

Policy statement:

## **The Appointed Representatives Regime**

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# Executive Summary

1.1 The government views the Appointed Representatives (AR) regime as playing an important part in the provision of UK financial services, delivering a range of benefits to businesses and consumers. The regime provides a proportionate and cost-effective way for firms to engage in regulated activity without being authorised, allowing a broader range of providers to enter the marketplace. In doing so, the AR regime promotes competition, supports innovation and contributes to economic growth.

1.2 The government wants to ensure safe operation of the AR regime so that it can continue to deliver these benefits to firms, consumers and the UK economy. The government therefore intends to adapt the legislative framework for ARs to provide a proportionate level of protection for consumers of AR firms, while ensuring that the current broad scope of the AR regime is preserved, enabling the financial services sector and the UK economy as a whole to continue benefitting from the regime well into the future.

1.3 Targeted reforms to the legislative framework for ARs set out in this policy statement will:

- Help prevent misconduct involving ARs. Authorised firms wishing to use ARs will need to first obtain permission from the FCA – this will enable the FCA to ensure authorised firms have appropriate expertise and resource to effectively oversee their ARs and ensure they act responsibly.
- Provide appropriate consumer protection when things go wrong. Consumers will be able to take a complaint to the Financial Ombudsman Service (FOS) if they are unable to resolve a dispute involving an AR where the authorised firm is not responsible for the issue in dispute.

These targeted reforms follow the approach set out in the government's *Regulation Action Plan*<sup>1</sup>. In particular, these reforms are consistent with the government's vision for regulation as follows:

- **Support growth:** ensuring safe operation of the AR regime will promote confidence in the use of ARs and will enable the government to preserve the current scope of financial service activities that ARs can engage in.
- **Are targeted and proportionate:** Those authorised firms already using ARs will be able to continue to do so without

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<sup>1</sup> <https://www.gov.uk/government/publications/a-new-approach-to-ensure-regulators-and-regulation-support-growth>

having to apply for a new permission from the FCA – UK markets will continue to benefit, without disruption, from the 34,000 AR firms currently operating in UK markets.

The vast majority of complaints to the FOS involving an AR are currently dealt with by the FOS investigating the authorised firm responsible for the AR. In the relatively small number of cases where the authorised firm is not responsible for the issue in dispute, the FOS will in future be able to investigate the AR directly. This change will ensure that consumers of ARs have access to the FOS in these cases.

- **Are transparent and predictable:** the broad scope of the UK AR regime will not change and those firms currently using the AR regime can continue to do so without disruption.
- **Adapt to keep pace with innovation:** a key strength of the regime is the ease with which it allows new firms with new ways of doing business to enter the market, while benefitting from the experience and expertise of established authorised firms – the proposed reforms will preserve the support that UK regulation provides for competition and innovation in financial services.

1.4 On 17 March, as part of the government's Regulation Action Plan, the government announced a review of the FOS to ensure that the FOS operates as a simple, impartial dispute resolution service which quickly and effectively deals with complaints against financial services firms, and which works in concert with the Financial Conduct Authority. The conclusions of that review were published on 15 July<sup>2</sup>. The proposed limited extension of FOS jurisdiction to ARs set out in this document will be designed and implemented to be consistent with the conclusions of the FOS review.

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<sup>2</sup> <https://www.gov.uk/government/consultations/fs-sector-strategy-review-of-the-financial-ombudsman-service>

# Chapter 1

## Background

**1.1** The Appointed Representatives (AR) regime is a longstanding and widely used feature of UK financial services regulation. It was first established by the Financial Services Act 1986 for investment services activity, before being adapted and applied to a broader range of financial services activity through the Financial Services and Markets Act 2000 (FSMA 2000). Since the regime began in 1986, the use of ARs has increased and spread across much of the financial services sector. There are now around 34,000 ARs operating under around 2,400 authorised firms.

**1.2** An AR is a firm or person who carries on a regulated activity or activities under the responsibility of an authorised financial services firm. An authorised firm which appoints ARs in this way is referred to as a 'principal'. In appointing an AR, the principal assumes responsibility for the regulated activities carried on by the AR that have been agreed with the AR.

**1.3** The AR regime puts responsibility on the principal to ensure its ARs are carrying on regulated activities with a sufficient level of competence and are meeting relevant regulatory requirements. FSMA 2000 gives broad rule-making powers to the Financial Conduct Authority (FCA) to set binding regulatory requirements for authorised persons, including when authorised persons are acting in the capacity of principal.

