



Matthew Phillips
Conduct Policy Department
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By post and by email: CP12_33@fsa.gov.uk

21 February 2013

Dear Mr Phillips

CP12/33 – A new capital regime for Self-Invested Personal Pension (SIPP) operators

Please find attached the AMPS response to CP12/33 in the form of a report. We have provided a high level overview of our detailed submission, but our response is the entire report not just the overview.

Our responses have been thoroughly researched after consultation with 56 SIPP operators and we have provided supportive evidence or illustrative examples where possible.

We are not convinced (as we haven't been provided with any evidence) that a move away from expenditure or a close proxy for such is the best way to establish wind-down costs even if third parties have to be appointed to deal with the wind-down.

As such we present a revised expenditure-based model, but if the evidence suggests that expenditure for a firm not participating in regulatory arbitrage truly is not representative of wind-down costs, then we suggest it is number of SIPPs that is a more effective and representative calculation than Assets Under Administration.

The benefits of our alternative approaches include:

- Capital Requirements that align the interests of consumers and SIPP operators;
- A regime that is less open to manipulation and easier for the FSA to verify;
- Promotion of the benefits of good systems and controls;
- Financial Resources that offer greater protection for consumers;
- A change that will not cause a significant reduction in competition;
- A transitional period that will reduce consumers being put at risk of being abandoned.

Our report has been shared with members of the Association of Member-Directed Pension Schemes and distributed to press. We have also provided copies to the Smaller Businesses Practitioner Panel, the Office of Fair Trading and the Competition Commission.

I look forward to hearing from you and would be very pleased to discuss the contents of the report further and to agree whether any further data collection or consultation is required before final rules are brought in place.

PLEASE ACKNOWLEDGE RECEIPT OF THIS SUBMISSION.

Yours sincerely

A handwritten signature in black ink, appearing to read "Andrew Roberts".

Andrew Roberts
Chairman, AMPS



AMPS Response to CP12/33

**A new capital regime for
Self-Invested Personal Pension (SIPP) operators**

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Introduction

AMPS is the main trade body that represents self-invested pension providers such as Self Invested Personal Pension (SIPP) operators and Small Self-Administered Scheme (SSAS) practitioners. We have around 200 member firms from the largest pension providers to smaller SIPP operators, together with others involved with the industry. We represent 92 SIPP providers of whom 14 are also members of the ABI.

Our answers to the specific consultation questions are set out in this report. In formulating our detailed response, we consulted with SIPP operators using a variety of means including hosting four round table events that were attended by 56 SIPP operators and an online survey of 23 SIPP operators. We firmly believe that our response is balanced between the interests of consumers and SIPP operators. Our alternative proposal significantly increases the current capital requirements but in a measured way that does not harm smaller providers as much as the CP12/33 proposals.

The big message that SIPP operators should hold more Financial Resources to protect consumers from harm is an easy message to support, and so we expect you will receive some support from larger SIPP operators, consumer groups and other industry bodies. In particular:

- Larger SIPP operators may be able to meet your proposals and so support them, but perhaps need to consider the long-term impact of using an AUA-based regime.
- Consumer groups may not be aware of the consequences for existing consumers including a reduced choice of suppliers, harder access to high-return assets, an expected increase in charges and, for some, the danger of having their SIPP prematurely wound-down.
- Other industry bodies may support proposals which enhance their position if another financial services sector is subjected to harsher regulatory capital requirements.

We have confidence that the consultation process will determine whether such responses are self-serving or whether they look at the wider picture.

We therefore very much trust that you read our response with an open-mind, noting that our thoughts have been constructed following detailed discussions with a significant number of SIPP operators. We would be pleased to discuss any part of this response that does not align with your requirements.

Finally, for proposals that will have such a large impact on one industry, we were disappointed that a standard consultation window of three months was chosen. This has impaired the ability for more diverse options, such as insurance and rescue packages, to be investigated and evidenced.

Authors

This report is written by Andrew Roberts – chairman of the Association of Member-directed Pension Schemes - with assistance from Tim Dolan. It is issued on behalf of the Association of Member-directed Pension Schemes and has been approved by the committee. Details of the authors follow.

Andrew Roberts



Andrew Roberts graduated from Cambridge University in 1996 with a degree in Mathematics and qualified as a Fellow of the Institute of Actuaries in 2001. He joined Barnett Waddingham in 2005 and became a partner in 2008.

In 2011, Andrew was appointed as Chairman of the Association of Member Directed Pension Schemes, the trade association dealing with SSAS and SIPP matters.

Email: andrew.roberts@barnett-waddingham.co.uk

Telephone: 0151 235 6622

Tim Dolan



Tim Dolan leads Pinsent Masons' Financial Services Regulation team and is a financial services lawyer. He previously worked at the FSA, SJ Berwin LLP and the New Zealand Securities Commission.

Tim acts for SIPP operators, stockbrokers; payment services firms; insurers; private equity and hedge fund managers; spread betting and CFD firms; proprietary traders, banks and building societies.

Email: tim.dolan@pinsentmasons.com

Telephone: 020 7418 8259

High Level of Summary of Answers

We set out below a summary of the key points but refer to our full response in the following pages.

Q1 (Use of Assets Under Administration)

There are too many anomalies to support use of Assets Under Administration as a robust way of calculating capital requirements, as it may fail to provide consumer protection when needed.

Q2 (Impact of Non-Standard Assets on costs of wind-down)

Costs could increase, but not to the extent implied by the Capital Surcharge. SIPP members would still be responsible for normal SIPP charges during the wind-down and consumer should be compensated by the FSCS for any detriment caused by higher fees to switch SIPPs.

Q3 (Increase in Fixed Minimum Capital Requirement)

The increase to £20,000 is acceptable, and indeed we support a higher increase to a minimum of £50,000.

Q4 (Capital Surcharge)

The concept of a capital surcharge for SIPP providers whose wind-down costs are likely to be higher is acceptable but we propose an alternative method.

Q5 (Alternatives)

We present two alternative models both with a capital surcharge. The first uses turnover primarily as a better proxy for actual operator costs. The second uses number of SIPPs as a better measure of the scale of a SIPP operator than Assets Under Administration.

Q6 (Standard Assets list)

There are some key omissions from the proposed list of Standard Assets.

Q7 (Accessibility of Financial Resources)

The split should be determined with reference to plans with low liquidity rather than plans that contain Non-Standard Assets.

Q8 (Costs to operators)

We generally consider the assumed WACC of 6% to be too low (a WACC of 10% - 20% would be more appropriate) and that the Cost Benefit Analysis ignores some costs.

Q9 (Liquid Capital v Own Funds)

We generally support the move to Own Funds, though note that this could cause additional cost for firms who have Qualifying Property as part of their Financial Resources.

Q10 (One year transition period)

A one year period will lead to a concentration of exits and a struggle to raise the additional Financial Resources and so we suggest a phased-in change over three years. If there is real concern of consumer detriment in the intervening period, the FSA should deal with individual firms directly.

Q11 (Impact on competition)

We are concerned about the disproportionate impact on smaller SIPP operators which will severely reduce the market for consumers wanting to use typically small, local firms. The proposals are inconsistent with the Financial Conduct Authority's objective of promoting competition. The proposals will make writing new business more expensive for smaller operators and so could lead to a polarisation in the market and indeed could directly lead to the failure of some operators. As such, as we have referred your paper to the Smaller Businesses Practitioner Panel, the Office for Fair Trading and the Competition Commission.

Q12 (Supply of data)

We conducted face-to-face research with 56 SIPP operators and an online survey which 23 SIPP operators participated in. Our analysis shows that CP12/33 underestimates the percentage of Non-Standard Assets likely to be held by SIPP operators – most likely due to the impact of UK Commercial Property holdings – and that therefore the impact of the proposals will be greater than the FSA have modelled.

Detailed Response to Consultation Questions

Q1. Do you agree that AUA is an appropriate measure of the risk of consumer harm posed by a SIPP operator?

The fundamental reason for SIPP operators holding regulatory capital is not so much to measure the risk of consumer harm posed by the operator (which is naturally very limited) but rather to ensure the costs involved in winding down a SIPP operator can be met.

We do not agree that Assets Under Administration should be used for calculating a firm's capital requirement as there are some unintended consequences (which we refer to as anomalies) that would increase the risk of consumer harm as time progresses. This suggests that the proposed formula is not prudent. These anomalies are set out below together with some practical issues.

We have also spent a considerable amount of time comparing the FSA's proposals in respect of regulatory capital in CP 12/33 to the regulatory capital calculations required by other firms who are subject to IPRU-INV (such as private equity fund managers) and those firms who are subject to the BIPRU capital requirements. While some BIPRU firms are required to take account of Credit Risk and Market Risk and are required to complete an ICAAP the reality is that an Assets Under Administration test as proposed in CP 12/33 has not been used in any other sector by the FSA or, for that matter, under European law.

We do not understand why a small sector such as ours should effectively be a pilot for the FSA to trial a fundamentally different regulatory capital calculation method.

Rationale

Whilst Assets Under Administration broadly increases with the size of the SIPP operator, using Assets Under Administration in the formula causes some practical issues but, critically, will fail to protect consumers in the long term just when the capital requirement is needed.

