

DRF Briefing – Appointed Representatives

This is the second in a series of DRF member briefings designed to help with the migration from OFT to FCA regulation. The first, an overview of the new regime, is available here:

<http://www.debtresolutionforum.org.uk/resources/FCACompliance-HighLevelPrinciplesTCFandApprovedPersons2013.pdf> .

Introduction:

DRF has received a number of calls from its members about the pros and cons of becoming either an Appointed Representative, (AR), or a Principal taking regulatory responsibility for ARs.

It's a huge decision. And not a simple one. Do you want to reduce your compliance burden by becoming a member of a Principal's network and allowing them to take the big risks? Do you want to capture lead sources by establishing a network of ARs? Will it really make much difference to your compliance burden if you choose to become an AR? Do you, as a Principal, really want the risk to your authorisation that some ARs may pose?

The FCA AR regime is well established. ARs are a common business arrangement for financial services firms who are already subject to FCA authorisation. The detailed FCA supervision rules for Appointed Representatives are available at <http://fshandbook.info/FS/html/handbook/SUP/12>

When the FCA takes over regulation of Debt Management on 1st April 2014, Debt Management firms will not only be able to become ARs or Principals but those choosing to be AR's will be able to enter into Multi Principal Arrangements. It is worth noting that if an AR is in a Multi Principal Arrangement, (i.e. it is an AR for more than one Principal), a single FCA Authorised firm needs to be allocated regulatory responsibility over the AR – some Principals might only want to take responsibility for ARs with whom they have exclusive arrangements. In a Multi Principal Arrangement, the Principals must have a written agreement which details which Principal has taken regulatory responsibility for the AR It is that Principal whose authorisation would be at risk if the AR was not compliant.

We understand from the FCA that firms who, at interim permission stage, indicated they were likely to wish to become Principals are likely to be the first to be examined for full authorisation. Firms that indicated they were likely to want to become ARs will be amongst the last. The hope is that, by the time FCA comes to look at the latter category, most will already be part of a Principal's network and examination for full authorisation will become unnecessary. In addition to the requirements for FCA authorisation, firms who wish to become Principals will be required to demonstrate to the FCA that they have appropriate systems and procedures in place in order to take regulatory responsibility for ARs.

Main duties and responsibilities of ARs and Principals:

An AR must have a written contract with an FCA authorised firm, (known as a Principal), under which the Principal accepts full legal and supervisory responsibility for the AR carrying on FCA regulated activities. It is worth noting that the AR has no direct relationship with the FCA. The Principal's responsibilities include any liabilities that might arise and for ensuring that the AR complies with FCA regulation. The FCA rules make it

clear that *“the firm is responsible, to the same extent as if it had expressly permitted it, for anything an AR does or omits to do, in carrying on the business for which the firm has accepted responsibility.”* The Principal must inform the FCA of the details for their ARs and report to the FCA on the activities of their ARs.

The Principal must at all times have adequate controls and resources to ensure that its ARs are fully compliant (for example that their AR's deal with clients according to the six “Treating Customers Fairly” outcomes manner and can to deliver the same level of protection to clients as the Principal itself). Principals must be able to demonstrate to the FCA that they have rigorous management information to allow close and continuous supervision and monitoring of AR's.

All ARs must have at least one person who performs a Governing function (e.g. CEO, Director or Partner) that is an FCA Approved Person. The person does not apply to the FCA on their own behalf to be an Approved Person of an AR as their Principal must apply for them.

ARs, FCA fees, Prudential Requirements and client money:

Currently, it appears that ARs will not be subject to the Prudential Standards and Requirements proposed by the FCA for Debt Management firms in the consultation paper CP13/10 (although the final rules are not expected until March 2014). The FCA have proposed that the prudential requirement for commercial DM firms would be the higher of £5000 or 0.25% of relevant debts under management. This requirement would not be levied on firms who are ARs.

The FCA have proposed that AR's of Debt Management firms can handle client money in the form of cash or cheques as long as they pay them in to the Principal's bank account within 1 business day of receiving them.

ARs will not be permitted to hold client money in their own bank account and must have processes whereby any automated payments, (e.g. debit card payments), are made by the client directly into an FCA authorised Principal's client money bank account.

As ARs do not hold client money for more than one day and therefore will not be allowed to make repayments to creditors on behalf of customers, ARs will not be subject to the FCA's proposed requirements for client accounts etc.

The benefits and drawbacks of being an AR or a Principle:

For ARs there are clear financial benefits in not being obliged to pay the FCA application/periodic (annual) and other fees and levies or meet the prudential requirements outlined above. ARs will also report to their Lead Principal rather than the FCA. Some AR's who may lack the resources to meet the proposed FCA rules may find that the financial support and compliance know-how of a Principle may mean that they can continue to trade viably.

The downside is that ARs are will lose a degree of independence in the arrangement.

For Principals, taking on ARs represents a clear opportunity to grow their business but at significant potential risk and certain increased cost. Principals will need to undertake very significant levels of due diligence and ongoing monitoring/supervision of potential and existing ARs to ensure the AR does not pose a risk to their own FCA Authorisation; it is worth restating that any breaches of FCA rules by an AR are always the responsibility of the Principal.

When can I apply to be an AR or Principal?

Firms that have completed their application for Interim Permission will already have been asked if they intend to be an AR or a Principal. There is no fixed timetable for full FCA authorisation of Principals however it is anticipated that firms who have indicated that they wish to become Principals will be assessed for full FCA authorisation by October 2014. Firms that wish to become ARs they will be required to confirm with the FCA that this remains the case and that they do not wish to become fully authorised by the FCA.

In practical terms, firms that wish to become ARs should begin to search for a Principal as soon as possible. For Principals, there is likely to be a 1st mover advantage to approaching potential ARs. DRF have suggested to the FCA that all Principals should become fully authorised at the same date so as to avoid a situation where those Principals that become fully authorised first “hoover up” all those firms wishing to become AR’s. We are awaiting the FCA’s view on this suggestion.

Considerations for your business:

- If you’re planning to become a Principal, does your firm have the skills and resources to undertake the due diligence needed to understand and eliminate the risk posed by potential ARs?
- And, once you’ve built an AR network, does your firm have the necessary level of skills and resource to undertake ongoing monitoring and support for ARs?
- As an AR you will lose some independence and control over your business. Is this something you’re happy to do?
- ARs and Principals will probably need to take legal advice before entering into either an exclusive or Multi Principal Arrangement in order to ensure the contract meets FCA requirements. This may well be a significant cost.

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