

Solicitors and investment fraud

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This report is about the risk to the public, and indeed to the reputation of the profession, caused by the small number of solicitors who become involved in helping investment schemes that may well be frauds.

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Introduction

In this year's Risk Outlook we identified risks to the integrity and independence of solicitors as one of our priorities. Solicitors must meet high professional standards set independently in the public interest and I know the vast majority do so. But when things go wrong it is important that we take robust action to protect the public and public confidence in the profession.

This report is about the risk to the public, and indeed to the reputation of the profession, caused by the handful of solicitors who become involved in helping investment schemes that may well be frauds.

We know the vast majority of solicitors and law firms would not knowingly become involved in such schemes, but you should all be aware of the signs.

Solicitors and law firms are widely respected and the promoters of fraudulent investment schemes sometimes actively seek the involvement of solicitors to give their activities an impression of credibility or security.

Where solicitors are involved in such schemes, we will take action in the public interest, and this report gives cases studies of such action.

In a time of very low interest rates, investors are being tempted by promised returns which, even if they are 10 percent are still 10 times more than banks and building societies offer on savings accounts. We have warned the profession in the past and taken action to stamp out law firm involvement in fraudulent schemes.

We are aware that some solicitors believe that they can act in relation to these schemes as long as they limit their involvement. But where there are warning signs, they will be at risk of serious misconduct and often of dishonesty.

I hope this report will help solicitors and the public identify potential frauds. We have included some case studies to demonstrate the harm that can be caused to the public and the consequences solicitors have faced when they have not met their professional obligations.

As we reform our regulation, we are working to offer solicitors more flexibility to provide services in a way that suits their customers. But less bureaucracy does not mean less accountability. On the contrary, it means that high professional standards are all the more important. This report goes to the heart of professionalism and offers insight into an area that both the public and solicitors need to be very aware of.

Paul Philip

Chief Executive

Common investment scams

The promoters of investment scams often try to legitimise them through the involvement of solicitors and law firms. It lends credibility to what they are doing and provides comfort to investors. It also provides the promoter with a significant opportunity to conduct a fraud through a law firm's client account and to launder the proceeds of the fraud in that way.

Examples where a solicitor or law firm has been used to legitimise potentially fraudulent investment schemes include:

- prime bank instruments
- carbon credit trading
- diamond trading, "rare earth minerals" (or metals) and graphene
- fine wines
- land-banking – buying a small strip of land which it is said will increase hugely in value if planning permission is obtained to develop it
- hotel rooms – taking a lease of a hotel room.
- overseas agricultural rights
- famous works of art being the "security" for an investment scheme
- proposed property developments abroad
- advanced fee fraud – where individuals make upfront payments for good, services or investments that do not materialise.

It is possible to buy and sell some of these products through established markets but many of them are not suitable for investment by members of the public. It is highly unlikely they will produce anything like the kind of profits stated by promoters. And some will be outright frauds.

It is important to note that many solicitors and law firms carry out legitimate investment activities under the regulation of the Financial Conduct Authority (FCA) or by relying on Part 20 of the Financial Services and Markets Act 2000 (FSMA)¹ ². This report focuses on solicitor and law firm involvement in what are usually scams, rather than the wider issues around the safe conduct of legitimate investment business³ ³.

Solicitor and law firm involvement

The vast majority of solicitors and law firms have no involvement in fraudulent activity of any sort. However, solicitors and law firms have been found to be involved in potentially⁴ ⁴ fraudulent investment schemes in the following ways:

- acting for the promoter of the scheme
- acting for potential investors, or claiming to protect their interests
- passing investors' money through client account, sometimes as an "escrow agent".

Where we find evidence of solicitors and law firms supporting potentially fraudulent investment schemes, we will take action to protect the public.

Acting for the promoter of the scheme

Promoters of fraudulent schemes often target vulnerable people, or older people with access

to capital⁵ [5]. They attract investors by offering higher returns than those possible through conventional investments. In one case returns offered were 40% per month⁶ [6]. But we have seen an increase in schemes offering slightly more modest returns. At a time of very low interest rates, even a promised return of 5% or 10% can be tempting for some.

Because many people are wary of such schemes, the promoters reassure them by saying that a solicitor or law firm is involved.

