Adams v Options SIPP: the perils of unregulated introductions

Introduction

The Court of Appeal's recent judgment in *Adams v Options UK Personal Pensions LLP* [2021] EWCA Civ 474 has the potential to have very significant implications for "execution-only" SIPP providers and others in the regulated sector who accept clients brought to them by unregulated introducers. If the unregulated introducer oversteps the mark and undertakes unauthorised regulated activities, the authorised entity may find itself on the wrong end of a claim by the consumer to unwind the transaction and return the funds under s.27 FSMA. While an authorised entity such as a SIPP provider may have no control (or even detailed knowledge) of the introducer's operations, and may have sought to protect itself by putting in place appropriate contractual controls and disclaimers, the contractual protections in place may well fail to protect it from such a claim. Following the FCA's intervention, this judgment provides a powerful precedent for consumers, with the Court declining to exercise its discretion under s.28 FSMA to uphold the transaction. In the result, it appears that there is a significant degree of irreducible risk for SIPP providers in this very common business model. SIPP providers and others who used regulated introducers as part of their business model will no doubt be focusing even further on the day to day operations of their introducers and the systems and controls they need to prevent them straying into the regulated sphere.

The first instance decision and the grounds of appeal

Mr Adams had a personal pension plan with Friends Life. He saw an advertisement on the internet about "releasing some cash from your pension" which led him to the website of CLP, an unregulated broker. His case was that CLP advised him that he could "unlock some pension money" if he transferred his pension pot out of the personal pension plan and invested it via a SIPP into long leases of storage pods, which he was told would be a safe investment with better expected returns than those he could achieve in his personal pension plan. Mr Adams's evidence was that he was assured that his money would be safe because it would be held with "a large, reputable pension management company", namely Options SIPP (then called Carey Pensions) ("**Carey**").

Having been so assured (and given a cash-back inducement by CLP), Mr Adams decided to invest in the storage pods. There was no suggestion that Carey acted anything but in accordance with its normal "execution-only" practice. It gave no advice to Mr Adams, as its terms made clear and emphasised again and again.

In the event, the investment performed poorly. Mr Adams brought proceedings against Carey on three grounds:

1. That the actions of CLP amounted to the carrying on of a regulated activity in contravention of the general prohibition, specifically in respect of the regulated activities of arranging deals in investments and/or advising on investments. So it was argued, Mr Adams was entitled to have his transaction into the SIPP reversed, with compensation, pursuant to s.27 FSMA – irrespective of what Carey as the SIPP provider did or did not do, or knew or did not know. Mr Adams further contended that the Court should not exercise its discretion under s.28(3) FSMA to allow the agreement to be enforced and the monies paid across to remain as they were;
2. That by establishing for Mr Adams a SIPP which was manifestly unsuitable for him, Carey itself was in breach of rule 2.1.1R of the Conduct of Business Sourcebook Rules ("**COBS**") requiring it to act honestly, fairly and

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professionally in accordance with Mr Adams's best interests, a breach of which is actionable by him as a private person pursuant to s.138D FSMA; and
3. That CLP provided to Mr Adams negligent investment advice for which Carey was liable as a result of a joint venture, common design or agreed common business model.

At trial, HHJ Dight CBE, sitting in the High Court, dismissed all three claims: *Adams v Options Sipp UK LLP* [2020] EWHC 1229 (Ch). Mr Adams appealed in respect of the two claims under FSMA. Of those two, the Court of Appeal declined to consider the COBS claim on the grounds that Mr Adams was seeking to advance a radically different case from the one advanced before the Judge: he abandoned the particulars of the alleged breach of COBS 2.1.1R advanced at first instance and sought to establish that breach by reference to entirely different particulars, which would have required further factual and expert evidence. The result was that all depended on the claim pursuant to s.27 FSMA.

On that claim Mr Adams's appeal succeeded. The two main issues for the Court of Appeal were:

1. Whether CLP was carrying out a regulated activity and in the course of such a regulated activity said or did something which led to Mr Adams transferring his pension (thus triggering the availability of relief under s.27); and
2. If so, whether the Court should exercise its discretion under s.28 to nevertheless allow Carey to enforce its agreement with Mr Adams and retain the funds transferred to it.