**1.4** As use of ARs has spread and evolved, challenges to safe operation of the regime have come to light. Work by the FCA in recent years has identified evidence of increased risk of detriment to consumers who engage with ARs (as compared with consumers who engage directly with authorised firms). The FCA has taken steps to address this concern and to minimise opportunities for abuse of the regime. This includes implementing new rules and guidance for principal firms aimed at strengthening principal firm oversight of ARs; enhancing FCA scrutiny of principal firms as they appoint ARs; and more targeted FCA supervision of principals, informed by improved data and analysis to identify where the risks with AR use exist.

**1.5** The government welcomes the steps taken by the FCA, but following a review of the regime, the government has concluded that reform of the overall legislative framework for ARs is also needed. This review has taken into account responses to the Call of Evidence issued under the previous administration in December 2021, as well as the experience of the FCA and the Financial Ombudsman Service in dealing with supervisory challenges and complaints involving ARs.



**1.6** This policy statement sets out the government's policy approach to the AR regime and explains the targeted reforms that the government intends to make to promote confidence in the use of ARs and to preserve the benefits that the regime provides for firms and consumers.

## Chapter 2

# Overview of responses to the Call for Evidence

**2.1** In December 2021, the previous administration issued a Call for Evidence to seek views on the overall scope, benefits and risks associated with the current regulatory approach for ARs.

**2.2** A total of 38 responses to the Call for Evidence were received from a range of businesses that use the AR model, from trade bodies which represent some of those businesses and from individuals and organisations that work to protect consumers. All returns have been analysed and given consideration as part of the government's review of the AR regime.

### Support for the Appointed Representatives regime

**2.3** Most respondents viewed the AR regime as an important and beneficial element in the UK's regulatory approach for financial services. Many respondents, who were themselves financial services businesses which use ARs, explained the benefits of the regime. These benefits can be summarised as: facilitating competition in financial services markets; supporting innovation by allowing new and creative providers to enter the market relatively easily; and enhancing the consumer experience by allowing financial services to be sold alongside, or packaged with, non-financial products for the convenience of consumers.

### Challenges to safe operation of the regime

**2.5** While explaining the benefits of the regime and arguing for its preservation, most respondents also acknowledged that there are challenges to effective and safe operation of the regime. These respondents argued that a small minority of principal firms do not provide adequate oversight of their ARs, which can lead to misconduct and poor outcomes for consumers. These respondents were receptive to some reform of the AR regime and believed that poor principal oversight could be addressed without altering the overall scope of the current AR regime.

**2.6** A small number of respondents believed that the challenges to safe operation of the regime should be addressed through reducing the current scope of the regime, by preventing ARs from carrying on regulated activities which pose more significant risk of harm to retail

consumers.

## Views on reforming the AR regime

2.7 The Call for Evidence, while not making proposals for reform, discussed a number of reform options that might be considered to:

- reduce opportunities for abuse of the regime;
- improve the overall standard of principal firm oversight and AR conduct; and
- provide more effective consumer protection when things go wrong. Some respondents provided views on some of the reform options.

2.8 One reform attracted broad support: the introduction of a new 'principal permission' which would require authorised firms to secure specific permission from the FCA before being able to appoint ARs. Broad support for this reform was consistent with the majority view on the problem to be addressed, that problem being the poor standard of principal oversight in some cases. Respondents argued that this problem could be addressed by vetting the suitability of authorised firms to act as principal, rather than changing the overall scope of the AR regime. Some respondents, while expressing support for this reform, cautioned against implementing the reform in ways which would increase the regulatory burdens on principals and ARs. These respondents argued that a complicated and slow permissions process could undermine the benefits of the AR regime.

2.9 There was also some support for in some way extending Financial Ombudsman Service (FOS) protection to cover instances where an AR engaged in a regulated activity for which the principal had not accepted responsibility, and which then resulted in loss to a consumer. Currently, consumers in this position often have no recourse to the FOS.

2.10 Respondents also provided views on the option of extending principal firm responsibility to all regulated activity of an AR, whether or not the principal had accepted responsibility. Some respondents raised concerns about the impact this would have on business models which rely on ARs. These respondents were concerned that this option would significantly increase the risk to principals and could result in some businesses reducing or ending their use of ARs.

