

## **Warning notice**

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## **Status**

This warning is to help you understand your obligations and how to comply with them. We may have regard to it when exercising our regulatory functions.

## **Who is this warning notice relevant to?**

This warning notice is relevant to solicitors and all law firms, their managers and employees.

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.

We have warned for a number of years about the risks posed by dubious or questionable investment schemes. This warning notice has been updated to reflect some of the recent key issues highlighted in our [Risk Outlook](https://www.sra.org.uk/archive/risk/risk-outlook/) [<https://www.sra.org.uk/archive/risk/risk-outlook/>] and [Thematic Report](https://www.sra.org.uk/sra/how-we-work/archive/reports/investment-schemes-that-are-potentially-dubious/) [<https://www.sra.org.uk/sra/how-we-work/archive/reports/investment-schemes-that-are-potentially-dubious/>], including the risk that fraudsters are continually changing the look and feel of "investment" schemes to avoid features that have been warned about previously. Practitioners in many fields of law may therefore find that they are at risk of facilitating high risk or dubious investment schemes.

## **The SRA Standards and Regulations**

If you are, or are considering, becoming involved in making, arranging or advising on any investments or other financial products that are regulated by the Financial Conduct Authority (FCA), you will need to make sure that you are entitled to carry on those activities.

If your involvement in these schemes is not directly linked to the legal services that law firms provide, you will need separate authorisation from the FCA.

If your involvement arises out of the delivery of legal services, then you will need make sure that the work can be carried out under the scope of our regulation (see [SRA Financial Services \(Scope\) Rules](https://www.sra.org.uk/solicitors/standards-regulations/financial-services-scope-rules/1) [<https://www.sra.org.uk/solicitors/standards-regulations/financial-services-scope-rules/1>]).

In all cases, even if the investment or product is not an FCA-regulated product, you must comply with the requirements set out in the SRA Standards and Regulations.

In particular, you must act:

- in a way that upholds public trust and confidence in the **solicitors'** profession and in legal services provided by **authorised persons** (Principle 2)
- with independence (Principle 3)
- with integrity (Principle 5)
- in the best interests of each client (Principle 7)

Paragraph 1.2 of the SRA Codes of Conduct for solicitors, RELs and RFLs and for firms also requires you to make sure that you do not abuse your position by taking unfair advantage of clients or others, including prospective or actual buyers/investors.

You should also be mindful of your obligations to safeguard money and assets entrusted to you by clients or others (paragraph 4.2 and 5.2 of the SRA Codes respectively) and, as set out in the SRA Accounts Rules, specifically to make sure that client money is kept safe, and that your client account is not used as a banking facility (rule 3.3).

## **Our expectations**

We expect you to act with integrity and protect consumers by robustly analysing the risks of any investment scheme you are involved in. The obligation rests on you as a firm to carry out all necessary checks and you should not rely on the word of the seller or other promoters of a scheme.

If you suspect that a transaction is potentially fraudulent, dubious or so high-risk that it is unfair to buyers or investors, you should provide full and frank advice to your clients and refuse or cease to act. We are particularly concerned about the dangers of schemes where your involvement or that of your law firm is used to give an impression of credibility or security for example, by being inappropriately named in promotional material or other literature relating to a scheme.

## **Our concerns**



We continue to receive reports about law firms that are involved in dubious or questionable investment schemes. This is a key risk for consumers resulting in significant financial losses, which in some cases can be more than £1 million per scheme. We are seeing:

- Solicitors and law firms being used to give credibility to a scheme rather than because legal work is required. These sorts of schemes have been highlighted in previous warnings issued by us
- Funds transferring through a law firm's client account, without the transactions being connected to any underlying legal work, in breach of rule 3.3 of the SRA Accounts Rules (at risk of laundering money or otherwise improper payments being made)
- Dubious or risky schemes being presented as routine conveyancing or investment in "land" when the reality is very different
- No real legal work being carried out and legal fees are being generated when they are not necessary.

