BlackRock

30 June 2020

RPI Consultation Team
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RPI Consultation Team
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Submitted via email to: RPIConsultation@hmtreasury.gov.uk

RE: Consultation on the Reform to Retail Prices Index Methodology

Dear RPI Consultation Team,

BlackRock[1] is pleased to have the opportunity to respond to the consultation on the Reform to Retail Prices Index Methodology, issued by the HM Treasury and the UK Statistics Authority (UKSA). BlackRock supports a regulatory framework that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We understand that the RPI has a range of statistical features in its construction that lead some statistics experts to consider it undesirable for ongoing use. Given their statutory objectives, we sympathise with the position of the Authority in seeking to discontinue the production of RPI and replace it with an index linked to CPIH.

However, such a change would have a material impact on holders of index-linked gilts, representing a transfer of value from those holders to the UK Government in lost future redemption proceeds, potentially in the range of £122bn to £154bn over the period to 2068[2]. As our response to the consultation question sets out, the earlier this change is made the larger this value transfer will be. This is highly likely to apply to all index-linked gilts given provisions in the prospectus of some index-linked gilts to protect against material and detrimental changes to RPI is of little practical value given current real yields.

We are especially concerned about the impact on UK Defined Benefit (DB) Pension Schemes and LGPS and the consequent retirement outcome of many millions of their members, as well as the pensions of other individuals. The proposed change would be financially detrimental to anyone promised an RPI linked defined benefit pension by their employer via the company pension scheme or an insurance provider via an annuity. This would almost universally be the case.

Given the complex nature of pension scheme liabilities and differing investment strategies, the proposed changes will create winners and losers. As a fiduciary responding in the interest of our clients it is therefore difficult for BlackRock to represent each

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

[2] Range Based on the change taking place in 2025 or 2030 and using data from April 2020, assuming inflation index levels as of 3 September 2019. See Table 2 for full details.

individual scheme's circumstances, and we have encouraged our clients to also respond with their unique situations to enable a better understanding of the range of impacts.

This point aside, we would suggest there is an inherent lack of fairness to the proposed change. Those schemes that have hedged all of their inflation risks – both RPI and CPI linked - with the available RPI linked instruments could see a material negative impact on their funding level and the security of their members' benefits. By contrast, those which have not hedged all of their RPI linked liabilities could see an improvement in funding level and reduction in deficits. Paradoxically, the pension schemes most negatively impacted by the proposed change are those that have made the greatest efforts to follow the Pension Regulator's legal requirement to manage funding level risk by investing "assets backing DB liabilities in a way that is appropriate to the nature, timing and duration of the expected future retirement benefits payable under your scheme." [3]

Beyond the index-linked gilt market, there are a wide variety of other financial instruments that reference RPI, including swaps, property contracts and corporate bonds. While the format of the proposed reform should not materially disrupt the function of the inflation swap market, it has the potential to cause dispute and frictional costs across many other public and private financial instruments such as corporate index-linked bonds and lease contracts. There are also a wide range of uses in RPI in wider society, such as to set rail fares or student loan interest payments and there will be societal transfers of value over time as a result of the proposed reforms.

The issues of fairness, potential contract disputes and value transfers could be addressed by changing the proposed reform to redefine RPI as CPIH plus a spread, as we suggest in our answer to question 6. Defining this spread is a non-trivial exercise given the nature of inflation indices and the changes to RPI that have been made over the years, however other recent areas of reform that have had to address similar challenges, such as LIBOR reform, could provide a template.

Finally, any proposed reform should be progressed as quickly as is possible in the current environment while carefully considering the concerns raised around fairness and ensuring an efficient and liquid index-linked gilt market can continue in the future. Ambiguity over the proposed reforms has already created significant uncertainty for index-linked gilt markets and pension schemes trying to use these to manage risk. There is the potential for knock on impacts to other areas of the pensions ecosystem, such as the levels of protection offered by the Pension Protection Fund and the costs of supporting this. While these should be considered by Government in appropriate detail, a protracted delay and continued uncertainty is not helpful in allowing impacted parties to plan for their financial futures.

