Report on insurance for multi-occupancy buildings

September 2022

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1 Executive summary

Background

1.1 The cost of buildings insurance to residential leaseholders and other property owners of multi-occupancy buildings has increased across the United Kingdom in the wake of the Grenfell tragedy. In addition to the immediate horror of the events of 14 June 2017, hundreds of thousands of leaseholders have subsequently had to endure the difficulties and trauma of living in buildings with known fire safety issues. These problems have been compounded by the associated increases in the cost of their insurance.

1.2 On 28 January 2022 the Secretary of State for Levelling-up, Housing and Communities asked us to review, in consultation with the Competition and Markets Authority (CMA), the way the market for multi-occupancy buildings insurance operates to:

- shed light on the underlying causes of year-on-year price increases
- assess the causes of the marked restriction in coverage available for multiple-occupancy buildings

1.3 We were also asked to make practical recommendations for measures that industry, Government and regulators can take to achieve the goal of widely available and affordable cover for leaseholders of multi-occupancy buildings.

Our review

1.4 Our work has focused on understanding and assessing the factors which affect premiums for mid-rise and high-rise multi-occupancy buildings (those exceeding 3 floors or 11 metres in height) and the impact on leaseholders. In most cases, leaseholders have no ability to influence the choice of broker or insurer (and associated levels of premium and remuneration) but ultimately bear the costs. We have considered:

- insurers' risk appetites, underwriting and pricing approaches (the methodology used to assess the risk and set the price)
- the effect on pricing of cladding or material fire risk, as well as other factors, such as pooling together the risks of multiple buildings
- the role of parties both within and outside the scope of FCA regulation (including insurance brokers and property managing agents) in the distribution chain, and the impact of the remuneration paid to them
- relevant changes to the regulatory environment for buildings and fire safety

1.5 To inform our work, we requested extensive information from a sample of 17 insurers and 26 brokers[1], which constitute the majority of insurers and brokers active in the multi-occupancy buildings insurance market.

1.6 The information we obtained through our request consisted of:

- qualitative and documentary information on areas such as risk appetite, underwriting approach and standard policy wordings (including applicable terms, conditions and excesses)
- quantitative data on policies underwritten in the period 2016-2021 for mid-rise and high-rise multi-occupancy buildings, covering key policy features such as the premium and the sum insured, and information on risks like claims and exposure to flammable cladding[2]

1.7 We have provided more detail on our scope and methodology when considering and analysing the data received in the overview section below.

1.8 Our analysis uses data from a subset of the firms we approached with our request (13 insurers and 13 brokers) as other firms were either unable to provide the requested information or provided information that could not be reliably incorporated into our work.

1.9 Alongside our analysis of the information received from insurers and brokers, we reviewed the range of other information we received on this topic (including MPs' letters and complaints regarding the actions of insurers and brokers). We also carried out a programme of engagement with both market participants and other stakeholders. Our programme of engagement included:

- two sets of roundtable workshops with insurance industry participants (including insurers, insurance brokers and trade bodies)
- roundtable workshops with a range of demand-side stakeholders including leaseholder representatives, cladding action groups, freeholders, property managers and property industry trade associations
- separate meetings with other demand-side stakeholders including property industry trade associations and housing associations who have been significantly affected by the issues in this report

1.10 We have provided more detail on our programme of engagement in the overview section below.

1.11 We have used the information and insight from these workshops and meetings to challenge and validate the information from firms and our analysis of this. This has informed our conclusions about the availability and affordability issues in this sector, the harms these are causing and the actions and interventions likely to help to mitigate these.

1 Our sample included both composite and Lloyd's of London and London market insurers of a variety of sizes, as well as brokers active in this sector ranging from the largest international brokers to small specialist property brokers.

2 In the context of this report flammable cladding means cladding containing a range of combustible materials, this being defined as anything not achieving a fire classification as appropriate to the type and height of a building, as set out at page 44, Table 12.1 in The Building Regulation 2010 - Amendments to the Approved Documents – June 2022 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1080214/ADB_amendment_booklet_June_2022.pdf. For further information on fire classification see BS EN 13501-1:2018 which provides the reaction to the fire classification procedure for all construction products, including products incorporated within building elements.

Our key findings

1.12 Our review and analysis of the qualitative and quantitative information received and our stakeholder engagement have highlighted the following issues affecting insurance for multi-occupancy residential buildings in the period from the Grenfell tragedy until the end of 2021.

Supply of insurance for mid-rise and high-rise multi-occupancy residential buildings has contracted significantly

1.13 There has been a significant contraction in the supply of insurance for mid-rise and high-rise multi-occupancy residential buildings over the period, notably for buildings affected by cladding or other material fire safety issues. Before the Grenfell tragedy, there were fewer than 20 insurers operating in this market. Of the insurers in our sample, 11 reported that they have reduced activity in this market or withdrawn from it completely. Only 3 reported no material change (the appetite and actions of the other 3 insurers in our sample were not clear from the responses received). We found that those within the market have limited or no appetite for writing new business. Insurers told us that the contraction results from the declining underwriting profitability of this line of business (see paragraphs 3.26 and 3.69). We found some evidence that underwriting profitability has decreased due to sustained inflation in escape of water claims over the last 15 year and this was exacerbated by the more severe fire risks identified after the Grenfell tragedy.

1.14 The contraction in supply is likely to have reduced competition in this market. Competition can drive lower prices as purchasers can choose between suppliers. In a contracted market, there is less pressure on prices which can lead to increases.

1.15 We have observed trends which are consistent with market contraction, as well as the increased risk exposure from identifying that a building could be destroyed by fire due to flammable cladding or other material fire risks. These include, in some cases, multiple insurers underwriting a single policy and risk layering. This frequent use of excess layers or secondary markets[3] allows the risk to be spread across more than 1 insurer to reduce their individual exposure to catastrophic loss. However, risk layering is likely to be more complex and more costly. It can also involve reduced coverage or higher excesses where individual insurers (particularly excess layer or secondary markets) have different risk appetites or willingness to provide elements of cover.

Premium rates have doubled between 2016 and 2021

1.16 Premium rates for multi-occupancy residential buildings have risen significantly. Mean prices have increased by 125% from 2016 to 2021 across the sample, driven primarily by the risks from properties with flammable cladding or other material fire safety risks. The number of properties insurers have identified as having such issues has risen throughout the period and more steeply between 2020 and 2021, as more detailed building surveying work is undertaken and completed across the population of affected buildings. In some cases, a lack of appropriately qualified surveyors and building fire safety experts has delayed insurers' efforts to better understand the risks being underwritten.

3 Excess layer or secondary insurers are those who sit behind the primary insurer and will only suffer losses in the event that a claim exceeds a certain level. For example, for a building with a total sum insured of £50m, it may be that the primary insurer would underwrite the first £20m of the total sum insured, with 3 excess layer insurers then covering the layers from £20-£30m, £30-£40m and £40-£50m. These insurers would only be exposed to paying claims in the event of losses of a sufficient scale to reach the relevant layer. Excess layer insurers may include reinsurers and other insurers who do not normally underwrite or have specific expertise in this insurance product, as they sit behind and place a degree of reliance on the primary insurer.

1.17 The increases in premium for properties with flammable cladding and other material fire safety risks are lower where these properties are insured as part of a larger property portfolio along with properties without these risks, than where they are insured on an individual basis.

