complaint

Mr P has a spread betting account with IG Index Limited. He says he has been treated unfairly by IG in a number of ways. His points include:

- IG should not have allowed him to open a spread betting account.
- IG's interests conflict with his – it profits from his losses. As a result it does not give adequate warnings of the risks involved and it allows excessive leverage.
- IG closed out his positions unfairly causing him very large losses.
- IG has no power to allow customers to run up losses that exceed the funds in their accounts.

Mr P says his health and wellbeing have been affected by the unfair treatment he has received from IG.

background

what Mr P says:

- Mr P had invested in equities. He had suffered some losses. He thought about spread betting but decided against it.
- Mr P became interested in speculating on crude oil prices. He wanted to be able to profit from the price falling. He was attracted to a service provided by IG which he tried out and decided to use.
- Mr P soon lost money. Mr P was very concerned. He stopped trading to re-think. When he was satisfied he understood the reasons for prices moving against him he started trading again. Initially things went as he expected and then he suffered more losses.
- IG closed Mr P's position in late 2014 when a margin call was not satisfied.
- This was done unfairly as all positions were closed. If left open some would have made a profit.
- Mr P's losses are significant and have caused him a huge amount of worry and stress.
- IG should never have allowed him to get into that position. IG should not have allowed him to have a spread betting account as he failed the appropriateness test for the account.
- IG allowed him to have an account contrary to his best interests. Over 80% of spread betters lose money. IG profits from those losses which is why it allowed him to open the account.

what IG says:

- Mr P applied for a CFD account in October 2014. It carried out an appropriateness assessment which Mr P failed. It warned him the account might not be appropriate and Mr P decided to proceed with his application and he opened the account.

- Mr P applied for a spread betting account in November 2014. Again an appropriateness assessment was carried out. And again Mr P failed that assessment. It warned Mr P the account was not appropriate for him. And again Mr P decided to proceed with the application and he opened the account.

- Mr P traded on the CFD account actively from late October 2014 until mid-December 2014. The account was used for a small number of trades in 2017 and 2018. This account remains open on the restricted basis that trades can be closed but no new positions opened since Mr P made his complaint

- Mr P traded on the spread betting account from November 2014 for the remainder of that year and throughout 2015, 2016 and 2017. This account also remains open on the restricted basis that trades can be closed but no new positions opened since Mr P made his complaint

- Mr P deposited in total around £55,000 in the CFD account and £143,000 in the spread betting account and his total losses are around £185,000 (but this is variable as some positions are still open).

- It dealt with Mr P's applications in accordance with its appropriateness policy.

- It has operated the accounts in accordance with their terms and conditions as agreed with Mr P when he opened the account. In particular it closed trades appropriately.

- It does not have a conflict of interest with Mr P. It has a hedging policy that means it does not have a financial interest in its clients losing their bets or trades.

- It's reasonable to restrict the operation of the accounts once Mr P complained about the appropriateness of the accounts for him.

- It does not think it has acted inappropriately or unfairly.

I issued a provisional decision in Mr P's complaint in December 2018. I did not think Mr P's complaint should be upheld. My provisional decision included:

> **"my findings**
>
> I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.
>
> In considering what is fair and reasonable in all the circumstances of the complaint I am required to take into account:
>
> - relevant law and regulations; regulators rules and guidance and standards; and codes of practice;

- and where relevant what I consider to be good industry practice at the relevant time.

While I have considered all the many points made I will not comment on all that has been said. I will concentrate on what I consider are the main issues.

Mr P had both a CFD account and a spread betting account. There is no material difference between the two in relation to complexity, gearing, risk and potential for profits and/or loss. Mr P has generally just referred to spread betting to cover both accounts. I will do the same.

The central issue in this complaint is whether it was fair and reasonable in the circumstances to allow Mr P to spread bet. Mr P says IG has allowed him to bet because of a conflict of interest – because it profits from his losses. I will deal with this second point first.

conflict of interest:

Mr P says IG is the counterparty to his bets, so if he loses it must win. It therefore has direct financial interest in his betting.

