Happy Birthday to the SIPP

5 March 2020

This week marks the 30th anniversary of the first self invested personal pension (SIPP).

The SIPP has come a long way since 1990, with changing and increased regulatory scrutiny and the creeping development of SIPP provider obligations. A lot has happened over the last 10 years or so since the first FCA (then FSA) paper on SIPP provider obligations was published. However, despite all the SIPP industry press and commentary there remains uncertainty and legal debate over many issues affecting SIPP providers.

We explore these issues in this legal alert – from the known knowns of FOS, to the known unknowns of the long awaited judgment in *Adams v Carey*, to the unknown knowns of ongoing SIPP due diligence and finally the unknown unknown – where will the SIPP be when it celebrates its 60th birthday in 2050?

What is a SIPP?

The SIPP was introduced by Nigel Lawson, the then chancellor, in the 1989 Budget and implemented by the Finance Act 1989. The government's intention was to allow customers greater choice over the investment of their pension contributions.

SIPPs were regulated by HMRC until April 2007 and permitted investments in a broad range of products, with the key exception being residential property.

The advantage of a SIPP, like other pension products, is that there is no tax on the investment or capital gains made within the SIPP wrapper.

Most SIPPs today operate with at least 2 entities – a regulated FCA entity which operates the SIPP and a trustee entity which holds the assets within the SIPP as a bare trustee and is normally not FCA regulated. Some SIPP providers also operate with a third entity that is often not regulated by the FCA and administers the SIPP – collecting fees for example.

Entities within the SIPP structure are not regulated to provide investment advice; as a result SIPPs are not authorised to comment on the suitability of an investment for an individual customer. SIPP providers normally have contractual arrangements in place where they agree that the customer (or their financial adviser) can direct the SIPP to make certain investments, albeit that the SIPP retains the right to veto any given investment, for example, if the investment could lead to a tax charge on the SIPP.

The SIPP until A-Day

The first SIPP was sold in March 1990 and whilst uptake was initially slow, it was the implementation of the new pension tax regime under the Finance Act 2004 (also known as "A Day") which simplified SIPPs. This led to the introduction of the SIPP as a mainstream pension product for consumers.

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The changing regulatory landscape

The other key development in the mid-2000s was the transfer of the regulation of SIPPs from HMRC to the then FSA (now FCA). This took place in April 2007. The operation of a SIPP became a regulated activity as part of the FCA's remit over firms 'establishing, operating and winding up a personal pension scheme'.

At the time SIPP regulation moved to the FCA, the FCA Handbook did not set out the FCA's views on the obligations of SIPP providers, nor was any new guidance provided. Instead SIPP providers carried on in much the same way as they did when they were regulated by HMRC. In fact, there still remains no specific part of the FCA Handbook addressing SIPP providers.

Despite this, it did not take long before the FCA started to make noises in the SIPP market and make its thoughts known on what it expected of SIPP providers.

The first FCA intervention came in September 2009 as part of a Thematic Review. The FCA stated that SIPP operators "did not pose a significant risk to our statutory objectives" but went on to note that there was a "potential for significant customer detriment". The 2009 Thematic Review noted the FCA's view that SIPP providers misunderstood their role and it was not the case that they bore little or no responsibility for the quality of the SIPP business that they administered.

A further Thematic Review Report was published in 2012 investigating whether SIPP operators had modified their practices in line with the 2009 Thematic Review. In the FCA's view there remained a lack of regulatory compliance, poor systems and control. Issues highlighted in the report included: (1) an increase in the number of non-standard investments held by some SIPP providers with poor monitoring of those investments and (2) a lack of evidence of adequate due diligence being undertaken on introducers and investments. At this stage the FCA said it expected SIPP providers to review their business, including paying attention to the evidence and quality of due diligence undertaken on introducers and investments.

Despite the 2011 Thematic Review stating that further guidance would follow later that year, no updated formal guidance was published until October 2013. The 2013 guidance accepted that SIPP providers were not responsible for the advice given by third parties relating to the SIPP, such as investment advice from financial advisers, but the FCA expected SIPP providers to have procedures and controls in place to enable them to gather and analyse management information to in turn enable the identification of possible instances of consumer detriment and financial crime. The guidance referred to SIPP providers contacting members and the firms giving advice to ask for clarification where appropriate. The guidance also addressed due diligence / good practice for introducers and investments within SIPPs.

The 2013 guidance was followed with a Dear CEO letter to SIPP providers in July 2014 noting that failings in the FCA's eyes continued in the wake of the 2011 Thematic Review.

The impact of the FCA's regulatory approach to SIPPs

Not long after the 2013 guidance and 2014 Dear CEO letter, a steady stream of complaints started to make its way to FOS. We have continued to see increases in complaints against SIPP providers year on year since 2010:

FOS Annual Report – Complaints Data	
Year	**Volume**
2018/2019	3,811
2017/2018	2,051
2016/2017	1,574
2015/2016	1,174
2014/2015	1,032
2013/2014	1,039
2012/2013	697

The 2018/2019 FOS Annual Review also listed SIPPs as the most complained about product against IFAs.

Where are we now?

Not a week seems to go by without SIPP industry news – whether that is the FOS figures on complaints, the default of a SIPP firm or the pressure defaulting SIPP firms are said to be placing on the financial services compensation scheme (FSCS).

But in light of all of the developments over the last 10 years or so, what is the position when it comes to SIPP provider obligations, what remains unclear, what remains untested and what lies in store for the SIPP industry?

Known knowns – FOS' fair and reasonable approach

SIPP providers often face an uphill battle before FOS.

