DRN-4422097

The complaint

Mr M complains that Gain Capital UK Limited trading as City Index unfairly categorised him as an elective Professional Client when it shouldn't have. He says this caused him significant financial losses for which he would like to be compensated.

What happened

Mr M was an experienced trader. In March 2019 he got in touch with City Index as he was looking to open a Contract for Difference (CFD) trading account with it. As part of that process, Mr M clicked through a link to become an elective professional client and City Index contacted him so that he could provide the relevant evidence.

In 2019 the rules on Elective Professional Clients were set out in the Financial Conduct Authority's Handbook, under the Conduct of Business Rules (COBS) 3.5.3. This said:

'*Elective professional clients*

A firm may treat a client other than a local public authority or municipality as an elective professional client if it complies with (1) and (3) and, where applicable, (2):

(1) The firm undertakes an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved (the "qualitative test");

(2) In relation to MiFID or equivalent third country business in the course of that assessment, at least two of the following criteria are satisfied:

a. The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
b. The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;
c. The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged;

(the "quantitative test")'

COBS 3.5.3(3) then set out the process by which this categorisation would need to happen.

City Index asked Mr M to provide evidence of his employment and of his trading history. It did not ask him to provide any evidence of the size of his portfolio. As part of his employment, Mr M said:

'I'm product owner for wealth and investment products, so not only do I manage the global asset management business, but manage and build investment products for the overall

proposition, this includes leveraged products, the use of investment vehicles such as OTCs, futures and other derivatives'.

By way of verification, City Index checked Mr M's role on a popular professional networking site and satisfied itself that what he said was accurate.

In terms of trading, Mr M said that he had held a trading account 'for more than 12 months' and provided trades for the period February 2016 to September 2017. City Index accepted this evidence and categorised Mr M as an elective professional client.

Mr M proceeded to trade on the account on three main indices: Wall Street, UK100, and Germany30. Between March 2019 and March 2020, he placed 1,570 trades and invested over £610,000. He withdrew around £454,000 during that time, and with the addition of goodwill gestures and rebates of over £51,000, was left with a negative balance of £25,431 at the end.

In July 2020 Mr M complained to City Index about this negative balance – in essence complaining about the closure of some of his trades, and about the presence of a credit facility which he disputed he ever asked for. City Index looked into his complaint and concluded it had done nothing wrong. It said there was evidence he had specifically requested a credit facility and the trades had been closed correctly. It maintained his negative balance was due. Mr M referred his complaint to this service.

One of our investigators looked into Mr M's complaint. He considered that the main issue was in fact Mr M's classification as an elective professional client, and asked Mr M for some further information. Mr M said:

- He had some 'small trading' activity but not sufficient to meet the requirements of being an elective professional client.
- In terms of his background, he only had a 'professional history working within retail banking and have no professional background or qualification with trading or investment products relating to trading'. He said that he was told by City Index to mention the sort of activities their compliance team would be after in order to pass this part of the criteria.

On review of the evidence, the investigator concluded that City Index hadn't done anything wrong and didn't uphold Mr M's complaint. Mr M remained unhappy, and so the case was passed to me to decide.

I issued a provisional decision in September 2023. In it I said:

I'm satisfied Mr M fulfilled the 'qualitative test', namely that he was capable of making his own investment decisions and understanding the risks involved. The evidence he provided of his previous trades demonstrate that Mr M was a very experienced trader, who knew exactly what markets he wanted to trade on and how much he wanted to invest.

But in order to comply with the rules, City Index needed to satisfy itself that Mr M also met at least two of the three quantitative criteria. Mr M did not provide nor was he asked to provide any evidence of his existing portfolio – so I make no comment about whether he may or may not have fulfilled that criteria because I simply do not have that evidence.

