The Appointed Representatives Regime – Time for an overhaul!

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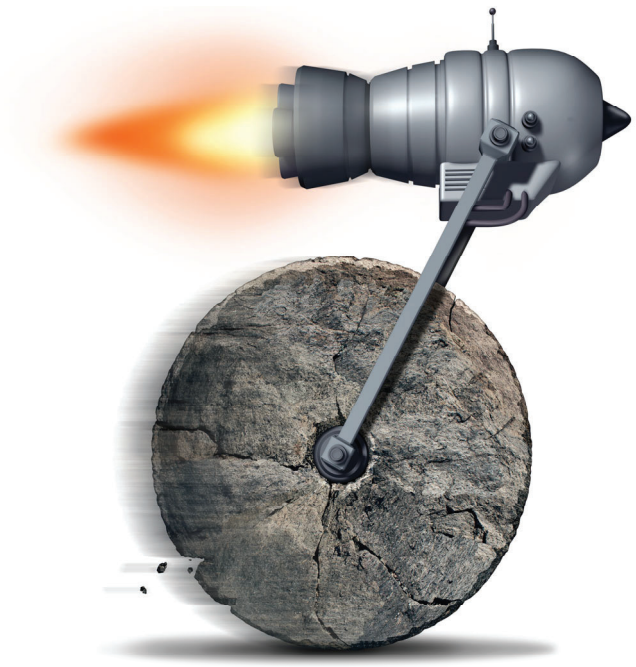

The Appointed Representatives Regime (AR) has been a big part of the retail financial services landscape for over a generation, since 1986 in fact. Its' scope was broadened in the Financial Services and Markets Act (2000) and, since then it has remained untouched.

'That's strange' you may say and for two good reasons. Firstly, as the financial services market has changed so much in the last 20 years why has the AR regime not been reviewed and potentially updated? And secondly why, when SM&CR represents a complete overhaul of accountability and conduct, was the AR regime not included? Strange indeed! However, the Treasury Select Committee's recent inquiry into the Greensill scandal identified ARs operating beyond their remit as one of the causes. Coincidence? Maybe. However, last month both the FCA (1) and HM Treasury (2) published documents calling for information from the industry. Importantly, both documents give insight into the need for review and clues on the potential 'direction of travel' of any amended legislation and regulation.

Firstly then, its useful to recap as to why the AR regime was created in the first place. With the growth of financial services in the 1980's, the regulator agreed to a model where authorised firms (Principals) could employ unauthorised advisers (ARs) to sell simple products, e.g. general insurance, on their behalf on the proviso that the Principals took responsibility for providing oversight and control of the AR's conduct to prevent consumer or provided a cost-effective distribution channel for authorised firms, it would increase competition and it was easier for the regulator to supervise Principal firms than thousands of individuals. The success of the AR regime, however, was based on the ability of Principal firms to have both the expertise and resource necessary to provide the expected oversight and control of ARs. Over the years, the AR network in the UK has become very large, with over 3,600 Principal firms providing oversight to approximately 40,000 AR's or IARs. Admittedly, half of these arrangements are small with many Principal firms having just a single AR within their control. However, there are still many Principal firms that have many hundreds of individuals under their direct supervision and control.

Thematic Reviews in General Insurance in 2016, and Investment Management in 2019, identified the 'significant failings' in the application of the AR regime. And the statistics in the FCA's recent CP on the Appointed Representatives Regime CP 21/34 provide the background as to why both FCA and the Treasury want to strengthen the rules now. For example:

FSCS: In 2018 and the first half of 2019, ARs accounted for 61% of the value of all claims totalling £1.1b. That's a staggering £670m.

Supervisory Cases: Principal firms represent 50-400% more supervisory cases and complaints than non Principal firms

FOS Complaints: Principal firms have more complaints per £1m of revenue compared to non-principals, particularly where they are smaller in size.

Since the inception of the AR regime, the range of products distributed by ARs on behalf of Principal firms has risen enormously as has the range of business models under which this type of arrangement typically operates. For example, the original legislation was intended that smaller firms could become Principals and employ ARs to sell simple products. Using the AR Regime to allow a Principal firm to have many hundreds of ARs, selling complex products on behalf of a Principal firm I suspect was never envisaged when the original legislation was conceived.

