ML FINANCIAL ASSOCIATES

A guide to SIPPs

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Introduction

A Self-Invested Personal Pension, commonly known as a 'SIPP', is a form of pension available to all investors who choose to invest into a private pension.

The SIPP is a personal pension like any other, bound by the same rules. However, the SIPP does have one distinctive element:

It allows the investor to self-invest, or to take control of the pension (which is why sometimes they are referred to as 'self-controlled' pensions).

Although the only major difference between a standard personal pension and a SIPP is the self-investment element, this is a major difference – one that creates a series of advantages for pension investors to benefit from.

Our guide aims to explore how SIPPs work, to look at the advantages, to dispel some myths about SIPPs, to look at how they have developed over the past few years and to explain them in a way we hope you will find easy to follow.

A brief history of the SIPP market

The roots of the SIPP market can be traced back to the Finance Act 1973, when legislation introduced the Small Self-Administered Scheme (SSAS) for controlling directors of companies. SSASs are similar to SIPPs in that they offer wider choice, flexibility and control when compared with standard pension plans.

Many changes in pensions took place in the years after this but it was in 1988, when the Personal Pension was introduced, that we saw the seismic change. Personal Pensions were a new type of pension, brought in with a view to extending the reach of pensions to the widest possible population.

In 1989, Nigel Lawson extended the Personal Pension legislation and introduced the SIPP. In his budget speech of that year, he explained that he wanted to "make it easier for people in personal pension schemes to manage their own investments."

However, for the next decade or so SIPPs failed to be anything other than a peripheral product as the generous rules and flexibility that they offer today were not fully in place and the SSAS remained a clearly superior option for those people who could access either.

A combination of factors since 2000 have moved SIPPs into the mainstream: the internet now allows SIPPs to be run at much lower cost and to be far more accessible, driving costs down across the market, and the Pensions Reforms introduced in April 2006 opened up new possibilities for SIPP investors.

With the introduction, on 6th April 2015, of new rules to how a private pension can be drawn, supported by new (and more favourable) death tax rules, SIPPs are more appropriate for many. These changes removed some of the traditional restrictions applying to pensions and widened the range of circumstances where people may benefit from the use of a SIPP. The SIPP is now firmly in the mainstream.

How SIPPs compare to standard pensions

As stated earlier, a SIPP is simply a personal pension that allows for the investor to self-invest and exercise an element of control.

Technically, a SIPP is no different to any other type of personal pension - the rules applying are exactly the same.

A personal pension which is not a SIPP will be one where the money is handed to the pension company and the pension company's funds are used. The pension investor is effectively passing the control and the investment management over to the company to manage.

Many standard (non-SIPP) pensions do offer wide fund choices, often including funds from other investment managers, but they do not allow for full self-investment; a crucial difference.

The myths which often put people off using a SIPP

We hope our brief explanation of how the SIPP market has developed over the past four decades will have emphasised how 'mainstream' and accessible SIPPs have become.

However, in the earlier years SIPPs were not so flexible and accessible and as a result there are some myths about SIPPs which may put some people off considering them as a viable solution. Here are the common ones, which we hope to dispel!

1. They have higher costs than a "normal" pension

As the SIPP market has blossomed and grown over the past couple of decades, with more SIPP providers entering the market each year, costs have tended to be driven downwards and the cost of running a SIPP is now more in line with general non-SIPP pension charges. On average, SIPP charges remain slightly higher than a standard pension, however on the plus side, this is reflected in the greater investment freedom and the wider investment choices.

It is also worth noting that this is not an area of the market where charges can easily be compared. One investor may use a SIPP to buy property, self-invest into unlisted company shares and buy esoteric investments, all of which could involve higher charges and costs. Another SIPP investor may use their SIPP to create an investment portfolio using a passive investment approach around Exchange Traded Funds (ETFs), which would have very low charges and costs.

The important point is SIPP charges are not wildly out of kilter with the rest of the market for most SIPP products and options.

2. They are too complex

For pension investors, the rules surrounding pensions can often seem cumbersome and complex. Like anything of this type, this, on its own, can be a reason for investors to shy away from pensions. If it is difficult to understand what it "is all about" then it can be difficult to engage or get enthusiastic. However, this is the position for pensions generally. In the main, the rules and regulations relating to SIPPs are just the same as for any other pension. They are no more, or less, complex.

