The Committee finds that the UK Statistics Authority is at risk of being in breach of its statutory duties on the publication of statistics, by refusing to correct an error that it openly admits exists in the Retail Prices Index (RPI). This error, made in 2010 when the process for collecting price quotes for clothing was altered, has resulted in RPI being 0.3 percentage points higher since 2010. As a result, commuters and students pay more because rail fare increases and student loan interest rates are linked to RPI, and holders of index-linked gilts at the time received an unwarranted windfall. The UK Statistics Authority has a duty to "promote and safeguard the quality of official statistics".
>
> The Committee calls for the Authority to follow the procedure for correcting the error and, given that RPI remains in widespread use, resume a programme of regular methodological improvements.[24]

The Committee also recommended that there should be a single general measure of consumer prices that includes owner-occupier housing costs. This was to prevent the government cherry picking inflation measures to save money.

> The Committee also recommends a single measure of general inflation for use by the Government. This is to prevent so-called 'index-shopping' by Government, where indices are chosen because of their impact on the public finances rather than their merits as measures of inflation.[25]

September 2019

Following the Lords Committee's report, the UK Statistics Authority (UKSA), the Bank of England and the Chancellor all corresponded with each other on the future of RPI. These were made public in September 2019.[26] In light of the Lords Committee's report, UKSA proposed that:

- the publication of the RPI be stopped at a point in future; and
- in the interim, the shortcomings of the RPI should be addressed by bringing the methods of the CPIH into it.[27]

Any changes to RPI proposed by UKSA requires consultation with the Bank of England on its impact on owners of index-linked government bonds.[28] Furthermore, any changes to RPI need the Chancellor's approval if the Bank finds that it may have a detrimental impact to relevant bondholders.

The Chancellor's consent is no longer required from 2030, when UKSA could make changes - such as those proposed above - to RPI on its own. UKSA leadership has said that, while it can't bind its successors, it

[24] Ibid.
[25] Ibid.
[26] UK Statistics Authority, Response from the Bank of England (Section 21)
[27] UKSA, UK Statistics Authority Statement on the future of the RPI, 4 September 2019
[28] Section 21 of the *Statistics and Registration Service Act 2007*

expects that UKSA would go ahead with these proposed changes in 2030 if required.[29]

The Bank of England found that UKSA's plans were material and detrimental to holders of relevant gilts (as the interest they receive from government would be lower than they are now using RPI). This meant the Chancellor had the power to determine what, if any, action would be taken.[30]

In September 2019, the Chancellor, Sajid Javid, responded to UKSA's proposals.[31] He noted the benefits of aligning RPI with CPIH over time while observing that such a change could be disruptive given the widespread use of RPI in the economy. The Chancellor announced his intention to consult on the changes in January 2020, including on the timing of when to change RPI to resemble and then fully align it with CPIH. He also said any change would not occur before February 2025.

For reference, the difference in annual inflation rates between the CPI and CPIH has been small. Annual changes in CPIH have been 0.1 percentage points lower than CPI in the three-year period from January 2017 to December 2019.[32] [update]

March 2020 consultation

In March 2020, HM Treasury and the UK Statistics Authority (UKSA) launched a consultation on reform of the Retail Prices Index (RPI) methodology. The reason was that:

> 1. The Retail Prices Index (RPI) is the oldest measure of inflation in the UK and is used widely across the economy and in financial contracts. However, it has a number of shortcomings meaning that it has at times greatly overestimated, and at other times underestimated, the rate of inflation.
>
> 2. The UK Statistics Authority (the Authority) is independent from government and responsible for official statistics on inflation measures in the UK. But, in certain circumstances, changes to the RPI require the consent of the Chancellor of the Exchequer before they can be implemented. The circumstances giving rise to this requirement to seek the Chancellor's consent expire in 2030.[33]

In the response to the consultation published on 25 November 2020, the Chancellor of the Exchequer, Rishi Sunak, said he could see the statistical arguments of UKSA's intended approach to reform the RPI. However, in order to minimise the impact of the proposal on the holders of index-linked gilts, he would be "unable to offer his consent to the implementation of such a proposal before the maturity of the final specific index-linked gilt in 2030."[34]

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[29] UKSA, UK Statistics Authority Statement on the future of the RPI, 4 September 2019
[30] Ibid.
[31] Letter from the Chancellor to Sir David Norgrove, UKSA, 4 September 2019
[32] Library calculations averaging differences in annual changes of CPIH and CPI over January 2017 and December 2019 based on ONS, Consumer price inflation tables, 15 January 2020, tables 57 and 58
[33] HM Treasury and UKSA, Consultation on Reform to the Retail Prices Index methodology, 11 March 2020, section 1
[34] HM Treasury, UKSA, A response to the consultation on reform to the Retail Prices Index methodology, 25 November 2020

2.2 Impact on DB schemes

A defined benefit (DB) pension scheme is one that provides pension benefits based on salary and length of service. Private sector DB schemes are funded – which means that contributions from employers and employees are paid to a fund, which is invested and from which pension benefits are paid as they fall due. So that they can meet their liabilities as they fall due, they are subject to funding requirements, overseen by the Pensions Regulator.[35]

Changes to the RPI can impact DB schemes in two ways. Firstly, it can affect the price of pension promises (i.e. the scheme's liabilities) if pension benefits are RPI-linked. According to the Pensions Policy Institute (PPI), sixty four percent of DB schemes uprate pensions in line with the RPI.[36] Secondly, it can affect the value of their assets. According to the PPI:

> The total value of DB scheme assets currently invested in index-linked bonds is around £470bn. The total value of the bond-related impact on DB schemes of the switch to CPIH could be a reduction in value of around £80bn if the switch is made in 2025 and around £60bn if the switch is made in 2030. There will also be material impacts from investments in other RPI-linked assets.
>
> Schemes currently hold a principal amount of around £350bn in swaps and index-linked gilt repurchase agreements, the inflation increases on which will be repaid at a lower than previously anticipated expected rate.[37]

PPI estimates that the overall effect of the change is likely to be an increase in scheme deficits. Individual schemes "should be able to make estimates of the impact on scheme funding by calculating the proportion of assets they hold in RPI-linked gilts and the potential reduction in liabilities they could see in respect of RPI-linked member benefits and deferred benefit revaluations."[38]

In its response to the consultation in November 2020, the Government said that the impact by scheme would depend on "the extent to which it is hedged and nature of its liabilities." Schemes with RPI-linked assets but CPI-linked benefits would see the value of their assets fall but the total value of their liabilities remain unchanged:

> 68. The extent to which a DB pension scheme will be impacted by reform will depend on the extent to which it is hedged and the nature of its liabilities. A number of respondents outlined that the key drivers of the direction and scale of the impact will depend on the proportion of scheme assets that are held in index-linked gilts (and other RPI-linked assets), and whether the benefits the scheme is required to pay out are (broadly speaking) linked to the RPI or CPI.
>
> 69. Some schemes will be no worse off from the change. For instance, a perfectly-hedged scheme which uses index-linked gilts

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[35] Defined benefit pension scheme funding, Commons Library Briefing Paper, July 2020
[36] PPI response to HM Treasury and UKSA Reform to RPI methodology consultation, April 2020, p4
[37] Ibid
[38] Ibid

> to match its RPI-linked liabilities might not be impacted. Dependent on scheme rules, the total value of its RPI-linked liabilities will fall in line with the reduction in the total value of the scheme's assets with minimal impact to the scheme's funding position.
>
> 70. However, some DB pension schemes will see a negative impact on their funding positions. The majority of responses from DB pension schemes came from well-hedged schemes with CPI-linked liabilities. These respondents noted that, owing to their hedging of liabilities with RPI-linked assets (a substantial proportion of which are index-linked gilts), reform will see the total value of their assets fall while the total value of their liabilities will remain unchanged.
>
> 71. For these DB schemes, a deterioration in their funding position means that existing deficits may increase, or that surpluses may be reduced. For schemes already in deficit, either the length of the recovery plan or the amount a sponsoring employer is required to contribute each year may increase. The impact may also hasten the speed at which schemes wind down.
>
> 72. However, DB pension schemes with CPI-linked liabilities are in a minority. A small number of respondents noted around a third of DB scheme benefits are liked to CPI, with much of the negative impact on schemes overall falling on schemes with purely CPI-liabilities. It is worth noting that some DB pension schemes have some liabilities linked to CPI and other liabilities linked to the RPI, so the interaction can be complex.[39]

Impact on DB scheme members

The PPI found that many DB pensioners would experience a reduction in lifetime benefit, with women and younger members experiencing a greater reduction:

> 7.1 A 65 year-old female DB pensioner's average lifetime loss from the switch to RPI could be between 5% and 9% depending on the date of the change, and for a 65 year old pensioner man the average loss could be between 4% and 8%.
>
> 7.2 A member who defers for 10 years, in 2020, and takes their benefit at age 65 in 2030, could receive a pension at retirement of between 12% to 17% less, male, and 13% to 18% less, female, than they would have received under RPI indexation, depending on the date of the change.[40]

The government consultation received 550 responses from the members of DB pension schemes whose benefits are linked to the RPI.[41]

Responses

In its response to the consultation, the Association of British Insurers called for the latest possible implementation date to reduce the impact on savers and recommended compensation for savers.[42]

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[39] HM Treasury, UKSA, A response to the consultation on reform to the Retail Prices Index methodology, 25 November 2020

[40] PPI response to HM Treasury and UKSA Reform to RPI methodology consultation, April 2020, p4

[41] HM Treasury, UKSA, A response to the consultation on reform to the Retail Prices Index methodology, 25 November 2020, para 95

[42] Government proposals to reform the RPI could cost £122 billion, ABI, 21 August 2020

The Pensions and Lifetime Savings Association (PLSA) said the change would be of concern to DB pension schemes, particularly given that there was already much uncertainty and schemes were "potentially facing significant impacts on funding levels arising from COVID-19 and TPR's new DB Funding framework." It called on the government to take steps to mitigate the impact of the RPI changes.[43] In its response to the consultation in November 2020, the Government said the reform would not be implemented before 2030. However, it would not offer compensation to holders of index-linked gilts but would keep the "occupational pensions system under review."[44] The PLSA expressed its disappointment:

> The PLSA has advocated for solutions which mitigate the enormous cost to schemes, employers and savers, either through one-off payments or by technical measures that better reflect the higher value under the current RPI measure. The Government says it will keep the occupational pensions sector under review. We will certainly continue to press our case against this deeply unfair decision.[45]

In its response to the consultation in August 2020, the Pension Protection Fund (PPF) said that the proposed change to the RPI index would cause the value of its assets to fall, with no corresponding change in its liabilities. This was because its liabilities are CPI-linked but it largely uses RPI-Linked Gilt and RPI derivative markets to hedge its liabilities against inflation risk. It expressed its concern about the impact on DB pension schemes, their sponsoring employers and members. It said the reform would raise questions of fairness, given the impact on schemes that had been acting prudently, in trying to protect themselves from inflation risk:

> RPI assets were bought by ourselves and DB pension schemes in good faith (particularly given a range of consultations that concluded RPI should continue unchanged as a legacy measure). Asset holders now face double digit reductions in value over the lifetime of some assets. Looked at another way, it could be said that savings to the Government from reduced payments on the stock of index linked gilts are being funded – in part – by pension schemes and their members.[46]

For more on the background, see Pension Protection Fund, Commons Library Briefing Paper, CBP 3917, October 2020.

On 9 April 2021, the trustees of the BT Pension Scheme, Ford Pension Schemes and Marks and Spencer (M&S) Pension Schemes – representing nearly 450,000 members and £83 billion of assets - confirmed that they were seeking a judicial review of the decision effectively to replace RPI with CPIH from 2030, arguing that the far-reaching implications of the decision had not been fully considered. They said:

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43 PLSA, Response to joint HM Treasury/UKSA consultation: Reform to RPI methodology, August 2020, Executive Summary

44 Ibid

45 PLSA disappointed by RPI methodology decision, 25 November 2020v

46 PPF response to HM Treasury/UKSA consultation on reform to RPI methodology, August 2020

It is estimated that over 10 million pensioners, through no fault of their own, will be poorer in retirement either from lower payments or lower transfer values as a result of the effective replacement of RPI with CPIH. Women will suffer the most from this change as they typically live longer.