1.18 While we have been able to identify the main drivers of the price increases, we were not able to assess whether the increase in premium rates is fair and appropriate for the risks being underwritten. This is due to the complexity of underwriting and risk pricing this line of business, not least given the evolution in the fire risk assessments being undertaken since Grenfell and the issues being identified, as well as the limitations in the data available to us. But we do recognise that the reduction in availability of cover and the significant increase in premium has had material negative impacts on leaseholders.

1.19 We found that insurers' approach to pricing is based on total loss, as opposed to loss of life. Successful remediation for the risk of loss of life does not, on the basis of the way insurers price, usually equate to remediation of the issues in terms of fire risk to the building and the potential for total loss. This means insurers do not believe the premium reduction from remediation will result in the premium returning to the rates previously charged. The level of reduction will depend on the extent to which the full range of identified fire risk factors have been addressed.

1.20 The data provided by insurers included a very limited number of buildings where flammable cladding had been fully remediated during the period under review. From those buildings, it appeared that, regardless of insurers' approach to pricing, the premium would remain subject to the general level of claims inflation applicable to this market over the period.

Commission rates for brokers vary but we found evidence of some high commission rates and poor practice which are not consistent with driving fair value to the customer

1.21 Brokers arranging multi-occupancy buildings insurance for the owners and managers of these buildings can be remunerated in a variety of ways, including through fees and work transfer payments. However, based on our analysis and the discussions in our workshops, this remains primarily a commission-driven remuneration model, especially when insuring individual buildings rather than portfolios of buildings.

1.22 The commission rate paid by the insurer to the broker varies significantly. In most cases within the observations we received and used for our analysis it is at least 30% (they range from <10% to 62%). The level of some commissions in this market are an area of significant concern.

1.23 The broker often shares the commission with the freeholder or the property managing agent. Brokers in our workshops explained they share their commissions so that freeholders and property managing agents can be remunerated for the support they provide to procure insurance and then to deliver elements of post-sales service. For example, to provide necessary evidence on the buildings' features, instruct survey work and administrative services. Property managing agents, most of whom are not regulated by the FCA, are usually remunerated by the leaseholder for the activities they perform through a service charge. Freeholders often play a more limited role in obtaining insurance. So, it is often not clear why it is appropriate or necessary for property managing agents or freeholders to receive additional remuneration via broker commissions. We are very concerned that this practice does not represent value ultimately for the leaseholder.

1.24 While property managing agents are generally not FCA-regulated, we want to ensure that the remuneration all parties receive is fair relative to the benefits their work provides. The level or even existence of commission is generally not made clear to leaseholders and the amounts of broker commission freeholders or property managing agents get are even less likely to be known to leaseholders. Leaseholder groups noted concerns about remuneration and the potential for secret or hidden commission and profits. We share these concerns, particularly where there is no transparency and the amounts in question are broker commissions from the regulated activity of arranging insurance.

1.25 Commission percentage rates have fallen across the period for buildings with flammable cladding within our analysis. The mean commission rate retained by the broker and the commission rate passed to the freeholder or the property managing agent for these buildings fell by 6 percentage points in the period after the Grenfell tragedy. However, the mean absolute value of commissions more than tripled for brokers between 2016 and 2021 (261% increase) and more than doubled for freeholders/property managing agents (137% increase).

1.26 Commission percentage rates remained broadly stable across 2016-2021 for buildings without flammable cladding. However, the mean absolute value of commissions gradually increased in the same period (by 51% for brokers and 30% for freeholders/property managing agents).

Concerns relating to quality of service, renewals and frictional costs

1.27 We found that the distribution of insurance for multi-occupancy buildings is complex due to the nature of property ownership in the UK. We found that the demand side[4] is weak and is unable, or potentially unwilling, to place downward pricing pressure on insurers or brokers. This is exacerbated by leaseholders, who in almost all cases have the insurance bill passed to them, having no role in the process to exert any leverage or information that would allow them to challenge the chain.

1.28 We have seen that buyers, including property managing agents and freeholders (or their representatives), are finding it more difficult to get insurance than before Grenfell, and that this issue was acute for buildings with flammable cladding. They noted a lack of choice with often no alternative to the incumbent insurer and a range of frictional costs and service issues. We found that these issues included the increasing volume and variety of risk information and buildings surveys requested by insurers, the rejection of risks or refusal to underwrite the entire risk by the incumbent insurer and the late provision of quotes leaving no time to negotiate or seek alternative options.

1.29 Where alternative insurance providers are available, we heard that certain frictional costs can limit the extent to which freeholders and property managing agents switch away from their incumbent insurer at the end of a policy. Although not conclusive, our analysis suggests that renewals with the same provider have higher premiums.

4 By demand side, we mean the buyers of insurance for multi-occupancy buildings, including freeholders, property managing agents, housing associations, right-to-manage companies and their representatives.

Lack of transparency and increased cost for leaseholders leading to significant distress

1.30 Leaseholders and their representatives noted many of these same issues. They also expressed understandable frustration with the many parts of the process of insuring buildings where they do not receive relevant information, access or rights despite the fact that they pay for the insurance. Their experience is frequently of an ongoing lack of transparency and disclosure from both the insurance and the property sectors. This includes often finding it difficult to get even the limited or partial information they are currently entitled to. These issues have caused considerable distress for many leaseholders, including on their mental health and wellbeing.

1.31 Leaseholders also explained their material concerns around remuneration practices, and the lack of regulatory protection or access to recourse. Leaseholders generally have no voice in choosing the insurer or broker, despite the fact that this determines the amount they have to pay for insurance and the benefits they can receive from it. In this context they also noted the significant potential for unmanaged conflicts of interest where freeholders or property managing agents make these choices and may be driven by their own interests, including the associated levels of earnings.

Competition is not working effectively for customers

1.32 Our review found some evidence that competition in this market does not appear to be working effectively to ensure that all customers (and the leaseholders who bear the costs) can consistently get appropriate insurance cover for multi-occupancy buildings at affordable prices. Features of the multi-occupancy residential buildings insurance market that could be limiting or undermining effective competition are:

- The exit of some insurers from the market has reduced the number of firms prepared to underwrite material numbers of buildings exposed to flammable cladding risks to a core group of 5 insurers. The remaining 5 insurers supplying insurance for these buildings have limited commercial incentive to supply this insurance, reducing the pressure on insurers to lower prices.
- Leaseholders often have limited visibility on why a particular insurance policy may be selected over others, as well as on the remuneration paid to parties in the distribution chain. They also have few routes to challenge the insurance costs passed on to them by freeholders. This limits their ability to put pressure on the different elements of the insurance cost (eg insurance premium, commission to brokers and freeholders/property managing agents).
- The fact that some freeholders and property managing agents receive a share of the insurance commission could be giving them an incentive to consider the impact on their own remuneration when choosing an insurance policy.
- Costs and frictions associated with searching for alternative offers and switching to a different insurer could be dampening competition between insurers, leading to higher premiums.

Other findings on the regulation of insurers and brokers

1.33 We have found that there were material issues and shortcomings in the availability, accuracy and quality of data consistently recorded by insurers and brokers. These have significantly affected our ability to carry out our analysis and reach definitive conclusions.

1.34 We expect regulated firms involved in this line of business to improve the quality, depth and consistency of information they systematically record and are able to report, particularly features and risk factors materially affecting the premium.

1.35 While the lack of consistent data has limited the ability to draw firm and reliable conclusions, it suggests that remediation, where it is sufficiently extensive to address key fire risks to the building as well as risks to life, can effectively reduce premiums.

