

# Investment schemes that are potentially dubious

17 August 2020

A thematic review to enhance our understanding of typical schemes and explore how and why solicitors become involved

## *Introduction*

### *Background*

Most solicitors provide appropriate advice to their clients on the benefits and risks of investing and most investment schemes have a sound financial basis. Solicitors carry out these activities by relying on Part 20 of the Financial Services and Markets Act 2000 (FSMA) or under regulation by the Financial Conduct Authority (FCA)<sup>1</sup> [n1] .

All investments carry risks but in today's financial climate with low rates on savings, some buyers may seek alternative and riskier ways of obtaining a greater return on their investment. That can put people at risk of losing their money in dubious investment schemes - in this review losses were typically more than £1m per scheme.

While most solicitors would never willingly get involved in potentially dubious schemes, those that do, whether knowingly or not, lend a veneer of credibility which sellers can exploit to help persuade consumers that their offer is legitimate.

The sellers and promoters of these schemes, which usually offer attractive returns, may suggest that the solicitor's involvement is a safeguard that protects the buyer's financial investment. However, that is not the case and these schemes can result in significant consumer losses that are not recoverable, causing real distress and undermining public confidence in the profession.

All solicitors should be mindful of the risk of acting in a dubious scheme. They should act with integrity and protect consumers by robustly analysing the reality and risks of any financial arrangements they are involved in. If solicitors suspect that a transaction is potentially fraudulent or so high risk that it is unfair to buyers, they should provide full and frank advice to buyer clients and cease to act for seller clients.

We have warned that it is professional misconduct for a solicitor to act or to continue to act in a dubious investment scheme. We will take disciplinary action against any solicitors who fail to carry out reasonable enquiries to

satisfy themselves that transactions they are involved in are not fraudulent or who take unfair advantage of buyers.

In the last five years, we've taken 48 solicitors and two firms to the tribunal, resulting in 16 strike offs, eight suspensions and £870,000 worth of fines. We have also issued guidance and published three warning notices about the key signs of dubious investments in 2013, 2016 and 2017.

However, we continue to receive reports about a minority of solicitors who are involved in dubious investment schemes, as well as claims on our compensation fund when they fail. In many instances the claims do not fall within the rules of the fund, but nevertheless, the sums that have been paid out are considerable and the risk of further claims led us to increase the profession's contribution to the compensation fund for several years.

This review explores how and why firms become involved in dubious schemes, provides case studies, shares good practice and sets out red flags to help firms avoid any involvement.

We carried out a review of 40 open and closed internal files related to dubious investment schemes reported to us. We complemented our review with visits to six firms we identified as being potentially involved in dubious investment schemes.

The work was undertaken between September 2018 and June 2019, with visits to six firms taking place during March and April 2019.

This review should be read in conjunction with our updated warning notice [<https://www.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/>] , which includes details of the types of schemes that we have seen and supports solicitors and firms to identify the risks and to put in place effective controls.

## *Key findings*

### *Types of scheme*

Dubious investment scheme sellers continue to change the nature of the schemes they are involved with on a periodic basis. This is most likely in an attempt to avoid detection, with changes often made as a direct result of warnings about certain types of schemes which have been made by the SRA and other agencies.

We found that the types of dubious investment schemes which solicitors are most likely to become involved with can be typically be categorised into four areas:

- Buyer-led developments or refurbishments (eg off-plan)



- Fractional developments (eg rooms, spaces or units within wider schemes)
- Alternative investments (eg precious metals, fine wines)
- Complex financial products (eg loans, shares, bonds).

In recent years (since 2017) we have seen a significant increase in reports linked to off-plan and fractional investments, especially linked to a number of collapsed developments schemes in the north west of England.

While cases linked to alternative investments used to be the most common type of issue we investigated, we had just one case involving such schemes between 2015 and 2017.

### *Why solicitors are targeted*

Those selling dubious investments will typically look to engage solicitors to help them sell or administer a scheme, as by involving a solicitor they make the opportunity look more credible and safer in the eyes of potential buyers.

