

Government response to consultation – The impact of using CPI as the measure of price increases on private sector occupational pension schemes

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Introduction

1. The Chancellor of the Exchequer announced in the June 2010 Budget that, with some exceptions, the Government proposed to use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) as the basis for increasing most benefits and public sector pensions. On 8 July 2010, the Minister for Pensions, Steve Webb MP, announced that the Government intended to use the CPI for statutory minimum revaluation and indexation for occupational pension schemes and for relevant payments made by the Pension Protection Fund (PPF) and the Financial Assistance Scheme (FAS).

Consultation overview

2. On 8 December 2010 the Department for Work and Pensions (DWP) published a consultation paper seeking views on the impact of the decision to use the CPI as the measure of price increases on private sector occupational pension schemes. The consultation also sought views on proposed amendments to the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006. The consultation document was sent to the organisations listed in Annex A and made available on the DWP website.
3. A paper copy of this Government response can be obtained from:

Lisa Hayes
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7th Floor, Caxton House
Tothill Street
London SW1H 9NA
Email:adelphi.sft@dwp.gsi.gov.uk
4. The Government response describes the comments made by respondents and provides the Government's response. The response should not however be taken as an authoritative interpretation of the law. Such interpretation can only be provided by a court.
5. The consultation document asked respondents to focus on twelve questions. We received a range of comments mostly relating to the questions asked. The Government's response covers all significant issues raised by respondents.
6. One hundred and fifty one responses to the consultation were received. Eighty seven of the responses were from pension scheme advisers and consultancies, pensions industry representative organisations, insurance companies, pension scheme trustees, member representative organisations and trade unions. The remaining responses were from individuals.
7. A number of the responses were complex and detailed, and many were relevant to particular schemes or circumstances. Whilst we have not been able

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to comment on every point raised in this response, we have read and considered every submission. This response provides a fair representation of the comments received. The Government will continue to work with individual respondents on a range of issues relating to the decision to use CPI as the measure of price increases. A list of respondents is provided in Annex B. The Government is very grateful to everybody who took the time to comment on the consultation document.

Impact Assessment

8. An assessment of the impact of the decision to use CPI as the measure of price increases for indexation and revaluation of private sector occupational pensions was published on 11 February.
9. A revised assessment taking account of the changes arising from consultation will be published shortly.

Responses to consultation questions

10. This section summarises the main points made by respondents to the consultation and sets out the Government's response.

Question 1: The Government welcomes views on whether the impact of using CPI has been correctly summarised

Points made

11. Two thirds of respondents commented on this question. The majority of those agreed the summary was correct.
12. A few respondents had concerns centred on the impact of the drafting of scheme rules. For example, some schemes have different rules for revaluation and indexation, and some may fall into one or more of the categories listed.
13. A number of individual respondents felt that, although the summary focused on the impact the change to CPI would have on schemes, it did not fully cover the impact it will have on those pensioners whose pensions are linked to the Pension Increase (Review) Order. This order sets out increases to public sector pensions. It is common for former public sector employees to retain the right to increases linked to public sector pensions after their employer is privatised

Government Response

14. The Government recognises there will inevitably be exceptions to any attempt to categorise or summarise how individual pension schemes provide for revaluation and indexation of pension. Having considered all the responses the Government is satisfied the impact of using CPI was fairly summarised.

Question 2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation

Points made

15. Just over half of the respondents addressed the question of whether it is right to require employers to consult on changes to scheme rules on indexation and revaluation, of which the majority were in favour:

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“it would be consistent with the spirit of the consultation requirements to apply them in respect of changes to scheme rules on indexation and revaluation.”
The Society of Pensions Consultants.

Most of those who agreed considered that it was appropriate for employees to be consulted on such changes, and important that they understand the implications.

16. A small number of respondents considered that applying the employer consultation requirements would be unhelpful. The main concern from these respondents was that the need to consult should only be used for accrued benefits. A small number questioned whether, when the scheme rules allowed a change in revaluation and indexation, consultation would be required.
17. A number of respondents said that it would be wrong if the requirement only required consultation with active members – especially given that any change to revaluation or indexation rules would have the greatest impact on deferred and pensioner members.