Monitoring and update

1.36 We will continue to monitor this market while we take forward our program of actions in concert with the insurance industry, Government and other stakeholders. We will publish an update statement in 6 months on the progress made against the recommendations and potential remedies set out in this paper.

Recommendations and potential remedies

1.37 We have set out our recommendations and potential remedies below in Section 4 of our review. They are summarised below:

Key findings	Action we will take	Recommendations for others
There has been a contraction in supply and competition is weak in the market, with insurers having limited appetite for buildings with flammable cladding. This is resulting in high premiums for some buildings causing harm to leaseholders and others who ultimately bear these costs	We will continue to work with the insurance industry and Government to develop proposals for how a cross-industry risk pooling solution could work in practice, including considering the role of the reinsurance sector.	We recommend that the Association of British Insurers (ABI) work with Government and us to create a risk pooling solution, providing a plan for this solution and its implementation within 2 months. This plan should include estimates of the impact on premiums. We recommend that the British Insurance Brokers' Association (BIBA) engage with the design of the risk pool to limit the commission costs, reducing the price passed on to leaseholders. We recommend that the Department for Levelling Up, Housing and Communities (DLUHC) consider Government providing financial backing of the risk-pool.
There is an ongoing lack of transparency and disclosure for leaseholders from both the insurance and property sectors	We will consult on improved information disclosure from regulated parties for leaseholders. We are seeking views on exactly what information this should cover.	We recommend that Government consider imposing a legal requirement on freeholders and property managing agents to provide information on the insurance policy to leaseholders. This should include passing on the information which regulated insurers and brokers provide to them.
Leaseholders are not customers in FCA rules or in insurance contracts	We will consult on amending our rules to classify leaseholders as *customers*. We are seeking views on to which parts of our rules this change should apply to.	Government may wish to consider ways in which leaseholders could be made parties to insurance contracts. We also recommend Government consider ways to give leaseholders a straightforward and easily accessible route to challenge insurance costs passed on to them by freeholders.

Key findings	Action we will take	Recommendations for others
The increases in absolute commission earned by brokers, freeholders and property managing agents may be disproportionate to increases in service costs	Our rules require that the prices paid represent fair value. We will undertake a review of those brokers who charge the highest commissions, and publish our findings. We are also considering further rules on remuneration. This could include preventing remuneration being paid to unauthorised parties, and prohibiting remuneration calculations as a percentage (instead requiring it set in monetary terms).	Government may wish to consider legislation applying directly to unregulated property managers and freeholders regarding their remuneration.
There are material issues and shortcomings surrounding the availability, accuracy and quality of data recorded consistently by insurers and brokers involved in the multi-occupancy buildings insurance market.	We will support the insurance industry in the development of a common code for the core risk data which should be collected and recorded consistently to facilitate the risk pooling arrangement and the functioning of a competitive and effective market.	We recommend that the ABI and BIBA work with industry participants to establish a common code for the core pieces of risk information to be systematically collected and recorded for multi-occupancy buildings affected by flammable cladding or other material fire safety issues. We recommend that this code is designed and communicated by the end of 2022, and implemented by the industry by the end of February 2023.
The lack of appropriately qualified surveyors and building fire safety experts was also identified as having delayed insurers' efforts to better understand the risks being underwritten.	Remedies are outside our remit.	Recommendations are outside our remit.

Risk pooling

1.38 We have found that prices have increased for insurance for multi-occupancy buildings with flammable cladding by 187% and that availability has decreased. We have also found competition in this market is not working well to support increased availability or lower prices. We have considered a range of interventions to tackle the problems identified and these are set out at Section 4 below.

1.39 As set out in the summary above, we have identified a range of remedies based on disclosure and transparency, targeted regulation of practices in the insurer and broker industry to improve the way premium are provided on renewal and quality of service. These will support this market. However, we have not found evidence showing that there is excess profitability in this market for insurers and so, based on the way competition is working, we do not anticipate that prices will decrease for the majority of customers as a result of these proposed remedies.

1.40 We therefore consider the intervention most likely to reduce prices for the minority of multi-occupancy buildings with the most substantial price increases, would be cross-industry risk pooling or sharing. This would enable the risk of covering certain higher risk buildings, notably those severely affected by flammable cladding (or other material fire safety risks giving rise to the risk of total loss of the building), to be shared across multiple insurers. An effective risk pooling arrangement is also likely to reduce the amount of work required of brokers and other parties when placing the risk; especially if the current layering is no longer needed. This should result in a corresponding reduction in commissions, and we would expect this reduction to be passed on to leaseholders.

1.41 Any such pooling arrangement could potentially be designed for and targeted solely at those multi-occupancy buildings not already benefitting from the pooling effect of being insured as part of a larger portfolio of buildings. This would differ from the layering described above in paragraph 1.15 in that it could potentially involve the primary insurers active in this market pooling the more complex or challenging risks between them, on similar terms and without the level of risk premium often required by secondary markets.

1.42 Industry figures suggest greater and quicker reductions could come from Government providing backing to cover this minority of higher risk multi-occupancy buildings. These buildings are those which are beyond or at the margins of the risk appetite of insurers due to the impact of flammable cladding (or other material fire safety issues giving rise to the risk of total loss of the building) and not already benefitting from the pooling effect of being part of a larger portfolio of buildings.

1.43 Our recommendations in relation to risk pooling are:

- The ABI, on behalf of the insurance industry, continue to work with Government and us to create an effective risk pooling arrangement to share the risks of properties affected by flammable cladding and other material fire safety risks. This includes developing criteria for accepting buildings into the pool. We would expect a plan for this arrangement and its implementation to be in place in the next 2 months. This plan should include estimates of the impact on premiums for eligible buildings.
- BIBA, on behalf the insurance broking industry, engage with the design of a risk pooling arrangement and consider how to ensure that substantive commission reductions are achieved and can be reflected in the amount leaseholders pay. In this context we would expect the amount of work performed and value added by the broker to be the key driver of the level of remuneration and assessing whether this is reasonable and appropriate, in the context of the relevant product governance rules. This is as opposed to the level of remuneration being determined more arbitrarily as a set percentage of premium even where very substantial increases in that premium have not been matched by commensurate increases in the amount of work undertaken by the broker.
- DLUHC consider whether Government backing of a risk pooling arrangement could lead to quicker and more substantial reductions in the costs paid by leaseholders.

Stronger protections for leaseholders

1.44 There continues to be a complex distribution chain in this sector, with many parties sitting between the insurer and the leaseholders who ultimately pay for the policy. Leaseholders often do not receive sufficient information to enable them to understand the policy and the price they are paying. We will consult on improved information disclosure for leaseholders. This could include information about the policy, including about remuneration of all parties in the distribution chain. We will also consult on changes to our rules to specifically include consideration of leaseholders' interests.

1.45 Our product governance rules require firms to consider fair value and act as an important protection against unjustified commission levels. Using these rules, we will undertake a multi-firm review of those brokers who charge the highest commissions and consider whether further rules on remuneration (such as preventing percentage-based commission structures) are required. We intend to publish the outcomes of this review in the first half of next year. This will include considering whether leaseholders may benefit from additional specific rules preventing some potentially harmful practices around commission, in the context of a market where premiums have increased substantially.

1.46 As we cannot make rules for unregulated firms, we recommend that Government could consider requiring freeholders and property managers provide the required information to leaseholders, and whether there should be new obligations about commission received by unregulated parties.

