DRN-4149576

The complaint

Mr S complains that City Credit Capital (UK) Ltd (CCC) allowed him to trade Contracts for Differences (CFDs) even though it wasn't appropriate for him. He says CCC should've refused to allow him to open an account.

What happened

In August 2016 Mr S, through an unregulated introducer, approached CCC to open a CFD trading account with it. He had met an unregulated broker who he would appoint to manage his trading account and completed an application form. This confirmed:

- Mr S had an annual income of between £30,000 and £80,0000
- He was about to turn 69 years old.
- Mr S had no experience in CFDs, spread betting, Forex, Futures, Options or ETFs.
- Mr S would use a fund manager to trade the products.

On 11 August 2016 CCC sent Mr S a letter which said the following:

"We have reviewed your application and have noted that you have limited/or no experience in trading derivatives. In light of this, we need to draw your attention to our Risk Disclosure Statement (attached) to ensure that you fully understand the risks involved in trading derivatives. You should not deal in derivatives unless you understand their nature and the extent of your exposure to risk."

The letter goes on to give some options available to Mr S including opening a demo account, seeking further advice from a third party or appointing a limited power of attorney to manage his account. The letter concluded with the following statement:

"Of course, these are only suggestions. Should you still wish to open your account we would be happy to accept your application upon receipt of the funds."

The letter had a Risk Disclosure Statement attached which set out specific risks related to trading leveraged products including CFDs.

Mr S went on to open his account and appointed an unregulated third party to trade on his behalf. He's told us he traded over $68,000. He complained in 2021. CCC said that it had complied with the necessary regulations and provided Mr S with sufficient warnings when he applied for his account. So, it says it hasn't done anything wrong.

Our Investigator felt the complaint should be upheld and recommended CCC refunds Mr S's losses. She said:

- CCC didn't follow the proper process set out in COBS 10.2 and 10.3 which put Mr S at unnecessary risk of financial harm.
- CCC didn't specifically warn Mr S that the account wasn't appropriate for him. It's letter's suggestions reduce the impact of the risk warning.
- CCC's process suggests little consideration has been given to the guidance set out in COBS 10.3.3.

CCC disagreed and asked for an Ombudsman to issue a decision. A summary of its response points are as follows:

- The Investigator's outcome is flawed and mis-applies the relevant regulatory requirements.
- CCC's processes complied with the relevant FCA regulatory requirements in place at the time.
- CCC's processes were properly applied and recognised Mr S had a lack of experience in trading derivatives and highlighted that to him.
- COBS 10.3.1R requires CCC to provide a warning to Mr S. It does not require it to *"specifically warn [the client] [that the firm] had concluded the account wasn't appropriate for him*" as the Investigator had suggested. CCC said *"the rule simply records that where appropriateness is not confirmed, then the client must be warned"* and this is what CCC did.
- CCC gave Mr S an explicit warning that he shouldn't deal in derivatives unless he fully understands the risks and it gave him the Risk Disclosure Statement.
- COBS 10.3.3 specifically relates to particular transactions and doesn't apply to the opening of an account itself.
- Mr S was solely responsible for the assessment and appointment of his Limited Power of Attorney.

I sent out my provisional decision on 20 April 2023 setting out why I was intending to uphold this complaint. The reasoning from this, which forms part of this decision is copied below:

"It isn't in dispute that on the basis of the information Mr S gave, trading in derivatives wasn't appropriate for him. He had no trading experience at all and there's no evidence of his other investment experience. So, I've considered whether CCC did what it was obliged to do under the regulations.

COBS 10.3 says:

> *(1) If a firm considers, on the basis of the information received to enable it to assess appropriateness, that the product or service is not appropriate to the client, the firm must warn the client.*
>
> *(2) This warning may be provided in a standardised format.*

Guidance at COBS 10.3.3 allowed firms to use their own discretion, having regard to the circumstances, when deciding whether to allow consumers to open an account despite it not being appropriate. CCC has suggested that it provided a sufficient warning to Mr S and it was Mr S's choice to go ahead having had that warning. So, CCC doesn't think it's done anything wrong. However, I'm not persuaded that CCC followed the correct rules set out in COBS 10.3. I'll explain why.

The European Securities and Markets Authority (ESMA), in my view, clarifies how COBS 10 should be applied by firms in a document called "Questions and Answers: relating to the provision of CFDs and other speculative products to retail investors under MiFID".

In section 4 titled "The assessment of appropriateness when offering CFDs or other speculative products to retail investors" it says, under question 2:

"For example, the warning should be designed in such a way that it is an actual interruption in the process of authorising the opening of an account of entering a particular transaction. The warning should be stated in clear language, indicating that, on the basis of the answers provided, the specific product or service in question is not appropriate for the client as the client is not likely to understand the risks involved. It should also recommend clearly that the client does not proceed."

The FCA carried out a review in 2017 and confirmed ESMA's guidance, It said that risk warnings should be designed to interrupt the application process. And they should "use clear language to communicate that a specific product or service is not appropriate for the applicant because the applicant's answers lead the firm to the view that the applicant does not have the knowledge and experience to understand the risks involved, with a clear recommendation against proceeding with the transaction." It went on to say that "when presenting a risk warning, applicants should not be asked to confirm an intention to proceed with a transaction as the next step in the application process".