Some schemes even directly refer to the fact that a solicitor they are working with is regulated in their marketing material, in effect giving the false impression that the scheme itself is regulated.

Most typically the roles a solicitor was being asked to play in the investment schemes we looked at included completing the conveyancing of a property transaction (53 per cent) and providing a client account through which investment funds could pass (50 per cent).

We also found a significant number of examples where solicitors were being asked to draft contracts or provide legal advice to buyers. This is despite the fact that in nearly half of cases they did not have direct expertise, knowledge or experience in the given type of investment opportunity.

### *Typical firm profile*

Generally, we found that larger firms, typically with a turnover more than £500,000 are slightly more likely to be targeted/unwittingly get involved in dubious investment schemes. However, our files contained examples of firms of all sizes being involved and no firm should be complacent about taking steps to protect consumers.

In terms of geography, we found that neither a firm's location, nor its proximity to any related investment property, necessarily impacts on the likelihood that they will be targeted.

In many schemes promoters first identify potential buyers by cold calling across geographical areas, and then source a solicitor in those areas using the same approach.

### *Typical buyers targeted*

In most cases we reviewed we found dubious investment scheme promoters specifically look to target certain types or demographics of buyer. It is important that all solicitors remain mindful of these patterns and consider these when risk assessing and completing due diligence on any piece of work they are asked to get involved with:

- **Overseas:** More than half the cases we reviewed were targeted at overseas investors (especially those from South East Asia).
- **Older people:** A fifth of the schemes specially targeted retirees and older people (in particular involving unregulated schemes which sought buyers to release pension funds early).

### *Issues with solicitors*

#### *Not acting the best interests of buyers*

When they are acting for a seller in an investment scheme, our review found that some firms need to do more to make sure that they do not take unfair advantage of buyers. For example, we found that almost half of firms in our file sample were involved in schemes where the third-party buyers did not have their own independent legal advice.

In some cases, firms provided limited advice to these buyers and the buyers mistakenly believed the firms were acting for them. Additionally, we found some solicitors acting for buyers failed to act in their best interests if their firm was a panel firm for the scheme promoter.

#### *Lack of due diligence*

In more than three quarters of the cases we reviewed we found examples of solicitors' independence and their ability to act fairly to buyers was potentially compromised by pre-existing relationships they had with scheme promoters. This over familiarity meaning they failed to conduct sufficient due diligence or scrutiny on behalf of buyers.

#### *Retained clients*

Six firms in our sample attempted to justify their role in a dubious scheme by carving out the purported legal work from the investment and limiting the scope of their retainers with buyers. This was not in accordance with the buyer's explicit instructions in any of our files and was not in their best interests.

### *Our actions*

We expect firms to identify and take steps to mitigate potential risks to buyers. If firms are asked to act in a matter that has a financial investment element, we expect them to carry out robust enquiries into the validity of the scheme and their role within it.

If firms suspect a scheme is dubious, they should provide full and frank advice to buyers and should not act in these circumstances. A firm limiting their retainer, for example by separating the investment element or by stating that they are not advising on the investment itself, will not be protected from a finding of misconduct if they fail to act in a client's best interest.

We continue to take action against solicitors that fail to heed our warnings and involve themselves – unwittingly or otherwise – in schemes that turn out to be dubious.

Of the 40 historic cases we reviewed for this report:

- one has been closed due to insolvency
- seven have been intervened into
- twenty have been referred to the Solicitors Disciplinary Tribunal (SDT)
- twenty-one have been subject to a formal finding (SDT or Adjudication)

Further work is still required in 31 of these matters.

We also referred three of the six firms we visited during the review into our disciplinary processes for issues reacting to failing to act in the best interests of their clients and/or third parties.

*Download the full thematic review (PDF 43 pages, 461KB)*

[<https://www.sra.org.uk/globalassets/documents/sra/research/dubious-investment-schemes---thematic-review.pdf?version=4a3940>]