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Dear CEO

**Action required: review of Self Invested Personal Pension (SIPP) operators**

As you may be aware, we have recently conducted a thematic review of SIPP operators following up on the guidance we issued in October 2013 (FG13/8). In this review, we focused on:

- the due diligence procedures SIPP operators used to assess non-standard investments, and
- how well firms were adhering to the relevant prudential rules

During our review, we found that a significant number of SIPP operators are still failing to manage these risks and ensure consumers are protected appropriately, despite our recent guidance. In our view, the failings we identified put UK consumers' pension savings at considerable risk, particularly from scams and pension fraud. We have already discussed this with the firms concerned, explaining that these failings are unacceptable and need to be addressed.

I am now writing to you, and to the CEOs of all SIPP operators, because our thematic review indicates that these failings continue and are widespread, despite previous communications. We are concerned that many firms in this sector continue to demonstrate a lack of engagement with some areas of their regulatory obligations, and hence pose a threat to the quality of outcomes experienced by consumers.

We have already required several firms to limit their business as part of our thematic review and in some cases have initiated Enforcement investigations. Over the coming months we intend to visit more firms, and expect to see significant improvements. We will also build these areas of focus into our regular supervisory work for smaller (C4) SIPP operators, so we have an opportunity to engage with every firm, and we will use this work to review firms' actions.

I would encourage you to review the key findings from our thematic review in the Annex to this letter, and ask you to take action to ensure that your business is able to demonstrate an appropriate degree of protection for consumers' pension savings.

Where firms fail to meet our expectations and continue to put UK consumer outcomes at risk, we will take further action.

Yours sincerely

Clive Adamson  
Director of Supervision

## **Annex to Review of SIPP operators Dear CEO letter**

### **Action required**

We are asking you to review your business in light of these findings. We expect you to specifically review that:

- when your firm undertakes non-standard investment business<sup>1</sup> you have adequate procedures in place to assess these investments, and
- the capital position within your firm is being accurately reported<sup>2</sup>

### **Key review findings**

Our thematic review identified significant failings in each of the following areas:

- due diligence procedures to assess non-standard investments, and
- SIPP operators' compliance with UK prudential rules

These failings continue to occur despite the guidance issued to SIPP operators following the last thematic review:

[www.fca.org.uk/your-fca/documents/fg13-08](http://www.fca.org.uk/your-fca/documents/fg13-08)

### **Due diligence on non-standard investment business**

Principle 2 of the FCA's Principles for Business requires all firms to conduct their business with due skill, care and diligence. SIPP operators should ensure that they conduct and retain appropriate and sufficient due diligence, for example, assessing that assets allowed into a scheme are appropriate for a pension scheme. Our thematic review found that most SIPP operators failed to undertake adequate due diligence on high-risk, speculative and non-standard investments despite being aware of the Financial Services Authority (FSA) guidance originally published in 2012 which clarified our expectations of firm conduct.

Our review assessed due diligence processes in these five key areas:

- correctly establishing and understanding the nature of an investment
- ensuring that an investment is genuine and not a scam, or linked to fraudulent activity, money-laundering or pensions liberation
- ensuring that an investment is safe/secure (meaning that custody of assets is through a reputable arrangement, and any contractual agreements are correctly drawn-up and legally enforceable)
- ensuring that an investment can be independently valued, both at point of purchase and subsequently, and
- ensuring that an investment is not impaired (for example that previous investors have received income if expected, or that any investment providers are credit worthy etc.)

Please note that the due diligence necessary for individual investments may vary depending on the circumstances, and the five areas highlighted above are not exhaustive.

<sup>1</sup> Our thematic review used an approach to categorising non-standard assets based on the proposed definition used in FSA consultation paper CP12/33 but excluding most UK commercial property if not arranged as a fractional investment.

<sup>2</sup> SUP 16.3.11 R, and SUP 15.6 Inaccurate, false and misleading information – FCA Handbook.

We found that most firms do not have the expertise or resources to assess this type of business, but were still allowing transactions to go ahead. This increases the risk that a pension scheme may become a vehicle for high risk and speculative investments that are not secure assets, many of which could be scams. It is not acceptable for firms to put consumers at risk this way.

Although our thematic review focussed on non-standard investments, it is important to note that guidance on due diligence applies to all investments.

Findings from our review included firms failing to:

- understand the nature of an investment, especially contracts for rights to future income, and sale and repurchase agreements
- check that money was being paid to legitimate businesses, and
- to independently verify that assets were real and secure, or that investment schemes operated as claimed

We found that, typically, firms had difficulty completing due diligence for non-standard overseas investment schemes where firms did not have access to local qualified legal professionals or accountants. Also, since the last review of SIPP operators, we noted an increase in the number of opaque investment structures, such as special purpose vehicles and limited companies, created to pool investment monies and finance other businesses. Firms had difficulty establishing where money was being sent, and whether underlying investment propositions were genuine.

We also found that many SIPP operators accepted investments into their schemes without adequate consideration of how investments could be valued or realised.

Finally, we found many firms continuing to rely on marketing and promotional material produced by investment providers as part of due diligence processes, despite previous guidance highlighting the need for independent assessment of investments.

## **Prudential rules**

We found that many SIPP operators which are not subject to the Capital Requirements Directive (CRD) are failing to apply the correct prudential rules to their business. In some instances, firms were found to be operating in breach of current minimum capital requirements.

Many of the firms we assessed were unable to identify the correct prudential rules that applied to their business, and we found a general lack of understanding of prudential requirements amongst senior management.

Findings for SIPP operators not subject to CRD included firms failing to:

- understand that a liquid capital requirement applies to firms with SIPP operator permissions (dependent in some instances on the scope of this business)
- identify and deduct illiquid assets, such as tangible assets and most loans, from capital
- ensure that inter-company loans and other loans met the criteria for eligible liquid capital

- correctly calculate an Expenditure Based Requirement (EBR) using audited figures that reflected the true cost of regulated activities, and
- to correctly calculate a firm's capital requirement, often omitting requirements for certain assets or position risk

We also found that regulatory returns for prudential reporting were frequently inaccurate and only partially completed.

### **Summary of action required**

We ask you to review your business in light of these findings. We expect you to specifically review that:

- when your firm undertakes non-standard investment business<sup>3</sup> you have adequate procedures in place to assess these investments, and
- the capital position within your firm is being accurately reported<sup>4</sup>

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<sup>3</sup> Our thematic review used an approach to categorising non-standard assets based on the proposed definition used in FSA consultation paper CP12/33 but excluding most UK commercial property if not arranged as a fractional investment.

<sup>4</sup> SUP 16.3.11 R, and SUP 15.6 Inaccurate, false and misleading information – FCA Handbook.