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CUMMINGS PEPPERDINE

EVERYTHING YOU NEED TO KNOW ABOUT APPOINTED REPRESENTATIVES

WHY BECOME AN APPOINTED REPRESENTATIVE?

If you feel the time is now for you to establish your investment management business in the UK and set-up your investment fund, with the opportunity cost being too great to wait 6-9 months for your FCA application to be approved, you should consider becoming an appointed representative ("AR").

WHAT IS AN APPOINTED REPRESENTATIVE?

An AR is a person or firm which is able to arrange deals in investments and advise on investments by being authorised under the umbrella of a firm which is directly authorised by the FCA (the "principal") which is already authorised to arrange deals in investments and advise on investments. Principals are often referred to as "hosting platforms". Hosting platforms can also be used by ARs to undertake portfolio management, by employing staff on secondments – more on this below.

Often hosting platforms are used by ARs while they make their own FCA application. Noting hosting platforms will usually want the AR to commit to being with them for at least 12 months.

As an AR, you will need to match the asset-class of your business to the expertise of the principal. So, for example, if you specialise in private credit or long/short equity, you will

need to find a principal who also specialises in private credit or long/short equity. It is worth noting, it can be challenging to find principals who specialise in crypto currencies and who have the time and capacity to take-on ARs.

In order to be an appointed representative, the AR must meet certain requirements, namely:

- it must not be an authorised person;
- it must have entered into a contract with its principal and comply with the requirements in the specific appointed representative regulations; and
- the principal must have accepted responsibility in writing for the authorised activities of the AR for the business specified in the contract.

If these conditions are satisfied, the AR will become an 'exempt person' for the purposes of the Financial Services and Markets Act and may then arrange deals in investments and/or advise on investments.

It is important to note that the relevant individuals will need to be approved to perform the customer function pursuant to the FCA's approved person regime.

It is also important to note that the arena of hosting platforms has always been very closing watched by the FCA, who are constantly providing guidance to improve the compliance of the appointed representative industry – more on this under "FCA update" below.

REGULATED ACTIVITIES WHICH AN AR MAY CONDUCT

Appointed representative regulations (the "Regulations) list the type of activities that an AR may conduct, and these are also set out in SUP 12.2.7 of the FCA Handbook.
These can generally be summarised as advising and arranging activities.

An obvious point but one to note is that the AR cannot conduct any activity which does not fall within the scope of its principal's permission. If an AR wishes to carry on regulated activities wider than its principal's scope, then it must obtain authorisation in its own right.

All AR business will be FCA-regulated, as no PRA-regulated activities are set out in the Regulations, so a person cannot be an AR in respect of a PRA-regulated activity.

PORTFOLIO MANAGEMENT

The hosting platform can often also be used for portfolio management. This is achieved by the principal seconding-in an employee or employees of the AR to carry out the principal's regulated tasks, for example, portfolio management of assets of the AR, or administrative jobs like dealing with the AR's investors. The FCA "continue to monitor the secondment arrangement... ...closely" – See "FCA Update" below.

THE ADVANTAGES OF BECOMING AN APPOINTED REPRESENTATIVE

While the appointed representative regime is not a route which every firm or person will take, others find it useful for a number of reasons, including:

- applying for direct authorisation from the FCA can be costly and time-consuming (an application can take up to 6 months to process);
- it may be more efficient for small businesses to be an AR rather than obtain direct authorisation;
- on-going compliance costs for an AR are likely to be much less than for authorisation;
- ARs need not comply with regulatory capital requirements; and
- it may obviate the need to seek authorisation under the AIFMD.

FCA RULES APPLICABLE TO APPOINTED REPRESENTATIVES

As well as complying with the Regulations, the AR and its principal must comply with the applicable FCA rules, which can be found in SUP 12 of the FCA Handbook. The AR needs to understand and comply with the regulatory requirements applicable to the business it is carrying out and cannot delegate these to its principal. The AR's principal is responsible, however, for ensuring that the AR complies with the Handbook. An AR is therefore required to allow its principal access to its staff, premises and records so that the principal can carry out its supervisory responsibilities.

Where an individual is appointed as an AR, in addition to complying with SUP 12, the principal should also ensure that, where applicable, the rules for representatives in COBS 6 (which deals with information about the firm, its services and remuneration) are complied with.