The first issue: did the introducer undertake a regulated activity?

The relevant provisions of the regulatory framework were substantially the same at the time of the relevant events as they are now.

Section 27 FSMA provides (as it did at the time) that an agreement between an authorised person and another party, which is otherwise properly made in the course of the authorised person's regulated activity, is unenforceable as against that other party if it is made "*in consequence of something said or done by another person ("the third party") in the course of a regulated activity carried on by the third party in contravention of the general prohibition*". In such cases, s.27(2) provides that the other party is entitled to recover any money or other property paid or transferred by him under the agreement, as well as compensation for any loss suffered.

The Court of Appeal therefore needed to answer two questions: did CLP carry out a regulated activity in breach of the general prohibition; and if so, were Mr Adams's transactions made as a consequence of that.

Two types of regulated activity were alleged: arranging deals in investments and advising on investments. They are (and were) specified by, respectively, articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("**RAO**"). So far as relevant:

1. Article 25 provides that making arrangements for another person to buy, sell, subscribe for or underwrite a particular investment which is a security or a relevant investment, is a specified kind of activity.
2. Article 53 provides that advising a person on the merits of buying, selling, subscribing for or underwriting a particular investment which is a security or a relevant investment (or exercising any right to do so conferred by such an investment) is a specified kind of activity.

It was common ground that the investment in the storage pods did not meet the definition of a "security" or "relevant investment" for the purposes of articles 25 and 53. However, pursuant to articles 3 and 82 RAO, rights under a personal pension scheme are a "security". So the focus of the enquiry was on the pension wrapper and the rights relating to that and in particular whether CLP had made arrangements for Mr Adams to, or advised him on the merits of, selling his rights

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under his previous pension, which was held with Friends Life and/or acquiring his rights under his SIPP with Carey.

The FCA's published guidance prior to this judgment was to the effect that rights under a personal pension scheme are bought or sold whenever the investor exchanges assets within the scheme. PERG 12.3 explains that rights are bought or sold "*where the member or his agent instructs the operator to buy assets of any kind either from existing cash holdings or from the proceeds of selling existing assets (since, in switching the assets, the member is converting his rights from an entitlement to benefits from the performance of certain assets to an entitlement to benefits from the performance of other assets – the former rights are sold and the latter are bought)*".

On this basis, Mr Adams's primary case (supported by the FCA) was that while the storage pods themselves were not a "security" or a "relevant investment", the investment in them (i.e. the purchase of the leases with the money newly transferred into Mr Adams's Carey SIPP from his Friends Life pension) was a relevant transaction in terms of acquiring rights under his SIPP, and therefore a security for the purposes of the regulated activities under consideration.

The Court of Appeal rejected that case, holding at paragraph 66 that investing a cash holding held within a SIPP into another investment does not involve buying or selling the rights under a pension scheme. As such, while CLP had stepped into the activity of providing advice, that advice was in respect of exchanging assets, neither of which was a relevant investment or security, and so that could not form the basis of a regulated activity.

However, that was not the end of the enquiry. While the advice on the ultimate investments was not a regulated activity, that advice was not limited to the ultimate investment, but also to moving from one pension scheme to another and so potentially related to disposing of rights in the investor's pre-existing scheme with Friends Life and acquiring rights under the new scheme with Carey. This concept was illustrated with a simple example: if a person praises an unregulated investment which would need to be acquired by means of a particular vehicle, then the law may – depending on the circumstances – treat him as advising that the vehicle should be adopted (paragraph 68).

