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Is the bubble about to burst?

November 2010

Over recent years the SIPP market has experienced significant growth, new products, the FSA's thematic and pension switching reviews and changes in Government policy with a great deal of it happening all at the same time. Add to that volatile market conditions and economic uncertainty and you could be forgiven for retiring to a dark room with a wet cloth on head and a large glass of the red stuff in hand. However, despite these challenging conditions the SIPP industry continues to prosper.

As we approach the 21st anniversary of the first SIPP, what does the future hold? Are SIPPs a long term mainstream solution for pension savings or is the growth bubble about burst? To answer this question we must consider the nature of the market demand and the potential barriers to success.

Market demand
In a recent survey of advisers carried out by A J Bell we looked to identify why advisers used our Sippcentre product. The top three reasons identified, in order of preference, were range of investments, online functionality and low charges. In total 90% of advisers noted that low charges was the single biggest driver for their recommendation.

It makes sense then that many non SIPP providers play heavily on the suggestion that SIPPs are expensive. Many will lead with the question that you will be paying for flexibility or functionality that you are not using? The simple truth is that it depends on the type of SIPP you are using and what you want to do with it! It is a mistake to assume that all SIPPs are identical in structure and application of charges. SIPPs come in all shapes and sizes. A case study can be used to clearly demonstrate my point.

We have a client, male, aged 40 with a transfer value of £100,000 and a plan to retire at age 65. Using the charges on our own Sippcentre product, the point should become clear. If I assume that the client is paying a fee direct to his adviser for the advice and initially holds his fund in cash, I am able to isolate and identify the cost of the SIPP wrapper.

Reduction in yield (RIY) is – **0.17%**.

The client and adviser are of course in control of all investment, benefit and remuneration decisions and hence the total cost. If we assume that they decide to invest in a range of UK exchange traded funds (average TER of 0.35% p.a.) and include adviser remuneration of 3% initial plus 0.5% trail there is a natural increase in the RIY.

Reduction in yield (RIY) is – **1.07%**.

If they consider a more sophisticated investment solution e.g. a range of collectives where the average charges are 1% initial plus 1.60% p.a. (I think most will agree this is at the sophisticated end and above the average cost for most clients), we again see a natural increase in the RIY.

Reduction in yield (RIY) is – **2.00%**.

Any decision in future to use options such as income drawdown will introduce additional charges. In short, the client will only be paying for flexibility and functionality as it is introduced or used. More importantly, it is impossible to generalise and say that SIPPs are expensive. The increase in SIPP popularity has been driven by the availability of low cost online products like this that give advisers the opportunity to build bespoke investment solutions with costs that compete head on with the other pension solutions available in the mainstream market.

Potential barriers to growth?

Regulatory pressure
In September 2008 the FSA published a press release making it clear that they expect firms to ensure that suitable advice is provided on any transfer to a SIPP. The release outlined clearly that the FSA expects firms to ensure any advice to

transfer is suitable and based on an assessment of the customer needs to help consumers make decisions that are right for them.

It then goes on to say that this would include determining whether there is a genuine need for the investment flexibility and control associated with a SIPP. You must provide a clear explanation of the costs involved and how the recommendation meets a customer's needs and attitude to risk. This should be normal business practice for advisers so does not represent a barrier for the future.

December 2008
The FSA report on the quality of advice on pension switching was issued in December 2008. It summarised the findings of the thematic work looking at advised transfers to Personal Pensions including SIPPs.

Part one of the review assessed the quality of advice given to customers since A-day to switch their existing pensions into a personal pension plan or SIPP and the firms' systems and controls relating to this advice.

Part two assessed whether the actions of pension providers affected the quality of this advice.

The FSA visited 30 adviser firms, assessing 500 files and found that the advice was unsuitable in 16% of cases. A number of reasons were provided as examples.

Initial press coverage suggested that the issues and problems identified in this thematic review related to the SIPP market. The report simply does not provide sufficient information to identify whether the cases involved were transfers to SIPP or Personal Pensions. Correspondence we had with the FSA confirmed that the thematic review was structured to assess the common risk of unsuitable advice for customers switching into both product types. The sample selected was broadly representative of the market for advised switches into Personal Pensions and SIPPs. The FSA pointed out that the methodology adopted did not attempt to make a comparative assessment between SIPPs and PPPs. The review identified a number of areas where improvements were needed but this applies to all transfers to SIPP and Personal Pension. For anyone that takes sensible notice of the findings it is no more a barrier to SIPP recommendations than it is those that favour Personal Pension.

September 2009
In September 2009, the FSA published a report and accompanying documents about its review of Small SIPP Operators.

The main findings outlined that:

- The FSA did not believe that, taken as a whole, small SIPP operators posed a significant threat to the FSA statutory objectives. They were pleased to discover some very well run firms, and many examples of good practice. Nevertheless, the project uncovered a number of concerns on how firms conduct their business.
- Some firms were failing to appreciate the scope and nature of their TCF responsibilities and failing to demonstrate fair treatment through use of appropriate management information (MI) and evidence;
- Misunderstandings were found among some SIPP operators regarding their responsibilities for the quality of business they administer, where advice is the responsibility of a third party;
- Systems and controls issues were identified, including in relation to Training and Competence regimes, accuracy and transparency of illustrations, disclosure of charges and firms' communication of the open market option.

As before, for any firm that runs their business sensibly and takes notice of the findings it is not a barrier to future SIPP recommendations.

In a world full of dated pension products and old fashioned fund ranges and investment options that will never evolve, the popularity of SIPPs will continue. Many in the pension industry fall foul of confusing evidence of popularity with a suggestion of wide spread abuse. I am fortunate in that I benefit from discussing with clients and advisers the reasons behind their use of SIPPs. From this I see lots of evidence of sensible use and very limited suggestions of abuse, when people question the continued popularity of SIPPs it is worth considering the points made above whilst keeping this in mind.

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Please note this document is intended for trade and national press individuals.

Notes for Editors

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A J Bell is continuing to grow rapidly in challenging capital markets. Invesco Perpetual and Midas Capital own 37% and 10% respectively of the share capital, the remainder being owned by Andy Bell and the management team.

Established in 1995, A J Bell specialises in providing administration, trustee and actuarial services for SIPP and SSAS.

A J Bell is now the largest privately owned provider of self administered pensions and stockbroking services in the UK, with in excess of 44,600 individual SIPPs and assets under administration exceeding £12.6bn. It also provides third party SIPP administration services for Barclays Stockbrokers, Halifax Share Dealing, Skandia and TD Waterhouse.

Our customer proposition - Market leading, low cost, transparent, service, value, choice, leading functionality, integrity, award winning.

Our business - Market leaders, growing, innovative, own intellectual property, profitable, stable, we don't provide advice or investment management.

Research by CoreData Research places Sippcentre alongside Standard Life as advisers' two most preferred SIPPs.

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