The marketing material of the investment company and the contract for the investment will often refer to the solicitor or law firm, sometimes giving their SRA number and client account details. A scheme which uses such information should be treated with extreme caution because there is no reason for respectable investment companies to do this.

Investors are told that their money is safe because it will be paid into a law firm's client account, which is controlled by a solicitor. It will often be said that the law firm will not transfer the money out of the client account unless certain conditions are met. The law firm releases the money either immediately or when the investment scheme promoter says that the condition has been fulfilled. The condition is itself meaningless – for example, the provision of a certificate. The investment rarely yields any profit and in some cases the initial investment capital is lost, or misappropriated from the client account. Fraudsters may use other investors' money to pay supposed "profits" and make it look as if the scheme is initially working.

Investors are often led to believe that the solicitor or law firm's insurance will protect them and that they will also be covered by the SRA Compensation Fund if things go wrong. However, insurers may refuse to pay claims, especially when they suspect dishonesty on behalf of the solicitor or law firm. The SRA Compensation Fund is discretionary and may also refuse to pay claims, particularly if investors have contributed to their loss by not taking enough care to protect themselves.

Acting for potential investors, or claiming to protect their interests

Solicitors and law firms must act in the best interests of each client⁷ [7]. Whether a particular investor is a client of the solicitor or law firm involved in facilitating an investment scheme will depend on the facts of the case. Some solicitors involved in the promotion of potentially fraudulent investment schemes leave this as ambiguous as possible.

But whether an investor is a client or not, the law firm still owes duties to people who are not their clients. Failing to act with integrity and independence can never be excused because the person affected is not a client.

A solicitor or law firm must not take advantage of anyone, including non-clients, under Outcome 11.1 of the SRA Code of Conduct 2011. They must also have regard to the public interest and the proper administration of justice at all times⁸ [8].

We have seen cases where the solicitor or law firm provides reassurance, often leaving investors with the highly mistaken impression that the firm is, if not exactly acting for them, at least looking after their interests to some extent.

Examples of solicitor and law firms taking advantage of investors include:

- allowing their name to be used in promoting the scheme
- "administering" the scheme or encouraging money to be paid when they know or suspect that the scheme is dubious
- drafting or issuing contracts which may contain unfair or unclear terms

- giving undertakings, which are binding promises in law to support the scheme – a solicitor was committed to prison for 6 months when he did not comply with a court order to fulfil his undertaking⁹ [9]
- discouraging investors from getting advice from their own solicitors or other advisers
- giving or allowing the impression to be given that indemnity insurance or our Compensation Fund will pay if money is lost
- misappropriating money
- following loss of money, strongly resisting any suggestion that investors were clients or that they owed them any duties.

Passing investors' money through client account

Fraudsters know that investors feel safer if they can send their money to a solicitor's client account. A solicitor who allows this is actively helping the fraud and laundering the proceeds. That is what solicitors must bear in mind as a starting point.

By passing money through their accounts, solicitors and law firms can find themselves in breach of rule 14.5 of the SRA Accounts Rules 2011:

"You must not provide banking facilities through a client account. Payments into, and transfers or withdrawals from, a client account must be in respect of instructions relating to an underlying transaction (and the funds arising therefrom) or to a service forming part of your normal regulated activities."

We have warned about the client account (and any other account the solicitor can control) being used as a banking facility several times¹⁰ [10]. We know that the promoters of potentially fraudulent investment schemes and their law firms try to avoid the signs of fraud which we and other regulators have warned about. For example, they set up spurious legal work or transactions to try to evade the effects of rule 14.5.

The most common form of evasion involves the law firm drawing up contracts between the investor and the investment company or intermediaries. The firm then 'administers' the contracts as an attempt to show that some legal work is being done.

We have also seen unnecessarily complex financial transactions involving various intermediaries (including the law firm). The intention is to obscure what is happening and make it both difficult to understand what has happened and how to go about recovering losses.

Sometimes, the law firm carries out anti-money laundering checks on investors, claiming that this activity is a legal service. It is often an attempt to create a service to evade rule 14.5 because the transaction is often not actually covered by the Money Laundering Regulations 2007.

Deliberate evasion of a regulatory rule can be dishonest¹¹ [11]. We will look very closely at any actual or attempted evasion and at any adviser who designs or recommends it.