1.47 To put pressure on firms to improve their practices around product selection and remuneration, leaseholders need an effective, cheap and timely mechanism to challenge costs passed on to them. Without that, giving them additional information is unlikely to lead to any significant benefit. Government may consider ways to give leaseholders a straightforward and easily accessible route to challenge insurance costs passed on to them by freeholders. One option, for example, would be an independent alternative dispute resolution mechanism.

Industry data and approach

1.48 The absence of a consistent approach to underwriting, broking and recording key risk information in the multi-occupancy property insurance market serves to create significant frictions for users of this market. It also makes it very difficult to consider the appropriateness and fairness of premium and remuneration levels, as set out in Section 3 of this report. This has also had a substantial impact on our ability to quantify the impact of various remedies.

1.49 We understand the need for market participants to be able to follow their own underwriting and broking methodologies, to be able to provide cover for a diverse range of risks, price appropriately and facilitate competition. However, this does not preclude a greater degree of consistency being established for the core elements of risk information relevant to broking and underwriting policies for buildings affected by flammable cladding or other material fire safety issues. This is particularly important for those factors which are significant drivers of increased prices, and which will remain relevant throughout the coming years as remediation work is undertaken to reduce the fire risks identified in these buildings.

1.50 In this context, we recommend and expect that the ABI and BIBA work with industry to establish a common code for the core pieces of risk information to be systematically collected and recorded for multi-occupancy buildings affected by flammable cladding or other material fire safety issues. It may be appropriate for this code to reference relevant standards established by other bodies, such as Publicly Available Specification ('PAS') 9980: 2022, Fire risk appraisal of external wall construction and cladding of existing blocks of flats – Code of practice (published by the British Standards Institution), where such standards consider core risk elements of the fire risk of the building.

1.51 The lack of consistent data means it has not been possible for us to make observations in this report about the impact remediation of these issues has on the insurance premium charged for these buildings. We would expect any data collected to also record remediation information so we can measure the impact on the cost of insurance to leaseholders.

1.52 As such, there is a lack of clarity around the impact remediation has on insurance premium for these buildings. We accept that, from a claims perspective, there is a difference between the total loss of a building and remediation which serves to protect life. However, we would expect some recognition of the remediation work on premiums. We will do further work to ensure the industry is adopting appropriate and transparent processes and procedures to assess buildings where some remediation has occurred.

Next steps

1.53 We note that we do not preclude the opening of a market study into the subjects in this report if we do not see swift action and progress from the industry. A market study could lead to a market investigation referral to the CMA and a significant and detailed investigation into this market.

1.54 We will publish an update on progress on the recommendations summarised above (and set out in more detail in Section 4) in 6 months.

2 Overview

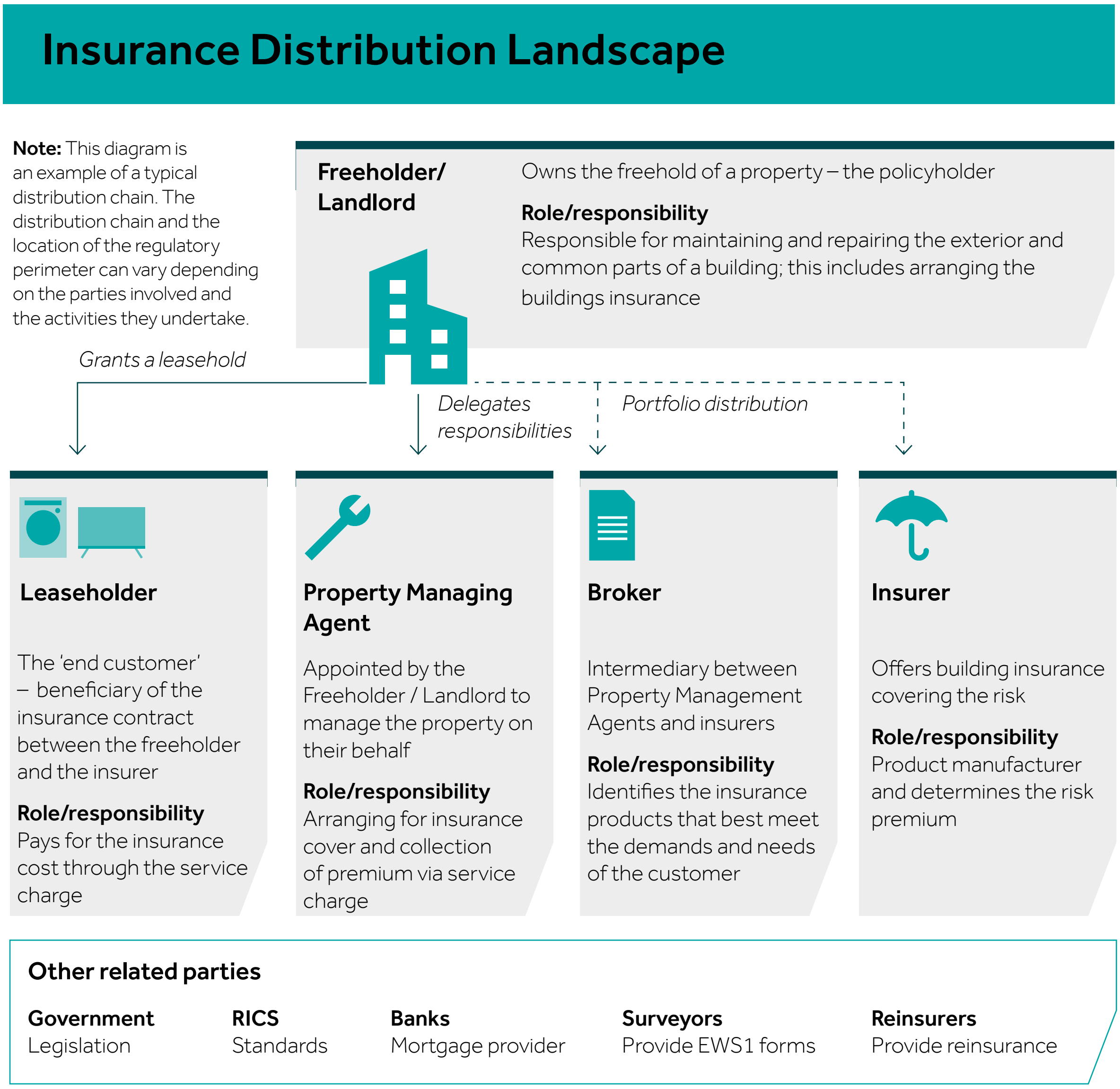
Market context

2.1 There are often several different parties involved in arranging insurance for multi-occupancy buildings. The freehold owners generally have responsibility for ensuring the whole property is insured, as the party with the insurable interest in the asset, but they are usually able to pass on the costs for insuring the building to the leaseholders. Many freeholders use professional property managing agents to manage their properties on a day-to-day basis. This role often includes undertaking many of the activities involved in obtaining insurance for the property, such as liaising with insurance brokers, arranging documents and surveys for presentation to the insurer and communicating with leaseholders.

2.2 Most insurance policies for multi-occupancy buildings are arranged and placed through regulated insurance brokers who present the risk and negotiate terms and prices with insurers, in exchange for remuneration in the form of commissions (a percentage of the premium) or fees. A proportion of the insurance commission deducted from the premium may be paid back to property managing agents or freeholder owners by the insurance broker. In some cases, notably where more complex risks are involved, multiple insurance brokers may be involved in arranging and placing the insurance cover. Insurance brokers are also often actively involved in the ongoing administration of the contract of insurance and related services, including those around claims. During the period covered by this review we have seen a reduction in the average percentage of commission taken by insurance brokers for multi-occupancy buildings. However, this reduction has been proportionally less than the increase in premiums on such buildings, so that there has been an increase in the overall level of remuneration to brokers through commissions. We set out and explain this in our findings below.