A SIPP is essentially quite a simple product for investors to use and where there are any challenges understanding the wider pension rules, we are here to help. There is no complexity which we cannot make simple for you!

As with the charges point above, SIPPs are just like any other pension, with the notable exception that you have control of your own pension.

3. They are only for the very wealthiest investors

This, possibly, was a fair point in the past and was – historically – a valid 'criticism'. This is because when the market was smaller and more specialised, SIPP providers tended to have high fixed upfront fees, high annual fees and a tariff of charges for additional services and work.

This meant that they were often considered poor value for any investment below £100,000, putting the SIPP out of most investors' reach. The SIPP product gained a reputation for being a specialised product only for those with high pension values.

However, as competition has grown and the market matured, with more and more SIPP products available from different providers and of different types, so the entry level has fallen. There are SIPPs now available for everyone.

4. They are good for buying commercial property but not for 'mainstream' investments

Some people associate SIPPs as a product that is only relevant when the pension investor wants to buy a commercial property, such as an office or factory.

They are a suitable product for investors who want to do this, however, the vast majority of SIPPs in the UK are being used as a general investment account, have no commercial property element and never will. They are being used so that the pension investor uses the SIPP to get a wide range of investment funds and to have greater control.

There is no doubt, in the modern market, SIPPs are suitable for mainstream investments and for just about every pension investor.

How SIPPs work

There are three main functions to operating a SIPP (this is basically also true of any pension):

Administration: there needs to be a firm that does all the paperwork, producing statements, and annual returns to HMRC, etc.

Trusteeship: pensions are held under a trust arrangement - every pension needs a trustee. The trustee will be responsible for making sure everything operates within the rules and regulations.

Investment Management: someone has to decide where money within the pension is invested and how this is managed – the money also needs to be managed thereafter.

With a ‘standard’ pension, these three functions are normally undertaken by one company. If you have a pension with Prudential, as an example, Prudential will take care of each aspect and you will use funds offered and managed by Prudential. Prudential will be the administrator, their trustee company will be the trustee and their investment management team will manage the funds.

A SIPP works differently. You choose a SIPP manager and they will (in most cases) take care of the administration and trustee responsibilities. However, you will direct the investment management. In some cases, you might be able to appoint your own trustee, separately.

As we outline throughout this guide, the SIPP really does personalise your pension to a considerable extent.

The self-investment factor does not mean you need to act as Warren Buffet, researching everything yourself, choosing the exact investments you will use. It means you can separate the investment management from the other parts, possibly mixing up the investments into different areas managed by different managers. You can (and most people who use SIPPs do) still use professional investment managers.

It also means, should you want to, you can do the investing yourself or you can decide to invest into shares directly or use the pension in conjunction with your business needs.
Hopefully, the picture is becoming clear: SIPPs separate out the investment part from the administration and trustee parts, opening up much greater facilities and, crucially, offering you large elements of control.

Different ‘types’ of SIPPs

One of the key points we wish to make in this guide is that the title ‘SIPP’ covers quite a wide field and beneath this title sit different types of SIPP which will be of use to different types of investor. There is no formal notification of these differences from a regulatory point of view (i.e. all personal pensions including SIPPs are covered by the same rules) so our explanation is our terminology to help explain some key differences:

1. Simple SIPPs

These are SIPP plans which have features allowing the investor to choose from a wide choice of funds, offered by many different fund managers (i.e. to provide significant choice) and to do some self-investing. However, simple SIPPs will not allow direct investment into shares, commercial property to be held or any more exotic investment options.

Simple SIPPs will have the elements of flexibility, choice and control but within the narrow framework of offering mainstream investment funds.

2. Hybrid SIPPs

A hybrid SIPP will be the same as the simple SIPP above but with some added features. For example, the SIPP trustee may allow for investment into commercial property and direct equity investing into listed shares (i.e. those on a recognised stock exchange), but they will not extend their options to every last possible permitted activity.

3. Full SIPPs

These are SIPPs which are completely unrestricted, where the trustee will accommodate any permissible investment or activity.

