DRN-3077317

Financial Ombudsman Service

The complaint

Mrs L complains that her bank, Lloyds Bank Plc failed to protect her from financial harm caused by a binary options scammer Xtraderfx.

What happened

Mrs L fell victim to an investment scam and disputes five payments made to Xtraderfx totalling £20,800 (taken between 15 October 2018 to 19 October 2018).
Mrs L feels that Lloyds bank ought to have done more to protect vulnerable people like her from falling victim to an investment scam.

Lloyds say Mrs L contacted it in November 2018 to report that Xtraderfx were not allowing her to withdraw money from her trading account and requested assistance with chargeback claims. It agreed to attempt chargeback claims for Mrs L but the claims were defended by Xtraderfx's bank and it concluded it couldn't take the claims any further.

Unhappy with its response, Mrs L contacted this service.

One of our investigators concluded that Lloyds ought to have had concerns from Mrs L's initial payment and ought to have done more to warn her that she had potentially fallen victim to a scam. He suggested that Lloyds return her disputed payments.

Lloyds didn't agree and in summary said:

- The thought process of today's Contingent Reimbursement Model (CRM) appears to be used but the transactions occurred in 2018 and were made using a debit card so the CRM would not apply.
- The bank can request a chargeback in some circumstances and binary options were potentially not covered by Visa when Mrs L completed her debit card payments to Xtraderfx.
- In the 12 months leading up to the first payment to Xtraderfx, Mrs L made similar value transactions and is a high volume user of her debit card including online purchases often multiple per day. It concluded the transactions were not unusual.
- It would question whether Mrs L should be to blame for what happened. It doesn't think Mrs L's acceptance of assurances her funds would not be at risk would be reasonable without any evidence of a guarantee or independent advice. It is not for the bank to provide investment advice.
- Binary options is a high risk investment. Mrs L does not appear to have a low appetite for risk and had she simply searched for 'low risk investment opportunities' and looked at the average gains over a year, she would have quickly found out that what she was expecting was too good to be true and should have been a red flag. There were also warnings about Xtraderfx in the public domain.
- The fact that Mrs L was told it was a risk-free investment, not only goes against the general nature of investments but also the nature of binary options specifically. Mrs L appears to have believed this was genuine without any evidence from Xtraderfx in support of this, which appears unreasonable on her part.

- Lloyds could not have known the transactions related to binary options or that Xtraderfx was involved in fraudulent activity at the time the transactions took place.

In light of Lloyds' disagreement, the complaint has now been passed to me for determination.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Not every complaint referred to us and categorised as a binary-options scam is in fact a scam. Some cases simply involve high-risk investment 'bets' on the performance of (e.g.) commodities, cryptocurrency or stocks that resulted in very disappointing returns or losses. Some binary-options traders promoted these products—which were not regulated by the Financial Conduct Authority ("FCA") or its predecessor at the time—using sales methods that were arguably unethical and/or misleading. However, whilst customers who lost out may understandably regard such acts or omissions as fraudulent, they do not necessarily meet the high legal threshold or burden of proof for fraud, i.e. dishonestly making a false representation and/or failing to disclose information with the intention of making a gain for himself or of causing loss to another or exposing another to the risk of loss (Fraud Act 2006).

Banks and other Payment Services Providers ("PSPs") have duties to protect customers against the risk of financial loss due to fraud and/or to undertake due diligence on large transactions to guard against money laundering (see below). But when simply executing authorised payments, they do not have to protect customers against the risk of bad bargains or give investment advice — and the FCA has confirmed that a fraud warning would not constitute unauthorised investment advice (see its predecessor's 2012 consultation paper on investment fraud, below). So, the first question to resolve is whether this particular retailer/trader was actually a fraudster.

I am satisfied that Xtraderfx were not carrying out legitimate binary options trades but were instead dishonestly defrauding customers, e.g. by not actually making trades/bets with the money received from clients but simply manipulating their online 'trading platform' to show purported gains in order to induce further 'investments' from victims such as Mrs L. In the absence of evidence to the contrary, I have concluded this because:

a) In January 2018, binary-options traders operating in the UK were required to be regulated by the Financial Conduct Authority (FCA) — whereas Xtraderfx were not. Nor were they regulated in any other jurisdiction so far as I am reasonably aware. This indicates they were operating illegally, probably with dishonest intentions. Legitimate firms tend to comply with regulatory requirements.
b) On 14 May 2018, an alert about Xtraderfx was published by the FCA warning that they were offering financial services in its jurisdiction without authorisation. This is a potential indicator of dishonest intentions.
c) On 6 July 2018, a further alert about Xtraderfx was published by the FCA warning that they were offering financial services in its jurisdiction without authorisation.
d) On 23 June 2020, the High Court of England and Wales wound up Xtraderfx citing it was in the public's interest to do so. In considering the petition for winding up, the Insolvency Service presented evidence that Xtraderfx targeted customers in the UK and abroad advertising its services online via social media channels and used false celebrity endorsements to do so. It was noted that if clients attempted to remove funds from their trading accounts, they were advised that no withdrawals could be made until personal identification was supplied, yet this information was not requested upon them accepting client deposits. It noted in some cases, clients lost