2.3 Insurers and brokers told us that it is increasingly common for multiple insurers to be involved in underwriting a single policy. This is often a direct consequence of the increased risk exposure from some buildings previously insured on the basis that their construction meant they could not be destroyed by fire but which have subsequently been found to have flammable cladding or other serious fire risks which have a material impact on the likelihood of a severe or total loss.

2.4 A typical distribution landscape for multi-occupancy buildings insurance is set out in the diagram below:



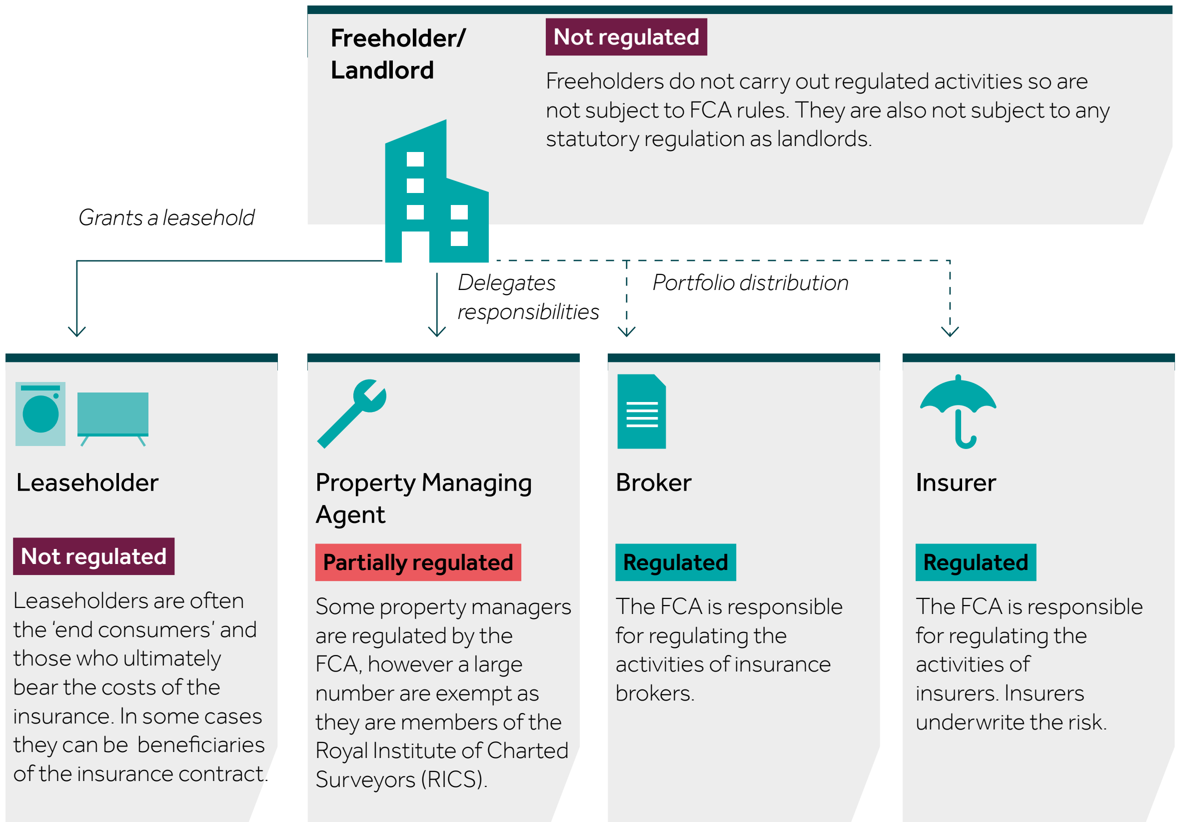
*Where a **Right To Manage** Company is established by leaseholders to manage the property on behalf of the landlord, leaseholders will be responsible for arranging insurance cover and collection of premium. In many cases the company will employ a property managing agent to undertake property management services on its behalf including obtaining insurance for the building.*

2.5 The diagram above captures a typical distribution arrangement for a single commercially owned multi-occupancy residential building. Two key variations relating to the ownership of the building which can also affect this distribution arrangement are where properties are owned within large residential or commercial property portfolios, and where the building is owned by a public sector body or a housing association. These variations can also affect both the availability and cost of insurance for a building. For example, being part of a larger property portfolio may make it significantly easier and cheaper to insure a building affected by flammable cladding or other material fire risks.

2.6 The range of parties and stakeholders involved in and affected by the insurance of multi-occupancy buildings brings complexity and creates unique challenges. Unlike most home insurance, leaseholder homeowners are not usually party to the insurance contract and so do not pay any premium directly to the insurance broker or insurer. Instead, their relationship is commonly with the freeholder only, with insurance costs forming part of payments due under the lease agreement. Insurers and insurance brokers typically have no direct relationship or communication with leaseholders, other than when the leaseholders may be direct beneficiaries of some elements of the insurance cover, such as being provided with alternative accommodation. A single insurance policy may ultimately be paid for by hundreds, or possibly thousands, of leaseholders through tenancy or service charges. Some of these leaseholders will be commercial organisations as well as residential property owners. Their level of knowledge and understanding, needs and expectations are likely to differ.

2.7 The complexity and scale of the risks involved in insuring multi-occupancy buildings has resulted in a relatively constrained market with a small number of insurers (less than 15) responsible for insuring most multi-occupancy residential buildings. A wider range of insurance brokers are involved in this sector. However, given the complexities involved around placing these risks these are generally larger insurance brokers or specialist property brokers. The period since the Grenfell tragedy has seen a further contraction in the market of insurers willing to underwrite multi-occupancy residential buildings and in the appetite of those insurers remaining in this sector to underwrite new risks, as we discuss below.

Regulated and unregulated parties within the multi-occupancy buildings insurance distribution chain



2.8 The parties involved in the insurance of multi-occupancy buildings sit across regulated and unregulated spaces. We are responsible for regulating the activities of insurers and insurance brokers. These firms must be authorised by us and must comply with our rules. Where we identify authorised firms causing harm, we can take action to address this. While some property managers are authorised by us, many are not as Part XX of the Financial Services and Markets Act allows them to undertake insurance distribution activities as members of the Royal Institute of Chartered Surveyors (RICS). Property managing agents are not subject to any statutory regulation for their property-related activities, though they may voluntarily belong to a trade association and submit to some form of voluntary regulation. Freeholders, who do not carry out regulated activities, are also not subject to our regulation or any other statutory regulation of their activities as property owners. Our powers to act against any of the unregulated parties are limited. The significant role played by unregulated firms in the property sector, and the 'gap' between regulated firms and leaseholders, both limit the affect our actions alone can have on identified harms.

2.9 Although the insurance market operates in broadly the same way across the UK, the ownership of multi-occupancy buildings can operate differently in some UK nations. We also know that some devolved administrations have taken a different approach to building remediation following Grenfell. In this report, references to 'government' should be taken to include the 4 different governments within the UK.

