

The complaint

Mr M's complaint is that Pello Capital Limited ('Pello') gave him unsuitable investment advice and led him into unsuitable investments.

What happened

One of our investigators provided a very detailed view on the complaint. In the main, she noted as follows:

- In November 2017 Mr M deposited £24,000 into his investment account. Thereafter he deposited an additional £5,000. Less than a week after his initial deposit, almost the entire deposit amount was invested in the Audley Funding 12% Bond ('the bond') which was a minerals exploration investment with a term of five years.
- Mr M had been introduced to Pello by an unregulated third party firm which undertook to have assessed him as a professional client. This assessment was relied upon by Pello until it was reviewed around January/February 2018. Pello's review included its expression of concern that he was not a professional client and that the bond was too risky for him – given that he was a cautious investor with notable reliance upon, and low capacity to lose, his deposited funds. Pello advised Mr M to sell the bond in the relevant secondary market, this took some time to achieve and the bond was not sold until July 2019 (however it was re-purchased immediately).
- Other investments (and liquidations and reinvestments), on Pello's recommendations, followed –
- in October 2018 around £4,300 (partly revenue from the bond and partly new money) was invested in Equiniti Group ('the EG fund'); this holding was then sold in April 2019 at a loss of around £400 and the proceeds were reinvested in Go Compare stock ('GC stock'); the GC stock was sold in July 2019 at a loss of around £200 and then immediately re-purchased.
- in December 2018 around £2,000 was invested in an Alternative Investment Market ('AIM') Oil and Gas stock ('the AIM stock').
- in June 2019 £28,000 was invested in another AIM stock called BigDish ('the AIM2 stock') on the basis of an extended settlement arrangement (for around a month) because Mr M did not have the purchase money available; by the time settlement was concluded in July it had lost around £15,000 in value; in the same month (July) 18% of the AIM2 stock was sold at a 25% loss.
- In August 2019 the AIM stock was sold at a loss of £130; the GC stock was sold at a loss of £350; the remainder of the AIM2 stock was sold at a loss of £6,000; and the bond was sold at a loss of £3,800; later in this month £14,000 was invested in ADM Energy stock, a few days later two thirds of the stock was sold and the remainder was sold in the following month (September) creating a total loss of £4,000.
- Mr M complained to Pello in late 2019, citing a total loss of over £20,000 in the investments it recommended to him, the unsuitability of its recommendations and its misuse of his funds. Pello disputed the complaint and, in the main, it said Mr M was a self-elected professional client with capacity to commit his funds to long term investments, with a high risk investor profile, with no reported changes in his

circumstances at the time of the investments and that contract notes for the investment activities in his account made them transparent to him.

The investigator did not accept Pello's assertions. She concluded that the complaint should be upheld. In the main, she found as follows:

- Pello ought not to have relied upon Mr M's classification as a professional (and high net worth) client by an unregulated firm because relevant regulations were not satisfied by that firm's assessment. It should have highlighted this to Mr M at the outset.
- Pello's engagement with Mr M during its review (apparent from telephone recording evidence) confirmed – to it – that the unregulated firm's assessment was incorrect; that he was a cautious/low risk investor with limited capacity for loss, with limited (or no) capacity to commit his funds to investments beyond the short term and with a capital preservation objective; that he was inexperienced in shares, he was single (without dependents) and that he had self-employed annual earnings of £25,000 (with monthly disposable income of £800); and that the bond was unsuitable for him (as expressly confirmed by the Pello adviser) because it mismatched his risk profile and objective.
- Despite Pello's awareness of the above in early 2018 (January/February) it unreasonably proceeded to lead Mr M, from October 2018 onwards, into investments (all the investments after the bond) which were as unsuitable for him as was the bond, in terms of mismatching his risk profile and objective. In addition, it ought reasonably to have determined at the outset that its service, as a whole, was unsuitable for him given that its service's key facts document said it primarily recommended high risk/speculative investments for investors with matching profiles. Mr M's profile mismatched such investments.
- Mr M should receive redress for Pello's unsuitable investment recommendations to him and for his resulting losses; in addition to £500 for the trouble and upset he has been caused in the matter.

Pello disagreed with this outcome. In the main it referred to evidence in support of the following key arguments:

- Transactions, for Mr M, in the bond and the EG fund were performed on an execution only basis, whereby Pello gave no advice or recommendation and its role was limited to executing Mr M's dealing instructions.
- Mr M wilfully agreed with the other investments that were recommended and made, he could have chosen not to proceed with the recommendations. He also understood and agreed with the risks of the extended settlement – T20 – arrangement for the AIM2 stock. Telephone evidence and an appropriateness questionnaire completed and signed by Mr M in November 2018 support this.
- At the outset and upon his introduction to Pello Mr M had self-assessed himself as an Elective Professional client. There is documentary evidence of this and it was an assessment that he alone defined, as it was neither done by the third party introducer firm nor was it done by Pello. Pello was entitled to rely on this and to rely on the implication, arising from it, that Mr M understood market risks and high risk investments.
- It was not required to conduct Annual Client Reviews ('ACR') for professional clients so the unsigned ACR evidence it previously sought to rely upon – and its previous arguments in this respect – can be ignored. [Initially, Pello had argued that the ACR document (for 2019) showed Mr M agreed that his risk profile was high/adventurous and agreed that he had a high capacity for loss.]
- The appropriateness questionnaire Mr M completed and signed in November 2018, without input from Pello, confirmed his high capacity for loss.

