

SIPPs (Self Invested Personal Pensions)

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Introduction

Originally designed for the privileged few, who could afford to invest several hundred thousand pounds into a pension plan, SIPPs are increasingly seen as the pension wrapper of choice for anyone who wants to grow their pension fund to more than £100,000 by the time they retire.

To understand a self invested personal pension it is necessary only to break it down into its two constituent parts.

It is easier to start with the subject part of the name, that is, *personal pension*. Most people have become familiar with personal pensions over the years. You or your employer may have contributed to a personal pension plan on your behalf or to the cut down, low cost version, the stakeholder pension.

Personal pensions allow you, or your employer, or both, to contribute to a pension fund which offers certain tax advantages. You can pay in lump sums or a regular monthly amount and gain full tax relief on these so long as you do not exceed the level of your annual income or £50,000 whichever is the lower.

At some stage after age 55 you decide what to do with the pension fund so that it can provide income to you in retirement. Until now the vast majority of people, upon reaching their retirement age, have taken up to 25% (the maximum) as a tax free lump sum and purchased an annuity, that is, a guaranteed income for life, with the remainder of their pension fund.

"It is 22 years since Nigel Lawson's final Budget gave birth to SIPPs. It is unlikely that anyone at the time could have foreseen just how long it would take for the product to gain support – nor would they have believed that in the space of just five years, the market would have more than quadrupled.

Now, almost 700,000 individuals have woken up to the extra flexibility and control that SIPPs offer, with the total value of investments into SIPPs fast approaching £100bn. All this in spite of financial scandals, market volatility and increasing longevity, all leading to growing numbers becoming disillusioned with the benefits of saving voluntarily through a pension scheme."

From an article in *Investment Adviser* 16 May 2011
by John Moret, Principal at Moretosipps

For many of those who have been able to build up a fund of £250,000 or more (which is a lot less valuable to provide a lifetime income than it sounds), the ability to leave their pension fund invested after retirement and drawdown an income each year is more attractive than purchasing an annuity.

Although there is no limit on the size of the pension fund that you can accumulate within a SIPP, there is an amount, called the Lifetime Allowance, beyond which the favourable tax benefits cease and heavy tax charges apply. The Lifetime Allowance applies to the total of your pension funds and is currently £1.8m and will reduce to £1.5m from 6 April 2012.

If we now consider the descriptive part of the name, *self invested*, we see that a SIPP is really just a personal pension plan which allows the investor a much greater say in the way that their pension fund is invested.

When personal pensions were first set up on 1 July 1988 your money would be invested in one or more funds offered by the insurance company operating the scheme. Investment decisions were left to the managers of the funds who were often employed by the insurance companies.

The managers of the funds would determine the asset allocation of each fund, that is, the amount invested in equities (stocks and shares), bonds (loans to companies) and property (commercial property). The majority of the money went into one or two large managed funds which the company offered rather than those that were specific to a geographic location or sector.

Over the years the providers of personal pensions have increased the number of more specialist funds on offer to cater for a growing demand, for example for funds in emerging markets. However, many of these have been poor performers when compared to those of their peers.

More recently, personal pension providers have offered funds managed by external fund managers but the fund of your choice might still not be on offer and the annual charges tended to favour their internal fund range.

As we indicated earlier, the extra investment choice available from a SIPP was the reserve of those who could afford very large investments into their pension funds, and who we might describe as sophisticated investors because of their experience of investment into various different types of assets.

Whilst such investors will still wish to use SIPPs, the advent of multi-manager funds investing into a wide range of assets and model portfolios set up and run by investment professionals, has opened up SIPPs to a much wider group of people.

In fact the majority of the clients of independent financial advice firms in the UK will find that SIPPs are now a suitable way to build up their pensions funds.

Employer Sponsored Pension Schemes

It is important before we go any further to make the point that if you have access to an employer sponsored pension plan then you should take full advantage of that before you consider making use of a SIPP.

Many people are still able to be members of a defined benefits (also referred to as a 'final salary') pension scheme. These are the gold standard for pension benefits as they contain a promise by your employer to provide a level of income in retirement that is linked to your salary and length of scheme membership irrespective of what happens in the investment market. If you have one of these it will act as a foundation to all of your retirement financial planning.

Even where your employer provides a more mundane pension scheme such as the Government sponsored NEST (National Employment Savings Trust) scheme that will be gradually introduced over the next few years, or a stakeholder or personal pension scheme, you should still take full advantage of that if your employer is contributing on your behalf, before considering use of a SIPP.

Most of us need as much help as we can get to build a sufficient size of pension fund, so any employer contributions on offer should be fully utilised. For example, some employers will match your contributions in stages up to, say, 10% of salary.

Until your contributions are such that you are getting the maximum available employer contributions you should not be looking to invest in any other type of pension scheme.

As soon as you leave that employer you will be able to transfer the fund that has been built up by both your and your employer's contributions into your SIPP to invest as you please.

In fact SIPPs are especially good places into which to transfer existing personal pension funds including those created by former employments.

