

Before the Arbiter for Financial Services

Case No. 007/2020

IT

('the Complainant')

vs

Calamatta Cuschieri Investment
Services Limited (C13729)

('CCISL' or 'the Service Provider')

Sitting of the 9 November 2021

The Arbiter,

Having seen **the Complaint** against Calamatta Cuschieri Investment Services Limited ('CCISL' or 'the Service Provider') relating to the alleged losses sustained on non-investment grade bonds which were invested into by the Complainant on the basis of the investment advice provided by the Service Provider.

Having considered, in its entirety, the Complaint including attachments, filed with the OAFS,¹

Where, in summary, the Complainant submitted that the Service Provider was responsible for the losses incurred on investments recommended to him by CCISL as he claimed the following:

- (i) That CCISL was negligent and has not acted in his best interests and with the due skill, care and diligence in breach of the MiFID Directive and MFSA's Conduct of Business Rules given the mis-selling of investments that were

¹ A fol. 1-49

unsuitable to his personal circumstances and incompatible with his liquidity requirements;

- (ii) That the portfolio of bonds recommended by CCISL did not reflect the Complainant's short time investment horizon (of 6 to 18 months) and his aim for income which needed not be much higher than that of a bank account, where any capital loss was to be kept minimal and where the ease of sale and liquidity of the investments at short notice had to be assured;
- (iii) That CCISL applied an aggressive and high-risk investment strategy which transformed his portfolio into a highly speculative and risky one with material positions (in excess of EUR100,000 each) placed into non-investment grade bonds - the *Lecta 6.5% 2019/2023*, the *Garfunkelux 7.5% 01/08/22* and the *CMA CGM 6.5% 2019/2022* - which bonds were unsecured and had a very low credit quality at the time of purchase;
- (iv) That CCISL did not adhere to its own asset allocation model that it applied for moderate risk investors whose financial objective was income. The Complainant submitted that whilst such model indicated an allocation of a minimum of 50% in investment grade bonds and a maximum of 30% in non-investment grade instruments, the Complainant's portfolio instead ended up being invested only 17.08% in investment grade bonds with the majority, 82.92%, invested in non-investment grade bonds.

The following explanations and submissions were submitted:

Background

The Complainant explained that he is a South African citizen who took up residence in Malta in 2016. He holds a Master's Degree in Drama and Film and his career is linked to fine arts and the operation of his own public relations company in South Africa. The Complainant explained that he had a property in South Africa which was sold in 2017 for around 12 million South African Rands (equivalent to EUR750,000) and held an investment portfolio in South Africa managed by Investec Fund Managers on a discretionary basis for around EUR600,000 primarily invested in equity funds and some individual equities.

He noted that his past investments never comprised any bond or debt securities, neither sovereign nor corporate, and neither investment grade nor non-investment grade.

The Complainant explained that in November 2016 he acquired a property in Malta which needed renovation at an estimated cost initially of EUR450,000.² He eventually contacted CCISL to first invest the said sum.

Relationship with CCISL

The Complainant explained that in 2018 he transferred the equivalent of EUR450,000 to a local bank account needed to finance the renovation of the property in Malta.

He was referred to and eventually contacted CCISL in May 2018 to enquire how the said sum could be invested in order to generate some income given that no interest was being earned on his bank account. He further explained that after a meeting with an official of CCISL, he was provided with an investment proposal and the account opening forms were then signed on 25 May 2018.

Opening of Account

The Complainant submitted that he made it clear to CCISL that his investment timeframe was very short as the money was required within 6 to 18 months in order to finance the house renovation costs.

He noted that the service from CCISL was an investment advisory one, as reflected in the *Opening of Account Form*, where his risk profile was indicated as *Moderate*, where *Income* was indicated as his financial objective.

The Complainant submitted that his net worth was closer to EUR2 million and not in the region of EUR13 million, as wrongly assumed by the Service Provider, given that his property in South Africa was valued as 12 million South African Rands.

² A fol. 1

CCISL's Investment Proposal

The Complainant noted that the Investment Proposal prepared by CCISL acknowledged that the money held at the bank was earmarked for the renovation of the local property and was to be needed in around 18 months.

The Complainant pointed out that the Service Provider itself stipulated the financial objective as follows: *'you would like to invest over the short term (around 18 months) to generate an income which is more than that currently available from cash deposits'*.³

It was further noted that the Investment Proposal classified the Complainant as a *'moderate risk investor'* and provided a matrix where the asset class mix in respect of a *'moderate'* risk profile and an investment objective of *'income'* constituted an allocation of 10% in cash, 50% investment grade, 30% non-investment grade and 10% in equities.⁴

The Complainant noted that CCISL's investment advisor had confirmed that *'due to the very limited amount of time available, I would usually recommend that you retain the funds in cash deposits'*, but the advisor then proceeded to say that given that the client is *'willing to accept a degree of risk and understand that the value of the investments will fluctuate'*, a recommendation was made to invest the sum of EUR435,000.⁵

The Complainant further noted that after it was agreed to remove the equity portion and invest only in bonds in line with the Target Plan for *'Income and Moderate Risk Profile'* he was recommended the following allocation:

Table A⁶

| | | |
|------------------------|--|---|
| Investment Grade Bonds | | |
| Ford Motor 4.346% 2026 | USD50,000 | Total allocation to investment grade bonds: 31% |
| Apple 3% 2027 | USD50,000 | |
| Heineken 2.75% 2023 | USD50,000 | |
| Total | <u>USD150,000</u> (equiv. to EUR135,000) | |
| Investment Grade Bonds | | |

³ A fol. 3⁴ A fol. 3 & 12⁵ A fol. 3⁶ Ibid.

| | | |
|--------------------------|------------|---|
| Lecta 6.5% 01/08/23 | EUR100,000 | Total allocation to non-investment grade bonds: 69% |
| Garfunkelux 7.5% 2023 | EUR100,000 | |
| Von der Heyden 4.4% 2024 | EUR50,000 | |
| CBC 4.4% 2027 | EUR50,000 | |
| Total | EUR300,000 | |

Actual Investment Portfolio advised by CCISL

The Complainant noted that the sum of EUR350,000 in May 2018 together with an additional capital investment of EUR200,000 in April 2019, amounting in total to EUR550,000, was ultimately invested as follows on the advice of CCISL:⁷

- EUR20,564 in *Von der Heyden 4.4% 2024* (non-investment grade) in May 2018
- EUR30,998 in *Von der Heyden 4.4% 2024* (non-investment grade) in May 2018
- EUR103,188 in *Lecta 6.5% 2019/2023* (non-investment grade) in May 2018
- EUR105,539 in *Garfunkelux 7.5% 01/08/22* (non-investment grade) in May 2018
- USD51,000 in *Apple 3% 2027* (investment grade) in May 2018
- USD51,262 in *Ford 4.346% 2026* (investment grade) in June 2018
- EUR40,800 in *SP Finance 4% 2029* (non-investment grade) in April 2019
- EUR98,895 in *CMA CGM 6.5% 2019/2022* (non-investment grade) in April 2019
- EUR51,466 in *Von der Heyden 4.4% 2024* (non-investment grade) in April 2019

The Complainant submitted that instead of adhering to its own asset allocation model for investors of moderate risk attitude and income as financial objective like himself, which model had a ratio of 5:3 (50% investment grade and 30% non-investment grade) his portfolio ended up being invested 17.08% in investment grade and 82.92% in non-investment grade bonds.⁸

Losses arising

⁷ A fol. 4

⁸ *Ibid.*

The Complainant alleged that he received an investment valuation as at 31 October 2019 which indicated an overall loss of 19% over an 18 month period with the massive losses being mainly caused by 3 speculative investments:

- (i) the 7.5% *Garfunkelux 2022* which experienced a 6.51% capital loss equivalent to EUR6,640;
- (ii) the 6.5% *Lecta 2019/2023* which experienced a 58.87% capital loss equivalent to EUR58,870 and
- (iii) the 6.5% *CMA CGM 2019/2022* which experienced a 22.94% capital loss equivalent to EUR22,020.⁹

Letter of Complaint & Reply

The Complainant noted that on 25 November 2019 he made a formal complaint with CCISL, through another local investment services provider, regarding *inter alia* the alleged shortcomings of CCISL and the request for the immediate sale of four investments in order to minimise losses - Von der Heyden, SP Finance, Apple and Ford, which it was claimed were of high risk given the very limited liquidity of Von der Heyden and SP Finance and the foreign currency risk in case of the Apple and Ford dollar bonds.¹⁰

Claim of Unsuitability of investments

The Complainant submitted that he lacked financial knowledge and experience in bonds and relied completely on the expertise of CCISL given that his academic background was in art, drama and film and not in finance.

He further submitted that he had never invested in bonds and was thus not in a position to assess the risks for such investments.