The reform also significantly reduces the value of RPI-linked assets held to meet pension promises to members, weakening schemes' funding positions and, in turn, adding pressure on sponsoring employers.[47]

[47] Trustees of the BT Pension Scheme, Ford Pension Schemes and Marks and Spencer Pension Scheme to seek Judicial Review of the decision effectively to replace RPI with CPIH from 2030, 9 April 2021

3. Development of limited price indexation (LPI)

3.1 *Pensions Act 1995*

Before April 1997 there was no general obligation on Defined Benefit schemes to increase pensions in payment - although contracted-out occupational pension schemes had to provide a Guaranteed Minimum Pension (GMP) and a required to index GMP rights accrued from 1988 to 1997, subject to a 3% cap.[48]

For more detail, see Guaranteed Minimum Pension Increases, Commons Library Briefing Paper CBP 4956, Feb 2020

A requirement to index-link pensions in payment was legislated for in 1990 but no commencement date was set - apparently because of uncertainty due to legal cases pending in the wake of the Barber judgement relating equal treatment.[49]

In 1993, the Pension Law Review Committee, chaired by Professor Roy Goode, pointed out that, from the individual's perspective, it is not just the adequacy of a pension that is important but also the question of how certain it will be:

> Most important is the uncertainty with regard to inflation. The individual is concerned not with money amounts but with what the pension will buy.[50]

Despite this, the Committee held back from recommending that Limited Price Indexation (LPI) requirements should be made retrospective:

> 4.18.71 A minority of us believed that without indexation of past accruals the value of the pension promise would be progressively undermined, but recognised that to require all earnings-related schemes to introduce LPI for pension rights accrued before the appointed date would place a considerable burden of costs on such schemes. Transitional arrangements which phased in the indexation of past accruals would help employers to control their costs. These could take the form of requiring scheme to LPI to only the most recent five years of past service at the time indexation is introduced for future accruals. Five years after that, a further five years of past accruals would be indexed. By repeating this pattern, all past service accruals would eventually be covered by LPI within twenty years. However a majority of us considered that, even with transitional arrangements, indexation of past accruals could not be justified.
>
> 4.18.72 In the light of this divergence of review, we have no recommendation to make on indexation for past or future accruals.[51]

The *Pensions Act 1995* introduced Limited Price Indexation (LPI) – i.e. a general requirement that pension arising from an occupational pension

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48 See SN-04956 Guaranteed Minimum Pension – annual increases (Thursday 2015)

49 See Library Briefing Paper 95/48 *The Pensions Bill: Non-state benefits*, 18 April 1995;*Pension Law Reform. The report of the Pension Law Review Committee*, para 4.18.67

50 *Pension Law Reform. The report of the Pension Law Review Committee*, para 3.1.10

51 *Pension Law Reform. The report of the Pension Law Review Committee*, vol 1

scheme accruing from 6 April 1997 had to be increased at a minimum by inflation capped at 5%.[52]

Despite the fact that LPI was not made mandatory for rights accrued from 1997, it appears that many schemes applied some form of inflation protection to pensions in payment on a voluntary basis and many applied LPI as made mandatory in 1997 retrospectively to all service.[53]

3.2 *Pensions Act 2004* – reduction in the cap

In 2002, Alan Pickering – who had been asked by the Labour Government to look at ways of simplifying pensions legislation and reducing costs - emphasised the need to keep schemes affordable to employers:

> It is important that employers keep their pension promise. However, we also think it should be easier for employers to re-shape pension arrangements in the light of contemporary economic or other circumstances. This might seem to be a considerable loss but it is better than an employer faced with unsustainable costs in their defined benefit schemes having to close the scheme altogether. A careful balance needs to be struck here between giving employers the right to amend pensions in the light of changed circumstances and their responsibility to keep their pension promise.[54]

He recommended that LPI should be abolished on the grounds that it was "disproportionately expensive."[55]

However, the Labour Government was unwilling to make changes to the LPI unless it "had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case."[56] In its June 2003 occupational pensions White Paper, the Government announced that it had decided to reduce the LPI cap to 2.5%:

> 10. We have therefore decided that we will relax this requirement, so that schemes are required only to index pensions in payment by inflation, as measured by the September annual increase in the Retail Price Index (RPI), capped at 2.5 per cent each year. This reflects the reality of an economic climate where inflation has been driven down to average just 2.4 per cent over the years since 1997. The change will also better align the regulation of defined benefit and defined contribution schemes – members of the latter are not generally obliged to purchase any cover against inflation at all.[57]

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52 *Pensions Act 1995,* section 51-5 and the *Occupational Pension Schemes (Indexation) Regulations 1996* (SI 1996 No 1679) as amended; HL Deb 24 October 1995 c977
53 Lewin and Sweeney, Deregulatory Review of Private Pensions- a consultation paper, March 2007; See ONS Occupational Pension Schemes Survey 2015, Table 18
54 Alan Pickering, *A simpler way to better pensions*, July 2002
55 Ibid, para 2.10-11
56 DWP, Simplicity, security and choice: Working and saving for retirement, December 2002, Cm 5677, chapter 4, para 45
57 DWP, Simplicity, security and choice: Working and saving for retirement. Action on occupational pensions, June 2003, Cm 5835

This was implemented for DB schemes by the *Pensions Act 2004*, with effect from April 2005.[58]

3.3 2007 review

In December 2006, the Labour Government asked Chris Lewin (formerly Head of UK pensions at Unilever) and Ed Sweeney (then joint Deputy General Secretary of Amicus) to conduct a 'deregulatory review' of private pensions.[59] They looked at whether the requirement to index-link pensions in payment should be removed but were unable to agree:

> We both, for example, recognise the strength of the arguments for and against the removal of the current requirement to provide limited price indexation ("LPI") after retirement, but have been unable to agree on whether removal would have the desired outcome in terms of encouraging continued strong provision through workplace-based pension schemes. Ed Sweeney believes that the case has not been made that employers would keep their defined benefit schemes open or adopt risk sharing approaches if LPI were abolished. Chris Lewin, on the other hand, believes that making LPI optional would open up important new avenues for risk-sharing and creativity in scheme design as well as encouraging scheme sponsors to continue to fund defined benefit provision.[60]

The Government decided not to remove the requirement on the grounds that it was an important protection for members and there was no clear evidence that removing it would have a direct and significant effect on employer provision:

> Removing the requirement to increase pensions in payment has the potential to deliver significant savings for employers, but at the expense of future pensioners. In the absence of clear evidence that removing the LPI requirement would have a direct and significant effect on employer provision, the Government does not believe that the removal of such an important protection for members would strike the right balance between employer concerns and member protection and has therefore decided not to make any changes to the current requirements.[61]

This decision was welcomed by the TUC.[62] The CBI said it had considered a proposal to make LPI increases discretionary but that consultation had indicated that few of its members would chose to implement it. For this reason, "it would have very limited impact in securing defined benefit provision in the future."[63] The Association of Consulting Actuaries had argued that the LPI should be removed in respect of future service.[64]

Chris Lewin and Ed Sweeney found that some schemes were prevented by "restrictive language in scheme documents" from taking advantage

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[58] *Pensions Act 2004,* sections 278 and 279
[59] Lewin and Sweeney, Deregulatory Review of Private Pensions. A Consultation Paper, March 2007
[60] Ibid, Executive Summary
[61] DWP, Deregulatory review – Government response, October 2007, p5-6
[62] 'Deregulation review "goes a step too far"', TUC press release, 22 October 2007
[63] CBI official response to Sweeney/Lewin Deregulatory Review of Private Pensions, 30 April 2007
[64] ACA, Response to the Deregulatory Review, April 2007

of the change to a 2.5% cap on LPI. This could be addressed by allowing trustees to change scheme provisions by resolution under section 68 of the *Pensions Act 1995*, where employer and trustees agreed.[65]

