Solicitors Regulation Authority

Investment schemes that are potentially dubious

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

August 2020

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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)[1].

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.

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[1] Under Part 20 of FSMA, Solicitors and firms can conduct some, but not all, investment activities for clients if the activities are incidental to the provision of professional services provided by the firm and are complementary to the provision of a particular service to a particular client, and they account to the client for any commission.
https://www.legislation.gov.uk/ukpga/2000/8/part/XX

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, 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.

Understanding dubious investment schemes

Concern

We are concerned that some solicitors are not taking adequate steps to assess the viability and credibility of investment schemes.

This may be because schemes have evolved from high yield financial arrangements, involving unusual products or prime bank instrument fraud, to more recognisable legal transactions such as conveyances. Therefore, it may be more difficult for buyers and firms to immediately identify them as being fraudulent.

However, there is also evidence that solicitors are failing to acknowledge that the services they provide add little value and they are taking unfair advantage of buyers by acting in transactions with no underlying legal transaction.

What do we expect?

We expect solicitors and firms to familiarise themselves with our guidance and warning notices to make sure they are aware of common features in dubious schemes so that they can advise buyer clients fully on the risks of a scheme.

We expect solicitors to act with integrity[2] and only act in matters where there is a justifiable reason for their presence. This means undertaking due diligence on the scheme, scrutinising relevant documentation and satisfying themselves that the scheme is genuine before they act. If a solicitor has reason to suspect that the scheme is dubious, they should refuse to act.

[2] Principle 5, SRA Principles 2019

Findings

Types of investment schemes

We examined the different types of investment product offered to buyers and found that these could broadly be categorised into four different types:

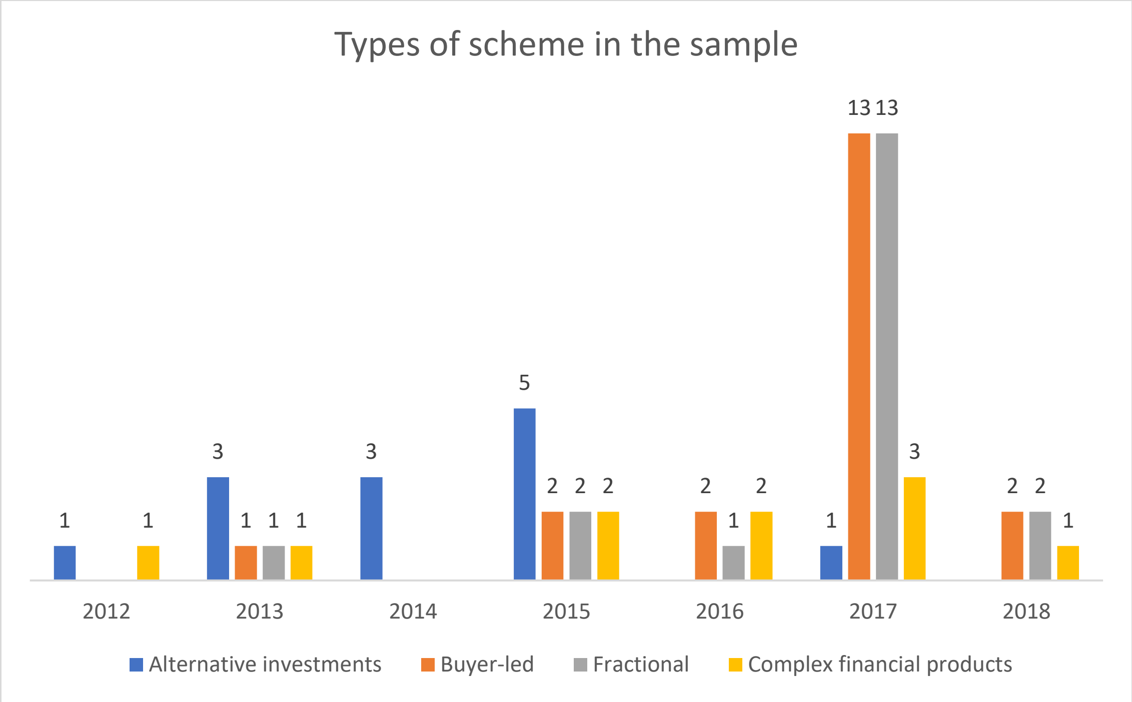
- buyer-led developments or refurbishments, for example: residential and commercial student accommodation blocks
- fractional investments, for example: hotel rooms, car parking spaces and self-storage units
- alternative investments, for example: diamonds, fine wine, rare earth metals/minerals or carbon credits
- complex financial products, for example: bank instruments, credit notes, loans, shares, pensions and mini-bonds

The chart[3] below shows the number of reports we have received about different types of investment products in our sample. The date refers to when the conduct file was opened by our Risk Assessment team, rather than when the investment was made.

From this we can see that reports about:

- alternative investments are not as common as they were previously
- complex financial products have remained consistent
- there was a significant increase in reports to us about buyer-led and fractional investments in 2017.

[3] There is considerable overlap between 'buyer funded/buyer-led and 'fractional' transactions, e.g. buying a share of a hotel yet to be built. For the purposes of the graph, 'fractional' relates to a share in an existing asset.



The spike in reports about buyer-led off plan investments in 2017 was because of the failure of several linked developments in the north west during 2016 and 2017, following the insolvency of the developer.

However, it is not necessary for a scheme to fail for a solicitor's involvement to give rise to a regulatory concern. In six files, the scheme had not failed but the solicitor's involvement had still been reported to us by third parties such as the police, another firm or an accountant.

Collective Investment Schemes (CIS)

Ten firms in our files were alleged to have been involved in a CIS. This is because the type of scheme they were involved in required buyers to pool their money together, for example to finance the construction of a building, or to buy a cemetery.

Some of these schemes also amounted to a 'Ponzi' scheme because buyers were incentivised with returns on their deposits before the development was completed.

Solicitors should exercise caution when being invited to be involved in any scheme that appears to involve a collective investment element such as crowd funding schemes. They run the risk of being involved in an unregulated CIS, which is a criminal offence.

Buyer-led property developments

Buying off plan property, typically residential, is not in itself unusual. However, we found that there were specific risks associated with buyer-led, also known as buyer funded investments.

These are projects in which developers circumvent mainstream banks and invite buyers to fund the entire construction of a development or its significant refurbishment. They are often marketed to overseas buyers and are attractive because plots are usually sold under market value and offer higher than usual market returns from future rental income, often purportedly guaranteed. They are also high risk because it is the buyer, rather than the developer who finances the project and they stand to lose the most if it is not completed.

Buyer-led property schemes often exhibited several red flags highlighted in our previous warning notices on dubious investment schemes. Common features in these transactions included:

- unusually high 'deposits' before completion
- high levels of returns guaranteed over a fixed period
- guaranteed or assured rental income
- guaranteed buy back by the seller
- dubious protections to secure deposits
- unfair and poorly drafted sale agreements
- most buyers are overseas making it difficult to verify progress

In some cases, the sale terms, or the sellers' credentials should have alerted solicitors to the risk that the schemes were not a genuine conveyance and there was no underlying legal transaction.

In most cases, buyer-led development schemes were not inherently fraudulent but inherently high risk and should have been treated with caution by the solicitor. Buyers paid unusually high deposits before completion, which allowed the developers to begin construction before all the plots had been sold.

However, the funds could be used for any purpose and there was a significant risk that sufficient capital might not be secured from the sale of remaining plots to complete the development. Concerningly, firms did not advise buyers about the risks these types of new developments hold and failed to make sure their interests had been protected in the event the scheme failed.

Schemes failed for a variety of reasons; because deposits had been released early and misappropriated, insufficient capital had been raised from deposits, developers went into administration or the development had simply not progressed. We have warned solicitors that they should strongly advise buyers not to enter these types of transactions.

Deposits

In traditional conveyances, deposits are typically paid when contracts are exchanged and are usually 5 or 10 per cent of the purchase price of the property. They demonstrate the buyers' intention to complete the purchase and protect the seller.

However, a common feature in 15 of the files reviewed, was the requirement to pay high deposits, often in staged instalments before exchange. We found cases where the total deposit paid by buyers was between 50 per cent and 75 per cent of the purchase price.

Paying a high deposit tied buyers into the scheme and increased the risk of them losing significant sums of money before the property was completed. In all the files we reviewed involving buyer-led developments, deposits were purportedly protected by securities such as a solicitor managed buyers' company holding the funds, insurance bonds and undertakings.

However, once deposits had been paid, these safeguards afforded little protection and buyers had limited control over how their funds were used. In some cases, deposits were used for a range of ancillary activities, including marketing costs and paying agents' commissions which were up to 25 per cent of the purchase price. In one case, a lender had been given a first legal charge over the freehold of the land rather than the buyers' company.

The use of the term 'deposits', rather than further instalments, implies that there is a genuine underlying conveyance, which may lead the buyer to think that their investment is protected. It tempts the buyer to invest further, even though the development may not have progressed. Psychologically, buyers might be reluctant to walk away from an investment if they have already paid a large proportion of the purchase price before exchange of contracts.

We saw examples of buyer-led development schemes involving student and residential accommodation blocks at two of the firms we visited. The schemes required deposits of up to 75 per cent before exchange and included additional costs such as £5,000 for a furniture package, a £5,000 reservation fee and general maintenance costs. We were concerned that such high deposits put buyers at significant risk of losing funds.

High returns

High deposits were counterbalanced with attractive returns which were typically higher than those offered by conventional savings accounts. For example, one firm in our file sample dealt with a scheme which offered the buyer a 6 per cent return on the original investment each month, which amounted to a total return of 72 per cent per year.

As well as the level of return on offer, we saw returns presented in a variety of ways:

- a set guaranteed level of return on a regular monthly or yearly basis
- a guaranteed level of return which would increase over time, for example 10 per cent in the first year then 11 per cent from year three onwards
- a guaranteed rate of return for a set period with an option to sell at the end of the term. For example, a guaranteed income of 7.5 per cent for the first three years with an option to sell the investment at the end of the third year for the purchase price plus 10 per cent
- a variable rate of return, for example the investment would return between 8 per cent and 12 per cent
- In some cases, returns were being offered before the transaction had completed, suggesting sellers were simply recycling buyers' funds in a Ponzi type scheme.

These returns are designed to be attractive because buyers see immediate benefits and guaranteed incomes provide an illusion of security. A staged return scheme may also persuade buyers to stay in the investment long term, especially if they have received the promised funds at the start.

Solicitors should be cautious about acting in schemes which offer guaranteed high returns over a fixed period. Such guarantees give the illusion of security but are often unrealistic.