We welcome the opportunity to comment on the issues raised by this consultation and will continue to contribute to the thinking of the Reform to Retail Prices Index Methodology on any issues that may assist in determining the final outcome. We welcome further discussion on any of the points that we have raised and are available to meet at your convenience.

Yours faithfully,

Anthony Manchester
Head of UK Public Policy

Alex Claringbull
Global Head of Liability Driven Investing

[3] Pension Regulator reference – page 64. https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-investment-guidance.ashx

Responses to specific questions

1. Do you agree that this proposed approach is statistically rigorous?

BlackRock is not best positioned to comment on this point and will defer to statistics experts who are best placed to opine on this area.

2. What will be the impact on the interests of holders of 'relevant' index-linked gilts (i.e. 2½% IL 2020, 2½% IL 2024 and 4 1/8% IL 2030) of addressing the shortcomings of the RPI in a) 2025 b) 2030 or c) any year in between?

In all cases being proposed, there would be no impact on the IL 2020 or IL 2024, given the final RPI Index for these bonds is August 2019 and November 2023 respectively.

For the IL 2030 there could be an impact in cases a or c. The final RPI index of relevance for this bond is due to be published in November 2029, so if the change were to happen in b. 2030 there would not be any impact upon the expected cashflows of this bond. If the change happened in a. 2025, then the holder would be impacted as they would be receiving lower inflation linkage between 2025 and 2029. Similarly, if any change happened in any year in between, and before November 2029, the holders of the IL 2030 will be impacted.

Another consideration is the prospectus wording shown in Extract 1. This states that if there is a change to the calculation of the Index to the detriment of bondholders, they have the right to redeem their bonds at par uplifted by Inflation until the repayment date. As Table 1 shows, if someone were given that option today (31st March 2020), they would be forfeiting future inflation indexation, receiving only £216 per £100 even though the bond in the market is worth £381. Therefore, this wording offers little actual protection, as the investor would still be better off holding the bond to maturity to benefit from the future inflation increases, even if they are lower than previously anticipated.

Table 1 – price of IL 2030 vs. index ratio if bond redeemed now

Initial RPI Index – October 1991	RPI Index – February 2020	Index Ratio as at Feb 2020	Price as at 31st March 2020
135.1	292	2.16136	381.194

Source: BlackRock. Data as at dates shown.

Extract 1 – From prospectus of the 2030 Index-linked Gilt

"If any change should be made to the coverage or the basic calculation of the Index which, in the opinion of the Bank of England, constitutes a fundamental change in the Index which would be materially detrimental to the interest of the stockholders, Her Majesty's Treasury will publish a notice in the London Gazette immediately following the announcement by the relevant Government Department of the change, informing stockholders and offering them the right to require Her Majesty's Treasury to redeem their Stock. For the purposes of this paragraph, repayment to the stockholders who exercise this right will be effected, on a date to be chosen by Her Majesty's Treasury, not later than seven months from the last month of publication of the old Index. The amount of principal due on repayment and of any interest which has accrued will be calculated on the basis of the Index ratio applicable to the month in which repayment takes place. A notice setting out the administrative arrangements will be sent to stockholders at their registered address by the Bank of England at the appropriate time."

Estimating the actual loss is difficult. Market levels on the 3rd September 2019 implied an RPI level for November 2029 of 413.20, which is an Index Ratio of 3.05848. If we then assume that RPI is 1% lower from January 2025 onwards, the November 2029 Index level becomes 393.94, implying an Index Ratio of 2.91591. This implies a loss on the redemption of £14.25 per £100 of Par, and this does not factor in the lower coupons from 2025 onwards.

3. **What will be the impact on the interests of holders of all other index-linked gilts of addressing the shortcomings of the RPI in a) 2025 b) 2030 or c) any year in between?**

All other index-linked Gilts do not have the wording mentioned above in their relevant prospectuses, however as we point out above this wording is unlikely to provide any protection in practice given the current level of real yields. Depending on the bond maturity therefore, holders would suffer lower coupon and redemption payments from the year the change is made to their maturity date.

Please see Table 2 which illustrates the approximate loss of redemption value from a 1% drop in RPI as at 3rd September 2019. If the reform takes place in 2030, this indicates a loss of £122.5 billion across all index-linked Gilt holders, increasing to £154.4 billion if the reform happens in 2025.

