More to SIPPs

SIPP blog – April 2016

Is big really best?

Earlier this week I spoke at a TISA seminar on Mastertrusts. I was a bit of an interloper – Mastertrusts are certainly not my specialist subject – but I was asked to talk about "lessons to be learnt from the SIPP market". What I discovered through a very interesting morning was that there are a lot of parallels in the development of the Mastertrust market with the evolution of the SIPP market.

There are apparently just over 100 Mastertrust providers according to The Pensions Regulator (TPR) – very similar in number to the FCA data on SIPP operators. Membership numbers are rather different –with around 5.4 million members of Mastertrusts whereas SIPP investors total about 25% of that figure. Asset figures for Mastertrusts weren't quoted but TPR at the end of 2015 put a figure of just under £30bn on all auto-enrolment schemes of which Mastertrusts are a significant part. That compares with my estimate for the SIPP market at the same date of c£175bn of assets.

One of the big concerns in the Mastertrust market at present is the viability and activities of some of the smaller providers. The TPR is looking at the need for capital requirements, fit and proper persons tests and even the equivalent of a "living will" to deal with the winding up of a scheme in the event that the scheme trustees go AWOL or the scheme fails in some other way. Here the parallels with the SIPP market are obvious.

There were presentations from a large Mastertrust provider and a smaller provider and there was quite a discussion about how the two can safely exist side by side whilst ensuring that it is not open season for the scammers and others. There was a clear sense that from a regulatory standpoint the risks of default or worse were much more easily managed if the market consisted mainly of large and well capitalised providers.

That of course is exactly what is happening in the SIPP market as I was able to explain. The FSA and FCA have been concerned form many years about the perceived risks in the SIPP market as a result of the high number of smaller providers. My latest data shows that even after the recent spate of takeovers – three this year to date and an average of 8 per year since 2012 – nearly half of the 80 providers for which I keep records administer less than 2,000 SIPPs. Indeed the top ten providers administer over 80% of the market by number and over 70% by assets. 55% of SIPPs are now administered by an investment platform and that proportion is growing all the time.

There is no doubt that the new capital requirements introduced by PS14/12 and effective from September have and will continue to prompt further M&A activity. As we know the capital requirement formula (even ignoring the capital surcharge for non-standard assets) is heavily skewed in favour of larger providers. At the threshold level of £200m of assets above which

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the constant multiplier of 20 applies in the initial capital requirement (ICR) formula the ICR is just over £280,000. At the smaller end most SIPPs would be of the "bespoke" variety. Taking the average value of a "bespoke" SIPP to be £200,000 that implies a capital requirement of £280 per SIPP -and note I've assumed no non-standard assets.

On the other hand if one takes a SIPP operator with 25,000 SIPPs at an average value of £160,000 (allowing for some platform based business) the ICR is just over £1.25million and the average capital requirement per SIPP is just over £50. The risk premium for being a client of a smaller provider is pretty severe –it will be interesting to see whether eventually this gets passed onto clients.

If one factors in the capital surcharge for non-standard assets the cost of the capital requirement escalates dramatically. There is little doubt that this imposition will at long last reduce the holdings by SIPPs of inappropriate assets such as green oil plantation, bio fuels and similar commodities and most overseas property. That is to be welcomed although I sense there will be some further arguments ahead as the demand for P2P investment via SIPPs increases – as it stands it would be deemed a non-standard asset.

But returning to the theme of this article I remain unconvinced that big is always best – certainly for the customer. The consolidation in the life industry and adviser sector certainly hasn't convinced me that the customer benefits. In the SIPP world I've had come personal experience of sales and acquisitions and I still have a big question mark over the merits of consolidation. I've yet to see an example of a sizeable SIPP book acquisition that has clearly demonstrated added shareholder value particularly where the price paid is at the top end of the range. The costs of integration and systems migration can be significant but if the mantra "big is best" is followed then more deals seem to be inevitable.

As a postscript I hear that the lights of the old PPML office in Castle Street, Salisbury will shortly be put out for the last time. That as one ex-member of staff said to me will be "the end of an era". For those readers a little younger than me PPML was one of the first – if not the first SIPP Provider – and at the turn of the millennium was the largest SIPP provider. At the time with James Hay also present there Salisbury was the centre of the SIPP world. Unfortunately due to an ignorant and misguided parent PPML's fortunes declined just at the time the SIPP market took off. The opportunity missed was enormous and despite the best efforts of its new owner its fortunes couldn't be turned around. The portfolio of business has now been broken up and the legacy business is spread around several SIPP businesses. It's a salutary lesson once again that big isn't always best!

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