The case study below is a high-profile failure of a buyer-led development, which is now being investigated by the Serious Fraud Office (SFO).

Case Study: Buyer-led off plan development investment scheme

The developer, 'The Pinnacle Alliance' (Pinnacle) was a group of linked companies developing several luxury apartment buildings including:

- Angelgate, in Manchester
- The Paramount, in Liverpool
- The Spectrum, in Sheffield
- The Quadrant, in Liverpool

Promoters marketed the scheme at property fairs in the UK and overseas and used promotions based on HM Government's Northern Powerhouse initiative. Brochures recommended that buyers use one of their 'panel' of firms, with the following wording:[4]

> "We prefer buyers to use an independent firm of solicitors appointed from the following panel: […]
>
> Our panel of solicitors have reported on the title to the development and are familiar with the transactional documents. This enables them to deal efficiently with buyers' enquiries and make sure that the transaction proceeds quickly and smoothly to exchange of contracts. Some panel solicitors can send a team overseas if there is a sufficient volume of transactions. If you as the buyer wish to use another solicitor, please ask your introducer agent to discuss.''

The introducer agent, however, worked for Pinnacle and had little incentive to give buyers a free choice of solicitor. Buyers were required to pay a high deposit upfront. In return, a rental income from the rooms was guaranteed, even if their room was not rented out.

Typical deposit arrangements were:

- 50 per cent of the purchase price due upon exchange of contracts
- 20 per cent four months after exchange
- 30 per cent on completion.

Additional sums included a reservation fee and money for an optional furniture pack. The firm set up a number of 'buyers' companies to receive the deposit funds and hold them as stakeholder, purportedly to protect them.

Pinnacle reported that the cost of the development had been seriously undervalued by £14m and that buyers had two choices: pay in more money or handle the construction themselves. Pinnacle eventually became insolvent and none of the developments were completed.

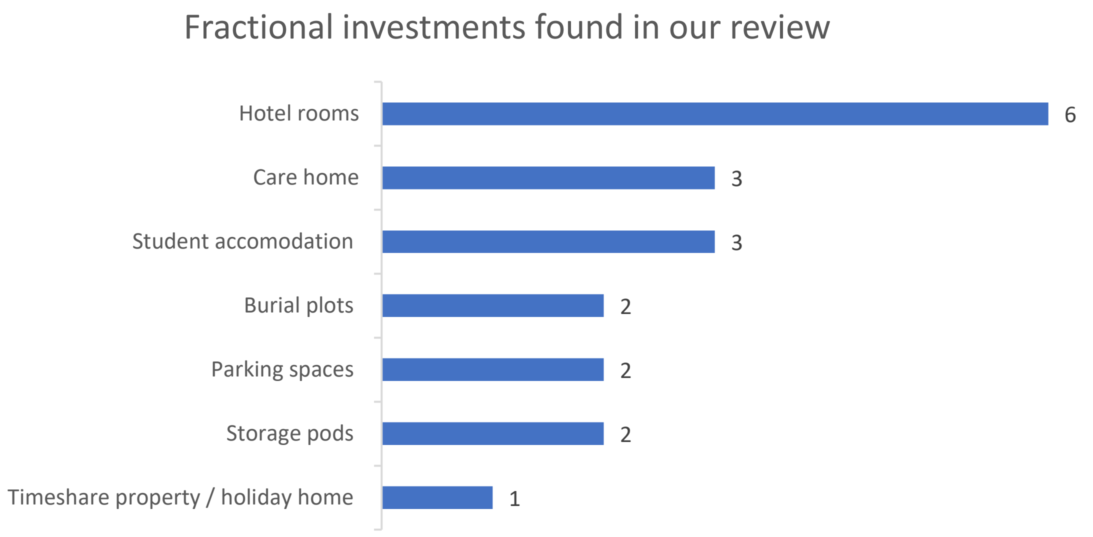
An administrator's report showed that 40 per cent of buyers' funds had been spent on marketing and administration, rather than building and development. The buyers' deposits had been released prematurely and were unrecoverable.

[4] For example: www.colordarcy.com/downloads/grove-house/Colordarcy-Grove-House-FAQs.pdf

Fractional investments

A fractional investment scheme allows buyers to share the ownership of a fraction of an asset. Nineteen internal files in our sample offered fractional investments and three firms in our visit sample had been involved in fractional ownership schemes.

They shared many similar characteristics to buyer-led development schemes. For example, offering high returns but also requiring high deposits, which in one file was 100 per cent before completion. This affords buyers little protection if the scheme fails. Sale agreements were often standard, generic documents with unfair and high-risk terms.



The most common fractional scheme in our files and in our visits involved hotel rooms. In most cases the rooms were leased to help finance a significant refurbishment of the hotel.

These schemes are likely to be popular because:

- property is often viewed as a credible asset
- it is an asset which is regularly bought and sold
- property values are perceived to increase over time
- property is a tangible asset that buyers can visit or use themselves
- investing in property is something which can easily be understood
- promoters can show buyers what the property will look like
- some buyers will already be familiar with the process of buying and selling property.

However, the success of fractional investments overall often depended on the scheme attracting enough overall investment and being well managed.

Hotel room schemes were always dealt with by firms as a straightforward conveyance, involving leasing rooms to the buyer and offering assured rents. However, we found that this was usually an overengineered sales transaction and any legal work was unnecessary.

In many cases, the terms of the purported investment and the promised returns were unrealistically high and difficult for the buyer to control or judge. For example, one firm we visited provided advice to two separate buyers on a sale agreement for the lease of 1/13 of an annual share of hotel rooms. Shares were held between 13 buyers and could be occupied by them on a first come first served basis as well as being booked by guests. There were also management costs and refurbishment costs.

This meant that it was unlikely that buyers would either recoup their money or be able to occupy a room. The advice, however, only summarised the contents of the contracts and did not advise clients fully on the risks. We referred this firm to our disciplinary process.

In relation to another completed hotel room scheme, we were concerned to note that two separate firms had reported that buyers who had purchased rooms in the same hotel were trying to get the seller to buy back the rooms because their promised returns were being delayed or had been missed.

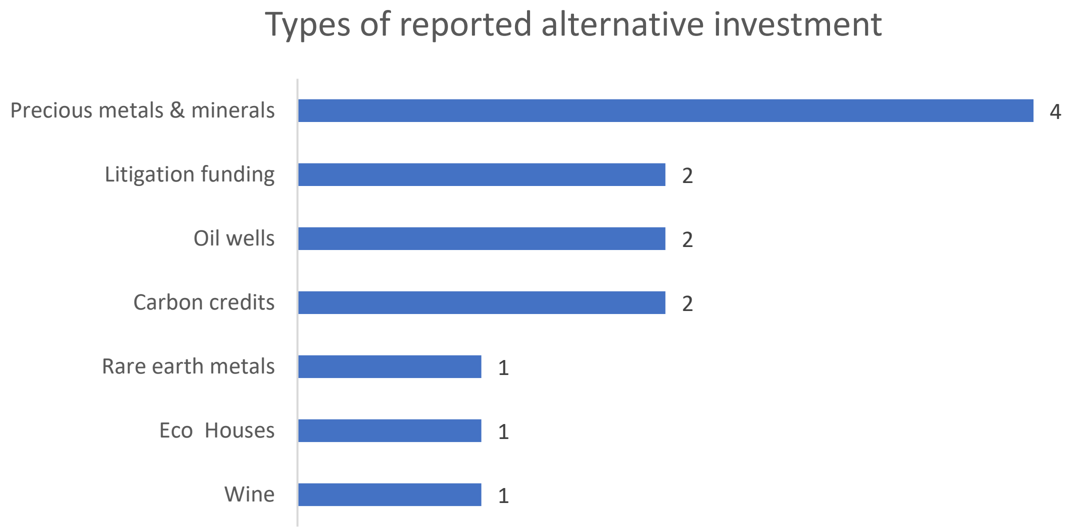
Similarly, investments in car parking spaces and storage facilities were also treated as standard conveyances. However, it was difficult to see why such schemes required the involvement of a solicitor or a lease arrangement. They were typically marketed as being 'a low cost, high yielding investment product that's hands off and hassle free'. In reality, the schemes were expensive, complex and high risk.

Car parking spaces were around £20,000 each and storage spaces were around £30,000 per 'pod' with additional management charges on top. Purchasers were offered a lease arrangement and guaranteed buy back option with guaranteed returns of 8 per cent per annum rising to 12 per cent after four years. However, renters were often offered vastly discounted rates to use the spaces.

In relation to storage pods returns soon dried up and buyers found that they had no resale value. The guaranteed buy back option could only be exercised in a one-month window following the fifth anniversary of the purchase and the seller had a further five years to complete the buy-back but only if they considered they had enough funds.

Alternative investments

Ten matters in our review of our internal files involved reports of dubious alternative investment schemes.



Commonly these transactions involved firms processing agreements of sale and transferring funds from buyer to seller without any real underlying legal transaction.[5] Investment

[5] A breach of Rule 3.3 of the SRA Accounts Rules 2019

commodities, such as rare earth metals tended to be complex, requiring significant technical knowledge in a highly specialised area.

Solicitors acted in these matters when they did not have the knowledge or expertise to provide value, for example certifying documents that they did not understand. Buyer clients were therefore, often misled about the true nature and value of their investments.

For example, a buyer in our internal files was provided with a Rare Earth Metal Trade Purchase Agreement for 100kg of yttrium at a price of £20,000 plus fees with "metal 99.5 per cent purity" recorded on the signed copy of the contract. The firm assured the buyer that evidence of the purchase had been seen. However, they relied entirely upon the seller's confirmation. In fact, the buyer had been sold a comparatively worthless metal oxide that had been deliberately misrepresented as pure metal.

Case Study: Carbon credits trading scheme
The firm was instructed by the seller in 2010, to act in a trading carbon credits scheme, marketed as a means of offsetting carbon emissions to make them 'greener'. The seller promoted the involvement of the firm and its regulated status to buyers. The Financial Services Authority (as was) subsequently published a warning in 2011, that these schemes were a scam. In the meantime, buyers paid money into the firm's client account in more than 1,500 transactions. The seller went into administration in 2014, leaving buyers with losses of over £14.7m. The firm accepted that the scheme was complex and unusual, and the firm had no relevant expertise, experience or knowledge. They should have appreciated the inherent risks that their involvement was designed to lend credibility to the transactions and to give comfort to buyers.

Complex Financial Products

Ten internal files in our sample involved the sale and trading of financial products such as bonds, pension schemes, loans and prime bank instruments. These are often collectively known as high yield schemes.