The Government consulted on proposals to introduce a statutory override to enable schemes to take advantage of the reduction in the cap on LPI and revaluation.[66] In its December 2007 response to the consultation, the Government said the statutory override should only be exercisable with the proper agreement of both trustees and employers and (for indexation) would be for future service only.[67] The change was introduced in the *Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009 (SI 2009/615).*

3.4 Calls for indexation of pre-1997 rights

Opening a Westminster Hall debate on the Digital Equipment Ltd: Pension Scheme on 17 January 2017, Corri Wilson drew attention to the impact on scheme members of not receiving indexation on pre-1997 pension rights:

> The Hewlett Packard Pension Association claims that withheld cost of living increases have so far cost pensioners an average of £24,000 compared with their colleagues whose contributions were made post-1997. That has led to severe financial hardship for many of those pensioners and has resulted in them being unable to afford an ordinary living pattern, being on the verge of poverty and requiring Government subsidies in the form of income support benefits.[68]

She called on the Government to address the issue in its forthcoming Green Paper on defined benefit pension schemes.[69]

The then Pensions Minister Richard Harrington responded that Government had a broad principle of not imposing requirements retrospectively:

> The Government have a broad principle in legislation, which I think is generally fair, of not imposing such retrospective changes, because of uncertainty. There is no doubt that this kind of change—this is not the only one we are lobbied about—will place unexpected and significant costs on employers.[70]

When legislation was first passed to require limited price indexation, the government of the time had been conscious of the need to balance the interests of different parties. The same applied now:

> We believe that the Government retrospectively changing the legislative requirements on indexation would be inappropriate and would have a significant impact on the schemes of employers involved. The legislation introduced in 1995, by Harold

65 Lewin and Sweeney, Deregulatory Review of Private Pensions, An independent report to the Department for Work and Pensions, July 2007, p24
66 DWP, Deregulatory review – Government response, October 2007, Executive Summary
67 DWP, Deregulatory review – Government response to consultation, Dec 2007, p7
68 HC Deb 17 January 2017 c272WH
69 Ibid
70 HC Deb 17 January 2017 c279WH

> Macmillan's successors in a Conservative Government, was introduced to provide a limited level of inflation protection. The then Government were conscious of this balance between protection against inflation and the ability of the schemes, and the employers who stand behind them, to afford such protection. Of course, the financial deficits in defined-benefit schemes are very much a topic of conversation in this House and in the press—particularly the trade press—and are something that will be discussed in the Green Paper.[71]

Although campaigners had argued that the effect of making rule changes would be "minimal", he had not seen any evidence to this effect. The Government would "do some further work and would be grateful for further data, to assess what the actual cost would be."[72]

In January 2018, current Pensions Minister, Guy Opperman, said the Government had no plans to change the rules.[73]

71 Ibid, c281-2WH
72 Ibid c279
73 PQ 102525, 8 January 2018

4. 2011 - switch to the CPI

4.1 Budget 2010

The primary legislation does not specify which measure of inflation should be used for minimum indexation and revaluation. Instead, it refers to the "percentage increase in the general level of prices in Great Britain."[74]

Following the 2010 general election, the newly elected Coalition Government announced in its first Budget on 22 June that it would switch from using the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) for the indexation of benefits, tax credits and public service pensions from April 2011:

> 1.43 Spending on social security and tax credits has increased by 45 per cent, around £60 billion, in real terms over the past 10 years. Welfare reform measures in this Budget reduce overall expenditure on social security, saving £11 billion in 2014-15. T**he Government will adopt the CPI for the indexation of benefits, tax credits and public service pensions from April 2011.** The Government will also introduce measures to control spending on tax credits, housing benefit and disability benefits. Alongside these reforms, it is introducing measures to protect pensioners and low-income families with children. Further details are set out in the fairness section of this chapter. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues.[75]

On 8 July 2010, the then Pensions Minister Steve Webb announced that the Government would also apply this when determining the required annual increase in occupational pensions:

> The Chancellor of the Exchequer announced in the Budget statement on 22 June that, with some exceptions, consumer prices rather than retail prices will be the basis for uprating most benefits and public sector pensions. The Government believe the CPI provides a more appropriate measure of pension recipients' inflation experiences and is also consistent with the measure of inflation used by the Bank of England. We believe, therefore, it is right to use the same index in determining increases for all occupational pensions and payments made by the Pension Protection Fund (PPF) and Financial Assistance Scheme (FAS).
>
> Consequently, we intend to use the CPI as the basis for determining the percentage increase in the general level of prices for the 12 months ending 30 September 2010 when preparing the order required under paragraph 2(1) of schedule 3 to the *Pension Schemes Act 1993* in relation to revaluation and indexation of pension rights in defined benefit pension schemes, and the order made under section 109 of that Act in relation to increases in guaranteed minimum pensions paid by contracted-out defined benefit schemes in respect of pensionable service between 1988 and 1997; and amend legislation to enable CPI to be used for relevant increases in respect of the [Pension Protection Fund] and [Financial Assistance Scheme].Using CPI will mean making some small changes to primary legislation to ensure we

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74 *Pensions Schemes Act 1993*, s83-4 and Sch 3 (2)
75 HM Treasury, Budget 2010, HC 61, June 2010

> can apply it fully in every circumstance. We will bring these before Parliament at the earliest opportunity.[76]

He said the legislation set a statutory minimum and did not prevent schemes from making more generous arrangements:

> Statute provides a floor above which occupational pension schemes have to operate. In other words, we will not force occupational pension schemes to cut their increases; we simply provide a floor, which used to be linked to the RPI and is now linked to the CPI. Schemes remain entirely free to go beyond that if they wish.[77]

A DWP press release explained how the change would be made:

> The proposed changes will affect how many deferred pensions are revalued in future, and how pensions in payment are increased. The changes apply to defined benefit rights in occupational pension schemes, and certain defined contribution rights in occupational pension schemes. The changes will affect the statutory minimum requirement for revaluation and indexation; occupational pension schemes will still have the freedom to pay more than the statutory minimum.
>
> In broad terms, a revaluation order is made each year which sets out the minimum rate at which occupational pension schemes should generally revalue deferred pension rights and pay increases on pensions in payment.
>
> For deferred pension rights, the order tabulates an overall revaluation percentage relating to each possible number of complete years between the end of someone's pensionable service and their normal pension age. The order that is in use for any year will use data on price inflation up to September of the previous year. For example, the order in use for 2010 uses data on price inflation to the year ending 30 September 2009 based on RPI. The order which will be in use in 2011 will use data on price inflation to the year ending 30 September 2010 based on CPI. The overall percentage that will apply to deferred pension rights which have been deferred for at least two complete years, where the relevant years straddle the change from RPI to CPI, will therefore be calculated as a combination of percentages based on RPI and then CPI.
>
> The order in use for 2011 will also be used to calculate annual increases on pensions in payment for 2011, and these will be in line with CPI. The Government expects to publish the order in November or December 2010.
>
> The Government will bring forward legislation at the earliest opportunity to ensure that other references to price inflation in pensions law are consistent with using CPI as the measure of price inflation from 2011 or as soon thereafter as Parliamentary time allows. For example, the Guaranteed Minimum Pension Increase Order that will come into effect in 2011 will be made on the basis of the CPI figures for the year to 30 September 2010.[78]

