

## Finalised guidance

# A guide for Self-Invested Personal Pensions (SIPP) operators

8 October 2013

## SIPP operator guidance

**This guidance relates to the following rule(s) in the FCA Handbook**

- Conduct of Business sourcebook (COBS) 3.2.3R (2)
- Supervision manual (SUP) chapter 3.10
- Client Assets sourcebook (CASS) 6 (where relevant) and CASS 7

**This guidance is likely to be of most relevance to**

- SIPP operators.
- It will be of wider interest among firms, trade bodies and consumer representatives.

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# 1. Regulatory responsibilities

This guide covers the following areas:

- Systems and controls
- Client money
- Management information
- Conflicts of interest
- Relationship with firms that advise and introduce prospective members
- Due diligence, and
- Financial crime

## Introduction

We have now concluded the second review of Self-Invested Personal Pension (SIPP) operators we have conducted since April 2007, when the activity of administering SIPPs became regulated by our predecessor regulator, the FSA, under the permission of 'establishing, operating or winding up a personal pension scheme'. The review looked at:

- the extent to which SIPP operator firms are adhering to our Principles and Rules
- the current risks associated with the sector
- actions taken by firms to mitigate those identified risks, and
- the level of further work we need to undertake to ensure a well-run, sustainable sector

This guide, originally published in September 2009, has been updated to give firms further guidance to help meet the regulatory requirements. These are not new or amended requirements, but a reminder of regulatory responsibilities that became a requirement in April 2007.

All firms, regardless of whether they do or do not provide advice must meet Principle 6 and treat customers fairly. COBS 3.2.3(2) is clear that a member of a pension scheme is a 'client' for SIPP operators and so is a customer under Principle 6. It is a SIPP operator's responsibility to assess its business with reference to our six TCF consumer outcomes:

[www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers](http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers)

## Systems and controls

Principle 3 of the FCA's Principles for Businesses requires all firms to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems. We would expect firms to establish and maintain systems and controls that are appropriate to their business, compliant with the regulatory system and to minimise risks, including the risk that the firm might be used to facilitate financial crime. A firm must keep adequate records to enable them to demonstrate these controls.

Firms that do not have a clear set of procedures in place may not be able to monitor or demonstrate the quality, accuracy and timeliness of the services they provide. Firms' senior management should be satisfied that they can demonstrate robust procedures for all aspects of

their SIPP administration. Examples of good practice we observed during our work with SIPP operators included:

- reconciliations of SIPP member bank accounts with the operator's SIPP bank account provider
- an analysis of the purchase and sale of all property investments (eg, checking that property does not contain a residential element or where the purchase is from a connected party that an independent capital valuation has been obtained and the purchase price reflects that valuation.)
- retaining proof of title of members' investments
- retaining evidence of members' instructions for investments and movement of funds
- business continuity procedures, and
- having a bespoke procedure to deal with and monitor execution only and direct customers. (eg recommending to prospective members that financial advice is sought regarding the transaction and recording the reasons a member wishes to deal direct.)

SIPP operators should also have a clear set of procedures in place to help them deal with appropriately and/or control their exposure to:

- investments that SIPP operators may not retain control over
- investments that are not allowed to be held by multiple trustees, or investment rules that do not allow the investment to be held by trustees
- residential property
- claims by those administering the estate of a deceased member and the possible tax consequences of failing to meet HMRC rules
- divorce settlements, earmarking or pension sharing orders, and
- due diligence conducted by third parties. (eg SIPP operators should ensure that reports and audits, upon which they rely, are genuine and from qualified reliable third parties.)

In relation to the supervision of their employees SIPP operators should:

- clearly establish roles and responsibilities and document them
- benchmark and monitor the skills, knowledge and expertise needed for each employee to discharge their responsibilities
- have procedures to ensure all employees are properly trained and competent, and
- regularly conduct, and then evaluate, the effectiveness of employee training

All of a firm's procedures should be monitored and reviewed regularly to ensure they remain fit for purpose. SIPP operators should also consider using internal or external audit facilities or compliance consultants to provide support and independent checks where appropriate.