On this basis, the Court of Appeal concluded that CLP had advised on investments within the meaning of art. 53 RAO not by reason of the storage pods, but by encouraging Mr Adams to achieve that investment in the storage pods by transferring his pension into a Carey SIPP, on which CLP had advised of the alleged benefits, telling him for example that he could "transfer [his Friends Life pension] into a pension that would perform better and allow [him] to invest in better investments", that the storage pods company would sell him pods "through [his] pension if it were in a SIPP", that Carey was "a large, reputable pension management company", etc. By doing so, CLP encouraged Mr Adams to sell his Friends Life policy and to transfer the proceeds into a Carey SIPP (paragraph 79). The recommendation of investment in storage pods carried with it advice on the merits of selling a "particular investment which is a security" (namely the Friends Life policy) and buying another "particular investment which is a security" (namely a Carey SIPP), and therefore constituted advising on investments within the meaning of art. 53 RAO.

Mr Adams also argued that in any event, CLP made arrangements for him to transfer his Friends Life pension to the Carey SIPP so that it can be invested in the storage pods, thus carrying on the regulated activity in art. 25 RAO and contravening the general prohibition on that second basis. There was no serious argument to the effect that CLP did not make such arrangements: although not all "arrangements" relied on were accepted, the Court of Appeal had no difficulty concluding that procuring from Mr Adams a letter authorising Carey to liaise with CLP about the transfer, undertaking of money-laundering investigations, and completing for Mr Adams his application form to Carey did constitute "arrangements".

The real battleground on the art. 25 RAO issue was as to whether the exemption in art. 26 RAO applied. This excludes from the scope of art. 25 "arrangements which do not or would not bring about the transaction to which the arrangements relate". As the Court of Appeal observed, art. 26 was clearly intended to limit the application of art. 25 by imposing a causal requirement (paragraph 93). The more difficult question was how that causal requirement was to be

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assessed. It was common ground, and the Court of Appeal accepted, that a "but for" test was inappropriate, because it could be both over-inclusive and over-exclusive (paragraph 94). The Court accepted the FCA's submission that for arrangements to "bring about" a transaction for the purposes of art. 26, they must play a role of significance: while a "but for" approach would be too simplistic, neither was a direct causal connection inevitably required (paragraph 97). On the facts, the test was satisfied: particularly pre-populating the application form for the SIPP with Carey for Mr Adams had sufficient causal potency in bringing about the pension transfer (paragraph 100). It followed that CLP was also in contravention of the general prohibition under art. 25 RAO.

Finally, as for the requirement in s.27 FSMA that the agreement be made "in consequence of something said or done" by CLP in the course of its contravention of the general prohibition, the Court of Appeal regarded it as obvious that the transactions were made in consequence of the contraventions (paragraphs 103-105).

As a result, all the relevant requirements of s.27 were satisfied, and Mr Adams was in principle entitled to the return of his funds as well as compensation unless the Court would exercise its discretion under s.28 FSMA to uphold the transaction.

The s.28 discretion issue

Section 28(3) FSMA provides, as it did at the time, that:

"*(3) If the court is satisfied that it is just and equitable in the circumstances of the case, it may allow–*

(a) the agreement to be enforced; or

(b) money and property paid or transferred under the agreement to be retained."

At first instance, the Judge held that if this had arisen, he would have held that it was just and equitable to enforce the agreement. Carey accepted that the Court of Appeal should exercise its discretion afresh because the Court of Appeal had held that the basis on which the Judge had exercised his discretion was flawed. Nevertheless, it is rather illuminating to contrast the Judge's reasons in favour of enforcement with the Court of Appeal's reasons against, despite their different legal departure points.

The Judge considered that, in short, there was "no reason in the circumstances why [Mr Adams] should not take responsibility for his own decision" (paragraph 130 of the first instance judgment). The trial established that, as a matter of fact:

1. Carey did not know what advice, if any, CLP may have given to Mr Adams beyond recommending the underlying investment and recommending Carey as a provider of a SIPP into which the investment could be wrapped.
2. Mr Adams knew that the investment was high risk, and he was content with this.
3. Mr Adams knew and accepted that Carey would not be providing to him advice.
4. If Carey itself had given Mr Adams detailed advice about the risks involved in investing in storage pods, he would have proceeded anyway.