Instead, City Index decided that Mr M qualified on the basis of his trading history and his *professional position. I'll deal with each of these in turn.*

Trading history

It's clear to me that the evidence Mr M provided of his trading history does not fulfil the requirements in COBS 3.5.3. The rule say that not only do the transactions have to be of significant size and of a specified frequency, they also needed to be carried out 'over the previous four quarters'. Whilst there were different approaches to what 'relevant market', 'significant size' and even '10 per quarter' meant at the time (approaches which both the European and Securities Markets authority – ESMA – and the FCA have provided guidance on), I'm not persuaded there was any doubt that previous four quarters clearly meant immediately before the application. It could not mean four quarters at some other point in history – and in Mr M's case, the evidence he provided was not just out of date, it was from two years before (2016 to 2017).

Furthermore, Mr M has provided evidence that the only trading he carried out in the four quarters immediately preceding his assessment as an elective professional client was limited and not of significant size. In total, he traded for a few weeks in March 2018 and November 2019, with no other trading of note. So had City Index asked for more recent evidence of his trading history, it would've been clear that he did not meet this criterion.

In looking at the way this evidence was reviewed by City Index, I'm satisfied that its conclusion that this evidence meant that Mr M's trading met COBS 3.5.3(2)(a) was not fair and reasonable.

Professional background

In my view this area is less clear-cut. Mr M has said that he was told what to say in order to satisfy City Index's compliance department – and as a result he used the words 'leverage', 'futures' and 'derivatives'.

I've seen no evidence that he was coached in this way, and on the contrary I can see that City Index did not initially accept his role as being enough to satisfy COBS3.5.3(2)(c) because it asked him for more detail.

The problem, in my view, is that Mr M's response did not really provide more detail. In providing guidance to firms on this aspect of the rules, ESMA said that:

'Investment firms must ensure that the position was professional in nature and held in a field that allowed the client to acquire knowledge of transactions or services that have comparable features and a comparable level of complexity to the transactions or services envisaged'.

Mr M doesn't explain in what way his role gave him this knowledge – for example whether it required him to know details on trading. And the screenshot of his profile which I've seen and which City Index relied on, in my view doesn't provide this level of detail either.

So, I'm not satisfied that City Index's conclusion that Mr M fulfilled this limb of the criteria was fair and reasonable either.'

In response to my provisional decision, Mr M made a number of comments, largely in relation to the way I had suggested compensating him – which involved clearing the balance he owes City Index and nothing more. He also said that the trades which were placed when he had a negative balance ought to be discounted as well as a £10,000 compensation payment that he says ought to have been made to him but was incorrectly added to his trading account. He suggested it would be fair and reasonable to instead ask City Index to rework the account with the leverage available to him as a retail client. He said that he expected compensation of around £160,000 if this was done correctly.

I considered his comments and before issuing this final decision, decided that I agreed with his proposal. I therefore wrote to both parties to confirm this and gave each party a chance to comment:

‘Although I'm not persuaded the financial compensation will necessarily be that different, I've decided that my role isn't to determine the precise financial loss, but instead to ensure that the methodology used to calculate the financial compensation is fair and reasonable. I want to be clear that I’m not at all persuaded, given Mr M’s trading, history and overall circumstances, that he would’ve fundamentally traded any differently or deposited less had his account been a retail trading account. His volume of trading in the space of around 12 months, as well as the size of his trades, his background and his previous trading history all indicate an experienced, knowledgeable and very active trader – and that would’ve been the case regardless of the nature of his account.

I’m also satisfied that whilst he wouldn’t have had access to a credit facility as a retail client, the amount he was willing to invest meant that I’m persuaded, on balance, that he simply would’ve managed his account differently – for example depositing at different times. I’m satisfied the evidence shows that when he had to deposit funds to support his trading he did so, and I’m persuaded he would’ve done that whether faced with a downside limit of zero or a negative figure. This means that I’m not persuaded by his comments that I should take into account individual trades placed when he had a negative balance, and I’m not satisfied that would be a fair and reasonable way to put things right for him. I’m persuaded the fair and reasonable way to put things right is to ask City Index to review the trades, recalculate the leverage that would've been available for each one, and only refund any negative balance at the end - plus any additional balance should there be one.

