

Opportunity knocks

The growth of the SIPP market will bring with it enormous opportunities.

John Moret, director of sales and marketing at Suffolk Life, looks at what the future holds for both providers and advisers

In a supplement to the October issue of *Money Management* the prospects for the SIPP market were examined. In particular, the different types of SIPP being marketed and the likely future demand were discussed. John Chapman questioned whether individual SIPP holders can outperform the life companies. He also raised concerns about likely SIPP persistency rates and argued that the array of charges in SIPPs make comparisons difficult and heighten the risks of confusion and exploitation.

In the January 2007 issue of *Money Management* Chapman returned to this theme in his article "Charges – sips or slurps?" where he questioned the appropriateness of SIPPs as a pensions savings vehicle for the mass affluent. He looked in some detail at illustrative charges on various SIPPs and suggested that "if the surge in SIPP sales is to be deemed a success, the SIPP industry must show that greater fund choice leads to superior asset allocation and thereby higher investment returns – sufficient to offset the heavier charges arising in SIPP investments".

Party of three

There can be no argument about the growth in the supply of SIPPs – or in the take up of the various type of products. **Graph 1** shows the historic growth in SIPPs by type of SIPP. The segmentation reflects what appear to be three different propositions.

Firstly, the bespoke SIPP. This is essentially the derivative of the original SIPP first marketed in 1990 and offers the widest range of investment options. The average investment is probably in excess of £200,000.

Secondly, the hybrid/deferred/midrange SIPP which is primarily the SIPP solution offered by life companies and others. The proposition may be dressed up in a number of different ways but essentially the primary aim is to gather

assets under 'management'. Some elements of the pension and/or investment administration may well be outsourced. The average investment is likely to be in the region of £100,000.

Thirdly, the 'commodity' SIPP, which is frequently offered on a no advice or online basis. The investment options may be limited in return for a lower charging structure. The average investment here is almost certainly less than £50,000. This product first saw the light of day in 2001 but some investment trust companies have offered a variant, although not online, since around 1996.

One can debate just what constitutes a SIPP and it appears from analysing the various survey results that different providers may take a slightly different view.

However, if a SIPP is defined as any personal pension that is established under a scheme that allows a range of investment options beyond those normally associated with a packaged product, regardless of whether those options are actually utilised, then the reported numbers are probably pretty accurate.

The actual make up of the market today is very difficult to determine – not least because some providers refuse to participate in surveys and others refuse to provide basic information. Consequently the number of SIPPs by segment and portfolio size against growth over the period 2005/06 needs to be interpreted with a good deal of caution, particularly where the numbers are based on informed guesswork rather than reported in surveys. Also, some providers will have been excluded simply because no information was to hand. However, even if the information is not totally accurate there are some clear trends.

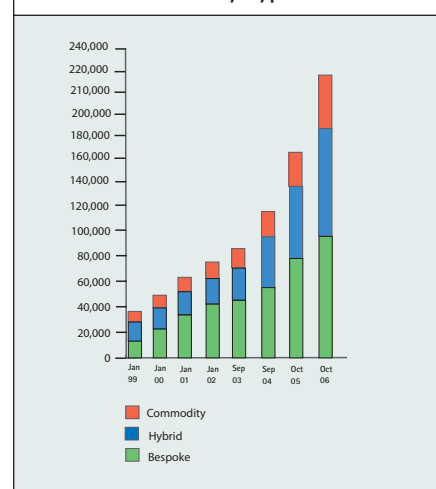
The smallest segment in terms of current numbers – both providers and number of investors appears to be the commodity SIPP, and yet this appears to be the fastest growing. This is perhaps unsurprising given

the A-Day changes which allowed full concurrency for all for the first time. This has opened up a big new market and may also help those providers with an entry route to the group or worksite SIPP market which is still in its infancy.

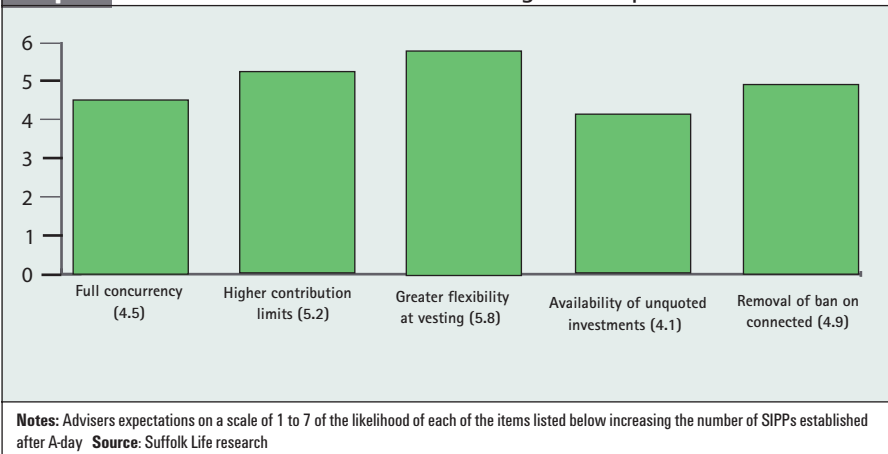
The segment with the biggest players in terms of number of SIPPs is the mid range SIPP. This is perhaps the segment where the numbers are most debatable in terms of what constitutes a SIPP.