Anomalies

We list below some key anomalies with the formula for the Initial Capital Requirement which suggest that it is neither an appropriate nor a robust formula:

Anomaly 1 – Capital is not there just when it is needed

Using an extreme example to illustrate this anomaly, a SIPP operator that markets itself as allowing Non-Standard Assets such as UCIS may meet the capital requirement when it sets out on business and continues to trade for the first few years. With 500 SIPPs whose average value is £50,000, the capital requirement at that point is £600,000.

It later transpires that the Non-Standard Assets are not accepted by any other SIPP operator, hence the concentration in business. Suspected fraud reduces the value of those Non-Standard Assets, which become suspended due to regulatory intervention, to nil. The Capital Requirement for the SIPP operator plummets to £20,000, releasing Financial Resources to the SIPP operator, who would still meet their regulatory capital requirement.

We expect that this is counter to what the proposals are trying to achieve.

Suspended Funds	Q1 2017	Q1 2018
Assets Under Administration	£25m	trace
%Non-Standard Assets	100%	100%
Initial Capital Requirement	£100k	trace
Capital Surcharge	£500k	trace
Total Capital Requirement	£600k	£20k

Anomaly 2 – Release of capital to SIPP operator despite no change in risk of consumer harm
A SIPP operator that is stagnant (same number of SIPPs, no change in underlying investments) from one year to the next should not be able to release Financial Resources should the market value of those investments fall. Being able to do so increases the risk of consumer harm.

In the example below of a small SIPP operator, £63,000 can be released from Financial Resources following a drop in Assets Under Administration of 15%. It does not follow that the cost of winding-down has fallen.

Static SIPP Operator	Q1 2014	Q1 2015
Assets Under Administration	£250m	£217m
%Non-Standard Assets	40%	40%
Initial Capital Requirement	£316k	£295k
Capital Surcharge	£632k	£590k
Total Capital Requirement	£948k	£885k

63k can be released from Financial Resources

Anomaly 3 – Uncontrollable calls for capital lead to non-robust business models

A significant unpredicted increase in capital requirement could occur from one quarter (or year) to another which, as well as not necessarily reflecting the additional capital required for an orderly wind-down as noted above, could in future cause the SIPP operator to fail to meet the new Capital Requirement even after meeting it for a number of years.

By way of example, a SIPP operator with 5000 SIPPs whose average size is £200,000 would have Assets Under Administration of £1,000m. The ICR would be £632k. With 40% in Non-Standard Assets, the total requirement would be three times this, at £1.896m. A 15% increase in market values would equate to an increase in capital requirement to £2.035m, i.e. an increase of £139k which would need to be provided to the business at short notice, and the SIPP operator cannot run its business in any way to mitigate this.

Additional unexpected calls for capital could be required if there is a material change in the percentage of plans that hold Non-Standard Assets – this could be as a result of an adviser deciding that all of their clients should have a small exposure to an esoteric investment for diversity and putting this strategy in place over a short period of time, possible by using technology.

Market Movements	Q1 2014	Q2 2014
Assets Under Administration	£1,000m	£1,150m
%Non-Standard Assets	40%	40%
Initial Capital Requirement	£0.632m	£0.678m
Capital Surcharge	£1.264m	£1.356m
Total Capital Requirement	£1.896m	£2.035m

Injection required of £139,000

Anomaly 4 – The cost of transferring or selling an asset is not linked to the value of an asset

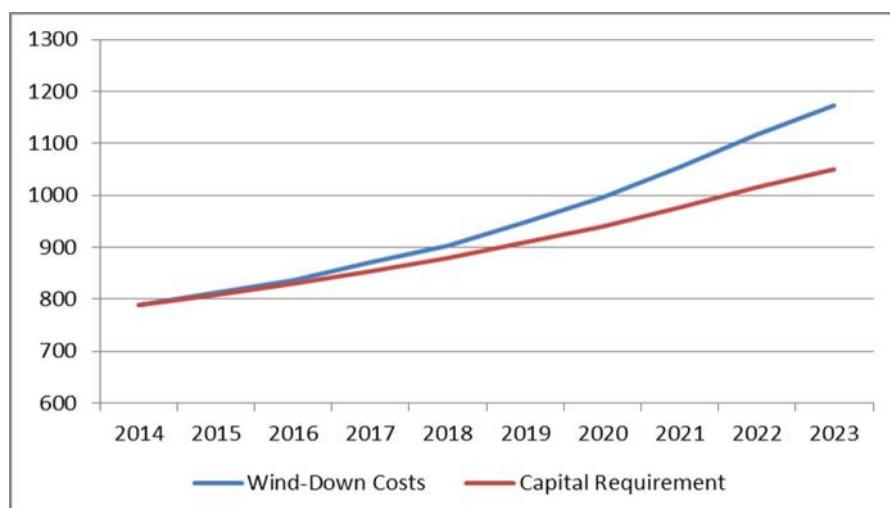
An investment account held at a discretionary fund manager with £10,000 in it will have the same SIPP administration costs to transfer or sell as the same investment account with £100,000 or £1,000,000 in it. The same is true of cash deposits, shares, unit trusts, directly held property, UCIS etc.

Using Assets Under Administration as a proxy for the size of a SIPP operator and thus the expected cost of wind-down is flawed as it fails to take account of this.

Anomaly 5 – Divergence from cost of wind-down as regime beds in

The mismatch between the cost of winding down a SIPP and the capital requirement will drift over time as the former will ordinarily be linked to wage/price inflation whereas the latter is linked to market values. For example, we expect that a stagnant SIPP business will need progressively more capital each year due to wage/price inflation whereas ICR will increase or decrease depending on SIPP asset values.

The chart below illustrates the point. Assuming that the formula proposed in CP 12/33 correctly approximates wind-down costs when introduced, the chart maps the divergence between costs of wind-down and the capital requirement. The assumed wage costs and market fluctuations are as per the table below the chart (and are set simply to illustrate the phenomenon).



	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Wage/Price inflation	3%	3%	4%	4%	5%	5%	6%	6%	5%	5%
Investment growth	5%	5%	6%	6%	7%	7%	8%	8%	7%	7%

Anomaly 6 – No distinction between large groups with small average funds, and small groups with large average funds

A SIPP operator that has 10 clients with an average fund size of £400,000 will have the same Initial Capital Requirement as a SIPP operator with 100 clients with an average fund size of £40,000. However we would contend that the larger SIPP operator (with more plans) should hold more financial resources as there are more individuals to communicate with in the event of a wind-down and the cost of transferring an asset is not-linked to the value of that asset.

Using Assets Under Administration as a measure of risk of consumer harm is flawed as it does not distinguish between these two situations.

Anomaly 7 – Misalignment of interests between SIPP operators and consumers regarding asset valuations

The Assets Under Administration test introduces a conflict of interest between the SIPP operator (who would favour a lower value of assets) and the consumer (who would favour a higher value) and this will be particularly acute for Non-Standard Assets which are by definition those assets that are open to subjective valuations. For example, it is generally accepted that a property valuation could vary by 10%, which is significantly more than the cost of transferring the property should the SIPP operator need to exit.

As the SIPP operator determines its valuation policies, it would be the SIPP operator's conservative valuation that would be adopted.

There are already reported discrepancies between SIPP operators in how they value assets:

From FTAdviser

<http://www.ftadviser.com/2013/01/14/regulation/eu-legislation/sipp-providers-valuations-challenged-YHeB6krDvXn7wWX9EURT1J/article.html>

Sipp providers' valuations challenged

Investors question self-invested personal pension (Sipp) providers' ARM fund valuation

By Nick Reeve | Published Jan 14, 2013

"Investors in the stricken ARM Asset Backed Securities life settlements fund have challenged self-invested personal pension (Sipp) providers after two firms took different stances on the value of the fund.

Bob Sharpe, a member of the ARM Help investor steering group, publicly challenged Sipp providers Carey Group and Standard Life to explain their valuations of bonds issued by ARM.

Carey Group, which runs Sipps transferred from the collapsed Rockingham Independent, has valued bonds issued by ARM at zero after consulting with HM Revenue & Customs (HMRC) and the FSA.

But Standard Life, which also has a number of clients invested in ARM bonds, still values the investment at its full purchase price as it believes "there may still be value" in the investments."

Anomaly 8 – Misalignment with SIPP operator charging structures

The majority¹ of SIPP operators have a business model predicated on offering an efficient and value for money administration service for which it charges a basic annual fee plus fees based on the transactional cost of carrying out administration activity.

Annual administration costs are not associated with the size of the Assets Under Administration as the activity involved in administering a SIPP with assets worth £1m will be broadly the same as a SIPP with the same number of assets worth £100,000.

This business model has the advantage of allowing SIPP operators to take an unbiased and neutral approach as to the size of funds, where clients choose to invest and the performance of those funds.

This indicates that a capital adequacy regime that is based on SIPP numbers would be more closely aligned to SIPP operators' business models than one based on Assets Under Administration. Applying a formula that uses Assets Under Administration may result in SIPP operators moving to a fee model that charges according to the size of contributions paid or transfers received.

SIPP operators who take charges based on a percentage of those funds are predominantly life offices or investment managers who are likely to be under alternative capital adequacy regimes.

Anomaly 9 – Capital Requirement will be lower at times where there is a higher risk of consumer harm

Financial pressure may cause a SIPP operator to exit the market. This financial pressure may be as a result of external economic forces, such as the current credit crisis which could result in a SIPP operator's line of credit with a bank being withdrawn.

This could coincide with low market values (depressed equity markets, property voids, etc) which would lead to a reduction in the capital requirement just when the risk of exit is at its highest.