The FCA requires firms to manage conflicts of interest. IG says it does manage the potential conflict through its hedging policy. Essentially Mr P does not believe IG.

In a recent court case called *Quinn v IG Index* [2018] EWHC 2478 the Judge said:

> *"9. Spread betting operators in general will hedge, and the defendant in particular hedges, bets both internally and externally. In consequence the defendant argued and I accept that the bet placer placing spread bets with the defendant is not betting against the defendant thereby eliminating at least that potential conflict of interest between a bet placer and the defendant. Although the degree to which the defendant hedges bets placed with it was questioned in cross examination, in my judgment it is almost self evident that a spread bet operator will operate in this manner since otherwise it would be exposed to enormous and unsustainable risks. Although the defendant's witnesses implied that the defendant adopted a hedging programme in order to avoid a conflict of interest with its customers, in my judgment the predominant purpose was to avoid the commercial risks I referred to above. I also accept the point made on behalf of the defendant that the primary method of hedging is by notionally setting off bets by different bet placers betting in opposite directions in the same market and externally hedging any potential losses not covered by this method. This too makes obvious commercial sense since it minimises the defendant's costs of operating its hedging programme."*

This is also how I understand IG's hedging to work. In the same case the judge also said:

> *"5.The defendant makes its profits by adding a margin to the spread…Two consequences flow from this – first, the client is not betting against the service provider so that no conflict arises and secondly the service provider is paid whether the client wins or loses so the service provider has no interest in whether the client wins or loses other than that if the client wins he or she is likely to continue betting."*

I accept IG has an interest in Mr P being a client, and in his trading actively, but not to the extent that Mr P alleges. There is a potential for conflict of interest but it does seem that is, or is substantially, managed by IG's hedging policy. I cannot see that

IG has a material financial interest in Mr P being an unsuccessful spread better or that his losses are IG's profits as Mr P alleges.

appropriateness:

IG is a regulated firm and is subject to conduct of business rules called COBS. Those rules include formal guidance.

Under COBS10 a firm that provides spread betting accounts:

- Must ask the client to provide information regarding his relevant knowledge and experience to enable the firm to assess whether the service is appropriate for the client.
- Then decide whether the client has the necessary experience and knowledge in order to understand the risks involved in relation to the service.
- If the firm decides the service is not appropriate it must provide a warning to the client.
- If the client still wants to go ahead with the application it is for the firm to decide whether to do so having regard to all the circumstances.

client's best interest rule:

COBS10 is not the only relevant rule. COBS 2.1.1 R says:

> *"A firm must act honestly, fairly and professionally in accordance with the best interest of its client…"*

appropriateness in Mr P's case:

Mr P says he did not have the required knowledge and experience to understand the risks involved in spread betting. He says a spread betting service was not appropriate for him and he should not have been allowed to spread bet.

IG says it did carry out an appropriateness assessment. It says it asked Mr P for relevant information and decided a CFD account was not appropriate for Mr P. It says that as a result of the score achieved in its assessment it gave the following warning to Mr P:

> *"On the basis of the information you have provided us, a CFD account may not necessarily be appropriate for you. Our websites contain a wealth of free educational material, including webinars, about CFD trading and we recommend you familiarise yourself with this material before you commence dealing with us."*

This was immediately followed by the option which Mr P could tick to accept:

> *"I acknowledge your warning that a CFD account may not necessarily be appropriate, but wish to proceed with my application nonetheless. I confirm I understand the risks associated with CFD trading."*

Shortly after this in November 2014 Mr P applied for a spread betting account. This time he had a lower score in the appropriateness assessment and the following warning was given:

> *"On the basis of the information you have provided us, we do not consider that a spread betting account is appropriate for you. You may still open a spread betting account but you should note that you may be exposing yourself to risks that fall outside your knowledge and experience. Our websites contain a wealth of free educational material, including webinars about spread betting and we recommend you familiarise yourself with the material before you commence dealing with us."*

This was followed by the same acknowledgement and confirmation that Mr P could tick to accept as with the CFD account.

