DRN-3956238

The complaint

Ms D, Mr D and Mr D1 (the complainants) complain that Kapwealth didn't provide them with the information it should have done about the Forex strategy each of their portfolios was invested in.

What happened

Kapwealth was in partnership with Marjan Technologies which had developed an investment strategy based on an algorithm – The FX Market algorithm – for trading forex assets. Kapwealth was the investment manager for the strategy and offered clients who wanted to invest in the strategy a discretionary management service for their investment.

Mr D was aware of the strategy before he discussed investing in it with Kaplwealth This was the result of him looking to purchase an equity interest in the business itself and attending investor seminars. Mr D invested an initial €50,000 into his portfolio to be invested in the strategy to be managed by Kapwealth and then a total further amount of €400,000. He also discussed the strategy with his children, Mr D1 and Ms D following which they invested €200,000 and €50,000 respectively into their own portfolios for Kapwealth to manage.

They each subsequently complained to Kapwealth because they were unhappy that performance fees had been charged on closed profit and loss and with the equity in the account being hidden so that losses weren't shown. Mr D also complained that the statements they were provided with didn't show the floating loss which encouraged him to invest more into the strategy.

One of our investigators considered the complaint and thought it should be upheld. He thought the investment strategy wasn't appropriate for the complainants as it was for professional clients and the criteria for them being treated as elective professional clients hadn't been met.

The investigator also said that as a discretionary manager of the complainants' portfolios it had a duty to make sure the decisions it made were suitable for them but Kapwealth had not considered suitability for any of the complainants. The investigator didn't think that leveraged trading on currencies was suitable for them.

The investigator also said the complainants had not been provided with the information they should have been at the outset about performance fees only being charged on closed positions and that this was payable when there were floating losses. He said there was a clear conflict of interest in Kapwealth managing the strategy in the best interest of the client at the same time it received a performance fee on closed positions.

Kapwealth didn't agree with the investigator. It said that the investigator had held it accountable for suitability when it hadn't recommended the product and that its role was limited to ensuring that the product was appropriate only. It said the client was looking for speculation and understood the risks and had approached it to invest in the strategy and if they didn't want speculation or didn't understand the risks they had been fraudulent in stating to the contrary.

It said that whilst the clients didn't have trading experience they weren't directly executing. The clients were party to the underlying software company which provided the trade signals and wanted to buy into the company so would need to understand how it generated revenue. There is evidence from the company that the client attended seminars and was in possession of the trade trading data and knew how the fees were levied but this hasn't been taken into account.

The investigator responded and said that his opinion had been based in part on the investment being deemed appropriate for professional client and the complainants not being such clients. He referred to the rules set out in the Conduct of Business Sourcebook (COBS) in the Handbook of the FCA at COBS 10.2.

Kapwealth repeated that whilst the clients didn't have trading experience they were executing the trades themselves so this wasn't so relevant if they understood the products and their nature, which they had said they did. It said the client had been engaging with the underlying software provider for several months so had sufficient knowledge. It also said that having attended seminars with the client it was satisfied that he knew the minute details of it. It also questioned how Mr D could have promoted the strategy to his family if he didn't know how it worked.

As Kapwealth didn't agree with the investigator the matter was referred to me to review. I issued a provisional decision upholding the complaint the findings from which are set out below.

"There appears to be some confusion as to what Kapwealth was required to do in its role as discretionary manager of the complainants portfolios. The investigator in his initial opinion referred to its obligation to assess appropriateness as well as suitability. Kapwealth has argued that it was only required to assess appropriateness.

Given there are important differences in the rules that Kapwealth must comply with between appropriateness and suitability I think it is important to explain what its obligations were.

The relevant rules are set out in the Conduct of Business Sourcebook (COBS) in the Handbook of the FCA. The rules relating to appropriateness can be seen under COBS 10A.1 which make clear that the chapter doesn't apply when a firm makes a personal recommendation or carries out portfolio management. So, it didn't apply to the service that Kapwealth provided to the complainants.

The rules regarding suitability at the time are set out under COBS 9A the relevant parts from which I set out below.