Government Response

18. Having considered all the comments the Government has decided to proceed with amendment regulations to make changes to scheme rules on indexation and revaluation a listed change for the purpose of the employer consultation requirements. This requirement gives any affected members the opportunity to have their say about changes to their pensions and ensures that they are fully aware of the implications of any such changes.

Question 3: The Government welcomes views on the draft Occupational Pension Schemes (Consultation by Employers – Amendment) Regulations 2011

Points made

19. As set out above, the Government proposed to make certain changes to scheme rules on indexation or revaluation a listed change for the purpose of the employer consultation requirements. The draft regulations were attached to the consultation document for comment.
20. Around a third of respondents responded to the question on the draft regulations. A key theme throughout the responses concerned the proposal that the requirement to consult should only apply where the change *would* be less generous. It was suggested that by using the word “*would*” we are assuming that the individual would always be worse off if a scheme (for example) switched from RPI to CPI for determining pension increases. Some of the unions felt very strongly that it introduced a degree of ambiguity into the process as it may not always be clear whether an amendment to a schemes rule on indexation and revaluation would be less generous.

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21. The proposed regulations impose a requirement to consult if the rules are amended to change the *rate* at which benefits are indexed or revalued. Some respondents suggested that the use of the word “*rate*” may be ambiguous and should be replaced with “*index*”.

Government Response

22. The Government recognises the potential difficulties created by the expression “would be less generous”. If, for example, a scheme proposed to adopt the CPI for revaluation of deferred pensions, it could theoretically result in a better outcome if the revaluation period was short and if CPI happened to be higher than RPI at that time.
23. Respondents made a number of alternative suggestions including “might be less generous” or “would be likely to be less generous”. These suggestions potentially create different issues. The expression “would or might” potentially increases the number of consultations required and could include some changes intended to be more generous (switching the inflation measure from CPI to RPI *might* be less generous for some members in some circumstances for example). The expression “likely to be less generous” could be seen as unhelpfully ambiguous.
24. The Government intends to proceed with the amendment regulations, but is still considering the most appropriate form of wording to address the concerns identified.

Question 4: The Government welcomes views on whether there are any issues that should be considered in respect of career average arrangements

Points made

25. Although the majority of respondents made no comment on this question, a small number said there may be issues in respect of career average arrangements. These focused on the process used for career average arrangements. For example some schemes may encounter issues if the rules make reference to RPI as they would need to track both CPI and RPI.

Government Response

26. Having looked at this issue carefully, the Government is satisfied that no action is required in respect of career average schemes. The requirement for revaluation of deferred pensions in a career average scheme is that deferred pensions are revalued in the same way as pensions for active members. Consequently there should not be any situations where schemes need to track both CPI and RPI for revaluation.

Question 5: The Government welcomes views on whether there are any issues that should be considered in respect of Guaranteed Minimum Pensions (GMPs)

Points made

27. The majority of respondents either had no comment to make on this question or were not aware of any further issues in respect of GMPs. Of those that did comment, the majority agreed that schemes rarely set out separate indexation and revaluation rules for GMPs.

Government Response

28. GMPs earned between 1988 and 1997 are increased by the lesser of inflation or 3 per cent. Although it is rare, there are schemes that do set out separate rules for GMP increases and, in these cases, CPI could act as an underpin as outlined in the responses to Questions 10 and 11.
29. Although the Government recognises making provision to ensure CPI does not act as an underpin for any scheme increasing GMPs would be consistent with the proposals for indexation of non-GMP benefits to by reference to RPI, the Government does not intend to legislate because the small number of cases.

Question 6: The Government welcomes views on whether there is any justification for overriding the rules of private sector occupational pension schemes to impose CPI as the measure of increase in prices

Points made

30. Almost all respondents commented on whether there is justification for overriding the rules of private sector schemes to impose CPI as the measure of price increases for revaluation and indexation. Although some respondents felt a statutory override was necessary, the vast majority agreed with the Government's view and were not in favour of imposing a statutory override:

“there would be absolutely no justification for overriding the rules of private sector schemes to impose CPI” - Trades Union Congress

“We welcome the proposal not to introduce a statutory override” – Association of British Insurers

These views were echoed by schemes, trustees and most of the individual responses.

