



Financial Services Authority

# Self-Invested Personal Pensions (SIPP) operators

A report on the findings of a thematic  
review

October 2012



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# 1 Introduction

## **Why did we carry out this thematic review?**

This is the second review of SIPP operators we have conducted since April 2007, when the specific activity of administering Self-Invested Personal Pensions (SIPPs) became regulated by the Financial Services Authority (FSA), under the permission of ‘establishing, operating and/or winding up a personal pension scheme’.

In 2009 we reported<sup>1</sup> that, when taken as whole, SIPP operators did not pose a significant risk to our statutory objectives. By 2011 our view of the sector was changing and, as noted in the Retail Conduct Risk Outlook 2011<sup>2</sup>, we had concerns about poor firm conduct and the potential for significant consumer detriment.

This latest review was undertaken to investigate these concerns and determine the extent to which SIPP operators had adapted their processes and procedures to reduce risks following our 2009 report. We also considered the level of compliance among SIPP operators with our Client Money & Assets rules (CASS), as part of our focus on these issues across the UK financial services market.

In April 2011 we contacted 72 SIPP operators asking them to complete and return a questionnaire. The responses were analysed, with telephone interviews conducted with a sample of the firms during July and August 2011. Seven firms were then selected for onsite visits in August and September 2011 that focused on general compliance, with a further seven firms selected for onsite visits that focused on compliance with CASS.

The findings of this review confirmed our concerns.

Poor firm compliance with regulatory requirements, particularly in the area of risk planning and mitigation, has significantly increased the risk posed by SIPP operators.

In addition to generally poor systems and controls, the majority of SIPP operators we visited were unable to articulate accurately the application of CASS to their business structure. This led in some cases to a failure to protect clients’ assets adequately, putting clients at risk of loss if a non-compliant SIPP operator were to fail.

We also found inadequate controls over the investments held within some SIPPs.

Together these findings make it clear that SIPP operators have the potential to lead to significant consumer detriment through a failure to adequately control their businesses.

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<sup>1</sup> [SIPP thematic review report September 2009](#)

<sup>2</sup> [Retail Conduct Risk Outlook 2011](#)

## **What should firms do now?**

All SIPP operators should review their business in light of the contents of this report. This applies to all SIPP operators, not just those who had a telephone assessment and/or a supervisory visit.

## **What will happen next?**

We believe that, when taken as a whole, the SIPP operator sector has the potential to cause significant consumer detriment. Accordingly, a programme of coordinated work is planned, with the aim of raising standards across the sector.

This will include a series of Consultation Papers and a Policy Statement to be published later in the year. These will implement changes, and propose some new ones, all aimed at strengthening the regime applicable to SIPP operators across:

- capital requirements;
- disclosure; and
- inflation-adjusted projections.

As well as these changes, we expect to undertake more supervisory work across the SIPP operator sector; focusing on a number of areas, including those highlighted in this document.

Firms unable to demonstrate during any future supervisory contact with the FSA, that they have analysed their systems and controls as a result of this thematic review, and made any necessary improvements, may be the subject of further regulatory action.

# 2 Project findings and firms' requirements

## 2.1 Overall project conclusions

Since regulating personal pension schemes we have seen a range of concerns common to the majority of SIPP operators.

Our work identified several firms that may have been used as a conduit for financial crime.

We found firms who were unable to identify investments that may attract a tax charge from Her Majesty's Revenue & Customs (HMRC), leading to potential consumer detriment.

Many firms were also unable to explain the application of CASS to their business, potentially putting clients' money at risk.

To address the immediate concerns identified during the project, we have used and will continue to use, our normal supervisory and enforcement tools, as appropriate. To date this has included requiring seven skilled persons reports to be undertaken under Section 166 of the Financial Services and Markets Act 2000 (with two of these focused specifically on client money and assets controls).

Once the results of the skilled persons reports are known we will consider what, if any, further regulatory action is required, including possible referrals to Enforcement.

We will work with our Enforcement colleagues and external stakeholders including HMRC, The Pensions Regulator (TPR) and where appropriate the Serious Fraud Office (SFO), to ensure we have a well run, financially sound sector.

During our review we found the following:

- A poor understanding among firms' senior management of regulatory requirements and their individual responsibilities.
- A lack of senior management oversight of the conduct of their firm.
- Poor corporate governance, which in some firms may have resulted in the firm being targeted by other parties for the purposes of facilitating financial crime. These other parties included both FSA-authorized and unauthorized firms, based in both the UK and abroad.