The Complainant claimed that in reality even CCISL's own model allocation was too risky for him given that he had expressly specified that the funds were required within a short time period.

He further submitted that an investment services provider acting responsibly would have either not accepted the funds for investment or else invested in

⁹ A fol. 5

¹⁰ *Ibid.*

either treasury bills of 3 to 12 months issued by the Malta Government or high-quality investment grade bonds strictly denominated in EUR and with a short maturity term.

The Complainant noted that four bonds (*Von der Heyden*, *Lecta*, *Garfunkelux* and *CMA CGM*) which were sold to him for a sum in excess of EUR100,000 each were all unsecured bonds and either unrated or speculative non-investment grade. It was further submitted that *Von der Heyden 4.4% 2024* and another non-investment grade bond, the *SP Finance 4% 2029*, which were both local bonds, had no credit rating.

The Complainant noted that *Von der Heyden* was not secured and *SP Finance* had a term of up to 2029 and thus much longer than his maximum 18 month investment horizon. It was also submitted that the local bonds had very little liquidity and could have been difficult to quickly realise them without incurring a loss.

He further submitted that the Ford and Apple bonds were the only two investment grade bonds but were denominated in USD and given the possibility of strong foreign exchange fluctuations even within few months, CCISL had introduced additional and unnecessary risk in his portfolio.

The Complainant claimed that the most negligent act of CCISL was that when investing in overseas non-investment grade instruments, CCISL selected bonds which had very low credit quality ratings by Moody's and Standard and Poor's at the time of purchase as follows:

- credit rating of B2 and B for the *Lecta* bond, being 5 notches below in the ladder of non-investment grade;
- credit rating of B2 and B+ for the *Garfunkelux* bond, being 4 and 5 notches below the best credit rating in the non-investment grade category;
- credit rating of B3 and B- for the *CMA CGM* bond, being 6 notches below the best credit rating in the speculative grade.¹¹

Claim of other regulatory breaches - no statement of suitability

¹¹ A fol. 6

The Complainant submitted that CCISL failed to provide a Statement of Suitability in respect of each of the nine bonds purchased in breach of Article 25(6) of MiFID II and MFSA's Conduct of Business Rules 4.4.36 and 4.4.37.

It was noted that the said rules required the provision of a statement to the client, before making a transaction, stipulating *inter alia* how the instrument met the preferences, objectives and other characteristics of the client as well as how the investments could be realised with respect to the required investment term.

Claim of other regulatory breaches - no signed purchase orders

It was claimed that in the context of an investment advisory service, CCISL should have only acted after the receipt of a purchase order duly signed by the Complainant. It was submitted that with the exception of the *Apple* and *Ford* bonds, the Complainant does not remember signing any other purchase orders and that the series of purchase orders sent by CCISL in reply to the formal complaint are indeed not signed by the Complainant.

Request for Compensation

The Complainant requested the Arbiter to:

- (i) declare that the complaint is fair, reasonable and equitable
- (ii) declare that CCISL has not acted in his best interests as required in terms of the MFSA's Conduct of Business Rulebook rule 4.1.5 and that CCISL also failed its fiduciary obligations including those under Article 1124A of the Civil Code;
- (iii) declare that CCISL failed to act with due skill, care and diligence and to abide by the applicable regulatory regime and that it did not perform its contractual obligations towards him;
- (iv) declare and order CCISL to pay legal interest from the date of the Arbiter's decision to the date of effective payment;
- (v) condemn CCISL to all the costs of his Complaint.
- (vi) to order CCISL to compensate him by reinstating him in his former financial position in respect of the losses arising on the (a) 7.5% *Garfunkelux*

01/08/22, Nominal €100,000 (b) 6.5% Lecta 2019/2023, Nominal €100,000 and (c) 6.5% CMA CGM 2019/2022, Nominal €100,000.

The Complainant further noted in his formal complaint to the OAFS that given that the said bonds had not yet matured and were still held by CCISL, the Arbiter should determine the market value and capital losses arising at the date of the decision of this Case in line with the procedure prescribed by the Court of Appeal.¹²

During the proceedings of the Case, the Complainant provided an update and formally informed the Arbiter of the sale of the *CMA CGM* and the *Garfunkelux* bond as well as the attempted sale of the *Lecta* bond. The Complainant submitted that the *CMA CGM* and the *Garfunkelux* bond were sold at a loss on the 24 and 25 June 2020 respectively, and that on these two investments the realised capital loss amounted to (EUR3,430) on the *CMA CGM* bond ('*Sale Proceeds*' of EUR92,570 less '*Cost Excl Int*' of EUR96,000) and of (EUR9,300) on the *Garfunkelux* bond ('*Sale Proceeds*' of EUR92,700 less '*Cost Excl Int*' of EUR102,000).¹³

With respect to the attempted sale of the *Lecta* bond, the Complainant remarked that in its email of 30 June 2020, CCISL advised him that '*this instrument has been restructured ... hence it can no longer be sold on the market*'.¹⁴

Further to the said developments, the Complainant requested the Arbiter to amend his request '*in the sense that the remedy being requested is now that Calamatta Cuschieri Investment Services Ltd are ordered to compensate me for the realised capital losses of €3,430 on CMA CGM and €9,300 on Garfunkelux and the entire purchase cost of Lecta of €103,188*'.¹⁵

Having considered CCISL's reply including attachments:¹⁶

¹² A fol. 7

¹³ A fol. 158 & 163-164

¹⁴ A fol. 158 & 162

¹⁵ A fol. 158

¹⁶ A fol. 57-145

Where, in summary, CCISL disagreed with the allegations made by the Complainant and refuted responsibility for the losses on the indicated investments as it claimed:

- (i) That CCISL followed the conduct of business rules and always kept the Complainant informed and updated;
- (ii) That it was not clear how the investments were not suitable as alleged by the Complainant given that CCISL's investment recommendations were given in accordance with the suitability requirements, in a timely manner and with the necessary warnings/information being disclosed to the Complainant to enable him to make an informed decision;
- (iii) That the Complainant was able to understand and do his own research and homework prior to taking any decisions and was kept regularly updated with *inter alia* quarterly reports;
- (iv) That the Complainant's objective was not to achieve minimal income but to reach a higher income to that he used to be paid in South Africa which ranged between 4-7%;
- (v) That the unfortunate events involving the Complainant's portfolio, namely the *Lecta* bond were the result of credit and market risk which could be understood well by a bond investor and also a property investor such as the Complainant;
- (vi) That the Complainant kept changing the circumstances relating to his financial situation and liquidity requirements and also gave conflicting and inconsistent information on his liquidity requirements and from where these were to be satisfied;
- (vii) That the Complaint was frivolous or vexatious due to numerous inconsistencies and the deliberate omission of documents held by the Complainant's representative which were not presented to the OAFS with the intent to mislead the case.

The following explanations and submissions were, in essence, made by the Service Provider in its reply:

Timeline of events

The following timeline of events was provided by CCISL:

- 14 May 2018 - Held an initial meeting with the Complainant during which CCISL discussed *inter alia* the personal circumstances, investment preferences and the possible returns and risks in relation to the investment of EUR450,000. Following the said meeting an investment proposal dated 21 May 2018 was provided to the Complainant (which included proposed investment allocations (as per Table 1 above),¹⁷

CCISL submitted that during the initial meeting the Complainant's net worth was declared to be in the region of 13 million Euro and the Complainant did not clarify that this was in a different currency.

- 23 May 2018 - Complainant commented on the investment proposal and communicated to the financial advisor that there was a change in circumstances as EUR200,000 cash was required by end October 2018.¹⁸
- 24 May 2018 - CCISL revised the investment recommendations accordingly, advising the Complainant to leave the amount required at the bank and recommending that he only invests EUR250,000 in *Ford Motor Co, Apple, Garfunkelux* and *Von der Heyden* bonds.¹⁹
- 25 May 2018 - The Complainant requested a meeting to sign the relevant forms and himself suggested to only leave EUR100,000 at the bank and he specifically asked for the *Lecta* bond to be reinstated in the revised portfolio.²⁰

CCISL pointed out that the financial adviser had subsequently warned the Complainant that '*this would entail a slightly more risky approach as it would mean increasing the High Yield (HY) bond allocation in comparison to the Investment Grade (IG) bond allocation*'.²¹

- 29 May 2018 - CCISL received the EUR350,000 funds and investment orders were made as per the revised allocation of the 24 May 2018 and the

¹⁷ A fol. 57 & 68-72

¹⁸ A fol. 58 & 73

¹⁹ A fol. 58 & 74

²⁰ A fol. 59 & 91

²¹ A fol. 59 & 109b

Complainant's additional request for reinstatement of the *Lecta* bond - despite the recommendation to keep the liquidity requirement at the bank.

