Warning notice

Investment schemes (including conveyancing)

Issued on 23 June 2017

Status

While this document does not form part of the SRA Handbook, we will have regard to it when exercising its regulatory functions.

Who is this warning notice relevant to?

All law firms should read this warning notice because so-called "investment" schemes are being continually changed to avoid features that have been warned about previously. Practitioners in many fields of law may find that they are at risk of facilitating a dubious investment scheme.

This warning is also relevant to members of the public who are considering paying money into what is promoted as an "investment" scheme where a law firm or solicitor is involved. They also should also read this warning and other material we have published.

We will be issuing a further direct warning to the public and law firms should ensure that they are familiar with that and all previous warnings.

Our expectations

That all firms and individuals regulated by us comply with the Principles and Outcomes of the SRA Handbook 2011 and have had regard to our published warning notices.

Our concerns

1. We are particularly concerned about the dangers of schemes where the involvement of a law firm is used to give an impression of credibility or security. That is considered in our previous warnings.
2. Schemes are being devised to mislead and to try to evade rules and previous warnings.
3. Dubious or risky schemes are being presented as routine conveyancing or investment in "land" when the reality is very different.
4. Dubious schemes are being designed in particular to try to evade rule 14.5 of the SRA Accounts Rules 2011 by which law firms must not provide banking facilities.

This notice includes reference to schemes that are being presented as routine conveyancing when our view is that they involve consumer clients unwittingly financing high risk or fraudulent property development. Those designing these schemes will no doubt move into other types of transaction or even possibly fraudulent litigation in order to avoid the more obvious indicators of fraud or high risk "investments".

You must be very alert to the risks of becoming involved in a dubious transaction and ensure that you investigate the circumstances carefully.If there are concerns, you should refuse to act or consider ceasing to act .Any involvement in a dubious scheme is likely to constitute serious misconduct.

Conveyancing or purported investment in land

Financing a development

Schemes are being promoted as involving the routine buying of a property when in reality the buyers' money is being used to finance a development or refurbishment. This is of particular concern when in unusual developments such as the buying of individual hotel rooms, rooms in care homes, or self-storage units. Our concerns also apply to some extent to any "off-plan" purchases. These may not be investment frauds but they still involve higher risk than the simple purchase of a property.

High deposits" are used by property developers to finance their developments. Investors are not being advised, or properly advised, that this often presents a much higher risk than simply buying an existing house or apartment.

Where you are acting for the buyers in these types of transactions, you must advise clients fully about the transaction and how it significantly differs from the simple buying of an existing property, such as:

1. Buying a property not yet built or completed i.e. off plan or subject to significant refurbishment, involves substantial risk that the developer or seller could fail and money will be lost
2. Promises of substantial returns are often illusory – and standard warnings in publicity about the risk of capital loss are not enough to ensure that a law firm has properly advised a client upon the transaction (see outcomes (1.1),(1.2),(1.12) of the Code of Conduct)
3. High "deposits" are being used to finance the development (see below).

We are seeing cases of solicitors simply processing transactions for buyers and adopting the language of conveyancing. The effect is to mask what is really happening. For example, investors provide money for a "deposit" which is released to the seller upon some (often spurious) condition. The investor's money is used to buy the property or finance its building or refurbishment. This carries substantial risks such as the money being misappropriated, the seller failing to complete the scheme or the seller becoming insolvent.

The usual deposit in a conveyancing transaction is 10 percent. It is paid to ensure that the buyer will complete the contract. In dubious schemes we have seen , the "deposit" has been 30 percent or even 80 percent. These are not market standard deposits but involve both pre-payment of the price and effectively the providing of finance to the developer. Referring to them as deposits is part of the psychology of presenting a risky "investment" as routine conveyancing. Clients are actually paying their money into often high-risk property development, and substantial losses have been suffered. You should ensure that clients fully understand the risks and it may well be necessary to strongly advise clients against entering into the transaction.

