Case Note: Burns v the Financial Conduct Authority [2018] UKUT 246 (TCC)

SIPP Mis-selling: Unmasking a Flawed Business Model

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Since 2014 the Financial Conduct Authority (FCA) has closed down several independent financial adviser (IFA) firms specialising in advising retail customers on transferring their existing pension funds into unregulated investments via a SIPP. The FCA has withdrawn regulatory permissions from firms and individuals, prohibited future involvement in regulated activities and imposed substantial fines.

Many IFA firms sold this type of product based on a business model that provided advice only in relation to the most suitable SIPP wrapper available to the customer, without addressing the merits of the investment proposed to be held in the SIPP. Two of the most egregious examples were the several businesses trading under the TailorMade brand and the business of a partnership known as 1 Stop Financial Services. These firms sold a total of £112 million of SIPPs holding unregulated products to around 2,000 customers.

Since the common business model at the heart of the transactions was that no advice in relation to the merits of investment held in the SIPP would be provided, firms often did not maintain indemnity insurance that could respond and provide redress to customers saddled with an unsuitable investment. Customers typically invested in esoteric, illiquid and high risk products which subsequently failed. Many have lost the entirety of their investment. For some that represents a loss of their entire pension savings. The IFA firms are now insolvent, and in the absence of insurance cover, their customers have to be content with compensation paid by the Financial Services Compensation Scheme (FSCS) with its current limit of £50,000.

The scale of the problem is reflected in the figures published by the FSCS. Up to 31 March 2014 the scheme had received 1,054 SIPP related claims. That number rose sharply in the period 1 April 2014 to 25 April 2018 when a staggering 13,183 SIPP related claims were made, and total compensation just short of £300 million was paid out by the FSCS. In the same period the scheme logged SIPP complaints against 495 firms, four of which accounted for 51% of the total compensation paid.

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Against this background Mr Burns, a former director of TailorMade Independent Limited, the regulated entity within the Tailormade group of companies, challenged a decision notice whereby the FCA imposed a financial penalty on him and prohibited him for performing any senior management function. In determining that challenge, on 1 August 2018 the Upper Tribunal released its decision which endorsed the FCA's assessment that the business model operated by the TailorMade brand (and substantially replicated by many other IFA firms) was fundamentally flawed.

The Tribunal expressed the view that the guidance provided in the perimeter guidance part of the FCA Handbook (PERG) was unclear, and that the lack of explicit guidance may have led some IFA firms to believe that there was no regulated activity in relation to an asset that was not itself a *specified investment* (i.e. the underlying investment), so long as no recommendation about acquiring the asset was made. Nevertheless, in its view, the construction to be applied to the relevant provisions of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) was clear: where a firm advises on the merits of a particular SIPP in circumstances where it knows that the customer's intention is for the SIPP to invest in particular assets (which are not themselves *specified investments* for the purposes of the RAO), then advice on the merits of the underlying investment(s) is a component of the advice on the merits of establishing the SIPP, and it is therefore a regulated activity.

It follows that, in advising a customer on such a SIPP investment, along with advising on the merits of the chosen SIPP wrapper, the adviser must consider the merits of the underlying investment in accordance with the suitability rules in COBS 9.2, the honest dealing/client interest rules in COBS 2.1.1 and the specific rules relating to pension transfers and opt-outs in COBS 19.1.

The Tribunal observed that, as a matter of general principle, it would have been readily apparent to any competent financial adviser that it was a wholly unsuitable proposition for an unsophisticated retail investor with a small pension pot to switch into a Sipp that was wholly invested in a single or a small number of oversees property investments. The evidence adduced at the hearing furthermore demonstrated that the investments proposed to be held within the SIPP were generally incompatible with the customer's attitude to risk.

The management team behind the TailorMade brand also permitted stark and obvious conflicts of interests to arise when it tasked one of the group companies, Tailormade Alternative Investments Limited, to act as a broker promoting the unregulated investment products that were then offered by introducers to customers. If a customer decided to acquire the unregulated investment, the introducer would effect the introduction to TailorMade Independent Limited to advise (in the limited terms already described) on the merits of transferring the customer's existing pension pot into a SIPP. The Tribunal observed that, accordingly, the chosen investment product and the transfer of the customer's existing pension into a SIPP were mutually dependent: one could not have taken place without the other. Although Mr Burns sought to distance the self-employed introducers from the TailorMade broker, the Tribunal had no difficulty in finding that, in reality, it was the TailorMade broker who made the customer introductions to the regulated TailorMade entity (i.e. TailorMade Independent Limited). This simply followed from the circumstance that the agreement between the introducers and the TailorMade broker was described as an "Agency Agreement" and that the introducers were, in fact, acting as the TailorMade broker's agents and promoted the investment products in that capacity. Such conduct breaches the fair dealing rule which obliges the adviser to act in the best interests of his client (COBS 2.1.1).

Comment

It is unfortunate that for many consumers who have fallen victim to this species of SIPP mis-selling, an FSCS claim with its compensation cap of £50,000 is the only route to obtain (at least some) redress. Where IFA firms continue to trade, it may be worth exploring whether the circumstances of the SIPP sale to the customer signpost a meritorious claim for negligent advice. The legal foundations for such claims, based on breaches of COBS 9.2, 2.1.1 and 19.1, look strong. In the absence of insurance cover, an important consideration will be whether the IFA firm is worth suing. That may well be so in the case of profitable, larger financial services companies or partnerships, where the partners' assets might be available to satisfy claims against the firm.

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