The most common type of these schemes, found in six files, related to bank instrument frauds which included prime bank guarantees, standby letters of credit or proof of (blocked) funds which are traded and monetised. They were purportedly sold on an 'exclusive' basis on terms that were so good, purchases were restricted to a small number of investments.

The premise of these schemes was typically that an investor has obtained a letter from their bank guaranteeing that specific funds were available to invest. The letter is sold to a broker who uses the letter to borrow funds for other investment schemes such as a business venture or a stock market trade. Fraudsters raise large sums of money from buyers and then disappear, defaulting on the payments.

Schemes were generally complex, involving intentionally technical language and solicitors acted when they had no expertise in the transaction. The services provided by solicitors in these schemes were limited to providing credibility, for example certifying and verifying documents, providing undertakings, acting as a paymaster or as an escrow agent without there being any underlying legal transaction.

Common characteristics in these schemes include:

- complex, opaque terms or technical banking jargon
- high rate of reward, for example, 25 per cent per week
- high sums required for scheme entry
- a disproportionate emphasis on confidentiality or restrictions
- a short scheme duration over weeks or months
- investments in foreign jurisdictions
- undertakings provided by the solicitor to protect buyers' funds

Case Study: An emerging risk: corporate mini-bonds

One of our visits was to a large firm that carried out corporate mini bond work, raising finance for companies in the form of a loan from individual buyers. Mini-bonds are marketed with the promise of above market rate returns over a fixed period and the buyer's capital is returned at the end of the period.

They are legitimate products; however, they are also high risk as the buyers have no control over how the funds are spent. The Financial Services Compensation Fund will not cover losses from a failed bond issuer because they are unregulated. Concerningly, there have been three high profile mini bond failures in the last four years, with Secured Energy Bonds in 2015, Providence Bonds in 2016 and London Capital Finance (LCF) in 2018, all collapsing following insolvency. The FCA has temporarily restricted the marketing of mini-bonds to retail customers from 1 January 2020.

LCF is being investigated by the SFO and there is also an internal investigation and inquiry at the FCA. The bond sellers falsely marketed the scheme as being like a tax-free ISA and claimed huge commissions from the sales. Buyers lost several m pounds and LCF's administrators reported that funds had been spent on possessions including a holiday home and a helicopter, rather than being invested into the company. We are aware of reports that solicitors may have been involved in these schemes.

The firm we visited dealt with several mid to large size, branded companies who were raising finance through mini-bonds. The firm did not act for the buyers or receive their funds and there is no evidence to suggest that any of these schemes have failed.

However, we were concerned that during our review of the firm's investment files their attitude to the risk of being involved in a dubious scheme, potentially exposed them to increased risk. This was because the firm did not view mini-bonds as high risk and said that they did not consider that our warning notices on dubious investments were necessarily relevant to them.

Good practice
Firms should keep up to date with our warning notices and the warning signs of dubious investment schemes because fraudsters will often change schemes over time to avoid detection. They should take steps to carry out due diligence checks to satisfy themselves and the buyer that the investment scheme is genuine.

Role of solicitors in dubious investment schemes

Concern

We are concerned that solicitors act in dubious investment schemes when there is no legitimate reason for them to be involved in the transaction. They may act as escrow agents or are simply there to add credibility to a sales transaction. If a solicitor does not understand the scheme, it is unlikely that they will be able to properly protect the buyer's interests.

We are concerned that promoters prefer buyers to use their own panel firms. These firms are promoted in promotional material and buyers are often provided with incentives to use them. However, these firms often failed to provide independent and honest advice about unfair terms[6] in sale agreements because they were motivated to retain referrals of business.

What do we expect?

We expect solicitors to act with integrity, maintain independence in the face of competing interests and behave in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons.[7]

Solicitors should only act in transactions when they have the necessary expertise and knowledge[8] and should make sure there is a legitimate reason for them to be involved. We expect solicitors to make sure there is a genuine underlying legal transaction in any work they carry out.

Findings

Sellers design dubious investment schemes to resemble genuine legal transactions to evade Rule 3.3 of the SRA Accounts Rules 2019. Twenty-seven of our internal files contained allegations that firms had transferred funds from buyers to sellers without there being an underlying legal transaction.

We looked at the services provided by firms in schemes and found that they commonly acted as an escrow agent or carried out activities that looked like a conventional conveyance. However, when we looked at whether the services were necessary and whether the solicitor's role added any value, we found that in just two files the services of a solicitor appeared to be necessary.

In many cases, the solicitor was simply processing funds through the firm and any legal work was manufactured as a means for solicitors to become involved in the scheme. For example, buyers who instructed solicitors to act in the conveyance of a hotel room were really financing the construction or refurbishment of a building up front.

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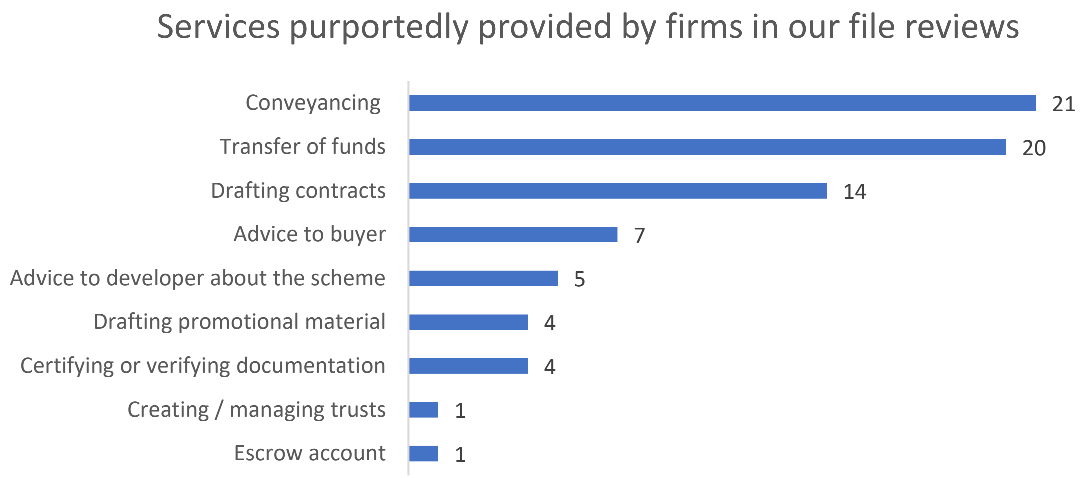
[6] Unfair Terms in Consumer Contracts Regulations 1999 - terms were often unclear or favoured one party over another

[7] Principles 2, 3 and 5 of the SRA Principles 2019

[8] Rule 3.2 SRA Handbook 2019



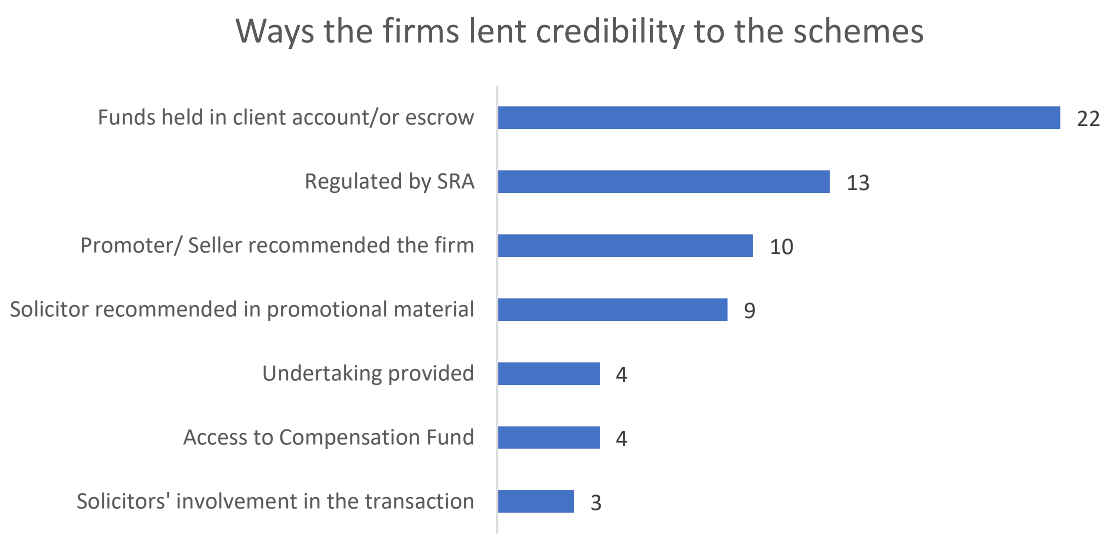
In cases involving unusual investments such as car parking spaces, storage pods or rare earth metals, there was a straightforward sales transaction between the buyer and the seller. There was no reason for a solicitor to be involved in the scheme, any more than they would be in the purchase or lease of a car.

Providing credibility

Firms should not underestimate the role they play in adding credibility to a dubious scheme. The primary way solicitors provided credibility in our files was by holding money in the client account or by acting as an escrow agent. In many cases firms allowed their accounts to be used as a banking facility.

Sellers overengineer schemes involving pooling money or direct sales to include unnecessary legal services, because they provide legitimacy and reassurance that buyers' funds are secure. However, when a scheme fails, the solicitor's involvement is unlikely to provide any security.

Many buyers in our internal file review, also wrongly assumed that the scheme was credible or regulated because a solicitor was involved. Some sellers actively promoted firms' regulatory status as part of their sales pitch in promotional material to reassure buyers.



Promotional material

Similarly, we found that solicitors often play a key part in the marketing strategy of dubious investment schemes because their presence can reassure potential buyers that the scheme is legitimate.

For example, nine firms allowed their details to be included in the scheme's promotional material to directly market the scheme to potential buyers. This material often primarily made oblique references to funds being held by the solicitor in a regulated account or secured by the compensation fund which suggested that the scheme itself was regulated or safe. There is no legitimate reason for promotional material in any scheme to refer to the compensation fund or the regulated status of solicitors. Of even greater concern, was that some firms were also actively assisting with the promotion of dubious schemes to buyers. For example, in four files, solicitors acting for the sellers in a buyer-led off plan scheme attended the promoter's property exhibitions overseas. In one file, the firm themselves introduced buyers in Hong Kong to selling agents involved in financing buyer-led developments in the UK through their Hong Kong branch.

Panel firms

Firms in ten of the internal files we reviewed were specifically recommended by promoters and sale agents in promotional material as panel firms.

These firms were typically described in brochures as being able to act quickly for buyers and provide a better service. Buyers were also often offered incentives such as free legal costs or legal advice. However, firms did not necessarily appear to have been selected by promoters because of their expertise to act in the transaction.

