The long and the short of SIPPs

In the second of his regular monthly features, Ray Chinn, head of pensions at LV=, continues to look at topical issues in the SIPP market, providing both long and short answers. This month the focus is on flexibility and transparency under SIPP contracts.

Some concerns have been expressed about the comparability of SIPPs in terms of the levels of flexibility they offer. Are these concerns justified?

Ray: The short answer: Yes. From a consumer perspective comparing SIPP products can be like comparing apples with oranges. If poor decisions are made as a result there is a real danger of customer detriment.

The long answer: The boundaries between personal pensions and 'pure' SIPPs have blurred over recent years. First it was the deferred SIPP - aka the personal pension – then the hybrid SIPP, now we have low-cost and starter SIPPs.

None of this would be a particular problem if consumers, and in some cases their advisers, understood that not all SIPPs are equal – but unfortunately this is not always the case. In most cases a simple or low-cost SIPP that invests only in collectives - like those available from some of the fund supermarket platforms, will fit customer needs adequately at outset. The real challenge arises some way down the track when funds have grown and the customer or the adviser decides some more esoteric investments are the order of the day – only to find that their current product does not offer this – resulting in a potentially expensive and time consuming transfer.

The antithesis to this is the 'full service' SIPP which may cost more and where the majority of the features are not utilised. There is some support available to advisers in this area with research tools that can help identify features that are / are not available, but for many consumers the fact that they have a SIPP may actually mean very little at all in terms of ability to meet their future needs. Getting across exactly who products are suitable for – both in the long and the short term is a key issue the industry must address to help to restore and maintain trust.

Linked to flexibility of products is the plethora of different charging structures under SIPPs. What should the industry be focussing on here?

Ray: The short answer: Transparency. Exactly how much is the customer paying and exactly what they are paying for – administration, investment management, advice and so on. Also how might these charges alter, if at all, depending on changes in circumstances or requirements.

The long answer: Given the number different SIPP models starting to appear in the market, there is a clear danger of confusing customers. The adage that 'there is no such thing as free lunch' is appropriate here. How exactly does a SIPP provider with a low, or even no, annual charge make money? The reality is that they are probably taking a 'cut' from the investment management fees to supplement their income stream. This means that a customer who thinks they are paying 1.5% p.a. for investment management is actually being charged, say, 0.75% for investment management, 0.25% for running the SIPP and 0.5% for ongoing advice.

Then there are those additional expenses that go to make up the Total Expense Ratio that can take some customers by surprise due to lack, or opacity, of disclosure.

Some argue that this is transparent and that when you buy a tin of baked bins Heinz and Sainsbury's don't break down the cost of the raw materials (beans, sugar, water, tomato sauce, tin can, and label) or their distribution and marketing costs. They would also argue that the single price is easier for the customer to understand. Fair comment when spending 37p on a tin of beans, but when investing a six figure sum in a pension arguably more information is essential. We should not confuse simplicity with transparency.

Those SIPPs with transaction fee models also need to ensure that the apparent transparency at outset is maintained throughout the duration of the contract to avoid customers can get caught out by 'unexpected' charges if they start to use some of the flexibility of their SIPP – "Income drawdown – that'll be an extra £150 per year, sir". Our challenge here is to provide propositions that are both simple to understand and also transparent in terms of to whom the customer is paying what for which service and when. This approach is also more in line with TCF principles and will become more and more prevalent as we move towards a post RDR world.

Next month – How are customer perceptions towards pensions changing for the better – driven by SIPPs as the 'must have' pension product?