These concerns have been borne out by our thematic review. Further concerns identified include:

1. Investment schemes have evolved from high-yield financial arrangements or prime bank instrument fraud, into what appear to be more recognisable legal transactions such as the purchase of land when the reality is very different.
2. Sellers are changing the structure of schemes periodically to avoid detection.
3. Schemes are being labelled as, for example, mini-bonds, but are in fact speculative investments promising a high return and the buyers' money is not being used in the way the seller it says it will. Since 1 January 2020, the Financial Conduct Authority has temporarily banned promotions of 'speculative mini-bonds' to retail consumers, unless the investor is considered to be 'sophisticated' or have a high net worth.

We have set out at the end of this guidance a list of some of the red flag indicators all firms should be aware of.

Each of these issues are explored in more detail below.

## **Conveyancing or purported investment in land**

### **Buyer-led financing of a development**

Schemes are being promoted as involved in the routine buying of a property when in reality the buyer's money is being used to finance a high-risk development or refurbishment. This is of particular concern in unusual developments such as the buying of individual hotel rooms, rooms in care homes, or self-storage units. Our concerns also apply to any off plan 'buyer-led' purchases. Off-plan means buying a property



while it is still in the planning or construction stages, which involves the use of the buyer's money to fund a project or property development.

We are seeing cases of solicitors simply processing transactions for buyers while adopting the language of conveyancing. The effect is to mask what is really happening. For example, buyers provide money for a 'deposit' which is released early to the seller upon some (often spurious) condition. The buyer's money is used to buy the property or finance its building or refurbishment.

The usual deposit in a conveyancing transaction is 10 percent. It is paid to make sure that the buyer will complete the contract. In some of the dubious schemes we have seen, the 'deposit' has been 30 percent or even as high as 80 percent. These are not market standard deposits but involve pre-payment of the price and effectively providing finance to the developer. Our view is that such high deposits are particularly high risk because the buyer has very little protection if the development fails. Referring to them as deposits is part of the psychology of presenting a risky 'investment' as routine conveyancing and which may lead buyers to believe that they are not parting with all of their money in one go. 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.

Buyers are not being advised, or properly advised, that these types of transaction often present a much higher risk than simply buying an existing house or apartment.

Such schemes have failed for a variety of reasons. These include for example:

- insufficient capital had been raised from deposits
- developers have gone into administration
- the development has simply not progressed
- money invested has been used by the developers for purposes not connected with the scheme

Where funding is provided for a substantial property development scheme by an institutional lender, that lender would typically have a high level of protection in place over the drawdown of funds. Where buyers' deposits are being used as an alternative source of finance to fund developments, their attention should be drawn to any differences between the level of protection in place over their funds and that which would typically be put in place by an institutional lender.

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



(if appropriate, advising against entering into the transaction). In addition to the issues outlined above we expect you to explain that:

1. Buying a property not yet built or completed ie buyer-led or subject to significant refurbishment, involves a substantial risk that the developer or seller could fail, and money will be lost.
2. Promises of substantial returns can be misleading. Standard warnings in publicity about the risk of capital loss are therefore not enough to make sure that you have properly advised your client upon the risks of the transaction.

### **Taking a lease of a room, a storage unit etc**

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

These 'fractional property' investments are where the buyer buys a portion or fraction of an investment property and receives a fraction of the rental income and a fraction of the capital growth. These schemes can involve a higher risk than the simple purchase of a property that has already been built. Such investments have been treated as standard conveyances. They were typically marketed as being 'a low-cost, high-yield investment product that's hands off and hassle free'.

However, in reality, 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. It is difficult to see why such schemes require the involvement of a solicitor as this is not a 'conveyancing' transaction in the usual sense with a view to title being registered against a piece of land or property. All that seems to be done here is that the law firm is receiving money into their client account and sending it on to the seller. This would be regarded as a breach of rule 3.3 of the SRA Accounts Rules.

Buyers may be inappropriately reassured that taking out a 'lease' means that they have a legal interest in the land or property when the reality is that their investment is dependent upon sharing the profits which would arise from the business being well managed.

We also see no particular reason why such investments should provide high returns and you must properly advise your clients of this and of the associated risk of their money being lost.

