Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

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By email: cp21-34@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to FCA consultation on Improving the Appointed Representatives (AR) Regime

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK.

The Panel welcomes the opportunity to respond to the FCA's consultation " Improving the Appointed Representative regime", Consultation Paper CP21/34 and the similar HM Treasury " The Appointed Representative Regime: Call for Evidence.

The Panel have long advocated for a review of the AR regime and we agree with the TSC Lessons from Greensill Capital inquiry that, "It appears the appointed representatives regime may be being used for purposes which are well beyond those for which it was originally designed" and recommended that "The FCA and HM Treasury should consider reforms to the appointed representatives regime, with a view to limiting its scope and reducing opportunities for abuse of the system".

The appointed representatives regime dates back to the Financial Services Act 1986, but as the scope of FSMA has extended, the significance of the appointed representative model has grown. Additionally, the nature of the regime, particularly Regulatory Hosting, and the business types transacted by ARs has become far more complex and consequently, the scope for consumer harm has grown. The growth in popularity of the regime is in large part due to it being viewed by ARs, Principles, Product Manufacturers and the Panel as being light touch and subject to reduced supervision.

A number of long-standing concerns have become more significant as the regime and range of AR activities undertaken has developed and become more complex - over and above light touch monitoring, supervision and control, these being that in the current appointed representative's regime and as noted in HM Treasury's Call for Evidence:

- despite use of the terms "principal" and "representative" there is no requirement that an appointed representative in fact represents or acts as agent of its principal
- because the scope of the appointed representatives regime is set out in the terms of a private contract, there is no straightforward way for the FCA or a customer of the AR to know the scope of the AR's right to perform regulated activities
- if an AR is acting outside the scope of the agreement the customer may be unprotected
- there is no limit on the amount of business that an appointed representative can carry on in that capacity – indeed, its regulatory income could exceed that of its principal, therefore increasing risk of conflict and consumer harm.

A further concern that the Panel have is the lack of AR regime expertise within the market, HM Treasury and the FCA, particularly in relation to the regulatory hosting model. Whilst the FCA and HMT may be well acquainted with the regime itself, they have limited experience of Supervising AR firms, which is where the Panel's concern stems from. The model allows for secondments of individuals to conduct regulated activities for which the principal has permissions, but which are not permissible within the scope of section 39 alone, such as discretionary fund management and dealing in investments.

In conclusion and with the increased standards that will be required by the New Consumer Duty in mind, the Panel believe that the FCA should transition from the AR model with all firms moving to being directly regulated. The FCA should exercise a risk-based approach to this with a key priority of transitioning AR firms to directly authorised. The Panel believe this should start with AR's providing investment, retirement planning, later life lending and tax planning advice (which is not a regulated activity but is being undertaken by some ARs). In the interim, FCA should tighten the regime, improve transparency, reporting, controls, and Principal firms' accountability. Additionally, capital adequacy levels should increase to reflect the increased risk of harm that a network of AR's presents.

Our responses to the questions posed in the consultation are included at Annex A below. Please note that the Panel have repeated responses in some instance as we believe they are applicable to the question and to ease response analysis.

Yours sincerely,

Wanda Goldwag

Chair, Financial Services Consumer Panel

Annex A – responses to questions

1. Do you agree with our proposal to require principals to provide more information on the business their ARs conduct?

Yes. The Panel believe that in order to better identify potential risks and harms and to target appropriate and timely interventions, the FCA requires more detailed information to assess, on an ongoing basis, the ability of Principal firms to monitor and control the activities of their AR's. This is more pressing given the increased regulator focus on value, customer vulnerability and importantly, in preparation for the introduction of the New Consumer Duty. The New Consumer Duty aims to enhance consumer outcome and reduce harms being faced. The Panel is concerned that the current level of Supervision for ARs is limited and therefore questions how firms can ensure they are adhering to the New Consumer Duty.

2. Do you agree with the reporting timeframes we are proposing for reporting?

Yes, the Panel view the timeframes as challenging, but are comfortable with them. We suggest point 3.19 would benefit from clarity as it currently mentions both 10 calendar and business days.