The matter was referred to an ombudsman.

What I've decided – and why

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

I have reached the same conclusion expressed by the investigator for broadly the same reasons she gave. I incorporate her main reasons (as summarised above) into this decision.

Pello's position can be summed up under the following three main points:

- Mr M was a self-assessed elective professional client and this sets the context for the service it provided to him.
- Its service to him was provided in two distinct respects - an execution only service for the bond and the EG fund transactions and an advisory service, defined by his professional client status, for the other transactions/investments.
- Its investment recommendations to Mr M were suitable for him, again based on his professional client status, and were wilfully agreed by him. In addition, the T20 arrangement for (and risks of) the AIM2 stock investment was explained to and expressly agreed by him.

I address these points as follows –

Classification of Mr M

Pello's assertion that Mr M self-assessed himself as a professional client "... *with no input from* [Pello] ...", and that it provided its service to him on this basis, is in conflict with what it told him in its welcome letter of 8 November 2017. In the concluding paragraph of this letter, under the heading "*Client Classification*", Pello said – "*In accordance with the FCA rules and Clause 4.2 of our Terms of Business, we have classified you as a Professional Client*" [my emphasis]

The implication that arises from the above is that Pello undertook responsibility for having assessed and classified Mr M as a professional client – an *elective* professional client, given that the *per se* category would have been inapplicable to the facts. This dismisses the notion that a self-assessment by Mr M was the basis of Pello's service provision. In addition, the investigator rightfully dismissed merit in the alternative notion that Pello relied on an assessment by the third party introducer firm. As that firm was unregulated any such reliance would not have met the regulations (as specified by the investigator) Pello was bound by.

In order to discharge the requirements of classifying Mr M as an elective professional client Pello had to apply – and satisfy itself that Mr M had passed – the regulators qualitative and quantitative tests (under COBS 3.5.3R); it also had to follow the procedure prescribed by the regulator (also under COBS 3.5.3R).

There does not appear to be evidence of a meaningful qualitative test assessment by Pello of Mr M and the same applies to a meaningful quantitative test assessment in the same respect. This could be viewed as consistent with Pello's position that Mr M assessed himself at the outset but, as noted above, it is inconsistent with evidence that Pello classified (and therefore assessed) Mr M as a professional client.

The qualitative test required Pello to establish and to be reasonably assured that Mr M had the expertise, experience and knowledge to make his own investment decisions and understand the risks involved in the investment service it provided. It is not disputed that Pello's investment service catered for high risk investments. Its welcome letter to Mr M, its key facts document and its final response to the complaint all expressly state this. I have not seen wider evidence to show that Pello conducted an assessment in which *reasonable*

assurance (of what COBS 3.5.3 (1)R required) was established, so it did not meet the qualitative test.

The quantitative test required Pello to be satisfied that at least two of the following applied to Mr M – that he had carried out significant sized transactions in the market relevant to Pello's service at an average of 10 per quarter over the previous four years; that he had a portfolio valued at over 500,000 Euros; that he was a professional in the financial sector.

Mr M was not a professional in the financial sector. Pello has submitted an application document which includes an internal on-boarding related email that says Mr M had a portfolio valued between £100,000 and £500,000. Wider evidence does not support this and it is not clear how Pello sourced this information at the time. There does not appear to be evidence of Pello assessing Mr M's transaction history. Pello did not apply – or ensure that Mr M passed – the quantitative test. It is also noteworthy that the procedure for a professional client classification, as prescribed in COBS 3.5.3R, does not appear to have been properly followed by Pello.

Overall and on the balance of available evidence, Mr M was not an elective professional client, Pello did not assess him (or did not properly assess him) as a professional client and Pello's high risk investment service should never have been made available to him. I consider this the relevant context in which to view Mr M's complaint.

Pello's Service to Mr M

As stated above, Pello provided a service for high risk investments by high risk profile investors/clients. It says it could provide this service to Mr M because he was an elective professional client, which made it implicit that he could undertake high risk investments. I have found, above, that this was not the case. Mr M was not an elective professional client – and there is no other evidence of a separate assessment of the appropriateness and/or suitability of high risk investments for him – so the inherent nature of the [high risk] investment service that Pello offered was a mismatch for him.