The Serious Fraud Office have previously investigated losses of up to £120m arising from the promotion of [self-storage schemes](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/>].



## **Collective investment schemes - criminal liability**

Many of these schemes are likely to be 'collective investment schemes' under section 235 of the Financial Services and Markets Act 2000.

Collective investment schemes are defined in the FCA Handbook Glossary (see link). If those involved in the schemes are not authorised by FCA, they will be committing a criminal offence and are likely to be imprisoned. You should exercise caution when being invited to be involved in any scheme that appears to involve a collective investment element.

Our view is that buyer-led schemes are likely to be regarded as collective investment schemes because the buyers are required to pool their money together, for example to finance the construction of a building. Some of these schemes might also amount to a 'Ponzi' scheme. This is a scheme which generates returns for early investors by acquiring new investors whose funds are then used to pay the initial investors a return on their deposits before the development completes.

If you are advising on such schemes, you will only be able to do so if you can satisfy the conditions set out in rule 2.1 of the [SRA Financial Services \(Scope\) Rules](https://www.sra.org.uk/solicitors/standards-regulations/financial-services-scope-rules/) [https://www.sra.org.uk/solicitors/standards-regulations/financial-services-scope-rules/].

If you are, however, involved in establishing, operating or winding up a collective investment scheme then you will need to be authorised by the FCA as these activities cannot be carried out under the scope of our regulation.

## **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 or advising on terms which are unclear or favour one party over another should carefully consider their approach. The FCA has published examples of [unfair terms on their website](https://www.fca.org.uk/firms/unfair-contract-terms/library) [https://www.fca.org.uk/firms/unfair-contract-terms/library]. The unfairness of the terms is often clear additional evidence that unfair advantage is being taken of the investor or buyer. In many cases, schemes will be targeted at foreign buyers who may have less time or be less able to question the terms of schemes that are being sold to them.

## **Evasion of rule 3.3 of the SRA Accounts Rules**

As well as trying to give credibility to their scheme, fraudsters will provide false assurances that the 'investment' will be kept secure in a law firm's client account. This facilitates the fraud and enables the money to be laundered.



Rule 3.3 prohibits law firms from using a client account to provide banking facilities to clients or third parties and makes it clear that payments into, and transfers from a client account must be in respect of the delivery by them of regulated services. Because of the artificial nature of the transaction or other fraudulent element, a firm's client account may be used solely to pass buyers' money through client account, which is prohibited.

You should carefully consider whether you are actually providing regulated services - regardless of how someone else may describe or brand your involvement in the scheme.

We have warned about the improper use of a client account as a banking facility and that warning notice should be [read alongside this notice](https://www.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/) [\[https://www.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/\]](https://www.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/).

## **Insurance bonds**

We have seen investment 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. You should also make sure that you do not become involved in insurance distribution activities unless you comply with the SRA Financial Services (Scope) and SRA Financial Services (Conduct of Business) Rules. Risk factors include:

1. The issuer of the bond is not regulated.
2. The bond is only valid for a limited time period.
3. The issuer is based in a jurisdiction where it is likely to be very difficult to enforce the bond.
4. Where there is any doubt about the propriety or financial soundness of the issuer.
5. The bond is written in terms unfamiliar to a lawyer in England and Wales.
6. Reputable insurers do not offer bonds for the particular type of investment.

## **Your relationship with the seller and the buyers**

### **Acting with independence**

In the majority of dubious schemes, the law firm acts for the seller of the scheme, although they can be used to act for buyers as well.

In some instances that we have seen, law firms already have a relationship with the seller, for example, as a client, through an existing





business or referral relationship or in some cases through a personal friendship.

Just because you have an existing relationship with a client should not give you false reassurance about new instructions relating to an investment scheme. Placing reliance on the basis of a former relationship could have a detrimental effect on your independence and could lead you, for example, to fail to scrutinise the transaction and/or the parties involved. We are concerned that you might be at risk of turning a blind eye to concerning aspects of a scheme because of these existing relationships or due to concerns about losing a regular stream of guaranteed income.

The fact that similar schemes by similar people or businesses have previously succeeded does not mean that future schemes are necessarily genuine, or lower risk.