- 19 December 2018 - The Complainant informed CCISL that there was a further change in his circumstances as the renovation cost projections went up by a further EUR250,000 (from EUR400,000 to EUR650,000) and he also needed additional cash for the purchase of 3 Shoreline apartments.²²
- January 2019 - A meeting was held at which point no instructions were given to redeem. CCISL noted that the meeting was then followed by an email from the Complainant on 28 January 2019 where he highlighted the need for the payments of the instalments of the apartments by end of March 2019.²³
- 6 February 2019 - The Complainant provided additional disclosure on a portfolio of around EUR600,000 held at Investec as he was unsure whether to redeem the portfolio held with CCISL or the one held at Investec as had been recommended to him by Investec.²⁴

CCISL submitted that despite the issues being disputed by the Complainant with respect to the liquidity requirements, the Complainant at the time was asking CCISL's financial adviser to take the management of Investec's portfolio.

- 26 March 2019 - The Complainant questioned the financial adviser about his options to redeem from CCISL's portfolio, his portfolio at Investec or part from both.²⁵
- 27 March 2019 - The Service Provider requested a current statement of the Investec portfolio to compare both portfolios and consider way forward. CCISL submitted that at this point the CCISL's bond portfolio was stable.²⁶
- 8 April 2019 - The Complainant communicated his decision that he will liquidate the Investec portfolio and requested additional investment options

²² A fol. 59 & 106

²³ A fol. 59 & 111

²⁴ A fol. 59 & 116

²⁵ A fol. 59 & 117

²⁶ *Ibid.*

for the redeemed funds.²⁷ At the Complainant's initiative 2 cheques totalling EUR400,000 were deposited.

A further meeting was held and additional investments were placed in the 6.5% *CMA CGM 2019/22*, 4.4% *Von der Heyden Group 2024*, 4.346% *Ford Motor 2026* and 4% *SP Finance plc 2029*. CCISL noted that the order in the *Ford* bond was cancelled as the price had changed and the investment in *SP Finance* only had an allocation of 40,000 out of the requested 200,000 units.

- 24 May 2019 – The Complainant was informed that a new financial advisor at CCISL will be taking over his portfolio as the former one had resigned.
- 27 May 2019 – The Complainant was provided with a portfolio valuation and details of the new advisor. At this point, the Complainant's portfolio was valued at EUR693,325 with the *Lecta* bond showing a decline of 27% in price as clearly shown in the valuation statement.²⁸
- 29 May 2019 – Outgoing bank transfer to the Complainant of EUR208,837. CCISL's newly appointed advisor provided regular updates on the portfolio including the *Lecta* bond during meetings and email communications.
- 30 May 2019 – The Complainant was provided with a written update on the *Lecta* bond to which the Complainant replied that there were irregularities in the handling of his portfolio.²⁹
- 12 June 2019 – The Complainant was provided with a further update on *Lecta* with a recommendation to start reducing his investment positions.³⁰
- 28 June 2019 – A further portfolio valuation was provided with the financial adviser asking again if withdrawals were anticipated to which the Complainant replied that this was not required in the next 6 months.³¹

²⁷ A fol. 59 & 119

²⁸ A fol. 59 & 124

²⁹ A fol. 60 & 128-129

³⁰ A fol. 60 & 126-128

³¹ A fol. 60 & 125

- 26 September 2019 - CCISL submitted that its financial advisors were all given the impression that the Complainant was satisfied with the level of service but this all changed when the Complainant was informed of a further price decline of around 40% and was advised to exit the *Lecta* bond.³²

Regulatory requirements

CCISL questioned how the Complainant's new investment service provider who was assisting him in his Complainant concluded that investments were unsuitable and questioned the biased opinion provided by the new adviser.

CCISL submitted that its suitability and financial assessment was done following discussions and confirmation of the Complainant's circumstances, investment objectives, financial situation, risk appetite and his understanding, knowledge and experience in investment products/services with this being recorded and given for the Complainant's review.

CCISL submitted that the required documentation was maintained, confirmed and signed by the Complainant and there was a long trail of communication with the Complainant who never claimed that the information was untrue.

CCISL submitted that the Complainant was English speaking, a marketing professional and keen writer who exhibited interest in economics and published articles on European economies particularly on Malta,³³ and all the communications were definitely understood by him. The Service Provider submitted that the Complainant was a client who one cannot say that '*does not do his research and homework prior to taking decisions*'.³⁴

CCISL submitted that it was the Complainant's responsibility to clarify and correct any inaccuracies relating to his financial position.

The Service Provider further submitted that it provided regular updates and valuations more than the applicable requirements. It noted that despite the quarterly statements provided to him, the Complainant only mentioned one statement, that of October 2019.

³² A fol. 60 & 134

³³ A fol. 60-61

³⁴ A fol. 61

CCISL referred to the *ESMA Guidelines on certain aspects of the MiFID II Suitability requirements* and noted that it was up to the firm to decide how to inform a client about the suitability assessment.

It *inter alia* submitted that *'the author of the complaint already served as judge and jury in identifying and deciding on regulatory breaches without actually referring to the ESMA guidelines and with no industry etiquette whatsoever but merely relying on personal assessments and/or opinion'*.³⁵

CCISL alleged that all communications had been provided to the new financial service firm, Finco Treasury Management and the Complainant, however *'the referenced documentation was left out from the complaint presented to the OAFS'*.³⁶

The Service Provider submitted that despite all the consent documents and evidence provided it was still being requested to provide signed purchase orders as proof of consent.

CCISL submitted that under ESMA rules, the Conduct of Business Rules and Article 9 Electronic Commerce Act it was acceptable to rely on electronic communications and highlighted that it was the Complainant who had actually consented to email communication as his preferred method of communication.

CCISL submitted that the claims of other regulatory breaches relating to no statement of suitability and no signed purchase orders were *'null and void and just a way of slinging mud'*.³⁷

Other alleged identified inconsistencies in the Complaint

The Service Provider submitted that the Investec portfolio was not on a 'discretionary' basis as was being portrayed by the Complainant but was rather

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ *Ibid.*

on an 'advisory' basis. It further noted that information on the Investec portfolio was only provided by the Complainant at a later stage.

CCISL submitted that at the time of the initial meeting, the Complainant's investment objective was not to generate minimal income as claimed. The Service Provider noted that this was rather *'to try and reach a higher income comparing to the interest rates complainant was used to being paid up in South Africa which range between 4-7%'*.³⁸

CCISL questioned why the Complainant would have moved funds to earn a minimal income when he could have opted for a fixed deposit account with his bank to achieve the said objective.

Furthermore, CCISL submitted that the Complainant's intentions also changed from requirements related to refurbishment to the financial of the shoreline apartments, from the redemption within 18 months to the injection of additional capital for investment and to not taking the advice to reduce positions to match his liquidity requirements.

The Service Provider noted that the portfolio did not comprise sophisticated or derivative instruments and no rules precluded investors from transacting in plain vanilla bonds.

CCISL also submitted that it failed to understand the suggestion by the Complainant's representative that the funds should have not been accepted or invested in Malta Government T-Bills as this would have resulted in negative yield.

CCISL submitted that the Complainant was at no point under pressure to not redeem or increase his capital invested. It pointed out that it was also the Complainant's decision to redeem his Investec advisory portfolio and bring to CCISL more funds for investments and at that point the Complainant was satisfied with the income being received of EUR37,000 as evidenced in the income report produced with its reply.³⁹

³⁸ A fol. 61-62

³⁹ A fol. 62 & 145

CCISL submitted that it was clear that the Complainant's own will to add more capital for investment in the same manner was to look for and increase the higher return on investment or ROI as referred to by the Complainant himself.

The Service Provider accordingly submitted that it cannot now be said that the Complainant was looking for minimal return as this was not his investment objective.

CCISL further submitted that it was rather confusing how one could base a complaint on liquidity requirements, when there was no history of redemption requests but instead inconsistent messages and requests to increase the portfolio.

Claims and validity of the Complaint

CCISL submitted that it followed the applicable conduct of business rules and provided clear information and kept the Complainant updated providing him with all the attention.

CCISL also submitted that it identified no shortfall to justify the Complaint or claim for compensation and noted that the Complainant did not provide any source of negligence but presented an already biased case.

The Service Provider submitted that the events on the *Lecta* bond resulted from credit and market risk which could be understood well.

CCISL submitted that the client's initial projections were off and he kept changing the circumstances involving his financial situation and liquidity requirements. It noted that the liquidity budgets were being changed and regularly adjusted by the Complainant who was also giving conflicting and inconsistent information about his liquidity requirements and from where he was prepared to liquidate. CCISL submitted that its advisors all tried to accommodate the Complainant, modified recommendations to meet the change in circumstances and kept him informed.

It further submitted that the Client was negligent with his own affairs rather than the other way round as the adviser had to rely on information given by the Complainant.