To the end, I intend to say the following in my final decision:

- *City Index need to rework all Mr M's trades and apply the leverage he would've had access to had he been a retail client. This includes the trades he made losses on, as well as the ones he made profits. This will give City Index an overall figure of the loss he would’ve made as a retail client.*

- *If this total would still have left Mr M with a negative balance, it needs to erase that negative balance and confirm that Mr M has no debt.*

- *If this total would've left Mr M with an additional balance above his negative balance, it needs to refund this to Mr M – in refunding any additional balance, City Index can take into account any withdrawals Mr M made during the life of his account.*

Mr M made some further submissions around our process, and the amount of compensation he said he had calculated he’d be entitled to. He also queried the figures I’d referenced in my decision around how much he invested – he said he had invested over £700,000.

City Index also replied. It agreed with my findings that it should not have opted Mr M up as an elective professional client. However, it disagreed with my revised way of putting things right. It said:

- It was unlikely that a number of Mr M’s trades could be replicated if his account had

been a retail client one, because it would have to 'speculate' as to his trading behaviour.
- It said it wasn't convinced by Mr M when he alleged he wouldn't have traded in the same way but even if it accepted that, it would still need to speculate as to what trades it needed to place.
- After reviewing the account, a number of adjustments couldn't be made, and there would've been insufficient margin available to Mr M to open the size trades that he did. And it gave some examples.
- It said that it wasn't persuaded that adjusting the quantities to a size equivalent to retail margin would be possible, as it would need to assume what volumes would have been trading. It said it would also not be possible to estimate how long any positions would've been held for, as Mr M may have made different trading decisions depending on the margin available to him.

It concluded that due to the speculative nature of this way of putting things right, it didn't consider it was fair – and instead said that writing off the balance should satisfactorily resolve the complaint.

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.

City Index has accepted my findings that Mr M should not have been classified as an elective professional client. I therefore see no reason to depart from my provisional conclusions and confirm them as final here.

City Index has on the other hand disagreed with my revised method for putting things right, and I therefore deal with that issue below.

Putting things right

Broadly, City Index disagrees with my method for putting things right because it says it would require it to 'speculate' as to what Mr M would've done had he been a retail client – however I'm not persuaded by the arguments it has provided for this.

In my view, it's fair and reasonable to assume that Mr M's trading strategy would've been, on balance, the same or nearly the same if he'd been classified as a retail client. The key driver here were the market movements Mr M was anticipating, and whilst the amount of leverage available dictated how much risk he was taking, I'm not persuaded a lower leverage would've fundamentally altered his predictions of the market. So I'm satisfied that using his existing trades as a basis for determining what his losses would've been as a retail client is fair and reasonable.

I do agree that Mr M would likely not have been able to trade in the same sizes because he would've had less leverage available – this is the very reason he shouldn't have been allowed to trade as an elective professional client.

In relation to the credit facility Mr M had, I accept that in principle he would not have had that as a retail client. However I'm satisfied that for the purposes of this calculation City Index can treat that as the margin he had available when recalculating what trades he would've placed during that period. This is because Mr M had previously withdrawn large sums of money, allowing him to enter this credit facility – and as he was trading with it, I don't agree it would be fair and reasonable to discount it.

So City Index needs to work out the size of trades he'd have been able to place with retail leverage, rather than professional, and for the same amount of initial margin. It should then adjust the corresponding profit or loss accordingly. The result of this exercise will give City Index an overall figure of the loss Mr M would've made as a retail client.

If this total would still have left Mr M with a negative balance, taking into account his deposits, it needs to erase that negative balance and confirm to Mr M in writing that he has no debt.

If this total would've left Mr M with an additional balance, compared to his existing losses, above his negative balance, then it needs to refund this to Mr M.

However, in refunding any additional balance, City Index can take into account any other credits and adjustments made during the life of his account – and it's this aspect that I don't think Mr M has fully appreciated. I'm therefore going to deal with the comments he's made on the figures I've used.

