Is the grass always greener?

Alison Padfield QC & Diarmuid Laffan analyse the obligations of SIPP providers

IN BRIEF

- *R (Berkeley Burke SIPP Administration Ltd) v Financial Ombudsman Service Ltd* shows that SIPP providers cannot rely on disclaimers to avoid liability where unorthodox investments turn out to be a scam.

In a landmark decision on the regulatory obligations of self-invested personal pension (SIPP) providers, the High Court has approved a decision of the Financial Ombudsman Service (FOS) requiring a SIPP provider to compensate its client for an unorthodox investment which turned out to be a scam. This was notwithstanding the fact that the SIPP provider, Berkeley Burke SIPP Administration Ltd (Berkeley Burke), acted for the client, a Mr Charlton, on an execution-only basis and, hence, that Berkeley Burke was under no obligation to assess and advise him on the 'suitability' of the investment in light of his personal circumstances.

In *R (Berkeley Burke SIPP Administration Ltd) v Financial Ombudsman Service Ltd* [2018] EWHC 2878, [2018] All ER (D) 07 (Nov) the High Court rejected Berkeley Burke's claim for judicial review of the decision of the FOS in which it concluded that Berkeley Burke failed to carry out sufficient due diligence on the unorthodox scheme in which Mr Charlton proposed to invest his pension, and thereby to establish whether it was an 'appropriate' investment for a SIPP.

The investment

Mr Charlton, who was a gardener, was introduced by an unregulated financial adviser, Big Pebble Ltd, to a 'green oil' investment scheme that supposedly involved investing in Jatropha tree plantations held by a company called Sustainable AgroEnergy plc (Sustainable AgroEnergy) in Cambodia. He was then introduced by Big Pebble to Berkeley Burke. He opened a SIPP with Berkeley Burke and instructed them to invest his pension pot of £24,195 in the Sustainable AgroEnergy scheme.

Mr Charlton signed a series of documents in which it was made unambiguously clear, in particular, that the proposed investment was high-risk and could be illiquid, that Berkeley Burke was not advising him on the suitability of the investment, and that he should seek independent advice. Berkeley Burke carried out minimal due diligence on the scheme. This was essentially limited to identifying whether it was an investment that benefited from the tax advantages of SIPP investments under HMRC rules.

In due course it emerged that the scheme was fraudulent and that Sustainable AgroEnergy lacked title to the land in Cambodia. Following an investigation by the Serious Fraud Office, three of Sustainable AgroEnergy's directors were jailed for fraud and the company was placed into receivership. In September 2012, Mr Charlton complained to the FOS.

The ombudsman's decision

The FOS issued its final decision on the complaint on 2 February 2017. The provisions underlying the FOS's power to determine complaints are key to understanding both the FOS decision and the High Court's subsequent judgment. Under s 228(2) of the Financial Services and Markets Act 2000 (FSMA) the FOS must 'determine [complaints] by reference to what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case'. In its *Handbook of rules and guidance*, the Financial Conduct Authority (FCA) sets out both rules and guidance for SIPP providers, and procedural rules which flesh out the FOS's complaints jurisdiction.

The handbook contains high-level rules setting out the fundamental obligations of firms regulated by the FCA. These include Principle 2, which requires firms to conduct their business 'with due skill, care and diligence', and Principle 6 which requires them to treat their customers fairly. The Conduct of Business Sourcebook (COBS) section of the handbook contains more detailed conduct rules on specific issues. These include COBS 9 on the suitability of a firm's recommendations to its clients, and COBS 11 on the manner in which client orders should be executed.

In determining what is fair and reasonable in all of the circumstances, the FOS is required to take into account relevant law and regulations, regulatory rules, guidance and standards, and (where appropriate) what the ombudsman considers to have been good industry practice at the relevant time (DISP 3.6.4R).

In determining what amounted to good industry practice, the FOS placed significant emphasis on thematic reports issued by the FCA's predecessor, the Financial Services Authority (FSA), in 2009 and 2012. In these reports, the FSA expressed alarm at the general lack of due diligence carried out by SIPP providers into the intermediaries introducing clients, and the investments they accepted. The FOS also relied on binding guidance issue by the FCA to SIPP providers in 2013, in which it indicated that providers should carry out due diligence on the investments proposed to them with a view to determining whether they are appropriate pension investments.

In relation to Mr Charlton's complaint, the FOS held that good practice required Berkeley Burke, in assessing whether the Sustainable AgroEnergy scheme was an appropriate investment for a SIPP, to:

- identify Sustainable AgroEnergy as a high-risk, non-standard investment, requiring appropriate due diligence;
- ensure that the investment was genuine and not a scam;
- independently verify that Sustainable AgroEnergy's assets were real and secure, and that the investment operated as claimed; and
- ensure that the investment could be independently valued, both at point of purchase and subsequently.

