

### **Non-Standard and Unregulated Investments in SIPPs – 18 Months On.**

The Financial Conduct Authority's (**FCA**) somewhat belated interest in this area continues. This is an update on recent developments following the Thomas Simon briefing note of May 2014.

FCA has now written to SIPP administrators and trustees asking for details of:-

- Non-standard and unregulated investments held by them,
- The financial advisers who recommended clients to invest in non-standard investments (this is a more effective way for FCA to elicit this information than asking financial advisers directly), and
- Non-standard investments made by customers on an execution-only basis.

The topic is being widely reported in the financial press.

Whilst the pretext of the request is information which FCA says it requires for the forthcoming capital adequacy rules (the investment profile of SIPP providers will effect the amount of capital required for SIPP administrators when the intended changes take effect in September 2016), what is driving the FCA's request is clearly concern about the use of SIPPs as vehicles for potentially unsuitable investments with consumer detriment.

Before dealing with the implications from this latest FCA initiative, which has all the hallmarks of a thematic review leading to remedial as well as disciplinary action, it is interesting to note the scale of the current SIPP market. As at May 2014, FCA estimated that around £100bn of assets were administered via SIPPs with the overall UK pensions market having approximately £2 trillion of assets. SIPPs have captured the imagination of many investors disillusioned with many years of poor investment performance of conventional pension products. SIPPs are, in some ways, consistent with the Government ethos of giving people greater control over their pensions. The SIPP sector is also entering into a period of consolidation brought about by increased regulatory scrutiny as well as the forthcoming capital adequacy requirements.

### **What are Non-Standard Investments (NSI's)?**

The answer is simple – a NSI is an investment which FCA does not consider to be a “standard investment”.

The FCA's current list of "standard investments" is contained in the FCA Policy Statement PS14/12 (page 5, Appendix 1). In essence, these assets are easy to value and liquid. These "standard investments" include:- deposit accounts, LSE & AIM listed shares, Government and local authority bonds, corporate bonds and unit trusts. The FCA list of "standard investments" may appear somewhat underwhelming for SIPP investors given the degree of investment control they seek over their pension investments. FCA has set out proposals for amending the list of standard assets for the purposes of consultation (FCA paper CP15/19 – page 15); these being evolutionary rather than revolutionary in nature.

NSI's which have been commonly invested into SIPPs include:

- Non-listed shares,
- Non-listed corporate loans/bonds (many of these being a by-product of the difficulties SME's have had in obtaining bank funding since the banking crisis of 2008),
- Intellectual Property,
- Biofuel investment schemes,
- Overseas off-plan investments (in jurisdictions which recognise a trust form of ownership),
- Forex investments, and
- Miscellaneous UCIS's (unregulated collective investment schemes).

### **Why is FCA now interested?**

Many NSI's have failed to fulfil their investment objectives – unsurprisingly given that they were high risk and the depth of the recession over recent years. If the only issue related to investment failure then, leaving aside issues as to original appetite for risk and ability to bear investment losses on the part of investors, then FCA would have little interest. As well as carrying high risk, NSI's can be illiquid, difficult to value (some NSI's currently being valued by SIPP administrators at nil) and do not have FSCS protection.

The issues which now arise from investments of NSI's into SIPPs extend to:-

*Unsuitability of Transfer of Funds to SIPPs* – these have involved transfers from defined benefits pension schemes to SIPPs with some pretty disastrous effects. "Haven't we all been there before?" will be the question uppermost in the minds of anyone who has experience of the Securities and Investments Board review into the mis-selling of personal pensions in the mid 1990's which led to huge clear up costs (the compensation paid by two pensions companies with direct salesforces exceeding £1bn each). Memories in the financial services industry can be somewhat short! In some cases involving transfers from personal pension plans, there is no adequate justification for the migration of pension monies into

a SIPP or the original personal pension plan contained guarantees (e.g. guaranteed annuities under section 226 policies) which are lost by the transfer to a SIPP.

*Unsuitability of Investments into SIPPs* – this will apply even when the advice to transfer the original pension into a SIPP was suitable. FCA is concerned that many advisers were giving advice on the underlying transfer but not on the suitability of the investment made by the SIPP: the reason for the restriction for the scope of advice presumably being driven about concerns by the adviser about the proposed investment.

*Execution only NSI'S* – leaving aside the inherent need for advice on pensions matters (the A-Day pensions reforms of April 2006 arguably having failed to achieve simplicity in that area), FCA is concerned about NSI's having been taken out on an execution only basis on anything other than a small scale.

*Complexity of NSI's* – some NSI's have complex charging structures and somewhat arbitrary returns. Regrettably, the UK financial services industry has a track record of selling products to end users who do not understand their features, benefits and risks.

*Promotions of the NSI's* – some NSI's involve investment promotions which do not comply with the requisite regulatory rules as to who can issue them, others are misleading and lack balance especially as to the risks of the investment.

*Commissions being a driver for the NSI's* – commission bias has been a long standing regulatory concern given its link to adviser behaviour. Many NSI's carry hefty commissions, some of which may not have been disclosed to investors.

*The role of SIPP providers (administrators and trustees)* – the scope of their duties remain unclear. Conventional wisdom confined their duties to ensuring that any investment was HMRC compliant (e.g. did not extend to taxable property) but FCA has said that their obligations can extend to being gatekeepers (but with inadequate clarity). What is very much unsatisfactory is that the Financial Ombudsman Service and the Pensions Ombudsman have made decisions based on similar facts with pretty much diametrically opposed outcomes; the FOS taking a far more draconian approach towards the obligations of SIPP administrators than the Pensions Ombudsman.

*Unauthorised collective investment schemes* – these involved pooled assets where the participants do not undertake day to day management and control of the scheme. They differ from UCIS's due to the regulatory status of those who established them. Their legal mischief is that they contravene section 235 Financial Services and Markets Act 2000 with all that follows from that.

*Pensions Liberation* – the genesis of some NSI's lies in desires to access pension benefits before the requisite ages. Not only is this illegal but it can give rise to draconian tax charges.

Back to the FCA and repetition of previous mistakes in the financial services arena – this is another apparent example of regulatory failure to monitor what was happening in the market and anticipate what issues would arise. Horses and stable doors spring to mind!

Thomas Simon has a financial services team which specialises in advising on SIPP and SSAS matters – its expertise includes advising SIPP administrators, SIPP and SSAS trustees, financial advisers as well as investors. Its team includes personnel who have worked in the financial services industry which provides an extra dimension to the service Thomas Simon provides.

Please contact Stuart Brothers ([stuart.brothers@thomas-simon.co.uk](mailto:stuart.brothers@thomas-simon.co.uk)) or Rebecca Jones ([rebecca.jones@thomas-simon.co.uk](mailto:rebecca.jones@thomas-simon.co.uk)) if you wish to discuss any of the above matters with us further.