

Non-Executive Report of the:  <b>Pensions Committee</b>  18 June 2020	 <b>TOWER HAMLETS</b>
<b>Report of</b> Neville Murton, Corporate Director, Resources	<b>Classification:</b> Unrestricted Appendix to this report is restricted
<b>Proposed Changes to Retail Price Index (PRI)</b>	

<b>Originating Officer(s)</b>	Miriam Adams, Pensions & Investments Manager
<b>Wards affected</b>	All wards

## SUMMARY

The UK Government is to undertake a consultation into the calculation and use of RPI with reference to Index Linked Gilts, the effect on public finances and the integrity for the statistical system.

The result could see RPI no longer used as a statistic used by Index Linked government bonds and the Consumer Prices Index including owner occupier housing costs (CPIH). Thereby reducing the future change in RPI by around 1% per annum.

This could have a potentially major effect on the market and could cause a huge sell off-off in market.

## RECOMMENDATIONS

The Pensions Committee is recommended to:

1. Consider the paper prepared by Mercer (Appendix A);
2. Consider the options presented by Mercer (Appendix A page 12)
3. Consider the advice put forward by Mercer to switch to fixed index gilts as soon as possible using LGIM or Schroders;
4. Note the need to consider procurement implications of the above recommendations; and
5. Agree on a way forward.

### 1. **REASONS FOR THE DECISION**

- 1.1 This change could have significant and immediate financial consequences for investors in RPI-linked assets such as index-linked gilts. The Fund's assets are linked to RPI while its liabilities are linked to CPI. The Fund's investment adviser Mercer is of the opinion that following a RPI reform consultation, RPI is expected to fall while CPI will remain unchanged, which could lead to a

possible deterioration of the Funding level.

- 1.2 However, Insight investment, one of the Fund's fixed income manager is of the view that they would recommend in the consultation that RPI be amended to align with CPIH plus a margin to avoid potential losses.

## **2. DETAILS OF REPORT**

- 2.1 RPI has consistently risen at a faster pace than the recommended index CPIH, so to align the indices will reduce the value of future cash flows and the price of bonds will fall. It is anticipated that the market price of the Longest dated bonds will suffer the biggest price falls. That the market price of the longest bond in the market, maturing in 2068, could fall as much as 30% should the consultation rule that the change should occur.
- 2.2 It should be noted that these are all based on estimates and uncertainties, the consultation was due to commence in January 2020 and report by the end of the current financial year but this timeline has slipped to March with the results expected at the end of April. The current estimated timescales for any switch to take place in 2025 could change.
- 2.3 When investors invest in index-linked gilts they do so with the knowledge of the difference between RPI and CPI. Investors invest in RPI-related gilts, they factor in the fact that RPI is likely to rise more quickly than CPI.
- 2.4 In addition to Index-linked gilts held by the Fund (6%), other assets with exposure to RPI are property managed by Schroders (12% of portfolio), Baillie Gifford DGF (10%) and Ruffer Absolute Return (10%).
- 2.5 Mercer is of the opinion that given other price sensitivities of these assets and cost/practicalities of change as well as the flexibility in DGF, the Fund should limit any changes to the index linked portfolio.

## **3. COMMENTS OF THE CHIEF FINANCE OFFICER**

- 3.1 The full impact of this legislative change is not fully understood at this point. On 12 March, the Chancellor launched a consultation to understand the impact of the potential changes and what then will be required.

## **4. LEGAL COMMENTS**

- 4.1 All regulatory matters concerning the operation of the mandate would be managed by the fund manager. One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate having regard to these matters, for the Committee to receive information about asset allocation and ensure that funds are being managed in accordance with the Council's statutory obligations.

4.2 Recommendation 3 refers to changing index linked gilts to fixed index gilts. This is financial activity which is exempt under the Public Contracts Regulations 2015. Therefore, the committee is free to follow this recommendation should it so choose without the need for any further competitive exercise.

## **5. ONE TOWER HAMLETS CONSIDERATIONS**

5.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

## **6. BEST VALUE (BV) IMPLICATIONS**

6.1 The Pension Fund accounts demonstrate the financial stewardship of the scheme members and employers' assets.

## **7. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

7.1 There is no direct Sustainable Action for a Greener Environment implication arising from this report.

## **8. RISK MANAGEMENT IMPLICATIONS**

8.1 Any form of investment inevitably involves a degree of risk. The rigorous robust management of LBTH Pension Fund results in better performance and reduction in the contribution required from the Council towards the Fund.

8.2 To minimise risk, the Pensions Committee attempts to achieve a diversified portfolio.

## **9. CRIME AND DISORDER REDUCTION IMPLICATIONS**

9.1 There are no crime and disorder reduction implications arising from this report.

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### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- None

#### **Appendices**

Appendix A – Tower Hamlets RPI and ILG considerations (restricted)

### **Local Government Act, 1972 Section 100D (As amended)**

#### **List of "Background Papers" used in the preparation of this report**

#### **Officer contact details for documents:**

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