2.12 No respondents were in favour of giving the FCA new regulatory powers that would apply directly to ARs, such as powers to request information or investigate ARs. Respondents who discussed this option argued that this approach would effectively bring ARs under the direct supervision of the FCA, which would cut across the responsibility that principal firms have for their ARs and which would undermine the rationale for having an AR regime.

# Chapter 3

## Initial conclusions to the review of the AR regime

**3.1** As set out in the government's Regulation Action Plan, regulation should protect consumers while it encourages competition, new investment, innovation and economic growth. This approach to regulation has provided the basis for the government's review of the Appointed Representatives regime.

**3.2** The government views the AR regime as an important part of the UK regulatory approach for financial services, which delivers a range of benefits to businesses and consumers. The regime provides a proportionate and cost-effective way for firms to engage in regulated activity without being authorised, allowing a broader range of providers to enter the marketplace. In doing so, the AR regime supports competition and innovation, encouraging new investment and economic growth. After reviewing the regime, the government has concluded that it should be maintained and the current scope of regulated activities which ARs can carry on should not change.

**3.3** To ensure that the AR regime can continue to benefit consumers and businesses well into the future, the government wants to ensure that consumers have confidence in the safe operation of the regime. The government therefore aims to ensure that the regulatory approach provides an appropriate level of consumer protection while continuing to foster competition, innovation and the contribution that the financial services sector makes to UK economic growth.

**3.4** Most principal firms are responsible users of the AR regime, providing appropriate oversight of their ARs to ensure they comply with regulation and treat consumers fairly. But data from the FCA suggests that poor oversight by some principals is leading to increased risk of poor outcomes for consumers of ARs. The government's view is that it is possible to adapt the legislative framework for ARs in order to safeguard against abuse of the regime more effectively, while preserving the current scope and benefits of the regime.

**3.5** The FCA has already taken steps to strengthen regulation of principal firms in order to reduce opportunities for abuse of the AR regime. In its *2022 to 2025 Strategy and Business Plan*, one of its key priorities was to improve oversight of ARs. Over the past 3 years the FCA has taken the following action:

- Published new rules and guidance to strengthen the AR regime (*FCA PS22/11*), which came into force on 8 December

2022. The changes clarify and strengthen the expectations of principal firms' oversight of ARs, including ensuring they have adequate systems, controls and resources in place.

- Improved principals understanding of their obligations through increased engagement with them. For example, the FCA has written to all principals to outline the new rules and conducted proactive assessments to ensure principals are taking steps to address their requirements. The FCA has also increased direct engagement with principals through webinars and live events, including sharing information and best practice to help raise standards.
- Provided stronger scrutiny of authorised firms and applicants for authorisation which indicate an intention to act as principal. The FCA is also undertaking greater analysis of notifications of new AR appointments as they are received, adopting an holistic approach when considering these. This has driven an increase in the quality of due diligence conducted by principals when appointing ARs.
- Deployed targeted supervision of principal firms more effectively across the sector, using improved data and analytical tools. Principal firms are now required to provide the FCA with regular information on their ARs' business, revenues and complaints, enabling the FCA to target resource on the highest risk principals and their ARs.

**3.6** The government welcomes these FCA initiatives which are helping to improve the effectiveness of principal firm oversight and reduce the risk of harm to consumers who engage with ARs. However, in order to promote confidence in the benefits of the AR regime, the government wants to ensure the legislative framework appropriately reflects the importance of principal firms providing adequate oversight of their ARs; and to ensure there is proportionate protection of consumers when things go wrong.

**3.7** This chapter explains why the government has concluded that there are currently two regulatory gaps in the framework for ARs and how filling those gaps would provide a targeted and proportionate way of promoting safer operation of the AR regime.

## Gap in the regulatory framework: ensuring the suitability of authorised firms to act as principal

**3.8** The FSMA 2000 framework was designed to ensure individuals and businesses have confidence in the provision of certain financial services which are important to the functioning of an advanced economy like the UK. FSMA 2000 does this by specifying which financial services activities should be regulated and by ensuring only individuals or firms which meet certain minimum standards are authorised to carry

on those activities. The UK's financial services regulators provide the gateway to authorisation, checking that firms meet the required standard (Threshold Conditions) before gaining authorisation, and providing ongoing supervision to ensure authorised firms continue to meet that standard. This regulated space within which regulated activities are carried on is known as the 'regulatory perimeter'.