- Inadequate risk identification processes and risk mitigation planning, underpinned by poor quality management information (MI).
- An increase in the number of non-standard investments held by some SIPP operators, with often poor monitoring of this.
- Firms holding insufficient capital to absorb unexpected liabilities, risking the ongoing viability of the firm.
- A lack of evidence of adequate due diligence being undertaken for introducers and investments.
- An inability to articulate accurately the application of CASS to firms' business models, and where the rules do apply, generally poor systems and controls for compliance with these.
- Evidence of conflicts of interest existing within some SIPP operators, with firms acting as the administrator, trustee and adviser without sufficient controls in place to manage potential conflicts between these roles, and without clear disclosure of the potential conflict to members.
- Poor management of operational risk in some firms, with inadequate systems reliant on manual 'workarounds'.

## **2.2 Regulatory requirements and individual responsibilities**

In our 2009 report we identified that there was a relatively widespread misunderstanding among SIPP operators that they bear little or no responsibility for the quality of the SIPP business that they administer, as this is the responsibility of clients and clients' advisers. The work undertaken during this review evidenced that this perception remains prevalent in a number of the SIPP operators sampled.

As we stated in 2009, we are very clear that SIPP operators, regardless of whether they provide advice, are bound by Principle 6 of the Principles for Business: 'a firm must pay due regard to the interests of its customers and treat them fairly', in so far as they are obliged to ensure the fair treatment of their members.<sup>3</sup>

Over half of the senior managers we spoke to had no previous experience in a regulated environment. We believe this lack of relevant experience has contributed to the generally poor understanding of the regulatory obligations of the SIPP operators we encountered during our review.

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<sup>3</sup> COBS 3.2.3R(2) states that a member of a pension scheme is a "Client" for COBS purposes, and "Customer" in terms of Principle 6 includes clients



We expect all SIPP operators to take the necessary steps to familiarise themselves with the regulatory requirements of their role and ensure they have robust processes and procedures in place that allow them to keep up-to-date with any changes in those requirements.

We have published a variety of resources to support SIPP operators in meeting their regulatory requirements. These resources can be accessed through our website.<sup>4</sup>

## **2.3 Risk identification and mitigation planning**

We have previously identified inadequate systems and controls in SIPP operators, which did not allow firms to identify and mitigate risks to both their schemes and their members.

Despite our 2009 guidance, some SIPP operators had not made any changes to address weaknesses in their risk management systems and controls.

Firms were generally able to describe what appropriate risk mitigation systems looked like. However, when asked for evidence of their own risk mitigation systems and controls during our review, just under 40% of the firms in the general review provided MI that was of insufficient quality to identify risks and therefore to take appropriate action to mitigate them.

We found firms failing to implement necessary changes within their business following FSA guidance. Where we identified such firms during our review, we have used our full range of regulatory tools to ensure these firms safeguard their customers' interests in the appropriate manner.

Principle 3 of the Principles for Business states 'a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems'.

We expect all SIPP operators to review the systems and controls in place to allow them to comply with relevant FSA requirements, including Principle 3. All SIPP operators should ensure the systems and controls they operate are sufficiently robust to identify risks to the scheme and its members and, where identified, take appropriate action to mitigate those risks.

## **2.4 Client money and assets**

Our review found that the majority of SIPP operators we visited to review client money and assets controls:

- were unable to accurately explain the application of CASS to their business, where relevant, which could cause significant detriment to clients if a SIPP operator failed, for example through loss and/or cost to the client's pension; and
- demonstrated inadequate governance arrangements and systems and controls for client assets.

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<sup>4</sup> [http://www.fsa.gov.uk/library/other\\_publications/pensions/2007/sipps.shtml](http://www.fsa.gov.uk/library/other_publications/pensions/2007/sipps.shtml)

The SIPP operators visited generally had complex structures, with a number of components. This makes the application of CASS complicated and prone to misinterpretation or misapplication.