This trend appears likely to continue following *Berkeley Burke SIPP Administration Ltd (BB) v The Financial Ombudsman Service Limited (FOS)*. After an unusual turn of events at FOS level, including 2 separate final decisions, of which the first was removed from the FOS website, the SIPP provider, Berkeley Burke, judicially reviewed the reasonableness of the FOS' decision when it came to what due diligence FOS expected of SIPP providers of investments held within SIPPs.

The High Court upheld the FOS' decision, setting out in its judgment FOS' views on the due diligence obligations of SIPP providers, including that a SIPP provider must:

- Identify a SIPP as a high risk, speculative and non-standard investment so as to carry out sufficient due diligence;
- Consider whether an asset is appropriate for a pension scheme;
- Ensure that an investment is genuine and not a scam or linked to fraudulent activity;
- Ensure that the investment can be independently valued both at the point of purchase and subsequently; and
- Ensure that a SIPP does not become a vehicle for a high risk and speculative investment that is not a secure asset and could be a scam (see paragraph 35 of the High Court Judgment).

Although Berkeley Burke obtained permission to appeal the High Court's decision, the appeal did not go ahead as Berkeley Burke entered administration before the appeal hearing.

FOS continues to stand by its view on what it considers to be the fair and reasonable due diligence obligations of SIPP providers, partly backed up by an FCA Dear CEO letter issued in the wake of the High Court decision in Berkeley Burke, warning firms of their capital adequacy requirements to ensure they could meet "financial commitments".

FOS' analysis of the due diligence obligations on SIPP providers also appears to have been adopted by the FSCS. The FSCS has said that it will meet claims where it is established the defaulting SIPP provider failed in its due diligence on an asset .

It appears unlikely that the FOS' approach will change unless there is a different view as to what the legal obligations of a SIPP provider are.

Known unknowns – the legal position on due diligence and in-specie transfers

What we do not know is what a court is going to make of the legal obligations on SIPP providers when it comes to due diligence on introducers and investments.

These questions are due to be answered in the *Adams v Carey* decision. Judgment is awaited following trial in March 2018. Although it is likely the decision will be appealed given its importance, it will undoubtedly have an impact on ongoing claims and complaints.

At the same time as waiting for the judgment in *Adams v Carey*, the SIPP industry is also waiting for the Upper Tier Tribunal's decision in SIPPChoice on the issue of in-specie transfers. SIPPChoice succeeded in its appeal against HMRC's tax assessment and the proceedings before the Upper Tier Tribunal were heard last week. This decision will have an immediate impact on SIPP firms waiting to see if they must meet tax bills for having accepted assets in to a SIPP in lieu of a cash contribution.

Unknown knowns – ongoing due diligence and pension liberation

Aside from the issue of due diligence on SIPP assets and introducers of business at the time a SIPP is first established, and the initial investment made, we have the issue of ongoing due diligence. Once an investment is made within a SIPP what if any obligations does a SIPP provider have with respect to that investment and/or the introducer? This is not a question in the *Adams v Carey* proceedings and so judicial guidance is not expected any time soon.

Examples of where we have seen this issue arise include where a SIPP provider accepts a large volume of business from a financial adviser firm and all of the business is invested in the same underlying "high risk" asset. FOS has been critical of this approach, citing a SIPP provider's management information obligations to argue that the SIPP provider should identify the trend and stop accepting new business from the financial adviser. However, this does not answer the question as to when the issue should

be identified and when the business stopped – customer 5, customer 10, customer 50 or customer 100? There is of course also the argument as to whether it is the SIPP provider's job to police its business in such a way as well.

Another area we are also seeing increasing activity is where the SIPP invests pension funds via an investment manager. Here the SIPP provider often conducts a check on the investment manager (and financial adviser where relevant) but once the pension funds have been transferred to the investment manager, the SIPP provider does not have sight over what investments are then made via the investment manager. If those underlying investments include investments that the SIPP provider would not permit as a direct investment, should the SIPP provider do anything about it? If the SIPP provider does act, is it straying into giving investment advice that it is not permitted to provide?

There is also the issue of what SIPP providers should do if an investment starts to underperform. Trustees owe a duty to protect assets held on trust but does that mean SIPP providers should be actively taking part in litigation against investment providers of underperforming assets for example? If so, where should the money come from to fund that litigation?

These are known issues where the answers remain unknown. At the same time SIPP providers are facing complaint activity involving Elysian Fuels and Omega. Here shares were sold to SIPPs at a value of £1 a share, but HMRC is not accepting £1 as the share value and is arguing that the shares are worth substantively less. If HMRC is right, then any price paid for the shares above the accepted value, has been liberated from the SIPP and attracts penal tax charges on the SIPP and customer of up to 85% of the value liberated. What obligations does a SIPP provider have to verify the price it is paying for an asset and what steps must the SIPP provider take to verify the price is another issue on which there is currently no guidance? Again, these questions remain unanswered.

Unknown unknowns – the future of the SIPP market

Where does all this leave the SIPP industry?

In our view, it cannot be argued that SIPPs provide a valuable option for pension savers; allowing customers to exercise control and greater flexibility over their pension investments. However, with that responsibility comes risk for customers.

However, SIPPs have faced increased scrutiny and media coverage over the last few years. This has led to the consolidation of the SIPP market coupled with many SIPP providers declining to permit further investment in non-standard assets.

There is no doubt that SIPPs perform an important role in the choice for customers when it comes to how to invest their pension funds. As long as SIPPs continue to provide flexibility and the government encourages pension flexibility we expect SIPPs to not only reach their 60th birthday but to continue as an important pension product in 2050 and beyond.

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- Winner – Law Firm of the Year – Halsbury Legal Awards 2014
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