SIPP PROVIDERS DUTIES AND LIABILITIES: ADAMS v OPTIONS: COURT OF APPEAL

JAY JAGASIA and JOHN VIRGO

Guildhall CHAMBERS

Outline of talk

- SIPPs – a brief look at the history of the product (JV)
- Promotion of SIPPs and the problem of unregulated introducers (JJ)
- SIPP provider duties (JV)
- Defences to SIPPs mis-selling claims: (a) the statutory defence (JJ) and (b) efficacy of contractual defences (JV)
- Concluding remarks (JJ)

Guildhall CHAMBERS

SIPPS and the historical context (1)

- Pensions have a long history in the UK – dating back to medieval times (Royal pensions awarded for service to the King, pensions provided by Guilds and for the clergy; an established by Act of Parliament in 1601 set up a pension scheme for maimed soldiers and mariners)
- Occupational pensions gradually came to be provided for government employees in the seventeenth and eighteenth centuries (Chatham Chest, established in 1590 to provide pensions to disabled seamen and a pension scheme for retired Royal Navy Officers established in 1672)

Guildhall CHAMBERS

SIPPS and the historical context (2)

- By 1810 - a civil service pension scheme was in existence, providing benefits across the service
- By the 1890's other public sector employees were being granted pensions modelled on the civil service scheme, including: the police (1890) and poor law officials (1896)
- A uniform pension scheme for local government staff was established in 1922

Guildhall CHAMBERS

SIPPS and the historical context (3)

- The twentieth century saw a significant expansion in the provision of pensions, both by the state and by companies:
- State: State Pension Scheme was introduced by the Old-Age Pensions Act 1908
- Companies: Wills (1900), Cadbury and Rowntree's (1906), Pilkingtons (1910), Imperial Tobacco (1926), Lloyds and Lever Brothers (1929), and ICI (1937)

Guildhall CHAMBERS

SIPPS and the historical context (4)

- The focus of the above schemes was on employer provision
- From the mid-1950's self-employed individuals or those without access to an employer sponsored scheme could make provision for retirement by contributing to a retirement annuity contract (RAC)
- Introduced by the Finance Act 1956 and subsequently governed by section 226 of the Income and Corporation Taxes Act 1970 - known as "section 226 Policies"

Guildhall CHAMBERS

SIPPS and the historical context (5)

- On the whole public sector and company sponsored schemes provided:
  - defined benefits linked to a retiring employee's length of service
  - indexed increases of the pension pre- and post-retirement
  - contributions payable by the employer to the scheme
  - Essentially, the provider carried the risk

Guildhall CHAMBERS

SIPPS and the historical context (6)

- In the 1980's, with an increased emphasis on privatisation, the then Conservative government undertook a major revision of the UK pension landscape by replacing RACs with Personal Pension Policies (PPPs)
- This product became available from 1 July 1988
- Both RACs and PPPs allowed an individual to build up a lump sum for retirement, part of which had to be used to buy an annuity (at the latest, from age 75 years) and part of which could be taken as a tax-free lump sum.

Guildhall
CHAMBERS

SIPPS and the historical context (7)

- The new-styled PPP was able to accept transfers of defined occupational pension scheme benefits and had the flexibility to allow the policyholder to make further contributions into their pension
- Prior to this change, a transfer of occupational scheme benefits had only been possible into a “section 32 buyout policy”, introduced by the Finance Act 1981, and prior to April 2006 it was not possible to add contributions to the buyout plan

Guildhall
CHAMBERS

SIPPS and the historical context (8)

- Self-invested pension plans ("SIPPs") were introduced by the Finance Act 1989 as a form of personal pension plan which allows the plan owner to direct how their contributions are to be invested
- The Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001
- Finance Act 2004 removed these investment restrictions but there remains a range of investments, such as investment in residential property, which if made via a SIPP wrapper, will attract an unauthorised payment tax penalty

Guildhall
CHAMBERS

SIPPS and the historical context (9)

- This history reflects an ever increasing shift of risk from employer-pension-provider to pensioner
- 1988 and 1994, c8m people invested in PPPs; between 1 and 2m were victims of poor advice dealt with via the Pensions Review at a cost of c£11.8 billion by way of redress incurred by the industry
- Nonetheless the transfer of risk continued - The Finance Act 1995 also saw a further modification to the shape of permitted pension provision by the introduction of Pension fund withdrawals ("PFW"), also known as "income drawdown" plans

Guildhall CHAMBERS

SIPPS and the historical context (10)

- PFW was a response to low interest rates which saw annuity rates fall, rendering those products unattractive
- Income drawdown allowed the plan holder to draw an annual income, within limits set by the Government Actuary's Department which was likely to exceed the income which might have been secured by purchasing an annuity
- Many such plans were again mis-sold