Practical Issues

We list below some key practical issues with the formula for the Initial Capital Requirement:

Practical Issue 1 – The simple formula may not be so simple to verify

The value of an asset (most notably Non-Standard Assets) may be subjective. Presumably SIPP operators will need to report Assets Under Administration to the FSA, but in order for the FSA to be confident that the ICR has been calculated correctly, the FSA would need to verify the data submitted.

¹ Money Management SIPP survey of Oct 2012 shows that of the 58 providers covered offering 85 SIPP products, only 10 providers charge fees based on a percentage basis of which four providers have a monetary cap and/or collar. Of the six providers charging on a percentage basis only, four are life companies and two are investment platforms.

This would rely on the integrity of the SIPP operator, unless hundreds or thousands of valuations of Non-Standard Assets are checked. We understand that one driver for a move away from the expenditure-based model is, as mentioned in paragraph 2.12 of CP 12/33, to avoid SIPP operators incurring significant extra compliance costs where no measurable benefit is also provided and also to reduce regulatory arbitrage and the cost of manual supervision. A move to Assets Under Administration will require more onerous supervision.

Practical Issue 2 – Selecting the valuation date for Assets Under Administration

If valuations have to be valid as at 31 December each year, there will be a bottle-neck of valuation requests for Non-Standard Assets during a congested time of the year. The requirement for 31 December valuations will also result in a direct increased cost to the client.

It would be more cost efficient to be able to choose a valuation within twelve months of 31 December.

Practical Issue 3 – Additional cost of valuations

Even if valuations for calculating Assets Under Administration are aligned with each SIPP plan's anniversary date (i.e. to be consistent with the SMPI data) there could still be an increase in costs for consumers.

Many consumers accept historic valuations for their annual statements if these are considered still valid by the member. For example, a SIPP member who runs their business from property owned by the SIPP may have a good idea of the value of the property without needing a valuer to value the property. HMRC rules do not require a valuation other than to justify certain key calculations such as setting retirement benefits and reviewing drawdown pension limits. With an AUA-based model, the SIPP operator is likely to insist in more frequent valuations, leading to a cost for the consumer.

This is against the continuing background of pension charges being criticised by Government.

Practical Issue 4 – Monitoring assets held within portfolios

It could be difficult for a SIPP operator to determine the percentage of plans with Non-Standard Assets where assets may be traded without the intervention of the SIPP operator. This may be the case for Discretionary Fund Managers.

For example, a SIPP operator may have hundreds of clients managed by the same DFM who may decide that every client of theirs should have a small exposure to a geared property fund. To follow TCF principles, the DFM switches purchases a small holding in each of the SIPP portfolios. This could materially increase the percentage of Non-Standard Assets which the SIPP operator will not be able to plan for, or may not even reconcile for some time after the event. It will also require closer inspection of underlying portfolios, which will increase costs.

Practical Issue 5 – Multiple regulated entities

We are aware that many SIPP operators have an unregulated trustee company that can only act on instructions of the regulated SIPP operator. There are other SIPP operators, however, who use a regulated trustee company. The legal structure of the SIPP business should not cause a "doubling-up" of the capital requirement.

SIPP operators could alter their business structure, but this will not always be possible particularly within the one-year implementation time frame that you have proposed.

Q2. Do you agree that non-standard asset types can significantly increase the costs a SIPP operator would incur in a wind-down scenario (including meeting overheads as this process is completed)?

Yes, to a limited extent. We do not agree that the cost of winding up a SIPP operator with 100% Non-Standard Assets will typically be six times the cost had there been only Standard Assets, particularly given that ongoing fees will ordinarily be collected from the SIPPs even during the wind-down period.

A key wind-down cost is in reconciling data records and as such introducing measures to ensure that SIPP operators have high standards of systems and controls, and allowing the industry to agree consistent data standards to facilitate record transfers may lead to more significant improvements in consumer outcomes than applying a financial test.

We also wish to debate how the costs are split between the SIPP operator, the consumer and the FSCS.

We also note that many investments that are Non-Standard Assets would not, in fact, be problematic to transfer.

Rationale

The presence of some Non-Standard Asset types can reduce the number of potential suitors for a SIPP operator wishing to exit, impact on collection of fees and delay the time taken to transfer or sell assets to conclude a wind-down.

As such, we accept that the presence of Non-Standard Assets will increase the time required for an orderly exit and could – but might not - increase the costs.

The impact depends on whether the exit is voluntary or compulsory.

Voluntary Exits

Given the expectation of continuing fees, where a SIPP operator chooses to exit the market, we do not expect the extended time required to complete this process to increase costs where the exit simply requires a sale of the business. Even if there are some negotiations and structural changes required (such as carving out pieces of the business for sale to different parties), the ongoing fees should be sufficient to maintain service standards.

This is evidenced by a number of SIPP operators who have publically declared an intent to exit the market and have then continued in operation for months or even years thereafter with no adverse effects. Recent examples include:

Pointon York – was publically put up for sale² in September 2011 and eventually sold part of its business in November 2012 to Suffolk Life³.

² <http://www.moneymarketing.co.uk/pensions/sipps/pointon-york-put-up-for-sale/1037699.article>

Hornbuckle Mitchell – was publically put up for sale in July 2011 but remains in operation⁴.

If a replacement SIPP operator can be found, then the transfer of ownership can usually be concluded within six months (or within three months if there are time pressures involved) and the presence or otherwise of Non-Standard Assets has no bearing on this. This is confirmed by Rupert Curtis of Curtis Banks who recently purchased other SIPP books and attended the Bristol Round Table hosted by AMPS on 8 January 2013.

Compulsory Exits

Having met with the FSA to discuss the proposals, we understand that a key concern is that a replacement SIPP operator may not be found when a SIPP operator is forced to exit the market. This may be due to uncertainty over future HMRC tax charges or the cost involved in sorting out member records. This happened in the case of The Freedom SIPP Limited, though we believe that this case is unusual and should not be used as a template for a usual SIPP wind-down.

Most Non-Standard Assets will be acceptable to a replacement SIPP operator, unless there is uncertainty over HMRC tax treatment. Most SIPP operators, even if relatively new to regulation, will be experienced in dealing with what are allowable pension investments even given the change to the rules in 2006. HMRC should also take a pragmatic approach to raising tax charges against a replacement SIPP operator that is resolving issues.

Nevertheless, in a wind-down situation our view is that the SIPP members will continue to be responsible for normal ongoing SIPP fees. These are due even where there is insufficient cash within the member's SIPP to settle the fees (see later). We expect members will be given a fixed time period to select an alternative pension vehicle (to receive a cash or in-specie transfer) following which there will be a bulk transfer. This seems to be the case for The Freedom SIPP Limited⁵.

Given that the member may have been expecting to stay within the same SIPP plan for the duration of their policy, it may be seen unfair for the consumer to pay to transfer away (cost of advice, set up fee for new arrangement and transfer in/out fees).

Our view is that on the failure of a SIPP operator, these ancillary costs are due to the member but the member would be able to seek compensation from the FSCS. The SIPP operator contributes to the FSCS and so consumers should be able to seek compensation where there has been a failure of that regulated firm.

Whilst the FSA may wish to curb compensation payments from the FSCS, it should be noted that the population of consumers at risk is small and that the claims are also likely to be small

³ <http://www.moneymarketing.co.uk/pensions/suffolk-life-acquires-pointon-york-sipp/1062066.article>

⁴ <http://citywire.co.uk/new-model-adviser/hornbuckle-mitchell-up-for-sale/a511241>

⁵ <http://www.fsa.gov.uk/consumerinformation/firmnews/2010/thefreedomsipp.shtml>

(certainly less than £10,000 per member). It is unacceptable for both consumers and SIPP operators that SIPP operators have to contribute towards the FSCS but there is no agreed position from the FSCS as to when consumers may be able to make a claim.

As noted earlier, SIPP operators covered by CP12/33 generally invoice fees for running a SIPP rather than deducting a percentage of funds under management. The invoiced fees are ordinarily collected from a plan member's SIPP but, where this is not possible due to insufficient cash, the SIPP operator would⁶ either:

- a) collect fees once a known payment, such as a contribution or investment income, has been credited to the SIPP plan; or
- b) arrange for a disinvestment within the SIPP plan; or
- c) request that the plan member settles the fees personally.

A review of SIPP operator's terms and conditions on the internet confirms this to be a standard approach. Any third party appointed to manage the wind-down of the SIPP should have the right to collect fees that are properly due under the terms and conditions of the SIPP (or if not, SIPP operators should amend their terms and conditions to allow this).

We understand that collecting fees from members personally could be a lengthy process and therefore there is an argument for the SIPP operator holding reserves to account for this. Our view is that this will only require a small reserve and it is not correct to base the capital requirement calculations on the assumption that a SIPP operator will not be able to recover any fees from any clients with any proportion of Non-Standard Assets.

We note that an international "top four" accountancy firm was appointed as liquidators of The Freedom SIPP Limited⁷.

We consider that the wind-down could potentially have been dealt with on a more cost effective basis. We also believe that earlier intervention in that case could have dramatically improved consumer outcomes.

Accordingly, for the reasons mentioned above, if a SIPP operator is properly regulated and supervised then we genuinely consider that the existence of Non-Standard Assets will have a limited impact on the costs a SIPP operator would incur in a wind-down scenario and it would certainly not be six times the cost had there been no Non-Standard Assets in the SIPP.