All these factors meant, according to the Judge, that it would have been just and equitable to enforce the agreement between Carey and Mr Adams.

The Court of Appeal rejected this approach in trenchant terms, emphasising the consumer protection purpose of the provisions and giving a very strong steer that the starting position will be not to exercise the discretion unless there are particular reasons. That the investor might (or would on the lower court's findings) have gone on to do precisely the same thing will be of no likely weight in the assessment. The Court was uninfluenced by Carey's arguments that it did not

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know that CLP was contravening the general prohibition, that it had established a proper system and controls, that it did not itself commit any breach of duty, that Mr Adams's losses were not caused by Carey but rather by Mr Adams himself, and that Mr Adams deliberately misled Carey by confirming in writing that he was not receiving any monetary inducement for the transaction (paragraph 112). The Court's first two reasons for rejecting Carey's case bear quoting in full:

"*i) A key aim of FSMA is consumer protection. It proceeds on the basis that, while consumers can to an extent be expected to bear responsibility for their own decisions, there is a need for regulation, among other things to safeguard consumers from their own folly. That much reduces the force of Mr Green's contentions that Mr Adams caused his own losses and misled Carey;*

ii) While SIPP providers were not barred from accepting introductions from unregulated sources, section 27 of FSMA was designed to throw risks associated with doing so onto the providers. Authorised persons are at risk of being unable to enforce agreements and being required to return money and other property and to pay compensation regardless of whether they had had knowledge of third parties' contraventions of the general prohibition;" (paragraph 115)

The Court went on to give three further reasons on the facts of this case, namely that Carey ought to have been put on notice by the great number of clients referred by CLP who wished to invest in storage pods, that when it terminated its relationship with CLP it proceeded to finalise transactions with the pipeline of clients already referred, and that an administrative delay in receiving Mr Adams's pension funds would have given it time to reconsider allowing him to invest in storage pods. It is however clear that it is the first two reasons that are of the greatest significance, and will be invariably relied on by any claimant in similar proceedings.

Implications for SIPP providers and other authorised entities

As noted above, the judgment clarifies several important points for practitioners and clients in the financial services sector. Three such notable points, as discussed above, are:

1. The clarification that exchanging assets within a pension scheme does not in itself constitute buying and selling of rights under the scheme for regulatory purposes;
2. The express approval of the view (suggested at lower levels before) that advice on non-regulated investments from which advice on a regulated investment implicitly follows will be caught by RAO; and
3. The rejection of "but for" causation in favour of a "significant role" test in the analysis of making arrangements within the meaning of art. 25 RAO.

However, the key takeaways by far seem to be the potential impact of the Court's consideration of s.28 FSMA on the regulated market generally. Authorised entities will need to realise that the starting (and often ending) position will be that a consumer will be entitled to unwind the transaction if it involved an unregulated entity who breached the general prohibition in the process. The impact of this is likely to be felt across the sector where unregulated introducers are part of the business model.

Practically speaking, no investor is likely to pursue an unregulated introducer (possibly located overseas, as indeed CLP was) for negligent advice where she has the option of bringing proceedings against a substantial UK authorised person handling their investment, such as a SIPP provider, and seeking to unwind the original transfer pursuant to s.27 FSMA. Until the judgment of the Court of Appeal, SIPP providers and others in a similar position may have hoped that in such circumstances, provided that their conduct could not be criticised, the Court would be willing to allow the transfer to stand under s.28, protecting the "innocent" SIPP provider – as indeed the Judge at first instance would have been prepared to do. This judgment dispels that notion for good. While s.28 is by its nature fact-sensitive, and at least in theory should always leave room to argue that it would be "just and equitable in the circumstances of the case" to allow

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the agreement to be enforced, in practice SIPP providers and other authorised entities will face the formidable obstacle of the Court of Appeal's reasoning being grounded largely in policy reasons that will inevitably apply to any dispute with an investor introduced by a third party. Careful consideration will be required of the particular facts of each case, seeking to identify particular features of the transaction which may tip the balance away from arguments grounded in the consumer protection aims of FSMA.

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