Having heard the parties and seen all the documents, affidavits and submissions made,

Considers:

The Merits of the Case

The Arbitrator will decide the Complaint by reference to what, in his opinion, is fair, equitable and reasonable in the particular circumstances and substantive merits of the case.⁴⁰

Facts of the Case and other pertinent matters

The following is a summary of the pertinent facts of the case and other important matters as emerging from the documents provided, hearings and submissions made:

(i) *The Complainant*

The Complainant was described in the Investment Proposal dated 21 May 2018 prepared by CCISL as a South African national and Maltese resident born on 14 June 1964 who previously owned a PR Agency in South Africa. He was classified as a Retail Investor and was indicated as being financial stable with no financial liabilities.⁴¹

In CCISL's '*Opening of Account Form*' dated 25/05/2018, the Complainant's nationality was described as 'British'. In the said form he was indicated as a self-employed acting as a director of a local company, with his level of education up to a Masters level and his area of study in '*Drama & Film*'.⁴²

As to his investment experience, CCISL's '*Opening of Account Form*' indicates the Complainant as not being familiar with Government bonds; as having '*Invested Rarely*' in Corporate bonds in the range of 10,000-25,000; as having '*Invested Regularly*' in Shares (in the range of 25,000-50,000); as having invested rarely in funds (in the range of 10,000-25,000);

⁴⁰ Cap. 555, Art 19(3)(b)

⁴¹ A fol. 10 - 14

⁴² A fol. 17 & 21

and also as having invested rarely in complex instruments (in the range of 0-10,000).⁴³

With respect to his financial situation, the Complainant was indicated as having no loans, savings of '450000', a substantial property investment of '12000000' apart from his home with a value of '550000'.⁴⁴

(ii) Investment Objective & Risk Classification

CCISL's *Opening of Account Form* indicates the Investment objectives/strategy of the Complainant as being 'Income' (out of the other options of 'Capital Growth'/ *Balanced Approach*), with a 'Moderate' Risk Profile and a 'Short (up to 5 years)' Investment timeframe.⁴⁵

In the Investment Proposal, it is specified that the Complainant had '*an amount of around €450,000 at BOV which is earmarked for the renovation of your Maltese property in around 18 months' time*', where it was stated that the Complainant was '*not happy to leave this amount of cash idle with the current interest rate climate and would like to actively invest this sum until it is required*'.⁴⁶

The Investment Proposal specifies *inter alia* the following with respect to the Complainant's Investment Objectives & Risk Profile:

'You would like to invest over the short term (around 18 months) to generate an income which is more than that currently available from cash deposits.

You consider yourself a 'moderate' risk investor. In fact, on a risk scale of '1' to '7', where '1' is the lowest risk possible and '7' the highest, I would classify you as a '4'. This means that you are willing to accept a degree of risk in return for higher returns than those available from cash deposits but you value reducing risk and enhancing returns equally.

During our meeting I stressed the risk associated with market timing and therefore short term investing in particular and you confirmed that you

⁴³ A fol. 21

⁴⁴ A fol. 22

⁴⁵ A fol. 24

⁴⁶ A fol. 11

*understand this and are willing to accept fluctuations of capital of around 15%.*⁴⁷

In the *'Investment Recommendations'* section of CCISL's Investment Proposal, the adviser states *inter alia* that *'I would usually recommend that you retain the funds in cash deposits, as there is no investment I can offer you that would guarantee any return'*.⁴⁸ The adviser, however, still offered a recommendation for an investment portfolio highlighting *inter alia* that due to the investment term of the Complainant, investments in collective investment schemes were being excluded and that this meant less diversification. Furthermore, the adviser noted that *'We agreed to exclude investment into equities due to the more volatile nature of the price fluctuations and therefore, my recommendations are for a portfolio of individual, investment grade and high yield bonds'*.⁴⁹

(iii) *Investments Transactions undertaken during the relationship with CCISL*

The Complainant made the following deposits into his investment account with CCISL:

- EUR350,000 on 29/05/2018;⁵⁰
- EUR200,000 on 13/04/2019;⁵¹
- EUR200,000 on 23/04/2019.⁵²

A substantial withdrawal of EUR208,837.42 was made by the Complainant on 29/05/2019, a month after his last deposit.⁵³

Table B below provides a summary of the investments purchased on an *Investment Advisory basis* and the performance thereof as emerging from

⁴⁷ *Ibid.*

⁴⁸ *A fol. 13*

⁴⁹ *Ibid.*

⁵⁰ *A fol. 131*

⁵¹ *A fol. 130*

⁵² *Ibid.*

⁵³ *Ibid.*

CCISL's Portfolio Statement for the period 01/04/2018 to 11/02/2020⁵⁴ and the purchase/sale contract notes.⁵⁵

Table B - Portfolio of investments bought on an Investment Advisory Basis

| Investment Name | Date bought | Units purchased | CCY | Purchase Settlement Value | Date sold | Units Sold | CCY | Sale Settlement Value | Capital Loss/ Profit (excl. div.) | % of Capital loss (excl. div.) on purchase value |
|----------------------------------|----------------------------|------------------|------------|---------------------------|---------------------------|------------------|------------|------------------------|-----------------------------------|--|
| 4.4% Von der Heyden Group 2024 | 29 May 2018 30 May 2018 | 20,000 30,000 | EUR | 20,564.37 30,998.35 | 29 Nov 2019 | 50,000 | EUR | 51,482.90 | (79.82) | -0.16% |
| 7.5% Garfunkelux 01/08/22 | 30 May 2018 | 100,000 | EUR | 105,539.17 | 25 June 2020 | 100,000 | EUR | 94,816.33 | -10,722.84 | -10.16% |
| 6.5% Lecta 2019/2023 | 30 May 2018 | 100,000 | EUR | 103,188.61 | | | | | | |
| Apple 3% 2027 | May 2018 | * | USD | * | 29 Nov 2019 | 50,000 | USD | 52,421.15 | * | |
| Ford 4.346% 2026 | Jun 2018 | 50,000 | USD | 51,262.83 | 29 Nov 2019 | 50,000 | USD | 50,768.80 | (494.03) | -0.96% |
| SP Finance 4% 2029 | 17 April 2019 | 40,800 | EUR | 40,800 | 29 Nov 2019 2 Dec 2019 | 26,100 14,700 | EUR | 26,637.39 15,002.31 | 839.70 | +2.06% |
| 4.4% Von der Heyden Group 2024 | 26 April 2019 | 50,000 | EUR | 51,466.75 | 2 Dec 2019 | 50,000 | EUR | 51,488.91 | 22.16 | +0.04% |
| 6.5% Cma Cgm 2019/22 | 29 April 2019 | 100,000 | EUR | 98,895.83 | 24 June 2020 | 100,000 | EUR | 94,511.24 | -4,384.59 | -4.434% |

* Details not available from the Portfolio Statement and/or purchase/sale contract notes. An investment of USD50,000 into the Apple 3% 2027 bond at a cost of USD51,000 (EUR46,364) was however indicated during the proceedings of the case⁵⁶

(iv) Performance of disputed bond investments

⁵⁴ A fol. 130 - 133

⁵⁵ A fol. 35-40 & 163-164

⁵⁶ A fol. 156

As detailed under the section titled ‘*Request for Compensation*’ above, the Complainant requested compensation in respect of three particular debt securities which comprised part of the portfolio of investments indicated above, with these securities being the *Garfunkelux*, *Lecta* and *CMA CGM* bonds.

Table C below provides a summary of the performance of the three disputed investments taking into consideration the capital losses inclusive of any realised income arising from the respective investments as emerging from the information contained in CCISL’s Portfolio Statement for the period 01/04/2018 to 11/02/2020.⁵⁷

Table C - Performance of disputed bond investments (inclusive of dividends)

| Investment Name | CCY | Capital Loss/ Profit (excl. div.) | Total Dividends Received (Net of tax & Adm fee) | Total Loss/Profit (inclusive of dividends) |
|---------------------------|------------|--|--|---|
| 7.5% Garfunkelux 01/08/22 | EUR | -10,722.84 | EUR 12,730 (four payments of Eur3,182.50 - each calculated as div. received of Eur3,750 less tax on dividends of 562.50 and admin. fee of 5) | +2,007.16 |
| 6.5% Lecta 2019/2023 | EUR | * | EUR 8,272.50 (three payments of Eur2,757.50 - each calculated as div. received of Eur3,250 less tax on dividends of 487.50 and admin. fee of 5) | * |
| 6.5% Cma Cgm 2019/22 | EUR | -4,384.59 | EUR 5,515 (two payments of Eur2,757.50 - each calculated as div. received of Eur3,250 less tax on dividends of 487.50 and admin. fee of 5) | +1,130.41 |