⁶ 21 out of 22 SIPP operators who responded said that their terms and conditions allowed disinvestment of assets to settle fees, and 21 out of 22 also said that their terms and conditions allowed settlement of fees by the member personally.⁷

<http://www.fsa.gov.uk/consumerinformation/firmnews/2010/thefreedomsipp.shtml>

⁷ <http://www.fsa.gov.uk/consumerinformation/firmnews/2010/thefreedomsipp.shtml>

Q3. Do you believe that it is necessary to raise the fixed minimum capital requirement and, if so, do you feel that £20k is appropriate?

Yes the fixed minimum capital requirement should be raised.

We feel that the minimum could be increased beyond £20,000 to £50,000⁸.

Rationale

The FSA stated in a meeting with AMPS on 8 November 2012, following publication of the second thematic review coded GC12/12, that there was concern about the low barrier to entry to the SIPP industry. AMPS share this concern and therefore support an increase to the financial barrier, albeit in a measured way that will not result in the market closing to new entrants.

We support an increase in the fixed minimum capital requirement to more than £20,000. A survey of our members indicated that they would accept an increase to £50,000.

We also support improvement to other barriers to entry, such as a more thorough “fit and proper” requirement policed by the regulator during the authorisation application process including more of a focus on the nature and resilience of the systems and controls used by new SIPP operators. We consider this to be fundamental in reducing the potential for future consumer harm by new entrants who may be well capitalised given the expectation of future investment sales.

⁸ 23 out of 23 SIPP operators responding to our survey supported an increase to £50,000.

Q4. Do you agree with the capital surcharge as a concept and/ or feel that it is an appropriate component of the capital requirement? If not, how else would you ensure that SIPP operators hold sufficient capital to wind-down a SIPP book containing non-standard asset types?

We understand the capital surcharge concept, but as noted earlier our view is that its level is too high given the expectation of continuing fee income, and economies of scale should not apply to administering Non-Standard Assets. As such we do not support the proposed formula but have an alternative for consideration (see our response to Q5).

Rationale

The justification for the capital surcharge is that illiquid assets will naturally take longer to transfer or sell and so it will take much longer to wind-down a SIPP that has Non-Standard Assets.

This rationale is flawed as the SIPP will ordinarily be able to continue to be funded by usual ongoing fees, the cost of transferring assets would be met under the usual terms and conditions and – other than in extreme circumstances – would not need to be sold.

We suspect that there may be a concern over a small number of SIPP operators who have large groups of consumers invested in the same Non-Standard Asset. This concentration may concern the SIPP operator if the investment is deemed by HMRC to create tax charges or if there is class action, whether justified or not. However the Capital Surcharge doesn't adequately address the concentration of risk and unfairly penalises liquid SIPPs that have some illiquid assets.

If there is a key concern, the FSA should work with those specific SIPP operators that pose a risk to help the underlying consumers reach a solution that does not involve them being abandoned should the SIPP operator exit before the increased Capital Requirements come into force.

Q5. Do you have any comments on this approach, or evidence to support an alternative approach?

Yes.

As noted above, we have concerns regarding the use of Assets Under Administration as a robust method for determining ongoing capital requirements and consider that the structure of the capital surcharge delivers capital requirements far in excess of those required to protect consumers.

This excess increases costs for consumers and so needs to be readdressed. Increasing the amount of capital required does not automatically result in reduced consumer harm. It is better to have a proportionate level of capital requirement coupled with measures to decrease chance of consumer harm.

The proposed approach could also lead to some undesired consequences, such as SIPP operators offering cheap cash-only SIPPs to reduce their percentage of SIPPs with Non-Standard Assets or disallowing investment in term deposits that could only justify low fees but would increase the Capital Requirement.

We therefore present two alternative models for the initial capital requirement, and a revised capital surcharge based on the number of illiquid SIPPs. We also support a minimum fixed capital requirement of £50,000 and an additional capital requirement of 20% of the initial capital requirement for those firms who do not meet an objective systems and controls test.

The alternatives are described in the following pages, but summarised here:

Model 1

$$ICR_1 = 25\% \times (\text{the greater of annual Turnover and annual Expenditure})$$

$$CS_1 = 1000 \times (\text{Number of Illiquid SIPPs})$$

Model 2

$$ICR_2 = 10000 \times \sqrt{(\text{Number of SIPPs})}$$

$$CS_2 = 1000 \times (\text{Number of Illiquid SIPPs})$$

In each case, an Illiquid SIPP is defined as a SIPP that contains less than £1,000 in Standard Assets.

The models have been calibrated sensibly, but could be adjusted e.g. if £1,000 was considered too low to define an Illiquid SIPP, or if the factor of 1000 was considered too low capital surcharge for an illiquid SIPP.

The result of each alternative is expected to be lower than the calculation under the CP12/33 proposals, but we believe this is justified as:

1. During the wind-down process, consumers continue to be responsible for settling normal SIPP fees as set out in the terms and conditions;
2. There will be many Non-Standard Assets that are not difficult to transfer and so would not cause significant additional costs or time delays to wind-down a SIPP;
3. There is an increased Minimum Fixed Capital Requirement

We also consider that consumers would be better protected if each SIPP operators had a plan for wind-down of its SIPP in place and that this is more important than increasing capital requirement.

Alternative Model 1 for Initial Capital Requirement

$ICR_1 = 25\% \times (\text{the greater of annual Turnover and annual Expenditure})$

Rationale

CP12/33 notes two significant weaknesses of the current prudential framework. The first weakness was that the level of operator's expenditure is not necessarily aligned to the size and nature of the assets they administer. This is expanded upon in paragraph 2.3 of CP12/33 where the key concern seems to be that some SIPP operators have a large number of underlying schemes and substantial Assets Under Administration, but have expenditure booked in the regulated entity that is lower than the actual cost of running the regulated business. This process is described as regulatory arbitrage.

A move to using number of underlying schemes or Assets Under Administration would normalise this situation, but is not as logical as using the true actual cost of running the regulated business.

In a wind-down scenario, it may either be the incumbent SIPP operator or a third party that performs the administration. In either situation, our view is that it is more likely that the expenditure of the incumbent SIPP operator is a better indicator of running costs during a wind-down than a formula that uses Assets Under Administration and applies a crude formula to accommodate economies of scale.

Before moving away from an expenditure-based model, we would like further evidence presented that the incumbent SIPP operator's actual costs are not the best foundation for assessing at least the Initial Capital Requirement.

If it is found that the actual costs are a better base for the capital requirement, then we believe that there are proxies for actual costs that could be used as an alternative to expenditure to stop regulatory arbitrage.

Specifically, turnover would have to be channelled through the regulated entity and turnover should ordinarily be higher than actual costs for the business to be profitable. We therefore propose turnover as a better proxy for actual costs than expenditure, but introduce a minimum expenditure-based test too to protect the consumer against times when turnover is low (turnover could be related to retained bank interest which could in turn be variable).

We note that some companies may have other business activities contributing towards the turnover of the regulated entity – e.g. a SIPP Operator may also be running SSAs. We would leave this to each individual firm to decide whether to adjust their business model. Using “SIPP-only” turnover could potentially lead to regulatory arbitrage.

A model that uses data that can be extracted from audited accounts can be easily verified by the FSA and so is easier to check that a model that uses Assets Under Administration (which will require underlying asset valuation information to be checked).

Alternative Model 2 for Initial Capital Requirement

$$ICR_2 = 10000 \times \sqrt{(\text{Number of SIPPs})}$$

Rationale

We note that the proposals within CP12/33 are an explicit move away from an expenditure-based regime and therefore present an alternative model that does not use expenditure or a close proxy for expenditure.

We noted in Q1 that there are many anomalies with using Assets Under Administration as a base for calculating the capital requirement. A common theme coming out of the consultation that we held with SIPP operators was that a more appropriate measure would be number of SIPPs being managed by the SIPP operator. It is acknowledged in paragraph 2.3 of CP12/33 that part of the problem of the existing framework is that some operators with a large number of underlying schemes have low expenditure. Using the number of SIPPs is in our view better than using Assets Under Administration and would seem to address your concerns directly.

Our second model therefore uses number of SIPPs rather than Assets Under Administration for calculating the Initial Capital Requirement. Applying the same logic as presented in CP12/33, using square root of the number of SIPPs allows economies of scale to be taken into account. Whilst there will still be concerns about the formula favouring larger SIPP operators, using SIPP numbers rather than Assets Under Administration reduces this bias.

The Initial Capital Requirement will need to be calibrated correctly. One way of looking at the calibration is to express the ICR per SIPP, as noted in the following table:

	ICR₂	per SIPP
100 SIPPs	£100k	£1,000
400 SIPPs	£200k	£500
1600 SIPPs	£400k	£250
2500 SIPPs	£500k	£200
4444 SIPPs	£666k	£150
10000 SIPPs	£1,000k	£100
40000 SIPPs	£2,000k	£50

At our workshops, various SIPP operators offered a range of likely operation costs ranging from £200 to £500 (though we did not have many larger SIPP operators offer an opinion on this subject).