The figures in Table 2 are in future value terms as the redemption proceeds fall due. Coupon payments will also be smaller than previously expected as these are also inflation uplifted by RPI, which would further increase the impact through time but is not captured in the illustration in Table 2, shown overleaf.

Table 2 – impact on redemption proceeds from reform in 2025 vs. 2030

Stated Maturity	Uninflated Nominal	Redemption Value - Pre Reform	Redemption Value - Post Reform 2025	Redemption Value - Post Reform 2030	Loss Reform 2025	Loss Reform 2030
22/03/2026	13,454,768,000	18,882,703,078	18,700,275,643	18,882,703,078	- 182,427,435	-
22/11/2027	14,170,199,000	28,105,165,876	27,387,153,314	28,105,165,876	- 718,012,562	-
10/08/2028	10,938,739,000	15,484,831,458	14,979,772,028	15,484,831,458	- 505,059,430	-
22/03/2029	14,229,213,000	24,190,063,182	23,268,621,015	24,190,063,182	- 921,442,166	-
22/07/2030	4,841,239,000	14,806,634,682	14,116,466,861	14,806,634,682	- 690,167,821	-
22/11/2032	13,459,618,000	28,329,373,788	26,297,605,543	27,605,746,954	- 2,031,768,245	- 723,626,834
22/03/2034	14,570,332,000	30,065,294,874	27,550,008,633	28,920,449,085	- 2,515,286,241	- 1,144,845,789
26/01/2035	9,083,989,000	25,377,481,992	23,160,848,148	24,312,955,565	- 2,216,633,843	- 1,064,526,427
22/11/2036	12,143,309,000	24,468,346,751	21,849,205,606	22,936,066,940	- 2,619,141,146	- 1,532,279,811
22/11/2037	13,065,680,000	35,365,971,321	31,275,682,246	32,831,451,840	- 4,090,289,076	- 2,534,519,481
22/03/2040	14,090,030,000	38,569,183,934	33,344,994,981	35,003,699,724	- 5,224,188,953	- 3,565,484,209
10/08/2041	10,500,000,000	23,303,665,282	19,871,943,385	20,860,448,348	- 3,431,721,897	- 2,443,216,934
22/11/2042	12,559,257,000	38,244,611,166	32,217,576,182	33,820,199,109	- 6,027,034,984	- 4,424,412,057
22/03/2044	15,725,522,000	43,261,689,804	35,971,287,147	37,760,633,484	- 7,290,402,657	- 5,501,056,320
22/03/2046	13,485,568,000	36,716,441,253	29,935,868,980	31,424,991,048	- 6,780,572,272	- 5,291,450,205
22/11/2047	11,686,640,000	41,029,984,944	32,910,134,648	34,547,208,028	- 8,119,850,296	- 6,482,776,917
10/08/2048	10,222,715,000	27,584,309,284	21,963,050,458	23,055,574,927	- 5,621,258,826	- 4,528,734,357
22/03/2050	12,221,183,000	43,980,812,004	34,477,611,032	36,192,656,333	- 9,503,200,972	- 7,788,155,671
22/03/2052	12,366,020,000	41,168,667,716	31,645,738,933	33,219,916,327	- 9,522,928,782	- 7,948,751,389
22/11/2055	10,169,196,000	46,572,104,354	34,535,038,183	36,252,940,351	- 12,037,066,171	- 10,319,164,003
22/11/2056	5,980,305,000	20,412,554,976	14,989,073,701	15,734,686,376	- 5,423,481,275	- 4,677,868,599
22/03/2058	10,953,298,000	39,964,577,310	28,965,031,007	30,405,859,963	- 10,999,546,303	- 9,558,717,346
22/03/2062	12,479,737,000	54,973,907,300	38,312,536,326	40,218,345,152	- 16,661,370,975	- 14,755,562,149
22/11/2065	7,250,000,000	31,743,102,154	21,342,523,858	22,404,180,945	- 10,400,578,296	- 9,338,921,210
22/03/2068	12,600,000,000	60,964,398,202	40,063,262,006	42,056,158,474	- 20,901,136,195	- 18,908,239,727
		833,565,876,683	**679,131,309,865**	**711,033,567,247**	**- 154,434,566,819**	**- 122,532,309,436**

Source: BlackRock. As of April 2020, using inflation index levels as of 3 September 2019.