money despite paying insurance which was meant to retrospectively cover their losses. It was further noted that they failed to file statutory accounts and had no legitimate presence at their registered office. A Chief Investigator for the Insolvency Service said: '…This was nothing but a scam as (Xtraderfx) tricked their clients to use their online platform under false pretences and no customer has benefited as their investments have been lost'. In my judgement, the High Court has determined Xtraderfx were operating fraudulently and I am satisfied this was the case. I've also noted that the deceptive tactics reported by the Insolvency Service match Mrs L's experience and that of common binary options investment scam victims. Whilst this information was not available at the time of Mrs L's payments, it helps build an overall picture of scammers dishonestly seeking gains at the expense ofothers.

Having concluded that this was a scam rather than just a bad bargain or poor investment advice, I must now go on to consider four more issues in order to determine the outcome of the complaint:

a) Did Lloyds deal with Mrs L's chargeback claim fairly?
b) Were any of the disputed transactions so unusual or uncharacteristic for Mrs L and/or her account that Lloyds fraud alerts ought reasonably to have triggered some sort of intervention?
c) If triggered, would Lloyds' intervention have made a difference and prevented or reduced the loss?
d) And if so, was Mrs L partly to blame for what happened such that it would be fair and reasonable to reduce compensation proportionately?

<u>chargeback</u>

Whilst this is not material to the outcome, I thought I would clarify the options available to Lloyds in relation to a chargeback claim as it appears to have attempted chargebacks in Mrs L's case but were unable to recover the disputed payments. Chargeback is a voluntary scheme run by Visa whereby it will ultimately arbitrate on a dispute between the merchant and cardholder if it cannot be resolved between them after two 'presentments'. Such arbitration is subject to the rules of each scheme — so there are limited grounds on which a chargeback can succeed. Our role in such cases is not to second-guess Visa's arbitration decision or scheme rules, but to determine whether the regulated card issuer (i.e. Lloyds) acted fairly and reasonably when presenting (or choosing not to present) a chargeback on behalf of its cardholder.

Lloyds did attempt chargeback claims for Mrs L under reason code 13.3 (services not as described). In my judgment, it was not unreasonable of Lloyds to not have taken these claims further than it did using this reason code. For claims under this reason code to have succeeded at Visa's final stage of arbitration, Lloyds would have needed to provide evidence that Xtraderfx made written representations to Mrs L guaranteeing an amount of profit/return she was due to receive. It's clear this evidence was not available. But I am mindful that the Visa chargeback rules did cover binary-options (or investment) trading from 14 October 2017, i.e. prior to the disputed transactions: see Visa Business News, 26 October 2017:

> Effective 14 October 2017, issuers may use Reason Code 53 to address cases whereby a binary options (or forex) merchant has imposed obstacles to prevent cardholders from withdrawing funds. This chargeback right is limited to the amount available in the binary option account at the time funds are requested. Issuers cannot charge back more than the original transaction amount, so capital gains from binary options trades cannot be paid out via the chargeback process.

However, Reason Code 53 (later re-coded by Visa to 13.5) required Lloyds to present dated evidence that Mrs L had an available balance (in the form of a screenshot or confirmation from the merchant) and that she tried to withdraw sums equal to, or less than, her available balances on the same day.

Though not material to the circumstances of this case, it is worth adding for completeness that, from 1 December 2018, Visa's rules changed again to require binary-options merchants (and other "high-brand risk merchants") to be coded under Merchant Category Code ("MCC") 7995—Betting, including Lottery Tickets, Casino Gaming Chips, Off-Track Betting, and Wagers at Race Tracks. Visa Business News dated 6 September 2018 stated:

> Visa has discovered that certain binary options, rolling spot forex trading, financial spread betting and contracts for difference merchants are being acquired in markets that do not require licensing or regulate merchant trading platforms. In addition, some of these merchants are selling into countries where local laws prohibit such transactions or require licensing by the relevant financial services authority.

This change gave a further chargeback right available to the card issuer – reason code 12.7 (invalid data). This is where a merchant used an invalid MCC; but it has a much shorter timescale of 75 days from the transaction date for a claim to be processed. This 'reason code' would not have been applicable at the time Mrs L requested a chargeback as merchants like Xtraderfx were not yet required by Visa to 're-code'.