The firms' senior management should be able to demonstrate oversight and understanding of all regulatory requirements. This is vital to developing and sustaining successful cultures enabling firms to better identify and manage risks to the firms and their members.

### **Client Money**

Principle 10 of the FCA's Principles for Businesses requires all firms to arrange adequate protection for clients' assets when they are responsible for them.

Following supervisory work, we are concerned that the majority of SIPP operators may be unable to accurately explain the application of the client money and custody asset rules (CASS) to their businesses, where relevant. This matters as this could cause significant detriment to clients were a SIPP operator to fail, for example through loss and/or cost to clients' pensions.

All firms should ensure that senior management understand the application of the CASS rules to their business, and where they are unsure, to seek appropriate advice.

### Management Information (MI)

Principle 6 of the FCA's Principles for Businesses requires all firms to pay due regard to the interest of its customers and treat them fairly. SIPP operators are not responsible for the SIPP advice given by third parties such as financial advisers. We would expect SIPP operators to have procedures and controls in place that enable them to gather and analyse MI that will enable them to identify possible instances of financial crime and consumer detriment.

Such instances should then be addressed in an appropriate way, for example by contacting the members to confirm the position, or by contacting the firm giving advice and asking for clarification. Moreover, while they are not responsible for the advice, there is a reputational risk to SIPP operators that facilitate SIPP investments that are unsuited to their members.

Regardless of size, structure or business model, the collection and use of good MI is invaluable in helping to identify areas for improvement to ensure firms consistently deliver fair outcomes for their members. If appropriate, firms should consider how they can develop further MI to help identify any potential risks, issues or trends that might affect the fair treatment of their members.

We would also encourage firms to formally document how they review MI (to include an explanation of what the MI tells them, any risks, issues or trends and further investigations needed, any remedial action taken and the effectiveness of that action). Using MI in this manner will help demonstrate how firms manage risk to improve their business and overall outcomes for their members.

The following are examples of MI firms should consider:

- recording and retaining records of the due diligence completed on investments not approved and collecting and analysing the MI this provides;
- collection of MI to identify trends in the business submitted by introducers;
- ability to identify the number of investments, the nature of those investments, the amount of funds under management, spread of introducers, the percentage of higher risk or non-standard investments;
- ability to identify any issues with the production of illustrations or benefit crystallization events; and
- monitoring MI against established benchmarks linked to a firm's risk tolerance and business model. (for example the value of funds under management, client money values and how these change over time and the level of non-standard investments within a scheme.)

### Conflicts of interest

Principle 8 of the FCA's Principles for Businesses requires a firm to manage conflicts of interest fairly, both between itself and its customers, and between a customer and another client. We have identified instances of conflicts of interest with firms acting as the administrator, trustee and adviser to customers without sufficient controls in place, and where the SIPP operator is closely connected to an investment (for example, where a director of the SIPP operator is also a director of the relevant investment company) This conflict can be exacerbated if the director is also a trustee.

Firms who give advice on SIPPs as well as administer them can have potential conflicts of interest. Firms need to be able to demonstrate that they have fully considered all the options and their recommendations comply with all the normal [suitability requirements](#).

As a minimum, firms in this position must fully and prominently disclose the potential conflict to their members at the outset of any potential dealings, and at any future dealings with members when a conflict of interest may exist. This should be disclosed in writing to members, for example, in the terms of business or as part of any written agreement.

Senior management are responsible for setting up and implementing procedures to identify and manage any potential conflicts of interest. This could include having independent verification or third party checks. These procedures should be reviewed regularly to ensure they remain fit for purpose.