An alternative way of viewing the calibration is that for a SIPP operator of any size but with an average SIPP fund value of £250,000, ICR_2 will be the same as ICR in the CP12/33 proposals.

i.e.

$$\begin{aligned} ICR &= 20 \times \sqrt{AUA} \\ &= 20 \times \sqrt{\text{Number of SIPPs} \times 250000} \\ &= 20 \times \sqrt{250000} \times \sqrt{\text{Number of SIPPs}} \\ &= 20 \times 500 \times \sqrt{\text{Number of SIPPs}} \\ &= 10000 \times \sqrt{\text{Number of SIPPs}} \\ &= ICR_2 \end{aligned}$$

A model based on SIPP numbers will reduce regulatory arbitrage and the cost of manual supervision as SIPP numbers are easily quantifiable and could be sense checked against existing 'Gabriel' new business data submitted to the FSA or Gabriel submissions adapted to capture the total number of SIPPs being administered.

Capital Surcharge

$$CS_1 = 1000 \times (\text{Number of Illiquid SIPPs})$$

$$CS_2 = 1000 \times (\text{Number of Illiquid SIPPs})$$

The second weakness of the current framework noted in CP12/33 is that it does not reflect that some asset types are significantly more difficult and costly to transfer during a wind-down scenario than others.

Requiring SIPP operators to hold significantly more Financial Resources just in case the SIPP needs to wind-down is inefficient and will result in an unnecessary cost for the majority of SIPP consumers who will not be faced with a SIPP that needs to wind-down (in fact, more consumers will be at risk of being in a SIPP that is to be wound-down if the new capital requirements are not balanced).

Our view therefore is that a balanced approach would be for SIPP Operators to have to hold additional Financial Resources for every underlying SIPP plan that has low liquidity and so the member is less likely to be able to meet costs.

SIPPs that are unable to pay their fees will create the greatest difficulty for a SIPP operator or incoming third party tasked with winding down the SIPP. The presence of an easily transferrable commercial property or locked-in term deposit should not create difficulties provided that ongoing administration fees can continue to be collected.

We therefore suggest that it is "illiquid SIPPs" that create additional costs to the SIPP Operator rather than Non-Standard Asset SIPPs.

We do not agree that economies of scale ordinarily apply in this instance (they would only apply where there is a concentration of investments in the same fund, but allowing for this would create additional complexity).

As such, our version of the Capital Surcharge is based on a fixed additional amount per SIPP that has less than £1,000 in Standard Assets, i.e. assets that could be easily realised in order to meet fees.

Additional capital requirement

We propose that the Capital Requirement is increased by an additional 20% with that additional amount placed in an escrow account for SIPP operators that do not meet certain standards for systems and controls. The FSA identified concern in this area as part of the second thematic review and follow-up workshops, and our members support an increased capital requirement based on systems and controls⁹.

The challenge is for the test to be easy for the FSA to introduce, efficient to monitor and objective to apply. We suggest that in conjunction with the FSA's current regulatory framework, SIPP providers are assessed by other internationally recognised quality standards. Business management systems certified against ISO 9001:2008 and ISO 27001:2005 provide third party assurance to clients and the regulator of senior management commitment to:

- demonstrable ability to consistently provide products and services that not only meet consumer but also applicable regulatory and statutory requirements;
- develop procedures to enhance customer satisfaction and generate continual improvement;
- provide a secure environment to preserve the Confidentiality, Integrity and Availability of information (Information security);
- have a risk management based decision making process;
- place tighter controls on supply chains;
- have comprehensive Business Continuity and Disaster Recovery plans;
- hire and develop staff with the appropriate competencies for the work they are expected to perform; and
- have a series of control mechanisms such as Management Reviews, KPI's, Complaint handling, Corrective and Preventive action procedures, Internal Auditing which enable senior management to understand the effectiveness of the policies and strategies set for the company.

Whilst SIPP operators have to be properly run in order to be granted and maintain the necessary permissions, it is clear from the second thematic review GC12/12 that the FSA had insufficient resources to conduct thorough testing prior to granting permissions in 2007. Adopting existing standards would provide an objective framework that would give SIPP

⁹ 22 out of 23 SIPP operators responding to our online supported a 20% higher capital requirement applicable until a firm met a Systems & Controls standard

operators the economic motivation to demonstrating that their systems and controls are well-run.

Our suggestion is that the 20% additional requirement would be effective three years after the new rules come into force. The additional requirement would be held in an escrow account at the order of the FSA. This gives assurance to consumers that SIPP operators who do not meet an independently verified standard for systems and controls would have to hold an additional amount of Financial Resources in a ring-fenced account.

Comparison with CP12/33 proposals

The use of Assets Under Administration appears to be a simple formula that is easy to verify but actually has many issues for the FSA, SIPP operators and consumers including the subjectivity of valuations, additional cost of obtaining valuations and unexpected consequences that could impact on consumer harm.

By comparison, our alternatives are both easy to verify, don't have the practical issues and remove all or most of the unintended consequences.

The impact of having a Capital Surcharge at the level proposed by the FSA to vastly inflate the capital requirement for well-run SIPP operators that have a high percentage of Non-Standard Assets simply as UK-based commercial property is not deemed to be a Standard Asset will only lead to consumer detriment by way of increased costs without any expectation of benefit.

Our Capital Surcharge better targets the likely problem issues.

Q6: Do you think that this list covers all of those asset types that would not incur additional costs should they need to be transferred to another provider? Do you think there are any other asset types that should be included in this list? And, if so, why?

No – there appear to be some omissions from the list and we also contest whether the additional costs should be fully attributable to the SIPP operator.

We draw your attention to the following potential assets that ordinarily meet the criteria to be a Standard Asset (accurate and fair values, readily realisable within 30 days, and reconcilable):

- Investment-grade gold bullion
- National Savings & Investments products
- Assets held through an FSA-authorised firm (see below for detailed explanation)

We have also been asked to seek confirmation that Exchange traded funds (as opposed to exchange traded commodities) and Trustee Investment Plans are treated as Standard Assets.

We are also concerned about the impact of popular investment options such term deposits and UK-based Commercial Property not being treated as Standard Assets.

Rationale

Investment-grade gold bullion

Gold meets the criteria for being a Standard Asset. Investment-grade gold bullion does not create tax charges if held in a SIPP.

National Savings & Investment products

These also meet the criteria for being a Standard Asset and do not create tax charges if held in a SIPP.

Assets held through an FSA-authorised firm

As you will be aware, many SIPP operators allow the member to choose an authorised firm such as a Discretionary Fund Manager (DFM) to look after their investments. The SIPP operator would need to agree to use of a particular DFM, but once the account has been set up the DFM would be free to manage the underlying assets.

These DFM portfolios are portable in the sense that in the event of a transfer, the portfolio can be re-registered into the name of the new SIPP operator. The DFM will be able to provide reconciled valuations. The portfolio may meet the criteria for a Standard Asset but may include some less liquid holdings but this should not be seen as a barrier for transferring to another SIPP operator or cause an increase in the cost of transferring the portfolio.

We therefore suggest that such portfolios and similarly transferrable portfolios are included in the list of Standard Assets.

Term Deposits

We believe there could be consumer confusion to label term deposits as Non-Standard Assets and the impact on consumers if such accounts were disallowed by SIPP operators wanting to control their Capital Requirement calculation.

Whilst it is accepted that term deposits are usually locked in, they are ultimately transferrable and cause no concern for replacement SIPP operators.

The SIPP current bank account may not be the most favourable place to hold cash long term as its primary purpose is to act as a transactional account and hence term deposits are often utilised as an alternative. It would be to the detriment of consumers if SIPP operators disallow (or drastically increase the cost of) use of term deposits in order to help control their Capital Requirement.

Commercial Property

Directly-held UK-based commercial property is a common investment within SIPP wrappers and ordinarily can be transferred between SIPP operators with little difficulty and is seen as an attractive asset for a SIPP operator to manage.

Commercial property transactions are dealt with on a regular basis and would very much be construed as being standard investments by the SIPP industry and (after a suitable level of due diligence and a proper conveyance) are ordinarily transferrable. Though the SIPP may need to be administered for longer these costs would be attributable to the SIPP member as usual.

We understand the reasoning behind leaving out commercial property – it takes many forms and even straightforward property can be difficult to transfer if there is lending – but we do not believe that the total capital requirement targets the appropriate outcome if such common asset types are treated as Non-Standard.

Some small property syndicates, wrapped up in a company structure, would be easy to transfer regardless of borrowing.

Clarification

We also seek clarification as to the operation of the list in relation to a particular investment falling within an asset class.

We are unclear as to whether it is sufficient that an investment belongs to a Standard Asset class for it to be deemed a Standard Asset, or whether it must also satisfy the Standard Asset criteria and be on the list.

For example, an insured property fund may be readily tradable and its value reconciled with previous valuations. The insurance company may then suspend trading in that fund due to liquidity concerns. Would that fund move from being a Standard Asset to being a Non-Standard Asset? We suggest that it does not and that the criteria is amended to say that “Standard Assets must ordinarily be capable of being accurately and fairly valued on an ongoing basis ...” to deal with this issue.

On the other hand, if there is an investment that meets the criteria but is not on the list, would it be treated as a Standard Asset in any event or would it be deemed a Non-Standard Asset by virtue of being omitted from the Standard Asset list? An example would be investment-grade gold bullion that we highlighted above as being an obvious omission. We suggest that the asset has to be on the list to count as a Standard Asset (and that the list could be updated if need be in future to deal with noted omissions).

Q7: Do the timescales set out above appropriately reflect the time needed to access capital in a wind-down scenario?

We are unclear as to the logic behind the rule that proceeds of capital must be realisable within one year for a firm that holds only Standard Assets within its SIPP wrapper (and so may be expected to wind-down in a short-time frame) whereas a firm that holds Non-Standard Assets must have the Capital Surcharge element more readily-available.