Ultimately, the ombudsman concluded that Berkeley Burke's limited investigations into the Sustainable AgroEnergy scheme and its failure, for example, to establish


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that Sustainable AgroEnergy had title to the relevant land, meant that Berkeley Burke had failed to meet the standard of good industry practice, and hence to act fairly and reasonably with respect to Mr Charlton.

The High Court challenge

Berkeley Burke sought judicial review of the ombudsman's decision. Berkeley Burke argued that the ombudsman had erred in law by using the principles to subject Berkeley Burke to novel, unforeseeable due diligence obligations with no basis in the specific COBS rules:

- Berkeley Burke argued that this amounted to a circumvention of the FCA's statutory obligation to consult prior to exercising its rule-making power (the consultation argument).
- It also argued that the ombudsman's approach involved a misunderstanding of the role of the principles in the *Handbook*'s scheme, on the basis that the principles should only be used to augment or amplify existing rules but should not be used to make new ones (the augmentation argument).
- Finally, Berkeley Burke argued that the ombudsman's use of the principles conflicted with COBS 11.2.19R, which, in part, states that '…whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction'. Berkeley Burke said that it could not be obliged to reject as inappropriate an investment it had been instructed to make if it was subject to an absolute obligation to carry out the client's instructions (the conflict argument).

Under a second ground for review, Berkeley Burke argued that the ombudsman's decision infringed the public law concept of consistency, because it ran contrary to a number of decisions of the Pensions Ombudsman.

The decision of the High Court

In rejecting Berkeley Burke's claim, Mr Justice Jacobs placed significant emphasis on the High Court's judgment in *R (British Bankers Association) v Financial Services Authority* [2011] EWHC 999 (Admin), [2011] All ER (D) 222 (Apr). In that case the British Bankers Association had argued that the *Handbook*'s specific rules 'occupy the field', amounting to an exhaustive prescription of what regulated entities must do to satisfy the general principles, such that the principles should not be used to require anything going beyond specific rules.

Mr Justice Ouseley had rejected this approach, holding that on proper construction of the *Handbook*, it is the principles which occupy the field and apply to regulated entities in all circumstances, with the rules amounting to non-exhaustive expressions of what the principles may require. Jacobs J interpreted Ouseley J's judgment in *R (British Bankers Association) v Financial Services Authority* as indicating that the principles can be used not only to augment specific rules, but to identify firms' obligations in circumstances where no such rules apply.

This analysis was fatal to the consultation argument as it led to the conclusion that the FOS was not impermissibly deriving new rules; it was applying pre-existing ones, namely Principles 2 and 6, which had been consulted on. It was also fatal to the augmentation argument as, if the principles 'occupied the field' beyond the ambit of specific rules, the ombudsman was entitled to apply Principles 2 and 6 independently, and without reference to or by augmenting any specific rule. In summing up what he considered to be the flaw in Berkeley Burke's approach, Jacobs J indicated that Berkeley Burke was not, in essence, complaining about the derivation of new rules, but about the breadth of the pre-existing conduct rules and of the FOS's decision-making powers.

As regards Berkeley Burke's conflict argument, Jacobs J held that COBS 11.2.19R, and the corresponding provisions of the Markets in Financial Instruments Directive 2004/39/EC, should not be construed as importing an absolute obligation on providers to execute clients' orders. Those provisions are concerned with the manner in which an order should be executed once accepted, but do not address the anterior question as to whether an order should be accepted and executed at all. This meant that the supposed conflict was non-existent.

Berkeley Burke's second ground of appeal was rejected on the principal ground that the Pensions Ombudsman has a separate statutory scheme. Berkeley Burke had been unable to cite a single authority in which the public law principle of consistency had been applied to determinations made under different rules.

Future implications

This is a very significant judgment for the SIPP industry. Strongly-worded disclaimers will not absolve execution-only SIPP providers from liability to clients: they must act in line with what the FCA and FOS consider good industry practice, carrying out sufficient due diligence on proposed investments, or risk being found liable to clients if those investments turn out to be a scam.

An application has been made for permission to appeal to the Court of Appeal, and a hearing is awaited. In the meantime, the FCA is concerned that the judgment may provoke substantial claims against SIPP providers and has issued a 'Dear CEO' letter. This notifies SIPP providers of the ruling and reminds them of their obligation to notify the FCA should it affect their financial viability. The letter also says that, where relevant, firms should notify claims to their professional indemnity insurers in accordance with their policies. **NLJ**

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