These are the specialised SIPPs which will often include bespoke arrangements, for example, direct investment into unlisted shares, borrowing and other facilities which may help a pension investor use the SIPP in interaction with their business.

The advantages of using a SIPP – taking control

What do we mean by 'control'? We have identified control as the main difference offered by a SIPP and explained in an earlier section how this works.

In a way, 'control' can mean whatever you want it to mean. The different SIPPs we have outlined demonstrate that there are different levels of control.

Control is a way of describing how you have ultimate responsibility for your own pension. A SIPP - of whatever type you choose – is under your direction. You can still use fund managers and effectively hand over the investment decisions to professional firms and most people who use SIPPs will do this.

Our role here becomes important, because as advisers / planners, we work with you to source the right SIPP and then to help you with the way that the SIPP is constructed and run. The control element is something we can assist with and support; rather like a pilot and co-pilot both sitting at the controls.

Some of the dynamic possibilities offered by SIPPs

One of the most attractive aspects of a SIPP is that it allows you considerable investment choice - this includes using the plan to make some specialised investments and / or to interact with other financial planning areas, for example, to use the SIPP to help with business needs. We cover some examples below, but this is not a complete list by any means – they are merely indicative of the dynamic nature of a SIPP and its possible uses.

Property purchase

One of the most distinctive options available from a SIPP is the purchase of a commercial property. This means that an investor can use their pension to directly buy an office, factory, warehouse or any other type of property which is 'commercial' (as opposed to residential property, which is not allowed – this includes residential buy-to-let property).

An individual pension investor can buy a property (and the pension can arrange to borrow money to enhance the value of the property that may be purchased) or a group of pension investors can group together and buy property together via their individual pensions.

For example, people who are in business together (as shareholders or partners in a business) may decide they want to own their own offices or factory and club together to buy suitable premises. The rent paid from that property will be paid into the pension fund(s).

Direct investment

SIPPs permit the purchase of direct investments. For example, a pension investor may prefer to hold some direct shareholdings as an alternative to investing into funds. SIPPs allow for investment into listed shares and, in some cases, into unlisted shares. If your neighbour has started a company and is looking to attract investment, it may be possible for you to invest part of your pension into his or her business.

Family SIPPs

Although known as family SIPPs, this solution simply describes a position where different people pool their pensions into one aligned arrangement; they do not have to be family members. Put simply, a family SIPP is a small congregation of individuals' pension entitlements and savings under one 'master trust'. In this respect, it has the same dynamics as an investment club, where a small group put their monies together to pursue a consistent and common strategy. A family SIPP is especially useful where people are looking to gain the advantage of getting the benefit of having greater funds available (for example, to buy a property as above), or to gain greater diversification, or where families want to undertake wider and intergenerational financial planning.

Borrowing

Under strict conditions, SIPPs permit borrowing. This allows for the SIPP investor to consider possibilities beyond their current fund value. Borrowing is permitted quite widely, it is not just for property purchases. There are many ways borrowing may help create an investment opportunity which would not otherwise exist. Naturally, however, borrowing within a pension is going to increase the risks entailed.

Pension Death Tax

The changes introduced on 6th April 2015 to the way private pensions are taxed on death (the so-called "death tax"), opened up many new possible ways of organising the pension for beneficiaries. Pension funds, such as a SIPP fund, can now be tax efficiently managed and left for loved ones. Some commentators have described this as a family tree pension, i.e. the SIPP can be constructed in such a way that it can be passed from one generation to another. The more punitive tax rates which previously made this unattractive in many cases have now been removed or relaxed.

Using a SIPP in Retirement

Many people may consider that a SIPP is only applicable during the savings years, prior to retirement. However, SIPPs can be used once retirement has begun and there can be good reasons for doing so. One of the options retirees have is Income Drawdown. This is a means of taking income from a pension, but keeping the pension invested. This is normally seen as an alternative to cashing in the pension and buying an annuity. Since April 2015 and the introduction of the new Pension Freedom rules, the option of keeping a pension invested has grown much more favourable and many more people will now look at some form of Drawdown.

