



# Principal Firms Under the Spotlight

Challenges and obligations in  
the Appointed Representative  
regime.

December 2021

# Introduction

A directly authorised insurance business can be defined as a company given permission to provide insurance in the UK and supervised by the Financial Conduct Authority (FCA). In the UK, directly authorised insurance businesses can become Principal Firms (Principals), meaning they can appoint representatives to carry out certain regulated activities.

These representatives can be other businesses or individuals and are not authorised directly by the FCA instead they are registered with the FCA by the Principal Firm.



There are over  
**3,500**  
firms acting as  
Principals

In this paper we look at different types of Appointed Representatives and the responsibilities firms have when acting as a Principal.

# Who's Who?

An Appointed Representative (often referred to as an "AR") is a firm or individual that, due to a formal relationship it has with an FCA authorised firm, can conduct specific regulated activities without themselves being authorised by the FCA to do so.

**The Principal is responsible for the compliance of the AR**



In the AR relationship, the Principal allows the AR to undertake certain regulated activities that it itself is authorised to carry out.

At all times the Principal is responsible for the compliance of the AR, so establishing the suitability of an AR before appointing them is vital. Due diligence should be carried out to consider reputation, credit risk, legal registrations as well as screening all individuals involved with the AR for adverse media and sanctions. An anti-money laundering assessment should also be carried out.

# Types of Appointed Representative

## Introducer Appointed Representatives

IARs are limited to carrying out the regulated activity of the Principal but restricted to:

- Effective Introductions to the Principal, and/or
- Distribution of non-real time financial promotions.

This type of appointment is suitable for businesses that carry out a regulated activity where it is not core to their business. An example would be a veterinary practice that receives a commission for introducing customers to a pet insurer. Whilst an IAR may pose less risk of non-compliance to a Principal than a full AR, it is important the restrictions are properly documented in the IAR agreement and that suitability checks are carried out, both initially and ongoing.

## Appointed Representatives

Through the terms of engagement with their Principal ARs are able to conduct regulated activities in their own right and without the limitations of an IAR. ARs can be responsible for giving advice, handling premium and claims monies and negotiating terms with insurers.

The Principal and the AR work cooperatively through a written and agreed contract for the purpose of the Principal taking on the burdens of regulatory compliance alongside other services, often in exchange for a share of the commission returns that the AR generates through insurance sales, or for a fee.

# Product Responsibility

Principals are fundamentally responsible for the products their ARs sell or arrange and the advice they provide customers.

The FCA expects firms to put the well-being of their customers at the very heart of how they run their business. Principals must ensure their ARs abide by and deliver the six outcomes that the FCA labels “Treating Customers Fairly”.

**The Principal is responsible for products their AR sells**

## TCF Outcomes

### Fair Treatment

Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

### Suitable Advice

Where consumers receive advice, the advice is suitable and takes account of their circumstances.

### Products Designed to Meet Needs

Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

### Clear Information

Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

### Products Perform to Expectations

Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard as they have been led to expect.

### No Unreasonable Post-sale Barriers

Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

# Ongoing Relationship

‘Continuous monitoring’ means continually reviewing the AR’s suitability as well as looking at key performance indicators and discussing these regularly so trends can be spotted and action taken when necessary.

However, the FCA doesn’t detail the level of monitoring that should be carried out. Instead, it relies on Principal firms to decide according to the business risks each AR presents. This could mean allocating more monitoring resources to ARs with high levels of business, but by not consistently monitoring all ARs, compliance violation risks will naturally increase.



The FCA states:

“A Principal firm should be able to show close and continuous monitoring of Appointed Representatives.”

# Approved Persons & SM&CR

Controlled functions are activities relating to the carrying on of a regulated activity that, under part V of the Financial Services and Markets Act 2000, must be carried out by approved persons. Approved Persons must meet the FCA's fit and proper person requirements and must comply with the approved persons conduct requirement.

**“Individuals holding a controlled function can be held personally accountable by the FCA and in the event of failings can be fined personally.”**



Due to the implementation of the Senior Managers & Certification Regime (SM&CR), the Approved Person Regime no longer applies to directly authorised firms, but it still applies to their Appointed Representatives. This also means that SM&CR does not apply to Appointed Representatives.

Approved Persons at AR firms cannot apply to the FCA themselves, instead the Principal firm does this for them. Once approved their names are entered into the FCA's register, which is publicly accessible.

# Risks of Compliance Violation

In the instance of a Principal firm having reasonable grounds to believe that any of their agreed terms have been breached by an AR, it must complete and submit an 'Appointed Representative Notification Form' to the FCA. However, the FCA expects Principals to have robust oversight of their ARs through monitoring.

**95%**

of all Principals  
have more than one  
Appointed Representative

For these firms the burden of oversight is significant. Without fully automated processes it is likely that data will become outdated, monitoring not carried out continuously and failings in the key responsibilities of the Principal.

The FCA found that almost half of Principal firms within a sample could not portray their understanding of their obligations in ensuring their ARs complied with regulatory requirements. It noted a significant lack of provision of effective risk management and control frameworks to overcome and manage the risks of their ARs.

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The regulator said its 2021 review of the general insurance and investment sectors it had identified

**"SIGNIFICANT SHORTCOMINGS"**

in Principal Firms' understanding of their regulatory responsibilities for their ARs.

# Under the Spotlight

The FCA is contemplating changes to legislation to strengthen its scrutiny of Principal firms and the way they oversee their Appointed Representatives.

In its strategy statement on consumer investments, published in September 2021, the FCA said it will work with the Treasury to push for legislative changes to be made so it can strengthen the AR system for firms.

The FCA is seeking greater ability to challenge Principals on their ability to oversee the activities of their ARs and has issued a detailed survey questionnaire to Principal firms. Marked to for the attention of the Managing Director / Chief Executive, completion of the survey is compulsory.

One factor increasing the attention of the regulator is the number of complaints raised against the activities of ARs. The number of FSCS complaints paid out by non-Principal firms in 2018-19 H1 was £392.6m, compared with £641m for Principal firms and their ARs.

The FCA urges Principal firms to make **“sufficient checks”** on the AR firm or individuals to ensure they are financially stable and competent



# FCA's Response

The FCA's survey covers areas such as ARs' activities, revenue, business models, complaints and monitoring and must be completed by 17th December 2021. For Principals with multiple ARs this is a significant undertaking.

The FCA said its previous reviews had found shortcomings and some significant weaknesses in the control and oversight of ARs by many Principals.

In the recent statement, the regulator it will be increasing the scrutiny of firms when they appoint ARs and urges Principal firms to make "sufficient checks" on the AR firm or individuals to ensure they are financially stable and competent.

“ In the past there have been problems with ARs selling unregulated products, not approved by their network and without the Principal's knowledge.



# How Technology Firms Can Help

## Regulatory Technology

Regtech (Regulatory Technology) provides technologically advanced solutions to the ever-increasing demands of compliance within the financial industry.

As the FCA increases its focus on the AR sector Principal firms should be looking to automate the routine monitoring that is so vital to maintaining a compliant portfolio of Appointed Representatives.

Cost effective solutions mean that Principals can still operate AR distribution models whilst reducing effort, time and risk.



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