



**The impact of using CPI as the measure of price increases on private sector occupational pension schemes**

**This response is submitted by Unite, the UK's largest trade union with almost 1.5 million members across the private and public sectors. The union's members work in a range of industries including manufacturing, financial services, print, media, construction, transport and local government, education, health and not for profit sectors.**

**Pensions are a key element of most of our member's terms and conditions and one on which they place a high value.**

**Executive Summary**

- Unite is strongly opposed to the application of CPI for the purpose of pension increases and believes RPI linkage should be maintained
- CPI has been selected not because it is a better index but because it is a lower index. We believe that rather than being more appropriate for measuring pensioners' cost of living its methodology means it is actually less appropriate.
- Unite welcomes the extension of the requirement for employers to consult on pension changes to cover changes in the basis of pension increases, as these are a key factor determining the value of the benefit

- The inter-action of CPI with caps on pension increases will serve to compound the damaging effects in the company defined benefit scheme context
- Unite strongly supports the proposals not to impose CPI through overriding legislation or to allow modification orders as would allow schemes to by-pass the established restrictions on reducing accrued benefits.
- Any reduction in accrued rights would offend against the key principle of changes not reducing benefits retrospectively, which is fundamental to protecting members' rights to benefit and maintaining member confidence in schemes

### **The Unite case in detail**

1. Unite has opposed the Government decision to use CPI as the basis for inflation increases in respect of State Pensions and the public service pension schemes, and it also opposes the use of CPI to define the minimum basis of required increases in private sector occupational defined benefit schemes.
2. The Government's argument that CPI is a better index to reflect the inflation experienced by pensioners does not stand up to any serious examination. It has been based primarily on the influence of housing costs on the RPI and the fact that housing costs for pensioners are much lower than for households in general. But housing costs are not the main reason why CPI inflation is less than RPI inflation. Furthermore the housing costs argument cannot be applied in the case of revaluation of deferred pensions, as increases to these benefits relate by definition to members of working age.
3. It would have been possible for the government to use a modified RPI to take account of the housing point. However, on the same principle it would have been harder to deny the case for making other adjustments to reflect pensioner spending patterns. More credible attempts to measure inflation costs for pensioners have been made by Age UK's Silver RPI and by the Alliance Research Trust. Their indices indicate in recent times that

pensioners have been experiencing higher inflation than general RPI rather than the lower inflation measured by CPI.

4. The main reason why RPI is lower than CPI is because of the method of calculation, the former being an arithmetic mean and the latter a geometric mean. The non-mathematical issue lying behind this is that the geometric mean takes account of changes in spending patterns induced by relative price changes i.e it look at the increase in prices of what people buy when confronted with price changes rather than at the impact on what they bought previously.

5. We would suggest that pensioners are far less inclined to modify their spending patterns than consumers in general reflecting the fact that a higher proportion of their budgets are absorbed by necessities and they are more set in their ways.

6. If we consider a pensioner household and assume they spend half of their budget on food and the other half on fuel. If the price of food were to fall by 10% and the price of fuel to rise by 20% then the RPI arithmetic mean method of inflation calculation would suggest that the level of inflation they experience was 5%, whereas the CPI geometric mean method would suggest that it was only 3.9%.

7. The latter result is based on the notion that the pensioner turns down the heating and buys some extra food to compensate. The issue is then is this a realistic response and, even if it is, are they better off or worse off on account of their altered consumption? We would argue that pensioners will be less likely to switch and will feel worse off if they do, and that therefore the arithmetic mean and the RPI are more appropriate ways to measure inflation.

8. Which inflation measure is most appropriate is a legitimate topic of debate but it is doubtful whether there is a right answer and it would be difficult to construct a perfect index applicable to pensions in payment, deferred pension and, in CARE schemes, to revaluation rates. The Government has moved to CPI quite simply because it promised to be lower than RPI, and has completely failed to justify its superficial argument that it is a more appropriate index.

9. The level of pension increases provided by a scheme is a key aspect of the value of the benefits it provides. RPI has long been accepted as the measure used to define and regulate increases in pensions and has been the primary measure of inflation going well beyond the pension arena. This is reflected in the widespread references in scheme literature and communications which certainly create expectations, and in some cases entitlements, which are in advance of scheme rules.

10. The Government has chosen to exercise a discretion, which it believed the legislation allowed, to switch from RPI to CPI. From a member's perspective it has taken advantage of the 'small print' to cut the value of pension benefits and disregarded member expectations. It has taken a calculated risk that this change will not generally be open to legal challenge

Question 1 – Has the impact of using CPI been correctly summarised?

11. The Consultation Document does appear to accurately summarise the complex and diverse inter-relationship in different private sector schemes between scheme rules and the legislation in respect of increases.

12. What it perhaps fails to bring out is that the legislation on increases was only intended to provide for a minimum basis of increase and that good practice would always be that pensions should retain their full value before and during retirement.

13. In interpreting the impact of CPI in relation to private sector schemes account has to be given for the fact that increases are capped, which serves to compound the effect of the overall restriction on pension increases.

Question 2 – Should employers be obliged to consult on changes in indexation rules?

14. Unite would strongly support the extension of listed changes in respect of the employer consultation requirements to cover changes in scheme

rules on indexation and revaluation. This becomes more important the lower the minimum statutorily required pension increases are.