### **Relationships between firms that advise and introduce prospective members and SIPP operators**

Examples of good practice we observed during our work with SIPP operators include the following:

- Confirming, both initially and on an ongoing basis, that: introducers that advise clients are authorised and regulated by the FCA; that they have the appropriate permissions to give the advice they are providing; neither the firm, nor its approved persons are on the list of prohibited individuals or cancelled firms and have a clear disciplinary history; and that the firm does not appear on the FCA website listings for un-authorised business warnings.
- Having terms of business agreements that govern relationships and clarify the responsibilities of those introducers providing SIPP business to a firm.
- Understanding the nature of the introducers' work to establish the nature of the firm, what their business objectives are, the types of clients they deal with, the levels of business they conduct and expect to introduce, the types of investments they recommend and whether they use other SIPP operators. Being satisfied that they are appropriate to deal with.
- Being able to identify irregular investments, often indicated by unusually small or large transactions; or higher risk investments such as unquoted shares which may be illiquid. This would enable the firm to seek appropriate clarification, for example from the prospective member or their adviser, if it has any concerns.
- Identifying instances when prospective members waive their cancellation rights and the reasons for this.

Although the members' advisers are responsible for the SIPP investment advice given, as a SIPP operator the firm has a responsibility for the quality of the SIPP business it administers. Examples of good practice we have identified include:

- conducting independent verification checks on members to ensure the information they are being supplied with, or that they are providing the firm with, is authentic and meets the firm's procedures and are not being used to launder money
- having clear terms of business agreements in place which govern relationships and clarify responsibilities for relationships with other professional bodies such as solicitors and accountants, and
- using non-regulated introducer checklists which demonstrate the SIPP operators have considered the additional risks involved in accepting business from non-regulated introducers

## Due diligence

Principle 2 of the FCA's Principles for Businesses requires all firms to conduct their business with due skill, care and diligence. All firms should ensure that they conduct and retain appropriate and sufficient due diligence (for example, checking and monitoring introducers as well as assessing that investments are appropriate for personal pension schemes) to help them justify their business decisions. In doing this SIPP operators should consider:

- ensuring that all investments permitted by the scheme are permitted by HMRC, or where a tax charge is incurred, that charge is identifiable, HMRC is informed and the tax charge paid
- periodically reviewing the due diligence the firm undertakes in respect of the introducers that use their scheme and, where appropriate enhancing the processes that are in place in order to identify and mitigate any risks to the members and the scheme
- having checks which may include, but are not limited to:
  - ensuring that introducers have the appropriate permissions, qualifications and skills to introduce different types of business to the firm, and
  - undertaking additional checks such as viewing Companies House records, identifying connected parties and visiting introducers
- ensuring all third-party due diligence that the firm uses or relies on has been independently produced and verified
- good practices we have identified in firms include having a set of benchmarks, or minimum standards, with the purpose of setting the minimum standard the firm is prepared to accept to either deal with introducers or accept investments, and
- ensuring these benchmarks clearly identify those instances that would lead a firm to decline the proposed business, or to undertake further investigations such as instances of potential pension liberation, investments that may breach HMRC tax-relievable investments and non-standard investments that have not been approved by the firm

## Due diligence in respect of Unregulated Collective Investment Schemes (UCIS)

UCIS are complex, opaque, illiquid and risky, and tend to invest in high risk ventures such as films, green energy initiatives and overseas property funds. They may not be covered by FOS or FSCS protections.

We have stated previously that UCIS are high risk, speculative investments which are unlikely to be suitable for the vast majority of retail customers.

We have created a UCIS landing page which set out our views on these risks, and includes a number of communications we have issued to the industry and consumers:

[www.fca.org.uk/firms/financial-services-products/investments/ucis](http://www.fca.org.uk/firms/financial-services-products/investments/ucis)

If firms are involved with UCIS they should ensure that they:

- have enhanced procedures for dealing with UCIS
- have KPI's and benchmarks linked to the sale of UCIS to monitor the business they are conducting
- ensure that any third-party due diligence that they use or rely on has been independently produced and verified, or
- undertake appropriate due diligence on each UCIS scheme - this due diligence, together with all research should be kept under regular review

## Financial crime

Principle 2 of the FCA's Principles for Businesses is also relevant to financial crime. All firms including SIPP operators can be affected by financial crime, whether it is perpetrated by staff or by members or introducers. Our regulatory guide [Financial crime: a guide for firms](#) provides practical assistance and information for firms on actions they can take to reduce the risk of financial crime.