Scope and methodology

2.10 As set out in the executive summary above, our work has focused on understanding and assessing the factors which affect premiums for multi-occupancy buildings. We have considered:

- insurers' risk appetites, underwriting and pricing approaches (the methodology used to assess the risk and set the price)
- the effect on pricing of cladding or material fire risk, as well as other factors (eg pooling together the risks of multiple buildings)
- the role of parties both within and outside the scope of FCA regulation (including insurance brokers and property managing agents) in the distribution chain, and the impact of the remuneration paid to them
- relevant changes to the regulatory environment for buildings and fire safety

2.11 To inform our work, we requested extensive information from a sample of 17 insurers and 26 brokers[5], which constitute the majority of insurers and brokers active in the multi-occupancy buildings insurance market. The insurers and the brokers were selected independently of each other to get broad market coverage, following consultation with relevant trade bodies and exploratory market analysis.

2.12 The information we obtained through our request consisted of:

- qualitative and documentary information on areas such as risk appetite, underwriting approach and standard policy wordings (including applicable terms, conditions and excesses)

5 Our sample included both composite and Lloyd's and London market insurers of a variety of sizes, as well as brokers active in this sector ranging from the largest international brokers to small specialist property brokers.

- quantitative data on policies underwritten in the period 2016-2021 for mid-rise and high-rise multi-occupancy buildings, covering key policy features such as the premium and the sum insured, and information on risks like claims and exposure to flammable cladding

2.13 Our analysis uses data from a subset of the firms we approached with our request – 13 insurers and 13 brokers. A few of the remaining firms were not able to provide the requested information, while the information of others could not be reliably incorporated into our work. Issues and shortcomings surrounding the availability, accuracy and quality of data consistently recorded and retained by both insurers and brokers on the insurance of multi-occupancy buildings have presented significant challenges to performing this piece of work and analysing the key issues affecting those bearing the costs of this insurance. Going forward, all regulated parties involved in this line of business should work to improve the quality and consistency of information recorded.

2.14 Based on the estimates of the Department for Levelling Up, Housing and Communities (DLUHC), the insurer data we used for our quantitative analysis cover no more than 15% of all mid-rise and high-rise multi-occupancy buildings in the UK; our broker data cover no more than 8% of the buildings. This may be partly because of the process insurers and brokers followed to identify mid-rise and high-rise buildings in their books (ie using sum insured as a proxy), which differs from DLUHC's methodology to arrive at its estimates (which relies on Ordnance Survey data).[6] It may also partly be due to the cleaning process that we followed to arrive at a more reliable sample for our analysis. For more information on how we arrive at our clean dataset and more details on our sample coverage see paragraphs 3.2-3.21.

2.15 However, we are confident that our data reflect information from the most important insurance providers in the market. We verified this by cross-referencing the data we received from the insurers and the brokers. The insurers identified in more than 70% of our broker data observations are insurers that provided us with their own data. This suggests that we have surveyed and obtained information from the insurers currently underwriting most of the multi-occupancy residential buildings in the UK.

2.16 Despite the seemingly limited coverage of our sample, our assessment is that the use of both insurer and broker data and our data cleaning process, combined with the qualitative evidence we obtained, allow us to draw meaningful conclusions in the areas we cover in this report.

2.17 Alongside our analysis of the information received from insurers and brokers, we reviewed the range of other information we receive, including MPs' letters and complaints from consumers and their representatives about insurers and brokers. We also carried out a programme of engagement with both market participants and other stakeholders. Our programme of engagement included:

- two sets of roundtable workshops with insurance industry participants (including insurers, insurance brokers and trade bodies). The first set of workshops enabled us to enhance our understanding of this sector and the issues affecting the availability and affordability of insurance for multi-occupancy buildings. The second set allowed us to discuss and seek feedback on a range of potential actions and interventions to help resolve these issues.

6 It is possible that DLUHC's estimates overstate the actual number of buildings, as they themselves recognise.

- roundtable workshops with a range of demand-side stakeholders including leaseholder representatives, cladding action groups, freeholders, property managers and property industry trade associations, to understand their experience of multi-occupancy buildings insurance and seek their perspectives on the issues in this sector and a range of potential actions and interventions to address them.
- separate meetings with other demand-side stakeholders including property industry trade associations and housing associations to understand their experiences and perspectives.

2.18 We have used the information and insight from these roundtable workshops and meetings to challenge and validate the information from firms and our analysis of this, informing our conclusions about the availability and affordability issues in this sector and the actions and interventions likely to help to reduce these.

Theories of harm

2.19 When we began our work we identified 2 ways leaseholders may be harmed by current market practices. These were market failures through pricing or product supply, and through product distribution.

Harms from pricing and/or product supply

1. The severity of the building safety issues revealed following the Grenfell tragedy may have resulted in the following issues:
   a. Insurers retrenching, declining to bid for new business of multi-occupancy buildings, or charging particularly high premiums to insure them. This could reflect actual risk, or it could be the result of inaccurate risk assessments or strong risk aversion; and/or
   b. Some insurers withdrawing from the multi-occupancy buildings market, limiting competition and reducing the pressure to lower prices.

2. Following Grenfell, insurers may have also increased insurance prices for multi-occupancy buildings without cladding risks. This could be because:
   a. The issues with flammable cladding are seen as indicative of broader issues with building quality likely to lead to higher claims, for example, issues with plumbing systems leading to claims for escape of water throughout a building;
   b. The increased insurance premiums for buildings with flammable cladding acted as a reference point that also triggered higher premiums for buildings without cladding concerns; and/or
   c. Products may not be priced fairly, leading to leaseholders paying excessive prices relative to the benefits the policy provides to them.

Harms from product distribution

3. Freeholders, property managing agents and insurance brokers may be choosing insurance policies that maximise their own remuneration – any commission or fees they receive – rather than the policy that offers leaseholders the best value.

4. There may be a lack of pressure on freeholders, property managing agents and insurance brokers to search for the policy that offers the best value-for-money or to switch to better-value policies or cheaper alternatives which may benefit leaseholders because:
   - Freeholders know they can recover their costs from leaseholders so have no incentive to look for cheaper or better value policies;
   - Leaseholders may lack the information or the means with which to challenge service charges from the freeholder;
   - Freeholders' property managing agents and insurance brokers may have commercial arrangements with particular insurers which benefit them but not leaseholders, such as captive reinsurance arrangements; and
   - Switching costs, such as long onboarding processes, may be preventing freeholders from switching to a cheaper insurer or broker.

5. Insurers may be taking advantage of the lack of incentives to switch by charging higher prices than they would in a competitive market, for example, by charging a loyalty penalty.

3 Our review and findings

Key methodological points on the quantitative analysis

3.1 The data received from both insurers and brokers was not complete and had limitations, and so did not allow us to undertake the full range of analysis we would have liked to reach clear and firm conclusions. In many cases this was due to firms not collecting or consistently recording the relevant data. This includes key data points relevant to understanding the risk of loss and the drivers of price. Firms need to do more to collect and systematically record the relevant data required to drive consistency and transparency for users of this market and to ensure that they are able to evidence that they are consistently meeting their regulatory obligations, including around delivering fair value. We worked with the data available to ensure that it was as consistent as possible across firms and we have reflected the data limitations in our conclusions.