**3.9** The ability of ARs to carry on regulated activities under FSMA 2000 operates as an exemption to this approach. Rather than an AR being checked and authorised by a regulator, the principal firm accepts responsibility for the regulated activities of the AR. Similarly, rather than ongoing supervision by a regulator, a principal firm is responsible for overseeing its AR to ensure it continues to meet the relevant regulatory standards. A principal firm is therefore taking on a very important responsibility when appointing ARs. The proper discharge of a principal firm's duties is crucial to the effective functioning of, and confidence in, the AR regime, as well as the effective maintenance of the regulatory perimeter.

**3.10** FCA rules require principals to satisfy themselves of certain matters (such as having robust systems and processes in place to ensure a prospective AR's suitability and to provide effective ongoing oversight of an AR once it is appointed) before proceeding with an AR appointment. But any authorised firm is permitted to act as a principal and appoint ARs, with no further permission or approval needed from the FCA (subject to the limitations in legislation on the scope of business which ARs are permitted to carry on). The government has concluded that this represents a gap in the ability of the FCA to ensure appropriate standards are maintained within the perimeter for regulated activities.

**3.11** Acting as principal and providing robust oversight of ARs is, in itself, an important activity which can have significant implications for maintenance of good conduct standards across many parts of the financial services sector. A firm may be able to meet its regulatory obligations as a directly authorised firm, but may be ill equipped to oversee the activities carried on by another firm. This risks providing a route for unauthorised firms to carry on regulated activity without appropriate oversight, which increases the risk of harm to consumers.

## Proposal for reform: an FCA permission to act as principal

**3.12** In the government's view, a regulatory gateway should operate for any activity important enough to have implications for the effective functioning of financial services regulation as a whole.

**3.13** This principle was followed in recent reform of the approval of financial promotions. Previously, any authorised firm could approve the financial promotions of an unauthorised firm, with no specific mechanism in place to ensure authorised firms engaging in this activity were suitable. FSMA 2000 has now been amended so that authorised

firms wishing to approve financial promotions must seek permission from the FCA. This gives the FCA the opportunity to scrutinise applicant firms and ensure that authorised firms engaging in this activity are suitable and properly equipped to do so to an appropriate standard.

**3.14** The government has concluded that a regulatory gateway would also be appropriate for principal firms, as this would allow the FCA to ensure that authorised firms wishing to act as a principal have the necessary expertise, resources and systems in place to provide effective oversight of ARs.

**3.15** Introducing a gateway would likely require an amendment to section 39 of FSMA 2000 so that the appointment of ARs confers an exemption from the general prohibition only if the authorised firm making the appointment has received permission from the FCA to act as a principal. This would provide direct powers to the FCA to scrutinise a firm's fitness to act as principal before the firm is able to appoint ARs. The FCA would be able to take a proportionate approach to the scrutiny of applications at this gateway, taking into account, for example, the purposes and regulated activities in relation to which a firm intends to appoint ARs. As with Part 4A permissions, the FCA would be able to impose limitations or conditions on the permission to ensure the principal is only able to engage ARs to carry on the type and scale of business in ways which the FCA has assessed that the principal is well placed to provide effective oversight. And as with Part 4A permissions, the FCA would be able to vary a permission as necessary to reflect the changed circumstances of a principal firm (either on the application of the firm or on the FCA's own initiative). The FCA would also be able to withdraw a permission in certain circumstances.

**3.16** By ensuring that ARs are only appointed by authorised firms which are suitable to act as a principal, the regulatory framework would place greater emphasis on prevention of AR misconduct. And by giving the FCA the ability to vary or withdraw permission to act as principal, the FCA would be more effectively empowered to act swiftly and in a more targeted way to limit or stop AR activity which might pose a material risk to consumers.

## Implementation of a principal permission

**3.17** As explained above, introduction of a principal permission will likely require an amendment to section 39 of FSMA 2000 so that the appointment of ARs confers an exemption from the general prohibition only if the authorised firm making the appointment has received permission from the FCA to act as a principal. Amendment of section 39 will require primary legislation, so the reform can only be delivered once an appropriate place in the legislative programme is found for this reform.

**3.18** Nevertheless, the government is already working with the FCA to design the measure and to develop a proportionate approach to implementation. Consistent with the policy aim of preserving the

benefits provided by the AR regime, the government is committed to ensuring that the new permission does not disrupt business activity for those firms which already use ARs and does not introduce undue administrative burdens for suitable firms wishing to use ARs in the future. This means designing an approach to implementation which:

- a. Does not require existing principal firms to apply for the new permission;
- b. Embeds the principal permission in the new firm authorisation process so that there will not be a separate application process for new firms to follow; and
- c. Ensures that the FCA is able to limit, vary or revoke a permission to act as principal if this is necessary.

