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UK Financial Conduct Authority Identifies Significant Shortcomings in Firms Operating Appointed Representative Platforms

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On 20 May 2019, the UK Financial Conduct Authority ("**FCA**") published its findings of its multi-firm review into the supervision by principal firms of their appointed representatives ("**ARs**") operating in the investment management sector. A principal firm is an FCA-authorised firm which appoints another firm to act as its AR. In this capacity, the AR can carry out certain regulated activities under the 'umbrella' of the principal firm's FCA regulatory permission (most commonly these would be 'adviser-arranger' activities). Under the AR arrangement, the principal firm accepts regulatory responsibility for the actions of its AR.

The FCA identified significant shortcomings by principal firms as to how they understood and complied with their regulatory responsibilities in respect of their ARs. In particular, the FCA highlighted that many principal firms it had reviewed had weak or under-developed governance arrangements in place, a lack of effective risk frameworks, internal controls, resources and significant conflict issues. The FCA concluded that most principals were not assessing the risks that activities carried on by ARs posed to their own firms and, therefore, some principals may not be holding adequate financial resources for both liquidity and capital.

The FCA also identified issues in relation to alternative investment fund managers ("**AIFMs**"), where a third party "Host AIFM" model is used. In particular, the FCA noted circumstances where a principal firm is appointed as the AIFM to an alternative investment fund ("**AIF**") and the AR is appointed as an investment advisor to the AIFM. In this structure, certain individuals from the AR are sometimes seconded to the principal firm such that they can carry on portfolio management activity in their secondee capacity. The FCA highlighted issues under such an arrangement where the AR incorrectly claims to be the AIFM of the AIF, e.g., during the marketing of the AIF, when this role is legally undertaken by the principal as AIFM.

The FCA concluded in its review that there is a significant risk of harm to consumers and to the investment management market arising from the activities of ARs operating in this sector. Accordingly, the FCA has written a Dear CEO letter to the chief executive officers of principal firms with appointed representatives in the investment management sector, setting out the FCA's expectations.

It is important that firms operating appointed representative hosting platforms have in place, and are able to demonstrate they have, a robust risk and governance framework in their supervision of their hosted ARs. Equally, ARs should be aware that their principal firms may seek to increase their oversight and monitoring of the AR's activities in light of the FCA's findings.

A summary of the FCA's findings and Dear CEO letter can be found on the FCA's website here.

Related Professionals

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