In both cases Mr P did decide to proceed with his application and IG allowed him to open the account.

Mr P thinks this is not fair. But in principle it is allowed by the rules. Mr P has however referred to guidance in relation to the rules from the Financial Conduct Authority (FCA) and the European Securities and Markets Authority (ESMA). He says IG did not meet the standard in that guidance which says:

- Warnings should use clear language.
- Be designed to interrupt the application process and should not ask the applicant to confirm an intention to proceed as the next step in the process.
- It is best practice not to allow clients who fail appropriateness assessments to proceed with their applications.

guidance to firms:

Mr P applied for his accounts in October and November 2014. The guidance Mr P has referred to was issued after that in 2016.

I have reviewed all the guidance issued in relation to the appropriateness test in the UK by the Financial Services Authority (FSA) and FCA and by ESMA since COBS 10 was introduced in 2007.

In 2013 the FSA was replaced by the FCA. Up to that point the FSA had issued guidance on its website in Q&A format. It included:

> *"13. What if we think a client does not have the necessary knowledge and experience?*
>
> *If you believe the client does not have the necessary knowledge and experience, you must warn them (COBS 10.3). If the client does not provide information, or gives insufficient information, you must warn the client that on this basis you are unable to make a determination.*
>
> *If the client wishes to proceed in spite of the warning, our rules do not prohibit this. You would need to consider whether you want to proceed in the circumstances, taking into account the client, the nature of the service, the type of product or transaction envisaged, the particular risks for the client etc. You would wish to be satisfied that your chosen course was consistent with relevant general obligations under the Principles (such as the firm's duty to pay due regard to the interests of its customers and treat them fairly) or, for example, the general COBS duty that a firm must act honestly, fairly and professionally in accordance with the best interests of its client (COBS 2.1.1R).*

MiFID Connect has developed examples of possible wording that you might consider using when warning clients in these circumstances."

The MiFID Connect specimen warning was as follows:

"Warning to client that a product or service is not appropriate

The first warning that must be given to a client is where a firm determines, on the basis of information supplied to it, that an investment product or service is not appropriate for a particular client. As this will occur on a case-by-case basis, this warning should be tailored to the circumstances of the individual case.

On the basis of the information that you have previously supplied to us in relation to your knowledge and experience, we consider that [ ] is not an appropriate [product/service] for you.

[Where a firm feels it reasonable to do so it may also add:

If you still wish us to proceed on your behalf, we may still [purchase/sell/deal in/invest in][product]/[with the proposed service], but you should note that it may not be appropriate for you and that you may be exposing yourself to risks that fall outside your knowledge and experience and/or which you may not have the knowledge or experience to assess and/or control by way of mitigating their consequences for you.]"

In December 2012 ESMA published a MiFID Supervisory Briefing on "Appropriateness and execution only". This was guidance to national regulators such as FSA/FCA. It included:

"Warning the client

21. Under MiFID if a firm considers, on the basis of information received from its client, that the product or service is not appropriate for the client, the firm must warn the client. This warning may be provided in standardised format…

23. If a client asks a firm to proceed with a transaction, in spite of being warned by the firm, it is for the firm to consider whether to do so in the circumstances taking into account the client, the nature of the services, the type of product or transaction envisaged, the particular risk for the client etc.

Questions

- *What systems are in place to ensure that warnings are given where required and necessary? Are these acceptable?*
- *What warnings does the firm have in place:*
  - *…to warn the client that the product /service is inappropriate;…*
- *Are these warnings clear and acceptable?*
- *What policies does the firm have in place to decide whether:*
  - *…to deal with a client if the client demands a service/product that the firms believes is inappropriate?*
- *Are these policies acceptable?"*

Having reviewed all the guidance I cannot see that the existing guidance in 2014 said that the warnings should interrupt the application process and should not ask the applicant to confirm an intention to precede as the next step in the process.

IG says processes at the time were reviewed by its regulator and no action was taken against it. It says this tends to show its compliance with the rules and good industry practice at the time.

It is the case that the first warning was not as clear, or certain in its terms, as the second. However it is my view that IG's warning process was consistent with the rules and guidance at the time. Nor am I aware that good industry practice was materially different at the time.