Where firms were seeking to comply with the regime we found that the majority had weaknesses in the systems and controls designed to achieve this. Particular issues we identified were:

- a failure to effectively segregate client monies from firm monies – the fundamental principle underpinning the CASS regime;
- inadequate evidence of appropriate due diligence being performed on banks where client monies are deposited;
- inadequate reconciliations and record keeping, including an inability to distinguish between internal (CASS 7.6.6 G) and external (CASS 7.6.9 R) reconciliations;
- poor governance and senior management oversight of CASS risks in firms (echoing the broader findings of our review), which is particularly concerning where firms are required to appoint a CF10a, a dedicated control function for the oversight of client money and assets compliance in firms; and
- firms unaware of their duties to commission external audits of their systems and controls for compliance with CASS, as required by SUP 3.10.

These issues were compounded in some of the firms we visited by the application of similar controls to both their SIPP and Small Self Administered Scheme (SSAS) business, the latter of which is not regulated by the FSA.

Principle 10 of our Principles for Business requires all firms to arrange adequate protection for clients' assets when they are responsible for them and the issues highlighted are not new. The findings of this review of SIPP operators echo the key messages in our Client Money and Asset Report January 2010<sup>5</sup> that focused on compliance with CASS among investment firms.

This report is supported by specific guidance that intends to clarify our expectations for SIPP operators' compliance with CASS. We expect all SIPP operators to review this guidance and improve their CASS systems and controls where necessary.

## **2.5 Non-standard investments, due diligence and financial crime**

SIPPs are intended to provide individuals with the ability to invest in a wide range of opportunities. We have seen that the range of non-standard investments, such as some unregulated collective investment schemes (UCIS), held within some SIPPs has increased significantly, as has the customer base to which they are marketed.

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<sup>5</sup> [Client Money & Asset Report January 2010](#)

Approximately 70% of the SIPP operators in our general review reported that they held non-standard investments; however, over a quarter of the firms sampled were unable to identify the percentage of non-standard investments held due to poor quality MI.

Although the level and types of investments some customers are looking to hold within their SIPP has diversified rapidly over the last 24 months, firms' processes are not keeping pace.

Principle 2 of the Principles for Business, states 'a firm must conduct its business with due skill, care and diligence'.

Some SIPP operators were unable to demonstrate that they are conducting adequate due diligence on the investments held by their members or the introducers who use their schemes, to identify potential risks to their members or to the firms itself. In some firms this was made worse by an over-reliance on third parties to conduct due diligence on behalf of the operator. In some cases this has resulted in taxable investments being inadvertently held, and monies invested in potentially fraudulent investments.

During our review we also found that, although firms hold sufficient capital to meet the minimum regulatory requirements, they do not appear to have sufficient funds set aside to mitigate, for example, the liquidity risk posed by the type of investments held by their members if those investments prove to be the subject of any HMRC tax charges. Although the administrator typically has the right to reclaim charges from members, if the assets are illiquid or insufficient it is possible the SIPP operator may be unable to meet these liabilities as they fall due, threatening the ongoing viability of the firm.

Principle 4 of the Principles for Business, which applies to all SIPP operators, states 'a firm must maintain adequate financial resources'.

All SIPP operators should review the types and levels of investments their members hold and consider if the capital set aside is sufficient to meet their liabilities as they fall due and ensure they continue to meet Principle 4 at all times.

We will shortly issue a Consultation Paper that seeks to address the risk of SIPP operators failing to hold sufficient capital to meet their regulatory requirements.

# 3 Next steps

We expect all SIPP operators to review their business in light of the content of this report and be able to demonstrate that they have done so, paying particular attention to:

- the level of understanding among firms' senior management of regulatory requirements;
- the effectiveness of senior management oversight;
- whether inadequate corporate governance has resulted in their firm being targeted as a potential conduit for financial crime;
- whether the risk identification and risk mitigation planning in place is sufficiently robust to ensure the firm has safeguarded its customers' interests;
- the application of CASS to the firm's business model, and where this applies, the effectiveness of systems and controls to comply with the rules;
- the level of non-standard investments that are held within their schemes and what consideration has been given to ensure the firm holds sufficient capital resources to meet Principle 4 at all times; and
- the evidence and quality of the due diligence undertaken on introducers and the investments held within their schemes, particularly where this is conducted by third parties.

We intend to run a programme of workshops for SIPP operators to ensure that:

- we communicate face-to-face with firms;
- we explain our expectations;
- firms are aware of the requirements that apply to SIPP operators; and
- firms are aware how regulation fits in with SIPP operators' day-to-day activities.

These events are expected to take place later in 2012 and SIPP operators will be invited to attend. All SIPP operators should have completed their own business reviews in advance of their attendance at the education programme.