Financial Services Strategy
HM Treasury
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By email: appointedreps@hmtreasury.gov.uk

3 March 2022

Dear Colleagues

Re: HM Treasury – The Appointed Representatives Regime: Call for Evidence

Introduction

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 1.1m people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

The BVCA welcomes the opportunity to comment on the Call for Evidence ("**CFE**"). We are responding separately to the FCA's Consultation Paper 21/34 on "Improving the Appointed Representatives Regime" (the "**FCA CP**").

Summary and key points

The BVCA believes the Appointed Representative ("**AR**") regime provides a valuable and flexible alternative to full authorisation for UK firms. We agree with HM Treasury's view that the AR regime "remains a necessary and beneficial element of the UK's regulatory system". BVCA members use ARs in a variety of situations and wish to see the regime retained and strengthened. The BVCA supports measures which would improve the existing regime and enhance consumer protection. The BVCA is broadly supportive of the FCA's proposals intended to realise that outcome. However, it is important that changes to the regime do not reduce its advantages without a commensurate increase in protections.

Our view is that legislative change is not necessary to achieve the FCA's aim and that it should be possible for the FCA to do this within the current legislation. However, we have on a number of occasions raised concerns about the staffing capacity of the FCA to deliver effective and timely regulation. We therefore recommend that the government's efforts focus on increasing effective resourcing at the regulator, rather than legislative change to tackle any deficiencies in the AR regime.

BVCA responses to consultation questions

We set out our response to a number of specific questions below.

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Do you think the diverse use of ARs across different sub-sectors and business models has been a beneficial evolution of the regime? Do you have any concerns with any of the ways in which the AR regime is currently used?

The regime is a key part of the UK's competitiveness in financial services. In our sector, it is particularly valuable to, in particular:

- Newly launched venture capital firms, who may lack the resources to finance a full (12-month) FCA application process plus associated regulatory capital, liquidity and systems and controls investment. Venture capital is key to financing innovation in the real economy and the full FCA approval process acts as a barrier to entry. The AR regime is a way for venture capital firms to utilise existing regulatory expertise (in the regulated principal firm) to facilitate the launch of the first fund. Speed to market is a key component of this regime. The regime is also used for the launch of new business lines by existing regulated firms and may be used to launch smaller business lines in the UK which cannot financially support the full cost of a separate FCA authorisation.

- Business angels, where the AR regime enables business angels to carry out regulated functions such as deal promotions and deal arranging, online showcasing of deals or deal sharing, activities in relation to angel side-car funds and activities in connection with allocations from the British Business Investments Regional Angels Programme co-investment funds.

- University spin-outs, for example where there is collaboration between a university tech transfer unit and a fund manager. The university spin-out may use an AR arrangement in order to avoid breaching the regulatory perimeter at a time when it would be completely disproportionate to obtain FCA authorisation.

We also note that similar models exist in the European Union and elsewhere, and if the UK stopped allowing firms to utilise this approach, it would damage UK competitiveness as a place to locate and grow young businesses.

How appropriate and effective do you think the current regulatory approach is at ensuring the safe operation of the regulatory host model?

We consider that the regulatory host model is an important aspect of the AR regime. This model is used by a number of venture capital firms to provide market access.

We agree with the FCA's view in the FCA CP that it already has the full spectrum of powers to regulate this model of AR arrangement. We do not consider that any changes are required at the legislative level in this area.

In relation to points raised by HM Treasury:

- Resourcing issues can be faced by any regulated firm, this is not limited to host principals. HM Treasury notes that some firms have hundreds or thousands or ARs and a number of those are likely to be in other sectors of the AR market which rely heavily on networks of ARs, for example Independent Financial Adviser networks. Hosting arrangements should not be singled out inappropriately.

- Regardless of whether the FCA ultimately proposes to implement additional rules in relation to regulatory host firms, its existing proposed changes to information and notification requirements and to the responsibilities of principals[1] would have a material impact on the host sector.

- In relation to HM Treasury's comment regarding conflicts of interest, host principals are already subject to extensive conflicts of interest rules and guidance, which the FCA has a wide range of powers to enforce.

Do you think the above discussion is an accurate reflection of the challenges to effective operation of the current AR regime? Are there other challenges to fair and effective operation of the regime which have not been identified here? Do you think these challenges are manageable under the current approach? Do you think the range of regulated activities an AR may carry on is appropriate?

Yes. The range of regulated activities permitted enable ARs to undertake a range of intermediary and advisory activities where typically another authorised person will be engaged as well; but do not extend to activities which inherently pose more direct risk to the system and to the clients concerned (e.g. managing investments, dealing as principal or deposit-taking). They therefore strike a proportionate balance between the government's policy aims of increasing competition, fostering innovation and enhancing the consumer experience and, on the other hand, ensuring that consumers of services provided through ARs have the benefit of appropriate protections, as do consumers who deal directly with authorised firms.