That still leaves the decision to allow Mr P to spread bet. That decision still had to be consistent with the client's best interest rule.

the client's best interest rule:

To a degree, it is Mr P's case that it is self-evident that spread betting is not in a client's best interest if more than 80% of spread betters lose money.

The overall system of consumer protection is however more nuanced than that. The Financial Services and Markets Act 2000, and the rules made under it, recognise that there is a balance to be struck between protecting consumers on the one hand and the principle that consumers should take responsibility for their own decisions on the other.

In the *Quinn* case the client passed an appropriateness test and went on to bet and make large losses. The judge in that case made a number of points including the following:

- The rules have to be considered as a code rather than on the basis of individual rules in isolation.
- The appropriateness test does not cover expertise or competence. It only covers knowledge and experience relevant to understanding the risks involved.
- Overall the rules balance the need to protect consumers with the need to avoid interfering with the right of consumers with the necessary knowledge and experience to make their own decisions for which they must take responsibility.
- Contractual obligations imposing a duty to protect against someone from inflicting economic harm on themself requires very clear express words spelling out that duty. The same applies when interpreting the client's best interest rule.
- The need for a bet placer to have sound understanding is delivered by the COBS 10 appropriateness requirement not by imposing a wide ranging general duty to protect a bet placer from potentially inflicting harm on himself via COBS 2.2.1R

The Quinn case is different to Mr P's case. However it is clear that the court did not regard spread betting as so bad an idea that the presumption should be that it is not in a client's best interests to spread bet. And that the court thinks the appropriateness rule provides the necessary system of protection where a consumer does have the relevant knowledge and experience to understand the risks involved.

What about where the client does not have the relevant knowledge and experience? Does the rule still provide the relevant protection? I think the answer to that must be yes. It cannot be reasonable, in the absence of special circumstances, for a consumer to choose to ignore a warning in the rule and then claim the benefit of the

rule if things then go wrong.

The rule provides that a warning is to be given and that a client may still chose to go ahead with the application and that the firm must decide what to do. The rule does not say that the firm must refuse. The rule does not say the firm must provide the service. The firm is given discretion.

As the firm is given discretion I cannot say that the answer must always be that an application must be refused after an appropriateness assessment has been failed. The answer must depend on the circumstances of the case set in the context of the rules and law applicable at the time.

the circumstances IG says it took into account:

IG says it decided to accept Mr P's applications given that:

- It gave warnings about the risks of spread betting as part of the application process.
- It warned Mr P that the CFD account might not necessarily be appropriate for him (based on the score he achieved in the application) and that spread betting account was not appropriate for him.
- It referred Mr P to the educational materials on its website including webinars about spread betting.
- Mr P requested the account after being given the warnings and information.

It is not clear to me from what IG says that it gave any individual consideration to the circumstances of Mr P's application. It seems to me that IG's position is that it gave the warning it was obliged to give. It then went further than the rules require by providing educational materials on spread betting on its website and referring Mr P to that material. And then if Mr P wanted to spread bet it would let him do what he wanted to do. Is that enough?

Mr P has only said that he did not have enough knowledge or experience to understand the risks he was taking in spread betting.

Mr P has not said he lacked capacity to make decisions about what is and is not in his own interest.

Mr P has not for example said that he has a gambling addiction that means he cannot control his own betting. And, importantly, if he does have a gambling problem he has not said that he did anything to make IG aware of that problem.

Mr P has not said that he is a vulnerable consumer by reason of, for example, his age or financial situation. Nor am I aware of any information that was disclosed to IG at the time that it could have taken into account which would have revealed any vulnerability.

Mr P's position is essentially that his application should have been refused because he failed the appropriateness assessment. And because spread betting is so high risk that over 80% of spread betters lose money it is obviously too high risk for someone who fails the appropriateness assessment. He in effect argues that he

should automatically have been refused the account rather than he should have been refused the account for some individual circumstance.

my view on the appropriateness point:

It should be kept in mind that there is no allegation that IG advised Mr P. He made his own decision to apply for accounts with IG, and to proceed with the applications after warnings, and about what bets to make after he opened the account.

