Court of Appeal Clarifies Scope of FCA Client Classification Rules

14 November 2025

BACKGROUND

In *Linear Investments Ltd v Financial Ombudsman Service Ltd* [2025] EWCA Civ 1369, the Court of Appeal considered a challenge (under judicial review) to a decision by the Financial Ombudsman Scheme (the "FOS") that awarded compensation to a private investor who had misrepresented his trading experience for the purpose of the client classification process, which requires the firm to have reasonable assurance, based on a range of evidence that a firm decides to collect, that a client can make his own investment decisions and understood the risks involved (the qualitative test).

The FCA authorised firm, Linear Investments Ltd ("Linear"), operated a computer-driven derivatives strategy that included dealing in CFDs, designed for professional investors. The individual client, with limited relevant experience, applied for elective professional client status by completing standardised account opening questions, including questions on the individual's experience in trading CFDs and broader prior trading experience, with a request for evidence (such as prior trading records) to support the answers given.

Although the information that he provided was not complete or accurate, Linear accepted the client as an elective professional client. The client's portfolio subsequently suffered substantial losses. The client complained that the firm mismanaged his investment, provided inaccurate information about performance and gave him inadequate information about fees. Notably, he did not initially complain about his categorisation as an elective professional. Subsequently, he referred the complaint to the FOS.

The FOS concluded that Linear did not conduct an adequate assessment of the client's expertise, experience and knowledge to satisfy the qualitative test under COBS 3.5.3R. In particular, the FOS indicated that Linear relied solely on the tick-box answers, without further supporting evidence. The FOS was not satisfied that the client's answers to the questions in the account documents "amount to much more than self-certification on

the part of the client", and stated that the tick-box questions, which covered prior experience in trading CFDs, were inadequate because they did not ask for details of the size and relevant market on which the client traded CFDs. In particular, the FOS found that although the client had an investment portfolio of sufficient value, contrary to the answers on the forms, he did not have any relevant experience in trading CFDs and had not previously worked in the financial sector. The FOS concluded that the responses from the client did not provide enough information to give Linear reasonable assurance that the client was capable of making his own investment decisions and understood the risks involved.

The FOS awarded compensation benchmarked against the FTSE UK Private Investors Income Total Return Index plus interest.

Linear sought judicial review, challenging both the FOS's findings and its redress methodology.

THE COURT'S DECISION

Client Classification

The Court held that Linear was put on notice and should have verified the client's purported experience. The account form called for supporting evidence: the client's free-text response ("invested in blue-chip stocks") was vague and inconsistent with CFD experience.

The Court agreed that the FOS was entitled to conclude that Linear's assessment was inadequate, and that the client had been wrongly opted-up to professional client status. The judge noted in this regard: "I also consider that it is unlikely to be enough to satisfy COBS 3.5.3(1)R for a firm to simply require a client to complete a few very general tick boxes containing bald statements in relation to their trading experience and do nothing more".

Contributory Fault

In these circumstances, it was clear that the individual had himself misrepresented his experience, and the Court found that the misrepresentations contributed to his losses. If the client had not made them, Linear would not have made its services available to him and hence there would be no trading and no losses. In the Court's view, both parties were at fault and contributed to the losses. The issue was remitted for the FOS to reconsider the appropriate reduction in compensation.

Benchmarking Compensation

The Court affirmed that the FOS's statutory role is to decide what is fair and reasonable, not to apply strict legal principles. Selecting a lower-risk benchmark, as the FOS had done, was rational in this case, as the client should have been treated as a retail client and therefore would likely have pursued lower-risk investments.

IMPLICATIONS FOR FIRMS

The case is a significant framing of both how firms should conduct the client classification test and also confirms the redress available to individual clients. The English court has sided with the firm on prior cases on client classification, notably in *Bank Leumi (UK) PLC v Wachner* [2011] EWHC 656 (Comm), where an individual client sought to avoid trading losses by claiming that the firm had incorrectly categorised her as an intermediate customer (pre-MiFID equivalent of a professional client). In that case, the court held that the bank's categorisation did not have to be objectively correct, but it was sufficient for the bank to show that it had taken reasonable steps and care to arrive at the classification. In *Michael Duthie Wilson v MF Global UK Ltd* [2011] EWCH 138, the court also held in favour of the firm, in particular stating that, in taking reasonable care for the classification, firms are entitled to take clients' claims as to past trading and experience at face value, there being no general understanding that a client's statements of fact about himself or his expertise should be tested or doubted unless there is some reason to apply further scrutiny.

Firms relying on the elective professional client classification should review their onboarding processes to ensure that they obtain and evaluate all information necessary to satisfy the COBS criteria. Tick-box questions are acceptable, if carefully drafted, with the client providing supporting evidence. Where a client's information is incomplete or inconsistent, firms should seek additional evidence to verify his experience and understanding and identify any factors indicating that the client may not meet the relevant threshold. Firms will need to review each client's answers, and should maintain a clear audit trail setting out the rationale for each classification.

Most private fund sponsors only conduct the professional client opt-up to a limited degree, such as in the context of admitting "friends and family" investors to their funds. Although private funds are not comparable in terms of risk to CFDs, sponsors should carefully check the procedures adopted by their third-party distributors, not least to avoid being indirectly implicated in any redress sought by individual investors against the distributor.

The decision also highlights that investors can pursue compensation through the FOS, a much simpler and cheaper method compared to litigation.

Finally, the judgment confirms that contributory negligence remains a relevant consideration when assessing redress, where a client's own conduct has contributed to his loss.

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Please do not hesitate to contact us with any questions.

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