Additionally, there are regulatory and legislative cracks that Principals and ARs slip through. For example, the whole premise of the AR regime is that the principal firm is only responsible for things that the AR does as defined, in a contractual arrangement between the two. That sounds fine but what happens when an AR causes the consumer harm for things done outside of that contract? Can the Principal be held accountable by the FCA? Similarly, FOS can only investigate on behalf of consumers for actions within that contract and deciding

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whether the wrongdoing fell within the contract or not wastes time. Finally, the FSCS can only compensate consumers if they have a valid civil claim, rather than pursue redress with the principal.

Also, because regulatory accountability for ARs lies with the principal firm, the FCA currently only need be notified of an AR being recruited and have no right of pre-assessment of suitability as they do with other roles. Whilst you could argue that the same is true of SM&CR and those Certified personnel, because Certification is a legislative requirement, I for one believe that some firms are more likely to adhere to regulatory requirements in that respect than they might if there is just rulebook guidance in place.

If that is the background and logic for these documents being simultaneously published, what is current thinking from H M Treasury and the FCA? Well, as you can imagine there are strong hints in the FCA’s CP of how concerned both parties are based on historic events and statistical evidence.

The FCA has clearly stated that its objectives for the current review are:

- To increase consumer protection by clarifying Principals’ responsibilities and the FCA’s expectations of them.
- To improve data collection to enable early detection and so prevention, rather than post-event investigation.
- To increase consumer choice by strengthening the Regime.
- To reduce misconduct, complaints and redress.
- To increase competition by allowing ARs firms to operate in different markets whilst upholding the high standards of conduct expected.

Similarly, whilst HM Treasury believes the policy surrounding the AP regime is still correct, it does accept that the operation around the oversight of ARs needs tightening to prevent consumer harm.

The Treasury’s ‘Call for Evidence’ also hints at the possible reforms, specifically:

- The contract between the Principal and AR, i.e., exemption from ‘general prohibition’ of activity without authorisation (Section 39 of FSMA) which allows the AR to trade, could be tightened by placing a maximum size on the AR, restricting what ARs can sell to ‘simple’ products or only allowing ARs to sell products for which the Principal is authorised (and so has the expertise to oversee).
- Increasing the FCA’s ability to intervene before harm is caused, i.e. anticipate, by demanding Principals providing more data and extending the FCA’s scope, e.g. the introduction of ‘gateway permissions’ which would enable the FCA to scrutinise a Principal’s ability to supervise before they recruit ARs.
- Increasing the regulatory requirements placed on ARs, e.g. introducing a Prescribed SM&CR Responsibility specifically for oversight of ARs.
- Increasing the remit of FOS and FSCS to act by enabling them to investigate and compensate for wrongdoing outside of those activities specified in the written contract between the Principal and AR.

Whatever the shape the final proposals take, it is vital that the 'Principal – AR' model works well as it is both a significant route to market for providers and access point for advice for consumers.

Irrespective of the more technical changes, one thing is clear, the FCA will be expecting Principals to supervise ARs more closely and provide more information about AR's behaviour and more generally have a greater grip of exactly what business the AR is transacting under the cover of the principal.

The irony of this is that in the UK, if we look back to LAUTRO rules introduced in the early 90's for T&C, then subsequent rules that were updated in 1997 by the PIA, followed by the FSA and FCA, the market already has an effective regulatory framework to manage and oversight this kind of regulatory relationship in the form of the T&C rulebook currently overseen by the FCA. The question for us is, on this basis, where is it all going wrong?

I suspect that many firms are not Tech enabled and this is hampering their oversight of the activities of others. Imagine, you as a Principal firm responsible for the management and oversight of your own employees and then further groups of individuals that are not employed by you. If you don't have RegTech set up in such a manner that at the touch of a button you can see who, where, when and what it is very easy to see that a lack of control and oversight could lead very quickly to principals losing control of what their ARs are doing.

The Worksmart team know that by implementing a robust Training and Competence scheme within an organisation that is RegTech enabled by us, this will provide Principals with the oversight of both their employees and their AR's as both HM Treasury and the FCA expect, and consumers deserve.

A well-engineered T&C regime supported by a dedicated RegTech solution will provide the control expected. Therefore, in our opinion, there is no need to reinvent the wheel, simply a case of 'back to the future' in terms of the regulatory regime, but then brought into the 21st century with cost effective, efficient tech!

(1)**FCA**: Improving the Appointed Representatives Regime (CP 21/34)'

(2)**HM Treasury**: 'The Appointed Representatives Regime: Call for Evidence'