



## **Unlocking the market**

Regulatory hosts  
and umbrellas

October 2021

In order to carry out the activities of running a hedge fund, a firm needs to have appropriate regulatory permission from the Financial Conduct Authority (“**FCA**”). While established firms have the skills, scale, personnel, back office functions and infrastructure to obtain and retain such authorisation, start-ups and smaller financial services firms often do not.

This is where regulatory hosts, sometimes known as regulatory umbrellas, come into play. A regulatory host is an organisation which uses its regulatory permission to allow firms to comply with FCA regulated activities requirements without being directly authorised by the FCA. A regulatory host will provide a number of services. The two most common are:

1. the appointed representative (“**AR**”) regime; and
2. secondment agreements which allow specific individuals from the host firm to work within the client firm, as if they were the client firm’s staff.

An AR firm can undertake a limited number of regulated activities, including the provision of marketing (brand building), non-discretionary investment advice, and arranging transactions. AR firms cannot manage money and are explicitly excluded from undertaking investment management. Accordingly, if a firm requires the regulatory host’s assistance with managing assets, staff must be seconded.

Firms can become ARs of the regulatory hosting entity (known as a principal firm in the regulations), which will fully accept the responsibility for the regulated activities of its ARs. In order to do this the principal will undertake an extensive compliance monitoring programme, including: trade and communications supervision, implementation and maintenance of regulatory policies and procedures and the satisfaction of capital adequacy requirements, among other things.

The regulatory host arrangement is popular with start-up and smaller hedge fund providers which lack the regulatory knowledge, scale, back office and infrastructure to meet the requirements for FCA regulatory authorisation in their own right. Fees are typically paid for the use of a host’s regulatory permissions, which can lead to some mischaracterising the arrangement as a ‘client/supplier’ relationship.

In the FCA's Business Plan 2021/22, the FCA said that in recent years it has seen increased problems from principal firms having poor due diligence and oversight of their ARs. The FCA plans to take the following steps to ensure principals and ARs are competent, financially stable and deliver fair outcomes:

- increase its supervision to reduce the most significant risks from ARs in wholesale markets
- consult on cross-sector changes to improve and strengthen the elements of the AR regime
- consider whether the AR regime, much of which is set out in FSMA, requires legislative change

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*The Appointed Representative market has experienced and continues to face a number of challenges around perception and reputation. Changes to improve principals' ongoing oversight and due diligence of current and prospective ARs are welcome, however, the delay that getting such rules on to the statute book is not. Hopefully this will be one of the areas of the FCA's endeavours which are transposed from being based in statute to being based in regulation to allow greater responsiveness and flexibility in future.*

**Ben Watford**

Partner and Head of Hedge Funds,  
Eversheds Sutherland

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See Eversheds Sutherland's client briefing, "FCA Business Plan 2021/22". 

Some of the criticisms of regulatory hosting are based in fact, for instance, earlier this year, Marshall Sterling, a regulatory host, was the subject of an FCA supervisory notice for its failings in relation to the onboarding and supervision of three ARs. However, some is not, for instance press coverage of the Greensill Capital collapse, which wrongly cited regulatory hosting as a factor. Greensill would have failed whether it was directly regulated by FCA or operating as an AR.

As is so often the case, for every firm rightly castigated for lack of scrutiny, there are many others which work hard to ensure their AR firms meet the highest regulatory standards.

Steps can and should be taken to improve standards. The best way to do this is by highlighting the important role regulatory umbrellas serve in a fully functioning developed market in supporting best practices, and how best-in-class operators can work with the FCA to raise standards throughout the industry.

# The significance of hosts in a fully functioning market

There are around 40,000 AR firms operating in all aspects of regulated financial services, the majority of which operate in the insurance sector. It is thought that around 2,000 ARs operate in the alternative investment market.