For example, an overseas buyer reported that she was concerned that a promoter's recommended firm in a property development scheme was described on its website as an immigration and personal injury firm. The buyer turned down the firm as they were not confident that they could act for them in the conveyance.

The promoter subsequently directed the buyer to a new firm on the day they were due to sign the contract of sale and offered to cover all their legal costs. We were concerned that some buyers felt pressured by promoters to instruct panel firms and were not informed by firms that they could instruct a solicitor of their choice.

Good practice
While firms can market themselves and act as panel firms for commercial reasons, they must be satisfied that any promotional material they are asked to approve or appear in, is clear and not misleading. Solicitors should challenge sellers and buyers, if they are not able to offer a reasonable explanation for the basis of the scheme or why they should be involved. This could include asking sellers for any publicity they will use and checking that they do not misrepresent the firm or the protection they can provide. They should also make sure that buyers are aware that they can instruct an independent solicitor of their choice.

Why firms act in dubious investment schemes

Concern

We are concerned that some solicitors may become involved in dubious investment schemes because they are failing to scrutinise the reality of the transaction, acting outside their expertise or failing to acknowledge that their legal services add little value.

Solicitors may be at risk of being involved in a dubious scheme if they fail to have proper regard to our warning notices and the red flags that can identify a fraudulent scheme. This is a risk because operators of dubious investment schemes regularly adapt and change schemes over time to evade suspicion.

What do we expect?

We expect firms to act with integrity and not allow their independence to be compromised, for example by competing interests, such as reliance on sources of income[9]. Firms acting as a panel solicitor for a seller must still make sure that as well as acting in the seller's best interest that they treat buyers fairly and do not take advantage of them.

Firms should take steps to make sure that they are dealing with a genuine investment scheme. Firms can make sure they have the knowledge and skills to assess the credibility of schemes by carrying out due diligence checks and only acting in matters within their knowledge and experience.

Findings

Type and size of firm

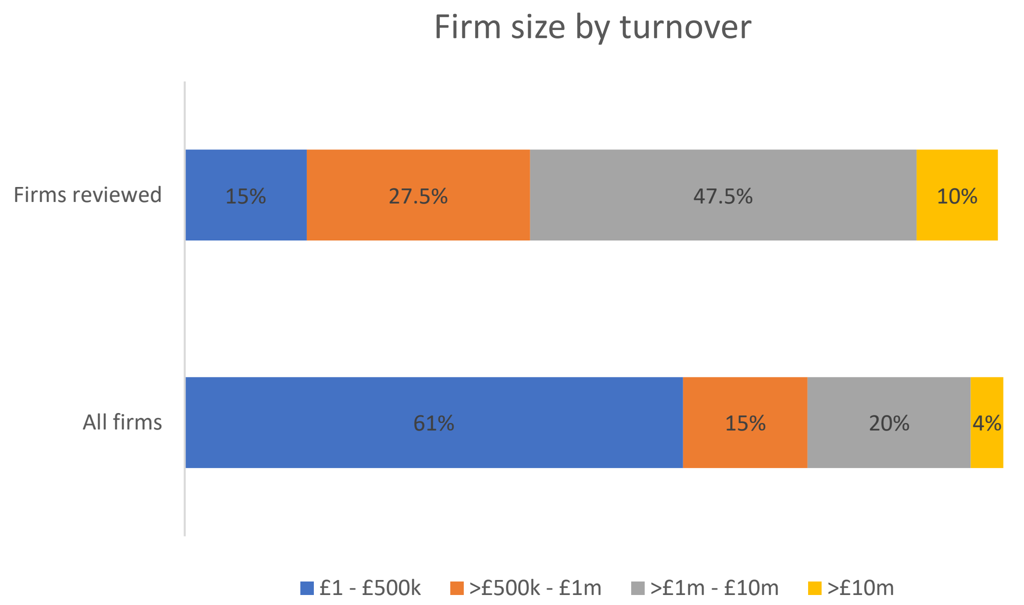
We looked at whether certain types of firms were more likely to become involved with dubious schemes. We looked at a firm's:

- size (by turnover)
- size (by solicitor headcount)
- location.

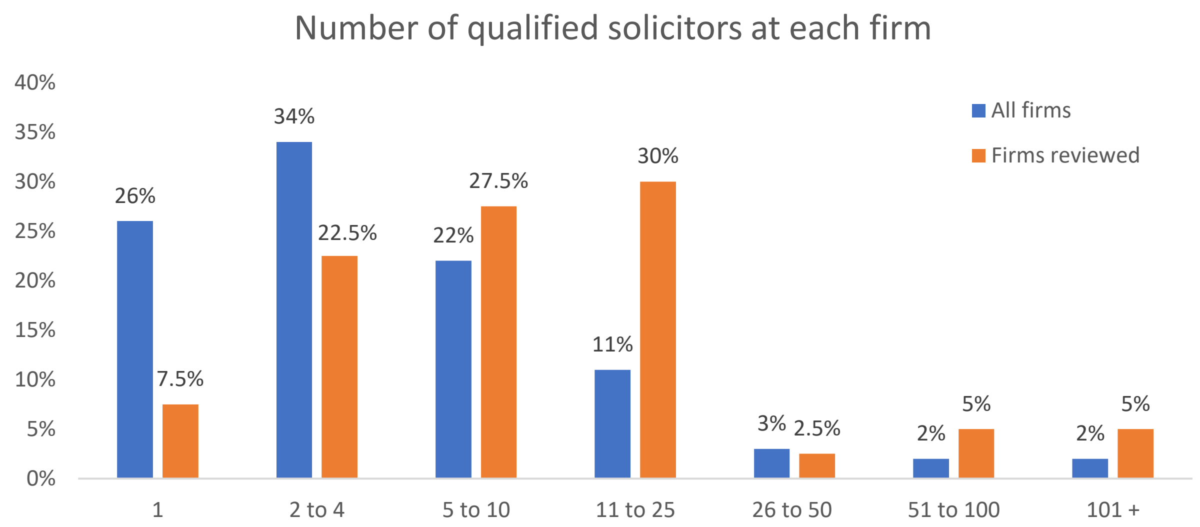
We also compared our findings with the general regulated population. Overall, we found that firms whatever their size and irrespective of location, are at risk of becoming involved with dubious schemes.

However, as the graph below demonstrates, we found that proportionally there were more large firms with a turnover of between £1m and £10m in our sample compared with the general regulated population.

[9] Principles 3 and 5, SRA Principles 2019



The evidence suggests that larger firms with 51 to 100 solicitors and trainees were proportionately more likely to have been involved in a dubious scheme. Additionally, there were more firms where the number of qualified solicitors and trainees were between five and 25, compared with the general regulated population as the chart below shows[10].



This suggests firms of all sizes are at risk, even large firms who often have:

- additional resources available, including specialist compliance staff
- the presence of colleagues to supervise each other's work and provide advice
- more sophisticated policies, systems and procedures.

Firms should not be complacent. It is each solicitor's individual responsibility to take steps to avoid becoming involved in a dubious investment scheme. One of the ways that solicitors can protect themselves is to be familiar with the risk factors and warning signs we publish.

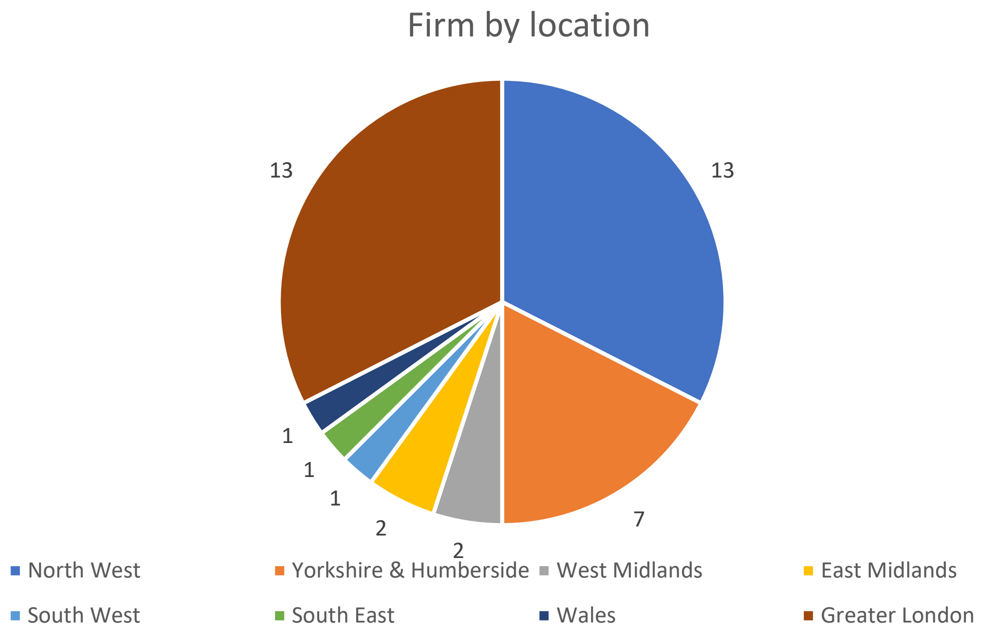
[10] For illustrative purposes the per centages have been rounded up

Firm location

We also found that in general, the location of firms did not correlate with the location of the dubious scheme. Therefore, a firm's proximity to a scheme does not appear to be a determining factor for sellers or buyers. For example, in our files:

- two firms based in the Midlands were instructed to act on behalf of buyers and a developer in relation to a scheme based in Essex
- nine firms were involved in buyer-led, off plan or refurbishment developments in the north west, however, only four of those firms were also based in the north west themselves.

It is also unlikely that firms in specific areas of the country are being targeted as the largest concentrations of firms were evenly spread between Greater London and the north west[11].



However, as set out in the chart below[12], in our internal file reviews we found that:

- dubious investments in complex financial products were almost exclusively concentrated in London and the north west
- only off plan and fractional schemes featured in our review of firms in Yorkshire and Humberside
- firms in the north west and Greater London were involved in a broader range of dubious scheme activity than other regions.

