

## SURVEY SIPPS

**FUTURE OF SIPPS** Despite the panic generated by the Budget, there is plenty to retain investors' interest in the Sipp arena

# A new world of Sipp

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**JOHN MORET**

This year may turn out to be a significant milestone for the self-invested personal pension (Sipp) market. Not only does it mark the 20th anniversary of the conception of Sipp, but it has also seen a Budget that some commentators are suggesting will see the beginning of the end of the Sipp boom. This is at a time when surveys continue to show continuing growth in all parts of the Sipp market.

The prospect of higher rate tax relief on pensions being curtailed had been well trailed in advance of the Budget. Most well informed individuals accepted that if introduced sensibly, fairly and gradually, this was not unreasonable. We should have known better. On pensions policy this government has a track record of U-turns (residential property), inconsistency (alternatively secured pension), unnecessary complexity (recycling of tax-free cash) and inequity (public sector versus private sector). At the time of writing, the full details of

the Budget proposals are still emerging but they appear to display all these traits.

### Budget fallout

The phasing-in proposals – or anti-forestalling measures as they have been labelled – seem to affect anyone deemed to be a high earner. This includes anyone who earns £150,000 or more this tax year or in either of the two previous tax years. A-day changes on allowable contributions provided individuals – including those now defined as high earners – with the ability to prefund or defer making pension contributions. This was on the understanding that provided they didn't exceed the annual allowance or lifetime allowance, there would be no tax charges and the rate at which they funded their pension would be down to them – subject to having adequate earnings. That understanding goes out of the window with these changes – a high earner who put off funding their pension will be hit, whereas those who took early action will be far less affected.

These measures affect those individuals:

**“In the world of pensions, continuing change in tax and legislative regimes will mean that advice will become even more important”**

- whose earnings are in excess of £150,000 in this tax year or either of the previous two tax years; and
- who change their normal regular ongoing pension savings (as defined in the draft legislation – it should be noted that this only includes contributions made quarterly or more frequently); and
- whose total gross pension contributions following any change to their normal regular ongoing pension contributions, including employer contributions, exceed £20,000.

The tax charge proposed is currently 20% on the excess over either:

- £20,000 if their pension savings were previously below £20,000; or
- the difference between their normal regular pension contributions and the new level of contributions.

One exception to this is defined benefit (DB) scheme members, where whatever the level of their earnings, the protected input amount will include the whole of their DB scheme irrespective of any increases in accrual. This applies also to new joiners, provided the scheme has 50 or more members.

## Drilling down

The definition of relevant income for the purpose of anti-forestalling is not the same as that previously understood for net relevant earnings. The biggest change is the inclusion of dividend income in the calculation. This will result in many of those who have previously been paid mainly in dividends, but contributed ad hoc to their pensions through employer contributions being caught by these new rules.

In addition, those individuals entering into salary sacrifice arrangements on or after April 22, 2009 will have to include the value of the sacrificed income in the calculation of relevant income. This does not affect those with arrangements made prior to April 22, however it is unclear if arrangements entered into but not commenced will be classed as regular contributions.

The self-employed will be particularly hard hit by these new rules because they tend to have more erratic earnings than employed individuals and are less able to plan their contributions over the longer term.

Ultimately the government plans to restrict tax relief on pension contributions, including those made by employers, for individuals with an annual income of £150,000 or more. The tax relief will be tapered from full relief to 20% (the basic rate level) for those earning over £180,000. HM Revenue & Customs will consult on the implementation of these new rules.

## Let the facts do the talking

These proposals have been suggested as the death knell for Sipp in some quarters. However, these concerns fly in the face of the facts. Some analysis of our Sipp portfolio has shown:

- Just under 30% of our Sipp investors made a contribution of some sort in tax year 2008/2009. Almost 80% of these contributing investors contributed over £20,000. These contributions may have been personal contributions or from an employer or both.

- Analysis of salary information we hold reveals that 27% have incomes registered at £150,000 or over. This suggests that around 6% of our Sipp investors made contributions of over £20,000 and earned over £150,000. It is this type of investor

## KEY STAT

# 27%

of Suffolk Life's Sipp investors earn £150,000+

who potentially is subject to the new 20% special tax charge if the same pattern of earnings and contributions applied.

- We don't have sufficient information to know whether any of these contributions would be deemed as normal regular contributions under the Budget proposals and potentially exempt from the proposed special tax charge of 20%. Equally, we don't have information on contributions that may be being paid into other pension arrangements.

This very simple analysis suggests that the impact of these changes on the Sipp market will not be as great as some have suggested. Bearing in mind that our Sipp proposition is aimed at the top end of the market where earnings are likely to be greater, if our experience is typical it is reasonable to conclude that in the run-up to 2011, less than 5% of current Sipp investors are likely to be subject to the additional tax charge. There is no reason to believe the experience of potential new Sipp investors would be materially different, so in the short term at least the future of the Sipp market continues to look bright – despite the Budget proposals.

## Room for Sipp

Longer term, the proposals may have a negative impact on the quantum of pension savings by high earners, which will in turn affect the size of transfer values and possibly reduce the attractiveness of switching to a Sipp.

However, there are other reasons why I remain optimistic about the future of the Sipp market. The world is changing and the importance of retirement planning continues to grow. These days, retirement planning involves considering assets within a whole range of tax wrappers, along with other propositions such as equity release and more subjective issues such as lifestyle planning. The opportunities for professional advisers are obvious – not least because demographics and other simple data, such as the proceeds of maturing defined contribution (DC) pension arrangements, all point towards significant growth in accumulating assets – all or much of which will be converted into income at some point.

Some estimates put the annual size of just the maturing DC assets at around £50bn by 2015 – and certainly if one looks at the value of the legacy pensions assets sitting within the coffers of life companies, this figure looks very realistic. When I last looked at this market I estimated that there was probably up to £500bn of assets at stake – and even allowing for recent falls in value there is still sufficient at stake for it to be of interest to all parties involved in the value chain.

To fully exploit the opportunities will require providers and advisers to alter their approach, and in some cases their business model. Platforms and technology will be crucial ingredients of this new world – with products becoming less relevant. That suggests that some of the traditional players may struggle to adapt – increasingly bogged down by legacy issues – whereas the future for newer entrants and some of the niche players looks more positive.

In the world of pensions, continuing change in tax and legislative regimes will mean that advice will become even more important. This growing complexity and increasing regulatory overhead will threaten providers' margins – as will the inexorable drive towards greater transparency, particularly in the area of pricing. The days of highly capital intensive products such as traditional personal pensions seem to be gone for good.

In the short term, many advisers will be focused on recession-proofing their business. Cost and financial controls will be all important, with technology again being a key enabler. Reputation and service quality will remain key success factors for providers and advisers alike.

What is certain is that the old product-driven model has no place in this new world. Instead advisers and providers will need to think about the implications on their business of retirement solutions that are truly cradle-to-grave. Sipp sit very comfortably in this new world, which suggests that despite the Budget changes, the growth prospects for the Sipp market remain strong. **PM**

**John Moret is director of sales and marketing at Suffolk Life**