4. **What will be the impact on the index-linked gilt market or those dependent on it of addressing the shortcomings of the RPI in a) 2025 b) 2030 or c) any year in between?**

As per our responses to Questions 2 and 3, the earlier the change is made the lower the Final Index Payment and coupon payments and in turn the larger the impact on bondholders will be. This is the case whether they be UK DB pension schemes, insurers, funds, individuals or overseas investors.

According to working undertaken by the Pension Policy Institute UK Defined Benefit Pension Schemes ("Schemes") are one of the most significant holders of index linked gilts as they make up most of the £470bn in index-linked bonds they hold,[3].

Schemes will be impacted in a variety of ways depending on their circumstances. Due to the way pension legislation has developed alongside individual scheme rules, Schemes

[4] Briefing Note Number 118: How could changes to price indices affect Defined Benefit schemes?, Pensions Policy Institute, 2020.

often hedge many different types of Inflation using RPI-linked gilts. Schemes have faced very limited alternative options other than the use of RPI linked gilts given the lack of CPI or CPIH linked issuance available. Depending on how they and their advisors developed their investment strategy, some have fully matched inflation exposures inherent in their liabilities, while others continue to face significant exposure to future inflation expectations.

This leads to a range of different outcomes depending on Scheme circumstances. Table 3 captures the extremes of this but in reality, many schemes will be some mix of liability linkages and level of hedging.

Table 3 – Permutations for Scheme outcomes

	Fully hedged with RPI	No hedge
RPI-linked liabilities	No impact as Assets and Liabilities should fall by the same amount on the day the change happens	Benefits from switch, the earlier the better, as hedging will be cheaper, and liabilities will fall relative to assets
CPI-linked liabilities	Suffer losses - larger the earlier the change happens – as assets fall but liabilities will not	No impact as both assets and liabilities are unchanged

Source: BlackRock.

An area of the market that should not be overlooked is Local Government Pension Schemes (“LGPS”). The majority of these schemes have CPI linked liabilities and while they tend to hold a relatively modest allocation to index-linked gilts compared to many Schemes given they are typically open schemes with very long investment horizons, the nature of their benefits leaves them particularly exposed to the proposed reforms. Losses in funding level for LGPS as a result could lead to higher contributions being required from local authorities to make up the shortfall, either diverting monies from other vital local services or requiring support from central Government.

Similarly, any Defined Contribution (DC) schemes and mutual funds who hold Index-Linked Gilts will suffer greater negative impact the earlier the change occurs. Individuals who have used Index-linked gilts as part of their own pension provision, for example via SIPPs, and who hold passive or active funds that invest in index-linked gilts will be similarly impacted.

In summary, if the proposed changes are made all index-linked gilt holders of all index-linked gilts would be expected to suffer a loss of value versus what they believed their asset was worth, with this value being transferred to the UK Government who will see their future liabilities fall. The earlier any change occurs, the larger this transfer of value will be. The overall impact on index-linked gilt holders financial position, particularly Schemes, is complex and will depend on their specific circumstances.

5. **What other impacts might the proposed changes to address the shortcomings of the RPI have in areas or contracts where the RPI is used?**

As identified in the former Chancellor’s letter from 4th September 2019, RPI is a widely used reference index in a range of financial contracts and services across the economy beyond just index-linked gilts. Below we have highlighted impacts relevant to our clients and funds, as well as identifying indirect impacts from the proposed changes in the index-linked gilt market.

Another major financial market utilising RPI is the inflation swaps market. In a similar way to the use of index-linked gilts, inflation swaps are used by many Schemes to hedge liabilities, which may constitute a mix of RPI and CPI linked future pensions. The impacts described in our answer to question 4 will apply in the same way for RPI inflation swaps being used by Schemes. If RPI is redefined in some way, we would expect no disruption to inflation swap markets with swaps continuing to reference the RPI rate and with ISDA wording specifying that swaps take their steer from a reference gilt.