…[Spread betting] does involve more risk than most forms of gambling as the bet placer does not put down all the money they could lose if they lose their bet. Spread betting is therefore subject to a higher degree of regulation than most other forms of gambling in order to protect consumers.

One of the protections mechanisms is the appropriateness test. This test is not however an absolute bar.

Clients who fail an appropriateness test can still choose to spread bet. If they do they are voluntarily choosing to take the risks of spread betting in the face of a warning that it might not be appropriate for them.

In this case IG gave warnings that were consistent with the rules and guidance at the time.

In the circumstances I do not consider it is fair and reasonable in Mr P's case that the risk of spread betting that he chose to accept should transfer from him to IG even if IG could have done more to think about the individual circumstances of Mr P's application.

Mr P asked for a CFD account and a spread betting account. He was warned about the appropriateness of the accounts for him. He chose to ignore those warnings. He chose to continue with his application. And he chose to use those accounts. He was not advised to do any of this by IG.

I sympathise with Mr P who now finds himself in a very difficult position causing him considerable stress and worry. I cannot however uphold his complaint.

Mr P's other points:

As I have said before the complaint has to be considered on the basis of the law and regulations at the time of the events in the complaint. At that time the leverage levels of up to 200:1 were permitted. The fact that there are now regulations limiting leverage to much lower levels does not make the leverage levels used on Mr P's trades unfair. They were the standard level used for the bets concerned not individually tailored to him. And Mr P could have mitigated the effect by making smaller bets or not betting at all.

I cannot see that the account has been operated unfairly. Mr P will have agreed to its terms and conditions when he opened the accounts and closing out all trades when margin calls have not been met is a normal way for a spread betting firm to manage the credit risk it is exposed to. It can also help prevent the client run up even greater loses. Picking and choosing which trades to close and which to leave

open is not a risk free option. If a spread better wants to leave their bets open they need to satisfy margin calls.

Mr P did agree to spread bet in accordance with the terms and conditions of the account which means he agreed to trade on margin and accepted the risk that he could run up losses in the way that he has. "

IG agreed with my provisional decision. Mr P did not. He made a number of points in response, including:

- Hedging is irrelevant. IG does make money from its customers' losses. Its business model is clear and a High Court judge has been fooled by false witnesses. And it does not set a precedent. The Financial Ombudsman Service should have more in depth knowledge of these matters and should not be so easily fooled.

- Hedging is for IG's protection it does not change IG's business model. If 80% of customers lose their bets why does IG need to hedge?

- I am wrong to apply rules and guidance as at the time the account was opened. The rules and guidance were the same as they are now – the aim is for firms to act fairly and have the customers' interest in focus. Nothing less.

- It is because firms did not act fairly and did not care about customers' interests that ESMA and FCA redrafted the rules and guidance to make more specific what is required.

- Had businesses been fair to their customers they would have followed exactly the same rules at the time in 2014 as they are now forced to follow, that is lower leverage limits, limited risk accounts, proper warnings, refusal to open accounts etc.

- When a business sees that 80% of its customers lose money and the business knows very well why this happens: lack of awareness of the risks, excessive leverage, etc, how could any right minded person not see that the business treats their customers unfairly?

- The case of *Quinn v IG* is very different. Unlike Mr P, the consumer in that case passed the appropriateness test. Applying COBS 10 correctly where the appropriateness test is not passed will lead to the account being refused. If the driving test is failed you cannot self-certify that you understand the risks involved and be issued with a driving licence. I should open my mind to the obvious. To conclude that IG acted fairly in the circumstances is biased in the extreme.

- If IG has discretion, it cannot just do whatever it likes. It must still act fairly and in the customer's best interests. The revised guidance clarifies this because previous practice was unfair.

- To say that leverage of 200:1 was permitted is too simplistic. For example, slavery has been permitted in the past but it has never been fair. If firms had acted fairly and in clients best interests they would not have allowed such high levels of leverage.