3. Do you have any suggestions on how the potential burden, particularly for firms with many ARs, of providing this information to us could be managed?

This is the crux of the concerns that we have with the AR regime as it currently stands, we do not feel that this is burdensome and that Principal firms should be both adequately and appropriately resourced. The Panel believe that AR's should have already been providing the FCA this should already be done.

4. Do you agree with our proposal to require principals to verify the details of their ARs?

Yes, and as with our answer to question 3, we feel that this should already be being done.

5. Do you agree with our proposal to include details on the regulated activities of each AR that a principal takes responsibility for on the FS register?

Yes, again we feel that this should already be being done. It is essential that details are presented in a way that consumers understand and with the New Consumer Duty understanding communication outcome in mind, we suggest FCA tests consumer understanding.

6. Do you agree with our proposal to require principals to provide complaints data on their ARs?

Yes, we view this as essential.

7. Do you agree with our proposal to require principals to provide revenue information for their ARs?

Yes, we view this as essential.

8. Do you agree with our proposal to require principals to notify us if they provide or intend to provide regulatory hosting services?

Yes. The Panel are of the view that " regulatory hosting" should be prohibited with firms being directly authorised instead. The Panel view this model far removed from the reason that the AR regime was initially introduced. A further concern that the Panel have is the lack of AR regime expertise in the market, FCA and HM Treasury, particularly in relation to the regulatory hosting model, developed to assist incubator businesses and its allowing secondment of individuals from an AR to the principal. This model enabling those seconded individuals to conduct regulated activities for which the principal has permissions, but which are not permissible within the scope of section 39 alone, such as discretionary fund management and dealing in investments. This is of concern to the Panel.

9. Do you agree with our proposed guidance for principals to put appropriate safeguards in place where a function or task is delegated to an AR or tied agent?

Yes. The Panel view the delegation of a function and/or task to an AR as a red flag that should give rise to FCA query given the potential for oversight issues and conflict. Our expectation of a Principal firm is that they should be appropriately and adequately resourced to supervise and manage their AR's, removing any need to delegate to them.

10. Do you agree with our proposals in relation to principals' annual assessment of ARs' fitness and propriety and the proposed considerations they should have to achieve this?

Yes, a key concern that we have with the AR regime at present is the lack of adequate supervision of AR firms. Whilst 4.15 proposes an annual review, we believe that Principal's approach should be risk based (this reflecting the increased scrutiny that FCA are intending to apply to new directly authorised firms). Assessment should be more frequent if for example, the number of complaints received is higher than expected with additional triggers for a refreshed assessment being:

- A sudden or sharp increase in business levels, complaints, business liabilities and particularly commission debt.
- A product provider withdrawing or amending agency facilities.
- A change in target market and/or permissions.
- A rise in staff turnover.

11. Do you agree with our proposed guidance on what we expect 'reasonable steps' to be?

Yes, this a key concern that the Financial Services Consumer Panel has with the AR regime as it exists today, why we believe that AR firms should only have one Principal, and importantly, why we believe that FCA should transition to a position where all firms are directly regulated. We view it as essential that Principal firms should be overseeing ALL their AR firm's activity.

12. Do you agree our proposals to clarify what we mean by adequate resources and controls and how to assess whether these are appropriate?

Yes, we believe that the level of monitoring, control, and scrutiny that ARs should, irrespective of the number, be subject to, must be as a minimum, equivalent to that an insurer, investment house or mortgage lender would have in place for its own directly employed salesforce. Importantly, with the same spans of control and level of resourcing.

13. Do you agree with the proposed circumstances which should trigger a review of principals' oversight appropriateness?

Yes, we do and hold that the approach taken should be risk based with red flags/key triggers going beyond those listed in 4.40 and include:

- A sudden or sharp increase in business levels, complaints, business liabilities and particularly commission debt.
- A product provider withdrawing or amending agency facilities.
- A change in target market and/or permissions.
- A rise in staff turnover.

