High value, high yield investment fraud – a continuing problem.

Ibukun Alabi (Managing Associate)

2ND DECEMBER 2020
Today there remains a significant and growing problem of high value, high yield investment fraud or “Ponzi schemes” marketed as genuine investments by seemingly legitimate corporate entities. Ponzi schemes are sophisticated investment scams that lure investors with promises of high returns at low risk and initially appear to meet those promises, by paying off earlier investors from later investors’ capital.

According to information published in 2019 by the Financial Conduct Authority (“FCA”), which is the conduct regulator for nearly 60,000 financial services firms and financial markets in the UK, data from its call centre showed that the most commonly reported scams involved investments in shares and bonds, forex and cryptocurrencies by firms that are not authorised by the FCA. Together these accounted for 85% of all suspected investment scams reported in 2018.

Section 21 of the Financial Services and Markets Act 2000 (“FSMA”) prohibits an unauthorised person from, in the course of business, communicating an invitation or inducement to engage in investment activity (or to engage in claims management activity) unless such promotion has been made or approved by an authorised person or is exempt.

The exemptions to that prohibition, include the promotion of investment activity to certain categories of people identified in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (“the FPO”) such as Certified High Net Worth Individuals (Article 48), High Net Worth Companies (Article 49), Sophisticated Investors (Article 50) and Self-Certified Sophisticated Investors (Article 50A) (“the FPO exemptions”).

The FPO exemptions are however commonly used by fraudulent scheme promoters to their advantage as they target high net worth individuals and self-certified “sophisticated investors” in the promotion of highly speculative schemes which, in many cases, bear the hallmarks of an investment scam and were never likely to secure the approval of an FCA authorised person.

Investors in such schemes might be persuaded to sign certifications or declarations identifying themselves as sophisticated investors or high net worth individuals even when they are clearly not in the category of investor intended to be exempt, under the corresponding FPO exemptions, from regulatory protections which might otherwise apply to them.

Such highly speculative and/or fraudulent investment schemes might use promotional materials which cite compliance with or exemption from section 21 of FSMA in language suggestive of regulatory compliance rather than caution to the investor that they are about to be led beyond the remit of significant regulatory protections. Some promotional materials go as far as to refer to the involvement of an FCA authorised firm in some abstract or potentially irrelevant capacity to provide a false sense of security to the prospective investor. Some are cleverly written to promise security and safety when in fact on closer inspection of the security, it becomes clear that it offers little protection before or after a default and that investors’ rights are difficult to enforce individually or as a group.

Even when an investment scheme might not of itself be outrightly fraudulent, the highly speculative nature of some schemes leaves investors equally exposed to the same harsh consequences (as an outrightly fraudulent scheme might), particularly where such investments are mis-sold to investors looking for a low-risk offering.

In January 2019, London Capital & Finance Plc, a company which had issued mini-bonds to thousands of customers, went into administration reportedly leaving more than 11,500 investors likely to lose more than £230m. In the aftermath of the collapse of London Capital & Finance, the FCA issued a temporary intervention on the marketing of speculative mini-bonds to most retail investors so as to “prevent consumer harm”. Mini-bonds typically offer high returns but expose the investor to much higher risks compared to other types of investments. A business does not generally have to be regulated by the FCA to issue mini-bonds. There is also usually no protection from the Financial Services Compensation Scheme (“FSCS”) with respect to investments in mini-bonds.
The FCA is currently consulting on a proposal to make the ban, which was previously put in place from January 2020 to December 2020, permanent. The ban however does not prohibit the marketing of such speculative mini-bonds to high net worth or sophisticated investors.

A good initial step for any potential investor would be to seek independent financial advice from an FCA authorised firm prior to investing. Anyone considering making an investment should note the FCA warning that if you deal with an unauthorised firm you may not be covered by the Financial Ombudsman Service or the FSCS if things go wrong.

An investor who considers that a scheme they have invested in might be a fraudulent investment scheme or has been mis-sold to them should seek legal advice as soon as possible.

Whilst the cost of legal action might seem a deterrent to investors who have already suffered significant financial losses, it is possible to pursue suitable claims on the basis of alternative funding arrangements (sometimes referred to as “no win no fee” arrangements) or as a third party funded claim.

---

Ibukun Alabi
Managing Associate
ia@humphrieskerstetter.com
+44 207 632 6906

Humphries Kerstetter LLP
St. Bartholomew House
92 Fleet Street
London EC4Y 1DH
Tel: +44 207 632 6900
www.humphrieskerstetter.com

Neither the author nor Humphries Kerstetter LLP assume any responsibility to any person in respect of this article. Nothing in this article is intended to be taken as legal advice. Legal advice specifically tailored to individual matters should be obtained if required.