15. Given the potential loss to members of benefits resulting from a change, its present exclusion is an anomaly. It has only been mitigated up to now by changes often being included in a wider consultation exercise embodying changes which are currently listed. However, in other cases, significant changes in indexation have been slipped in without members realising e.g. by trustees disclosing the change by putting an inconspicuous sentence in their annual report.

16. In bringing forward amendments to these regulations we would also invite the Government to clarify as being listed changes inflation-linked (and other) limitations on the amount of pay rises which will count as being pensionable pay.

Question 3 – Do the draft regulations provide adequately for consultation on changes?

17. The regulations as drafted appear to provide adequately for this consultation. However, in respect of the requirement being limited to changes which are less generous, other changes should be subject to actuarial certification in order to be accepted as being exempt.

Question 4 - Issues in respect of CARE pensions?

18. We do not see any particular issues in respect of how changes in the legislation on increases will impact on CARE schemes as it has only limited application to the revaluation rate which is critical to the value of schemes

19. Unite does have strong concerns about the trend toward the application of CPI, and especially capped CPI, to the revaluation rates used by CARE schemes. These can mean that from the inception of membership benefits accrued may be at risk of substantial depreciation even whilst the member, as an employee, is still building up new benefits.

## Question 5 – Issues in respect of GMP's?

20. We do not see any particular issues in respect of Guaranteed Minimum Pension rights in respect of legislation though we object to the knock-on implication in this areas of CPI being applied in respect of state pensions

## Question 6 – Should legislation over-ride pension scheme rules and impose CPI increases?

21. Unite welcomes the Government's decision not to propose an over-ride of scheme rules to impose or allow CPI increases to be paid in respect of past or future service benefits where current rules and legislation would have prevented this.

22. It is often suggested by advocates of an over-ride that schemes have only provided pension increases because they have been forced to do so. While there is some truth in this in respect of revaluation of deferred pension this is not the case generally for indexation of pensions in payment.

23. Prior to 1997, when legislation first required increases, around 70% of pension schemes already provided for guaranteed RPI-linked increases (and a further large block of schemes paid discretionary increases as a matter of course). The legislation was aimed at a minority of schemes who were being criticised for not paying increases while at the same time their sponsoring employers were taking contribution holidays.

24. The practice of guaranteeing increases had emerged voluntarily and by negotiation as being good practice. When legislation did consolidate this it was quite common for increase provisions to be agreed which were in advance of the legislative requirement.

25. It would be totally unacceptable now for increases in respect of past service benefits to be taken away by over-riding legislation. This would breach one of the key principles which underpins confidence in pension schemes which is that any changes should not be retrospective.

26. The precedents for over-riding legislation impacting on pension benefits have all been to improve benefits and to counter discrimination. The Government has rightly rejected calls for it to set a precedent for over-riding legislation to make benefits worse.

27. It is inconceivable that the government would legislate to interfere in commercial contracts in general or in annuity contracts in particular to substitute inferior terms. So why is it even considered that they should interfere in occupational pension schemes in such a manner.

Question 7 – Obstacles to schemes modifying their benefits to allow for CPI?

28. The rules of most schemes contain specific provisions which prevent amendments or modifications as would reduce members' accrued rights. These provisions usually preceded but were reinforced by legislation, in particular by Section 67 of the Pension Act 1995

29. There are very few schemes whose rules would prevent a change in rules relating to indexation or revaluation in respect of scheme benefits earned in the future, whether directly or by a requirement for difficult processes to be undertaken to secure agreement (e.g by member consent).

Question 8 – Should modification powers be given to allow schemes to bypass protections in rules and legislation and change to CPI?

30. Unite supports the Government's decision not to grant new modification powers to schemes. This would be an indirect alternative to the direct use of over-riding legislation and it is unacceptable for all of the same reasons

31. This would involve the Government interfering directly to disturb the balance of power within schemes and the protection for members' benefits. The protections against rule changes which affect past benefits are fundamental to members no longer working for the Company who are completely powerless in the face of an attack on their benefits.

32. It is not clear why inflation protection, as a key aspect of benefit value, should be subject to different criteria and lesser protection than other benefits. As has been noted, past legislation is not the main reason why schemes include provisions for pension increases

Question 9 – A selective modification power ?

33. In many cases it would not be possible to determine truly what scheme rules may have said in the absence of legislation. Provision in most cases preceded legislation and in its absence would no doubt have continued to develop or otherwise alternative improvements may have been negotiated.

34. It would neither be practicable or fair to try and implement a modification power which took account of the particular history of different schemes.

Question 10 – Should schemes with RPI-based increases have to underpin these with CPI?

35. As a general principle it would seem fair to legislate so that schemes committed to RPI increases should not, due to legislation, be required to pay increases that were the higher of CPI or RPI. It would seem unfair and administratively burdensome to require this dual basis of increases to be applied.

36. Failure to address this issue might encourage more schemes to switch to a CPI basis

Question 11 – Is the proposed approach to deal with this appropriate?

37. The legislative device proposed to resolve this would seem to be a sensible way of achieving the objective.

Question 12 – Other changes relating to CPI?

38. We have no comments to make on these miscellaneous amendments

**Submitted on behalf of Unite**

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