COBS 9A.2.1R:

"When providing investment advice or portfolio management a firm must:

(1) obtain the necessary information regarding the client's:

(a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;

(b) financial situation including his ability to bear losses;; and

(c) investment objectives including his risk tolerance,

(2) only recommend investment services, financial instruments and insurance-based

investment products, as applicable, or take decisions to trade, which are suitable for the client and, in particular, in accordance with the client's risk tolerance and ability to bear losses.

*[**Note:** first paragraph of article 25(2) of MiFID, first paragraph of article 30(1) of the IDD]"*

COBS 9A.2.4EU:

"54(2) Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients. Investment firms shall obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

(a) it meets the investment objectives of the client in question, including client's risk tolerance;

(b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;

(c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

*[**Note:** article 54(2) of the MiFID Org Regulation]"*

COBS 9A.2.6:

"55(1) Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

(a) the types of service, transaction and financial instrument with which the client is familiar;

(b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out;

(c) the level of education, and profession or relevant former profession of the client or potential client.

*[**Note:** article 55(1) of the MiFID Org Regulation]"*

The above rules state they apply to portfolio management, so they applied to the service Kapwealth provided. Furthermore, clause 7 of its own terms and conditions set out its obligation to assess suitability before providing its portfolio management service – unless an IFA has assessed suitability, which isn't the case here.

However, when the investigator questioned Kapwealth about suitability before he provided his opinion it said that as it had made no recommendation and didn't carry out an investment review, it only needed to consider appropriateness – which as I have said isn't relevant to the service it provided. It then repeated this in response to the investigator's opinion.

So, on its own evidence Kapwealth didn't consider suitability, despite the rules and its own terms making clear this is something it needed to do. Given what Kapwealth has said and the absence of any documentary evidence any suitability assessment was carried out I am satisfied that no such assessment took place.

Kapwealth was in breach of its regulatory obligations and its own terms and conditions in providing its portfolio management service to the complainants without having carried out a suitability assessment.

The complainants were required to provide some information about their financial positions and investment experience in the applications they completed but this wasn't for the purposes of a suitability assessment and wasn't sufficient in any event for such an assessment to be carried out, as I explain below.

I have only considered the applications Mr D and Mr D1 completed as Ms D's application is illegible. In their respective applications both Mr D and Mr D1 answered 'yes' to having a good understanding of leveraged products and the concepts of margin and to having a good understanding of the concepts of volatility and market liquidity and of the risks of trading.

However, the applications also required them to provide information about their level of previous experience in relation to a comprehensive list of investment products - from government bonds to CFDs and Forex, and with a catch-all of 'other investments' for anything falling outside of the individual products identified.

Both Mr D and Mr D1 answered 'none' to every single product and to the catch-all question. In other words their answers indicated they had no previous investment experience at all.

The applications also showed that; Mr D was a teacher and Mr D1 was a student; neither of them had a qualification that would assist in understanding leveraged products in general; their current level of knowledge of financial markets was 'none/limited/basic experience'.

Furthermore, the rules also require firms to obtain information about a client's financial situation when assessing suitability - including their ability to bear losses - as well as information about their objectives and risk tolerance.

The application did require some financial information to be provided but I think this fell well short of what Kapwealth needed for the purposes of a suitability assessment.

For example the information about Mr D1 showed that at the time he was a 24 year old student with an income between 0 – 10,000 and with a net worth between 100,001 – 500,000. He put €200,000 into his portfolio to be invested in the strategy and Kapwealth had no way of knowing from the information in the application whether this was all of net worth or not or if he could bear the losses that could result from investing this amount in the strategy.

Mr D had a more significant income – shown as between 75,000 and 100,000 – but had the same information as Mr D1 about his net worth, namely that this was 100,001 – 500,000. He invested a total of €450,000 and as with Mr D1 Kapwealth had no way of knowing from the information it had if that was the entirety of his net worth or whether he could bear the losses that could arise from his investment in the strategy.

I think it is obvious that the applications of Mr D and Mr D1 didn't contain the necessary information that Kapwealth would have needed to assess suitability and that it needed to obtain further details before it could carry out an assessment.