Case studies

In recent years there have been a number of cases where we have taken action against solicitors and law firms for involvement in investment scams. We also work closely with the

police where criminality is alleged. A solicitor was sentenced to five and a half years in prison in 2012¹² and in the same year a sole practitioner was struck off¹³. More recently solicitors have been struck off or suspended, sometimes with large costs orders because of the complexity of cases¹⁴.

When he was a High Court judge, the current President of the Supreme Court, Lord Neuberger, summarised an investment scheme he had seen in a case which led to a law firm being closed down and the solicitor struck off:

"Bank instrument frauds are based on documents which are full of impressive phrases, which on analysis make little sense, and which promise returns which are fantastic in both senses in which that word is used, namely fictional and enormous.

Once these investors part with their money, they are lucky if they see any of it again. Generally speaking a man may as well burn his money for all the good it would do him. At least it would remove the false hopes and subsequent agony that such so-called investments involve¹⁵."

In a particularly serious case from 2005, the Solicitors Disciplinary Tribunal (SDT) confirmed some principles that apply to these types of cases, its judgment being quoted in an appeal by the solicitor to the High Court:

"A solicitor who involves himself in transactions which he knows or suspects or should have known or suspected could have involved illegality or impropriety or gives such transactions credibility cannot but appreciate that his behaviour will be perceived as affecting his integrity and trustworthiness and affect the integrity of the Profession. The duties of a lawyer as an officer of The Supreme Court are not simply owed to the client but also involve the respect which the Profession owes to the law itself and justice.

A transaction, which on the face of it promises fantastic and incredible returns for no risk, does not have the quality of a likely lawful and honest transaction. A solicitor who does not establish the veracity of the transaction and those with whom he is dealing or who makes no proper enquiry or takes on trust extravagant and unlikely claims puts his and the Profession's reputation for prudence, integrity, honesty and trustworthiness at risk.

In the Tribunal's view a solicitor who accepts money into his client account does not have only the very limited duty to safeguard the funds ... but has wider duties to act so as to

ensure that the funds entrusted to him will be used for proper purposes and not to facilitate improper or potentially fraudulent activities of third parties. This is because the involvement of the solicitor and the use of his client account may give spurious authenticity and respectability to dubious transactions. His involvement will thus affect his own and the Profession's reputation for integrity, honesty and trustworthiness¹⁶ [n16] .

Case example one: sole practitioner facilitating investment fraud

A solicitor agreed to act for promoters of an investment fund, which was setting up a new scheme. The scheme involved moving funds between 'leveraged bank accounts'. These accounts were described to the solicitor as being 'on a 10:1' basis, meaning that if an investor paid £100,000 into an account the investment company would be credited with £1m to trade with on their behalf. The investors were not told about the "leveraged accounts".

The solicitor's role was to communicate with third party investors and to receive their funds. The investors were told that the money would be protected in the client account, and then transferred to the banks involved for investment.

The scheme was fraudulent, and the investors lost their money. The Solicitors Disciplinary Tribunal found that the solicitor had been used to give an appearance of legitimacy to a scheme that was clearly fraudulent, and which contained multiple indicators found on an SRA Warning Notice. The Tribunal concluded that the solicitor had acted without integrity in facilitating fraud and in providing banking services through the client account.

The solicitor was struck off the Roll and ordered to pay costs¹⁷ [n17] .

Case example two: one director in firm using client account as banking facility

A solicitor acted for a promoter of a scheme which had the signs of high-yield investment fraud. This type of fraud involved complex bank instruments being sold to individuals and companies with the promise of high returns. Investors sent the money to the law firm's client account, before the firm sent it on to an account owned by the promoters. In the course of this, more than £1m was transferred through the client account. The other directors of the law firm did not know about this, but trusted their fellow director and did not question what he was doing.

The director responsible was struck off the Roll by the Solicitors Disciplinary Tribunal. The other directors, after investigation by the SRA, agreed to accept a formal and published rebuke and to pay the costs of the investigation.

Actions

We take solicitor and law firm involvement in investment scams very seriously. This report has given examples of solicitors being struck off and, in some cases, sent to prison for helping to facilitate these frauds. We know the vast majority of solicitors and law firms would not knowingly become involved in such schemes, but they should all be aware of the signs.