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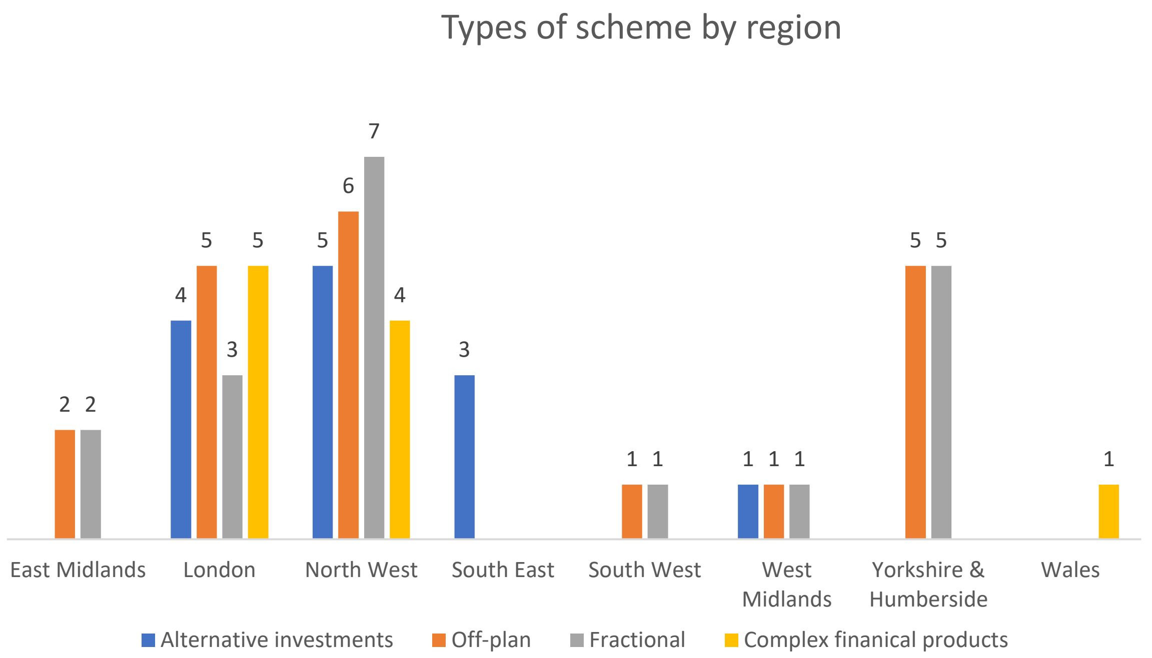
[11] For illustrative purposes the per centages in the chart have been rounded up

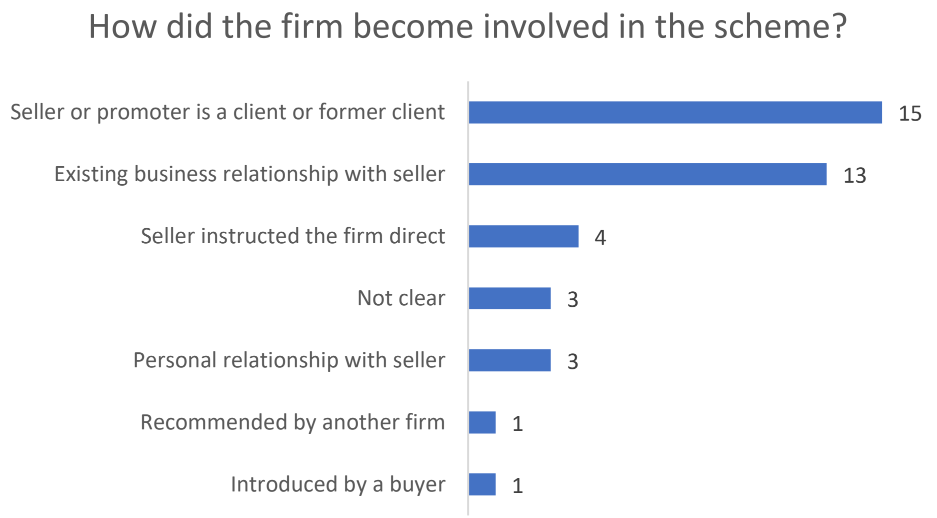
[12] As before, 'fractional' is here treated as separate to 'off plan'. Firms can be involved in more than one type of scheme.



The fact that firms are not necessarily targeted by their location, is possibly indicative of the way that buyers are harvested widely across geographic areas by promoters, using direct marketing methods and cold calling.

Buyers in our internal files were rarely an existing client when they instructed a firm to act in a dubious investment scheme. In sixteen files, buyers instructed firms because they were introduced by a promoter for example because they were the seller's recommended panel solicitor and identified in marketing material.

Additionally, most buyers, in 23 of our files, had been introduced directly to the scheme by sales agents acting for the promoter in a cold telephone sales call, online marketing or by direct marketing material.



In our visits, we also found little correlation between where firms were based and the location of the dubious scheme. For example:

- a firm based in Liverpool was dealing with several off-plan buyer-led development schemes in Newcastle, Bedford and Luton
- a firm based in Wiltshire provided advice to buyers in relation to two very similar fractional investment schemes involving a castle in Scotland and a hotel in Wales
- a firm based in Sheffield provided advice in relation to a fractional property scheme involving a hotel in Liverpool
- a firm in Cheshire was dealing with fractional investment schemes involving student accommodation in Huddersfield and London and car parking spaces at Gatwick.

Five firms told us that schemes were introduced to them most often by buyers and existing clients and in only two cases was work referred by the seller or a promoter directly. However, we noted that three firms were dealing with schemes that shared the same promoter. This suggests that promoters may select firms across geographical areas which are not necessarily linked to the location of the scheme. Buyers therefore do not appear to influence where the firm they instruct is located if they have been introduced by a promoter and use a panel firm.

At one firm, we saw evidence that promoters may test the water to identify potential firms by sending out 'feelers' in the form of unsolicited emails to firms.

Example of promoters selecting a firm's location
The firm received the details of two separate overseas buyers in an unsolicited email from a promoter. The email said that the developer was looking for local firms to act in an investment scheme in a hotel based in the north west. The hotel was being refurbished and they were marketing the purchase of several rooms on a fractional basis to finance the work. The firm accepted the instructions but did not obtain any further buyers from the promoter. The firm suspected that this was because they had asked too many difficult questions to the seller about the terms of the agreement.

Relationships

In contrast, firms were approached directly by a seller or promoter 'cold' to introduce a scheme in just four files. This sales technique has an interesting parallel with promoters who cold-call buyers. In both cases, the target is persuaded by the seller that it is a genuine transaction and they will receive financial returns.

A key factor however, in 31 files was having an existing relationship with the scheme operator, for example, as a client, through a business or referral relationship and in three files through a personal friendship.

Many of the firms we reviewed had a personal or business connection with the seller of the scheme and often, it was an existing or long-standing client who first proposed the arrangement to the firm.

It appeared that in some, if not all, cases, the existing relationship gave the solicitor a measure of reassurance about the scheme, however misplaced. This had a detrimental effect on the firm's independence and for example, led to a lack of scrutiny of the transaction and/or the parties. This underlines the need for solicitors to apply the same level of scrutiny to all business proposals, wherever they come from.

Examples of personal connections between the firm and the operators of the scheme included:

- having known the operator in a previous career
- various personal friendships
- a family relationship
- an employee's existing business connections.

Case study: Early Pension Release Scheme and the solicitor's best friend
A sole practitioner who had lost a key revenue stream was introduced to dubious investment schemes, including an early release pension scam, by a longstanding client and close friend. The solicitor allowed his friend to use his practice address as a company correspondence address, to arrange signature of client care letters, and to work for him on an ad hoc basis. The scheme required buyers to release money from their pensions into a new fund controlled by the seller. This transfer incurred deductions of up to 30% including a 5% payment for the firm. The firm acted for both the seller and the buyers in the transaction and had little knowledge of the scheme. The firm simply processed the transactions through the client account and ignored any warning signs.

Reliance

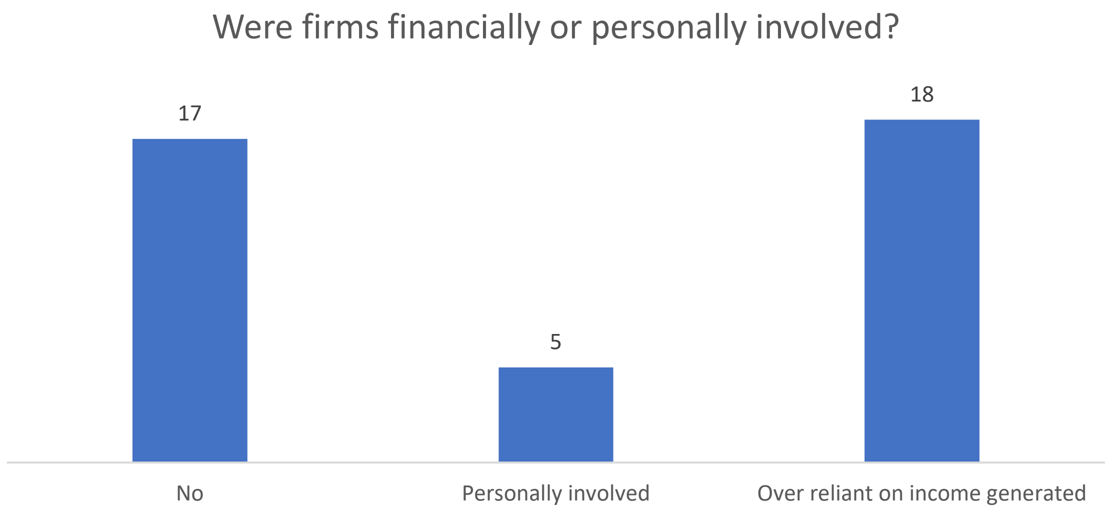
In 15 files, a key reason for the firm's involvement in a scheme was that a seller was already a client or a former client. In one case, this was a long-standing client who had instructed the firm for more than a decade.

Over reliance on existing client relationships, resulted in the solicitor's independence being compromised, a conflict of interests or firms 'turning a blind eye' to concerning aspects of a scheme. Seven firms relied on seller clients both in terms of understanding how the scheme worked and in conducting due diligence. Tellingly, all seven firms had an existing or long-standing relationship with the sellers.

Reliance on a single source of work, for example from promoters who refer buyers to panel firms also exposes the firm to considerable regulatory and business risk. For example, in one file, 78 per cent of new instructions from buyers over a six-year period came from one source, a promoter for a scheme dealing with investments in storage pods and car parking spaces. The schemes were high risk, but the firm provided limited advice because the schemes were their main source of income.

Financial incentives

In most cases, there were no indications in our internal files that the firm was personally or financially involved in the dubious scheme itself, for example by way of commission, a share of profits or directly misappropriating funds.



Examples of the solicitor being personally involved, or misappropriating funds included:

- in two cases, the solicitors had set up the scheme themselves and received financial incentives in return for doing so. They therefore had a personal interest in the success of the scheme
- in one case the operator of the scheme helped a solicitor to set up his firm, introduced the buyers and used their funds to pay for the firm's salaries for the first few months.

We also noted that in general, the fees associated with most dubious transactions were fixed fees and not unusually high per transaction. However, the volume of work received and the fact that in most cases little, if any, legal work was required ensured that the transactions were still lucrative.