So far as Ms D is concerned, the copy of the application she completed that has been

provided isn't legible so I cannot say what information was provided in her application.

I have considered whether the strategy could have been suitable for any of the complainants if the necessary information had been obtained and a suitability assessment carried out. Mr D has confirmed that none of them had any previous investment experience and as such I am not satisfied that the strategy was suitable for any of them.

Kapwealth has suggested that because Mr D was already aware of the strategy - having attended investor seminars and intending to have an equity interest in Marjan - he had the necessary knowledge and experience. I am not persuaded by this argument.

Investor seminars are not a replacement for actual knowledge and experience gained through investing in my view and whilst Mr D may have thought purchasing an equity interest in Marjan was a good opportunity this also doesn't, of itself, establish he had the knowledge and experience to understand the risks of the strategy.

I would also point out that even if Kapwealth thought that this was a reason to think that Mr D had the necessary knowledge and experience, it provides no explanation for it providing its service to Mr D1 or Ms D.

One further point about the suitability of the strategy is that the seminar slides Kapwealth has provided refer to the strategy being suitable only for professional clients, which I think is understandable given the complexity of the strategy. However, the complainants were all retail clients. In response to the investigator's query about this Kapwealth said that it changed the client criteria for the strategy because of concerns over negative equity protection.

Whilst I acknowledge that professional clients wouldn't be entitled to negative equity protection, this doesn't explain how it determined that a strategy it thought was only suitable for professional clients was then somehow suitable for retail clients.

Were the complainants provided with the information they should have been?

The complainants argue they weren't made aware of floating losses on their accounts and that this gave a false impression as to how the strategy was doing. They also argue that they weren't made aware that the performance fee was charged on closed trades whilst there were losing trades still open.

The terms and conditions of the portfolio management agreement referred to payment of an initial management fee of 1% of the total portfolio amount upon account opening and a monthly performance fee of 50%. The terms provide no further information about the performance fee, such as whether it is payable on closed positions only.

Kapwealth argues that Mr D was aware of the basis on which the performance fee was charged and point to a slide from one of the investor seminars that Mr D attended which referred to this.

It has also provided a statement from Mr L, a director and the controlling owner of Marjan, who has stated that Mr D had numerous meetings with Marjan in which it shared its full business model and that this included live trading and that Mr D was aware that positions were open at the end of each month and that performance fees were generated on closed positions only.

There is no evidence that Mr D1 or Ms D attended the seminars or met with Marjan, so this evidence is only relevant so far as Mr D is concerned and has no relevance to Mr D1 or Ms

D. Kapwealth has provided no evidence or explanation as to why Mr D1 or Ms D would have reason to know the basis on which the performance fee was charged given it didn't provide any information to them about this.

Insofar as Mr D is concerned I am not persuaded on the limited evidence that Kapwealth has provided - consisting only of a seminar slide and a statement from Mr L - that he was aware the performance fee would be charged on closed positions only whilst there were still losing open positions.

There are various rules that I think are relevant regarding the information that Kapwealth provided to the complainants. However, the starting point I think is that it was obliged to provide clear, fair, and not misleading information to its clients as set out in COBS 4.2.1R.

I am not satisfied that Kapwealth did provide clear, fair and not misleading information to the complainants as it didn't make clear the performance fee would only be charged on closed positions and that this was payable when floating losses could be increasing month on month.

I think it is also worth referring to specific rules regarding costs information that Kapwealth needed to comply with. Under COBS 2.2A.2(1)(d) Kapwealth had to provide appropriate information in good time to its clients about all costs and charges. It seems to me that appropriate information would include information about the basis on which the performance fee would be charged, namely on closed positions only.

There are more specific rules about costs information under COBS 6.1ZA which I won't set out in detail. However, one rule I think is worth referring to is COBS 6.1ZA.14ER under which it was required to provide an illustration showing the cumulative effect of costs on the return both on an ex-ante and post-ante basis. Kapwealth provided no such illustration as far as I am aware and had it done so this potentially would have painted a different picture to what was shown in the documents they were provided with.