31. Several respondents said that a statutory override was needed:

“urge the government to introduce legislation that would directly override scheme rules” - CBI

32. Among actuarial consultancies and legal firms, some were concerned about the possible inconsistency of outcome for schemes and members arising from different approaches to drafting scheme rules. They took the view that a statutory override would level the playing field, not only between schemes in the private sector, but also between public and private sector schemes:

“overriding legislation would remove the inconsistency of treatment arising from drafting” - the Society of Pension Consultants

Government Response

33. As set out in the consultation document the Government is very mindful of the need to preserve and promote confidence in saving into private pensions. Whilst acknowledging that providing consistency would make for a “level playing field”, ultimately the decision on whether it is appropriate to have a level of scheme benefits that is greater than the statutory minimum is a matter best left to providers and trustees.
34. The Government is satisfied the consultation process has not identified any new or compelling evidence to warrant the introduction of a statutory override. The Government does not think it appropriate to override the rules of schemes that in some cases provide better benefits than the statutory minimum and where the trustees and employer are happy to continue with that arrangement.

Question 7: The Government welcome views on whether there are other reasons why a scheme whose rules do contain a modification power would nonetheless be unable to, or find it difficult to, use CPI for indexation and revaluation

Points made

35. The majority of respondents had a view on whether a scheme that does have power to modify its own rules would nevertheless be unable to switch to CPI for indexation and revaluation. Most agreed that the consultation document covered the most important issues, the main one being section 67 of the Pensions Act 1995.
36. Section 67 of the Pensions Act 1995 protects members’ accrued rights from the effect of detrimental modifications to scheme. As set out in the consultation document, what is, or is not, an accrued right may depend on the rules of particular scheme, so many of the responses (with their own scheme rules in mind) felt that it would be difficult to make changes without having to consider the impact of section 67.

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37. Some respondents commented that even if schemes had a modification power they may still find it difficult to use it (again section 67 being one reason for this) and others stated that a modification power should only be used for future service accrual.

Government Response

38. Based on the responses received, the Government is satisfied that it outlined the most important issues in the consultation document and recognises that the main issue is section 67.

Question 8: The Government welcomes views on whether it is right to rule out granting modification powers

Points made

39. The majority of respondents had a view on whether it is right to rule out granting modification powers. Views were evenly split between those that agreed with the Government's proposal to not introduce a modification power and those that thought a modification power was needed.

40. In general, pensions groups, trade unions and individuals agreed with not granting a modification power:

“Yes, [it is right to rule out granting modification powers] because of the conflicts that could arise from giving either the trustees or the employer these powers” - The Chartered Institute of Personnel and Development

41. The respondents that wanted the Government to grant a modification power were mainly from legal firms, who considered that such a power is needed in order to resolve the uncertainties they have over the application of section 67 of the Pensions Act 1995:

“The advantage of granting modification powers would be to clarify the position of such changes and remove the uncertainty concerning section 67 of the Pensions Act 1995” – Aviva

42. A small number of respondents explored the idea of having a restrictive modification power. This centred on having a modification power open to schemes for a specific period of time to allow them to make any changes, or one that could only be used for future service accruals.

Government Response

43. Although the responses were split, the Government maintains the view that members' trust in schemes and scheme rules could be severely damaged if it intervenes to give schemes the power to change their rules. So having considered all the views expressed in the responses, the Government does

not propose to introduce a modification power to make it easier for schemes to adopt CPI as the relevant index.

Question 9: The Government welcomes views on whether there would be a way to restrict any modification power to those schemes which had previously adopted RPI solely in order to match the statutory minima

Points made

44. Respondents raised two areas of concern in relation to a restricted modification power. The first was that it would be impracticable to enforce or use and the second that it would be difficult to identify which schemes had adopted RPI solely to match the statutory minima.
45. The strongest views were on the ability to prove that RPI had been adopted to match the statutory minima. Many respondents felt that it would not be possible in practice to clearly demonstrate that any scheme which had previously adopted RPI, had done so to match the statutory minima. Some respondents felt that most schemes would not have documented the reasons for adopting RPI and, given the time that may have passed since that decision; there may not be a clear audit trail.