### *How firms might be affected by financial crime*

The guide and our financial crime thematic work, together with our SIPP operator's thematic work, identified a number of ways firms could be affected by financial crime, for example:

- introducers using a firm in an attempt to liberate pension funds outside the normal retirement benefit procedures
- someone using a firm's services to disguise the source of illicit funds
- members defrauding a firm, or being defrauded by third parties, as a result of a firm's failure to ensure that adequate systems and controls are in place, or applied, to detect financial crime, or fraud, and
- not having controls in place, such as robust recruitment procedures, or monitoring of key procedures, such as co signatory requirements or trustee requirements, to prevent a staff member committing fraud

If a firm knows about or suspects money laundering or terrorist financing, it should be reported to the Serious Organised Crime Agency (SOCA). More information is available on the [SOCA website](#).

### *What firms need to do*

To reduce the risks of financial crime, firms need to have appropriate risk management systems and controls in place to address the risk of financial crime and be able to demonstrate that a risk assessment is undertaken regularly.

## 2. Client money and custody assets

### SIPP structure and business models

In any SIPP structure, we expect an entity to hold monies and assets of the SIPP in the name of the trustees. We would also expect at least one entity in the structure to be conducting duties that fall within the FCA (formerly FSA) Part IV Permission of establishing, operating or winding up a personal pension scheme (operator).

SIPP operators (and/or trustees regulated by the FCA) are expected to be able to demonstrate when we ask them how our client assets requirements (CASS) apply to their SIPP structure. For example:

- CASS 8 only applies to a SIPP operator only controlling (without holding) client money.
- CASS 7 applies to a SIPP operator holding and controlling client money.
- CASS does not apply to a bare trustee, to the extent that the bare trustee is not regulated by the FCA. However, if the trustee is conducting **any** operator duties, or is able to perform such duties under the terms of the trust deed, it is **not** a bare trustee and requires the FCA Part IV Permission of establishing, operating or winding up a personal pension scheme. If the SIPP trustee falls within the scope of regulation, it is likely to be holding and controlling client money and should apply for the authority to do so.<sup>1</sup>

Trustee firms regulated by the FCA and holding client money may apply CASS 7.1.15FR<sup>2</sup>, which identifies the requirements of CASS that apply. The aim is to remove any duplication of equivalent requirements under other relevant legislation and/or other legal arrangements.

### Regardless of CASS 7.1.15FR, firms are reminded of their overarching duties under Principle 10.

Firms should consider carefully whether and how CASS applies to their SIPP structure and we expect firms to seek specialist, independent advice if senior management are unclear on this point.

### Governance

#### **Principle 10 Clients' Assets: A firm must arrange adequate protection for clients' assets when it is responsible for them; CASS 1A.3 Responsibility for CASS operational oversight; CASS 7.3 Organisational requirements: client money**

We expect firms to have robust governance in place, including identifying which director(s) or senior manager(s) have responsibility for CASS operational oversight (CF10a in the case of CASS large and CASS medium firms). We also expect there to be procedures and controls in place to identify CASS risks and escalate these to the firm's governing body where appropriate.<sup>3</sup>

<sup>1</sup> [PERG 10](#) (question 23 (4)): Guidance on activities related to pension schemes and [FSMA \(Regulated Activities\) Order](#): Article 66 Exclusions applying to several specified kinds of activity

<sup>2</sup> CASS 7.1.15FR refers to which CASS rules are applicable to trustee firms

<sup>3</sup> [Policy Statement 10/16: Client Assets Sourcebook \(Enhancements\) Instrument 2010: Chapter 5 Increased CASS oversight](#)

We do not necessarily expect the individual responsible for CASS operational oversight to have in-depth technical knowledge of compliance with CASS, provided they have sufficient resources available to them to address this knowledge gap; for example, staff with appropriate technical knowledge reporting to them.

However, the relevant Controlled Function (CF) is responsible for the firm's compliance with CASS and needs to be able to demonstrate that they carry out this responsibility effectively. For example, where a CF is reliant on other staff, they should have sufficient understanding to effectively oversee these staff, and be able to monitor and challenge their work appropriately. The CF can only undertake this job effectively if they understand and are able to explain how CASS applies to their SIPP business, potential risks to clients and how these are being mitigated.