Guildhall CHAMBERS

SIPPS and the historical context (10)

- As from 6 April 2007, the activities of establishing, operating and winding up personal pension schemes became regulated by the Financial Services (now Conduct) Authority ("FSA")
- FSA's Consultation Paper, The regulation of personal pension schemes including SIPPs (April 2006); the regulator declared an intention that as regards the conduct of business there should be "consistency for consumers across all personal pension schemes" so that "that consumers are given suitable advice from across the whole range of products"
- The achievement of that objective has at best seen mixed results

Guildhall CHAMBERS

The up to date landscape

- The Taxation of Pensions Act 2014 threatens a further explosion in claims in allowing unrestricted access to funds in a money purchase pension arrangement as from 6 April 2015
- This new “pension freedom” has seen an immediate and marked increase in pension fund withdrawals. In the first three months from April 2015, 204,581 pension were accessed, compared with 95,372 in the same period in 2013; in the same period, 71,455 consumers accessed some form of income drawdown option, with 120,688 consumers have accessing some form of cash withdrawal
- There were 12,418 annuity sales in the first 3 months of the 2015/2016 tax year, compared with 89,896 for the same period in 2013
- This may prove to be an extension to SIPP mis-selling activity

Guildhall
CHAMBERS

Promotion of SIPPs by unregulated introducers – Outline facts in *Adams*

- Exemplar of the problems associated with unregulated introducers – (1) client (2) C (3) CLP (4) Store First
- A is a goods vehicle driver and had a modest PPP with Friends Life valued at c.£52k
- Was in need of money and saw an online advertisement which said ‘release some cash from your pension’
- That advertisement led to CLP’s website
- CLP was based in Spain and was unregulated
- Mr Terence Wright jointly controlled CLP and in October 2010 the FSA had published an alert concerning him – C did not appreciate this until some time later

Guildhall CHAMBERS

Outline facts cont.

- C accepts first referral from CLP in August 2011
- Terms of Business entered into between C and CLP thereafter – structured in such a way as to support C's 'execution-only' business model (littered with 'no advice' boilerplate)
- CLP confirmed to C at start of relationship that it typically received **commission of between 2-5%**
- A first makes contact with CLP in February 2012 and as a consequence decides to transfer PPP, establish a SIPP with C to receive transfer funds and use those funds to acquire Store First store pods in Blackburn to be held in SIPP

Guildhall CHAMBERS

Outline facts cont.

- **May 2012 –** after SIPP established but before transfer of PPP effected and before store pods purchased, **C discovers CLP was receiving commission from Store First of c.12%**
- **25 May 2012 –** as above, **C discovers that CLP paying inducements to investors and C terminates relationship with CLP - Inducements = tax charge**
- **May 2012 –** as above, **C discovers earlier FSA warning notice re Terence Wright**
- June 2012 – PPP transfer into SIPP
- 19 June 2012 – A signs Store First investment instruction and Declaration & Indemnity
- July 2012 – Store pods investment completed
- August 2012 – C suspends further investments re Store First

Guildhall CHAMBERS

Nature and scale of problem

- C has no control over CLP apart through contract and no visibility of CLP's activities
- 'Pipeline' cases = C executes transactions after it had sufficient knowledge to terminate relationship with CLP, relying on Declaration & Indemnity
- C had c.580 clients who invested in store pods, most of whom were introduced by CLP
- Investments were made over 6 month period, represented 10% of assets held in C's SIPPs, accounted for 20% of C's income in 2011 and nearly 30% in 2012
- Unrealistic to suggest that CLP's activities did not lead to those investments

Guildhall CHAMBERS

The statutory claim

- Section 19 and general prohibition – prohibition on anyone other than **authorised** or **exempt** persons from carrying on **regulated activities** in UK – NB CLP was neither
- Section 22 – Regulated activity = activity of ‘specified kind’ carried on by way of business and (for our purposes) relates to an investment of a ‘specified kind’
- ‘Specified’ means specified in RAO
- Section 23 = criminal consequences
- Sections 26-30 – civil consequences
- Section 26 = enforceability in 2-party situation
- **Section 27 – enforceability in 3-party situation**

Guildhall CHAMBERS

The statutory claim cont.

- Conditions of section 27: (1) agreement made by authorised person in the course of carrying on RA not in contravention of GP (SIPP and C) **(2) in consequence of something said or done by TP in the course of a RA carried on by TP in contravention of GP**
- Civil consequences = Agreement is unenforceable; statutory restitution; compensation

Guildhall CHAMBERS

The statutory claim cont.