ROLE AND RESPONSIBILITIES OF THE PRINCIPAL

The AR is appointed by a principal and the parties must enter into a written contract to this effect. The contract must contain certain required terms as required by the Regulations, as to which please see "Required contract terms for all appointed representatives" below.

Acting as a principal places a considerable burden on the principal in terms of costs and time and the burden increases the more ARs a principal has. This means that some authorised firms can be reluctant to take on ARs, their concerns often centring on the strict requirement to take responsibility for the AR's actions and the potential detrimental impact on the principal's reputation in the event that the AR acts negligently or outside its authority, all of which will bring greater scrutiny on them from the FCA.

Obligations of principal prior to appointment

Prior to entering the contract, the principal is obliged by the FCA rules to ensure that its ARs are fit and proper to deal with clients in its name and that clients dealing with the principal's AFs are afforded the same level of protection as if they had dealt with the principal itself. This is because the principal is responsible, to the same extent as if it had expressly permitted it, for anything the AR does or omits to do in carrying out the business for which the principal has accepted responsibility.

The principal must therefore establish on reasonable grounds that:

the appointment does not prevent the principal from satisfying and continuing to satisfy its own threshold conditions;

- the AR is solvent, is otherwise suitable to act for the principal and has no close links which would prevent it being effectively supervised by the principal;
- it has adequate control over the AR's regulated activities for which the principal is responsible;
- it has the resources to monitor and enforce compliance by the AR; and
- the AR is ready and organised to comply with other applicable requirements in SUP 12.
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SUP 12 in the FCA Handbook provides further clarification as to how a principal can determine the solvency and suitability of a proposed AR.

Continuing obligations of principal

During the AR appointment, the principal will be responsible for:

- the acts and omissions of the AR at senior management level;
- continued monitoring of the AR's suitability;
- financial checks;
- making sure the AR does not hold client money;

- obtaining approval of AR's staff under the approved persons regime;
- ensuring that the AR satisfies the FCA's training and competence requirements;
- monitoring the AR's compliance with the AR agreement;
- keeping records of its AR, including any multiple principal arrangements; and
- notifying the FCA of certain events, such as the termination of the AR's appointment or any change in information or conditions of appointment or any approved person ceasing to perform a controlled function.

An AR can have more than one principal, albeit that certain activities prohibit multiple principals, for example any designated business for retail clients. If a principal appoints an AR which is already an AR for another firm, the principal must enter into a written agreement, a multiple principal agreement, with every other principal the AR may have. Again, the multiple principal agreement must contain certain required terms set out in SUP 12 (see SUP 12.4.5C).

REQUIRED CONTRACT TERMS FOR ALL APPOINTED REPRESENTATIVES

The terms of the contract which are required in all AR agreements are set out in SUP 12.5 and include the following:

- provision permitting or requiring the AR to carry on business consisting of one or more of the regulated activities listing in the Regulations;
- provision prohibiting the AR from carrying on regulated activities in breach of the general prohibition under s.19 of FSMA;
- provision obliging the AR to carry out its regulated activities in a way that is, and is held out as being, clearly distinct from any of the AR's other business that is performed as an AR of another firm;
- provision prohibiting the AR from representing other counterparties or enabling the principal to impose such a prohibition;
- provision enabling the firm to impose restrictions as to the other counterparties the AR may represent or as to the types of investment for which the AR may represent other counterparties;
- any provisions that are required to enable the principal to comply properly with any limitations or requirements on its own permission;
- provision requiring AR to co-operate with the FCA in any information gathering exercise i.e. being readily available for meetings, granting access to records, answering questions and granting access to business premises;
- provision requiring AR to give to the principal's auditors any books, accounts and vouchers of the AR and entitlement to information and explanations from the AR's officers;
- provision giving the principal the ability to terminate the contract if it has reasonable grounds to believe that certain conditions set out in SUP 12.6.1R(2) are not satisfied, or are likely not to be satisfied;
- provision requiring AR to comply, and to ensure that any persons who provide services to the AR comply with all relevant requirements that apply to its activities as the principal's AR;
- provision requiring the AR to notify the principal that it is seeking appointment as the AR of another firm and any change in the business it carries out for that other principal and the termination of any such appointment; and
- provision prohibiting the AR to hold client money.