For example, a firm in our internal file sample acted in relation to an investment scheme involving diamonds and fine art. The buyers transferred the purchase money for the diamonds to the firm who deducted their fee of £200 + VAT from each diamond transaction before sending on to the seller. This was without the buyers' knowledge and was received for simply transferring the purchase money to the seller. In this case, the buyers didn't receive their purchases or their money back.

Knowledge and expertise

Nineteen firms in our sample were recorded as acting outside their area of expertise, knowledge and experience. Arguably, some of these firms may have been unwittingly involved in a dubious scheme because they were particularly complex or opaque and they were unable to determine its legitimacy.

Nevertheless, it is of concern that the solicitors proceeded to act in these matters when they were not able to act in their clients' best interests or treat other parties fairly. There was no reason why the firms should have acted, and this did not prevent us from taking disciplinary action.

For example, one of the schemes we investigated involved a purported investment backed by a “Sovereign Heritage Bearer Bond” from the Japanese government. The bond was supposedly created to raise money after the Second World War but was so secret that the current government in Japan was unaware of its existence and so would deny it if asked. It was also deemed to be a fake by the private bank which was to be involved in the scheme. Despite this, the solicitor proceeded[13].

Attitudes and behaviours

A key factor that may expose firms to a greater risk of being unwittingly involved in a scheme is the perception that they are unlikely to be at risk. These attitudes and assumptions may mean that they ignore their normal procedures or do not take appropriate steps to mitigate this risk.

Our review has shown that all types and sizes of firms are at risk of being involved in a dubious investment, even large well-resourced firms with sophisticated compliance systems. Schemes come in many guises and their profitable nature can mean firms turn a blind eye to the justifiable suspicions they should raise.

For example, one large international firm allowed £21m in funds from fraudulent investment transactions to be paid into their client account. They were put on notice by buyers, the police, and even the Federal Bureau Investigations that the transactions were dubious, but they failed to make any reasonable enquiries about the nature of the schemes or prevent the solicitor from continuing to act.

Most firms we visited said that they had read our warning notices. However, one of the largest firms we visited who dealt with investment work specifically, said that while they had read our warning notices, they did not think it applied to their firm.

One firm said that they had not read our notices because they do not carry out investment work any longer. We noted that the firm continues to advertise timeshare and fractional investment work on their website. The firm justified their position by saying that it employed an external compliance consultant who will read and refer them to any warning notices if they were relevant. We are concerned that this complacency potentially exposes the firm to a greater risk of becoming involved in a dubious investment scheme.

Due diligence

In our internal file reviews, it found that in more than half (63%) of cases, solicitors had failed to carry out proper due diligence on those who ran the schemes.

This exposes firms to considerable risks and may lead them to being involved in dubious schemes.

On eight occasions, we found that the firm had not carried out any due diligence at all, instead relying on the promoter or developer to do this for them. Relying on third parties to carry out due diligence is high risk and it is a firms’ responsibility to make sure they are satisfied that they have been appraised of all relevant issues in the transaction.

Some firms simply ignored their normal processes and procedures. For example, a large firm acted as an escrow agent despite this being flagged up in due diligence as a potential breach of the SRA Accounts Rules 2019, if they were not instructed on an underlying matter. The firm also raised the concern that they did not know whether the transactions were legitimate, however they still acted.

[13] *SRA v Connick* (1126-2014)

Good practice
Solicitors are responsible for their own regulatory compliance and due diligence checks are a key tool that can help firms to avoid becoming involved in schemes that are fraudulent or dubious. Firms should not allow their client account to be used to receive funds or act as an escrow agent if investment funds could simply be sent by an investor direct to the seller.

Avoiding conflicts, acting fairly and not taking unfair advantage

Concern

We are concerned that a key characteristic of firms who are involved in dubious investment schemes is that they often fail to maintain their independence and fail to treat buyers fairly, providing a poor standard of service.

This may be because firms are reliant on the scheme as a source of work and revenue and prefer the interests of the seller and their own interests to those of their clients. Some solicitors also think they can act in schemes or avoid fully advising buyers about the risks of a scheme if they limit the scope of their retainer and deal with the legal work separately.

Many buyers are also in an unfairly disadvantageous position in dubious schemes. This may be because they are unrepresented third parties, or buyers from overseas or because the scheme's terms are complex or unfairly loaded in favour of the seller. They are therefore reliant on the solicitor to advise them about the risks.

What do we expect?

Solicitors must:

- act in the best interests of each client[14]
- treat buyer clients fairly[15]
- not take unfair advantage of third parties[16]
- protect buyers' interests[17] by making sure that they are aware of all the risks of the transaction.

Firms can do this by making sure they have appropriate systems and controls for identifying own interest conflicts of interest. For example, by [reviewing our guidance]() and training staff to be aware of the circumstances own interest conflicts can arise. If the terms of a scheme are unfair or the risks are too high, they should consider whether it is appropriate to advise the buyer to withdraw from the scheme and refuse to act.

A solicitor's duty to act in their client's best interests is at the heart of any transaction they carry out. Limiting the retainer or taking on work outside their usual expertise puts this duty at significant risk. They should act in good faith and take active steps to assess whether their ability to act in the best interests of the client could be weakened by factors such as:

- any financial interest
- a personal relationship
- a commercial or business relationship.

Where a conflict is identified firms should cease to act.

[14] Principle 7 SRA Principles 2019
[15] Rule 1.2 SRA Code of Conduct for Firms 2019
[16] Rule 1.2 SRA Code of Conduct for Firms 2019
[17] Rule 1.4 SRA Code of Conduct for Firms 2019

Findings

Firms should make sure that they do not take unfair advantage of third-party buyers when they are acting for the seller in an investment scheme. However, we found that almost half of firms in our file sample were involved in schemes with third-party buyers who did not have their own independent representation.

In some cases, firms provided limited advice to these buyers and the buyers mistakenly believed the firms were acting for them. Five firms were alleged to have failed to advise buyers to seek independent advice and four firms failed to advise third party buyers that they were not acting for them.

Additionally, solicitors acting for the buyers in the transaction also failed to act in their best interests if they were a panel firm for the promoter. For example, in all the files where panel firms acted for buyers in buyer-led off plan developments they failed to advise them about the higher risks associated with these agreements.

Limiting the retainer

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.

For example:

- a firm agreed to act for a promoter of a scheme but limited the scope of the retainer to just preparing trust documents. The seller was later convicted of running a fraudulent scheme
- another firm claimed that they could only provide limited advice in relation to the conveyance rather than the underlying investment scheme
- a very large firm identified early in the transaction that the scheme was potentially fraudulent so limited the scope of the retainer to acting as an escrow agent. We still took regulatory action against the firm.

Solicitors often separated the transaction in this way to justify why they were acting and to protect their own position by ignoring the red flags relating to the investment. Limiting the retainer takes unfair advantage of buyers and does not protect solicitors from a finding of misconduct.

We also found evidence that firms we visited had attempted to limit the retainer. For example, a firm was asked by a potential buyer to advise on a contract for a fractional ownership in a resort. They provided limited advice about several unfair terms but ignored others and set out the following disclaimers that made the advice almost meaningless:

- they had not inspected the resort
- they had not inspected the title/planning of the land
- they had undertaken no financial due diligence on the management of the company
- they had not looked at the tax implications of investing in the scheme.

Conflicts of interest

Managing conflicts of interest when acting for clients is crucial to acting fairly with buyers and in the best interest of clients. Significantly, 20 firms in our sample were alleged to have acted when an own interest conflict existed.

This is linked to our finding that many firms had a personal or financial interest in the scheme, for example because they were reliant on referrals of business from the scheme promoter.

We identified that in many cases acting as a panel firm for promoters led to firms favouring the relationship, they had with the promoter over that of the buyers. For example, a panel firm in our files deliberately provided extremely limited advice to buyers in relation to high risk dubious fractional schemes in order to preserve the referral of new work from the promoter.

Most firms in our internal file sample acted for the seller and just 13 firms acted for the buyers. However, where firms acted for buyers, we were concerned to note that there was an increased risk of conflict in the transaction. For example:

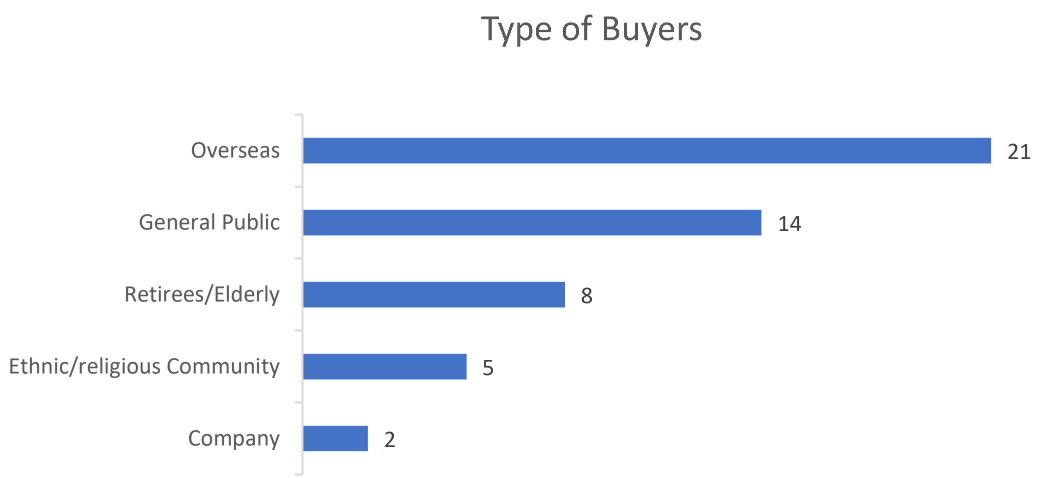
- five firms acted for the seller at the same time as buyers
- two firms acted for both buyers and seller in linked transactions, for example, the seller and subsequently the buyer.

For example, a firm initially acted for the developer in an off-plan scheme involving hotels and student accommodation. They helped them to establish the scheme by drafting key documents including the agreement for lease. The firm subsequently accepted 882 referrals of buyers and provided advice to them about the same documents without informing them of their involvement.

These findings were also highlighted by evidence in our firm visits that firms may not have systems in place to manage conflicts. Only two of the six firms we visited had controls in place to manage conflicts and only one had a system where fee earners had to certify whether they had any connection to external third parties.