### **Segregation: acknowledgement letters**

**Principle 10 Clients' Assets** (see above); **CASS 7.4 Segregation of client money; CASS 7.7 Statutory trust; CASS 7.8 Notification and acknowledgement letters**

We expect firms holding client money to:

- identify the flow of client monies through their business so that senior management are clear when the firm has a fiduciary responsibility to clients in accordance with CASS, and when the firm has discharged that responsibility
- segregate client money from other monies on a daily basis (including money belonging to the firm and money that belongs to clients but does not fall within the scope of CASS), and
- demonstrate when asked that they have effectively segregated client money, and how this is achieved

A firm that is both the operator and the trustee may apply the table in CASS 7.1.15FR, and under this rule an acknowledgement letter is not required. However, where acknowledgement letters are in place we expect them to be in line with the requirements of CASS 7.8.1R.

### **Segregation: due diligence on the bank a firm deposits client monies with**

**Principle 10 Clients' Assets** (see above); **CASS 7.4 Segregation of client money (CASS 7.4.7R – 7.4.10R)**

We expect firms holding client money to periodically review their due diligence of each bank (or credit institution) it has placed client money with (CASS 7.4.7R and 7.4.8R). In light of recent economic events and in accordance with Principle 10, firms should consider whether the current frequency of these reviews remains appropriate, or if more regular reviews are required.

We also expect firms to be able to show that the governing body of the firm has approved the selection of all banks or credit institutions used to hold client money. The governing body of the firm should also approve all subsequent reviews of that due diligence to ensure the selection of bank remains appropriate.

### **Reconciliations, including record keeping**

**Principle 10 Clients' Assets** (see above); **CASS 7.6 Records, accounts and reconciliations (& CASS 7 Annex 1); CASS 8 Mandates**

We expect firms holding client monies to ensure they keep, and are able to evidence at all times, accurate records of the client money held for each individual client; and to be able to

demonstrate that this money has been effectively segregated from other monies on a daily basis. We expect the relevant CF, and the firm's governing body, to have put in place systems and controls to ensure this segregation takes place, and to take action against reconciliation discrepancies (CASS 7.6.13R to 7.6.15R) if these arise (see below).

We expect a firm to:

- operate distinct internal reconciliation (the client money requirement and client money resource) and external reconciliation (client money resource and third party statements) processes, and to be able to show this when asked;
- be able to confirm whether the firm adopts the standard method for the internal reconciliation as set out in CASS 7 Annex 1G and be able to explain and evidence when asked how their internal reconciliation reflects Annex 1G, through either:
  - > the individual client balance method CASS 7 Annex 1G(6(1) and 7) or
  - > the bank balance method (also referred to as the net negative add back method CASS 7 Annex 1G(6(2)))'; and
- be able to demonstrate the internal reconciliation is carried out **daily** in accordance with CASS 7 Annex 1G.

If the firm wishes to deviate from the standard method of internal client money reconciliation (CASS 7 Annex 1G) in any regard, the firm must show and explain how the desired method affords equivalent protections in accordance with CASS 7.6.7R. The firm's external auditor must also confirm in writing to the FCA that, in the auditor's opinion, the firm has adequate systems and controls in place to enable it to use a non-standard method effectively, in accordance with CASS 7.6.8R.

While discrepancies may arise from internal reconciliations, we confirm it is rare to have an actual [shortfall](#) (as defined within the Handbook glossary) or an 'excess' event as a result of an internal client money reconciliation. Such instances are likely to be timing differences in the majority of SIPP businesses. However, the investigation of any discrepancies identifies whether these are genuine timing differences or errors in firm records. So the investigation of discrepancies arising from reconciliation remains an important step in ensuring the firm is maintaining accurate records.

We expect firms to hold records outlining their role in relation to any SIPP business and be able to evidence this e.g. in the form of extracts from the trust deed and scheme rules, mandates, client agreements, terms of business, terms and conditions, records of operational functions (client bank accounts, reconciliations etc.).

Accurate records of client money are of paramount importance as the cost of unravelling client money from non-client money is borne in part by the client money pool should an operator become insolvent.

