

FEATURE



Looking at how a Sipp works will help advisers get the best deal

SIPPS ADVICE How advisers research the quality of Sipp is a complicated task, but there's a lot more to consider than just cost and product features

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In preparing this article I was drawn to four items in particular that have caught my eye recently. The first was the Financial Services Authority's (FSA) final notice of April 8, 2008, in which it announced it had decided to impose a financial penalty of £525,000 on Liberata Financial Services.

The second was some research findings on the self-invested personal pensions (Sipp) market, conducted by a trade magazine under the title *New Model Research*.

The third was another survey commissioned by a Sipp provider, which was headed up 'Sipp market cost comparisons'. And the last was an article 'A battle of the giants', published earlier this year in *Money Management*, which looked at the boom in Sipp sales and considered whether a simple personal pension would be a better choice. There is an obvious Sipp connection – at least with the last three items – but first it is worth having a look in a little more detail at each of these items.

The FSA notice makes interesting reading and related to breaches of FSA principles 2 and 3 – essentially around inadequate risk management systems and lack of proper business controls. This evidenced itself in a number

of policyholders not receiving important documents, such as annual policy statements, which in turn led to a financial loss in some cases. In the FSA's view, the failings resulted in customers not being treated fairly.

This case in itself has nothing to do with Sipp as far as I am aware, however, now that Sipp are regulated in the same way as personal pensions, the timely and accurate production of annual statements is one important measure of the efficiency of a Sipp operator. The accuracy of such statements will depend on a number of factors including, of course, the reliability of the investment valuations upon which the statement is based.

Here we immediately hit an important issue. Many Sipp hold investments with third-party investment managers, including discretionary managers. But there are differences in the way in which the Sipp provider will record information about the investments. Many will simply open an investment account with the manager. No effort is made to track investments – instead, when a valuation is required the provider will ask the investment manager to provide one.

This approach raises several issues including the steps that the provider takes to satisfy themselves that the information is correct – for example, regularly auditing the investment manager.

It also means the provider will be unable to publish comprehensive and up-to-date information on a Sipp investment portfolio on their website, for example. Another consequence is that the Sipp operator may only find out some time after the event that an unacceptable investment has been purchased.

The alternative approach is for the Sipp operator to track or 'shadow' the investments that are bought and sold on their own systems, including dividends and reinvestments etc. This allows the investor and their adviser to receive an annual statement that is effectively a balance sheet and profit and loss account for each individual Sipp. It also means up-to-date information and valuations can be displayed via a web portal.

To achieve this cost effectively, the Sipp operator will need to have electronic links with individual discretionary investment managers. This is no small undertaking, as there is no industry-wide platform in use. One or two Sipp operators have negotiated individual links with managers, but many operators continue not to shadow – with the outcomes mentioned above.

Linked to this point is the approach the operator takes to cash and stock reconciliations. This is a potential regulatory minefield with complex regulations, which are also affected by the regulatory framework adopted by the Sipp operator. The detail is outside the scope of this article, but suffice to say the regulatory framework for Sipp operators is not a level playing field – an issue that often escapes advisers and is of growing importance as compensation arrangements come under increasing scrutiny.

The point of the above comments is to emphasise the increasing significance of technology in a regulated Sipp world, and the need for operators – and indeed advisers – to be aware of the extra risks that may be introduced by continuing reliance on manual processing and unaudited information supplied by third parties. In the context of annual statements, the potential for errors is all too clear.

The second item to which I referred was a recent survey of Sipp operators in *New Model Adviser*. As part of the survey, advisers were asked

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to rate 11 factors when recommending a Sipp operator on a scale of 1 to 5. The average results showed that reputation for good service was easily the highest rated factor at 4.63. The range of investments offered came second at 4.45, whereas low charges came seventh at 3.89.

Quality of service with a Sipp comes at a price – usually the costs of investing in technology and well trained and technically competent administration staff. For operators, the ability to maintain service levels as their business grows is a key challenge. There is a world of difference between administering a few hundred Sipp operators and several thousand, which is why the merger and acquisition of more Sipp operators seems inevitable.

This leads naturally onto my third item – the Sipp market cost comparison commissioned by Sippcentre and published by Coredata. This has provoked some debate. The stated intention of the survey was to demonstrate “massive disparity between the charges that different Sipp providers’ levy in the same circumstances”. It certainly achieved that – in some recent advertising Sippcentre claimed that “the most expensive comparable Sipp costs between 75% and 230% more than Sippcentre”.

However, selective use of a small number of investment scenarios is a dangerous base on which to build a claim: “We don’t aim to be the cheapest, just the most efficient.” In particular, to ignore in any comparison the impact of lower rates of interest payable on cash, for example, stretches the credibility of such a claim, particularly when other scenarios involving property are based on purchase by a single investor, which is far from the norm.

A focus on price by operators accompanied with claims of ‘low cost’ and even ‘no cost’ Sipp operators in isolation of service levels seems a highly dangerous strategy to follow – particularly given some of the points made above. It reminds me of the old Spanish saying: ‘Cheat me in price but not in the goods that I am buying.’

My final item is the earlier article in *Money Management*, which highlighted the very topical issue

of the suitability of Sipp operators. The article looked in detail at the impact of charges on different types of Sipp, concluding that “in too many instances, charges can wipe out benefits”, and made a strong plea for the publication of past investment performance so that the value added by the wider investment choice of a Sipp is evident. That type of information would no doubt be helpful, although finding a representative cross-section of Sipp portfolios would be a challenge.

However, focusing solely on charges ignores the other reasons why Sipp operators have proved so attractive. Choice and control are certainly two of the key factors – allowing the investor and their adviser to adapt to changing circumstances through having a consolidated view of their pensions wealth under the Sipp.

Surveys of the Sipp market confirm the continuing interest and growth. The forthcoming results of the FSA’s thematic review of Sipp sales may shed some light on the whole suitability issue, and advisers will clearly need to take account of their findings. The priority to be accorded service quality and flexibility as against lower charges will no doubt continue to be an issue for many advisers. Perhaps most importantly, advisers need to undertake proper due diligence on their preferred providers and regularly review this.

Anecdotal feedback and media comment suggests growing numbers of advisers are becoming disillusioned with the level of service provided. One adviser recently went as far as saying: “Over the last couple of years, we have encountered problem after problem. Some small, some large, but all adding up to a pretty sad indictment of the Sipp administration sector at the present time.”

I suggest that advisers should not be overly influenced by pricing and other product features. Instead, they should invest some time getting under the bonnet of their preferred Sipp to understand how it works and whether it measures up to their expectations.

PM

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