- It is no answer to say that Mr P could not have traded at all. He traded on the basis that he thought the service was of adequate quality. It is no answer to a person who

buys faulty goods that they could have chosen not to buy – the supplier is still liable to the consumer.

my findings

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 my view remains unchanged.

The situation is not comparable to buying faulty goods. The spread betting account gave access to a spread betting service as it was intended to do. Spread betting is a high risk activity and not appropriate for everyone. But the account itself gave access to that service – the service Mr P applied for. The issue is not about inadequate quality of the account as such it's the more fundamental point of appropriateness and fairness – the fairness and reasonableness in all the circumstances.

As I said in my provisional decision, in considering what is fair and reasonable in all the circumstances of the complaint I am required to take into account:

- relevant law and regulations; regulators rules and guidance and standards; and codes of practice;
- and where relevant what I consider to be good industry practice at the relevant time.

While I have considered all the many points made I will not comment on all that has been said. I will concentrate on what I consider are the main issues.

It is right to say that you cannot fail the driving test and then self-certify that you understand the risks and then be issued with a licence allowing you to drive. That simply is not an option. The law and regulations about driving just do not allow for it.

The situation with spread betting is not the same. The rules at the time provided that an appropriateness assessment had to be made before a consumer could have a spread betting account. The rules did not make having an account conditional on passing the assessment. The rules expressly provided that the consumer could still have a spread betting account if he still wanted one after warnings had been given.

So the situation is not binary as with passing or failing the driving test. However, in fairness to Mr P, nor is it just a matter of the firm giving the warnings. The situation is more complex because:

- one rule allows the consumer to have an account after failing an appropriateness test after warnings are given
- and another rules requires the firm to treat customers fairly and act in their best interest.

So there is balance to be struck between these two rules. One does not automatically out-weigh the other and render the other redundant in this area. As the judge said in the *Quinn* court case the COBS rules have to be considered as a code rather than on the basis of individual rules in isolation.

Bearing that in mind, as the rules require a firm to act in a client's best interest and treat the customer fairly, and the rules allow a firm to open a spread betting account for a client who fails the appropriateness assessment, the two things cannot be incompatible. Spread betting cannot be so fundamentally bad or flawed that an account can never be opened for a client who has failed an appropriateness assessment. The answer to the overall fairness

assessment is not automatic. All the circumstances need to be considered. Those circumstances were considered in my provisional decision as set out above.

Clearly IG makes money from its clients doing business with it. And I accept that it will have some profits (or losses) from trades overall and that not all positions will be netted off against other clients bets or hedged. IG will seek to manage the risk to which it is exposed but it is unlikely that it completely eliminates it. But I do accept that IG's hedging works, or substantially works, in the way the judge described in the Quinn case. I do not accept that IG has an unmanaged conflict of interest which has unfairly motivated it to allow Mr P to have the spread betting account he asked for contrary to his best interests.

I consider it more likely than not that Mr P was given the relevant warnings at the time he applied for his accounts. The need for those warnings is long standing and IG's application process will have had those warnings built in as a matter of course in 2014. I accept that Mr P may not now remember them or remember what they said. That does not mean the warnings were not given.

I accept that I can consider recent guidance. It is however also right that I consider the guidance that had been published at the time Mr P applied for his account as I have done. And it is my view that warnings were given as required by the rules and in accordance with the guidance at the time.

After being told the accounts were not appropriate for him, and after being given the warnings, Mr P decided to open the accounts and trade on one or other of them for some time. It is unfortunate that Mr P's trading has been unsuccessful and that he has accumulated such large losses but IG did not advise him to open the account or advise him about which trades to make. Those were Mr P's decisions and it remains my view, for the for the reasons set out in my provisional decision and above, it is not fair and reasonable in all the circumstances that the risks of those decisions and the consequences of that trading should transfer from Mr P to IG.

my final decision

I do not uphold Mr P's complaint. Under the rules of the Financial Ombudsman Service, I'm required to ask Mr P to accept or reject my decision before 30 April 2019.

Philip Roberts
ombudsman