More to SIPPs

SIPP blog – May 2014

I have been calling for reform of the regulatory framework for SIPPs almost from the time that SIPPs were first regulated in 2007. I make no apologies for returning to this subject because I feel passionately that the current approach is simply not working. These comments are prompted by three recent events:

1. The FCA final notice on 1 Stop Financial Services which led to two individual advisers being banned. If you haven't read this I urge you to do so- albeit it makes depressing reading! The headlines are that over a period of two years this firm –and a connected unregulated introducing firm – set up almost 2,000 SIPPs for a range of customers such as a builder, a joiner, a window cleaner and a publican (these are all disclosed in the report)! The total sums invested were £112million – an average of about £55,000 per client. The investments included overseas property developments - almost half of the clients were invested in developments operated by Harlequin – and diamonds.
   I have no personal knowledge of this business and have no argument with the FCA's decision. However I do question the effectiveness of the monitoring process which allows a very small advisory firm to process around 0.75% of the total UK SIPP market new business during the relevant period without apparently any questions being asked by the regulator or indeed SIPP operators – particularly given the concentration of investments in overseas property developments operated by one organisation.

2. The FCA alert regarding pension transfers used to invest in unregulated products via SIPPs. The alert refers to the final notice above so there is a clear connection. It's hard to argue with the main thrust of the alert which is that where an adviser recommends a SIPP then the suitability of the proposed underlying investments for the SIPP must form part of the advice given. Of course there are situations where the transfer might be made into cash –and then reinvested. Presumably that advice is just as unsuitable.
   However my main gripe with this alert is the introduction of yet another classification of investments – "non-mainstream propositions". These aren't defined anywhere – and contrast with the definition of "non-standard assets" introduced by the FSA in CP12/33 just over a year ago. These were defined as "asset types which would incur additional time and cost should they need to be transferred to another operator."
   In the Alert the FCA provide some examples of what they term "non-mainstream" propositions – overseas property developments, store pods and forestry. But what about investment in what for some investors would be very "suitable" investments such as

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unquoted shares or gold bullion? Are these to be viewed as “non-mainstream”? This terminology may be a forerunner to the way in which new capital requirements for operators are to be defined. If it is then it would have been helpful for this alert to have been issued at the same time as the capital requirements. If it isn’t then unfortunately we have yet more terminology being introduced in this area – which given its importance seems unhelpful.

3. I have recently completed my latest update on the SIPP market – you can find out more at www.moretosipps.co.uk I estimate that today there are around 1.2 million SIPPs with assets totalling around £150 billion. Over the last 12 months the market grew by 14% if measured by number of SIPPs and by 20% if measured by assets. Following the radical proposals announced in the 2014 budget regarding changes in the way that benefits can be taken I believe we can expect to see an acceleration in the growth rates for the SIPP market over the next few years. I expect the number of SIPPs to top 2 million by the end of 2017 with SIPP assets by then having climbed to well over £250billion.

I believe that this cocktail of accelerating growth and regulatory uncertainty could have disastrous consequences. I simply don’t believe that issuing more warnings about “suitability” and potentially constraining operators to reject all but the most conventional of investments and cajoling them to monitor the activities of regulated advisers – I appreciate I am anticipating the outcome of the latest thematic review and the related announcement on capital requirements – is the right way ahead.

Flexibility has always been a key feature of SIPPs –which is why they became more popular than the traditional personal pension. That flexibility embraces both income provision and investment choice. It would be unfortunate if the price to be paid for the inadequacies of some so called advisers is to constrain investment choice. In my view that isn’t the way to tackle this issue.

Most of the problems started with the pension tax reforms introduced in April 2006 – notably the ability for any firm that was regulated to set themselves up as a Scheme Operator. Prior to that date organisations that were not eligible to be a provider had to link to an eligible provider such as a bank or building society. Whilst far from foolproof this did at least introduce an extra layer of governance. Up until April 2006 the investments allowed to be held in a SIPP were defined on a list published by HMRC. Thereafter any investment was allowed but a new definition of taxable property was introduced –which in turn was split into two categories –

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“residential property” and “tangible moveable assets”. The rules around these as we know are complex and still open to interpretation.

I think it is time to accept that these changes haven’t worked - indeed worse than that they have encouraged the development of bad and in some cases illegal practices. It’s also led to huge additional cost for the SIPP industry ultimately to the detriment of SIPP investors. The FCA has a thankless task trying to monitor activity and adapting their rulebook to fit a tax wrapper that is designed to be heterogeneous.

What is urgently needed is a wholesale review of the whole tax and regulatory framework for SIPPs. It’s clear that the current piecemeal approach hasn’t worked –and in my view will never do so without destroying or severely curtailing the attributes that have made SIPPs so appealing. I believe we must revert to a new list of “permitted investments” and at the same time do away with the “taxable property” regime. Operators would remain responsible for due diligence on investments – I would envisage for example that unquoted shares would be on the permitted list although I would for example prohibit all overseas residential property investment.

I would also review the criteria for “approval” as a scheme operator – moving to a more risk based approach where the capital required to be approved – or reapproved - as an operator reflects the perceived regulatory risk – I am assuming that the dual regulatory regime for pensions regulation will unfortunately remain in force.

These two measures would eliminate the need for investment related capital requirements and would allow the FCA to concentrate on enforcing a proper and “suitable” advice regime – the lack of which in my view has contributed to the majority of SIPP failings to date. Regrettably I see no sign of this happening. Instead we are likely to be faced with more criticism of operators failing to run their businesses properly along with more adviser failings. All of which will contribute to more tarnishing of the SIPP brand at a time when demand is increasing. What a shame!

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