14. Do you agree with our other proposals for principals to ensure they can effectively maintain pace with AR growth?

Yes, but strongly recommend that maintaining pace with AR growth is insufficient and that Principal firms should have the stretch and capacity to deal with additional control and supervisory demand, more so given the higher standards required by the new Consumer Duty.

15. Do you agree with the proposed guidance for principals overseeing individuals at their ARs to a comparable standard as if they were directly employed by the Principal?

Yes, this reinforces our view that the FCA should seek to transition away from AR models with Principal firms employing advisers themselves or AR firms being directly authorised.

16. Do you agree with our proposal on principals ensuring AR's activities do not present an undue risk of harm to consumer or market integrity?

We do, and additionally with the need to meet the higher standards that will be required by the FCA's proposed New Consumer Duty, the Principal must be made fully aware that they are responsible for delivering the new duty, and the AR equally aware that they need to implement it. The Panel believe that the Principal and AR should be equally responsible, as if both were authorised, in ensuring that the AR's activities do not present undue risk of harm to consumers and market integrity. Additionally, both the Principal and AR firms should be proactive, not just dealing with harm that has occurred but additionally looking forward, anticipating, and preventing potential harm that has not yet crystalised.

17. Do you agree with our proposals in relation to principals conducting an (at least) annual review of their ARs' activities and business?

Yes. The Panel believe that the approach taken should be risk based with red flags/key triggers going beyond those listed in 4.63 and include;

- A sudden or sharp increase in business levels, complaints, business liabilities and particularly commission debt.
- A product provider withdrawing or amending agency facilities.
- A change in target market and/or permissions.
- A rise in staff turnover.

18. Do you agree with our proposals for the termination or remediation of AR contracts?

Yes. The Panel would add that supervision and safeguarding measures should be put in place to prevent harm and believe that there should be an obligation on the AR to continue to serve clients where appropriate to ensure continuation of service.

19. Do you have any comments on our proposed requirement for principals to create, and maintain, a self-assessment document?

As presented in point 4.76, there is a very real risk that this could be perceived as a tick box exercise – especially as from point 4.77 – it is far from certain that anything will be done with this. The Panel believe that to promote good conduct and behaviour, this document should be owned by a responsible and accountable leader who will ensure that it is hosted on the firm's website to enable actual and prospective customers to see it.

20. What do you consider are the harms and benefits in the regulatory hosting model? It would be helpful to set out your views on whether principals providing regulatory hosting services can exercise adequate oversight over their ARs and be commercially viable and if so, how?

The AR model today looks significantly different and poses greater risk of harm than that first introduced to enable the retail general and protection insurance, savings, and mortgage needs of consumers to be served by readily accessible micro intermediary firms. The development, marketing, and significant growth of the Regulatory Hosting platforms, especially those seeking to recruit investment advisory AR firms concerns the Panel, despite the FCA's 20 May 2019 "Dear CEO" letter[1]. The low compliance overhead and risk "benefits" of Regulatory Hosting promoted by Principal platforms, particularly to start up and incubator firms, does not benefit consumers who are exposed to risk of harm that can and does result from Principal firms lack of financial resource, experience, effective governance, effective management and supervision, transparency, monitoring, and spans of control. The risk of harm is compounded by potential conflict and additionally the Senior Managers and Certification Regime not applying to host Principals AR's.

The Panel are and remain unconvinced that Principal firms can adequately, and viably, exercise oversight, particularly to ARs marketing and providing pension, investment, later life lending and retirement planning services with consumers better served if AR firms of this type were directly authorised.

21. Do you consider that the regulatory hosting model in the investment management sector (as described), including the secondment model, is appropriate?

No, see our response to Q20.

22. Do you consider that the use of the 'Host AIFM' model, including where staff are seconded from principal to AR, is compatible with ensuring good outcomes for consumers and markets?

No, please note our response to Q20, our concerns including risk of conflict.

23. How should ARs be allowed to market themselves in relation to activities they cannot lawfully undertake, e.g., acting as investment managers?