The above finding extends to Pello's claim that the bond and the EG fund were execution only investment transactions and that it did not recommend them. I do not consider it necessary to address the merits of this claim. The primary point is that no service from Pello – execution only or otherwise – should have been made available to Mr M, given the high risk nature of the service and given that he was neither a professional client nor had he been assessed as a high risk profile investor. In terms of the latter, I note that Pello no longer relies on the unsigned ACRs.

In the above context, I consider Pello responsible for both unsuitable and inappropriate investments – and for the redress due to Mr M for investing in them. As the investigator noted, there is evidence that by early 2018 Pello conceded that the bond was unsuitable for Mr M and that he was a cautious/low risk investor with limited capacity for loss and a capital preservation objective. Yet it unreasonably proceeded (later in 2018) to play a pivotal role in assisting Mr M to invest in the EG fund – another of the high risk investments Pello offered. Thereafter, as I address below, it unreasonably continued to play pivotal roles (with recommendations and in an undisputed advisory context) in other high risk investments for Mr M – despite knowing they mismatched his investor profile.

Pello's Recommendations

Pello says Mr M wilfully agreed with its recommendations. I consider this a redundant point, given that it was Pello's responsibility – alone – to ensure its recommendations were suitable for Mr M. Whether (or not) Mr M agreed with the recommendations had no meaningful

bearing on whether (or not) Pello discharged its duty to make suitable recommendations. It was the expert in the relationship and Mr M was in receipt of its advisory service, so it is arguably to be expected that Mr M would agree with what he expected to be suitable investment advice.

Pello's argument about the T20 arrangement for the AIM2 stock investment does not defeat the salient point I have made above – that the investments it offered were inherently unsuitable for Mr M. In terms of addressing the argument on its own merit, I note that the document Pello has relied upon – in which it says Mr M signed an undertaking that he understood and agreed with the risks in the arrangement – does not support it. Firstly, the document confirmed to Pello that Mr M had no previous experience of T20 settlement arrangements – the box he was asked to tick to confirm such experience was not ticked. Secondly, the document does not detail or explain the market related risks in the arrangement (or in extended settlement arrangements in general).

The investments which Pello does not dispute recommending – the GC stock, the AIM stock, the AIM2 stock and the ADM Energy stock – were high risk investments which were unsuitable for Mr M's cautious/low risk and limited capacity for loss profile. They also conflicted with his capital preservation objective. The profile and objective were known to Pello in early 2018, many months before these investments. The investments mismatched Mr M's objective, risk profile and his capacity for loss.

The same applies to the investment transactions – which featured a highly speculative strategy – that took place in relation to these investments and in relation to the bond and the EG fund. In this respect, I refer to the initial investments, the liquidations (partial and whole) and the reinvestments that took place, as summarised in the background section above. They too were unsuitable for Mr M for the same reasons.

Conclusion

Overall, on balance and for the reasons given above, I uphold Mr M's complaint.

Putting things right

Fair Compensation

I consider that fair compensation will be to put Mr M as close as I can to the position he would probably now be in if he had not been given Pello's unsuitable service and unsuitable advice. I take the view that he would have behaved differently. It is not possible to say *precisely* what he would have done differently, but I am satisfied that what I have set out below is fair given his circumstances, cautious investor profile and capital preservation objective at the time.

What must Pello do?

To compensate Mr M fairly, Pello must:

- Compare the performance of Mr M's portfolio of investments (all the investments made through Pello) with that of the benchmark shown below and pay him compensation in the form of the difference between the *fair value* and the *actual value*. However, if the *actual value* is greater than the *fair value*, no compensation for financial loss is payable.
- Pay Mr M interest as set out below. Income tax may be payable on any interest awarded.
- Pay Mr M £500 for the trouble and upset the matter has caused him.

- Provide Mr M with details of the calculation of compensation in a clear and simple format.

investment	status	benchmark	from ("start date")	to ("end date")	additional interest
Mr M's portfolio investments	surrendered	the Bank of England average return from fixed rate bonds	date of investment	date of surrender	8% simple per year from the end date to the date of settlement

actual value

This means the actual amount payable from the investment at the end date.

fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark. To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Pello should use the monthly average rate for fixed rate bonds with 12 to 17 months maturity as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other payment out of the investments should be deducted from the *fair value* at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there are a large number of regular payments, to keep calculations simpler, I will accept if Pello totals all of those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because:

- Mr M had a cautious risk profile, limited capacity for loss and wanted to preserve his capital.
- The average rate for fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to capital.
- I consider that benchmark used above broadly reflects the sort of return Mr M could have obtained from an investment suited to his profile.
- The additional interest is for Mr M being deprived use of any compensation money since the end date.

My final decision

For the reasons given above, I uphold Mr M's complaint. I order Pello Capital Limited to pay him compensation as detailed above and to provide him with a calculation of the compensation in a clear and simple format. Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 6 July 2020.

Roy Kuku
Ombudsman