Whilst I think a chargeback claim would have been more suitable using reason code 13.5 (rather than reason code 13.3), I've not seen that Mrs L had the required evidence for a claim to have succeeded under reason code 13.5, so I don't think her prospect of success through the chargeback scheme was possible.

<u>unusual or uncharacteristic activity</u>

Lloyds is aware of our general position on a PSP's safeguarding and due-diligence duties to protect customers from the risk of financial harm due to fraud. We have published many decisions on our website setting out these principles and quoting the relevant rules and regulations. It is unnecessary to rehearse them again here in detail. Though to be clear, I'm not referencing any requirements under the CRM as I don't think it applies to Mrs L's case.

It is common ground that the disputed payments were 'authorised' by Mrs L for the purposes of the Payment Services Regulations 2017 ('the Regulations'), in force at the time. This is because they were made by Mrs L using the legitimate security credentials provided to her by Lloyds. These must be regarded as 'authorised payments' even though Mrs L was the victim of a sophisticated scam. So, although she did not intend the money to go to scammers, under the Regulations, and under the terms and conditions of her bank account, Mrs L is presumed liable for the loss in the first instance.

However, taking into account the law, regulatory rules and guidance, relevant codes of practice and what I consider to have been good industry practice at the time, I consider Lloyds should fairly and reasonably:

- Have been monitoring accounts—and any payments made or received—to counter various risks, including anti-money-laundering, countering the financing of terrorism, and preventing fraud and scams;
- Have had systems in place to look out for unusual transactions or other signs that might indicate its customers were at risk of fraud (amongst other things). This is particularly so given the increase in sophisticated fraud and scams in recent years, which banks are generally more familiar with than the average customer; and

- In some circumstances, irrespective of the payment channel used, have taken additional steps, or made additional checks, before processing a payment, or in some cases declined to make a payment altogether, to help protect customers from the possibility of financial harm from fraud.

I am satisfied there were enough 'triggers' in this case to have alerted a responsible regulated bank such as Lloyds that Mrs L's account was being subjected to unusual and uncharacteristic activity. There were reasonable grounds to suspect a fraud or scam, and therefore justify an intervention (such as phoning her in order to ask discreet questions about the nature and purpose of the payments).

First, regulated firms ought reasonably to take notice of common types of scams. As long ago as June 2012, the FCA's predecessor indicated—in its consultation paper entitled Banks' Defences Against Investment Fraud: detecting perpetrators and protecting victims—that it was good industry practice for firms to build up an updated watch-list of types of scams and potential perpetrators; and regularly to share "timely and detailed intelligence" with other banks, UK and overseas regulators, the police, etc. Whilst the regulator gave no specific timings, it is not unreasonable in my view to expect an international bank to update its watch-list and communicate internally to staff within, say, one month of an alert being posted by the FCA or International Organization of Securities Commissions (IOSCO). In my judgment, such alerts should automatically trigger alarm-bells—and lead to the payment being paused—pending further enquiries (and a possible scam warning) to the payer.

In Mrs L's case, there was a warning about Xtraderfx on the FCA's published warning list and IOSCO's Investor Alerts Portal over six months prior to her initial payment. It is not unreasonable to expect a large international bank that regularly updates its internal alerts to include information about payees who had tried to carry out regulated activities without permission. I accept the warning would not have identified what type of investment was being 'sold'; and it did not necessarily follow from the nature of the warning in isolation that these were fraudsters. But given the timing of the alert relative to the first payment, I do think Lloyds ought to have blocked it; and it had several months to update and communicate its watch-list. The bank had constructive if not actual notice that the payee might not be a legitimate merchant – therefore, it would have been reasonable for it to have properly questioned Mrs L before processing all the payments in order to satisfy itself that all was well.

If Lloyds had fulfilled its duties by asking suitably probing questions, there is no reason to doubt that Mrs L would have explained what she was doing. In such circumstances, whilst the bank had no duty to protect her from a bad bargain or give investment advice, it could have explained to her that there was a regulatory warning and invited her to look more closely into this trader. It could have also explained its own customer experiences with unregulated and unlicensed high-risk investment traders in that customers would often be prevented from withdrawing available balances. After all, at that time, there was information in the public domain—which a bank ought to have known even if a lay consumer ought not—about the very high risks associated with binary options trading, including many warnings of potential fraud (e.g. Action Fraud's June 2016 warning; the European Securities and Markets Authority's July 2016 warning; the Financial Conduct Authority's consultation paper of December 2016; and the Gambling Commission's December 2016 scam warning that "an unlicensed operator is likely operating illegally"; City of London Police's October 2017 report noting victims had lost 'over £59m' to binary options fraud; Visa's Business News publication of October 2017 where it expanded its chargeback scheme rules to cover binary options and investment disputes arising from merchants often unlicensed and unregulated deploying 'deceptive practices'; and so forth). After all, Xtraderfx isn't new to regulated firms and we've seen several Lloyds customer complaints about this particular 'dealer'. It seems likely that

Lloyds would've seen a number of consumer complaints prior to and following the FCA's warnings to have been familiar enough with this scammer's deceptive trading practices.