There is a further point about the information Kapwealth provided. Regardless of the information provided about the performance fee, the monthly statements didn't show the floating losses and I think as such were not clear, fair, and not misleading. I think this is important for a couple of reasons.

Firstly, Mr D invested €50,000 to start with and then later invested a further €400,000 that he may well not have invested if he had been aware of the floating losses on his account. Secondly, Mr D1 and Ms D invested as a result of Mr D making them aware of the strategy following his own investment and it seems to me this discussion and their investment may well not have taken place if he had been made aware of the floating losses."

I said Kapwealth should compare what each complaint got back from their investment in the strategy with what they would have received if they hadn't invested and pay the difference together with simple interest.

I gave both parties the opportunity of responding to my provisional decision and providing further information they wanted me to consider before reaching my final decision. The complainants agreed with my findings but Kapwealth didn't.

It said that we had not fairly assessed and acknowledged the scale of evidence supporting its assertions and the lack of assertions to the contrary. It said that our approach and attitude is inherently slanted in favour of the complainant and it feels its evidence of the complainant's own extensive active contribution is being discounted

Kapwealth said that it had provided a list of consistent activities which show the complainant's active intention, desire, and participation and that they were the drivers of the whole investment. It said 'experience' is way broader than just an opinion – and then provided dictionary definitions for the word 'experience'.

Kapwealth said that by defining 'experience' narrowly and ignoring the evidence of the complainant's real and tangible exposure to the concepts and operation of the strategy creates a catch-22 situation in that someone who has never previously invested in a product would never be able to ever invest in that product. It said that there had to be some threshold of experience that should be enough to make a decision they can invest and the complainant clearly exceeded that threshold.

In response to my finding that it had provided no explanation for the service provided to Mr D1 and Ms D Kapwealth said Mr D was promoting the service to them.

It said that in effect it had an insistent client that it tried in good faith to implement a service for which he was fully aware of and promoted and it has provided extensive proof of the pre-activities and pre-knowledge and intent of the complainant – who has never stated he didn't understand the product nor that he didn't have enough knowledge and experience.

Kapwealth said that the client was actively looking into investment solutions and the assumption he wouldn't have invested in something else is unfair.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Kapwealth has suggested that my provisional is biased towards the complainants and that I have not fairly assessed the scale of evidence in support of the assertions it has made. However, I have considered all the evidence provided by the parties and reached a fair, reasonable, and impartial decision having done so. Kapwealth has provided no new information or evidence that would lead me to change the findings in my provisional decision, which form part of my findings in this final decision.

The starting point is that Kapwealth didn't carry out a suitability assessment as it was required to do both by the rules and under its own terms and conditions – it mistakenly considered that because Mr D had decided to invest in the strategy beforehand and it didn't recommend it that this meant it wasn't required to assess suitability.

However, as it was providing a portfolio management service it was required to assess suitability of the service it was going to provide and shouldn't have proceeded to without having carried out such an assessment in respect of each complainant – its own terms and conditions explain that it will carry out such an assessment.

In considering whether Kapwealth could have provided its service if it had carried out a suitability assessment, the information available doesn't support a finding that it could - as on the available evidence the leveraged currency trading the Forex strategy involved wasn't suitable for any of the complainants.

In my provisional decision I commented on the fact that the Forex strategy was originally directed only at professional clients - which I think made sense given the complexity and risks involved in the strategy. This was then changed so that it was made available to retail clients.

The reason that Kapwealth put forward for this is that professional clients wouldn't benefit from negative equity protection. However, the fact retail clients had the benefit of negative equity protection didn't make the strategy any less complex or less high risk. It simply meant that a retail client couldn't lose more than the total funds in their trading account. I am not satisfied that the availability of negative equity protection reasonably explains the decision to make the Forex strategy available to retail clients.

And even if it was considered a suitable strategy for some retail clients - such as sophisticated investors - I cannot see that a strategy which had previously only been considered as suitable for professional clients, could reasonably be considered suitable for retail clients who were novice investors.