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[1] https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-expectations-of-principal-firms-in-investment-management.pdf

No, this a concern given the promotion by some host Principal platforms being that an advantage of this model is that it enables ARs to spend greater time marketing their services and servicing clients.

24. What do you consider are the harms and benefits in smaller principals with larger ARs? It would be helpful to set out your views on the conflicts of interest from the principal being overly reliant on its ARs for income within these business models and on whether these firms can exercise adequate oversight over their ARs, and if so how.

We share and echo the concerns outlined in points 5.23 and 5.24 and additionally the risk of control and oversight failure resulting from conflict of interest - particularly where AR firms are distributing protection insurance and with commissions being taken on an indemnity basis with resulting commission clawback liability being built up. We support the policy options described in point 5.33, particularly the banning of regulatory hosting as outlined in points 5.35 and 5.36 plus, the specific consent requirement described in point 5.43.

25. Do you consider there are challenges where principals appoint overseas ARs? Are there benefits to appointing overseas ARs?

We share the concerns outlined in points 5.25, 5.26 and 5.27 with lack of available information on these Principals highlighting the need for intervention and to better manage risk of harm to consumers, we are of the view that overseas ARs should be directly regulated.

26. Do you have any comments on the policy options set out above in paragraph 5.34 onwards?

Whilst we support the options described, as per our response to Q20, despite the 20 May 2019 " Dear CEO" letter, the Regulatory Hosting model and it being increasingly promoted as a light touch and low-cost regulatory solution for fintech and investment start-ups and incubators concerns us. More so given the increased standards that the New Consumer Duty will require, and we are of the view that consumers would be better serviced if this model was prohibited, and AR firms directly authorised.

27. Are there any other options we should consider?

Insurers, investment houses and mortgage providers have long viewed AR networks as lower cost and risk distribution relative to distributing via directly their own employed sales forces and/or branch networks. The Panel remind FCA that product providers have an important role to play in preventing harm by closer monitoring of distributor standards, behaviours, culture and importantly, proposition value, vulnerable customer support and customer outcomes - particularly in regard network Principals and AR's that they have commercial relationships with and especially where said Principals operate narrow panels. We believe that product manufacturers should have a named executive responsible for monitoring the firms conduct, behaviour, and standards of the Principals and ARs that they grant agencies to, reporting concerns to the FCA as required. This individual would be responsible for managing conflict particularly in situations where the firm in question submits large volumes of business and/or has a significant commission liability or debt with the product manufacturer.

The Panel are additionally concerned by the development of a number of life insurers and distributors, particularly network Principals, of bespoke pricing where premiums rates and as a result commission rates, are increased to reflect claimed additional value that the Principal and AR's are delivering to their customer. The Panel recommend to FCA that

value exchanges of this type, together with their transparency, clear disclosure and customer understanding of them be urgently reviewed as risk of conflict and importantly, customer harm and detriment is increased. We are also aware of a marked increase in recent years of insurance, mortgage, pensions and investment sector, product manufacturer and network Principal "award" and " training" events and suggest that a revisiting of FCA inducement rules is merited.

28. Do you have any suggestions on how we should define 'regulatory hosting' or what we should consider in doing so?

See our response to Q20, we believe that Regulator Hosting should be prohibited, and firms directly regulated, especially where AR firms are distributing investment, pension, savings, investment, retirement planning, tax planning and lifetime mortgage products and services.

29. Do you have any views or comments on where prudential standards should be introduced or enhanced to reflect the harm posed to consumers and markets by firm?

Over and above our responses to all the questions posed, given the increased standards that will be required by the New Consumer Duty, the Panel believe that the FCA should transition from the AR model with all firms moving to being directly regulated. A risk-based approach taken to this with priority of transitioning to direct authorisation starting with AR's providing investment, retirement planning, later life lending and tax planning advice. In the interim, FCA should tighten the regime, improving transparency, reporting, controls, and Principal firm accountability. Spans of control, monitoring, FCA supervision levels and the ability of the FOS to investigate complaints should be those that would apply if the Principal firm directly employed the AR. Additionally, capital adequacy levels should increase to reflect the increased risk of harm that a network of AR's presents.