* *Investment not yet matured/redeemed*

(v) Other pertinent matters relating to the Lecta bond

⁵⁷ A fol. 130 - 133

- i. *Current status* - The Lecta bond is the last remaining disputed investment. In its email of the 30 June 2020, the Service Provider noted *inter alia* that *'this instrument has been restructured as per our previous correspondence dated 16/01/2020 hence it can no longer be sold on the market.'*⁵⁸ CCISL further noted in the same email that *'There is still the option for clients to elect to restructure and be given the new notes.'*⁵⁹ The option to restructure included a note that *'your holdings will be locked under the lock up agreement scheme as per the announcement.'*⁶⁰
- ii. *Recommendation to Sell* - It is noted that on the 26 September 2019, the Complainant was informed that CCISL had issued a 'Sell' recommendation on the *Lecta* bond. In his affidavit of 17 July 2020, CCISL's advisor stated *inter alia* that:

*'...on the 26th September, client was informed on the latest developments on Lecta. It was made clear that the company issued a stance to 'SELL' due to a downturn in the company's performance and poor prospects. At this point, I advised the client to close the position at 40 and avoid going through potential defaults or restructuring procedures.'*⁶¹

The said advisor further stated in his affidavit that:

'On the 27th of September, I called the client to confirm whether he had received the email and to make sure he would be informed, for him to be able to take a decision and not miss out on potential opportunities to exit the position. My call log notes read the following: "called client and explained the situation in detail. He said he is aware of the email and will not be taking a decision today. I explained the potential of getting a worse price if we wait and he has stated that 'he is aware, but because of the irregularities of changeover between advisors he was not

⁵⁸ A fol. 162 & 159

⁵⁹ A fol. 162

⁶⁰ *Ibid.*

⁶¹ A fol. 179

*informed of the price change of Lecta in the 70s and that this situation is the companies fault”.*⁶²

- iii. *Change in value* - Table D below provides an overview of the change in value of the *Lecta* bond as reflected in the respective Portfolio Valuation statements produced during the case.

Table D – Change in value of the Lecta bond investment⁶³

| Bond | Change in Value as reflected in the Portfolio Valuation Statement respectively issued as at the following dates: | | | | | | | | | |
|------------|--|---------|----------|---------|---------|---------|---------|----------|----------|---------|
| | 30/6/18 | 30/9/18 | 31/12/18 | 31/3/19 | 27/5/19 | 30/6/19 | 30/9/19 | 31/10/19 | 31/12/19 | 09/4/20 |
| 6.5% Lecta | -1.09% | +3.37% | -7.23% | -6.69% | -27.35% | -23.02% | -56.93% | -58.87% | -52.16% | -53.52% |

Considerations - The Suitability Assessment

The Conduct of Business Rulebook (issued by the MFSA in December 2017 as subsequently updated) ('the COB Rulebook') includes various requirements relating to the provision of investment advisory services and the required suitability assessment.

The COB Rulebook, which applied to the Service Provider at the time of the disputed transactions,⁶⁴ transposes *inter alia* the MiFID Directive and its Implementing Measures and '*contains the Conduct of Business Obligations*' to which regulated entities are '*required to adhere in their day-to-day operations*'.⁶⁵

Hence, reference shall be made to the requirements contained in this Rulebook as part of the considerations of this Case, particularly the sections of

⁶² A fol. 179-180

⁶³ A fol. 41, 124, 138-144, 161

⁶⁴ The first version of the COB Rulebook issued 20 December 2017 applied at the time of the transactions undertaken in May and June 2018, and the COB Rulebook '*Last Revised on 2 April 2019*' applied at the time of the transactions undertaken within the Complainant's portfolio in April 2019.

⁶⁵ Introductory Part of the Conduct of Business Rulebook issued by the MFSA.

the COB Rulebook on the assessment of suitability, record keeping obligations and assessment tools.

As outlined in the COB Rulebook, there are three key criteria that need to be taken into consideration to determine whether an investment instrument is suitable for a client. The following criteria need to be satisfied as detailed in the COB Rulebook:⁶⁶

- '(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) 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'*

Following consideration of the various issues raised and extensive submissions made by the parties throughout the proceedings of the case, as well as the indicated criteria, the Arbiter would like to make the following observations and conclusions:

a) *Structure of the portfolio*

The Arbiter shall first analyse the composition of the portfolio. As can be seen from Table E below, **nearly 60% of the investment portfolio comprised just two assets, the 7.5% Garfunkelux and the 6.5% Lecta, at the time of the commencement of the portfolio and during the initial months. Hence, individual exposure to the said investments was indeed quite considerable and stands out in the portfolio composition.**

⁶⁶ Reflected in R.4.4.21 (just after G.4.4.23) in the first version of the Rulebook issued 20 December 2017, and in R.4.4.30 in the version of the Rulebook '*Last Revised: 2nd April 2019*'.

Table E – Allocation of disputed investments as a % of the whole portfolio⁶⁷

| Bond | Allocation as reflected in the Portfolio Valuation Statements respectively issued as at the following dates: | | | | | | | | | |
|-------------------|--|---------|----------|---------|---------|---------|---------|----------|----------|---------|
| | 30/6/18 | 30/9/18 | 31/12/18 | 31/3/19 | 27/5/19 | 30/6/19 | 30/9/19 | 31/10/19 | 31/12/19 | 09/4/20 |
| 7.5% Garfun kelux | 29.32% | 28.78% | 27.61% | 27.85% | 12.87% | 18.85% | 21.05% | 21.4% | 41.92% | 40.17% |
| 6.5% Lecta | 29.66% | 30.14% | 28.75% | 28.25% | 10.48% | 15.74% | 9.48% | 9.23% | 20% | 23.20% |
| 6.5% Cma Cgm | - | - | - | - | 13.46% | 17.86% | 17.36% | 16.60% | 38.08% | 35.06% |

From the documentation produced during the case, it is also evident that **a high percentage of the portfolio was invested into non-investment grade**. In its email of 25 May 2018, CCISL itself indicated that the allocation of investment grade ('IG') and high yield ('HY') investments, (the latter being in this case the non-investment-grade bonds), was initially between '36% IG, 64% HY' on a portfolio of EUR250,000.⁶⁸ As indicated in the same email the allocation was to increase to '25% IG, 75% HY' with the reinstatement of the EUR100,000 investment in the *Lecta* bond.⁶⁹

The basis for the high exposures to non-investment grade instruments both individually and collectively within the whole portfolio is however not clearly and thoroughly documented in CCISL's Investment Report and other forms used in respect of the investment advisory service.

It is noted that in his affidavit of 16 July 2020, the advisor of CCISL explained *inter alia* that '*... I was the one pushing him towards IG names like Apple, Heineken and Ford. In fact, in my initial conversations with IT, I recommended a much high weighting towards these IG names, however, IT was not happy with the overall interest rate that would have resulted if*

⁶⁷ A fol. 41, 124, 138-144, 161

⁶⁸ A fol. 109(b)

⁶⁹ A fol. 109 (b) & 110

we had allocated more to safer bonds. He understood clearly that going for higher coupons meant higher investment risk'.⁷⁰

The said advisor further stated that *'It would have made no difference to me at all (financially or otherwise) to allocate low return investments to stay at a low risk/low return strategy but this was never IT's objective, in fact it was the reason why he wanted to move out of the bank accounts and kept topping up the investment portfolio looking for a higher yield'.⁷¹*

The Arbiter notes that whilst the Complainant's objective was not 'a low risk/low return strategy' it was, however, neither a 'high-risk strategy' but rather one of 'moderate risk' where he was 'willing to accept fluctuations of capital of around 15%' as disclosed in the Investment Report.⁷²

It is noted that as indicated in Table D above, and also reproduced in Table F below, the *Lecta* bond experienced nearly a 30% drop in value within less than a year and it kept reducing further in value for around 50% of its original value in subsequent months.

Given the high individual exposure to the Lecta bond and the other disputed investments and the drop in value on such, as summarised in Table F below, it is clear that the fluctuations of capital experienced by the Complainant went beyond the 15% threshold he was willing to take as disclosed in the Investment Report.