How we get to our final datasets for the analysis

3.2 We requested data on building insurance policies from 17 insurers and 26 brokers. Our analysis uses data from a subset of these firms – 13 insurers and 13 brokers. Of the remaining firms:

- 3 insurers and 7 brokers explained that the multi-occupancy residential buildings insurance market is not a sector where they underwrite or intermediate large volumes of business
- 2 brokers explained that, while they operate in this area, they do not systematically record the requested information in an electronic format
- 1 insurer's data could not be reliably interpreted as they were provided without using the template supplied[7]
- 1 broker is a Managing General Agent that exclusively intermediates between insurers and other brokers in this market, rather than between insurers and freeholders/property managing agents, so the information it provided is not directly comparable to that of other brokers[8]
- 3 brokers only provided data on policies with renewal/inception dates after 2021

3.3 Our insurer data record 269,798 observations for the period 1 July 2016 – 31 December 2021. Our broker data contain 104,041 observations for the period 1 January 2016 – 31 December 2021. For each year we assume that each observation corresponds to an individual building and this is consistent with what firms have told us about the data they have supplied.[9]

3.4 The focus of our work is on mid-rise and high-rise buildings. For this reason, our request to insurers and brokers was for information on buildings exceeding 11 metres or 3 floors in height. In cases where it was not possible to use these metrics as identifying factors,

7 Excluding this insurer has negligible impact on our analysis as the dataset it provided reports fewer than 30 observations.
8 Excluding this broker has negligible impact on our analysis as the dataset it provided reports fewer than 80 observations.
9 In the insurer data each observation has a unique building address and postcode variable. Instead, in most cases the broker data only report the building postcode, and we may see the same postcode for multiple observations in each year. When the broker data report the same postcode for multiple observations in a year, we assume that observations which share the same postcode correspond to neighbouring buildings.

insurers and brokers relied on the proxy of a sum insured exceeding £2.5 million. This proxy was considered appropriate to get to a more complete sample of high-rise and mid-rise multi-occupancy residential buildings identified by firms. This because, based on the information available to us, we consider the sum insured for any buildings exceeding 11 metres or exceeding 3 floors in height is unlikely to be less than £2.5m, taking into account the scale of these buildings and anticipated level of rebuild costs.

3.5 To mitigate the risk that our sample includes low-rise buildings that were misidentified as mid-rise or high-rise[10], we further filtered the data we received as follows:

- Insurer data: We matched our insurer data with a building heights dataset by Ordnance Survey (OS) and filtered out all observations which, according to OS, correspond to buildings that fall short of the 11-metre threshold. The matching was done on the basis of building address and postcode. We removed observations that could not be matched with the OS dataset, for example, due to the address format provided, from our sample. This step dropped 129,900 observations from our insurer data.[11]
- Broker data: We removed all observations from our sample that, according to the brokers, correspond to buildings below 4 floors, as well as observations for which no height metric is provided.[12,13] This step dropped 61,472 observations from our broker data.[14]

3.6 For buildings insured as part of a larger portfolio, the insurers and the brokers were asked to provide building-level insurance information where available. For example, the premium charged to each individual building in the insured portfolio, rather than the total premium for the entire portfolio. However, in some cases certain insurers and brokers only provided policy-level data. We excluded such observations from our analysis, as we cannot extrapolate the desired building-level information from the policy-level data. At this step we dropped 72,920 observations from our insurer data and 4,555 observations from our broker data.

3.7 Finally, we also dropped from the broker dataset:

- 144 observations where 100% of the commission is reported as being passed on to the freeholder/property managing agent. This is because we consider these to be data input errors.
- 745 observations for which the breakdown of the commission rate between the broker and the freeholder/property managing agent is not provided. This is because the breakdown of the commission rate is a key variable in the analysis we conducted on the broker data.

3.8 Following the data cleaning exercise outlined above, our final insurer dataset contains 66,978 building-level observations between 1 July 2016 and 31 December 2021, and our final broker dataset contains 37,125 observations between 1 January 2016 and 31 December 2021. These are the datasets we have used for the quantitative analysis reported in this document.

10 We confirmed that such misidentification was a frequent occurrence by tracking a sample of the building addresses in our data on Google Maps.

11 44,718 observations were dropped because they could not be matched with the OS dataset. 85,182 observations corresponded to buildings with height less than 11 metres.

12 The floor height variable is systematically provided in the broker data but not in the insurer data.

13 The address information in the broker data is often incomplete or contains non-systematic errors. For this reason we were not able to use the OS data to identify building heights in the broker dataset.

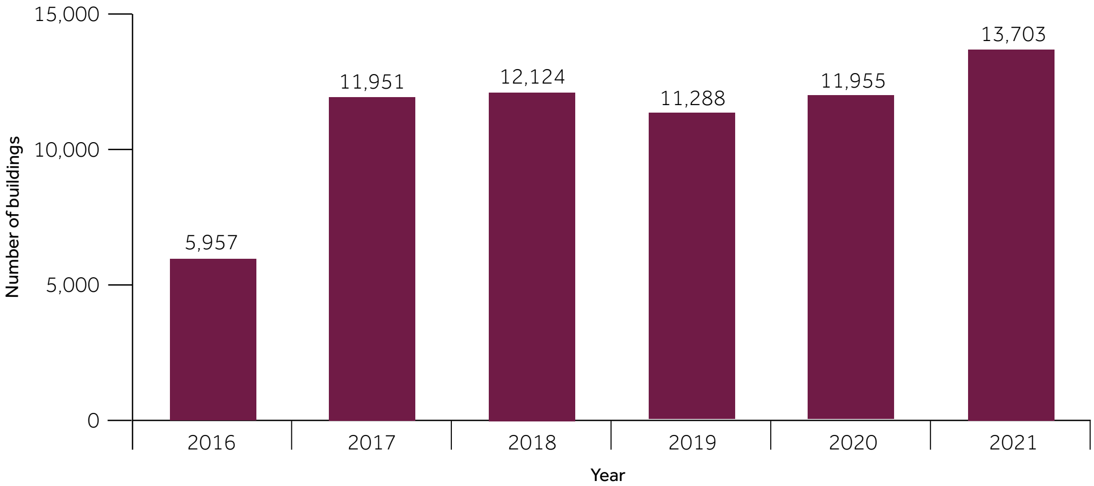
14 59,617 observations were dropped because no height information was not provided. 1,855 observations corresponded to buildings with 3 floors or fewer.

3.9 Our final datasets have much fewer observations than the data we originally received.[15] However, using our clean datasets we are more confident on the following 2 key points:

- our results are not influenced by insurance information on low-rise buildings, which lie outside the scope of our work
- our results are more reflective of building-level trends, as they are not contaminated by policy-level information – for policies covering portfolios of buildings – or data input errors

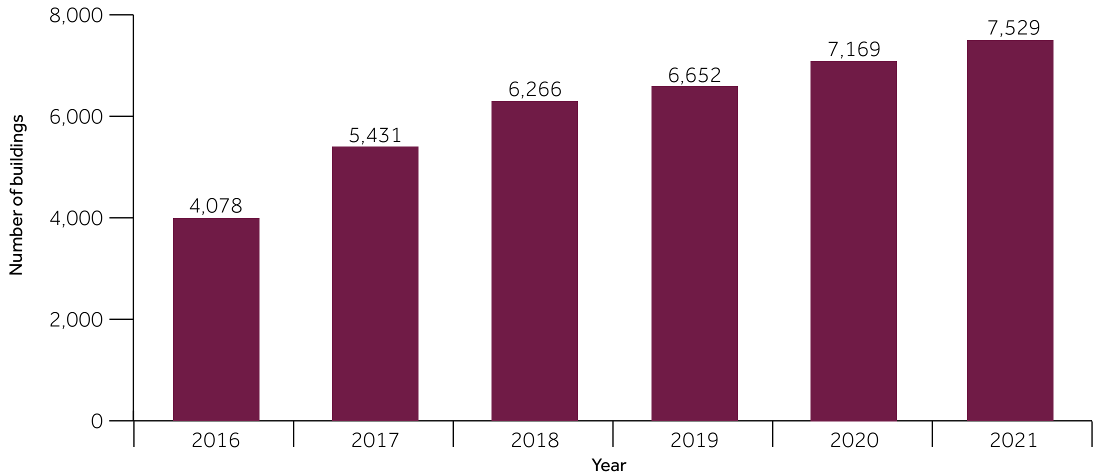
3.10 The following 2 bar charts show the number of observations in our final datasets in each year – in other words, the mid-rise and high-rise buildings captured by each dataset in each year.[16] We note that our insurer data cover only the second half of 2016.