- RAO
- Regulated activities (the specified activities)
  - ‘Arranging deals in investments’ – art.25 of RAO – NB exclusions in arts.26, 27 and 33
  - ‘Establishing, operating or winding up a personal pension scheme’ – art.52
  - ‘Advising on investments’ – art.53 of RAO
- Regulated investments (the specified investments)
  - Rights under a pension scheme
- NB definitions of ‘buying’, ‘selling’ and ‘security’ in art.3

Guildhall CHAMBERS

The statutory claim cont.

- Both arts.25 and 53 need to relate to ‘security’ or ‘relevant investment’
- Investment in store pods not a ‘security’ or ‘relevant investment’
- BUT A’s rights under PPP and SIPP were each a ‘security’ because satisfied definition of ‘personal pension scheme’
- CA agreed with C and rejected argument that even though store pods are not regulated product the investment in them was a relevant transaction because rights to cash under SIPP converted to rights to storepods – support for argument found in *Avacade*, *Burns v FCA*, *TenetConnect* and **PERG 12.3 –** those authorities and the guidance will now need to be reconsidered in the light of that rejection
- Reasons for rejection: (1) A’s rights under SIPP are not ‘rights under contract’ but rights under trusts (2) A did not ‘convert’, ‘dispose of’ or ‘sell’ his rights merely by altering investment
- Consequence = advice on a SIPP exchanging assets neither of which is a regulated investment not a regulated activity

Guildhall CHAMBERS

The statutory claim cont.

- Not the end of the story because there had been regulated advice by CLP on sale of PPP and buying SIPP
- Meaning of 'advice' – see *Walker, Rubenstein* and [75] – "*any element of comparison or evaluation or persuasion is likely to cross the dividing line*" between information and advice
- "*Braided stream of advice*" given about regulated and unregulated investments where advice on unregulated investments justifies advice on regulated investments and becomes part of regulated advice
- [68] "*…advice on a unregulated investment is sometimes capable of involving advice on a specified one within the scope of article 53 of the RAO and so of being regulated activity*"
- Consequence = although advice on store pods not in itself caught, caught because of regulated advice re PPP and SIPP which was indivisible from unregulated advice

Guildhall CHAMBERS

The statutory claim cont.

- Art.25(1): "*making arrangements for another person…to buy, sell, subscribe for or underwrite a particular investment which is…a security*"
- Potentially very wide but cut down by statutory exclusions – art.26: "*arrangements which do not or would not* ***bring about*** *the transaction to which the arrangements relate*"
- Causal requirement- not 'but for' and not 'direct and substantial causal connection'- middle ground of 'causal potency' (i.e. arrangements which play a role of significance)

Guildhall CHAMBERS

The statutory claim cont.

- Question for CA – did CLP make ‘arrangements’ for A to transfer his PPP and put proceeds into SIPP which were such as to ‘bring about’ those transactions?
- Answer = yes, because of (1) procuring letter of authority authorising C to liaise with CLP (2) undertaking of money laundering investigations by CLP and (3) completion of SIPP application form by CLP – considered to be “*significantly instrumental*” in transfers despite being administrative in nature
- Wide approach to meaning of ‘arrangements’ which is consistent with *Avacade* and approach of UKSC re CISs in *Asset Land*

Guildhall CHAMBERS

The statutory claim cont.

- SIPP entered into because of regulated activities carried out by CLP in breach of general prohibition
- SIPP is *prima facie* unenforceable but subject to statutory defence in s.28
- [131]: "*There is nothing to prevent a regulated SIPP provider…from accepting instructions from clients recommended to it by an unregulated person, and from doing so on an 'execution only' basis. But the basis on which they contract with their clients will only go so far to protect them from liability. If they accept business from the likes of CLP, they run the risk of being exposed to liability under s.27…*"

Guildhall CHAMBERS

Due Diligence - FOS

- FOS has recognised duties framed around PRIN 2 (conduct business with due care and skill) and 6 (TCF)
- First affirmed in *ex parte Charlton* [2018] EWHC 2878 (Admin) which conformed to a typical scenario
- Mr Charlton was persuaded by unregulated introducer to transfer his PPP fund of c£24k to BB to invest in japtropha trees in Cambodia offered by Sustainable AgroEnergy plc which was operating a fraudulent scam; investment made in September 2011 and lost by February 2012
- No investigation as to whether trees planted or if Sustainable AgroEnergy had title to them

Guildhall CHAMBERS

Scope of Duty per FOS

- Identified SA as a high-risk, speculative and non-standard investment, so it should have carried out sufficient due diligence
- Considered whether SA was appropriate for a pension scheme
- Ensured that the investment was genuine and not a scam, or linked to fraudulent activity
- Independently verified that SA's assets were real and secure, and the investment operated as claimed
- Ensured that the investment could be independently valued, both at point of purchase and subsequently
- Ensured C's SIPP wouldn't become a vehicle for a high-risk and speculative investment that wasn't a secure asset, and could be a scam

Guildhall CHAMBERS

COBS 2.1.1R

PRIN provisions are not enforceable by private investors but are echoed in COBS 2.1.1 R i.e. the client best interest rule which may therefore equally impose DD duties on the SIPP operator

- HMRC “sippable”?
- Recognised legal title?
- Capable of being valued?
- Fraud?
- Capable of being realised?
- Appropriate?
- Burden on trustee?
- Status/ bona fides of introducer?
- FCA warning notices?