The Benefits of a SIPP

We can summarise what we have learned so far and expand on this in the following list of the benefits of a SIPP:

- All of the tax benefits of a personal pension plan.
- Greater choice of investments in your pension fund. Instead of relying on insurance company funds you can use virtually any unit trusts, OEICs (Open Ended Investment Companies), investment trusts, direct shareholdings and ETFs (exchange traded funds, these are shares which track an index and have lower annual charges), as well as structured products and cash deposits. You cannot invest in exotic products like jewellery, fine wines, antiques and classic cars.
- You can also invest directly in commercial property although not all SIPPs will allow this. You can borrow up to 50% of the current value of investments in your SIPP which can assist in purchasing your property. This is mainly used by the principals of businesses to purchase their own business premises. Investing in buy-to-let residential property is not allowed.
- Great control of investments in your pension fund. With many SIPPs you can see the value of all of your investments in your pension fund at any time from any computer with internet access. You can also give instructions easily to switch between one investment and another within your SIPP.
- A great place to consolidate existing pension funds and save money on individual pension fund charges.
- The ideal vehicle from which to drawdown an income in retirement rather than purchasing an annuity. Your money stays invested while providing you with a very flexible retirement income.

Potential Disadvantages of SIPPs

- If you are using a SIPP recommended by an independent financial adviser then the adviser will either help you with your initial investment choice, and suggest changes over the years, or the adviser will have outsourced this to a specialist investment firm.

Such outsourcing can either be to a discretionary fund manager (DFM) or to a set of model portfolios. It is important that you are aware of the total cost of either the in-house or the outsourced management of your pension fund which will be in excess of the on-going charges made by the SIPP provider.

There is no point in paying 2.5% to 3% pa this advice if your investment requirements could be met by the type of funds available in one of the better stakeholder pension plans where charges are capped at 1.5% for the first ten years.

Arch Financial Planning Limited has an outsourced investment proposition because we believe that the professional investment firms we have involved will provide a better return for our clients than if we tried to carry out the investment research ourselves.

The total annual costs for our clients using our range of model portfolios held on the Nucleus SIPP (an online wrap platform), including the charges for the SIPP, the fund charges and our own charges, are usually in the range of 1.6% to 1.9% pa.

- Many SIPPs are on a direct-to-customer basis and in that case you are on your own as far as the investment strategy goes. If you do not want to control the investments then you will need to appoint someone to do it and again you will need to closely consider the costs of doing so.
- If you are not going to transfer existing pension funds into your SIPP, or make single contributions of £10,000 or more, and your only monthly contributions are going to be £500 or less, then you should seriously consider using a stakeholder pension plan with a reasonable range of 20 or so funds rather than a SIPP.
- As mentioned earlier, you should not invest in a SIPP instead of obtaining an employer pension contribution. However, once you have paid a sufficient employee pension contribution to obtain the maximum employer contribution then you can use a SIPP for the excess bearing in mind the minimum contribution levels mentioned in the last point.

- Whilst you can transfer existing personal pension plans into a SIPP you should use an independent financial adviser to report to you on the advisability of doing this. You should be very wary of transferring defined benefit/final salary pension benefits into a SIPP due to the loss of guaranteed pension benefits that you will experience.

Arch Financial Planning Limited uses specialist pension switching software, Selectapension, to compare the charges of your existing pension plan with the Nucleus SIPP and aid us in looking at the advisability or otherwise of transferring your existing pension plans.



Fund Consolidation

Before the advent of SIPPs, and the online investment platforms on which many of them are administered, it did not make a great deal of sense to consolidate your personal pension plans so that the whole of your pension fund was being invested by one insurance company.

You might, for example, have moved everything to Equitable Life! However, moving existing personal pension plans to a SIPP can make a lot of sense provided that your charges are not increased over all. Many non-stakeholder personal pensions have fixed monthly policy fees and although these might be just a few pounds you don't want to be paying three or four lots of these.

It has been shown that having the right asset allocation in line with your attitude to risk is a vital part of any investment planning. It is clearly easier to arrange this if your personal pension funds are all in the same place provided that you have the breadth of investment choice and the control which a SIPP provides.

Furthermore, independent financial advisers are moving to a fee, or adviser charging, basis as a result of the Retail Distribution Review which comes into force at the end of 2012. You don't want to turn up to your IFA's office a few months before your retirement with five different personal pension plans for him to have to deal with.

More clients are investigating the pension drawdown method of receiving an income in retirement and a SIPP is an ideal vehicle to continue to invest the pension fund and handle the regular or irregular amounts that you wish to draw down.

Arch Financial Planning Limited uses the Nucleus SIPP for many of the reasons already stated in this Guide but our clients also benefit from the fact that there are no additional charges made by the SIPP over and above the 0.35% pa charged for the Nucleus Wrap itself.

There are, for example, no additional charges for holding the pension fund as a drawdown or flexible drawdown plan within Nucleus as opposed to a normal SIPP plan, and there are no charges for withdrawing down any amounts from the pension fund either as a single lump sum or as regular withdrawals.

Please note that this information does not constitute personal advice and should not be treated as a substitute for specific advice based on your circumstances.

Any information given in this Guide relating to income tax legislation is based on our understanding of legislation and practice in force at the date of this Guide. Whilst we believe our interpretation of current law and practice to be correct in these areas, we cannot be responsible for the effects of any future legislation or any change in interpretation or treatment.

In particular you are warned that levels of tax and tax reliefs and also State Benefits that may have been referred to, are subject to alteration and, in any case, the value of such reliefs and benefits may depend on an individual's circumstances.

For personal advice

If you would like to discuss a new SIPP investment or the transfer of your existing personal pension plans to a SIPP, please ask your usual Arch adviser or contact us via one of the following:

Tel: **0845 3700 661**
or **01483 204600** (if local)
Email: **enquiries@arch-fp.co.uk**
Online: **www.arch-fp.co.uk**



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