Storing up trouble – analysing the Court of Appeal's decision in *Carey Pensions*

What does it mean for the wealth management market?

As many of you will have seen, as part of our recent 'Wealth Management – A Year in review – 2020' report we considered two key legal decisions in *Carey* and *Avacade*. Both cases deal with the FCA's regulatory perimeter and are likely to have great significance for the wider wealth management sector. The Court of Appeal (CoA) has now handed down its judgment in *Carey*, overturning the first instance decision.

The CoA decision is both welcome and, at the same time, disappointing. We had hoped for commentary (if not clear judicial guidance) on key questions around:

– The status of mere introductions under Article 25(2) of the Regulated Activities Order (RAO);

– More generally, guidance on the activities or arrangements involved in 'making arrangements with a view to transactions in investments' as per Article 25(2); and

– The effect of COBS 2.1.1 from a regulatory perspective looking forward and in terms of liability for past conduct.

Unfortunately, the CoA appears to have largely swerved these topics (which, whilst appropriate for the case, is disappointing for all those interested in financial services regulation). It is hoped the *Avacade* appeal, scheduled to be heard in July, will cover these areas, but in the meantime the *Carey* decision is not good news for those appellants in the *Avacade* appeal.

Who will this decision effect?

This decision has provided commentary on a number of useful areas. Our big take away – which is unlikely to be a surprise to anyone in the market – is that dealing with unregulated introducers is ever more an area fraught with danger from a regulatory and liability perspective. This transcends beyond the SIPP market.

In our view, execution only services or limited advice type services are most at risk. We say this as truly independent and comprehensive COBS 9A suitable advice is more likely to mitigate against the dangers of unregulated introducers as it should stop the introducers leading the investment decision. That being said, firms should use that as a fall back rather than rely on that fact and still implement robust procedures for unregulated introducers.

From unregulated businesses, any company or individuals involved in lead generation or a 'sales process' will need to be very aware of this decision where the investor owns or will own a regulated product or 'specified investment' (including any wrappers).

The decision

Article 53

Newey LJ reviewed various authorities and summarised the relevant principles to consider when determining if advice has been provided. The key points are worth quoting in some detail:

– "*Advice on unregulated investments can potentially be material to whether (and, if so, what) advice is being given on specified investments. Where… someone lauds an unregulated investment which could be bought only by selling a specified one, he can fairly be regarded as advising on the merits of selling the specified investment regardless of whether he voices criticisms of it. The advice on the new investment conveys the message that the existing one would be less good*".

– "*If a person praises an unregulated investment which would need to be acquired by means of a particular vehicle, it may very well, depending on the particular facts, be right to see him as advising that the vehicle be adopted*".

– "*In short, advice on an unregulated investment is sometimes capable of involving advice on a specified one within the scope of Article 53 of the RAO and so of being regulated activity*".

– "*That the simple giving of information without any comment will not "normally" amount to advice*".

– He agreed with Judge Havelock-Allan QC[1] that the provision of information which "*is itself the product of a process of selection involving a value judgment so that the information will tend to influence the decision of the recipient*" is capable of constituting advice.

– "*I also agree with Henderson J[2] that "any element of comparison or evaluation or persuasion is likely to cross the dividing line*"".

– "*I would add that "advice on the merits" need not include or be accompanied by information about the relevant transaction. A communication to the effect that the recipient ought, say, to buy a specific investment can amount to "advice on the merits" without elaboration on the features or advantages of the investment*".

– Generic advice is not sufficient to satisfy the requirement that the advice relates to a "*particular investment*". For example a

[1] *Rubenstein v HSBC Bank plc* [2011] EWHC 2304 (QB), [2012] PNLR 7

[2] *Walker v Inter-Alliance Group plc* [2007] EWHC 1858 (Ch), [2007] Pens LR 347

recommendation to invest in European equities would not fall within Article 53.