Without regulatory hosting, many firms undertaking regulated activities would be effectively shut out of the market and the speed at which innovative strategies could be brought to market would be significantly curtailed. Regulatory umbrellas are key to a vibrant, competitive market. In the absence of umbrellas, the FCA would need to deal with hundreds, if not thousands, of additional applications each year and would need to be capable of supervising thousands of additional firms. A well-regulated regulatory host sector substantially reduces the supervisory burden on the FCA.



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*Without the regulatory hosts, it would take you six months to a year to launch a new fund. Typically it takes three to four months to prepare a regulatory application and fund documents for submission to the FCA. Following submission to the FCA, depending upon the number of questions raised, it takes another three to six months to obtain authorisation.*

*By comparison, using a regulatory host, a fund can be launched in six weeks. That's a huge time saving. Alongside that, the new fund benefits from the cost saving of the host assuming responsibility for the capital adequacy requirements and already having in place tried and tested compliance and control functions and risk compliance manuals.*

**Ben Watford**

Partner and Head of Hedge Funds,  
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Over the past 5 years there has been a strong positive evolution in the acceptance from institutional investors and counter parties in the regulatory hosting model. At IQEQ, we are often approached by investors who have identified talent asking us to set up that talent in a compliant and regulatory robust way. Familiarity with regulatory hosting from previous experiences gives them piece of mind that the manager is 100% focused on delivering alpha and managing money while still backed by a team of professional compliance experts. This ensures operational due diligence (“ODD”) is on par with funds with multi-billion assets under management (“AUM”), whilst perhaps being as lean as a portfolio manager (“PM”) and an analyst.

**Andrew Frost**  
Executive Director, IQEQ



Regulatory hosts are a vital part of our diverse financial industry. They enable strong competition and the continued evolution of an industry that is a huge contributor to the success of the British economy. Their support for fledgling firms ensures robust and compliant firms once they ‘graduate’ into fully regulated, standalone organisations. Working alongside many of the largest regulatory hosts and standalone funds in the alternative investment space, we have witnessed the impact that diligent oversight and compliance led operations can have on success and growth. What cannot be denied is the way we do business and regulatory focus has changed immeasurably over the last 18 months because of COVID. Still, more importantly, the societal shift and expectations for transparent, conduct-focused firms have come to the forefront in recent times. The FCA is pushing hard for transparency of operations and compliant conduct and oversight, not just of regulatory hosts but across the entire financial industry. Therefore, there is a responsibility on firms of any size to get with the times to satisfy not just the regulator but, more importantly, meet the expectations of investors and society as a whole.

**Sean Morgan**  
Supervision Commercial Director  
& Regulatory Lead, Fingerprint



# Choosing a host

Start-up hedge funds are faced with a wide choice of regulatory hosts and PMs typically come from a background where they haven't previously had to consider how to select someone to help them meet their compliance obligations.

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***Not all hosts are created equal. Firms need to do their due diligence to ensure they work with a reputable host which has their best interest at heart. They are paying for support, not impunity.***

**Ben Watford**

*Partner and Head of Hedge Funds,  
Eversheds Sutherland*

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Paradoxically, this can work against best-in-class hosts - those conducting their supervisory obligations with the proper care and diligence - as they will naturally seem the most demanding of their ARs. Take for instance the regulatory obligation to monitor and supervise communications: ARs are naturally protective of their ideas, strategies and 'private' communications. If they are unaware of their host's regulatory obligations (e.g. SYSC 3.2.8, 4.1.1, 4.1.6, 6.1.4, 8.1.1, 9.1.1A, SYSC 10A.1.6 and SYSC 10A 10A.1.7) they may balk at demands for access to messages, calls, chats and emails. Hosts which lack the will to implement proper oversight will be at an advantage in attracting ARs that are mistakenly (or even deliberately) seeking an inappropriately light touch, however, that light touch may risk the host and its ARs being exposed to compliance failures, reputational damage, potential fines or even criminal charges.