BECOMING AN APPOINTED REPRESENTATIVE

In order to become an AR:

- the AR must enter into a written agreement with a principal whose scope of permission covers the regulated activities relevant to the proposed AR's business;
- the agreement must contain the required terms set out in SUP 12.5;

- once the agreement is finalised, the principal must notify the FCA via ONA within 10 business days after commencement of activities (see SUP 12.7.1R);
- the FCA will add the information to the FCA Register;
- once appointed, the AR must understand and comply with all rules and regulatory requirements relating to its business as an AR, including record-keeping requirements, and must use the following regulatory wording where appropriate: "[name of AR] is an appointed representative of [name of principal] which is authorised and regulated by the Financial Conduct Authority [of the United Kingdom]."

PERSONAL LIABILITY

It is key to be compliant with FCA rules for a number of reasons, not least those of personal liability

Section 400 of FSMA 2000 provides for the personal liability of officers of a corporation, and members of a partnership or other unincorporated association that commits an offence under FSMA 2000 and also under the FS Act 2012.

If an offence committed by a body corporate is shown to have been committed with the consent or connivance of an officer or to be attributable to any neglect on his part, the officer as well as the body corporate is guilty of the offence and liable to be prosecuted against and punished accordingly (section 400(1), FSMA). Just because individuals have been charged, it does not mean that the company will evade liability.

Similarly, section 400(3) makes the partners liable. Where an offence is committed by an unincorporated association other than a partnership, section 400(6) imposes liability on officers of the association or members of its governing body.

FCA UPDATE

The FCA has recently published a webpage setting out good practice and areas for improvement for ARs. The FCA's aim is to improve the oversight that principals apply to their ARs and, having assessed the key risks and drivers of harm that it has found in its work so far, it has given examples of good practices and areas for improvement.

These include the:

- the initial appointment and ongoing oversight of ARs - firms must have robust procedures, systems and controls to ensure they conduct appropriate due diligence checks on ARs, both on an initial and ongoing basis. Areas for improvement include making enquiries with other principals where an AR has been (or is currently) appointed to another principal and not solely relying on automated checks when undertaking background searches on ARs;
- the on-going monitoring of ARs - areas for improvement here include firms being more proactive to identify harm caused by their ARs and not only relying on very limited management information to monitor AR conduct. Principals are also expected to monitor websites to ensure compliance of any financial promotions. In addition, the FCA has found a potential conflict of interest between persons who were maintaining and developing commercial relationships with ARs, while simultaneously being responsible for a compliance function involving the ongoing monitoring of the ARs;
- ending AR relationships – principals must be clear on when and how to end an AR relationship in line with the requirements in SUP 12.8. The FCA is concerned that some principals did not check an AR's website after termination to ensure it no longer stated that it was an AR of the principal, and some principals were unable to explain their offboarding policy and did not maintain up to date policies and procedures.

The FCA would like all principals to consider its findings and address any gaps during their initial and ongoing AR monitoring.

Other "hot issues" for the FCA include the need for principals to ensure that:

- the controllers, directors, partners, proprietors and managers of an AR are fit and proper;
- the AR is solvent and suitable to act for the principal;
- the principal has adequate controls over the AR's activities;
- the appointment does not prevent the principal from satisfying and continuing to satisfy the threshold conditions; and
- the principal is able to monitor and enforce compliance with relevant requirements.

We expect the FCA to continue keeping pressure on principals offering hosting platforms and on ARs, particularly those with secondment arrangements and those trading crypto currencies.

THE TEAM

Cummings Pepperdine is a leading advisor in crypto. We are one of a select few that advises a large and diverse global client base in the crypto space and the only to provide a complete crypto solution building on the three key areas of law, tax and FCA with legal underpinning at every point.

In law, we have a team of qualified and regulated solicitors and a barrister who retains right of audience.

In tax, we have one of the only crypto tax advisors who is both a qualified solicitor and qualified chartered accountant.

In regulation, our team comprises specialists in crypto compliance monitoring structures and governance oversight who are known to the FCA for the quality of their work.

The team is led by Claire Cummings, a leading solicitor specialising in crypto law and the current and evolving regulation. Claire is on the advisory boards of a crypto exchange and strategic advisor and is also the founder of The Centre for Digital Assets and Democracy. Claire has also acted as compliance officer, MLRO and director of an FCA regulated fund manager and qualified under SIB to trade derivatives. As a leading expert in crypto, Claire is a sought after speaker and has published multiple articles on the legal and regulatory issues surrounding cryptocurrencies and the crypto eco-system. Claire is named at the Top 10 influencer in London for hedge funds (2&20, 2022) and is included in the CityWealth Crypto Top 100

Claire Cummings

The Cummings Pepperdine Online Training Programme, includes sections focussing on Appointed Representatives, has been designed by a specialist board of compliance consultants, solicitors, chartered accountants, tax advisors and regulatory consultants. We believe that we are the only firm which offers training created by this range of qualified advisors.