– "*However, I do not think advice necessarily has to apply to just one product or asset for* Article *53 to be in point. For example, advice to buy shares in BP would be in respect of a "particular investment" (or, perhaps more accurately, a number of "particular investments") even though more than one class of BP shares was listed*".
– Newey LJ went on to reference PERG 4.6.6G, PERG 5.8.5G and PERG 5.8.14G. He says "*I have indicated, it seems to me that the Perimeter Guidance Manual is right that advice does not have to concern only a single type of insurance policy or mortgage for Article 53 of the RAO to be applicable. Advice can relate to a number of "particular investments*"".
– "*For my part, I can well see that advice on the merits of using a particular insurance broker or adviser will not normally involve even an implied recommendation of a particular policy or policies and so will not be encompassed by Article 53*".

Taking all of these points together, Newey LJ concluded that "*While CLP [the unregulated introducer] was commending the ultimate investment in storepods, which were not a regulated investment, it was also encouraging Mr Adams to achieve that end by transferring out of the Friends Life policy and buying a Carey SIPP, both of which were regulated. In the circumstances, I cannot agree with the Judge that any advice from CLP related exclusively to the storepods*".

He went on to say "*I also part company with the Judge on whether "'recommending' a specific SIPP… falls short of advising on the merits of a particular investment". To the contrary, I cannot think of any reason why a recommendation of a specific SIPP should not constitute "advice on the merits" of a "particular investment*"". We would agree with this. It is the difference between a general recommendations of a provider versus a recommendation of an actual product. We were unclear quite what the judge at first instance was referring to with this as he had said that he had taken Mr Adam's evidence to indicate "*a recommendation of [Carey] and not of any of their specific products*", which appears to be contradictory to his other statement.

Interestingly, Newey LJ went on to say that "*However, it seems to me that "steering an investor in the direction of a specific SIPP provider" is certainly capable of being advice on the merits of a "particular investment" or "particular investments". As already indicated, I do not think advice need relate to a single product or asset to relate to a "particular" investment or investments. Moreover, Carey did not offer a wide range of SIPPs. While it marketed two species of SIPP (the "Full SIPP" and the "Restricted Investment SIPP"), the documentation we have seen indicates one overarching pension scheme, and in any event only the "Full SIPP" could be used for the purpose for which Carey was being recommended, namely, investment in storepods. In the circumstances, it seems to me plain that the advice as to Carey was sufficiently specific for it to relate to a "particular investment" within the meaning of Article 53 of the RAO*". In our initial article, we described how we can foresee a recommendation to a product provider could be contrived such that an implicit recommendation is made. Newey LJ has described (and the CoA found) just such an example.

Our initial article had concluded that it is "*hard to see how a recommendation of a product provider could or should generally amount to advising on a particular investment, as contemplated by the RAO*". Whilst we still consider this to be the position, as can be seen from Newey LJ's decision where he says *"For my part, I can well see that advice on the merits of using a particular insurance broker or adviser will not normally involve even an implied recommendation of a particular policy or policies and so will not be encompassed by Article 53*", it does appear there is the potential for this line to become more blurred.

However, factually, Newey LJ highlighted that "*Mr Adams explained in his witness statement that "Ben" had told him that he "could unlock some pension money if [he] moved [his] pension … and reinvested it with StoreFirst by buying Storage Pods", that he could "transfer [his Friends Life pension] into a pension that would perform better and allow [him] to invest in better investments",… that his pension "would do better and it would be safely and securely held with a reputable UK based pension provider" and that his pension "would be held with reputable UK pension provider*"". With this in mind, it is hard to argue there was not, at the very least, implicit (and personalised) advice that Adams' should transfer out of his Friends Life pension. Equally, Newey LJ made clear that the recommendation of Carey, in the specific circumstances, could only have related to one SIPP product (and Carey only offered two). The real lesson here is to ensure – like the Court of Appeal – that firms view the process and arrangements as a whole and not in isolation. There must also be more attention paid to implied recommendations (whether personal or general).

Article 25(1)

Newey LJ set out a number of principles relevant to determining when arrangements satisfy Article 25(1), these are:

– The causal requirement arising from Article 26 is not a 'but for' test.
– There is no requirement that the arrangements which are said to "bring about" any transaction must result in the transaction actually taking place.
– The exclusion in Article 26 implies a "causal potency" in Article 25(1). He went on to say "*For arrangements to "bring about" a transaction for the purposes of Article 26, they must play a role of significance. Whether or not arrangements "bring about" a transaction is not to be judged simply on a "but for" basis, but neither is a "direct" connection inevitably required*".