Table F – Change in value of other disputed investments⁷³

| Bond | Change in Value as reflected in the Portfolio Valuation Statement respectively issued as at the following dates: | | | | | | | | | |
|------------|--|---------|----------|---------|---------|---------|---------|----------|----------|---------|
| | 30/6/18 | 30/9/18 | 31/12/18 | 31/3/19 | 27/5/19 | 30/6/19 | 30/9/19 | 31/10/19 | 31/12/19 | 09/4/20 |
| 6.5% Lecta | -1.09% | +3.37% | -7.23% | -6.69% | -27.35% | -23.02% | -56.93% | -58.87% | -52.16% | -53.52% |

⁷⁰ A fol. 172

⁷¹ *Ibid.*

⁷² A fol. 11

⁷³ A fol. 41, 124, 138-144, 161

| | | | | | | | | | | |
|-------------------------|--------|--------|---------|--------|---------|--------|---------|---------|--------|---------|
| 7.5% Garfun kelux | -4.14% | -3.23% | -12.65% | -9.80% | -12.49% | -9.63% | -6.23% | -6.51% | -1.71% | -20.26% |
| 6.5% Cma Cgm | N/A | N/A | N/A | N/A | -2.77% | -9.02% | -17.80% | -22.94% | -5.11% | -26.07% |

b) *Riskiness of the disputed investments*

It is noted that the Service Provider never contested the claim that the non-investment grade instruments were unsecured and had a very low credit quality at the time of purchase of between 4 to 6 notches below the best credit rating in the speculative/non-investment grade credit ratings as alleged by the Complainant in his submissions.⁷⁴

Such credit ratings would indeed indicate a prevalence of high risk attached to the said investments.

c) *Complainant's Risk Tolerance*

The risk that the Complainant was ready to take was documented as follows in the Investment Report:

'You consider yourself a 'moderate' risk investor. In fact, on a risk scale of '1' to '7', where '1' is the lowest risk possible and '7' the highest, I would classify you as a '4'. This means that you are willing to accept a degree of risk in return for higher returns than those available from cash deposits but you value reducing risk and enhancing returns equally.

During our meeting I stressed the risk associated with market timing and therefore short term investing in particular and you confirmed that you understand this and are willing to accept fluctuations of capital of around 15%'⁷⁵

The risk that the Complainant was exposed to in his portfolio was ultimately higher in view of the high exposure to non-investment grade

⁷⁴ A fol. 6 & 42

⁷⁵ A fol. 69

instruments both individually and collectively within the portfolio and given the nature of the said instruments as described in the preceding sections above.

If the Complainant was willing to sustain a greater capital loss for higher returns as alleged by the Service Provider, then this should have been adequately and clearly documented as required in terms of the COB Rulebook which provided as follows:⁷⁶

'If the Client is able to sustain greater capital losses and is willing, following discussion, to tolerate a higher level of risk to potentially generate the desired level of return, the Regulated Person should document that this is the risk that the Client is willing and able to take, along with the reasons for this.'

The risks of poor assessments of the risk tolerance are also highlighted in COB Rulebook which provides the following:⁷⁷

'Poor outcomes in assessing the risk a Client is willing and able to take can occur if Regulated Persons, in particular:

- a) fail to collect and account for all the information relevant to assessing the risk a Client is willing and able to take as part of suitability considerations, for example because they:*
- fail to assess a Client's capacity for loss;*
 - do not have a robust process to identify Clients that are best suited to placing their money in cash deposits because they are unwilling or unable to accept the risk of loss of capital;*
 - use poor questions and answers to establish the risk a Client is willing and able to take;*
 - inappropriately interpret the Client's responses to questions (particularly where Regulated Persons rely on tools with*

⁷⁶ G.4.4.16 in the first version of the Rulebook issued 20 December 2017, and in G.4.4.27 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

⁷⁷ G.4.4.17 in the first version of the Rulebook issued 20 December 2017, and in G.4.4.28 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

sensitive scoring or attribute inappropriate weighting to answers); or

- b) use vague, unclear or misleading descriptions or illustrations to check the risk that a Client is willing and able to take.'*

It is further noted that during the hearing of 29 July 2020, the Complainant stated *inter alia* that *'I did know that shares in the stock market are very volatile and that if there is a specific timeframe, then maybe shares were not the right instruments to be using for my requirements'*.⁷⁸

The Complainant further stated, during the same sitting, that *'Mr Calleja told me that at a certain point a bond will always get redeemed at a hundred and that was the explanation ...'*

This further substantiates the notion that the Complainant does not seem to have had a clear understanding of the risks of the instruments he was being exposed to when investing in the non-investment grade bonds, and may have rather had a false sense of security that he won't experience much volatility or risk in the recommended bonds as compared to equity investments. The fact that the Complainant avoided equity investments altogether in his portfolio points further towards his wish to have a more stable and secure investments, also in light of his short term investment horizon.

Ultimately, the Arbitrator has not seen adequate and clear documentation which backs or justifies the higher risks being taken in the recommended portfolio.

- d) *Other shortfalls - 'Suitability Test' in the Market Order Forms*
- i. **Wrong timeframe - The 'Suitability Test' section in the Market Order Form in respect of the EUR100,000 invested into the '7.5% Garfunkelux 01/08/2022' and '6.5% Lecta 2019/2023' both purchased in May 2018 indicates the 'Investment Objective' of the Complainant as being of 'Long Term'⁷⁹ in clear contradiction of the**

⁷⁸ A fol. 185

⁷⁹ A fol. 26

short-term investment timeframe indicated in CCISL's Investment Profile and the Opening of Account Form.⁸⁰

(The short-term investment timeframe was only reflected in the Market Order Form in respect of the EUR100,000 invested into '6.5% CMA CGM 2019/22' which was purchased in April 2019 where the 'Investment Objective' of the Complainant under the 'Suitability Test' was this time correctly indicated as 'Short Term').⁸¹

- ii. ***Inaccurate details*** - The part on '**Knowledge & Experience**' in the same section of the Market Order Form indicates *inter alia* that the Complainant had '**Previously invested in assets that are similar to the proposed investments**'.⁸²

This is not really reflective of the disclosure included in CCISL's Opening of Account Form - which had indicated the previous investment experience in Corporate Bonds as '**Invested Rarely**' - as indicated in the section titled '**The Complainant**' above under '**Facts of the Case and other relevant matters**'. Nor is such disclosure reflective and in agreement with the statement made by the Complainant during the hearing of this case where in reply to the question posed during the sitting of 29 July 2020 as to whether he had ever invested in bonds, the Complainant confirmed that:

'As far as I'm aware, I don't think I had actually ever in South Africa through Investec, had any bonds in my portfolios. So the answer is that probably never, no familiarity, no experience; they have never been part of my portfolio'.⁸³

- e) **Asset Allocation Model**

Furthermore, the Arbiter considers that the reasons why the Service Provider has materially departed from its own 'typical' asset allocation model reflected in the Investment Report for moderate risk investors whose financial objective was income - which suggested a minimum of

⁸⁰ A fol. 11 & 24

⁸¹ A fol. 98

⁸² A fol. 93 & 94

⁸³ A fol. 183

50% in investment grade bonds and a maximum of 30% in non-investment grade instruments - **has not been clearly and adequately documented and justified in the Investment Report nor in any other document relating to the suitability assessment.**

(f) *Request for re-instatement of the Lecta & CCISL's Responsibility*

Whilst the Complainant had suggested re-instating the proposed EUR100,000 investment into the *Lecta* bond (as per his email of 25 May 2018)⁸⁴ after this was removed by CCISL's advisor who, in his email of 24 May 2018,⁸⁵ recommended to the Complainant to leave EUR200,000 at the bank following the Complainant's notification that he was going to require EUR200,000 by October 2018,⁸⁶ **the Arbiter considers that nevertheless this does not diminish the responsibility of CCISL in the circumstances in question.**

This is considered so in view that CCISL was not providing an execution only service but an *investment advisory service*. CCISL ultimately itself endorsed the transaction on an investment advisory basis, in the process making it as its own advice.

CCISL's advisor confirmed, in his email of 25 May 2018, that '*I don't mind your suggestion at all*'⁸⁷ and the transaction to purchase the *Lecta* bond was proceeded with on an investment advisory basis.⁸⁸

The Arbiter considers that CCISL cannot abdicate from or reduce its responsibility in respect of the transaction made on an investment advisory basis on the claim that the *Lecta* bond was requested to be re-instated by the Complainant himself.

If CCISL was not in agreement, then such matter should have been raised accordingly and CCISL should have not proceeded with the transaction in its capacity as investment advisor of the Complainant. CCISL was

⁸⁴ A fol. 110

⁸⁵ A fol. 74

⁸⁶ A fol. 75

⁸⁷ A fol. 109(b)

⁸⁸ '*Advisory Order*' as reflected in the Market Order Form - A fol. 94

ultimately duty bound, as investment advisor, to only proceed with suitable investments.