Type of buyer

In most files it appeared that a certain type or demographic of buyer had been specifically targeted by sales agents and promoters. The largest group of buyers in our internal file review were from overseas, usually from South East Asia. [18]



(Nb. More than one type of buyer featured in many schemes)

Overseas buyers featured most heavily in buyer-led off-plan property purchases and fractional ownership schemes. In five files, overseas buyers, were directly targeted at

[18] 14 firms had several different combinations of types of buyer in a scheme

overseas property exhibitions and encouraged to buy off plan property developments in the UK. Developers like Pinnacle even had offices in Hong Kong and marketed several developments in the north west of England through a local sales agent, [Hong Kong Homes.]

Promoters may target overseas buyers because of the unfair advantages it provides. For example, they can exploit language and cultural differences and potentially their unfamiliarity with conveyancing transactions in the UK. It would also be in the seller's interests to have buyers at arm's length from the transaction.

It was of concern that many of the firms in our files, did not take steps to make sure these buyers were treated fairly and, in some cases, also took advantage of their lack of knowledge and vulnerability.

Typical examples of witness testimony from overseas buyers in our internal files are illustrated below and show the trust placed in the services provided by the solicitor.

"We did not ask the firm any questions as we were not familiar with legal matters and we put our full trust in them."

"The solicitor told us that the contract was a standard form of contract in the UK. We trusted that he would protect our interests, so we did not raise further questions."

"The solicitor explained that it was a very safe investment since there was a charge on the land, therefore any loss could be recovered from the sale of the land."

Good practice
Solicitors should consider preparing a specific risk assessment or formal process to assess the risks associated with new investment schemes. This could include training employees to take regular steps to identify and report potential conflicts and supervising staff working in investment work. Firms should check that all the parties are clear who they act for in investment scheme transactions so that they do not take advantage of third parties.

The impact of being involved in a dubious investment scheme

Concern

We are concerned that a small minority of solicitors continue to put consumers at risk by their presence in dubious investment schemes. We have seen that in most cases this involvement is designed to add credibility and facilitate fraudulent or very high-risk schemes by encouraging buyers to invest.

The impact of investing in a dubious or fraudulent scheme can be devastating for victims. In turn, the regulatory and financial consequences for solicitors who are involved in dubious schemes are extremely serious and this cost is also borne by the profession, in terms of regulatory and reputational costs.

What we expect

Solicitors must protect consumers from being exposed to the risk of being involved in a fraudulent or dubious investment scheme by scrutinising the transaction and carrying out due diligence on the scheme and the parties. If a scheme appears to be dubious, solicitors should provide full and frank advice to buyers and refuse to act.

Solicitors should act with integrity,[19] and act in a manner which protects the client's interests[20]. The service should also recognise the attributes, needs and circumstances of each client[21].

Findings

We saw evidence that certain types of buyers were targeted because of their vulnerability or because of their access to funds. Sellers often misleadingly promote a solicitor's involvement in an investment scheme as providing a safeguard for buyers because their funds are held in the firm's client account.

Our internal file review sample did not always record specific information about the level of losses buyers had incurred in failed schemes. However, where they did, total scheme losses were over £10m in 11 files. This had a lifechanging effect on buyers.

We have identified that when a scheme fails, the solicitor's involvement does not provide the security the buyers may expect. Insurers are unlikely to pay out, and the Compensation Fund may not reimburse buyers who failed to make adequate checks or where other factors which limit the Fund's discretion are present.

When the expected safeguard fails, and clients lose money, this can lead to a loss of trust and confidence in the profession. This extends beyond the jurisdiction, for example, the Pinnacle schemes involved large numbers of buyers from Hong Kong and solicitors were specifically blamed by victims in protests about the failure of the schemes.

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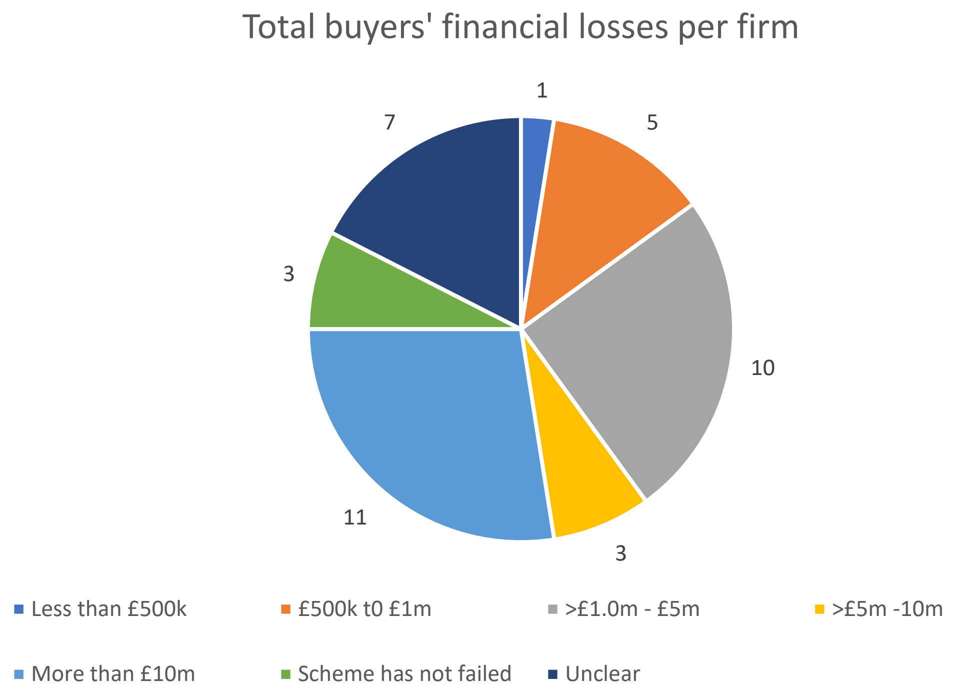
[19]Principle 5 of the SRA Principle 2019
[20]Principle 7 of the SRA Principle 2019
[21] Rule 4.2 of the Code of Conduct for Firms 2019



Consumers with SIPPs

In eight files, older consumers were targeted by cold callers and persuaded to release their pensions early or invest lifesavings from a SIPP into another product. However, these schemes were unregulated and high risk because the companies were not well established, or the value of products were overestimated.

Individuals aged over 55 are targets for so called 'pension liberation scams' because they now have access to their entire pension pot and a greater flexibility to invest their retirement funds in different ways. Common types of scheme promoted to these buyers in our internal file sample, were high risk financial products and fractional ownership schemes such as car parking spaces and self-storage units.

The SFO is currently investigating several pension investment schemes and self-storage pod investment schemes that had been targeted at older consumers. These consumers lost life changing sums of money intended to support them in old age.

Regulatory outcomes

Involvement in a dubious scheme also has significant risks for firms. Of the 40 internal files we reviewed, 14 firms (35 per cent) in our sample were closed by the time of our review, seven (17.5 per cent) of which, had been subject to an intervention. In total, 20 firms were referred to the SDT to await a hearing or decision.

Thirteen investigations in our file sample had been concluded. Of these:

- four resulted in a strike-off
- four resulted in a suspension
- four resulted in fines[22]
- one was closed with a letter of advice.

[22] Some of the strike off and suspension decisions also resulted in fines against other parties.

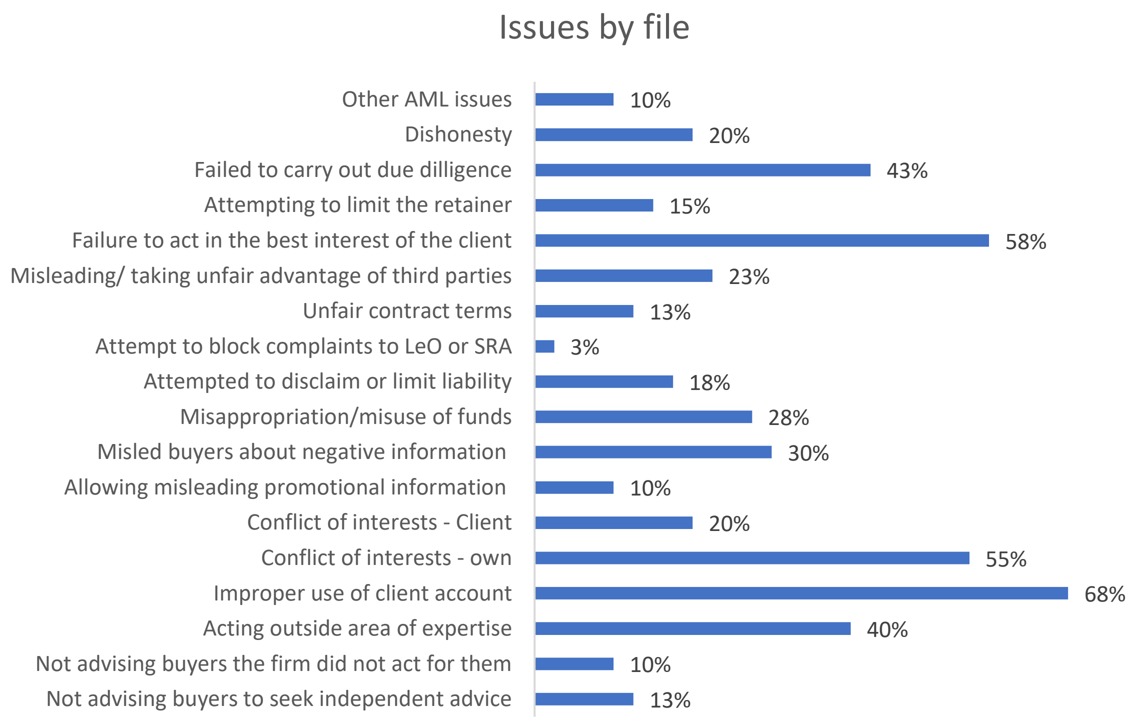
Some involved multiple sanctions against different parties. Therefore, most investigations resulted in serious penalties and consequences for the solicitors involved.

We also take disciplinary action against firms when the investment scheme has not failed. In 15 per cent of the internal files we reviewed, the scheme had not failed however we found the following issues of misconduct:

The firm:

- acted outside their area of expertise, knowledge and experience
- allowed the client account to be used to transfer funds without there being an underlying legal transaction
- allowed misleading information to be shared in promotional material
- misled buyers in relation to negative information about the scheme
- misappropriated funds
- attempted to disclaim or limit liability
- acted in a transaction with unfair contract terms
- misled/took unfair advantage of third parties
- failed to act in the best interest of the client
- failed to carry out due diligence.

The most common allegation, appearing in 27 files, was that the firm or solicitor used the client account to transfer funds when there was no underlying legal transaction. The files, however, involved a wide variety of misconduct, some of it particularly serious.