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[76] HC Deb, 8 July 2010, c14-16 WS
[77] HC Deb, 19 July 2010, c4
[78] Statement on moving to the CPI as the measure of inflation, DWP press release, 12 July 2010

Responses

TUC expressed concern, describing the change it as a "stealth cut on the pensions of middle-income Britain":

> Over someone's whole retirement this will add up to a significant loss. CPI is less than RPI in most years because it excludes housing and council tax costs. But even if all other things are equal CPI is on average half a per cent less than RPI because it is calculated in a different way if pensions in payment today had been linked to CPI instead of RPI for the last twenty years they would now be 14 per cent lower.[79]

On the other hand, the Pensions and Lifetime Savings Association said it would allow trustees and fund managers more flexibility and make it a "little easier for firms to keep schemes open." It argued that "the detail needs to be right so that the change can be applied smoothly and simply." [80]

The CBI hoped the Government would introduce overriding legislation, to help schemes take advantage of the change (see 3.2 below):

> Statutory indexation is the biggest single regulatory cost borne by final salary schemes. That makes getting it right important. As CPI is a more accurate reflector of inflation for pensioners than RPI, we welcome this announcement. We hope that the Government will also table overriding legislation, to ensure that schemes whose rules currently prevent them from taking advantage of this change can do so.[81]

In February 2012, a petition on the Downing Street website calling for the RPI measure to be re-introduced for public and private pensions had over 100,000 signatures.[82]

Expected impact

The impact of the switch to the CPI would depend on whether a scheme provided indexation and revaluation in accordance with the statutory minimum, or whether it had RPI written into its rules.[83] The Government estimated that three quarters of schemes had RPI written into their scheme rules for indexation but only a quarter had done this for both indexation and revaluation. The one quarter of schemes with RPI-linked indexation and revaluation would not see a change in their liabilities (though without legislation to remove the CPI underpin, they would have seen an increase). Those with RPI-linked indexation but revaluation by the statutory minimum would see liabilities reduce by an average of 16%. Those schemes which did both indexation and revaluation according to the statutory minimum (less than one in five schemes) would see a 20% reduction in liabilities. As regards the impact on scheme members, Steve Webb said:

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[79] TUC Press Release, 8 July 2010, 'CPI indexing will reduce value of occupational pensions'
[80] PLSA Press Release, 'Indexation changes give final salary pensions more flexibility', 8 July 2010
[81] CBI Press Release, 'CBI comments on changes in occupational pensions' 8 July 2010
[82] Petitions to the UK Parliament, Public and private pensions - change from RPI to CPI
[83] DWP, Impact of the move to CPI for occupational pensions, 12 July 2011

> If a person gets done by CPI on revaluation and CPI on indexation, and they are an average person leaving the scheme 15 years before the end on a average income with average characteristics, it might be a 20% impact over the course of their retirement. So it is an average worst-case scenario. [84]

The impact on individuals would "vary enormously according to age, length of service and so on."[85]

4.2 Consultation on a statutory override

The Government believed that many of the 70-80% of scheme members that had RPI-indexation written into their rules would find it hard to change them.[86] Whether they were able to do so would depend on a number of factors:

> Whether the scheme has any relevant amendment provisions within the trust deed and rules. Some do not – sometimes as deliberate policy to fetter future discretion
>
> - The extent of amendment powers. Some are limited to specific provisions, either by default or design
> - The question of where any amendment powers are vested. Some amendments are at the discretion of the employer, some the trustees and some a combination of both. (Any change that might increase costs in a DB scheme will generally require at least the consent of the employer) [87]
>
> Schemes that contained relevant amendment powers may not find it easy to change the basis for indexation of pensions in payment or revaluation. This is because:
>
> - trustees will be conscious of their duty to act in the best interests of the beneficiaries of the trust, and would need to reconcile that duty with any change expected to erode the value of benefits in the long run. There will of course be counter-arguments to consider relating to the longer term viability of the scheme
> - there are legislative restrictions on modifications to schemes in section 67 of the *Pensions Act 1995*. Considering whether explicit references to RPI indexation and revaluation in the rules of an occupational pension scheme constitute a "subsisting right" raises a number difficult legal questions (see also para 40 below)
> - trustees will need to consider whether any reference to RPI in scheme rules or other scheme documentation confers any rights to indexation or revaluation at a particular rate
> - the power to amend may impose onerous conditions before it can be used e.g. consultation, evidence, administration issues etc. [88]

It considered whether to introduce legislation directly over-riding scheme rules but decided against this on the grounds that it would:

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[84] PBC Deb, 14 July 2011 (afternoon), c305
[85] Ibid, c305
[86] DWP, The impact of using CPI as the measure of price increases on private sector occupational pension schemes, December 2010, para 37
[87] Ibid, para 38
[88] Ibid, para 39

a) represent an unwarranted interference in the rights of employers and trustees to manage their financial affairs. It would potentially override arrangements agreed through collective bargaining arrangements, privatisation agreements and private contracts;

b) create unnecessary complications and difficulties in respect of employment and other contracts; and

c) potentially have a detrimental impact on members in schemes where the employer is prepared to fund increases at a rate above the required statutory minimum.[89]

An alternative would be to make it easier for schemes to change their own rules. However, the Government decided against this, on grounds that trust in pensions was important and government intervention demanded strong justification. Where a scheme did intend to change its rules for future accruals, employers would be required to consult.[90]

While the Government's decision was welcomed by the TUC, the Pensions and Lifetime Savings Association expressed that concern pension funds were under great stress and needed to be given "the breathing space that an option to switch to the CPI would have given."[91]

The Government legislated in the *Pensions Act 2011* to ensure that where a scheme had chosen to stick with RPI increases, if the CPI was higher in any particular year, the scheme could still pay an RPI-linked increase.[92] It also removed references to the RPI for the purposes of calculating indexation of Pension Protection Fund compensation.[93]

4.3 Legal challenges

The switch to the CPI resulted in legal challenges from schemes whose scheme rules did not allow them to switch from the RPI.