Guildhall CHAMBERS

Key FCA publications

DD duties implicit in the key FCA publications and accepted by Jacobs J in *ex parte Charlton*

- Self-Invested Personal Pensions (SIPP) operators – A report on the findings of a thematic review – September 2009
- Self-Invested Personal Pensions (SIPP) Operators – a report on the findings of a thematic review October 2012
- FSA Alert issued on 18 January 2013 (Advising on pension transfers with a view to investing pension monies into unregulated products through a SIPP)
- **FCA SIPP Operator Guidance October 2013**
- FCA Further Alert dated 28 April 2014 (Pension transfers or switches with a view to investing pension monies into unregulated products through SIPPs)
- "Dear CEO" letter of 21 July 2014
- FCA alert published on 2 August 2016, and
- FCA Alert dated 24 January 2017 (Advising on pension transfers – our expectations)

Guildhall CHAMBERS

Adams and the FOS endorsed duties

- Although breaches of COBS 2.1.1R were alleged both at trial and on appeal, both courts concluded they were not developed or addressed by expert evidence and declined to comment
- In principle, if advanced in future:
  - Expert evidence may be appropriate
  - The regulator's position indicated in (1) the publications cited above; (2) the Skeleton Arguments submitted by in *Adams;* (3) the FOS position confirmed in *ex parte Charlton* and (4) the emphasis on consumer protection all point to COBS 2.1.1R imposing these duties

Guildhall CHAMBERS

The statutory defence – s.28

- Section 28(3) gives court discretion to allow an agreement which is *prima facie* unenforceable by operation of s.27 (and s.26) to be enforced, and money and property to be retained, where the court "*is satisfied that it is just and equitable*" to do so
- In 3-party situation, by s.28(4)(b), court must have regard to the issue mentioned in s.28(6): "*The issue is whether the provider knew that the third party was (in carrying on the regulated activity) contravening the general prohibition…*"
- If knowledge is satisfied, this will be weighty factor against grant of relief but, if not, this will not necessarily mean relief will be granted – see *Helden v Strathmore* at first instance

Guildhall CHAMBERS

The statutory defence cont.

- As to s.28(6), CA concluded that this requires actual knowledge and not constructive knowledge, which is a potentially surprising outcome – based on narrow approach to statutory construction of ‘knew’ – but constructive knowledge still relevant to factors to be taken into account
- CA generously found that C did not have actual knowledge in circumstances where there was strong direct and circumstantial evidence to support such knowledge

Guildhall CHAMBERS

The statutory defence cont.

CA concluded that it should not exercise its discretion for following reasons:

(1) Key aim of FSMA is consumer protection

(2) Section 27 "*designed to throw risks*" of accepting introductions from unregulated entities on regulated entities

(3) Huge volume of introductions through CLP and most invested in store pods – C on notice that unregulated advice provided by CLP – "*After all, it is hard to suppose that 580 people would spontaneously decide to invest in Blackburn storepods*"

Guildhall CHAMBERS

The statutory defence cont.

(4) Knowledge in May 2012 about higher commission, payment of inducements and FSA warning notice – terminated relationship with CLP but executed pipeline transactions

(5) C took no steps in intervening 2 months and simply acted as if nothing material had taken place and disclosed none of what it knew to A

Guildhall CHAMBERS

Defences

- Mr Adams signed the usual disclaimers confirming he:
  - was not being advised by the SIPP operator
  - was taking responsibility for his own investment decisions
- Disclaimers?
  - Held ineffective to defeat s27 claim
  - The need to safeguard consumers from their own folly applies equally to COBS 2.1.1R
  - Logically – if the duty is recognised, any disclaimer would be caught by COBS 2.1.2R

Guildhall CHAMBERS

Concluding remarks

- Significant case and there are a number of other existing cases which will be directly affected by outcome
- Primacy of consumer protection
- Wider learning on ‘advice’ and ‘arrangements’ will be relevant more generally – particularly braided stream of advice which will capture unregulated activities where they are interconnected with regulated advice – wide approach to ‘arrangements’
- Despite what certain commentators might say, the COBS claim is still very much alive and left to be argued on another day
- Contract controls will only assist so much where unregulated introducers are involved

Guildhall
CHAMBERS