THE APPOINTED REPRESENTATIVES REGIME – CHANGE IS COMING!

In December the FCA published a Consultation Paper[1] about improving the Appointed Representatives Regime (AR). In a coordinated move, HM Treasury also published a 'Call for Evidence'[2] on the same subject which will have given interested observers a clue to the level of concern about the effectiveness of the Appointed Representatives Regime.

For some time now the FCA have made it known that they have growing concerns about the performance of the AR regime for consumers. In their 21/22 business plan they stated, *"We want principals and ARs that are competent, financially stable and ensure fair outcomes for consumers when selling products or giving advice."* Consequently, it has been clear to see that the winds of change are blowing for the AR Regime.

If you delve into the detail that the FCA have laid out in Chapter 2 of the CP, where they provide statistical evidence that underlines the concerns about the effectiveness of the regime, it's easy to see why the regime is scheduled for regulatory intervention in 2022 and beyond. A few of the statistics that it is worth highlighting are as follows:

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

Supervisory Cases:
Principal firms represent 50-400% more supervisory cases 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

These statistics supported the findings of Thematic Reviews into **General Insurance** in 2016 and **Investment Management** in 2019 which identified *'significant failings'* in the application of the AR regime.

The final, important, piece of evidence indicating that the AR Regime is not working as intended came from the Treasury Select Committee's report, (June '21), into the Greensill scandal which identified ARs operating beyond their remit as one of the causes of the collapse of the company.

Given that the AR network in the UK is large, with over 3,600 Principal firms providing oversight to approximately 40,000 ARs, the AR Regime represents a major part of the retail financial services landscape and, if this part of the market is malfunctioning, it is a major problem!

So, the evidence is significant and indicates that change needs to happen.

But what has gone wrong with the AR Regime, which has been a big part of the retail financial services landscape for over a generation? Originally, the AR Regime was set up to enable a cost-effective route to market for authorised firms (Principals) by allowing unauthorised advisers (ARs) to sell simple products, e.g., general insurance, on their behalf on the proviso that Principals took responsibility for providing oversight and control of the AR's conduct to prevent consumer or market detriment.

The regulator's reasoning at the time was that it 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.

[1] CP21/34: Improving the Appointed Representatives regime (fca.org.uk)
[2] CIF: Appointed_Reps_Regime.pdf (publishing.service.gov.uk)

Since the AR Regime was set up in the 1980s, the financial services world has changed significantly. Firstly, the range of products distributed by appointed representatives on behalf of Principal firms has risen enormously, as has the range of business models under which this type of arrangement typically operates. 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.

Secondly, there are regulatory and legislative cracks that Principals and ARs have often slipped 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 stipulated in a written contract 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 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.

Because regulatory accountability for ARs lies with the Principal firm, under the current arrangements the FCA is only notified when an AR is recruited but has no right of pre-assessment of suitability as they do with other regulated positions.

Whilst you could argue that the same is true of Certified personnel under SM&CR, because Certification is a legislative requirement, I for one believe that firms are more likely to adhere to regulatory requirements in that respect than they might if there is just rulebook guidance in place.

What changes can we expect? The FCA states in its CP that it wants to see: -

- Increased consumer protection by clarifying Principals' responsibilities and the FCA's expectations of them
- Improved data collection to enable early detection and so prevention, rather than post-event investigation
- Increased consumer choice by strengthening the regime itself
- Reduced misconduct, complaints, and redress

Similarly, HM Treasury's 'Call for Evidence' identifies four areas of likely change: -

- The contract between the Principal and AR, i.e., exemption from 'general prohibition' of activity without authorisation (Section 39 of Financial Services and Markets Act, 2000), 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., by anticipating where future problems might arise, by demanding that Principals provide more regulatory data and extending the FCA's scope of oversight, 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

The irony of this is that the market already has an effective regulatory framework to manage this kind of regulatory relationship in the form of the TC rulebook (T&C) which is currently overseen by the FCA, but rarely talked about publicly in any great detail. T&C would provide the structure, standards and 'early sight' evidence and KPI's required for effective oversight of AR's (if implemented correctly) and so help to reduce, and ultimately prevent, wrongdoing.

So why hasn't T&C been more widely and more effectively used in the AR/Principal scenario? Well, the majority of successful T&C regimes we see are underpinned by dedicated T&C RegTech and, I suspect, that many firms are not as 'Tech Enabled' as you might think.

Dedicated RegTech in the form of a T&C solution can contain details on licences and authorisations, performance against agreed KPIs, day to day activity observations and assessments as well as CPD and on-going input to maintain and enhance competence. Combined, these elements could provide Principal firms with not only the tools to provide that oversight and input to help maintain competence and capability, but also would provide the evidence and re-assurance that our regulators are obviously looking for in this respect.

As the FCA becomes more 'data-led', the data collected by RegTech systems could be made accessible to the FCA to provide them with evidence of effective oversight aligned to positive consumer outcomes. This could provide the FCA with reassurance of effective oversight within firms and enable them to identify the 'outliers', (Nikhil Rathi's term), before they cause significant harm.

Solving a significant problem without reinventing the wheel, could certainly be worthy of merit for this regulatory conundrum. But only time will tell whether the FCA choose to enhance the TC rulebook and reach!

JULIE PARDY, DIRECTOR REGULATION & MARKET ENGAGEMENT, WORKSMART LTD
www.worksmart.co.uk/