

UP TO DATE COMPLIANCE NEWS FOR FIRMS IN THE INVESTMENT MANAGEMENT SECTOR

3 June 2019

Dear CEO: FCA expectations of principal firms in investment management sector

A multi-firm review was undertaken by the FCA into the supervision by principal firms of their appointed representatives (“ARs”) in the investment management sector.

This review was prompted by a previous review of the general insurance sector in 2016 which identified significant shortcomings in the control and oversight of ARs by their principals.

FCA FINDINGS

The review included a survey of 338 principals and site visits of 15 firms. The FCA found significant shortcomings in relation to principal firms' understanding of their responsibilities for, and level of control and oversight of, ARs. Most principal firms within the survey had under-developed governance arrangements, including lack of effective risk frameworks, internal controls and resources.

The main concerns noted by the FCA included weaknesses in respect of:

- Onboarding due diligence of ARs and assessment of risk by the principal (failure to assess whether in house expertise was in place to adequately oversee the activities);
- Ongoing compliance monitoring programmes in both the principal and AR which are tailored to the risks identified (reliance on affirmations rather than close and continuous monitoring);
- ARs either acting outside, or representing themselves as conducting activities outside, of their permitted scope of regulated activities (e.g., ARs representing themselves as investment managers);
- Inadequate capital and liquidity assessments relating to risks within the AR business model (e.g., reliance on PII insurance);
- Principals not calculating their own capital requirements correctly because they have not included the risks and impact of the ARs.
- Inherent conflicts of interest (e.g., treating the AR as a paying client rather than a firm subject to oversight) and the recording and reporting of these conflicts;
- Misrepresentation by foreign owned ARs of their FCA status (foreign entities with similar names marketing with statements about their FCA status); and
- Failure to include their AR revenues when submitting from ARs in annual fee tariff data requests to the FCA (regulated income to be reported to FCA for the calculation of the principal firm's FCA annual fee).

The FCA will continue their focus on principal firms and may conduct additional reviews and surveys into the oversight of ARs in the future.



NEXT STEPS

Firms should:

- ✓ Share the Dear CEO letter with your Board or Management Committee;
 - ✓ Assess your firm's obligations as a principal as set out in the FCA Handbook;
 - ✓ Address each of the points in the FCA's recommendations;
 - ✓ Remediate any deficiencies in your risk and governance frameworks
 - ✓ Update the AR onboarding due diligence checklist to include:
 - scope of AR activities and review of AR website (if available)
 - alignment of AR's activities with principal's FCA scope of permission
 - confirmation of AR's solvency and financial projections
 - AR's ownership and staff structure
 - professional indemnity insurance taken by the AR
 - AR to receive principal's compliance manual and policies
 - implement a signed AR Agreement
- Speak to us about Newgate's AR onboarding checklist template
- ✓ Update your AR risk-based compliance monitoring framework to include:
 - any changes to AR's activities
 - review of AR's financial resources: management accounts, overheads, liquid assets
 - AR staff changes, Close Links and Controllers
 - AR revenue for inclusion in principal's annual fee tariff data
 - Implement and maintain conflict of interest register
 - assess level of resources required by principal firm to adequately supervise number of ARs
 - update principal's risk framework (e.g., ICAAP)
 - review of logs / registers to be maintained by AR – financial promotions, Personal Account dealing, gifts & hospitality, AML KYC of clients
- Contact us about the automated AR monitoring framework on the gateway@ system

Please do get in touch to discuss the FCA findings outlined above in more detail. Newgate can assist you in the onboarding due diligence and monitoring of ARs using our gateway@ system or through regular face-to-face meetings to help strengthen your existing controls and mitigate the risk of regulatory scrutiny.

If having taken these steps your firm cannot demonstrate compliance with the FCA Handbook and that you are adequately managing the risk associated with your responsibility as a principal firm, then the FCA expects you to consider ending your relationship with your ARs.

The FCA review and the Dear CEO letter can be found [here](#) and [here](#) respectively.