Taking a lease of a room, a storage unit etc

Schemes are being promoted by which investors take a lease of a supposed asset such as a hotel room, care home room, parking place or storage unit. This list is not exhaustive as fraudsters will continue to search for similar "assets".

Buyers pay a substantial amount for the asset and also pay conveyancing costs sometimes of several thousand pounds. There is no obvious reason for someone wanting to invest in a hotel to take out a lease and pay for the conveyancing of one room..

Investors may be inappropriately reassured by thinking that taking out a lease means that they

have an interest in land or property when the reality is that their investment is dependent upon the business being well managed. In these circumstances there is no greater security than there would be in the more conventional method of buying shares in the hotel.

We also see no particular reason why such investments should provide high returns. and solicitors must – properly – advise their clients of this and of the risk

The Serious Fraud Office have announced an investigation into losses of up to £120m arising from self-storage schemes.1 [#n1]

Collective investment scheme – criminal liability

Many of these schemes are likely to be "collective investment schemes" under s235 of the Financial Services and Markets Act 2000.2 [#n2] If those involved in the schemes are not authorised by the FCA they will be committing a serious criminal offence and are likely to be imprisoned as was the group convicted in a land-banking case including a solicitor.3 [#n3]

In that case when sentencing the solicitor and others involved in the "landbanking" the judge commented:

"It was a subtle and cruel fraud because it involves the concept of owning land, a commodity that the public are bound to think has value and on which they cannot lose and on which they can easily be persuaded that they can make very substantial profits."4 [#n4]

Unfair terms

The documentation in dubious schemes is often, but not always, obscure. It is frequently unfair to the consumer and any solicitor involved in drafting such documentation must pay close attention to the detail. The unfairness of the terms is often clear additional evidence that unfair advantage is being taken of the investor or buyer.

Evasion of rule 14.5 of the SRA Accounts Rules 2011

Fraudsters want to tell investors that a law firm is involved in a transaction because that gives credibility to their scheme.

We have warned about this several times and we brought in rule 14.5 to prevent law firms from providing both credibility and the facility simply to transfer investors' money through client account. This facilitates the fraud and provides a first form of layering of the proceeds. We are concerned that processes of apparent legal work or advice (such as unnecessary conveyancing) are being manufactured and designed both to evade rule 14.5 and to generate fees for the law firm that the client should not have to incur.

Insurance bonds

We have seen schemes promoted as being secured by insurance bonds which have proved worthless.

Where you are aware that the transaction is said to be secured by an insurance bond you should satisfy yourself about its validity or enforceability and advise the client properly and fully. Risk factors include:

1. The issuer of the bond is not regulated.
2. The issuer is based in a jurisdiction where it is likely to be very difficult to enforce the bond.
3. Where there is any doubt about the propriety or financial soundness of the issuer.

4. The bond is written in terms unfamiliar to a lawyer in England & Wales.
5. Reputable insurers do not offer bonds for the particular type of investment.

Relationship with investors

In most dubious schemes, the law firm acts for the promoter and not for the investor.

However, we have also seen firms acting for both or sometimes for the investor only. If you are not acting for investors, you must make that absolutely clear and strongly advise them to take their own independent advice from professionals they choose themselves. You will be at risk under Outcome (11.1) and Indicative Behaviour (IB)11.7 if you do not..

Attempts to prevent or reduce the likelihood of investors obtaining their own legal advice may well be evidence of dishonesty.

Any attempt to prevent buyers or investors from obtaining objective and independent legal advice is a serious red flag indicator. This could involve, for example:

1. Clear or subtle attempts to dissuade them from instructing their own solicitors – such as indications that they do not need legal advice or that the promoter and their solicitors will "deal with everything".
2. A requirement, or pressure, to instruct a particular firm (which may have past links with the developer or be motivated not to advise about the risks of the transaction to maintain a flow of work).
3. A refusal by the scheme promoter to accept any changes to standard "conveyancing" documentation – where the terms are in any way unusual such as requiring a high "deposit" or its release to finance the development.