Do you think changes to the scope of the section 39 exemption for ARs should be considered? If so, what changes do you think should be made? How might changes to scope affect ARs, principals and their consumers?

As noted above, we do not consider that the case is made out for any change to the scope of the section 39 exemption. In particular we do not consider that the suggestion of a size limit for ARs is justified or appropriate:

- This risks adding unnecessary complexity. The CFE makes no case to justify imposing a need for full authorisation for this type of business and would be inconsistent with the "numerous benefits to consumers" HM Treasury has identified in relation to this category of ARs.

- The FCA's AR rules and guidance already contains a mechanism for requiring principal firms with AR business above a certain size threshold to comply with additional monitoring and professional indemnity insurance requirements through the "network" concept in SUP 12.2.6G and elaborated on by an FCA webpage[2].

We also disagree with the proposal that it should be a requirement for the principal to be carrying on the same regulated activities as its AR. Such a requirement would constitute a de facto ban on the regulatory hosting model since, as HM Treasury notes, a host firm does not "carry ... on any substantive element of a regulated activity itself". As noted above, we consider that this ignores the potential benefits of the hosting model, and focuses on the rarer circumstances identified as of concern to the regulator (which it already has powers to address).

What are your views on the FCA having greater ability to prevent poor oversight of ARs through the introduction of a 'principal permission'? Do you have views on other ways of enhancing the FCA's role in

[1] Chapters 3 and 4, respectively, FCA CP.

[2] https://www.fca.org.uk/firms/appointed-representatives-principals/networks

the regulation of principals and their ARs? What do you think would be the benefits and risks of enhancing the FCA's powers to regulate principals or ARs?

We agree that it is vital that the FCA be able properly to prevent poor oversight of ARs by their principals. However, we do not consider that any legislative changes such as the introduction of a 'principal permission', or the extension of the FCA's information-gathering and investigation powers to apply directly to ARs, are required in order to achieve this. The FCA is already able to require a principal not to take on ARs (or any more ARs) if that is appropriate, and already has power to initiate direct investigations into ARs. In addition the FCA already requires that principal firms include in their contracts with ARs provisions that give the FCA and the principal's auditors rights to require provision of information, cooperation, access records etc.

The concern expressed in the CFE is that "there is no opportunity for the FCA to scrutinise a principal's ability to provide effective oversight before the principal appoints an AR". We consider that this is not in practice the case. In particular it is frequently necessary for applications to be made to the FCA in relation to individuals involved with the AR under the approved persons regime, or for details of the AR to be included by the FCA on the FS Register, in either case which must be complete before the AR can commence business.

We would also like to make a number of further points here:

- ***Gumming up the machine:*** Many of our members are routinely experiencing acute delays in FCA applications across the board, including on authorisation applications. To add another approval process to the FCA's workload would exacerbate this issue and would compound the concern set out in the first bullet point in this answer about reducing the attractiveness of the AR regime to market participants.

- This proposal implicitly supposes that it is appropriate for the FCA to scrutinise a principal in this way. We do not consider that the CFE (or the FCA CP) make out the case for this, nor for the use to which it would be put. The FCA already imposes extensive requirements on principals as to the steps and checks to be made before appointing an AR – it is not clear what value to the process the FCA or HM Treasury consider would be added by such scrutiny by the FCA.

- It is an inherent feature of the AR regime that, with limited exceptions such as approved person approvals, an AR is subject via contract to monitoring by the principal rather than supervision by the FCA. This is fundamental to the flexibility of the regime. Imposing a principal permission and extending certain FCA powers to apply directly to ARs would undermine this and move ARs to an overlap of supervision by the FCA and monitoring by firms, leaving them potentially subject to greater scrutiny than authorised firms.

- In terms of powers available to the FCA, the FCA is able under s. 55J FSMA to impose restrictions on principal firms where it considers it desirable to advance one or more of its operational objectives. To the extent that the FCA has concerns about particular AR arrangements which it considers cannot be adequately addressed through enforcement of the rules in SUP 12, it is therefore always open to the FCA to put a restriction on the principal's permission limiting its ability to appoint ARs (for example, to prevent it from taking on more ARs or from taking on ARs in relation to certain regulated activities).

- We note that the FCA is proposing in the FCA CP significantly to strengthen the obligations on principal firms (in particular through its proposed changes to information and notification

requirements and to the responsibilities of principals[3]). To the extent that changes are properly required to minimise unnecessary risk, this is the appropriate approach.

- The responsibility for obtaining a principal permission would fall on the principal firm but the consequence of non-compliance by the principal would fall in part on ARs. This is because if a principal incorrectly informed a would-be AR that it had recently secured the permission and the FS Register was inaccurate, the AR would commit a criminal offence in performing regulated activities whilst the principal would only be in regulatory breach. Agreements to carry on regulated activities entered into by the AR would also be enforceable only with leave of the court (s. 26 FSMA), which would penalise the AR (as well as product providers that were not involved in the AR appointment) and could leave clients in legal limbo.