I've deliberately not specified figures in my award – but Mr M has not showed me any evidence to confirm the amount he says he invested versus what I've seen from the ledger of his account. I can confirm that the evidence I have shows:

- 154 card deposits, starting 11 March 2019 and ending 26 February 2020, for a total of £610,802.28. I've not seen sufficient evidence that Mr M invested in excess of £700,000.

- 21 withdrawals, starting 17 April 2019 and ending 13 February 2020, for a total withdrawn amount of £454,317.99.

- 12 Customer rebates, financing finance adjustments and a promotion, for a total of £41,955.65.

- Two goodwill gestures – one for £557.50 on 12 March 2019, and one for £10,000 on 30 January 2020. I've considered Mr M's comments in relation to these payments, but I don't agree they should be discounted. Whether or not they were intended to be paid to his bank account, it's clear to me that he made use of them for trading – and as such ought to be fairly and reasonably included in the inflows and outflows of the account for the purposes of the calculation.

- An overall trading loss of £234,429.22.

- These figures lead the final balance of £-25,431.78 – which is the balance Mr M was left with when he stopped trading. So I'm satisfied these figures are reliable and Mr M will need to provide City Index with evidence to the contrary if he disputes these sums.

Mr M has also asked for 8% simple interest on any loss. I've considered his request for this, but I don't agree it would be fair and reasonable. It's important that I make clear to Mr M that previous ombudsman decisions do not set a 'precedent', nor am I bound to follow them. Each case is decided on its own facts. This service awards 8% simple interest in situations where a consumer has been deprived of their money, and it isn't possible, on balance, to quantify the impact not having this money has had on a range of decisions the consumer may have made had they had the money available.

However, in Mr M's case, I'm satisfied that given his significant volume trading, his background, and the amount he was willing to invest, he would most likely have carried on trading had he been able to. I want to be clear that I have no doubt that Mr M was fully aware that he was trading as a professional client and was intent on doing so. He knew exactly what he was doing on his account and was more than willing to trade significant volumes in the pursuit of higher rewards. So, I don't agree that awarding him additional interest is fair and reasonable, and in my view, this would overcompensate him. For these reasons, I'm satisfied that no further compensation, to what I've set out above, is payable.

I consider that to put things right Mr M's losses need to be calculated by reference to what his trading results would've been had he been a retail client, placing the same trades – and then any refund needs to take into account his deposits (and any other credits) and withdrawals. So:

- Where 'A' is the trading loss he incurred as an elective professional client, and 'B' is the outcome of reworking the trades as I've said above.

- 'C' represents any other credits applied to the account (adjustments, goodwill gestures and the existing credit facility which was used to trade and was owing at the end), and 'D' the overall refund due to Mr M,

  (A – B) – C = D.

  For example: Mr M made a trading loss of around £234,000 but his trading loss as a retail client may have been around £11,000. The difference means that Mr M's trading loss would be reduced by around £223,000 – but if this were refunded to Mr M, he'd be overcompensated as the result would be an overall profit on the account (when considering his existing withdrawals and overall deposits), when that's not what would've happened. Instead, the other inflows and outflows from the account would need to be taken into account. Mr M had an existing negative balance of around £-25,000. He also had the benefit of £52,512 in goodwill gestures and other adjustments and promotions. These sums would need to also be deducted, leaving a total due to Mr M of around £145,000.

  I've given this example as a guide, and not to be relied on as I've not carried out the calculations myself. The trading losses Mr M would've sustained as a retail client may have been more or less than this.

  However this is how I expect this balance would need to be reduced by the adjustments, credits and goodwill gestures that Mr M received on the account when deciding how much to refund to Mr M.

- City Index needs to provide the calculation to Mr M in a clear and simple format so that he can understand how it has followed this methodology, and how it has come up with any figures due.

My final decision

My final decision is that I uphold this complaint and award compensation as above. Gain Capital UK Limited trading as City Index must pay the compensation I've awarded above within 28 days of when we tell it Mr M has accepted this final decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 6 December 2023.

Alessandro Pulzone
Ombudsman