If the concern is ultimately liquidity of a SIPP plan to meet running costs, then the test should be on whether a SIPP is illiquid or not, rather than whether it holds Non-Standard Assets or not.

For example, a SIPP may hold 50% of its assets in structured products that have a three-year lock in. But the SIPP will be able to meet its running costs out of the remaining 50% that is held in cash.

Q8: Would this rule change incur significant costs to your business? If so, please explain/quantify these costs. This question is only applicable to operators.

We note the Cost Benefit Analysis and suggest that the FSA conduct more thorough research in relation to the Compliance Costs, Weighted Average Cost of Capital and likely increase in Financial Resources before proceeding with such radical changes.

Anecdotally, we understand that SIPP operators expect that the Compliance Costs will be far higher than £3,750 as a one-off cost.

We also understand that the Weighted Average Cost of Capital is likely to be higher. CP06/3 used research conducted in 2004 applicable to investment firms and so is outdated and references a sector that we do not believe is applicable to the majority of SIPP operators. Our consultation with a banking expert agreed with this conclusion.

The Cost Benefit Analysis also does not take account of the cost involved in adjusting business models, noted as one of three options that a SIPP operator may take as a result of the changes. Adjusting a business model may require amendments to trust documentation, updated terms and conditions, new supporting literature, revised processes and staff training – all of which have not insignificant costs attached to them.

We also note that no allowance has been made for Systems updates. By creating a Standard Asset list that is not already in operation, systems will need to be updated to produce the P% required in the Capital Surcharge. This may be a valid cost of introducing a new capital adequacy regime but it should not be ignored.

Q9: Do you agree that not all of the existing components of Liquid Capital are relevant to SIPP operators and that Own Funds is a more appropriate form of financial resources?

We agree that not all of the existing components of Liquid Capital are relevant to SIPP operators but the corollary is not necessarily that Own Funds is a more appropriate form of financial resources.

Rationale

The Tier 3 elements of Financial Resources comprise:

- Net trading book profits
- Short-term Qualifying Subordinated Loans and excess Tier 2 capital
- Illiquid assets
- Qualifying Property

These components are hard to apply to SIPP operators and we would support an amendment to Tier 3 components. The current components (and definitions) seem more relevant to investment managers than SIPP operators.

We would be concerned if there is a blanket removal of Tier 3 without consideration of whether there are SIPP operators that hold Qualifying Property as part of their financial resources. Whilst property takes longer to liquidate if access to capital is required, it does at least stop errant business owners from withdrawing the financial resources at short notice (if for example they realise that their firm is on the point of collapse). There is therefore some additional protection for consumers in having some percentage of the financial resources that are harder to access.

We are aware that some SIPP operators¹⁰ hold Qualifying Property and so a suitable transitional period to allow those SIPP operators to refinance will be needed Qualifying Property can no longer count towards Financial Resources.

¹⁰ 2 out 23 responding to our online survey said that they used Qualifying Property

Q10: Do you believe that a transitional period of one year is appropriate?

No. A transitional period of three years with staged implementation of any increase in a firm's Capital Requirement would be more appropriate and in our view would reduce the number of consumers likely to be caused harm by a number of SIPP operators choosing to exit the market at the same time.

Rationale

The Consultation Paper states that there is an expectation that 14% - 18% (equivalent to around a dozen) SIPP operators will exit the market as a result of the proposals. It is currently difficult to obtain finance and so we consider that this number will be higher if there is a one year transitional period. Introducing a staged three year period would help manage the move to the increased requirements in a measured way that would not force otherwise well-run SIPP operators to exit. We do not understand how a more rushed approach could be consistent with the Financial Conduct Authority's objective of promoting competition.

Furthermore, a one year transitional period compresses the exits into a small timeframe which has the adverse effect of increasing supply of businesses for sale just when demand is low as SIPP operators will be directing "spare" capital towards meeting their own increased requirements. Spreading the transition over a longer time period will both allow more SIPP operators to remain in the market, presumably with adequate capital at the end, and increase the number of SIPP operators who can look after consumers who have to move SIPP operators given the forced exits.

Given that the FSA's view (which we cannot corroborate as we have not been privy to the information) is that there are a number of SIPP operators at risk of exiting with insufficient capital, there is clearly motivation that the situation is addressed without delay.

Our proposal to stage the implementation addresses this. We propose that a firm must go a third of the way towards meeting the increased requirement by the end of one year, two-thirds of the way by the end of year two and meet the full requirement by the end of year three.

Q11: In your opinion, would this proposal lead to a significant reduction in the level of competition within the SIPP sector?

Yes. We know that there will be a reduction as we are already aware of firms that are planning to exit the market if the current proposals are implemented. There are also reports that the number of SIPP operators will fall to 40 by 2015.

Furthermore, the application of the formula means that the cost of taking on new business for a smaller SIPP operator can be damagingly more than for a larger SIPP operator, leading to a trend towards new business being directed towards larger SIPP operators who face much lower regulatory costs per SIPP.

Given our concerns, we have referred your proposals to:

- The Smaller Businesses Practitioner Panel (www.sbpp.org.uk)
- The Office of Fair Trading (www.oft.gov.uk)
- The Competition Commission (www.competition-commission.org.uk)

Copies of our e-mail referrals are contained in Appendix 1.

Rationale

We have serious concerns in this regard. Our association was formed out of the SIPP Provider Group which included in its membership SIPP operators who have run SIPP's professionally and successfully for many years prior to both the mass adoption of the SIPP moniker and regulation by the FSA. These firms, who have not typically put consumers at risk throughout their history, are now seeing the value of their businesses reduce because of the radical overhaul of the capital adequacy regime and in many cases are reluctantly choosing to exit the market. Those that remain will also see it harder to win new business as their regulatory costs will be disproportionately higher than larger firms. As mentioned in respect of Q10 we do not understand how such a result would be consistent with the Financial Conduct Authority's objective of promoting competition.

Market exits

The exit of smaller SIPP operators should in no circumstances be dressed up as a victory for consumers, not least as it is the complete opposite. Well-run firms that find it difficult to raise capital in these current economic climates or who choose to exit as a result regulatory creep will leave a subset of consumers prematurely seeking pension transfers or switched, en masse, to a larger SIPP operator they did not select in the first place.

The justification within CP12/33 for accepting the exit of a dozen SIPP operators seems purely opinion-based, which is not sufficient in our views to validate proposals that could reduce competition, put people out of jobs and leave a material group of consumers looking for a home for their pension.

In paragraph 35 of Annex 1 of CP12/33 the FSA suggest that there will be an adequate number of SIPP operators left for there to be sufficient competition. Suffolk Life, who recently acquired a book of business from Pointon York, are on record as saying that "regulation will cut the number of self-invested personal pension providers from around 160 to fewer than 40 by

2015”¹¹. This is the SIPP market as a whole – the SIPP operators covered by the CP12/33 proposals will be smaller than 40 and those small SIPP operators covered by the proposals smaller still. This restricts consumer choice.

Within CP12/33 there is also a belief that “operators who cannot raise capital to meet these new requirements will increase the risk of harm to consumers if they leave the market” and so by “dealing with this problem now as opposed to allowing the risk to increase, we believe that costs to the FSA and consumers are ultimately reduced.” [see Paragraph 13 of Annex 1 of CP12/33]. In fact, what the proposals would do is create the problem they purport to solve.

Using an increase in capital requirements as a mechanism for advancing the exit of firms that the FSA consider place consumers at risk is an ill-conceived strategy. It penalises well-run firms and gives no additional incentive for well-run firms to use capital to improve consumer outcomes by investing in systems and controls, which was a key desire of the thematic review issued in 2012.

The sensible strategy would be to engage with those firms that the FSA has evidence are putting consumers at risk and to introduce a balanced capital requirement for all firms that can be achieved in good time and in good order.

Implementing the proposals within one year would create a disorderly exit of firms, all wanting to exit at the same time and not finding a large number of buyers. Introducing balanced measures over a sensible timeframe would create an orderly increase in consumer protection.

Furthermore, the proposed formula creates a very high entry to market for any new SIPP operator unless they wish to purchase an existing SIPP operator. If a new SIPP operator, specialising in SIPP commercial property transactions, expects to gain 100 SIPPs in its first year with an average fund value of £300,000, the capital requirement at the end of the year would be £660,000:

	Q1 2014	Q1 2015
Assets Under Administration	Nil	£30m
%Non-Standard Assets	0%	100%
Initial Capital Requirement	-	£110k
Capital Surcharge	-	£550k
Total Capital Requirement	£20k	£660k

¹¹ <http://www.ftadviser.com/2013/02/05/pensions/sipps/sipp-market-bloodbath-predicted-following-fsa-intervention-qmdNzuPSti2LiPKRErog5K/article.html>

Cost of new business

As noted, the corollary of the FSA's proposals is that it will be much more costly for a smaller SIPP operator to take on a new client than it will be for a larger SIPP operator to do so. This is blatantly anti-competitive.

For example, a small SIPP operator may have 500 customers who hold an average of £200,000 with half of them investing in commercial property. The increase in financial resources that that company would need to hold if accepting one new customer with £200,000 to invest in commercial property would be £700.

Compare this with a large SIPP operator who may have 40,000 customers who hold an average of £150,000 with only a quarter of them investing in commercial property. The increase in financial resources that this larger company would need to hold if accepting one new customer with £200,000 to invest in commercial property would be £58.