We have seen evidence of conflicts of interest. Acting for both investor and developer is likely to be serious misconduct.Outcome (3.5) (see also IB 3.4)

We have seen solicitors supposedly acting for investors who appear more focused on ensuring the scheme continues than upon advising their investor clients properly.

Firms sometimes argue that they were not required to advise clients on a transaction because they had a "limited retainer". We have not seen a case where the retainer was limited at the client's (genuine) request. Limited retainers, particularly when dealing with consumers and small businesses, are in fact a red flag warning of serious misconduct. The law firm is aware that there is or might be a problem and is trying to avoid telling the client this.

The fact that a law firm acts only for the promoter does not mean that they owe no duties in conduct to buyers or investors. Solicitors must not facilitate dubious transactions. They must not take unfair advantage. They must act with integrity. Solicitors must rigorously assess the transaction and refuse or cease to act if, applying all warnings we have issued and considering past cases, there is any doubt about its propriety or whether buyers or investors are being misled in any way.

If you fail to make inquiries you will be at risk under the principles detailed below. In these circumstances the courts have warned that they "consider that by ordinary standards such a state of mind is dishonest."5 [#n5]

The SRA Principles

You must ensure that you do not become involved in potentially-fraudulent financial schemes.

You must also ensure that you advise your clients fully, frankly and in good faith.

If you fail to observe our warnings this could lead to disciplinary action or criminal prosecution. Attempting to protect yourself by, for example, limiting your retainer will be ineffective if you simply should not become involved.

If you are, or are considering, becoming involved in any financial arrangement, you must ensure you comply with the Principles in the SRA Handbook. While all Principles may be relevant, some require particular attention:

a. Integrity (Principle 2)

b. Independence (Principle 3)

c. Best interests of the client (Principle 4)

d. Behaving in a way that maintains the trust the public places in you and the provision of legal services.(Principle 6)

You must also ensure you do not take unfair advantage of investors in any way either for your client or yourself.

Practical tips

a. Be familiar with all of our warnings.

b. Analyse the scheme or supposed transaction carefully and critically, with our warnings in mind.

c. Refuse to act or cease to act if you have concerns.

d. Look critically at documents to assess what they mean (if anything) and whether they are fair.

e. Apply the SRA Principles

f. Avoid rationalising suspicious factors - such as by thinking "the warnings do not mention the type of transaction I have been asked to deal with, so it must be safe".

g. Do not allow your client account – or any account you control – to be used to receive investment money that could simply be sent by an investor directly to an investment company.

h. Do not attempt to evade rule 14.5 of the SRA Accounts Rules 2011 by trying to manufacture a process of legal work or advice.

Enforcement action

Failure to comply with this warning notice is likely to lead to disciplinary action.

Further assistance

If you require further assistance with understanding your obligations in relation to supposed investment schemes please contact the Professional Ethics Guidance team [/contact-us/#helplines] .

Notes

1. https://www.sfo.gov.uk/2017/05/22/sfo-seeks-information-from-investors-in-storage-pod-schemes/ [https://www.sfo.gov.uk/2017/05/22/sfo-seeks-information-from-investors-in-storage-pod-schemes/] See also https://www.theguardian.com/money/2017/may/27/pensions-scam-self-

storage-serious-fraud-office-warning
[https://www.theguardian.com/money/2017/may/27/pensions-scam-self-storage-serious-fraud-office-warning]

2. See for example Financial Conduct Authority v Capital Alternatives Limited [2015] EWCA Civ 284.
3. R v Crawley, Walker, Forsyth, Peters and Petrou, Southwark Crown Court, April 2015, see https://www.fca.org.uk/news/press-releases/eight-convicted-role-unauthorised-collective-investment-scheme [https://www.fca.org.uk/news/press-releases/eight-convicted-role-unauthorised-collective-investment-scheme]
4. R v Crawley mentioned above.
5. Barlow Clowes International Ltd & Anor v Eurotrust International Ltd & Ors (Isle of Man) [2005] UKPC 37.