# Derisking regulatory hosting

**In 2018 the FCA conducted a review of principal firms in the investment management sector, which followed their 2016 thematic review TR16/6: Principals and their appointed representatives in the general insurance sector.**

The FCA found that the operational infrastructure for robust compliance monitoring and oversight was not at the level it expected or required. As a result, the regulatory hosting industry undertook a de-risking of their AR client roster and developed the best practice which the best regulatory hosts now provide.

Some answers to the problems sit with the FCA. Currently, the terms of regulatory permissions to undertake a regulated activity entitles regulated firms to act as a regulatory host for firms undertaking the regulated activity for which the host has permission. This means any regulated firm can agree to host ARs with no checks or systems in place. Some market participants have suggested the FCA should create a new, separate permission which a firm should be required to obtain before it is able to provide regulatory hosting.

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*Currently any change in the regulatory permissions regime will require primary legislation, although we note that the TIGRR report [a report commissioned by the UK Government into post-Brexit opportunities to reform regulation, which Lord Frost has said will be implemented] suggested that much of the financial services regulatory framework which currently sits at primary legislation level should be transposed into secondary legislation so that the regulators, including the FCA, can respond far more quickly when regulatory reform and development is required.*

**Andrew Frost**  
*Executive Director, IQEQ*

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Technology will provide solutions to many of the problems faced by regulatory hosts and their ARs. The FCA is embracing supervisory technology to maintain regulatory oversight and manage market. Regulatory hosts and their ARs should consider utilising the multitude of innovative tools available in the RegTech market.

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*We are technologists, and we believe in the power of technology to improve outcomes across the industry, not just for meeting regulatory requirements effectively, but to improve business growth, regulatory compliance and the internal and external transparency of operations. Technology plays a crucial role in providing effective governance and oversight for regulatory hosts and single regulated firms. Technology has advanced to a point where KYC and onboarding, due diligence through to monitoring trades, market data, electronic communications and voice for multiple firms or single entities can be streamlined, sometimes even into one cohesive platform utilising cloud technologies, APIs, algorithms and automation. Gone are the days of manual, time heavy, ineffective processes which result in little successful output. With the multitude of technologies available, operations can be streamlined and processes strengthened quickly, effectively and in a cost-effective manner. It's a no brainer.*

**Sean Morgan**

*Supervision Commercial Director  
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# How Eversheds Sutherland can help

## Eversheds Sutherland has experienced funds lawyers in London, Luxembourg, Germany, Ireland and the United States.

We have a broad insight into global regulatory trends and issues. A breadth we match with a commitment to dedicated and focussed client support.

We offer more than legal advice. Our team are trusted business partners with a real presence in the industry. We co-ordinate with and can make introductions to a wide network of professionals including prime brokers, fund directors, administrators, banks and depositaries.

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Together with our global network stretching across 35 countries, we keep a keen eye on the world's legal and regulatory developments to ensure our clients stay ahead of the curve.

**To find out more about our Hedge Funds practice, visit our hub.** 

# How Fingerprint can help

## Our platform, Fingerprint Supervision, is a communications monitoring, automated risk identification, investigation case management and compliance workflow software platform.

Powered by automatic risk identification and Natural Language Processing technologies, Fingerprint provides a fit for purpose, user-friendly front-end and reporting dashboard designed for compliance professionals. Fingerprint enables systematic, efficient, and effective corporate compliance and governance activity for the smallest regulated firms to the largest regulatory hosts.

Fingerprint Supervision is utilised by regulatory host firms to achieve efficient regulatory compliance oversight on a multi-tenant basis. The AR's communications data is managed separately according to regulator and GDPR requirements while supervisory functions and management information and reporting across all ARs is accessed via a single sign-on streamlined dashboard, allowing hosts holistic oversight of their entire AR portfolio. There are several significant benefits to utilising a holistic oversight platform: strong governance and scalability of hosting as your business grows; effective and streamlined compliance operations which enable robust, effective oversight of all ARs via a single login; efficient and transparent operating costs; privacy of individual's data within each AR is protected as each ARs data is stored separately and compliantly.

**For more detail see: What is Fingerprint?** 

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