If we assume that the larger company has the same average fund value of £200,000 and 50% investing in commercial property, the additional financial resource would still only be £78, as highlighted below.

	Small	Large (1)	Large (2)
Number of SIPPs	500	40,000	40,000
Average SIPP size	£200k	£150k	£200k
Assets Under Administration	£100m	£6,000m	£8,000m
%Non-Standard Assets	50%	25%	50%
Total Capital Requirement	£700,000	£3,485,685	£6,260,990
Number of SIPPs	501	40,001	40,001
Total Capital Requirement	£700,699	£3,485,743	£6,261,068
Increase in Capital Requirement	£699	£58	£78

Given the above, we question whether the proposals are in alignment with the FSA's principles which include minimising adverse effects on competition:

From <http://www.fsa.gov.uk/about/aims/principles>

Competition

The need to minimise the adverse effects on competition that may arise from our activities and the desirability of facilitating competition between the firms we regulate.

These two principles cover avoiding unnecessary regulatory barriers to entry or business expansion. Competition and innovation considerations play a key role in our cost-benefit analysis work. Under the Financial Services and Markets Act, the Treasury, the Office of Fair Trading and the Competition Commission all have a role to play in reviewing the impact of our rules and practices on competition.

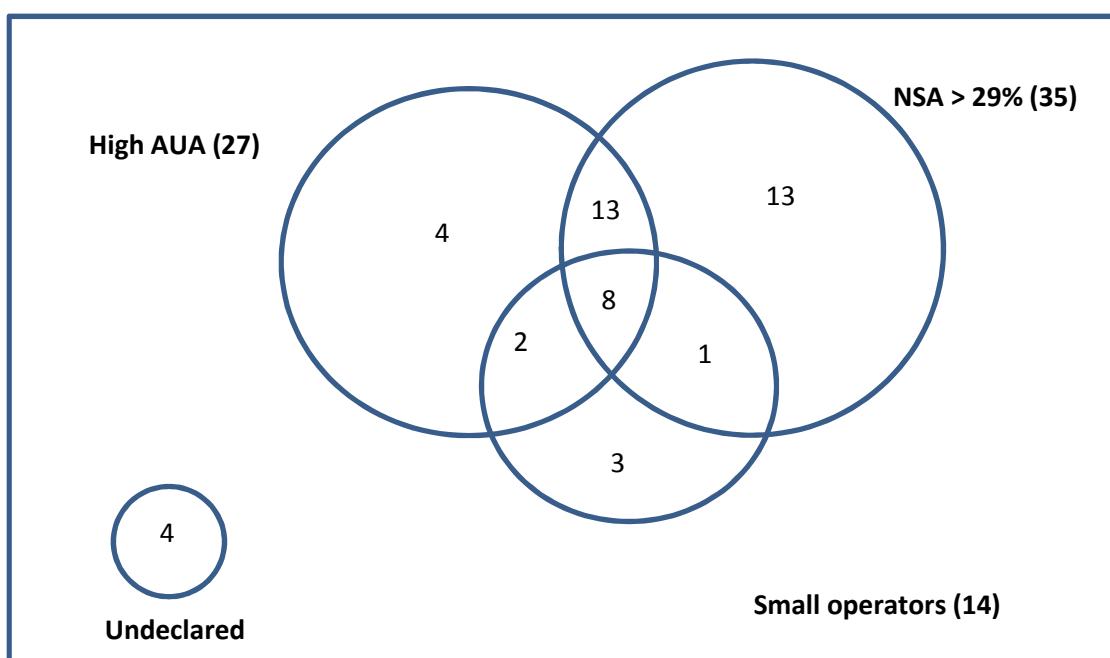
Q12: Can you provide any evidence or data that might further inform our analysis of the likely impact of our proposal?

We had 56 SIPP operators represented at our round tables (see **Annex 1**). Of these, 48 participated in a short survey held at the round table, though not all answered all questions. The key findings are noted below.

Sample

The split of respondents by number of SIPPs, size of Assets Under Administration and percentage of Non-Standard Assets was as follows:

Round Table survey respondents (48)



Current Regime

Most SIPP operators hold at least 13 weeks' expenditure. Out of 48 replies:

31 were under 13 weeks' expenditure rules

11 were under 6 week's expenditure rules

4 were under the 5k fixed minimum capital requirement

2 listed "other"

Margin

91% of respondents held a margin over their required Capital Adequacy, with 83% holding at least 10% more. Out of 48 replies:

4 said they held no margin above regulatory capital requirements

4 said they held a margin of up to 10%

6 said they held a margin of up to 25%

32 said they held a margin of over 25%

2 did not respond

NSA Percentage

The percentages of Non-Standard Assets are arguably far higher than anticipated in CP12/33.

46 SIPP operators provided information on their NSA percentage the round tables. The average percentage NSA was 40.8%, with the median being 40%. 21 out of the 46 had percentages higher than 40%.

46 SIPP operators provided information on their NSA percentage for the online survey. The average percentage NSA was 44.6%, with the median being 43%. 13 out of the 23 had percentages higher than 40%.

The distribution was as follows:

NSA %age	Round Table	Online
0 – 5%	2	
6% - 10%	1	
11% - 15%	1	
16% - 20%	3	
21% - 25%	2	2
26% - 30%	5	3
31% - 35%	4	2
36% - 40%	7	4
41% - 45%	4	3
46% - 50%	10	5
51% - 55%	1	1
56% - 60%	1	1
61% - 65%	1	
66% - 70%		
71% - 75%		
76% - 80%	1	
81% - 85%	2	2
86% - 90%	1	
91% - 95%		
96 %- 100%		
Undeclared	2	
Median	40%	43%
Average	41%	45%

We conducted some further analysis online by asking what percentage of plans had directly-held UK-based commercial property (but no other Non-Standard Assets). Four of the 23 SIPP operators only had this type of property as Non-Standard Assets in their plans. On average, 64% of plans with Non-Standard Assets only had directly-held UK-based commercial property in them (the media was 77%).

Impact of CP12/33 Proposals

The impact of the CP12/33 proposals is significant for many operators, perhaps not unsurprisingly given the level of NSA percentage and the constant chosen for the capital surcharge. The impact is large regardless of the regime currently in operation.

40 operators provided information on the impact. The median increase to Capital Adequacy under the FSA's proposals is 8 times. The average, excluding four smallest and four largest (i.e. the middle 80% of the sample) is 10 times.

The distribution was as follows:

Cap Ad Increase	Round Table	Those on 13 weeks'
x 2	1	1
x 3	1	1
x 4	3	2
x 5	4	3
x 6	3	2
x 7	3	2
x 8	5	4
x 9	1	1
x 10	5	4
x 15	3	
x 20	6	5
x 30	1	1
x 40		
x 50	1	1
x 60		
x 70		
x 80	1	
x 90		
x 100	1	
x200	1	1
<i>Undeclared</i>	8	4
Median	8	8
Truncated Average	10	9
(average excludes)	8 outliers	6 outliers

Annex 1

Details of AMPS industry consultation

AMPS hosted a series of round table discussions during January as part of its consultation with the SIPP industry.

56 SIPP operators were represented, as noted below.

BRISTOL (11)

8 January 2013

Attivo Financial Services
BW SIPP LLP
Cabot Trustees Ltd
Cardens Pension Trustees Ltd
Central Tax & Trustee Planning LLP
Curtis Banks
European Pensions Management
Gaudi Regulated Services Ltd
JLT Premier Pensions
Morgan Lloyd Services Ltd
The Lifetime SIPP Company Ltd

NOTTINGHAM (13)

22 January 2013

Berkeley Burke SIPP Admin Ltd
Brooklands Pensions
Carey Pensions
David Booler & Co
Greyfriars Asset Management
Heritage Pensions
LV Retirement Solutions
MAB Pensions Ltd
Mattioli Woods
MW Pensions
Talbot Muir
The Pension Partnership
Westerby Trustee Services Ltd

LONDON (19)

15 January 2013

AJ Bell
Alltrust
AWD Chase de Vere
Brown Shipley
Corporate & Professional Pensions
DP Pensions Ltd
Denton Pension Management
IPM SIPP Administration
Killik & Co
London & Colonial
MC Trustees (Pensions) Ltd
MoretoSIPPS
NSS Trustees Limited
Pointon York SIPP Solutions Ltd
PSG SIPP Limited
Rowanmoor Group
SIPP Choice
Suffolk Life
Uptel Ltd

BOLTON (13)

23 January 2013

@SIPP Plc
Acomb Trustees Ltd
Guardian Pension Consultants Ltd
Harsant Pensions
Highgrove Trustees Ltd
Invest Acc Pension Admin Ltd
Liberty SIPP Ltd
Michael J Field Consulting
MW Pensions
Robert Graham Trustees
Taylor Patterson Associates
Wensley Mackay
Yorsipp Ltd

Annex 2

Collecting ongoing fees

We contend that SIPP operators ordinarily invoice fees which are collected from the SIPP but where there are insufficient funds held in the SIPP's cash account to settle the fees, the SIPP operator would have the right to disinvest assets or ask the member to settle the fees personally. Often, the lack of sufficient cash is resolved before either of these actions are taken by receipt of new contributions or investment income into the SIPP.

There may be a concern that a SIPP member is not legally obliged to pay fees to a third party appointed to administer the SIPP if the terms and conditions do not specifically allow this. If as part of this consultation exercise it is agreed that this is critical to funding the wind-down process and so impacts on the Capital Requirement of a SIPP operator, each SIPP operator would review their terms and conditions and adjust accordingly.

