

21 August 2020

State Street Global Advisors
20 Churchill Place
Canary Wharf, London
E14 5HJ
T +44 20 3395 6000
ssga.com

RPI Consultation Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

RPI Consultation Team
Room 2.001
Office for National Statistics
Cardiff Road
Newport
NP10 8XG

Submitted via email: RPIConsultation@hmtreasury.gov.uk

Dear Sir / Madam

Re: Consultation on the Reform to Retail Prices Index Methodology

State Street Global Advisors (SSGA) welcomes the opportunity to comment on the UK Statistics Authority (the Authority) and HM Treasury (HMT) consultation paper on the reform to the Retail Prices Index (RPI) methodology.

For four decades, SSGA has served the world's governments, institutions and financial advisors. Through our pioneering approach, SSGA has become the world's third largest asset manager, with nearly \$3.05 trillion¹ under our care. We manage a significant amount of index-linked gilt assets on behalf of pension schemes and other institutional investors and are responding to this consultation to represent their interests.

We are broadly supportive of, and recognise the need for, change to address the shortcomings of the RPI. However, it is important for the changes to be made in a way that is fair and transparent and that does not involve arbitrary redistribution of economic value between different parties, and thereby undermine trust in the gilt market.

Our views are broadly in line with the response submitted by the Investment Association (IA). However, we believe it may be helpful to provide further details on specific questions, which we have set out below. Should you wish to discuss any aspect of our response further, please do not hesitate to contact us.

Yours sincerely,

Stephen Yeats
Head of Investments UK
State Street Global Advisors

¹ Assets under management as of 30 June 2020 includes approximately \$67 billion of assets with respect to which State Street Global Advisors Funds Distributors, LLC (SSGA FD) serves as marketing agent; SSGA FD and State Street Global Advisors are affiliated.

Detailed Comments on Specific Questions**Q2. 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?**

We note that these specific ‘relevant’ gilts have provisions in their prospectus that state that an option must be offered to holders of these gilts to redeem their stock, in the event that the RPI undergoes a change that is materially detrimental to holders.

We believe that the proposed changes to RPI would “constitute a fundamental change in the index which is detrimental to the interests of stockholders”. The option to redeem would therefore apply, and we believe this would constitute a fair compensation to remedy the holders of these gilts.

Q3. 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?

The proposed change to RPI will have the effect of creating a reduction in the value of the coupon and principal payments of all other index-linked gilts, relative to the scenario where the existing calculation continues to be used. Investors will have purchased gilts on a reasonable expectation that indexation would be provided on the basis of the RPI index and, as such, will face a detrimental impact from the proposed change of calculation basis.

We would therefore encourage HMT and the Authority to consider some form of adjustment to return these gilt-holders to the position they expected to be in upon their initial purchase of these RPI-linked gilts. For example, in line with the IA’s response, we would suggest HMT and the Authority consider implementing a change to the indexation basis for index-linked gilts which would make RPI equal to CPIH plus a spread based on the average difference between RPI and CPIH. This would mitigate for the loss that holders of RPI index-linked gilts would sustain due to the change to the RPI methodology.

Q4. 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 highlighted in our response to Question 3, under the proposed changes laid out in the consultation, there is a change to the implied contract that RPI-linked gilt holders entered into when initially purchasing these gilts. We have concerns that this change to contract terms could have a negative impact on trust in the gilt market from the perspective of investors, both in the UK and overseas.

Q5. What other impacts might the proposed changes to address the shortcomings of the RPI have in areas or contracts where the RPI is used?

We would also highlight to HMT and the Authority the impact beyond the index-linked gilt market. In particular, the proposed changes will have an impact on inflation swaps, as well as corporate bonds linked to RPI.

Inflation Swaps

RPI swaps are typically used by pension schemes to hedge liabilities, which in turn may be linked to either CPI or RPI. For these Schemes, they will face a significant decrease in the value of their positions as the fixed rate they pay on the swap will remain the same whilst their RPI linked leg would be repriced lower. Again, this will not align the party with the position they expected when entering into the contract, and some adjustment or mitigation will be required to avoid an arbitrary redistribution of value between the swap parties.

Corporate Bonds

There are also a number of corporate index gilts linked to RPI, which will also decrease in overall asset value if the RPI methodology is aligned with that of CPIH, although the individual terms of these bonds might offer protection to investors for material change in the inflation index.

Q6. 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 would note that the proposed changes will reduce the future benefit payments of many pension scheme members and annuity holders whose benefits have been promised to be indexed in line with the RPI index as originally calculated. Irrespective of the impact on the gilt market and the funding status on the pension scheme (which will depend on the matching between assets and liabilities) this represents a material redistribution of value. Again, we would argue for mitigation or adjustment to avoid scheme members being put in a worse position than they would reasonably have expected to be in.