Moreover, with respect to the recommendation to sell the Lecta investment in September 2019, as indicated under part (ii) of the section titled '(v) Other pertinent matters relating to the Lecta bond' above, it is noted that the fact that the Complainant has not sold the bond at the time, does not diminish CCISL's responsibility or the Complainant's claim for compensation against it, given the nature of the issues being raised relating to the suitability of the investment in the first place and also that at the time the *Lecta* bond had already experienced a reduction of over 50% in value as indicated in the portfolio valuation statement issued at the time (Table D above refers).

g) *Other matters – the type of warning*

CCISL submits that its advisor warned the Complainant when stating that '*I don't mind your suggestion at all*', as he followed such statement with the warning that,

*'However, I would mention that this would entail a slightly more risky approach as it would mean increasing the High Yield (HY) bond allocation in comparison to the Investment Grade (IG) bond allocation ...'*⁸⁹

In this respect, **the Arbiter however considers that even here the warning provided by CCISL was not adequate and sufficient. The advisor only mentioned '*a slightly more risky approach*' but the additional material exposure into the *Lecta bond*, another non-investment grade instrument, is considered to have rather brought a much higher risky approach and not just a slightly higher one.**

The Arbiter notes that during the hearing of 16 September 2020, CCISL's adviser stated the following in respect of the risks associated with the high yield bonds:

'... I reply that I do not have the report in front of me, but I specifically remember that in terms of risk, I said, and I reiterate, that:

⁸⁹ A fol. 109(b)

(1) there was no investment that can guarantee such a return in the time span he was stipulating; and

(2) when I went on to recommend specific investments and the risks associated with them, I also specifically mentioned the risk rating, the X and P rating in a table form of each individual bond that I was recommending.

I also have in that report a risk section specifically which goes into the general risks of investing in bonds.

*In the Investment Recommendation Section there is a table with the name of the bond, the coupon it is providing, the credit rating it has and all the relevant information.'*⁹⁰

The Arbiter notes that the Investment Recommendations section in CCISL's Investment Report, however, includes no details of the credit rating contrary to what was claimed.⁹¹ Furthermore, no evidence has either emerged of the table of a risk rating in respect of each individual bond that may have been provided to or discussed by CCISL with the Complainant.

It is further noted that during the hearing of 29 July 2020, the Complainant testified that *'Being asked if Mr Calleja explained in some detail the credit ratings of the instruments and the fact that some of the instruments, the Maltese securities in particular, had no credit rating whatsoever, I say that the answer is definitely no'*⁹²

As also indicated above, the Arbiter does not have the comfort that the applicable risks were really highlighted and adequately explained. The risks may have rather been downplayed with the Complainant ending up with a wrong or inaccurate perception as to the real risks being taken and exposed to. This conflicts with the requirements of the COB Rulebook:

⁹⁰ A fol. 189-190

⁹¹ A fol. 13-14

⁹² A fol. 186

'When providing Products, Services and/or, where appropriate, Ancillary Services to Clients, a Regulated Person shall:

- a) Act honestly, fairly and professionally in accordance with the best interests of its Clients;*
- b) At all times carry out the regulated activities with utmost good faith, integrity, due skill, care and diligence;*
- c) Do everything which is reasonably possible to satisfy the needs and requirements of its Clients and shall place the interests of those Clients before all other considerations. Subject to these requirements and interests, a Regulated Person shall have proper regard for others; ...'⁹³*

During the proceedings of this case, the Arbiter has not seen documentation which clearly and sufficiently highlights and explains the risks to the Complainant, providing him with relevant details on the investments, particularly on the following three aspects:

- (i) the risks between the non-investment grade as compared to investment grade;**
- (ii) the respective credit rating of each recommended instrument; how such rating compared in the credit rating classification; and what the respective rating meant in practice as to the risk of the instrument;**
- (iii) the risks associated with high individual allocation to respective investments and the risks associated with the high allocation overall within the portfolio to non-investment grade instruments.**

It has not emerged either, during the proceedings of the case, that the Service Provider has provided information to the Complainant to ensure that he clearly understands the risks involved as indicated in the COB Rulebook:

⁹³ R.4.1.4 in the first version of the Rulebook issued 20 December 2017 and in R.4.1.5 in the version of the Rulebook '*Last Revised: 2nd April 2019*'.

First Version of the COB Rulebook issued 20 December 2017:

'G.4.4.5 *Regulated Persons should take steps to ensure that the client understands the notion of investment risk as well as the relationship between risk and return on investments. To enable the client's understanding of investment risk, Regulated Persons should consider using indicative, comprehensible examples of the levels of loss that may arise depending on the level of risk taken, and should assess the client's response to such scenarios. The client should be made aware that the purpose of such examples, and their responses to them, is to help determine the client's attitude to risk (their risk profile), and therefore the types of Products (and risks attached to them) that are suitable.*

Version of the COB Rulebook 'Last Revised: 2nd April 2019':

'G.4.4.13 *Regulated Persons should take reasonable steps to ensure that the Client understands the notion of investment risk as well as the relationship between risk and return on investments. When presenting questions in this regard, Regulated Persons should explain clearly and simply that the purpose of answering them is to help assess Clients' attitude to risk (risk profile) and therefore the types of Products (and risks attached to them) that are suitable.*

G.4.4.14 *Regulated Persons should appraise the Client's understanding of investment risk (including concentration risk) and risk-return trade off. To this end Regulated Persons should consider using indicative, comprehensible examples of the levels of loss/return that may arise depending on the level of risk taken, and should assess the Client's response to such scenarios.'*

Other relevant provisions reflected exactly (apart from numbering) in the COB Rulebook issued 20 December 2017 and the COB Rulebook 'Last Revised: 2nd April 2019':

*'Regulated Persons should consider the knowledge and experience of a Client and properly discuss with the Client the nature of the assessment of the risk they are willing and able to take. This should enable the Regulated Persons to secure the Client's engagement and check understanding. Where a Regulated Person does not adequately communicate and check understanding of the level of risk a Client is agreeing to take, this can lead to unsuitable recommendations.'*⁹⁴

...

'The level of information gathered by a Regulated Person should be appropriate to the nature and complexity of the Product or Service being sought by the Client, but shall be to a level that allows the Regulated Person to provide a professional Service and include details (where applicable) of the Client's:

...

*(d) Attitude to risk, in particular, the importance of capital security to the Client.'*⁹⁵

Moreover, the suitability assessment tools used by the Service Provider particularly with respect to the risk classification and the risk of capital loss are considered to be lacking as no sufficient and adequate information has emerged, such as, the following aspects covered in the COB Rulebook:⁹⁶

'Establishing risk categories with relatively broad definitions supported by brief sub-sections within each definition that in combination aided understanding. This may include:

a) a short summary description that is fair and balanced;

⁹⁴ G.4.4.7 in the first version of the Rulebook issued 20 December 2017 and in G.4.4.16 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

⁹⁵ G.4.4.9(d) in the first version of the Rulebook issued 20 December 2017 and G.4.4.18(d) in the version of the Rulebook 'Last Revised: 2nd April 2019'.

⁹⁶ G.4.4.52 in the first version of the Rulebook issued 20 December 2017 and in G.4.4.86 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

- b) *bullet points that provide more detail of the risk of capital loss and the nature of typical investments in each category; and*
- c) *a simple chart showing the 'shape' and variability of annual returns over a period that helps the Client to understand that they need to be comfortable to accept the gains and losses associated with a particular level of risk.*

The above-mentioned examples are 'considered as a good practice because it attempts to explain the risk in a number of different ways' in order to ultimately aid the client to understand the risks.

h) *Other matters - Frequent changes*

In its submissions the Service Provider highlighted that there were frequent changes being made by the Complainant in his circumstances and investment/liquidity requirements.

However, it is considered that this does not reduce or change CCISL's responsibility. The focus should remain on the composition of the portfolio as structured in the initial period when the disputed investments were made and the circumstances applicable at the time. Updating of the client's profile and circumstances during the relationship that a financial services provider has with his client is duly considered as being part of the process of the service provided, where the frequency of updating of the profile and circumstances is needed, as outlined *inter alia* in the COB Rulebook as follows:

First Version of the COB Rulebook issued 20 December 2017:

'G.4.4.22 Frequency of updating might vary depending on, for example, Clients' risk profiles: based on the information collected about a Client under the suitability requirements, a firm will often determine the Client's risk profile, i.e. what type of Services or Products can in general be suitable for him taking into account his knowledge and experience, his financial situation and his investment objectives. A higher risk profile is likely to require more frequent updating than a lower risk profile.'

Certain events might also trigger an updating process; this could be so, for example, for clients reaching the age of retirement.'

G.4.4.23 Updating may, be carried out during periodic meetings with Clients or by sending an updating questionnaire to Clients. Relevant actions might include changing the Client's profile based on the updated information collected.'

Version of the COB Rulebook 'Last Revised: 2nd April 2019':

'G.4.4.52 Frequency of updating might vary depending on, for example, Clients' risk profiles and taking into account the type of Financial Instrument recommended. Based on the information collected about a Client under the suitability requirements, a Regulated Person will often determine the Client's risk profile, i.e. what type of Services or Financial Instruments can in general be suitable for him taking into account his knowledge and experience, his financial situation (including his ability to bear losses) and his investment objectives (including his risk tolerance). For instance, a risk profile giving to the Client access to a wider range of riskier Financial Instruments is an element that is likely to require more frequent updating. Certain events might also trigger an updating process; this could be so, for example, for Clients reaching the age of retirement.