**3.19** The government, working with the FCA, will develop a detailed proposal for design and implementation of the principal permission and will consult on the proposal in due course.

### Gap in the regulatory framework: FOS coverage of ARs that act outside of their contract with the principal firm

**3.20** Within the UK's regulatory framework, the Financial Ombudsman Service (FOS) plays a key role by providing consumers and firms with a quick and cost-effective way of resolving disputes when things go wrong. In doing so, it promotes consumer confidence in regulated activities, providing reassurance that there is a straightforward process for raising a complaint.

**3.21** Overall, the ability of the FOS to investigate complaints involving ARs is consistent with the operation of the AR regime. Just as the FCA regulates principal firms to ensure they are providing effective oversight of their ARs, the FOS will investigate the principal firm which is responsible if there is a complaint involving an AR. The compulsory jurisdiction of the FOS applies to authorised firms carrying on regulated activities.

**3.22** Under FCA rules, the principal firm has a responsibility to ensure that the AR does not conduct regulated activities that fall outside of the business for which the principal firm has agreed to take responsibility. But sometimes an AR's conduct, which is the cause of a complaint, may be something that the principal did not accept responsibility for. If the FOS investigates and finds the complaint concerns something for which the principal is not responsible, then the FOS has to declare it cannot deal with the complaint. As the FOS's jurisdiction applies to authorised firms only, there is nothing the FOS can currently do to further assess and decide a complaint against an AR only, once it becomes clear that the principal firm is not responsible.

**3.23** Although this circumstance arises in a relatively small percentage of FOS cases, the government views this as a gap in the consumer protection arrangements for regulated activities. The



government has concluded that the FOS should be able to investigate complaints made in relation to the carrying on of regulated activities, regardless of whether the regulated activity is directly carried on by an authorised firm, or through ARs.

### Proposal for reform: ensuring the FOS is able to investigate any complaint involving regulated activities carried on by an AR

**3.24** The government intends to use a targeted extension of the FOS compulsory jurisdiction to ensure that all consumers of regulated financial services, whether dealing with an authorised firm or an AR, have access to the FOS on a consistent basis. As is the case now, the FOS will continue to handle a complaint involving an AR by investigating the principal firm which has responsibility for the AR. Where the FOS decides that a principal firm is responsible for misconduct involving an AR, the FOS will continue to direct any redress measures to the principal firm. But in cases where the FOS decides that a principal firm cannot be held responsible for its AR's actions, the FOS will be able to directly investigate the AR itself. If the FOS upholds a complaint against an AR, the FOS will be able to direct any redress measures to the AR itself.

**3.25** It is important to emphasise that this extension of the FOS's jurisdiction will only apply in circumstances where a principal firm is not held responsible by the FOS for the actions of its AR. The proposed reform will not in any way diminish the high level of responsibility and oversight that principal firms are required to provide for their ARs. That responsibility includes the principal taking all reasonable steps to ensure that the AR is only carrying on regulated activities to which the principal has agreed, in accordance with FCA rules.

**3.26** This targeted extension of the FOS's compulsory jurisdiction will ensure that consumers who suffer loss when dealing with ARs will consistently have access to the FOS, whether the principal is in fact responsible or not. In doing so, it will promote consumer confidence in the AR regime and safeguard the benefits that the regime provides in support of competition, innovation and economic growth.

**3.27** The government, working with the FCA and the FOS, will develop a detailed proposal for the extension of FOS jurisdiction and will consult on the proposal in due course. The government has now published the conclusions of its review of the FOS. The proposal to extend FOS jurisdiction to ARs will be developed to be consistent with the conclusions of the FOS review.

# Chapter 4

## Next steps

**4.1** The purpose of this policy statement is to provide certainty to firms and consumers on the future of the UK's AR regime. In the government's view, the targeted reforms to the legislative framework set out in the previous chapter will promote confidence in continued operation of the regime, so that consumers, firms and the UK economy can continue to benefit from the regime well into the future.

**4.2** As noted earlier in this document, the government has now published the conclusions of its review of the FOS. The proposal to extend FOS jurisdiction to ARs will be developed to be consistent with the conclusions of the FOS review.

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