The SRA Principles and Outcomes clearly state that a solicitor must act with integrity and independence and must not take unfair advantage of people. We have also issued a number of warnings setting out the red flags of an investment scam.

Good practice for solicitor and law firms

Solicitors and law firms must not become involved in potentially fraudulent investment schemes.

Good practice includes:

- reading our Warning Notices and following what they say
- conducting due diligence on any promoter of an investment scheme
- not allowing the client account to be used as a banking facility
- not manufacturing artificial advice or services to give the appearance of an underlying legal transaction
- remaining independent of a client
- not taking unfair advantage of people
- contacting the professional ethics helpline if you have an ethical dilemma
- considering any complaints or contact from people who are not your clients but are affected by a transaction you have facilitated
- never allowing someone in the law firm to carry out transactions which the other partners or senior managers do not understand.

You can help us tackle this problem by letting us know if you become aware of a law firm or solicitor being involved in a questionable scheme.

Further information

Our warning notices can be found at:

Contact our Professional Ethics team [[contact-us##helplines](#)]

Report any concerns [[contact-us##helplines](#)]

The FCA scamsmart service [<http://scamsmart.fca.org.uk>] provides information to would-be investors and regularly updates a list of common investment frauds. The tools it suggests for identifying investment fraud include:

- rejecting unsolicited calls
- checking the FCA Warning List
- getting impartial advice.

Action fraud [<http://www.actionfraud.police.uk>] is the UK's national fraud and cyber crime reporting centre.

Notes

1. Under Part 20 of FSMA, solicitors and law firms can conduct some, but not all, investment activities for clients if the activities are:
 1. incidental to the provision of professional services provided by the firm and
 2. are complementary to the provision of a particular service to a particular client and
 3. they account to the client for any commission received.
2. Rule 3 of the SRA Financial Services (Scope) Rules 2001

[solicitors/handbook/finerscope/part1/content] sets out a list of activities that professional firms cannot conduct under the exemption.

3. Some frauds involve the conduct of unauthorised investment business, mostly commonly " collective investment schemes". For example, Financial Conduct Authority, eight convicted for role in unauthorised collective investment scheme [<https://www.fca.org.uk/news/press-releases/eight-convicted-role-unauthorised-collective-investment-scheme>], June 2015
4. We do not need to prove that a scheme is a fraud. We take action where risk factors suggest the scheme is dubious and may be a fraud.
5. Over 55's at heightened risk of fraud, says FCA [<https://www.fca.org.uk/news/press-releases/over-55s-heightened-risk-fraud-says-fca>], Financial Conduct Authority, May 2016.
6. Wood-Atkins SDT Case No. 11270-2014.
7. SRA Principles 2011.
8. Where two or more SRA Principles come into conflict the one which takes precedence is the one which best serves the public interest in the particular circumstances, especially the public interest in the proper administration of justice. Compliance with the Principles is also subject to any overriding legal obligations SRA Principles, 2011.
9. A solicitor was committed to prison for 6 months when he did not comply with a court order to fulfil his undertaking. See Citadel Management Inc v Thompson [1998] Lexis Citation 3090.
10. We issued various warnings about investment fraud and improper use of client accounts from the mid-1990s onwards.
11. See the dishonesty findings in Beresford v SRA in which payments were "dressed up" as administration and other fees when they were referral payments, England and Wales High Court (Administrative Court) Decisions, Case No: CO/4142/2009 EWHC 3155 Admin [<http://www.bailii.org/ew/cases/EWHC/Admin/2009/3155.html>], 2009
12. See SRA v Steele SDT Case No. 10956-2012. This was reduced on appeal to four years four months
13. See SRA v Horsfall SDT Case No. 11031-2012.
14. SRA v Farmiloe SDT Case No. 10257-2009. SRA v Yildiz SDT Case No. 10997-2012.
15. Neuberger J, in Dooley v The Law Society (2000).
16. See Simms v Law Society 2005 England and Wales High Court (Administrative Court) Decisions, Case No: Case No: CO/778/2004 EWHC 408 Admin, [<http://www.bailii.org/ew/cases/EWHC/Admin/2005/408.html>] 2005
17. Wood-Atkins SDT Case No. 11270-2014.