On 7 November 2018, the Supreme Court held that the wording of the rules of the pension scheme of the charity Barnardo's did not entitle it to switch from the RPI to the CPI. The rules provided for pensions in payment to be increased by 5% or the RPI, whichever is lower. The dispute was over whether the definition of RPI in the scheme rules (i.e. the "General Index of Retail Prices published by the Department of Employment or any replacement adopted by the Trustees without prejudicing Approval") allowed Barnardo's to adopt another index that it considered more appropriate, such as the CPI. The High Court held that it did not, unless the RPI had been discontinued as an officially published index and replaced. This decision was upheld by the Court of Appeal and then by the Supreme Court. In his ruling, Lord Hodge said:

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89 Ibid, para 31

90 DWP, Government response to consultation, June 2011, para 18 and 34

91 Sebastian Cheek, 'Industry blasts RPI-CPI announcement', *Professional Pensions,* 8 December 2010

92 *Pensions Act 2011*, s19

93 Ibid s20; For more on the background to this, see section 4 of Library Briefing Paper RP 11/52 Pensions Bill (June 2011) and RP 11/68 Pensions Bill: Committee Stage Report (October 2011).

> While, since 1991, the RPI has fallen from favour as an appropriate measure of the cost of living, it is not appropriate to use hindsight of such post-execution events to assess whether a provision makes good commercial sense.[…] While the requirement of indexation by reference to the RPI imposes obligations on Barnardo's and contributes to the pension deficit at a time when many see the CPI as a more reliable index for the cost of living, the court must construe the scheme without any preconceptions as to whether a construction should favour the sponsoring employer or the members.[94]

Responding to the judgment, legal experts said other schemes with similar wording would "now be stuck with RPI."[95]

BT took a legal challenge in relation to Section C of its pension scheme, which provided RPI-linked benefits. It argued that it should be able to change to another index. However, in January 2018, the High Court ruled that the rules would only permit BT to switch to another index if the RPI ceased to be published as a measure, or became inappropriate, neither of which had happened.[96] This was confirmed by the Court of Appeal in December 2018.[97] In July 2019, BT said its application for permission to appeal to the Supreme Court had been unsuccessful.[98]

Long-running litigation between British Airways and the trustee of one of its pension schemes was settled in November 2019. This related to the trustees' decision – following the switch to the CPI - to use their unilateral power to amend the Scheme's rules by inserting a power to grant discretionary pension increases.[99]

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94 'Barnardo's (Appellant) v Buckinghamshire and others (Respondents) [2018] UKSC 55 On appeal from [2016] EWCA Civ 1064 – Supreme Court press summary, 7 November 2018

95 'Barnardo's loses UK legal battle to reduce pension liabilities', FT, 7 November 2018 (£)

96 BT PLC v BT Pension Scheme Trustees Ltd and Linda Bruce-Watt, [2018] EWHC 69 (Ch), January 2018

97 Section C court case update, BT pensions, December 2018; British Telecommunications PLC v BT Pension Scheme Trustees Limited & Bruce-Watt

98 Section C court case update, BT pensions, July 2019

99 High Court approves settlement of BA Pension Scheme litigation, Ratcliffe Chambers, 28 November 2019

5. Whether there should be flexibility in scheme rules

5.1 British Steel Pension Scheme consultation

In May 2016, the current Government launched a consultation on what might be done to help the British Steel Pension Scheme (BSPS) in the wider context of efforts to protect the UK steel industry. This included a proposal from the trustees to be allowed to reduce indexation and revaluation on future payment of accrued pension rights to the statutory minimum. This would require a change to the 'subsisting rights provisions', which prevent detrimental changes to accrued rights without member consent. The consultation asked for views on the case for disapplying these provisions for the BSPS only, to allow it to reduce indexation and revaluation. The Government said it would only consider this if regulations contained "clear safeguards to ensure member protection was not further compromised." It would also look to impose a series of conditions that the sponsoring employer would need to meet as part of any agreement to facilitate a reduction in indexation and revaluation.[100] However, some outside commentators expressed concern that this would undermined the principle that pensions promises, once made, cannot be changed retrospectively.[101]

In its March 2018 White Paper, the Government reported that the Pensions Regulator had been able to secure a better outcome for the scheme members, without the need for changes to pensions legislation:

> 199. We believe that the agreement to separate the BSPS from Tata Steel UK Limited and its other employers through a RAA together with Tata Steel UK Limited's agreement to sponsor the new pension scheme and thereby providing members with the option to transfer into a new Defined Benefits scheme is a very positive outcome considering the difficult circumstances.
>
> 200. Concerns that Tata Steel UK Limited would unreasonably avoid its liabilities have proved unfounded as the Regulator has been able to secure an outcome that is better for pension scheme members than if it had become insolvent: all without the need for changes to pensions legislation. As a result, we have concluded that it is not necessary or appropriate to bring forward new legislation either to permit the trustee to reduce the pension scheme's liabilities by reducing future increases (option three in the consultation paper) or to allow the transfer of members to a new scheme paying lower benefits without individual member consent (option four in the consultation paper).
>
> 201. While Tata Steel UK Limited and the BSPS were arguably an exceptional case, lessons can and will be learned to the benefit of other employers, schemes and their members.[102]

This is discussed in more detail in section 1 of British Steel Pension Scheme, Commons Library Briefing Paper, CBP-8288, June 2020.

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[100] *Pensions Act 1995* ,s67
[101] 'Got a final salary pension? Time to steel yourself', *Financial Times, 2 June 2016*
[102] DWP, Protecting defined benefit pension schemes, Cm 9591, March 2018

5.2 Conditional indexation

In its 2016 report on Defined benefit pension schemes, the Work and Pensions Committee recommended that the Government consult on permitting conditional indexation:

> 110.**Pension promises are just that. Any change to the terms of them should not be taken lightly. In circumstances where an adjustment to the scheme rules would make the scheme substantially more sustainable, however, a reduction in benefits could well be in the interests of members. Some schemes have more generous indexation rules than others more by accident than design, and indexation by CPI rather than RPI is certainly preferable to corporate insolvency and a pension scheme in the PPF. Trustees should be empowered to take decisions in the long-term interests of scheme members.**
>
> 111.***We recommend that in its forthcoming Green Paper the Government consul on means of permitting trustees to propose changes to scheme indexation rules in the interests of members. These proposals should be subject to regulatory approval but the presumption should be in favour of change. This measure should not only facilitate permanent changes to indexation rules; in many cases a conditional arrangement, whereby the scheme and employer have some breathing space to overcome difficulties, but then revert to more generous uprating when good times return, may be most appropriate.***[103]