## CASS audits

### SUP 3: Auditors

We expect firms to be aware of and, where appropriate, act on the requirement to appoint an external auditor to provide a client assets audit report in accordance with SUP 3.1.2R and SUP 3.10.4R.

Where the table in SUP 3.1.2R indicates SUP 3.10<sup>4</sup> is applicable, an auditor of the firm must submit a client assets report (a reasonable assurance report or a limited assurance report) to the FCA in accordance with SUP 3.10.4R.

### Other issues, including physical assets on site under the SIPP

#### Physical assets on site under the SIPP

**[FSMA \(Regulated Activities\) Order: Article 66 Exclusions applying to several specified kinds of activity](#); [PERG 10 \(question 23 \(4\)\)](#): [Guidance on activities related to pension schemes](#)**

The Perimeter Guidance Manual (PERG 10.3 Q23 (4)) sets out the following:

'As trustee, your company is likely to be responsible for [safeguarding and administering investments](#) held as scheme assets. If it makes use of a specialist custodian it will be [arranging safeguarding and administration of assets](#). These are potentially regulated activities. But they will not be if:

- your company is not holding itself out as a custodian and is not remunerated for providing custody services in addition to what it is paid for acting as trustee (see article 66(4) of the Regulated Activities Order); or
- (as respects arranging for another person to provide custody services) it delegates custody to a suitably [authorised](#) or [exempt person](#) (see article 66(4A) of the Regulated Activities Order).'

Assets under the SIPP may fall outside of CASS in two ways:

- a separate bare trustee (not regulated by the FCA) is set up to hold SIPP assets, or
- firms may apply the exclusion in Article 66 of the Regulated Activities Order

If firms fall within the scope of the exclusion in Article 66, assets under the SIPP fall outside of CASS 6, we nevertheless expect firms to register these assets under a name that clearly identifies to whom the assets belong, and in particular ensures segregation of these from assets belonging to the firm.

We also expect firms to protect physical assets under the SIPP where these are available on site, for example through locked storage, restricted access, access logs, etc. While it is relatively straightforward to replace some asset documentation, we expect operators to consider what arrangements are appropriate to minimise the risk of loss or diminution of assets, or the rights in connection with those assets. The operator should also consider the risk of loss caused by misuse, fraud, poor administration, inadequate record keeping or negligence.

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<sup>4</sup> [SUP 3.10: Duties of auditors: notification and report on client assets](#)

Firms are reminded that Principle 10 requires a firm to arrange adequate protection for clients' assets when it is responsible for them even if CASS does not apply to those assets or monies.

### **Bank accounts which are not client bank accounts**

We have seen examples of bank accounts which are clearly **not** client bank accounts, but where firms have nevertheless arranged for trust notification and acknowledgement letters (apparently consistent with the requirements of CASS 7.8). This is incorrect.

Where the bank account is not a client bank account and does not contain client money (as defined in our glossary) there should **not** be any trust notification or acknowledgement letter as this may incorrectly claim that money held in these bank accounts is client money within the CASS regime. Where this has occurred, firms should contact the relevant bank and ensure the incorrect trust acknowledgement is rescinded and that records set out the accurate position.

This is not to be confused with accounts that contain client money as defined in our Handbook but where, under CASS 7.1.15FR, the firm considers a trust acknowledgement letter under CASS 7.8.1R is not required.

## Annex 1: Cost benefit analysis

1. As we are not making any new rules, our statutory cost-benefit analysis (CBA) requirements do not apply. However, we have committed to consider conducting and publishing an analysis of the costs and benefits of any guidance that is likely to result in firms or consumers incurring significant costs that were not formally considered when we consulted on the rule or the principle the guidance relates to.
2. We do not expect the guidance, *A guide for SIPP operators*, to increase costs. We do not expect material costs to arise, as the guidance is intended to clarify our existing conduct of business rules and client asset rules. We are not amending or changing the current rules. We already expect firms to collect the information needed to ensure compliance with our existing rules. We have therefore not conducted a cost benefit analysis (CBA) of this guidance.