I'm satisfied that the FCA's review in 2017 confirmed what was required already of firms warning its clients. So, whilst this review was after Mr S applied for his account in 2016, the regulations were the same and in place at that time. Having considered the statements above from both ESMA and the FCA, I think it's clear that a warning to a client following an appropriateness assessment must, at the very least, occur before the account has been opened. And in my view, the statements above also clearly show that in order for it to amount to a warning as described in COBS 10, the letter or email must clearly explain to the consumer that trading CFDs is not appropriate for them and advise them not to proceed.

I've thought about whether the risk warning CCC gave Mr S satisfied that above and I don't think that it did. In my view the warning provided to Mr S was not a warning that he should not trade CFDs. It simply repeated information Mr S had provided and attached a risk disclosure notice. There was no point in the letter where CCC informed Mr S that based on the answers he provided, trading CFDs wasn't appropriate for him and he should not proceed. The letter simply said that Mr S shouldn't go ahead if he doesn't understand the risks – rather than telling him that it isn't appropriate for him and he shouldn't go ahead. It then goes on to give him options and tells him that it would be happy to open his account. I don't find this satisfies the regulatory requirements set out in COBS and confirmed by the FCA and ESMA.

I'm satisfied that given the information Mr S provided, CCC was going to conclude that trading CFDs wasn't appropriate for him. And it ought to have written to him and explained this. It ought to have advised him not to go ahead with the application because, in its view, he had insufficient knowledge and experience to understand the risks. But I don't think its letter did this. The letter said:

"We have reviewed your application and have noted that you have limited/ or no experience in trading derivatives. In light of this, we need to draw your attention to our Risk Disclosure Statement (attached) to ensure that you fully understand the risks involved in trading derivatives. You should not deal in derivatives unless you understand their nature and the extend of your exposure to risk."

This doesn't tell Mr S that trading CFDs isn't appropriate for him and it doesn't encourage him to not go ahead. In fact the next step at the end of the letter is the option for Mr S to open the account if he transfers funds.

I do appreciate that when firms provide a sufficient warning, a client can still go ahead. In this case however, I think that if Mr S had been told that it wasn't appropriate for him and that he shouldn't go ahead then he would've stopped there and not proceeded. It's clear he met with CCC and it's also clear that from his complete lack of investment experience he was going to be reliant on CCC, as the regulated firm, to provide him with the information he needed about appropriateness to make the decision about whether to proceed.

As I don't think Mr S would've proceeded had CCC given him a warning that met its regulatory requirements, I don't think he'd have suffered the losses he incurred through trading. I'm mindful that Mr S had limited involvement in trading as he had an unregulated third party trading on his behalf. But I'm persuaded that Mr S wouldn't have opened the account had CCC not failed to warn him not to proceed. For the reasons I've explained, CCC's omission meant that Mr S was exposed to significant risks of financial harm – risks

that he didn't fully understand and, given the nature of this type of trading, he had limited protection from."

Responses to my provisional decision

Mr S didn't respond to my provisional decision. CCC disagreed with it. In summary, its representative made the following points:

- COBS 10.3.1R *"simply mandates that the firm must warn the client that the product or service is not appropriate. There is no prescriptive form of words set out in the rule and it would be clearly wrong to require that."*
- The ESMA guidance quoted in the provisional decision hadn't been published at the time Mr S applied for his account so it is inappropriate to imply any requirements from this guidance.
- Even if the guidance was in place, CCC met those requirements.
- It quoted parts from its letter to Mr S and said that from that there could be "*no doubt in his mind that he should not engage in trading derivatives unless he had satisfied himself and taken the opportunity to improve his knowledge and understanding before he did so."*
- "*Neither the ESMA guidance or FCA review were in place when the account was opened and applying them with retrospectivity as set out in the decision would be wholly wrong*."
- The conclusion that Mr S would not have proceeded and wouldn't have suffered losses is flawed. There is no credible evidence in support of that contention.
- It is unfair to hold CCC to a standard which wasn't published at the time the account was opened.

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.

Having done so, I've reached the same outcome as in my provisional decision – an extract of which is above and forms part of this decision. I understand that CCC disagrees with this. I've reviewed and considered its detailed comments carefully. Whilst I've not commented on every point, this decision focuses on what I consider to be the main point of disagreement – whether CCC's risk warning to Mr S met the requirements of COBS 10.3.

I first want to address why I've relied upon information from ESMA and the FCA which, as CCC has pointed out, postdates the opening of Mr S's account. The guidance was issued to highlight the expectations of both regulators as to how firms ought to be complying with the rules that were already in place when Mr S opened his account. I'm not seeking to apply any new rules retrospectively, but I am relying on guidance which, in my view, was explaining how ESMA and the FCA expected firms to already be applying the relevant rules and highlighting examples of bad practice.