We set out extracts from two SIPP operator's documentation illustrating that terms and conditions typically provide that a SIPP member is ultimately responsible for fees that cannot be collected from the SIPP directly. Our online survey noted that 21 out of 22 SIPP operators had terms and conditions that provided for this.

Berkeley Burke

http://www.bbsippadmin.com/appdocs/BBSA_T&C_160312.pdf

20.4 Notwithstanding any minimum balance requirement required under clause 9.3, we reserve the right to require you to maintain a balance in your trustee bank account, of not more than £2,000.00, to ensure that our annual administration charges are met throughout the duration of the term of an investment.

20.5 Where there are insufficient funds within the trustee bank account, we may require you to pay further funds into the trustee bank account or dispose of fund investments or assets to meet the amount(s) due. We are entitled to dispose of scheme assets or investments if the amount remains unpaid after 30 days. Where there remains a shortfall, we may require you to pay us the amount due.

James Hay

<http://www.jameshay.co.uk/DocumentView.aspx?DocumentID=2812&DocumentRef=JHS0003B>

12 Charges

To the extent that any charges due to the Provider, the Trustee or the Scheme Administrator are not paid from the SIPP, you or your estate will be personally liable for the payment of the charges due.

Appendix 1

Copies of correspondence with SBPP, OFT, Competition Commission

1. Letter to Smaller Businesses Practitioner Panel dated 12 February 2013
2. Response from Smaller Businesses Practitioner Panel dated 13 February 2013
3. Letter to Competition Commission dated 12 February 2013
4. Response from Competition Commission dated 14 February 2013
5. Letter to Office of Fair Trading dated 12 February 2013



Andrew Roberts, Association of Member-Directed Pension Schemes,
c/o Barnett Waddingham LLP, Port of Liverpool Building, Pier Head, Liverpool, L3 1BW
Tel: 0151 235 6622 | Email: andrew.roberts@barnett-waddingham.co.uk

12 February 2013

SBPP Secretariat
Financial Services Authority
25 The North Colonnade
Canary Wharf
London, E14 5HS

Dear Sirs

FSA proposals that threaten competition in the SIPP industry

I am the current chairman of the Association of Member-directed Pension Schemes, which is essentially the trade association for SIPP providers.

Background

I am contacting you with reference to Consultation Paper CP12/33 issued by the FSA in November 2012 which details a proposed new regime for calculating capital requirements for bespoke SIPP operators. The consultation period runs until 22 February. More information can be found here: <http://www.fsa.gov.uk/library/policy/cp/2012/12-33.shtml> and the actual Consultation Paper can be found here: <http://www.fsa.gov.uk/static/pubs/cp/cp12-33.pdf>

The proposals disproportionately affect smaller firms operating SIPPs and this is acknowledged by the FSA. Whilst we support a review of capital requirements, we question whether the FSA has the mandate to reduce competition in the market by increasing the financial resources that SIPP operators have to hold to such an extent that many will have to exit.

Market research

I surveyed 48 firms out of the 75 or so covered by the FSA's proposals. The median increase in financial resources was an 8 fold increase, though some firms were 30, 50 even 200 times higher. This means that a typical SIPP operator who holds three months' worth of running costs to ensure the good running of its business will have to hold two years' worth of running costs. This is inefficient and will increase costs for consumers. I cannot think of any other industry where businesses have to hold two years' worth of running costs.

Reduced choice for consumers

According to the FSA's own estimates, their proposals will cause 14% - 18% of these 75 firms (i.e. around a dozen) to exit the market [see Paragraph 32 of Annex 1 of CP12/33]. These are likely to be smaller firms as the financial requirement becomes less onerous the higher the value of your SIPP book. In fact, in their paper the FSA describe the three types of firms that will be faced with the greatest impact [From Paragraph 25 of Annex 1]:

- Operators with low expenditure, but high assets under administration;
- Smaller operators;
- Operators that hold a large percentage of non-standard asset types.

As an Association, we are naturally concerned that a dozen of our member firms could be forced to close their business involuntarily because of a new regulatory regime that favours larger providers. To counter this point, the FSA contend [in Paragraph 13 of Annex 1] that they "believe that operators who cannot raise capital to meet these new requirements will increase the risk of harm to consumers if they leave the market. By dealing with this problem now as opposed to allowing the risk to increase, we believe that costs to the FSA and consumers are ultimately reduced."

This appears to be an opinion-based rather than an evidence-based statement. We are concerned that a well-run small operator that simply is unable to fund the disproportionate increases to its capital requirement should not be forced to leave the market. The correct strategy would be for standards to be improved to above an acceptable level, thereby protecting consumers by reducing the risk of an operator failing its customers. It seems that the bespoke SIPP industry (which looks after approximately 200,000 consumers) is being singled out for draconian treatment whereas other industries with far greater exposure to consumers are left on an expenditure-based regime.

Winning new business will be disproportionately expensive for smaller providers

Furthermore, the corollary of their proposals is that it will be much more costly for a smaller provider to take on a new client than it will be for a larger provider to do so. This is blatantly anti-competitive.

For example, a small provider may have 500 customers who hold an average of £200,000 with half of them investing in commercial property. The increase in financial resources that that company would need to hold if accepting one new customer with £200,000 to invest in commercial property would be £700.

Compare this with a large provider who may have 40,000 customers who hold an average of £150,000 with only a quarter of them investing in commercial property. The increase in financial resources that this larger company would need to hold if accepting one new customer with £200,000 to invest in commercial property would be £58. (If we assume that the larger company has the same average fund value of £200,000 and 50% investing in commercial property, the additional financial resource would still only be £78).

Naturally, there is little incentive for larger providers to argue against the proposals as they will typically be able to meet their less dramatic increases in financial resources and look likely to benefit from a reduced market going forward that would favour them.

Conclusion

In conclusion, the Association would be enormously grateful for your review of the situation and escalation if seen appropriate. There is no doubt that the FSA's proposals are unashamedly discriminatory against smaller firms and our suggestion would be that the FSA i) work to improve standards within smaller firms where they believe there are shortcomings and ii) address any capital adequacy gaps by working with the Association to come up with a balanced formula and not rush in proposals that will reduce competition in the market and discriminate against smaller businesses.

I have focussed my comments on the impact on smaller providers of the FSA proposals. There are other issues in relation to their proposals which make it not fit for purpose.

I would be pleased to discuss this matter further with you, as you see fit.

Yours faithfully



Andrew Roberts
Chairman, Association of Member-Directed Pension Schemes
andrew.roberts@barnett-waddingham.co.uk

From: Daniel Measor [mailto:Daniel.Measor@fsa.gov.uk]
Sent: 13 February 2013 15:55
To: Andrew Roberts
Cc: Charlotte Freed
Subject: RE: FSA review of SIPP capital adequacy [CP12/33]

Dear Andrew,

Thank you for your email and letter to the SBPP secretariat team raising your concerns regarding CP12/33. This is not something that the Panels have focused on to-date, but I can certainly understand your concern about the impact on small SIPP operators. I have now read your helpful summary of the issues, as well as the consultation paper and CBA.

I would of course encourage you and your members to respond to the consultation and express your concern and make any alternative proposals (although I recognise the difficulty of doing this). In addition, I will follow up with the policy team myself and investigate the issues further on behalf of the Panels to see if there is anything we can contribute to the debate.

As discussions between the Panels (and secretariat) and the FSA are often private in nature, I may not be able to report back fully on these conversations; however, if there are points I'm able to share I am happy to do so.

Kind regards,

Daniel Measor
EU Policy Officer | Practitioner Panels
The Financial Services Authority

Tel: 020 7066 2504
Mobile: 07585 888 737



Andrew Roberts, Association of Member-Directed Pension Schemes,
c/o Barnett Waddingham LLP, Port of Liverpool Building, Pier Head, Liverpool, L3 1BW
Tel: 0151 235 6622 | Email: andrew.roberts@barnett-waddingham.co.uk

12 February 2013

Chief Executive Office
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

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COMPETITION  COMMISSION

15 FEB 2013

Andrew Roberts
Association of Member-Directed Pension Schemes
c/o Barnett Waddingham LLP
Port of Liverpool Building
Pier Head
LIVERPOOL
L3 1BW

From: David Saunders
Chief Executive

Direct line: 020 7271 0118

14 February 2013

Dear Mr Roberts

Thank you for your letter of 12 February 2013 about the FSA's proposed changes for calculating capital requirements for bespoke SIPP operators and the effect this will have on smaller firms operating SIPPs.

I should explain that the Competition Commission has no powers to initiate its own investigations but acts on references made to it from other competition and regulatory authorities, principally the Office of Fair Trading (OFT). Your concerns should be directed to the OFT and I have therefore forwarded your letter to the OFT Chief Executive, Clive Maxwell, who will I am sure give this his full attention.

You sincerely
David J. Saunders

David Saunders
Chief Executive
david.saunders@cc.gsi.gov.uk



Andrew Roberts, Association of Member-Directed Pension Schemes,
c/o Barnett Waddingham LLP, Port of Liverpool Building, Pier Head, Liverpool, L3 1BW
Tel: 0151 235 6622 | Email: andrew.roberts@barnett-waddingham.co.uk

12 February 2013

Enquiries and Reporting Centre
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

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Yours faithfully



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