HIGH COURT REJECTS JUDICIAL REVIEW OVER RPI TRANSITION...

WHAT NEXT?

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Centrus

High Court Rejects Judicial Review over RPI Transition

On the 1st September 2022, the UK High Court dismissed a judicial review, brought by some of the country's largest defined benefit schemes, over the UK government's plans, to effectively replace the Retail Prices Index ("RPI") with the Consumer Prices Index including Housing ("CPIH").

The ruling makes further legal challenges unlikely and the UK Statistics Authority ("UKSA") can now legally and practically implement the proposed changes to RPI in February 2030.

What now for Gilts?

The judgement decided three important things:

• Firstly that the UKSA has the power under the SRSA 2007 to amend RPI using the methods and data sources of CPIH.

• Secondly, cessation of RPI will not have taken place in 2030 and therefore does not represent an early redemption event; and

• Thirdly that in making his decision to award no compensation to Gilt holders, the Chancellor took adequate advice with regards to the interests of holders of legacy instruments.

What it means is that Gilts should now trade on the assumption that the indexation used will transition to CPIH in 2030.

"Gilts should now trade on the assumption that the index will transition to CPIH in 2030"

What are the implications for other financial instruments using RPI?

Although the judgement helpfully confirmed that no cessation of the index will happen upon transition while the RPI index (revised) continues to be published, it was silent on whether the changes proposed amount to the making of "fundamental changes" to the coverage or basic calculation of the RPI.

This is relevant because along with cessation, this tends to be a key test of whether new indices or adjustments to indices are required in commercial contracts involving RPI. In the case of many RPI-linked corporate bonds, it also drives potential adjustments to the index to ensure that both parties are protected from deviations to the originally conceived commercial deal.

We expect any disputes in commercial contracts involving RPI to revolve around whether the changes involved amount to a fundamental change to the basic calculation of RPI, and if they judged to, what is the right adjustment.

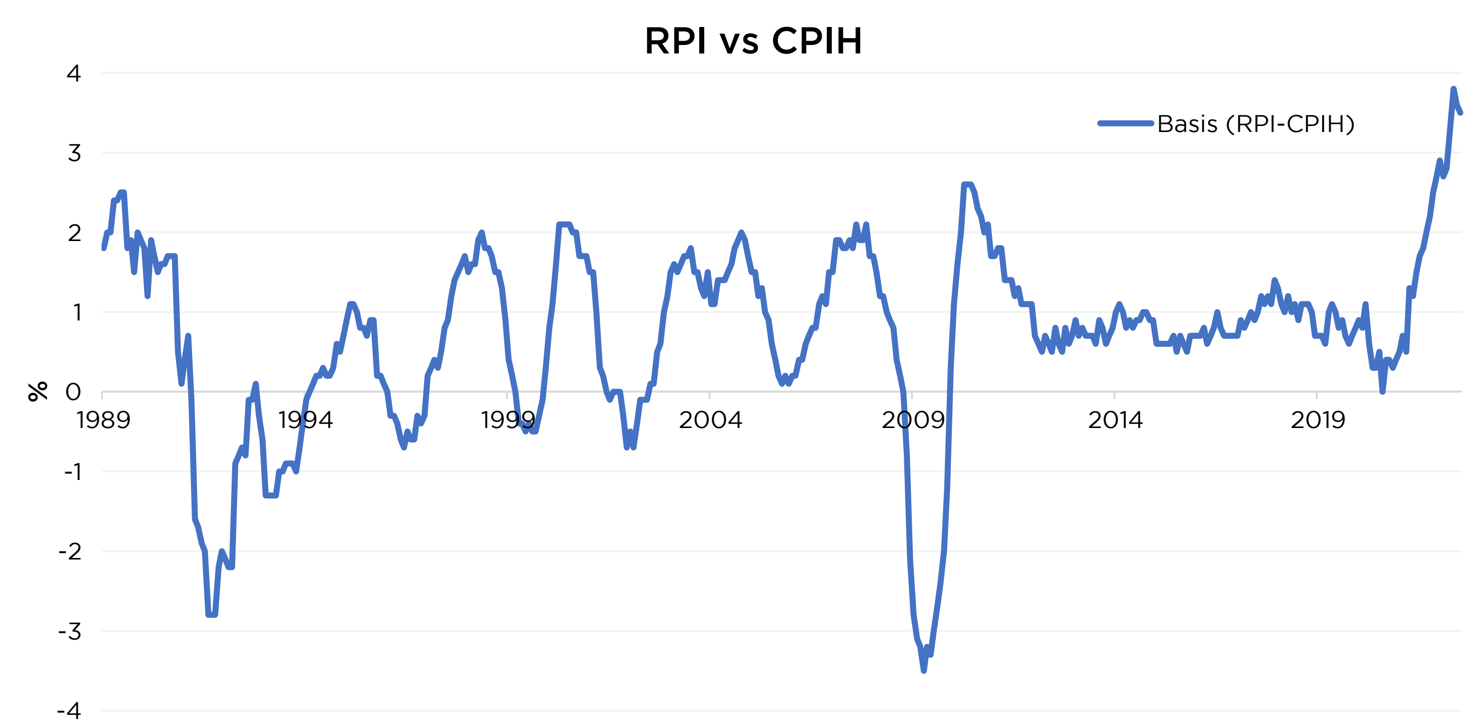
With the 12 months to July 2022 indices for RPI and CPIH showing 12.3% and 8.8% respectively, it is clear that the issue is of material commercial significance, which is of course why the Judicial Review was brought.

While the issue will not come around until 2030, it is likely in our view that all parties will want clarity and the removal of uncertainty as soon as possible.

The markets are expected to treat the issue differently. The index-linked swaps market regulated by ISDA documentation is expected to follow what happens in the Gilts market – so no adjustments are expected for any perceived differences between the indices. The index-linked corporate bond market is a series of individual contracts all with slightly different terms. While we have no doubt that blocks of interested parties and associations will seek a common market-wide deal, we think that a broad market solution is unlikely given the different terms of individual bonds.

As a result, we expect the fall-back solution of the appointment of independent market experts to be tested. I say tested because the role is likely to be a challenging one and any determination likely to be contentious open to possible challenge.

Persuading an expert to do the role may be a hard task. Assuming an expert is appointed, they will be faced with the contrasting positions of the historical evidence of the different outturn results of the two indices with the Government's determination that it sees no case to pay compensation on Gilts, supported by the High Court's endorsement of that determination.



"History tells us that markets move quickly to resolve uncertainty"

What happens now?

Nothing automatically happens until 2030.

Whilst the Libor transition took time to build momentum, history tells us that markets move quickly to resolve uncertainty so we expect that counterparties (both issuers and holders) with contracts involving RPI beyond 2030 are unlikely to want to wait until the last minute to gain clarity on how their contracts will evole.

We would welcome discussions with both issuers and holders of the instruments in question in order to explore the various options they now face

For more information, please contact Geoff Knight, Managing Director at Centrus.

About Centrus

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Centrus is an independent financial services group that believes in finance with purpose.

We specialise in corporate finance, analytics and investment management and are united by a culture that values imagination, energy and purpose.

We believe this can unlock significant value for our clients and their communities. Above all, we're working towards a more modern financial landscape.

It is a simpler and more responsible way of doing business by delivering real money and tangible benefits to the real economy.

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