– The fact that the process was out of CLP's hands to control did not prevent any finding that the arrangements satisfied Article 25(1).
– It is not determinative that the arrangements can be termed as administrative.

At first instance, HHJ Dight summarised the six steps alleged by Adams to have amounted to Article 25(1) arranging, these were:

– procuring the letter of authority (i.e. the letter authorising Carey to liaise with CLP);
– procuring a discharge form in respect of the Friends Life transfer;
– the undertaking of money-laundering investigations;
– the completion of the application form 'which had been delegated to CLP' (the judge found that such delegation did not actually take place);
– the instructions to Store First to identify pods to be sold; and
– the explanations that CLP was expected to provide in relation to key features and the terms of business.

Of these arrangements, the CoA determined that the following three amounted to arrangements in relation to the specified investments (i.e. the Friends Life policy and Carey SIPP) and that they could be said to have brought about the transfers:

– the letter of authority;
– money-laundering investigations; and
– completion of the application form.

Newey LJ concluded that "*In my view, what CLP did was thus significantly instrumental in the material transfers. In other words, there was, in my view, sufficient causal potency to satisfy the requirements of Article 26 of the RAO*". These examples of arrangements are useful in showing what amounts to 'arrangements'. It is also worth pointing out that the three steps found to not be arrangements were exempted on the facts and should not be viewed as indicative of what is acceptable.

Additionally, Andrews LJ stated "*However, when considering whether Article 25(1) or Article 53 of the RAO has been contravened in a given case it is of crucial importance to stand back and consider the behaviour of the unregulated entity holistically*" thus showing the importance of a holistic rather than formulaic approach. In reality, we would recommend firms considering this question from both perspectives.

Based on this finding, along with the Article 53 finding, Newey LJ stated the Court did not need to consider Article 25(2). This is disappointing as this is (arguably) the more difficult regulated activity to define owing to the current lack of judicial guidance and inconsistent judgments.

Sections 27 and 28 FSMA 2000

Having determined that CLP acted in breach of the 'general prohibition', Newey LJ went on to consider Sections 27 and 28 of FSMA. He held, unsurprisingly, that the relevant transactions were 'in consequence of' CLP's arranging deals within Article 25(1). Therefore, subject to Section 28(3), Mr Adams would be entitled to recover money and other property transferred under the agreement with Carey.

Newey LJ determined that, for the purposes of Section 28(6) and whether the provider knew that the third party was (in carrying on the regulated activity) contravening the general prohibition, the word "knew" required actual knowledge rather than whether Carey should reasonably have known.

Paragraph 112 of the judgment sets out the facts on which Carey argued the Court should grant relief under Section 28(3). Paragraph 115 sets out the reasons why Newey LJ decided not to grant relief. Amongst them he highlights the key aim of FSMA being consumer protection, the inherent risk for authorised firms of Section 27 FSMA and dealing with unregulated introducers, as well as a number of case specific considerations.

Litigation and FOS: The basis on which the Court of Appeal refused relief to Carey is interesting. The Court seemed heavily influenced by the overarching aim of FSMA being consumer protection, i.e. protecting Mr Adams, even though he chose to make a speculative and high-risk investment. The Court also emphasised the inherent risk that dealing with unregulated introducers poses for an authorised firm like Carey. Protecting a consumer in this way, arguably from the consequences of his own informed investment decision and the influence of the introducer, may chime with the approach taken by the FOS in such situations and provide the FOS with confidence to continue that approach.

Jonathan Hyde, Financial Risks Director – on the Court's rationale for refusing to exercise its discretion under Section 28(3).

What is perhaps disappointing is that there is no real indication as to how the factors should be balanced. Perhaps this was a case in which the Court felt it was not a difficult exercise. We thought it was significant that Mr Adams knew what he was doing was high risk and speculative and he chose to do it, in part, to obtain a payment out of his pension. Evidently, the Court decided this was not an important factor.