This shows that many firms who are involved in dubious schemes are acting when an own interest conflict exists. This highlights our earlier concerns that firms are failing to act in the best interests of buyer clients and failing to maintain their independence when they are faced with competing, usually financial, interests.

We also referred three of the six firms we visited into our disciplinary processes for failing in their duties to clients and/or third parties, for the following reasons:

- failure to act in the client's best interests and provide a proper standard of service in relation to the advice provided in potentially dubious transactions
- involvement in a dubious buyer-led off plan transaction, particularly serious due to a recent SDT decision for very similar activity
- breach of money laundering obligations: failure to carry out adequate source of wealth and source of funds checks on a high-risk client transferring money via a third party with no explanation.

Case Study: A firm recently subject to an SDT finding
The investigation and tribunal proceedings had a significant personal impact on the firm. They explained that the length of the investigation leading up to the tribunal proceedings had a personal toll on staff. We asked the firm whether they had any learning points they could pass on to other firms. The firm said that they hadn't appreciated all the warning signs in the transaction and failed to carry out various due diligence tasks. They explained that: • they now take care to check all buyers are either clients or have independent representation • they would be able to spot a dubious transaction if it happened again because of the number of warning notices we publish and because they now check these regularly

Good practice
Solicitors should assess the credibility and viability of an investment scheme by analysing the scheme and scrutinising the documents with our warnings in mind. They should contact our Professional ethics helpline if they have any dilemmas about acting on behalf of a buyer or a seller they suspect may be introducing a dubious scheme to the firm.

How firms can protect buyers from being involved in dubious investment schemes

Concern

We are concerned that some solicitors are not taking adequate steps, or do not have adequate systems, policies and procedures in place to protect buyers from the risks they face in dubious investment schemes.

This may be because they do not always perceive themselves to be at risk of being involved in a dubious scheme and may not take note of the warning signs in our warning notices. This may result in a lack of investment in systems and controls to protect buyers and firms or alternatively, ignoring existing controls and usual procedures.

It may also be because firms do not see their role as being responsible for providing advice on the investment element of a scheme even when it is integral to a transaction.

What do we expect?

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.

This includes considering why they are being asked to assist in the transaction and whether they have the competence and expertise to act. Firms should consider whether contract terms are so high risk, that they are unfair and dubious.

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. Involvement in a dubious scheme is likely to constitute serious misconduct.

Findings

We have shown that the potential outcome for solicitors who are involved in dubious investment schemes can be extremely serious. Firms have the tools to check the credibility and viability of schemes but may not consistently use them or apply them adequately.

Our findings reveal that these schemes have many common features that can help solicitors to identify schemes that are potentially dubious or fraudulent.

Some of the red flags that firms should look out for are as follows:

- high deposits paid in instalments before exchange
- comparatively high returns
- complex and unfair ageement terms
- transactions require limited administrative work or only processing funds
- guaranteed buy-back of a product or property for profit
- having an interest in the scheme eg: panel firms and referrals
- sellers ask firms to promote the scheme or appear in marketing material
- sellers ask firms to hold buyers' funds in the client account
- exclusive offers on investment products that require secrecy
- buyers are mainly from another jurisdiction to the location of the scheme
- third party buyers do not have representation
- sellers ask firms to provide security for buyers' deposits
- high commissions due to sellers from deposits

Firms can protect themselves and their clients in the following ways:

Due diligence

Our findings revealed that dubious schemes are more likely to resemble common conveyancing transactions, rather than an investment in a niche or alternative product. Therefore, they may be more difficult to spot and carrying out due diligence is a particularly important safeguard for firms to use.

Due diligence checks are not simply for anti-money laundering purposes. They are a necessary investigative process that can help to assess the risk of a new client or the legitimacy of a new transaction. A failure to carry out appropriate due diligence may mean that firms unwittingly become involved in dubious schemes.

Most firms we visited said that they carry out due diligence checks in relation to the parties in an investment scheme. We were concerned however, that one firm said that they did not carry out any due diligence because they did not view an investment scheme as being high risk. Another firm said that they were not sure what due diligence had been carried out because this was dealt with by their compliance department.

We found that typically partners in a firm carry out due diligence checks on files. While allocating a senior member of staff is sensible given the high-risk nature of the work, firms should also have a system in place to supervise a partner's work. We reviewed several files at firms where individual partners dealing with dubious investments had not been supervised.

Firms should carry out appropriate due diligence checks using a variety of methods on all investment scheme work. This includes checking the source of funds and the parties involved, even if they are trusted and longstanding clients.

Systems and controls to mitigate risks

Having an agreed firm wide approach to new investment business can help firms to manage risks to the firm and to buyers from dubious investment schemes. This could include for example, controls which sets out the firm's procedures before accepting instructions to act in work which has an investment scheme element.

We asked the firms we visited whether they had any practical examples of systems and controls they have in place to make sure that they would not become involved in dubious investments. Only four of the six firms we visited said they did.

But those that did mentioned:

- all matters being logged on to a central drive
- the firm's anti money laundering checks on a company would show the beneficial owners and the financial history. This allowed fee earners to check whether a company is genuine and how long it has been trading
- undertaking general internet searches on individuals, companies and schemes to assess their credibility
- undertaking a search on Companies House to check a company's history
- staff receive training to understand what a dubious investment may look like and covered some of our red flags.

Firms should be alert to the fact that dubious investment schemes may be used to launder illegal funds, for example by transferring funds from unverified buyers through the client account. This is a significant risk in transactions where there is no underlying legal transaction and solicitors should make sure they do not abdicate responsibility for carrying out appropriate due diligence.

Firm wide systems and controls such as risk assessments and file opening checks can help firms to monitor and manage these risks. However, these controls can only succeed if firms acknowledge they are at risk and take active steps to interrogate transactions for any signs of dubious activity.

Panel firms - conflict checks

We found that conflicts can arise when firms manage the competing interests of a client and a financial or personal interest, for example, because of referrals of business.[23]

A regular stream of guaranteed income can cause a firm to lose sight of their duty to act in the client's best interests, and not those of the promoter.

[23] Rule 6.1 - 6.2 SRA Code of Conduct for Firms 2019

Solicitors and firms should make sure that such arrangements do not compromise their independence or fetter their client's ability to instruct a solicitor of their choice. This includes for example, allowing the firm's status or regulatory protections to be used as an inducement in promotional material issued by the seller.

Firms can mitigate these risks by having appropriate systems in place to assess the relevant circumstances of any transactions so that they can make sure that they can identify an own interest conflict.

Warning notices

Dubious investment schemes change over time as they become tainted by bad publicity. Firms should make sure they are familiar with the way schemes work, not just with the purported investment itself. This can be done by regularly reviewing our warning notices and guidance on dubious investment schemes to keep up to date with the key red flags to look out for.

Firms should never assume that the risk of being involved in a dubious investment does not apply to them. Firms of all sizes, incomes and locations need to be alert to the risks posed by dubious investments. We found that large firms with greater access to sophisticated compliance systems are as much at risk as smaller firms.

Our thematic review has shown that there are several red flags that can help solicitors to identify a potentially a dubious scheme. It is a firms' responsibility to make sure that they are aware of any potential risks in work they act in. If firms have been or may receive investment work in the future, we would recommend that firms make sure they are familiar with all the common characteristics of a dubious scheme.

Treat consumers fairly

Unfair contract terms for buyers are another red flag that may indicate that a transaction is dubious. Unusually high deposits and returns, terms that are overly complex or disadvantageous to buyers should be approached with caution.

Solicitors should be aware that limiting retainers in a dubious investment scheme is not acceptable practice. It facilitates dubious schemes and may provide buyers with false reassurance that the scheme is genuine. Solicitors may need to consider whether the best advice is that the buyer should withdraw from the transaction.

Good practice
Firms may wish to consider using some of the same type of safeguards used for anti-money laundering checks to identify and assess dubious schemes. This could include a checklist of steps to manage the key risks identified in this report, for example: • carrying out a risk assessment • carrying out a conflict check • due diligence checks and checking source of funds • making sure the firms' accounts are not being used as a banking facility • asking employees to confirm they are acting within their area of expertise before taking on work in an investment scheme. • ensuring all investment work is appropriately supervised.

Glossary

Alternative investments	An unconventional or unusual asset, for example fine wine, art, carbon credits or rare earth metals or minerals. A buyer may need some technical knowledge to understand its true value.
Buyers	Consumers who may or may not be clients of a firm, who pay money into a purported investment scheme.
Buyers' companies	A company set up by the sellers in a buyer-led property scheme which purports to represent the buyers' interests by holding deposits in a designated account. Sellers appoint a solicitor to manage the company and to release the funds to finance the construction in accordance with a declaration of trust.
Buyer-led/ buyer-funded off-plan development	A method of financing off plan property developments by using deposits from individual buyers. The money is used to fund the construction of the entire project including marketing costs. This can be a high-risk investment as construction often begins without all the funding in place. If the funds run out the development will not complete.
Collective investment scheme (CIS)	A method of collecting or 'pooling' money from several buyers to fund an investment. Establishing or operating a CIS is a regulated activity requiring authorisation from the Financial Conduct Authority (FCA). Subject to certain exemptions, it is illegal to promote an unauthorised CIS to the general public. Establishing, operating or winding up a collective investment scheme is also a prohibited activity under the Financial Services Scope Rules.
Dubious investment scheme	A significantly high risk or fraudulent investment scheme often characterised by guarantees of moderate to high financial returns which are offered to convince consumers to pay in money based on false or misleading information. Often there is an absence of information about the product or level of risk.
Fractional ownership	A method of purchasing a proportion of an asset. For example, hotel rooms, car parking spaces, student accommodation and storage pods.
Mini-bonds	Used by companies to borrow money directly from individual buyers over a fixed period in return for an attractive interest rate. The mini bond is not transferable and does not buy a share of the company. The buyer effectively becomes a creditor of the company.
Paymaster	An individual who receives funds in escrow from buyers in a large transaction and distributes them to the sellers and brokers in accordance with a paymaster agreement.
Ponzi scheme	A form of investment fraud which promises guaranteed high returns in a short period of time. Typically, the deposits of

	recent buyers are passed on to previous investors, creating the illusion of a profitable venture despite there being no genuine investment.
Prime bank instrument schemes	A purported guarantee from a ‘prime’ or mainstream bank. Fraudsters sell the guarantees at a discounted rate and on an invitation only basis with the promise of high returns over a very short period. This may also include fraudulent letters to mislead banks and other entities to provide loans.
Promoters	Promotional agents of the seller who market the scheme to buyers and to firms.
Self-invested personal pension (SIPP)	A pension plan which enables the holder to control where their retirement funds are invested.
Sellers	Individuals or companies who set up and sell investment products or purport to develop land and property.