The guidance and review gave clear explanations about what the regulators expected firms to do under COBS 10.3 and, whilst CCC said that it believes it was compliant, I disagree. CCC says that COBS 10.3.1 *"simply mandates that the firm must warn the client that the product or service is not appropriate".* The regulations say: "*If a firm considers, on the basis of the information received to enable it to assess appropriateness, that the product or service is not appropriate to the client, the firm must warn the client."*

I've already explained above what the guidance on this says. And even looking at the wording above I think it's clear that what the client needs to be warned about is the firm's conclusion that the service or product is not appropriate for them. This is the reason firms

must specifically assess appropriateness. I don't agree that a warning which doesn't specifically make it clear that the service isn't appropriate for the client is sufficient.

I accept that the warning could be in a standardised format, but the fundamental nature of the warning ought to be as I've set out above. I say this because other rules in COBS already mandate the types of 'standard' risk warnings which firms ought to be sending to all their customers. I'm satisfied that the intent behind COBS 10.3.1 is not for a warning about the product or its risks to be sent, as the firm ought to have already sent that information. In my view, the warning must convey to the client the outcome of the firm's assessment that the product is not appropriate – because this is the only interpretation that makes sense when viewing a firm's obligations as a whole.

The purpose of an appropriateness assessment is to establish which clients shouldn't be buying the investment or service due to not having sufficient knowledge and experience to understand the risks involved. And as explained, in my view, the warning must clearly warn the client – in this case Mr S – that the assessment the firm has carried out means it is not satisfied that the client understands the risks. A warning that doesn't set out the outcome of the appropriateness assessment – like the one CCC issued – would defeat the purpose of COBS 10, and the risk of consumer detriment that it is trying to address.

CCC has said its warning to Mr S would leave him with no doubt that he shouldn't trade in derivatives. But nothing in what it sent to Mr S told him that CCC's assessment established that he did not have sufficient knowledge or experience to understand the risks involved. It simply said that he shouldn't deal in derivatives unless he understands the risks – these are not the same message. For the reasons I've explained both here and in my provisional decision (an extract of which is above), I'm satisfied the warning needed to specifically reference the fact that trading CFDs was not appropriate *because* Mr S lacked the experience and knowledge to understand the risks involved.

I do note CCC disagrees with this conclusion, but I'm satisfied that it's warning didn't satisfy the regulatory requirements set out in COBS. This is confirmed by the guidance issued by ESMA where it said:

"The warning should be stated in clear language, indicating that, on the basis of the answers provided, the specific product or service in question is not appropriate for the client as the client is not likely the understand the risks involved. It should also recommend clearly that the client does not proceed."

The FCA echoed this in 2017 with its review. I've already said that the review and guidance simply explained what firms should already be doing in applying regulations that were in force at the time Mr S opened his account with CCC. And none of the information CCC sent to Mr S warned him that trading CFDs wasn't appropriate for him and it certainly didn't give a clear recommendation against proceeding.

So, for these reasons, and the reasons set out in my provisional decision, I'm satisfied that based on the information Mr S provided, CCC was bound to conclude that trading CFDs wasn't appropriate for him and it ought to have warned him of that fact and encouraged him not to proceed. CCC didn't do this, and as a result, I'm satisfied it hasn't treated Mr S fairly.

CCC has said that it doesn't think it's right to conclude that Mr S would not have proceeded. However, it hasn't provided anything for me to reconsider this point. Mr S didn't have any experience in trading in CFDs. He was in touch with others who would do it on his behalf but at no time was told that this wasn't something he should do based on his experience. The letter CCC sent to him pointed to tools that would help him understand and then said it would be happy to open an account for him. I think, that had he been given a warning that complied with the relevant regulations and warned him not to proceed based on his experience that he'd have done something differently. It would have been the only time that he was told that this wasn't a good idea and I think, given his situation, knowledge and experience, that this

would've stopped him from opening the account. As such, I don't think Mr S would've encountered the losses through this account.

Putting things right

To compensate Mr S fairly, CCC must:

- Compare the performance of Mr S' investment with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

- CCC should also add any interest set out below to the compensation payable.

Income tax may be payable on any interest awarded.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
CFD trading account	No longer in force	Average rate from fixed rate bonds	Date of investment	Date ceased to be held	8% simple per year on any loss from the end date to the date of settlement

Actual value

This means the actual amount paid 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, CCC should use the monthly average rate for one-year fixed-rate bonds 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 additional sum that Mr S paid into the investment should be added to the *fair value* calculation at the point it was actually paid in.

Any withdrawal from the CFD trading account should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simpler, I'll accept if CCC totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically.

Why is this remedy suitable?

I have chosen this method of compensation because:

- Mr S wanted to achieve a reasonable return without risking any of his capital.

- The average rate for the fixed rate bonds would be a fair measure given Mr S' circumstances and objectives. It does not mean that Mr S would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with little risk to their capital.

My final decision

For the reasons I've explained, I uphold this complaint. City Credit Capital (UK) Ltd should pay the amount calculated as set out above.

City Credit Capital (UK) Ltd should provide details of its calculations to Mr S in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 21 June 2023.

Charlotte Wilson
Ombudsman