### **Who are you acting for?**

We have seen some schemes where firms give the impression that they are providing some advice to the buyer. For example, we have seen examples where some buyers are not always clear that the panel firm they are referred to in promotional materials are acting for the seller rather than them.

Acting for both buyer and the seller in these cases is likely to constitute a conflict of interest and comprise serious misconduct (see paragraph 6.2 of the [SRA Code of Conduct for solicitors, RELs and RFLs](https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/) (<https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/>)).

We have seen solicitors - supposedly acting for buyers - who appear more focused on ensuring the scheme continues so that they get paid rather than advising the buyer client properly.

If you are not acting for the buyers, you must make that absolutely clear to them.

However, the fact that you may act only for the seller does not mean that you owe no duties to buyers. You should strongly advise them to take their own independent advice from professionals they choose themselves. Attempts to prevent buyers from obtaining objective and independent advice is a very serious matter. Examples of this might include:

1. Clear or subtle attempts to dissuade buyers from instructing their own solicitors – such as indications that they do not need legal advice or that the seller 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 seller to allow the buyer to seek their own advice on changes to terms and conditions – for example, where the terms are in any way unusual such as requiring a high 'deposit' or its release to finance the development.

### **Limited retainers**

You must act in your client's best interests and with integrity. We expect you, amongst other things, to point out clear and obvious risks that may not be obvious to your client. Clients should have sufficient information to make an informed decision about how their matter is handled and to give further instructions. Firms have argued that they were not required to advise clients on all aspects of 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, might be a warning of inherent issues with the scheme itself as it may be used to avoid involvement in, or advising clients about, more problematic areas. This approach is clearly not in the client's best interests.

### **Conclusion**

You must not facilitate or arrange dubious or fraudulent investments. For all investments or products that are regulated by the FCA, you must make sure that you are permitted to do so. In all cases you must not take unfair advantage of clients or others (Paragraph 1.2 of the Code of Conduct for solicitors, RELs or RFLs). You must act with integrity (Principle 5). In addition, you must rigorously assess the transaction and refuse or cease to act if there is any doubt about the propriety of the transaction or whether buyers are being misled in any way. If you fail to make proper enquiries you could find yourself in breach of some or all of our Principles and standards. You could also be found to have acted dishonestly.

### **Red flags**

Be alert to these sorts of issues:

- high deposits paid in instalments before exchange
- comparatively high returns
- complex and unfair agreement 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



- 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

## **Practical tips**

1. Be familiar with all of our warnings and the red flags that might guide you to consider your involvement in acting for the seller.
2. Make sure that your firm is not represented or referred to in promotional material in a way that suggests that you endorse the scheme or that you are facilitating the receipt of money without providing any other legal services.
3. Look at how buyers have been contacted to make sure that they have not for example, been cold called or been targeted because of their vulnerability or because of their access to funds.
4. Analyse the scheme carefully and critically, with our warnings in mind. Firms may wish to consider using some of the same type of safeguards used for anti-money laundering checks to identify and assess the source of funds/wealth for parties involved in an investment scheme.
5. Refuse to act or cease to act if you have concerns.
6. Have an agreed firm wide approach to new investment business to manage risks to the firm and to buyers from dubious investment schemes.
7. Look critically at documents to assess what they mean and whether they are fair.
8. 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" or limiting retainers.
9. Do not allow your client account - or any account you control - to be used to receive investment money that could simply be sent by a buyer directly to the seller.
10. Satisfy yourself that the legal work is genuine and that your client account is not being used as a banking facility. Do not attempt to evade rule 3.3 of the SRA Accounts Rules by trying to manufacture a process of legal work or advice.
11. Carry out effective and thorough conflict checks including assessing any own conflicts especially when relying on previous relationships or because of receiving referrals as a 'panel law firm'.
12. Where an investment is high risk, not usual or not standard, advise your buyer client explicitly that that is the case even if it results in a matter not proceeding.

## **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](https://www.sra.org.uk/contact-us/#helplines) [<https://www.sra.org.uk/contact-us/#helplines>].