Financial Regulatory Alert

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FCA Tightens Rule on Appointed Representatives: More to Come?

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On 3 August 2022, the UK's Financial Conduct Authority (FCA) released its policy statement[1] setting out new rules for authorised representatives and their principals, the authorised firms under whose regulatory umbrella they act. Although the revised rules apply directly to principals, they will have an indirect impact on authorised representatives as they will need to assist the principal in satisfying its requirements and will be subject to increased oversight. Most of the rules will come into force on 8 December 2022.

Background

Authorised representatives (ARs) are firms that are permitted to carry out a limited range of regulated financial services activities in the UK without obtaining a full authorisation from the FCA. Instead they act under the supervision of an authorised firm which acts as its principal and oversees the ARs compliance with, and takes on the responsibility for, the relevant regulatory requirements.

There have been broad calls for reform of the AR regime and the FCA note that principals of ARs are responsible for a disproportionate number of complaints from consumers covering a range of harms such as mis-selling and fraud. The recent House of Commons Treasury Committee report on Greensill Capital[2] highlights just one recent high-profile example of failings in the AR regime that have triggered this response from the FCA and associated review by HM Treasury. The FCA's new rules are designed to strengthen the oversight that principals are required to exercise over the ARs and ensure that both principals and ARs understand their regulatory requirements.

What is changing?

There are two main areas where the FCA are amending the AR regime: (i) information and notification requirements; and (ii) responsibilities of principals and the FCA's expectations.

Information and notification requirements

Under the new rules, principals will be required to:

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- notify the FCA of AR appointments 30 calendar days before the appointment takes effect (this will run in parallel with the three-month period for determination of applications for Approved Persons, if any);
- provide the FCA with additional information on all of its existing ARs and any new ARs, including information on the types of regulated activity the AR carries on, financial arrangements between the AR and its principal, details of the AR's group arrangements, information on the AR's financial non-regulated activities, anticipated revenue in the first year (from both regulated and non-regulated activities) and whether ARs will second anyone to the principal to carry on portfolio management or dealing activities. The above information will need to be provided in response to a "Section 165 data request" by the FCA and will need to be submitted within 60 days of receiving the request;
- provide the FCA with information on revenue of each of its ARs annually within 30 days of its accounting reference date;
- provide the FCA with information on complaints against each of its ARs annually within 30 days of its accounting reference date;
- notify the FCA of their intention to provide a regulatory hosting service at least 60 days before starting to provide these services[3]; and
- annually verify information on their ARs that appears on the FCA's register.

Responsibilities of principals and FCA expectations

Under this heading, principals will be expected to:

- monitor the AR's activities (including to ensure that the AR does not go beyond the scope of its appointment), business and senior management and submit a self-assessment of how they meet policy requirements;
- apply enhanced oversight of their ARs, including ensuring adequacy of systems and controls, sufficiency of resources and monitoring the growth of the AR to ensure that those systems and controls are still appropriate. Review of oversight appropriateness would also be triggered by a significant increase in complaints, a change in the AR target market or scope of appointment. If the AR gets too large, the principal should consider terminating the appointment;
- monitor and assess risk of harm to consumers and market integrity and overseeing ARs as if they were an employee of the Principal;
- carry out an annual review of the AR's activities, including fitness and propriety and competency and capability assessments of controllers, directors, partners, proprietors and managers at ARs;
- be clear about when, and proactively consider whether, they should terminate an AR relationship and assist with an orderly wind-down;
- put in place arrangements to ensure that no conflicts of interest arise when principals delegate functions to their ARs, e.g. compliance monitoring.

As part of the new rules, the FCA has issued guidance on its expectations for the oversight and monitoring set out above should be implemented and this is set out in SUP 12.

As can be seen from the above, the requirements all apply directly to the principal firm but will have a material impact on ARs, who will be required to provide additional information to the principal to be able to meet its notification requirements and ARs will be subject to more onerous oversight and review by the principal. As the business of an AR grows, this will be visible to the FCA through the annual reporting of revenue and the principal will have obligations to consider whether its systems and controls continue to be appropriate and even whether it is appropriate to continue the AR arrangement if the AR has become too large by reference to the principal's own business.

Next steps

The bulk of the new rules will come into effect on 8 December 2022, so ARs and their principals have four months to consider the new requirements and put in place the systems and controls required to comply with the increased monitoring and oversight demands.

In addition to the new rules issued by the FCA, the FCA is engaging with HM Treasury on its Call for Evidence[4] which is looking at whether additional legislative change is required in this area. In particular, the following reforms are being considered:

- changing the scope of the AR regime to prohibit ARs carrying out some activities where risk is perceived to be high or restricting ARs to less complex business models or less risky products;
- amending the scope of regulated activities an AR can carry out;
- imposing size limits (either absolute or relative to the size of the principal) or other restrictions on ARs;
- requiring the principal to carry on the same regulated activities as the AR to ensure it has sufficient expertise to oversee the AR;
- introducing a new regulatory permission to act as a principal so that the FCA can assess a firm's fitness before allowing it to appoint ARs;
- placing more regulatory obligations on ARs – for example, extending the Senior Managers and Certification Regime (SMCR) to ARs so that senior individuals in ARs take individual responsibility for the firm's activities and SMCR rules of conduct apply to AR staff;
- extending the ability of the Financial Ombudsman Service to investigate complaints involving ARs.

The above reforms are merely proposals for discussion at this stage and any such reform would need to pass through the full legislative process before being implemented.

[1] PS 22/11 – Improvements to the Appointed Representatives regime

[2] House of Commons Treasury Committee – Lessons from Greensill Capital

[3] The new rules define a regulatory host as a firm: (1) that offers or provides a service: (a) by which unauthorised persons, whether or not in the same group as the firm, may become appointed representatives of the firm; (b) for remuneration with a view to profit; and (2) to which either (a) or (b) applies: (a) the firm does not carry on any regulated activities other than through its appointed representatives; or (b) the regulated activities carried on by one or more of the appointed representatives of the firm are not connected to any regulated activity undertaken by the firm other than through its appointed representatives.

[4] HM Treasury – The Appointed Representatives regime: Call for Evidence

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