Income Drawdown has several advantages, including offering a more flexible income arrangement, the possibility of a growing income and potentially a better position should death occur after retirement. There are possible disadvantages of Income Drawdown to weigh against this, such as a risk that the income may be lower, that the invested fund may drop in value – either or both of which could make the option too risky for some retirees. This consideration is not one that we will cover in this guide, we simply wish to emphasise that if Income Drawdown is deemed the best option after retirement, then it would be possible to run the Income Drawdown arrangement through a SIPP and to hold a SIPP beyond retirement (or possibly transfer into a SIPP at the point of retirement). Indeed, arguably, a SIPP is the best type of pension for managing an Income Drawdown arrangement. This is because a SIPP offers the greatest range of underlying investment holdings. With the requirement to get the best risk controlled portfolio in place to manage the income required, this range and flexibility is a key part of a successful strategy.

'Is a SIPP right for me?'

If you are looking to have an element of control over your invested pension monies then a SIPP would be ideal. Of all the pension options available, the SIPP option provides the greatest flexibility and the control is with the investor. For many people, this is a critical factor. They prefer to have their own plan, under their own control. In these cases, a SIPP is the perfect solution.

Anyone who wants to invest into a commercial property through a personal pension will need to use a SIPP, likewise a business owner / director who wants to use some of the opportunities to self-invest into business assets would probably use a SIPP.

For pension investors who want maximum flexibility and / or a wide range of possible investment solutions, a SIPP is likely to be the best option.

They can also be the best way of managing an Income Drawdown plan in retirement (see section above).

Transferring to a SIPP

Many SIPPs are started by people who already hold money in a pension (a standard pension) and are seeking to improve their positions and see the advantages of a SIPP as a way of doing this. If you hold an existing pension, you should be able to transfer the value to a SIPP. You need to be wary of any costs of making such a transfer, however, in many instances, the transfer can be cost free. If there are costs then these need to be assessed. It may be that the SIPP benefits you wish to access are worth incurring some transfer costs for but, of course, the opposite may be the case and the costs of a transfer may be prohibitive. We can help you make such an assessment where required.

The new Pension Freedom rules are specifically ones targeted at and benefitting Private Pensions; therefore many people in occupational final-salary type schemes (known as defined benefit schemes) do not have the same freedoms and there may be value for some of those people in transferring to gain the advantages and benefits of the unrestricted access to the pension pot. In these cases, a SIPP would be an ideal product to use for the transfer value. Such a transfer should only ever be contemplated or pursued after the most specialist advice is sought and received, as transferring away from such an occupational scheme could involve losing other benefits, such as valuable guarantees.

How to choose a SIPP

As described in earlier sections, there are now many SIPP providers (well over 100) and there are many different types of SIPPs.

- In looking to choose a SIPP provider, there will be several factors to take into account - here are a few:
- What range of investment options are you looking to have available?
- Will you be wanting to use direct investment facilities?
- What are the charges?
- How will the SIPP be managed?
- What is the financial position of the SIPP provider?
- What are their service and administration standards?

We are here to help. SIPPs are one of the more specialised products within the financial services arena – the choice of SIPP provider is one we can advise you on.

As stated earlier, the SIPP will need to be chosen and then, thereafter, managed.
Although SIPPs are fundamentally self-invested pensions, with the advantage of self-control, you will still need and benefit from having an adviser/planner helping you with the various steps, including choosing a suitable provider, structuring and running an ongoing investment strategy and having technical advice from time to time, where appropriate.

Summary

SIPPs are mainly about ensuring that the control is with the investor, the pension holder. This is their main advantage. They offer flexibility and choice and as a result are a great way for any pension investor to manage their retirement savings, almost regardless of the stage in the process.

There are complexities in these areas, but these are ones that we can help you manage - SIPP providers operate within a sector of the financial services industry which has many rules and regulations and has been subject to much tinkering and change over the years.

However, the SIPP has become a central part of the pensions landscape and is likely to remain at its core for many years to come, especially now the Pension Freedom rules are in place for private pensions. The money you have in a pension is YOUR money and the future fund value is for your benefit during your retirement. We believe that SIPPs represent a wonderful way for you to manage your pension through, and then in, retirement.

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