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Why cost factors are key

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We live and work in a heavily regulated environment and sometimes it is all too easy to confuse popularity with the potential for widespread abuse. There is a potential connection between the two but evidence of popularity does not automatically mean that abuse is likely.

A key driver for pension recommendations is cost. As a result, many of the points of discussion shared and debated on the use of SIPPs will often involve the underlying cost. Some will argue that you can achieve the same result in a more cost-effective manner. Saying SIPPs are expensive is a little bit like saying eating out in a restaurant is expensive. Anybody who knows me will agree that I am a typical west of Scotland man with simple tastes and Celtic blood that drives me to consider cost more than most. I think this qualifies me to say that it does of course depend on your choice of establishment and selection from the menu. It might well be an expensive night out but on the other hand it might not, you (or your partner) are in control of where you go and what you eat. The same choice, control and eventual cost issue exists with SIPPs.

When considering the costs involved in any modern pension arrangement it is important that you look beyond general statements and consider some of the detail. This applies irrespective of whether you are using a traditional pension plan, an external fund link arrangement, a platform or indeed a SIPP.

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 much of it happening at the same time. Despite the challenging conditions the SIPP industry continues to prosper.

Market demand

In a recent survey of advisers carried out by A J Bell we looked to identify why advisers used SIPPs. It may be a surprise to some but the top three reasons identified, in order of preference, were low charges, on-line functionality and the range of investments. In total, 90% of advisers noted that low charges were the single biggest driver for their recommendation.

It makes sense then that many providers play heavily on the suggestion that SIPPs are expensive. Many will lead with the suggestion that you will pay for flexibility or functionality that you will not use. It is a mistake to assume that all SIPPs are identical in structure and application of charges. A case study can clearly prove this point.

We have a client, male, aged 40 with a transfer value of £100,000 and a plan to retire at age 65. For demonstration purposes I have used the charges on one of our SIPPs but the important point to focus on is the impact of the charges in different investment scenarios. If I assume 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 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. 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. Only by looking at the specific case can you determine the cost and answer any question of suitability.

The increase in SIPP popularity has in many ways mirrored the popularity of platforms. Low cost, on-line solutions have allowed advisers to build bespoke investment solutions with costs that compete head on with the other pension solutions available in the mainstream market. Are they expensive? Just like any decision to eat out, this is driven by the personal choice of the individual involved.

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

Notes for Editors

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

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



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