Where RPI swap markets could face a challenge were if RPI were to completely disappear. The proposed approach to continue to publish RPI but with reference to another index, adjusted or unadjusted, is therefore preferable to the cessation of RPI with regards to maintaining good order in the inflation swap markets that have developed around RPI.

We are also aware of many property-linked contracts, for example, long dated building leases having links to RPI. BlackRock invests in such leases on behalf of our clients through several strategies and changes to RPI to align it with CPIH will impact the value of these contracts. Analysis to date indicates that wording within contracts around how any such change should be treated can be quite variable and will likely require individual investigation and legal opinions to be sought by the various parties involved. While RPI is being retained as an index and simply redefined, any contracts that reference a material change to RPI being grounds for further action are likely to cause significant frictional costs in establishing the future value of payments or how to adjust contracts. This is a cost that should be carefully weighed by the by the Treasury and the Authority and they may wish to consider how other areas of policy such as legal guidance on how such matters should be interpreted could minimise these costs.

Another area with RPI linkage in financial markets is renewable power – revenue support known as Renewable Obligation Certificates (ROCs) is a material component of the total revenue for existing renewable power assets BlackRock invests in on behalf of clients and is linked to RPI, as is revenue resulting from Feed in Tariffs (FiTs). Several expense items are also linked to RPI, including Operations and Maintenance as well as Rent. A legal review of contractual terms within the industry would be necessary to determine the implications, but the value of renewable power assets would likely be negatively impacted as a result of the proposed changes to RPI.

The market for index-linked corporate bonds that reference RPI could be impacted in a very similar way if RPI were redefined as CPIH, which may be considered a fundamental change. A specific example of this which is linked to the UK government and should be considered with regards to both the potential frictional impacts of the proposed change and the impact to public finances is Network Rail Bonds. These bonds include specific wording in their prospectus to cover a fundamental change to the index as shown in Extract 2.

Extract 2 – From Network Rail Infrastructure Finance PLC Prospectus, 7 July 2006.

A) If:

(x) the Note Trustee has been notified by the Calculation Agent (or otherwise becomes aware) that the Index has ceased to be published (in which event, the Note Trustee will give written notice of such occurrence to the Issuer); or

(y) any change is made to the coverage or the basic calculation of the Index which constitutes a fundamental change which would:

(I) in the opinion of the Note Trustee, acting solely on the advice of the Indexation Adviser, be materially prejudicial to the interests of the Noteholders (in which event, the Note Trustee will give written notice of such occurrence to the Issuer); or

(II) in the opinion of the Issuer, be materially prejudicial to the interests of the Issuer (in which event, the Issuer will give written notice of such occurrence to the Note Trustee), and the Issuer and the Note Trustee together shall seek to agree for the purpose of the Notes one or more adjustments to the Index or a substitute index (with or without adjustments)

with the intention that the same should leave the Issuer and the Noteholders in no better and no worse position that they would have been in had the Index not ceased to be published or the relevant fundamental change not been made.

*B) If the Issuer and the Note Trustee fail to reach such agreement within 20 Business Days following the giving of such notice by or to the Note Trustee, a bank or other person in London shall be appointed by the Issuer and the Note Trustee, or, failing agreement on such appointment within 20 Business Days following the expiry of the 20 Business-Day period referred to above, by the Note Trustee (in each case, such bank or other person so appointed being referred to as the "**Expert**"), to determine for the purpose of the Notes one or more adjustments to the Index or a substitute index (with or without adjustments) with the intention that the same should leave the Issuer and the Noteholders in no better and no worse position than they would have been had the Index not ceased to be published or the relevant fundamental change not been made. Any Expert so appointed shall act as an expert and not as an arbitrator and all fees, costs and expenses of the Expert, the Issuer and the Note Trustee in connection with such appointment shall be borne by the Issuer.*

Agreeing adjustments to the index or a substitute index between issuers and Note Trustees on a case by case basis is likely to be challenging and the appointment of an Expert willing and able to advise on such a matter may also be practically difficult. If played out across many different bonds this has the potential to create significant frictional costs and disputes for both bond holders and issuers.

