Financial Services Law Briefing Note

Unregulated Products Invested through SIPPS – FCA Alert

The Financial Conduct Authority (FCA) has issued a further alert (following that issued in January 2013) about compliance failings in various IFA firms it has audited arising from advice given (or, as appears to have sometimes been the case, allegedly not given!) in relation to unregulated products sold through SIPPs. See www.fca.org.uk/news/sipps-further-alert.

What has been happening?

1. The Retail Distribution Review (RDR) in the financial services industry resulted in many advisers effectively having their FCA approvals lapse given their lack of appetite for the changes to the remuneration models which had served them well over many years. That much was expected. What may have come out of left field, however, has been the scale of participation of many former regulated advisers in the sale of unregulated products.

2. The SIPP market has grown with more than gusto over recent years with, post A-Day (6th April 2007), the choice of investments held within a SIPP no longer being confined to those set out in a Revenue approved list. This has resulted in a demand for many SIPP providers to allow alternative investments including unregulated products, investments in unlisted shares, unregulated collective investment schemes (UCIS) and third party loans. Tax charges still, however, apply in respect of some assets, e.g. tangible movable property and unauthorised payments. The *dramatis personae* in these transactions are usually an introducer (if an unregulated product), the adviser, SIPP trustee, SIPP administrator and the SIPP member (who may, in some SIPP arrangements, also be a trustee).

3. General disillusionment with what have been perceived to be inadequate investment returns and high charges in relation to pension products provided by insurance companies over recent decades. Indeed, FCA has launched an enquiry on this very aspect which has brought some traditional insurers out in a rash.

4. The FCA's concerns arising from its review of sales practices relating to SIPP recommendations with a nexus to unregulated products by some firms. The inference from this alert is that some firms had disregarded the January 2013 alert. FCA's review found examples of customers in final salary pension schemes or traditional pension schemes invested in mainstream funds and

with very limited investment experience having their pension monies invested in *"…non-mainstream propositions which were typically unregulated, high risk and highly illiquid investments". FCA found that "Generally speaking, we found **very poor** standards of advice*" (our emphasis). The two Final Notices referred to in the FCA alert relate to overseas property development investments sold on a very wide scale with what appears to have been a "tick box" as opposed to a purposive approach towards suitability and proper customer understanding of the transactions in which they were involved.

Following a review into the SIPP industry in 2009 carried out by the FCA's predecessor (Financial Services Authority) which did not have any widespread concerns, FCA is now clearly troubled about failings it sees in the advice process undertaken by IFA's.

What does this FCA Alert say?

- Advice cannot be given on a SIPP in isolation to the investments which it is intended will form part of that SIPP. Specifically, if a SIPP is recommended in the knowledge that a customer will transfer or switch funds from a current pension arrangement to release funds to a SIPP then the suitability of the underlying investment is an intrinsic aspect of the advice given to the customer. The FCA expressly state that "If the underlying investment is not suitable for the customer, then the overall advice is not suitable". An adviser cannot now argue that advice is only given on the SIPP tax wrapper in conceptual terms and that the adviser's remit does not extend to consideration of both the customers current pension arrangements as well as the assets which will form part of the SIPP. The financial services industry is more than aware of the carnage caused to insurers with their own advisers and IFA's from the debacle in the 1990's arising from pension transfers and opt outs and the extensive review and redress process ordered by the Securities and Investment Board in 1994.

- If the firm does not fully understand the underlying investment proposition intended for the SIPP then, given that it will be unable to provide advice on a holistic basis in relation to the overall transaction, it should not be advising on the pension transfer or switch at all. This is because it will be unable to fulfill its obligations under Rule 9 of the FCA Conduct of Business Sourcebook obligations to assess the suitability of the transaction as a whole.

- Firms need to ensure that proper disclosure is given to their professional indemnity insurers as to the true nature of their business model – this is reflective of the general duty of utmost good faith forming the basis of any insurance contract, breach of which enables an insurer to decline to indemnify the insured party.

- The FCA is on notice of what it interprets as avoidance tactics adopted by some firms including treating customers as "insistent" or as requiring only execution services (a concept which, arguably, should really be confined to products which a customer either has experience or a good understanding of) or having customers invest into a Small Self-Administered Scheme product

(SSAS). A SSAS, in crude terms a small occupational pension scheme, is not a FCA regulated product.

What does this FCA alert not say?

It is clearly falling short of the stance FCA has adopted in respect of the sale of UCIS products to retail clients (FSA CP12/9). By implication, FCA acknowledges that these products can be considered suitable and do have their place but that they need to fulfill the criteria of suitability and customers need to have a full understanding of the totality of the transaction as opposed to a discrete aspect.

FCA recognises that advisers work, and will continue to work, in this area but sates that "*…if you continue to work in this area, you must have a robust and compliant advisory process in place to ensure you meet our requirements, acting at all times honestly, professionally and in accordance with the best interests of the customer*".

Moving Forward

Whilst it should be surprising that firms have not had proper regard to the January 2013 alert, they would be foolish not to look at this alert with care. Indeed, FCA is making it clear that it expects both firms and individuals (no doubt to included those with CF1, CF10 and CF30 authorisations) to be referred to its Enforcement Division in respect of these failings.

This work will also be of relevance to the ongoing review FCA is undertaking of the SIPP industry. It, and previously FCA, have consulted on its proposed changes to the capital adequacy requirements of SIPP operators and has also commented on the due diligence it expects of SIP providers (CP12/33, FG13/8). SIPP operators have generally taken the stance that their focus on due diligence should be on compliance with HMRC requirements given that, in an advised sale scenario, the client's adviser will have undertaking due diligence on the investment asset. A Pensions Ombudsman case has supported this. Obviously, SIPP operators have to align their practices to what the FCA now says it expects of them with regard to their due diligence systems and controls – not only for investor protection but also in respect of matters relating to financial crime and pensions liberation.

Given the losses which can arise from high risk, speculative investments relating to unregulated products, we expect that this will be an matter of much interest in the coming months.

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