In response to my provisional decision Kapwealth has made the same arguments it has previously made about Mr D wanting to invest in the strategy, attending seminars, and being interested in taking an equity interest in Marjan. I considered everything it said previously in relation to these issues when making the findings set out in my provisional decision. It has provided no new evidence that would lead me to change my findings.

I note what Kapwealth has said about there being some threshold of experience that would allow a client to be invested in a product they hadn't previously invested in. In this case Mr D had not previously invested and was investing in a complex high-risk strategy involving leveraged currency trading, not some straightforward investment product like equities or bonds. I don't agree with Kapwealth that Mr D had the necessary knowledge and experience to understand the risks of such trading when he had no previous investment experience at all.

Furthermore, whilst I have concentrated on Mr D's knowledge and experience, the rules also require firms to obtain information about a client's financial situation when assessing suitability - including their ability to bear losses - as well as information about their objectives and risk tolerance. I am not satisfied that leveraged currency trading was suitable for Mr D regardless of his knowledge and experience, based on the information available about his financial situation.

I note that Kapwealth has referred to Mr D being an 'insistent client'. This has a specific meaning as set out in COBS 9.5A in the FCA Handbook. In short it is someone a firm has made a personal recommendation to but where the client wants the firm to facilitate a different transaction. That clearly isn't what happened in this case and if it had been the guidance sets out in COBS 9.5A sets out what a firm should do.

Insofar as Kapwealth is using the term 'insistent client' in some wider context in reference to Mr D's desire to invest in the Forex strategy, this didn't make it suitable for him and didn't mean that Kapwealth could provide the service it did when it wasn't suitable for him.

The points that Kapwealth has made about Mr D's knowledge and experience have no relevance to Mr D1 or Ms D. Its explanation in support of its service being suitable for them appears to be based on Mr D having promoted the Forex strategy to them. This clearly doesn't provide evidence that leveraged currency trading was suitable for them. I have seen no evidence either of them had the knowledge and experience for leveraged currency trading to be considered suitable for them.

I would also repeat what I have said above about the rules requiring firms to obtain information about a client's financial situation when assessing suitability - including their ability to bear losses - as well as information about their objectives and risk tolerance. And, as with Mr D, I am not satisfied that leveraged currency trading was suitable for Mr D1 or Ms D based on the information available about their respective financial situations.

In summary Kapwealth failed to carry out a suitability assessment for any of the complainants as it was required to do before providing its portfolio management service. I have seen no persuasive evidence that if it had carried out a suitability assessment that it could reasonably have concluded that leveraged currency trading was suitable for any of the complainants.

Furthermore, in addition to my findings about suitability I also made findings in my provisional decision about Kapwealth not providing the information it should have done to the complainants. Kapwealth has said nothing about my findings about its failings in that regard. These provide an additional and separate basis for upholding the complaint and awarding redress in any event.

Putting things right

The purpose of redress as far as possible is to put the complainant in the position they would have been in if the business had done nothing wrong. In other words, put them in the position they would have been in if their portfolios hadn't been invested in the Forex strategy.

Where there is persuasive evidence that a complainant would still have invested at the time either in a specific investment or generally then redress can be based on a comparison with the specific investment or with a benchmark.

I note that Kapwealth has said that Mr D was looking for opportunities to invest. However, there is no persuasive evidence he was interested in any other investment other than the Forex strategy. There is also no evidence that suggests Mr D1 and Ms D would have invested in something else if they hadn't been invested in the Forex strategy.

In the circumstances I am satisfied that it is fair and reasonable redress should be based on Kapwealth comparing what each complainant got back after investment in the strategy with what they would have received if they had not invested and left their money where it was and paying the difference to each of them.

In addition I think it should pay simple interest at 8% per annum on the amount it calculates is payable to each complainant from the date they each stopped investing in the strategy to the date of settlement.

My final decision

I uphold this complaint for the reasons I have set out above. Kapwealth Limited must calculate and pay the complainants the redress as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms D, Mr D and Mr D1 to accept or reject my decision before 19 April 2023.

Philip Gibbons
Ombudsman