PI insurance: Financial professionals and their insurers should take note of the Court's comments around the number of investors caught up in the Storepods investment. Over about six months, 580 of Carey's clients invested in Storepods. The Court of Appeal said "*it is hard to suppose that 580 people would spontaneously decide to invest in Blackburn Storepods. Thus there was reason for Carey to be concerned about the possibility of CLP advising on investments…albeit that it is to be assumed that it did not in fact appreciate that the general prohibition was being contravened".* We frequently see cases where significant numbers of people ask a firm to arrange an investment in the same product either as an insistent customer or on an execution only basis over a relatively short period of time. This might be directly or via a SIPP. A key issue is when should the firm start to question the volume of instructions and investigate whether a third party is involved and if the third party (or a known unregulated introducer) is secretly receiving a commission, suggesting that advice has been given and the general prohibition breached.

Part of the reason for Carey's downfall was that it had terminated its relationship with the introducer the day before it requested the transfer of Mr Adam's pension, although it seems that it had done so because of concerns expressed by the FCA about the introducer rather than because it had detected a suspicious pattern of investment. The Court does not comment on whether Carey should have detected the pattern, because the discussion of this point is framed in the context of Section 28(6) FSMA which refers to the actual knowledge of the provider, not what it should have known; however, the Court remarked that it could be appropriate to deny a provider relief for a contravention of the general prohibition by a third party if the provider should have known about it.

Further, we can envisage FOS accepting that a firm should have detected a suspicious investment pattern and investigated. 580 investments in Storepods in six months is quite extreme. Commission on Storepod investments represented 30% of Carey's income in 2012. It is hard to identify the point at which an investigation should be triggered. To an extent this will depend on the size of the firm and its typical volume of business in the area of concern. 58 investments in six months could easily be regarded as suspicious for a moderately sized firm. 5 seems less likely, but a small firm with no other investments of this type could be at risk.

On a practical level, firms have often informed us that while they can and do monitor (for example) the number of pensions transferred and/or SIPPs opened on a monthly basis, their systems do not permit them to monitor specific investments within SIPPs, so suspicious patterns would not be detected. We doubt FOS would be interested in such arguments and would strongly suggest that system upgrades may be in order.

Harriet Quiney, Financial Risks PI Litigation partner - on practical considerations for firms when arranging investments on an insistent client and/or execution only basis.

Client's best interest rule / COBS 2.1.1

In terms of COBS 2.1.1 and the 'client's best interest' rule, the CoA did not overturn the first instance decision.

However, this was mainly because of how the case was pleaded. Specifically, Newey LJ stated that Mr Adams' "*arguments represent not so much a challenge to the grounds on which the Judge dismissed the COBS Claim as an attempt to put forward a new case*". Unsurprisingly, Carey strongly asserted there was no justification for this, to which Newey LJ agreed and stated "*It follows that the appeal in respect of the COBS Claim must fail*".

Newey LJ went on to say that "*I would add that Mr Adams might anyway have struggled to overcome the Judge's finding that any breach of duty was not causative of loss*". Whilst that is good news for respondent firms, that is hardly a ringing endorsement of the approach undertaken by HHJ Dight at first instance. We assume any finding of lack of causation would likely have been based on Mr Adams accepting he had been warned more than once about the high risk speculative nature of the investment and proceeding anyway.

Accordingly, whilst this is good news, we expect there to be further attempts to categorise this rule as having far reaching consequences in later FOS and Court cases. This also does not change the fact that the FCA, at first instance, intervened to state that this rule could result in significant duties arising on firms.

Investment transfers within a SIPP

The CoA also stated that the FCA's views at PERG 12.3 are wrong. Newey LJ stated "*It seems to me that advice on a SIPP exchanging assets neither of which is a specified investment is not a regulated activity*". Andrews LJ went further in saying that this applied whether the SIPP "*has a trust structure… or is contract-based*".

Conclusion

We have already seen this decision described as very important. It evidently will have important implications but we consider it is just as important for the points it did not cover. We hope that the appeal in the *Avacade* case goes ahead and covers Article 25(2) and the status of introductions. However, we fear - as has happened in this decision - the CoA will find that *Avacade* were involved in Article 25(1) arranging and therefore, as with *Carey*, it does not need to consider Article 25(2). Equally, full CoA commentary on the client's best interest rule would also be valued.

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