There is also room for argument over the extent to which these propositions target the true high net worth investor. What is clear is that many of these SIPPs will be in the territory where John Chapman's questions about added value are very pertinent.

Graph 1 : The growth in the SIPP market by type of SIPP



Notes: Estimates derived from trade magazine surveys and industry data. Estimated number of SIPPs at 1.10.06: 220,000 - value c£30bn – which includes: the low cost commodity (frequently no advice) SIPP the hybrid/deferred SIPP predominantly offered by life companies the "bespoke/full range" SIPP offered by a large range of providers. Assumes SIPP market continues to grow at annual rates experienced in 2005/06 i.e. bespoke 22%, hybrid 48% and commodity 55%. Figures based on various trade magazine surveys.
Source: Suffolk Life research

Graph 2 : Advisers' reasons for SIPP business growth expectations

What is also very clear is that the number of providers entering or re-entering this space is growing rapidly. While most of these are life companies, with the regulatory changes from April 2007 we can expect to see some new entrants, particularly in the form of institutional and retail investment fund managers.

The most congested segment is quite clearly the bespoke market, which also appears to be growing at the lowest rate. No one knows just how many organisations are operating in this space. Surveys would suggest that there may be around 30 companies but from other statistics such as the FSA's expected number of applicants for authorisation the true number may be at least double that.

Whatever the figures, the sustainability of all those operators even without the overhead of regulation would be questionable. When the true costs of regulation start to bite, some large scale consolidation seems inevitable.

Provider intentions

The likely impact of regulation has been covered in numerous articles of late. From an adviser perspective the key issue to be ascertained from all current providers of their clients' SIPPs is their intentions post 6 April 2007 when regulation of SIPPs becomes effective.

At the time of writing it seems as though the number of applications for authorisation under the new regulatory framework is likely to fall some way short of the originally anticipated number.

Whether that implies that there will be operators acting post-April without the necessary authorisation remains to be seen.

For those operators who decide not to seek authorisation the only option is to find a way of transferring or disposing of their business to another authorised firm prior to 6 April. If that cannot be achieved then

there is a real issue as to what happens to that business – an issue for which to date the FSA has not suggested a solution.

It is when one starts to try and assess the likely impact of regulation on SIPP operators' costs that the position becomes more difficult. Explicit costs such as capital adequacy requirements are clearly defined, although insurance company operators will continue to be subject to their own rules.

For smaller SIPP operators the capital requirements alone suggest that it is difficult to envisage how a business could operate profitably without administering a portfolio of at least 1,000 SIPPs. Factor in the implicit costs of running a regulated business and the threshold may well rise to at least 2,500 SIPPs. Currently probably over a half of current operators and particularly those targeting the high net worth segment are actually running portfolios well below this threshold.

Reconciliation

It has been suggested that the introduction of the new regulatory regime will level the playing field among SIPP operators. While there is some truth in this, there is one important operational area which is frequently overlooked: that of asset and cash reconciliation.

Currently life companies are required to reconcile assets regularly. The position of other operators is far less clear. Many continue to rely on the investment provider's or discretionary manager's nominee records.

Whether this approach will remain acceptable after 6 April remains unclear. FSA rules state that assets have to be reconciled at least every 25 business days.

But there has been no recent guidance on this topic from the FSA in relation to SIPPs and all regulated operators will need to look closely at this aspect. The costs of shadowing investment manager's records is significant and if this becomes a

requirement for all regulated SIPP operators, the financial impact on those that do not currently undertake this task could be severe, especially where there are no electronic links in place with the investment managers.

All of this suggests that we can expect some upward movement in prices, particularly for the more bespoke SIPP propositions. However, this flies in the face of other downward pressures – John Chapman's arguments are just one example – leaving some uncertainty over just how the market is going to develop in the coming months.

From research that Suffolk Life conducted recently with its supporting advisers, there was clear evidence of increasing consumer interest in SIPPs with 84% of those researched agreeing that this was the case.

Interestingly only just over a half of those surveyed felt that the products on the market were satisfying consumer demand. This suggests that there is still work to be done by the product manufacturers and that there is an opportunity for new entrants with the correctly orientated product proposition.

Encouragingly 50% forecasted a rate of growth in the number of SIPPs being established in 2007 of between 20 and 39% with another 20% believing the growth rate could be even higher.

If the potential growth in the SIPP market were projected forward to 2010 using the approximate growth rates in each of the three market segments that were experienced over the year 2005-06, the market will quadruple by 2010. This will provide enormous opportunities for operators of SIPPs who can scale their businesses to cope and to operate profitably.

This is where the real opportunity may exist for the wrap and fund supermarket platforms, although the track record of these players and indeed the larger SIPP administrators in terms of profitability suggests that there are still a few challenges ahead.

Just who the winners and losers will be remains unclear. What is clear is that any operators with a tried and scaleable platform – and importantly with people who really understand the technicalities of running what is one of the most complex investment and pensions savings vehicles – have a tremendous opportunity.

Now is a good time for advisers with clients for whom SIPPs are suitable to undertake a review of SIPP operators to establish those that have the ambition, capacity and capability to grow their business profitability while maintaining service standards.