There is no evidence that Lloyds provided Mrs L with any meaningful warnings or gave her other reasons to doubt the legitimacy of the payments she was making.

<u>causation</u>

If Lloyds had asked Mrs L what the payments were for and the basic surrounding context, it is likely she would have fully explained what she was doing and that everything had been done over the phone and online with her 'broker'. Lloyds did not need to know for certain whether Mrs L was dealing with a fraudulent high risk investment trader or investing in a legitimate (albeit highly speculative) product; reasonable grounds for suspicion are enough to trigger a bank's obligations under the various regulations and principles of good practice. I consider there were such grounds here and, therefore, that Lloyds ought reasonably to have provided a scam warning in light of all the information then known to financial professionals about the risks associated with unregulated binary options.

If Lloyds had given a warning, I believe that Mrs L would have paused and looked more closely into Xtraderfx before proceeding. There is no evidence that she was willing to take high risks or had a history of speculative investments or gambling. It seems more probable that she would have made further enquiries into whether or not Xtraderfx were regulated in the UK or abroad. She could have discovered they were not and the various regulatory warnings about the risk of unregulated investment scams (see above). In other words, I am satisfied that a warning from her trusted bank would probably have exposed Xtraderfx's smoke and mirrors, causing her not to 'invest' and preventing any losses.

Even if she had not worked out that this was a scam, it is likely that a warning would have alerted her to the common issues arising in relation to binary options and unregulated high risk investment dealers, which in turn would have revealed the truth behind her supposed broker's (mis)representations — i.e. that they were not really regulated UK investments but highly-risky bets more akin to a wager in which the broker must lose if she is to win. So before Mrs L's payments were actually processed, she would probably have stopped in her tracks. But for Lloyds' failure to act on clear triggers of potential fraud or financial harm, Mrs L would probably have not lost any money.

<u>contributory negligence</u>

Despite regulatory safeguards, there is a general principle that consumers must still take responsibility for their decisions (see s.1C(d) of our enabling statute, the Financial Services and Markets Act 2000). In this case, I do not think that Mrs L was to blame for what happened; that she did not foresee the risk of this sort of harm or any harm. At the time of her 'trading', Xtraderfx was subject to an FCA warning but Mrs L would have needed to know how to search for a regulator's warning. Having reviewed what information would have been available on a web search at the time of Mrs L's payments, the FCA's warning did not appear with any level of prominence unless you included 'FCA' in your search. I do not place too much weight on general but arcane information in the public domain for reasons previously alluded to about the information imbalance between financial professionals and ordinary consumers.

Mrs L began with a small investment, so she was cautious. Once her trades apparently started to perform, she increased her deposits. Mrs L trusted who she believed to be experienced traders and had no cause to doubt their assurances. Unaware of the common deceptive tactics of scammers, as communicated by Visa to its acquirers and issuers in 2017, she made further payments. When Xtraderfx placed obstacles in the way of her withdrawing those funds, she contacted Lloyds for assistance. This was a sophisticated scam and whilst Lloyds suggest it was too good to be true, it hasn't acknowledged that Mrs L saw her trading account performing well and was being managed by a broker who she thought was a professional. I do not think she could earlier have foreseen the risk that the company she was dealing with was a scam and the trading account she was viewing was likely to be no more than a simulation.

In the circumstances, I do not think it would be fair to reduce compensation on the basis that Mrs L should share blame for what happened.

My final decision

For the reasons set out above, I have decided to uphold this complaint. I therefore require:

- Lloyds Bank Plc to refund Mrs L all of her disputed transactions paid to Xtraderfx (totaling £20,800);
- The funds were paid from Mrs L's current account but I've noted they were transferred into her account from a different source. Should the funds have originated from a current account Lloyds should add interest to the above sum (less any tax properly deductible) at our usual rate of 8% simple per year from the respective dates of loss, but
- Should the funds have originated from a savings account Lloyds is entitled to add interest to the sum at bullet point one (less any tax properly deductible) at the interest rate of the savings pot (account) the funds originated from per year (instead of 8% simple interest per year), from the respective dates of loss.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs L to accept or reject my decision before 28 January 2022.

Dolores Njemanze
Ombudsman