Green Paper

In its February 2017 Green Paper, Protecting defined benefit pension schemes, the Government it did not think indexation should be reduced or abandoned across the board:

> 273. Various commentators have suggested that indexation should be cut to reduce the burden on employers, either by allowing all schemes to reduce indexation to the statutory minimum, or to allow those schemes (around 75%) which have RPI written into their scheme rules to move to the currently lower CPI measure.
>
> 274. However, allowing all schemes to move from RPI to CPI or to move to statutory minimum indexation only (including removing any pre April 1997 indexation) would have significant impact on members' benefits. CPI has been lower than RPI in 22 years out of the last 27 years (and in 9 years, out of the last 10 years) up to 2015, and so would in all likelihood represent a reduction in members benefits. Many schemes also pay indexation above the statutory minimum.
>
> 275. Estimates from the Regulator are that moving from RPI to CPI would reduce aggregate scheme liabilities on a Technical Provisions basis by around 5-10%. Moving to statutory indexation only would mean an estimated of 15-20%.76
>
> 276. However, this could have a significant impact on members. Estimates from Hymans Robertson77 show that a move from RPI to CPI would take away around £20,000 in benefits over an average

[103] Work and Pensions Select Committee, Defined benefit pension schemes, HC 55, December 2016

> DB scheme member's life. Moving to statutory indexation only would increase this loss to members substantially.[104]
>
> 277. It would also likely have significant interactions with the gilt market and wider government financing objectives. Currently, index-linked gilts (ILGs) are linked to RPI, as this was the standard measure of inflation when ILGs were introduced. As pension funds hold nearly 23%[78] of their assets in ILGs, any changes to scheme indexation could have significant consequential effects on the price of these gilts, which would affect the Government's ability to issue debt in a cost-effective way.

However, it said there could be a case for conditional indexation:

> 280. One suggestion is that increases should be conditional on the scheme and the sponsor having the resources to make the payments – so that no increases would be paid, for example, if the scheme was in deficit and the sponsor was unable to make up the deficit, and the trustees were satisfied that the best interests of members would be served by suspending indexation to allow the employer to strengthen its corporate finances. Increases could be restarted in future years once the employer had recovered. The Work and Pensions Select Committee in their recent report recommended permitting trustees to propose changes to scheme indexation rules, in the interests of members.
>
> 281. Whilst this may be a suitable way of ensuring that stressed schemes and their employers are supported in their endeavour to address deficits in hard times, as with all measures designed to help a subset of stressed schemes and employers, there is a moral hazard issue. There is the danger this could encourage employers to allow the funding level of their scheme to deteriorate in the hope that this would help reduce their liability to inflation link the scheme benefits. Therefore, requirements that the sponsor funds the scheme to a high level and limits risk when 'times are good' may be needed in conjunction with allowing relaxations in times of stress.
>
> 282. We would be interested in views about whether indexation should be suspended in some circumstances, and if so, in what circumstances that could be allowed and how the moral hazard issues could be addressed.[105]

It also asked for views on whether it should allow schemes to switch to the CPI, given that it was 'something of a lottery' whether schemes had rules referring to the statutory minimum:

> 283. The purpose of indexation of member benefits is to provide a measure of protection against the true value of benefits being eroded over time by the effects of inflation. As Table 5 below shows, it is currently something of a lottery as to whether a particular scheme has rules which refer simply to the statutory minimum, or whether they refer to a specific index such as RPI, or commit to a specific percentage each year. The Government's preferred measure of inflation is currently CPI, which tends to be lower than RPI, although it is worth bearing in mind that CPI(H), may possibly become the official measure of inflation used by the Office for National Statistics (ONS) by March 2017.

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[105] DWP, Protecting defined benefit pension schemes, Cm 9591 March 2018

Table 5 The effect of indexation

Pre 1997 Indexation		Post 1997 Indexation	
Indexation	% of all DB/hybrid schemes	Indexation	% of all DB/hybrid schemes
None	21		
CPI	8	CPI	21
RPI	40	RPI	75
Fixed, up to 3%	21	Fixed, 3% or over	4
Fixed, over 3%	10		
The above classification uses the main factor driving indexation and ignores caps and floors apart from the fixed rates pre 1997.			

Source: tPR estimates using simplifications for ease of presentation

> 284. There is an argument that if the fundamental nature of the promise that was made to members was to protect them against inflation, then the specification in scheme rules of a particular rate of increase, or a specific index, may have made sense at the time, but may now be anachronistic, and has little to do with the fundamental nature of the promise to protect against inflation.
>
> 285. The PLSA DB Task Force research found that "increasing pensions by a lower level of inflation was seen to be the most palatable benefit adjustment if one had to be made". Introducing a statutory over-ride to allow schemes to switch from RPI to CPI could amount to a saving to sponsors and lower future pension increases for members amounting to £90 billion as discussed previously. However, the changes would impact schemes differently, where the largest schemes would experience the largest monetary savings, and not all schemes would see a benefit from such an easement, but some members' pensions would be significantly lower.[106]

Initial responses

The proposal to allow schemes to move to a different price index (such as the CPI) got different responses. The CBI said it "could provide real support to businesses."[107] On the other hand, the trade union Prospect was opposed, saying:

> We challenge the simplistic notion that changing the indexation of some pensions currently in payment from RPI to CPI will improve the medium to long-term funding of schemes or future occupational pensions provision. "These employers are likely to see this as a neat way of reducing their costs and are unlikely to redirect any savings into future pensions provision. At a time when large employers pay £5 in dividends to shareholders for every £1 paid in to the occupational pension scheme, we have little confidence that any changes will create sustainable improvements in the funding of such schemes.[108]

On the proposal to allow indexation to be suspended in some circumstances, former Pensions Minister Sir Steve Webb said:

> The most worrying proposal is to allow certain schemes to 'suspend' annual pension increases if money is tight. With rising

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106 Ibid

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108 DB green paper's case for indexation flexibility divides industry, Professional Pensions, 20 February 2017

> inflation, annual indexation is an important part of protecting the living standards of the retired population. There is a significant risk that relaxing standards on inflation protection with the best of intentions for exceptional cases could be exploited and lead to millions of people being at risk of cuts in their living standards.[109]

In the interim report of its DB task force, the Pension and Lifetime Savings Association found that "increasing pensions by a lower level of inflation was seen to be the most palatable benefit adjustment if one has to be made."[110]

White Paper

However, in its March 2018 White Paper, it said that it could not "accept any reduction in the value of member benefits" and was ruling out provision of a power for employers or trustees to change scheme rules to allow them to apply increases in line with the CPI rather than the RPI. It was also unconvinced of the case for allowing trustees or employers to override scheme rules:

> 217. Having carefully considered the financial impacts and the consultation responses we have concluded that we cannot accept any reduction in the value of member benefits and are therefore ruling out provision of a power for employers or trustees to change scheme rules so that schemes can apply inflation increases using CPI instead of RPI.
>
> 218. Any across-the-board change would allow sponsoring employers to reduce their liabilities at members' expense even if the employer had no difficulties in meeting their existing liabilities. Some people have argued that reducing the liabilities in this way would save employers money they could then use to invest or to increase the pay and/or pensions of existing employees. However, it is not practicable to ensure the benefits of any reduction in liabilities are shared in this way and the Government is not prepared to countenance a reduction in employer liabilities which might simply facilitate a transfer to shareholders of cash members are relying on to support them in retirement.
>
> 219. We are therefore not persuaded by the view that employers or trustees should be able to override scheme rules on grounds of rationality and fairness, given the lack of consensus on what constitutes fairness in this circumstance. We are of course aware that RPI is no longer endorsed by the Office for National Statistics (ONS) and that ONS now counts CPI(H), which includes housing costs, as its preferred measure of inflation. We are also aware that moving from RPI to CPI can in some rare cases be the least worst option for scheme members – for example, if the alternative is scheme failure. Therefore, while we will not be providing an override of scheme rules at this time, we will continue to monitor developments in the use of inflation indices across Government, in pensions, and more widely.[111]

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[109] DB Green Paper puts living standards at risk for millions – Steve Webb, Royal London, 20 February 2017

[110] PLSA, DB Taskforce interim report, October 2016, p25

[111] DWP, Protecting defined benefit pension schemes, Cm 9591, March 2018

6. Revaluation of deferred pension rights

There are also requirements on schemes to revalue the preserved pension rights of people who have left the scheme (for example, because they have moved jobs) before pension age.

Before 1975, those who left their jobs before their scheme's normal retirement age were significantly disadvantaged compared with those who stayed. In particular, they generally had no statutory rights to preserved benefits, or to receive back the contributions that they had paid into an occupational pension scheme. In practice many schemes did give members a right to a refund of their contributions but in some schemes, early leavers ended up with nothing. The *Social Security Act 1973* introduced for the first time, for those who left after April 1975, a right to a deferred pension. This was initially restricted to those who were over the age of 25 and had completed at least five years' pensionable service. The age requirement was subsequently removed by the *Social Security Act 1985*, taking effect from 1 January 1986, and the five-year period was reduced to two years from 6 April 1988 by section 10 of the *Social Security Act 1986.*

Revaluation of deferred pensions has been required in some form since 1986.[112] The purpose was to protect those who changed jobs during their career. The then Secretary of State for Social Services, Norman Fowler said:

> At present many people who change their jobs leave behind a pension, which is basically frozen in cash terms and, therefore, loses value up to the age of retirement. That provides the most fundamental complaint about the present arrangements. I shall therefore introduce legislation to require occupational pension schemes to revalue deferred benefits for future early leavers at 5 per cent a year compound or in line with prices, whichever is less, over the whole period from leaving to pension age.[113]

The Pension Law Review Committee, chaired by Professor Roy Goode, considered whether those who left early (and therefore become deferred members) should be in the same position as those who stay for the same period of service, or whether "some other way could be found to at least maintain the real value of the pension."[114] It looked at whether deferred pensions should be revalued in line with earnings but recommended that they should continue to be revalued by prices, capped at 5%.[115]

[112] Lewin and Sweeney, Deregulatory Review of Private Pensions. A Consultation Paper, March, p12; *Pension Schemes Act 1993,* Part IV
[113] HC Deb, 11 June 1984, cc642-3
[114] *Pension Law Reform. The report of the Pension Law Review Committee*, volume 1, p 24
[115] Ibid, para 4.7.17

Deregulatory review

Chris Lewin and Ed Sweeney were asked to consider whether the cap on mandatory revaluation should be reduced to 2.5% for service going forward. They found arguments on both sides:

> 80. Those who think that there should be a reduction in the cap believe that it makes no sense to cap increases to pensions in payment at 2.5% while allowing increases to pensions in deferment, which for most schemes relate to ex-employees, to remain capped at 5%. Surely, these stakeholders argue, the leavers should not be rewarded more than the stayers. Others reply that this last argument misses the point - revaluation is designed to preserve parity between leavers and stayers, rather than as between leavers and pensioners. [116]

They did not recommend a reduction in the cap:

> We have seen no evidence that this change would ease administration, encourage risk sharing or slow closure of final salary schemes. Although available data is patchy, it seems to us that women could be disproportionately affected by a reduction in the cap, because they are more likely to earn pension benefits early in their careers and then leave the workforce for periods of time to undertake caring responsibilities.[117]

However, they did say that they would "understand if Government took the view that, when looking at the package as a whole, a reduction in the cap from 5% to 2.5% was one of the measures needed" to encourage provision.[118]

The Labour Government consulted on the issue and found that the proposal to reduce the cap had been "generally welcomed by organisations representing employers and pensions industry", although most also cautioned against any expectation that, alone, it could have a significant impact on employers' decisions to continue with DB schemes. Most organisations representing scheme members "were strongly opposed to any change to the cap." The Government decided to reduce it to 2.5%:

> Taking all of the representations, for and against, into account, the Government has decided to proceed with this proposal, and to reduce the level of the cap going forwards to 2.5%, in line with the original policy intention to provide a degree of, but not total, protection against the effects of inflation. It believes that this achieves a balance between encouraging good employer provision while sufficiently protecting members' interests, and a relevant provision will be included in the forthcoming Pensions Bill. [119]

Section 101 and Schedule 2 of the *Pensions Act 2008* reduced the cap on the required revaluation of deferred pension benefits, for future accruals from 6 April 2009:

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116 Lewin and Sweeney, Deregulatory Review of Private Pensions, An independent report to the Department for Work and Pensions, July 2007

117 Ibid, para 81

118 Ibid, Executive Summary, para 5

119 DWP, Deregulatory review – Government response to consultation, December 2007, p4-5

The overall effect of the amendments is to provide that accrued benefit attributable to pensionable service on or after the commencement day is to be revalued by the rate of inflation over the relevant revaluation period, capped at 2.5% per annum. Accrued benefit attributable to service before the commencement day is to be unaffected by the amendments and a cap of 5% per annum is to continue to be applied to accrued benefits for service between 1985 and the commencement day. Where the time period between the end of pensionable service and the beginning of pension payments is longer than a year, the caps are applied to the rate of inflation as averaged over that time, and are calculated on a compound basis.[120]

[120] Pensions Act 2008 – Explanatory Notes; *Pensions Act 2008 (Commencement No 2 Order) 2009* (SI 2009/82)

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