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Watch our introductory video

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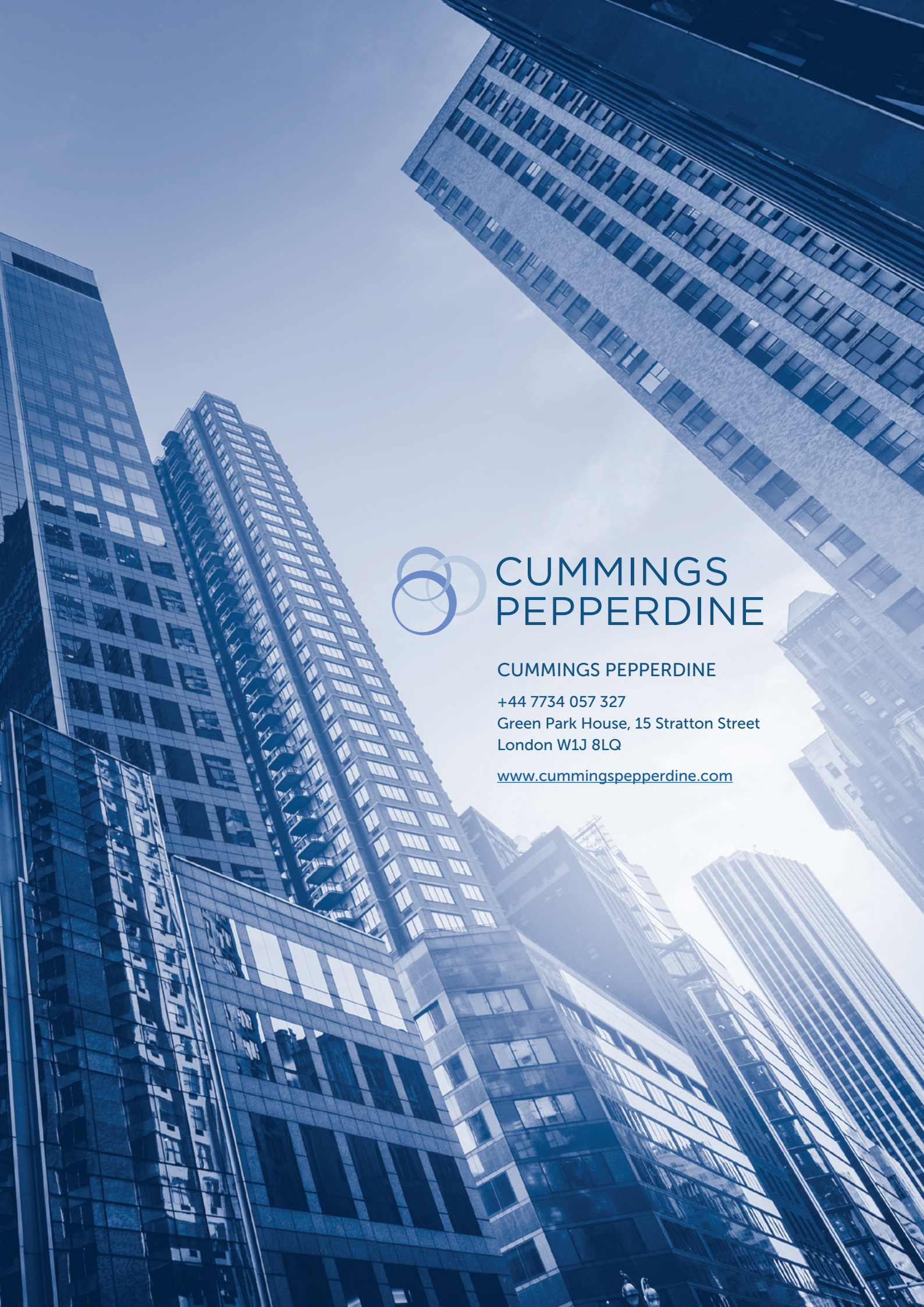

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