Government Response

46. The Government agrees with the points made that it would be difficult to be certain why a set of rules were drafted in the way that they were, and whether they were drafted solely with the intention of matching the statutory minima. The Government does not want to create a situation where it is possible to override scheme rules regardless of how or why they were drafted.
47. Having considered all the points made, the Government does not propose to introduce a modification power to those schemes which had adopted RPI solely to match the statutory minima.

Question 10 and 11: The Government welcomes views on whether you agree the issue of CPI underpins should be addressed

The Government welcomes views on whether there are any other options to address the CPI underpin issue

Points made

48. The majority of respondents had a view on the CPI underpin issue and whether it should be addressed. Overall the responses welcomed the

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Government proposals to take action so that schemes choosing to continue with RPI increases would not have to pay the increase at the higher of CPI or RPI in any given year.

49. A significant number of respondents, mainly lawyers and insurance companies/groups, asked why proposed legislation to remove the CPI underpin does not extend to revaluation of deferred pensions as well as increases to pensions in payment. The main concerns were that leaving the CPI underpin for deferred pensions would:
- increase the cost and complexity of scheme administration
 - increase scheme liabilities
 - increase the cost of buying out deferred benefits, and
 - complicate funding and investment issues
50. Without further legislation, schemes with rules that require revaluation on an RPI basis would be required to perform two calculations to see which was higher - one based on the scheme rules and one using the statutory revaluation order. This would require process and system changes which respondents felt are both costly and time consuming.
51. Another issue that was raised around the CPI underpin was that, as currently drafted the underpin exemption would not apply to schemes whose rules were altered after 1 January 2011, or where members were moved from one scheme to another under bulk transfer arrangements. It was felt by a few respondents that this was unfair, as some schemes may have changed their rules after this date, for example to remove ambiguity, and they would then have to apply a CPI underpin.
52. Around half of the respondents said they were not aware of any further issues or options to address the CPI underpin.

Government Response

53. The Government had originally considered making provision for removing the CPI underpin in respect of revaluation, but concluded it was not necessary.
54. Indexation and revaluation work in different ways. The indexation requirements in section 51 of the Pension Act 1995 look at inflation over a single year, and apply a relevant increase to the pension in payment. This process is repeated every year and the pension increased accordingly. This can lead to a ratchet effect for schemes with RPI indexation rules if a statutory CPI based increase is required in any year when CPI is higher than RPI. Revaluation, however, is a one-off exercise that looks back at inflation compounded over the whole period of deferral and results in a one-off addition to the accrued pension on retirement.
55. Consequently, the impact on schemes with RPI revaluation rules is not the same as the impact on schemes with RPI indexation rules.

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56. Assuming that in the long run RPI is higher than CPI and that years where CPI is higher are infrequent there is no “underpin” effect for revaluation in the vast majority of cases. Taken over the whole pre-pension period the revaluation addition calculated using RPI throughout the period of deferral will be greater than the revaluation addition required by the revaluation order. CPI will only affect a scheme with RPI revaluation rules in rare circumstances. This is likely to be for individuals with a short pre-pension period which happens to be (or include) a year where CPI is higher than RPI.
57. Nevertheless, the Government recognises that even a small risk of CPI acting as an underpin for revaluation of deferred pensions will potentially have a serious negative impact on the cost and complexity of running defined benefit pension schemes. Consequently the Government is looking at the possibility of tabling an amendment to the Pensions Bill to ensure CPI does not act as an underpin for schemes that revalue deferred pensions by reference to RPI.
58. The Government also recognises there will be circumstances where, for example there has been a bulk transfer of members where the limitations of clause 15 of the current Pensions Bill as drafted would act as a disincentive to business mergers and acquisitions. Consequently the Government is also looking at tabling an amendment to the Bill to make it clear the provision relating to CPI underpin applies where increases calculated by reference to RPI have been paid continuously since the start of 2011.

Question 12: The Government welcomes views on whether the proposed amendments to remove references to RPI from primary legislation are satisfactory

Points made

59. Most respondents had no comment to this question and of those that did have a view, the majority considered that the amendments were satisfactory and did what they were intended to do.