Finally, beyond the impact to specific financial instruments or funds BlackRock operates on behalf of our direct clients, there are a wide range of uses of RPI in wider society across an array of contracts and areas of the economy. Any change to RPI will have wider societal impacts, potentially including wealth transfers over time. Specific instances where an impact might be expected include student loans with interest payments linked to RPI, rail fare increases, mobile phone and broadband contracts and water, gas and electricity regulated price increases.

Scheme members due to receive an RPI uplifted pension in payment and/or deferment will be almost universally negatively impacted by the proposed change, with this impact larger the earlier the change comes into effect. As described in our answer to question 4 there will be some Schemes which would benefit from RPI being set equal to CPIH at some point in the future between 2025 and 2030. In theory this could create a circumstance where these gains increase the likelihood of the Scheme being able to pay all member benefits in full, rather than entering the PPF. This could leave some members in a better position as a result of RPI reform. However, we would expect this to be exceptional and for the vast majority of Scheme members who were expecting to receive RPI uplifted benefits, they will be worse off.

Holders of RPI-linked annuities (either purchased by choice or by law prior to the Pension Freedoms introduced in 2015) will also suffer greater negative impact to the future uplift the earlier the change happens.

For balance, it is important to also acknowledge that in some cases this future reduction of pension inflation uplift has been offset by previous changes to RPI methodologies that increased RPI relative to CPI. A change in 2010 to the methodology for the collection of clothing and footwear prices caused an increase in the so-called formula effect causing RPI to be higher than CPI by up to 0.3%. This has been widely acknowledged by many, including the Authority, to have been erroneous in hindsight. Some existing pension scheme members or index-linked annuity holders may have benefited from this for 15 or 20 years by the time any further changes to RPI are made.

Many other types of contract beyond pensions are linked to RPI such as student loan payments, rail fares, property ground rents and many household bills such as mobile phone and broadband not to mention many regulated services such as water and energy. Those paying for these services will benefit from an earlier switch should they continue to be linked to RPI, whereas those receiving these payments will of course be negatively impacted by an earlier switch.

BlackRock has not undertaken studies to consider how these impacts would affect different groups across society, which is likely to be highly complex. Many of these items could by choice be moved from RPI to CPIH by the government if they chose to legislate as such, without the need to change RPI to CPIH directly with the resultant impact on the index-linked gilt market, holders and Scheme members.

6. **Are there any other issues relevant to the proposal the Authority is minded to make of which the Authority or the Chancellor ought to be aware?**

We understand and support the Authority's desire to cease publishing RPI in its current form given the much-discussed deficiencies in some methodologies used and simplification it would bring to the range of inflation measurements, despite the implied challenges. This could be done in a fairer manner to underlying holders of index-linked gilts and other contracts linked to RPI by considering the redefinition of RPI not directly to CPIH but to CPIH plus a spread. This approach could be used to avoid value transfers while solving the statistical concerns inherent to the current RPI measure and reducing sources of friction where contracts make provision for fundamental changes to RPI.

Redefining RPI as CPIH plus a spread could ensure that faith in the index-linked gilt market is retained, reduce the risk of increased moral hazards for pensions schemes being encouraged to manage their money in certain ways by regulators and ensure that pensioners, both in Schemes and those who have purchased RPI linked annuities, do not lose out.

As set out in our response to question 4, the impact on UK defined benefit pension schemes is expected to be both large and highly variable depending on scheme circumstances. In general, it is more likely that schemes that have followed guidance from the pension regulator to structure their investments in such a way so as to align the risk of their assets with their liabilities and therefore have high inflation hedge ratios will be the most penalised by the planned reforms.

While industry wide data is difficult to obtain, BlackRock's anecdotal experience as an LDI manager has been that those who have hedged their interest rate and inflation risks over the last decade tend to have stronger funding positions. Those schemes that did not hedge have generally experienced falling funding levels as gilt yields have continued to decline in line with global trends.