If, in particular, the SM&CR was to be applied to ARs in some form:

a) **What changes, if any, should be made? It would be helpful to refer to the different elements of the SM&CR (which are set out in SYS23 of the FCA Handbook) in your answer.**

b) **Should there be a differential approach, with some ARs subject to more or fewer requirements than others? If so, which business models should be subject to more or fewer requirements? Who should oversee these requirements: the principal or the FCA?**

c) **What should the relationship between the principal and AR be when assessing the conduct standards of employees at an AR? For example, should the principal be ultimately responsible for deciding the fitness and propriety of an employee at an AR, or only for reviewing policies and procedures for determining fitness and propriety?**

Looking at the way the FCA has used the SMCR regime for enforcement since it was introduced, it is hard to see how any practical benefit has been derived to date from applying this outside the bank and insurance sector. There is a substantial overlap between the Code of Conduct under SMCR and the Statements of Principle under APER. Any regulatory benefit of switching to SMCR is not matched by the cost.

The FCA sets out in the FCA CP a number of proposals designed to ensure that staff at ARs meet appropriate standards, including: (i) a requirement that the managing body at the principal be required to review whether senior management at the AR remain fit and proper on an annual basis; (ii) a list of considerations principals should have in assessing the competence and capability of approved persons at ARs; and (iii) guidance on the practical considerations senior management at principals should use to conduct fitness and propriety assessments effectively[4].

The FCA's proposals would build on the Approved Persons Regime ("**APER**") which already applies to certain individuals within ARs, and the application of APER is broader than the Senior Managers Regime in that it includes the customer-dealing function, which in practice captures substantial numbers of client-facing staff at ARs. Applications for approval under the APER regime already require that principals (who are responsible for the application) confirm the accuracy of detailed answers when applying to the FCA.

Do you think there is a case for extending the ability of the Financial Ombudsman Service to investigate complaints involving the activity of ARs? What do you think the benefits and risks of this approach might be? Would this change affect how ARs are used by their principals?

[3] Chapters 3 and 4, respectively, FCA CP.
[4] Paragraphs 4.12-4.22, FCA CP.

We agree that it appears unsatisfactory for a consumer receiving financial services from an AR where those financial services fall outside the scope of the AR's appointment under the contract between the AR and the principal to be without any redress.

HM Treasury proposes two potential remedies: (i) extending the scope of s. 39 FSMA so that a principal is responsible for all of an AR's regulated activities; and (ii) extending the ability of the FOS to investigate complaints involving the activities of ARs. Taking each in turn:

(i) Extending the scope of s. 39 FSMA so that a principal is responsible for all of an AR's regulated activities

We disagree with this, for the following reasons:

- It would constitute a blunt solution as a result of which principal firms could incur FCA sanction for activities outside the terms of the contract they have chosen to enter into and in relation to which they may have little or no expertise (and may be following FCA guidance as to the extent of the AR risk it should take on). We consider that in turn it could exert a negative effect on the market which would be inconsistent with the government's policy aims for the AR regime of increasing competition, fostering innovation and providing a proportionate regulatory regime. It also has the potential to result in an outcome wholly at odds with the FCA's interests in ensuring that principals do not take on more risk than they have resource to monitor and manage.

- The approach is also inconsistent with regulatory expectations in these circumstances – see the rules in SUP 12 (SUP 12.4.5BR onwards). These rules require that where an AR has more than one principal, an agreement must be in place between all principals covering, inter alia, the scope of each appointment, complaints handling, control and monitoring, and co-operation. Making all principals responsible for each AR's regulated activities would drive a coach and horses through these agreements, and introduce new and unwarranted uncertainty as to the responsibility of principals. Related to the bullet point above,

- Principals are already required to take reasonable steps to ensure that ARs act within the scope of their appointment (SUP 12.6.6R), and the FCA is also proposing to strengthen its expectations of firms to monitor the activities of firms outside the scope of appointment[5].

(ii) Extending the ability of the FOS to investigate complaints involving the activities of ARs

We think it is important to set out here that the position of the consumer here may be less stark than the CFE implies:

- In practice, principal firms may often feel obliged to provide redress to consumers even where technically they may not be obliged to. This may be for various reasons, including the fact that the issue concerned may have arisen alongside other activity for which the principal did accept responsibility, the risk of reputational damage or encouragement from the FCA.

- ARs carrying on regulated activities outside the scope of their appointment commit a criminal offence, the result of which is that all agreements relating to those regulated activities are automatically unenforceable except with the leave of the court and give rise to rights to compensation or recovery of money/property (s. 26 FSMA). This is different from the position for authorised firms where they act outside the scope of their regulatory permission. In principle, consumers are therefore already able to obtain redress.

[5] Paragraphs 4.23-4.28, FCA CP.

- ARs are listed on the FS Register, the purpose of which is to allow users of financial services to check the status of the provider of those services. FCA rules also require at least some appointed representatives to disclose to clients the capacity in which they act (SUP 12.6.13R).

Yours sincerely,

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