Government Response

60. The Government is satisfied that the proposed amendments to remove RPI from primary legislation are acceptable.

Thank You

61. The Government would once again like to thank everybody who took the time to comment on this consultation document. The views expressed have been of considerable help in developing solutions to issues and highlighting areas of potential difficulty where further refinement has been required. Throughout the process the involvement of and engagement by stakeholders has been critical and we are extremely grateful for that support.

Annex A – List of organisations consulted

Accounting Standards Board
Association of British Insurers
Association of Consulting Actuaries
Association of Independent Financial Advisors
Association of Pension Lawyers
Auditing Practises Board
Board of Actuarial Standards
Confederation of British Industry
Engineering Employers' Federation
Federation of Small Businesses
Financial Ombudsman Service
Financial Services Authority
Independent Pensions Research Group
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants in Scotland
Institute of Directors
Institute of Payroll and Pensions Management
Investment Management Association
Joint Working Group on Occupational Pensions
Investment and Life Assurance Group
National Association of Pensions Funds
National Consumer Council
National Pensioners Convention
The Occupational Pensioners Alliance
The Pensions Advisory Service
Pensions Action Group
Pensions Management Institute
Pensions Ombudsman
Pensions Protection Fund
The Pensions Regulator
Redingtons
Social Security Policy and Legislation Division,
DSD, Northern Ireland
Small Business Service
The Association of Corporate Trustees
The Institute and Faculty of Actuaries
The Law Society
The Law Society of Scotland
The Society of Pensions Consultants
The Welsh Assembly
Towers Watson
Trades Union Congress
Travers Smith
UNISON
Unite the Union

Annex B – List of respondents

AB Wilh Becker Group
Association of British Insurers
Addleshaw Goddard LLP
Age UK
Aon Hewitt
Association of Consulting Actuaries
Association of Members of IBM UK Pensions Plans
Association of Pensions Lawyers
Aviva
Aviva Staff Pension Scheme
BBC (Pension Scheme)
BlackRock
British Airways Line Pilots Association
BT Pension Scheme
Burgess Salmon
Capita Hartshed
Confederation of British Industry
Chartered Institute of Personnel and Development
Church of England Pensions Board
Civil Aviation Authority Retired Staff Association
Committee of Unilever Pensioners
Communication Workers Union
DLA Piper UK LLP
DWF LLP
EEF Limited
Electricity Supply Pension Scheme
Eversheds LLP
GMB
Grant Thornton UK LLP
Heath Lambert Employee Benefits
Hogan Lovells LLP
Holman Fenwick Wilan LLP
Hymans Robertson LLP
ICI Pension Fund
Independent Commission Retirement Association
Jaguar Land Rovers
JLT Group
Liverpool Victoria
Lucas/TRW Pensioners Association
Marks & Spencer (Pension Scheme)
Mayer Brown International LLP
Mercer Limited
Met Life
National Association of Pension Funds
National Union of Rail, Maritime and Transport Workers
Northgate Solutions Ltd

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Norton Rose LLP
NTL Pension Association
Occupational Pensioners Alliance
Partnership
Public and Commercial Services Union
Pensions Management Institute
Pinsent Masons LLP
Pricewaterhouse Coopers LLP
Prospect
Prudential
Punter Southall Consulting Actuaries
Railways Pension Trustee Company Limited
RBS Pension Trustees Limited
Royal Ordnance Pensioners Association
Sackers LLP
Scottish Widows
Shell Pension Trust Limited
Short Brothers plc
Standard Life
TATA Steel
The Actuarial Profession
The Association of British Airways Pension
The Hundred Group
The Law Society of Scotland
The Phoenix Group
The Society of Pension Consultants
Towers Watson Limited
Trafalgar House Pension Trust
Transport Salaried Staffs Association
Travers Smith LLP
Trustee Board of Smiths Industries Pension Scheme
Trustee of the TI Group Pension Scheme
Trustees of the Airways Pensions Scheme and the New Airways Pensions Scheme
Trades Union Congress
UNISON
Unite the Union
Union of Shop, Distributive and Allied Workers
Verulam Consultants
Whitbread

In addition, 56 responses were received from private individuals.

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