Therefore, it is reasonable to suppose as a generalisation that those Schemes who will benefit most from the proposed reforms as they have unhedged RPI linked liabilities, would be those schemes that currently have lower funding levels. This could be considered superficially to have some wider benefits to the broader pensions system, for example reducing the number of schemes that may need to enter the PPF as their funding level is lower than the threshold for PPF benefits should their sponsor fail. However, given that following the National Statistician review of RPI in 2012, the risk of material downward revisions to the expected trend rate of RPI was considered by all to be negligible, it is patently unfair. Those schemes that have followed The Pension Regulator guidance, using the instruments available in the form of RPI index-linked gilts to match their liabilities, and yet may see a material negative impact to their funding level as a result of the proposed changes to RPI. Many schemes also made these hedging decisions post the 2012 CPAC review, where the reasonable expectation was set that RPI would be maintained as a legacy measure and not experience further changes. Many schemes we work with who expect to be negatively impacted by the proposed changes are therefore rightly frustrated by how these events have unfolded and the position they now find themselves in.

We acknowledge however that this approach of defining RPI as CPIH plus a spread is itself non-trivial. Determining what the spread should be would be a delicate balancing act and even with an independent group ruling or further a consultative approach to derive this, there may be winners and losers depending on what time horizon is chosen. RPI was until the last few years a regularly updated measure, with methodology and intended improvements made over time, driving changes in the difference vs. CPI.

Whatever change is eventually made to RPI, other areas of policy may need to be considered by Government more broadly, such as the impact on the PPF. Given the nature of the PPF's benefit structure being CPI linked it is likely that the PPF itself will be materially negatively impacted by any RPI reform as it is likely to have held RPI linked instruments to hedge these CPI linked liabilities in the absence of the issuance of CPI linked Gilts.

Ensuring that this does not degrade the protection the PPF offers to Scheme members is important, but in doing so Government could consider ways in which Schemes adversely impacted by this change as described above could be supported, by for example encouraging changes to how the PPF calculates its levy to reduce the ongoing burden on schemes that could experience a fall in funding as a result of any reform, and would have otherwise been in a stronger position, paying a lower levy. This area of policy could otherwise risk compounding the impacts on winners and losers from this reform, as those schemes who see a negative funding level impact could at the same time see their levy increase.

Finally, any reform needs to carefully consider the impact on the existing index-linked gilt market and any future planned issuance. Since the former Chancellor's letter on the 4th September 2019, the index-linked gilt market has entered a period of severe uncertainty, with the DMO reacting to this uncertainty by reducing issuance of long-dated index-linked gilts. As we help our clients face the financial implications and market volatility created by the Coronavirus pandemic, issuance of index-linked gilts continues to be very limited and liquidity in index-linked gilts is suffering as a result. We would strongly advocate resolution being reached on this matter as soon as possible to limit ongoing uncertainty.

As part of any reform to RPI it is vital that careful consideration is given to how functioning and liquid inflation linked debt markets can be maintained in the UK. To enable prudent risk management for a wide range of our clients it will be important to have access to the instruments needed to accurately hedge the inflation risks they face, whether those be RPI, CPIH or CPIH plus a spread.

This may include the need for issuance of multiple types of inflation linked debt. It is possible to envisage scenarios where there is ongoing demand for both CPIH and CPIH plus a spread linked debt to best hedge pension scheme and insurer liabilities and eliminate basis risks or qualify for matching adjustments under solvency II regulations. In addition, if all existing index-linked gilts were to become CPIH plus a spread while new index-linked gilts were only issued against CPIH, this could over time result in poor liquidity in the back book of index-linked gilts linked to CPIH plus a spread. Consideration should be given to future index-linked debt issuance plans to ensure there is no risk of fragmentation by issuing a range of types of inflation linkage and compromising the liquidity and function of the index-linked gilt market.

7. **Which lower level or supplementary RPI indices are currently used, and what are they used for?**

Other than research into the drivers of inflation we are not aware of any formal uses of lower level or supplementary RPI indices by BlackRock or our clients.

8. **What guidance would users of lower level or supplementary RPI indices find most useful for the ONS to provide?**

We do not have specific comments in relation to this question.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Consultation on the Reform to Retail Prices Index Methodology and will continue to work with the HM Treasury and UK Statistics Authority on any specific issues which may assist in the Reform to Retail Prices Index Methodology.