G.4.4.53 Updating may, be carried out during periodic meetings with Clients or by sending an updating questionnaire to Clients. Relevant actions might include changing the Client's profile based on the updated information collected.'

i) *Statement of suitability*

The COB Rules includes various requirements with respect to the provision of a suitability statement. In the case in question, the documents presented, which may be considered relevant to the suitability statement, are the Investment Report dated 21 May 2018, the Market Order Forms (which included a tick-box 'Suitability Test') and also the exchange of emails between CCISL's advisors and the Complainant.

The Arbiter has not convincingly seen a proper statement on suitability describing how the investment advice provided by CCISL met the preferences, objectives and other characteristics of the Complainant. Considering all the evidence submitted, the Service Provider did not prove that it had adequately adhered with the relevant provisions of the COB Rulebook, e.g.:

*'... When providing Advice, the Regulated Person shall, before the transaction is made or prior to the conclusion of the contract, provide the retail Client with a statement on suitability in a durable medium specifying the advice given and how that Advice meets the preferences, objectives and other characteristics of that Client. ...'*⁹⁷

Other relevant provisions reflected exactly (apart from numbering) in the COB Rulebook issued 20 December 2017 and the COB Rulebook 'Last Revised: 2nd April 2019':

'The suitability statement shall, as a minimum:

...

*c. explain why the Regulated Person has concluded that the recommended transaction is suitable for the Client, including how it meets the Client's objectives and personal circumstances with reference to the investment term required, Client's knowledge and experience and client's attitude to risk and capacity for loss. ...'*⁹⁸

⁹⁷ R.1.4.19 in both the first version of the Rulebook issued 20 December 2017 and the version of the Rulebook 'Last Revised: 2nd April 2019'. See also R.4.3.15 (2017 version); R.1.4.18(c) (2019 Version);

⁹⁸R.4.4.26(c) in the first version of the Rulebook issued 20 December 2017 and in R.4.4.37 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

'A Regulated Person is required to record all relevant information about the suitability assessment, such as information about the Client (including how that information is used and interpreted to define the Client's risk profile), and information about the Products [Financial Instruments] recommended to the Client or purchased on the client's behalf. Those records should include:

- a) Any changes made by the Regulated Person regarding the suitability assessment, in particular any change to the Client's investment risk profile;*
- b) The types of Products [Financial Instruments] that fit that profile and the rationale for such an assessment, as well as any changes and the reasons for them.'*⁹⁹

'The Regulated Person should retain copies of:

...

- b) All suitability statements provided to Clients in terms of these Rules. ...'*¹⁰⁰

Neither have any adequate periodic assessments emerged as per the following provisions of the COB Rulebook:

*'Where a Regulated Person provides a Service that involves periodic suitability assessments and reports, the subsequent reports after the initial Service is established may only cover changes in the Services or Financial Instruments involved and/or the circumstances of the Client and may not need to repeat all the details of the first report.'*¹⁰¹

'A Regulated Person providing a periodic assessment of the suitability of the recommendations provided pursuant to R.[...] shall disclose all of the following:

⁹⁹ R.4.4.31 in the first version of the Rulebook issued 20 December 2017 and in R.4.4.42 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

¹⁰⁰ R.4.4.34(b) in the first version of the Rulebook issued 20 December 2017 and in R.4.4.45(b) in the version of the Rulebook 'Last Revised: 2nd April 2019'.

¹⁰¹ R.4.4.28 in the first version of the Rulebook issued 20 December 2017 and in R.4.4.39 in the version of the Rulebook 'Last Revised: 2nd April 2019'.

- a) *The frequency and extent of the periodic suitability assessment and where relevant, the conditions that trigger that assessment;*
- b) *The extent to which the information previously collected will be subject to reassessment;*
- c) *The way in which an updated recommendation will be communicated to the Client.'*¹⁰²

'Regulated Persons providing a periodic suitability assessment shall review, in order to enhance the Service, the suitability of the recommendations given at least annually.

*The frequency of this assessment shall be increased depending on the risk profile of the Client and the type of Product [Financial Instrument] recommended.'*¹⁰³

Despite that it is up to the Service Provider to determine how to undertake the statement of suitability, it is provided in the COB Rulebook that, *'The format used should however enable a posteriori controls to check if the information was provided'*¹⁰⁴ and adequate record-keeping arrangements should be in place to clearly demonstrate the quality of the suitability process as also indicated in the COB Rulebook.¹⁰⁵

As also indicated in the COB Rulebook, a *'tick-box'* approach *'should not be used either ... to assess suitability'*.¹⁰⁶ Furthermore, *'a Regulated Person needs to be able to demonstrate how any recommendation or transaction is suitable for a particular Client given each of the constituent parts of the suitability assessment'*, as per the provisions of the COB Rulebook.¹⁰⁷

¹⁰² R.4.4.29 in the first version of the Rulebook issued 20 December 2017 and in R.4.4.40 in the version of the Rulebook *'Last Revised: 2nd April 2019'*.

¹⁰³ R.4.4.30 in the first version of the Rulebook issued 20 December 2017 and in R.4.4.40 in the version of the Rulebook *'Last Revised: 2nd April 2019'*.

¹⁰⁴ G.4.4.4 in the first version of the Rulebook issued 20 December 2017 and in G.4.4.12 in the version of the Rulebook *'Last Revised: 2nd April 2019'*.

¹⁰⁵ See also G 4.4.32 (2017 Version); G.4.4.66 (2019 Version)

¹⁰⁶ G.4.4.41 in the first version of the Rulebook issued 20 December 2017 and in G.4.4.75 in the version of the Rulebook *'Last Revised: 2nd April 2019'*.

¹⁰⁷ G.4.4.51 in the first version of the Rulebook issued 20 December 2017 and in G.4.4.85 in the version of the Rulebook *'Last Revised: 2nd April 2019'*.

The Arbiter considers that the Service Provider did not prove that it adhered to such requirements and to satisfy the required statement of suitability.

Concluding remarks

Whilst the Complainant is a well-read person, as can be evidenced from his exchange of communications with CCISL and the publicly available articles authored by him, and was financially stable, the Arbiter however considers that this still does not justify the high individual as well as collective exposure to non-investment grade instruments that was in the first place recommended by CCISL to the Complainant taking into consideration his circumstances, objectives and risk profile as outlined above.

As clearly emerging from the COB Rules, there are onerous obligations on an investment service provider to properly assess and document *inter alia* the risk a client is willing to take and his investment objective. The onus on the investment service provider is quite high in this regard and such a provider should be able to clearly and unequivocally demonstrate that such obligations have been properly undertaken.

As clearly stated above in this decision, the Arbiter considers that the Service Provider did not meet the relevant obligations emanating from the COB Rulebook. This is particularly so with respect to the aspects involving the Complainant's *'investment objectives including risk tolerance'*.

Accordingly, and for the various reasons amply explained above, the Arbiter considers that the investments recommended by CCISL were not suitable for the Complainant in his circumstances, primarily, given that the recommended portfolio did not meet and reflect his objectives and risk tolerance.

The Arbiter accordingly considers the Complaint to be fair, equitable and reasonable in the particular circumstances and substantive merits of the case and is partially accepting it in so far as it is compatible with this decision and as explained below.

Compensation

The Arbiter notes that two of the three disputed investments have ultimately not resulted in a net loss when taking into consideration the dividends received as indicated in Table C above. Hence, the Arbiter is not accepting the Complainant's request for compensation in respect of the *7.5% Garfunkelux 01/08/22* bond and the *6.5% CMA CGM 2019/2022* bond.

With respect to the compensation in respect of the *6.5% Lecta 2019/2023* bond, the Arbiter considers the compensation arrangement described below to be a fair, equitable and reasonable compensation taking into consideration the particular circumstances of this Case:

The Service Provider is to pay the Complainant the amount resulting from the following calculation:

- From the settlement value of EUR103,188.61 (which was incurred in respect of the purchase of the *6.5% Lecta 2019/2023* bond),¹⁰⁸ it is to be deducted the net income received from the said bond throughout its holding period as well as the amount of any net profit (inclusive of dividends and any realised currency gains/ losses) resulting on the overall portfolio of remaining investments that were made on an investment advisory basis.

The amount so remaining shall be the amount of compensation.

In accordance with Article 26(3)(c)(iv) of Chapter 555 of the Laws of Malta, the Arbiter orders Calamatta Cuschieri Investment Services Limited to pay the indicated amount of compensation to the Complainant.

With legal interest from the date of this decision till the date of payment.

Since the Arbiter has partially upheld this complaint, each party is to bear its own costs of these proceedings.

Dr Reno Borg
Arbiter for Financial Services

¹⁰⁸ A fol. 35