The number of mid-rise and high-rise buildings in the final insurer dataset, 2016-2021



Source: FCA analysis of building-level data collected from insurers

The number of mid-rise and high-rise buildings in the final broker dataset, 2016-2021



Source: FCA analysis of building-level data collected from brokers

15 We discuss the coverage of our sample in paragraphs 3.12-3.17.

16 The difference in the number of observations in each year between the two datasets stems from differences in the size of the initial samples (paragraph 3.3) as well as slight differences in our approach to data cleaning (eg paragraph 3.5) due to the different limitations of each dataset.

3.11 The number of building-level observations in our datasets increase over time. We understand from insurers and brokers that this is expected as their identification and recording practices have gradually become more detailed and systematic during the period since the Grenfell tragedy, allowing them to better identify the population of buildings that are within the scope of our work.

Sample coverage

3.12 Insurers and brokers explained that they were more likely to collect detailed information on buildings insured individually or in smaller portfolios. As such, the insurer and the broker data that we have used for our analysis are likely skewed towards such buildings compared with the population of all mid-rise and high-rise multi-occupancy buildings.

3.13 Based on estimates by DLUHC, our clean data from insurers cover no more than 15% of all mid-rise and high-rise multi-occupancy buildings in the UK; our clean data from brokers cover no more than 8% of the buildings. Though this proportion may appear relatively small, our assessment is that the use of insurer and broker data and the data cleaning process, combined with the qualitative evidence we obtained, allow us to draw meaningful conclusions in the areas we cover in this report.

3.14 DLUHC estimates a total of 90,500 mid-rise and high-rise buildings in England, up to 9,300 of which are estimated to be exposed to flammable cladding.[17] In contrast, as of 2021 our insurer dataset observes 13,703 mid-rise and high-rise buildings across the UK, of which 505 have been identified by the insurers as affected by flammable cladding. In the same year, our broker dataset observes 7,529 mid-rise and high-rise buildings across the UK, with 633 identified by brokers as affected by flammable cladding.

3.15 There are a few factors that are likely to be driving this seemingly large difference in the number of buildings identified in our dataset and the number of buildings in DLUHC's estimates.

- Initial sample selection: As explained in paragraph 3.4, the majority of insurers and brokers in our sample identified mid-rise and high-rise buildings in their books using as a proxy whether the sum insured exceeds £2.5 million. This approach may be leaving out some buildings which fall just below the sum insured threshold but which DLUHC's methodology classified as mid-rise. However reducing this threshold further would likely have added further complexity to the data and the cleansing process through including far greater numbers of properties which are not mid-rise or high-rise.
- Data cleaning process: As described earlier in this section, data limitations required that we undertake extensive data cleaning to arrive at a sample of data we can rely on for this analysis. As part of this cleaning we had to exclude a large number of observations because we could not confirm the building height. We also had to exclude a large number of observations for which the insurers and the brokers did not provide us with the building-level information required for our analysis. As noted above, this may mean that the observations used in our analysis are skewed towards those multi-occupancy buildings insured individually or within smaller portfolios, when compared with the population of all mid-rise and high-rise multi-occupancy buildings.

17 DLUHC estimates there are 78,000 mid-rise buildings (September 2021 estimate) and 12,500 high-rise buildings (April 2020 estimate) in England, of which 6,200-8,890 mid-rise buildings (May 2022) and 486 high-rise buildings (May 2022) pose a life-safety cladding risk that requires remediation.

- DLUHC's methodology to estimate the number of mid-rise and high-rise buildings: As recognised by DLUHC, their methodology to arrive at its estimates, which relies entirely on OS data, may be overstating the actual number of mid-rise and high-rise buildings.[18]
- DLUHC's methodology to estimate the number of mid-rise buildings with flammable cladding risks: DLUHC's estimate of mid-rise buildings with flammable cladding risks may be overstating the actual number of such buildings, as it is an extrapolation from a desk-based survey on a random building sample.[19] Further, not all buildings with flammable cladding risks may be identified as such by insurers in practice. For example, in our roundtable workshops we heard that insurers' information requests are sometimes less extensive for buildings that are part of a large portfolio, and so they may not always identify and record buildings with cladding risks within these portfolios.

3.16 Nevertheless, we note that more than 70% of the 104,041 observations in the broker data we received, before any observations are dropped in the data cleaning, correspond to buildings covered by the insurers who provided our insurer data. This provides us with assurance that we have surveyed and obtained information from the insurers currently underwriting most of the multi-occupancy residential buildings in the UK.[20]

3.17 Given the data limitations and the limited coverage of the sample, we have tested the consistency of our findings with qualitative evidence from market participants. Our conclusions reflect this.

Using each dataset

3.18 We use our insurer data for some pieces of analysis and our broker data for others. This is due to each dataset having different strengths and limitations.

3.19 Our insurer data provide more accurate information on risk, and particularly on the exposure of buildings to flammable cladding. We use these data for all analysis on insurance pricing and premium trends, as, according to stakeholders, the exposure to flammable cladding is a key factor that affected pricing since the Grenfell tragedy.

3.20 The information on exposure to flammable cladding contained in our broker data is less clear and more difficult to interpret as it needed to be manually compiled in a free-text field due to it not being consistently recorded. However, these data contain information on the split of commissions between the brokers and the freeholders/ property managing agents, which is not available in the insurer data (the insurer data only report the combined commission). For this reason, we use our broker data for all analysis on commissions.

3.21 We had planned to match the broker data to our insurer data. This would have allowed us to check for potential inconsistencies in the 2 datasets (eg whether the 2 datasets report a different premium for the same building in the same year) and to combine the strengths of the 2 datasets (eg to use the better flammable cladding information

18 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1025165/Building_Safety_Technical_Note_September_2021.pdf

19 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1076034/11-18m_buildings_publication.pdf

20 We have not been able to perform a similar cross-check on all the brokers that intermediate the buildings in our insurer data, as this requires identifying all firm names that are owned by the same parent company, which is a particularly time-consuming exercise.

of the insurer data in our analysis of commissions). However, we were not able to match the 2 datasets reliably due to frequent non-systematic errors in the broker data's postcode and address variables. The inability to match the 2 datasets does not materially impede our analysis, as the 2 datasets observe broadly similar overall trends on premiums and combined commissions.

Findings in relation to insurers' risk appetite and pricing

Insurers' current approach to underwriting and pricing

3.22 We understand that many insurers' underwriting appetite in this sector has become significantly more cautious since the Grenfell tragedy, in light of the existing risks crystallised by this horrific event and the materially increased loss exposures subsequently identified. In our roundtable workshops we heard that insurers had re-evaluated both the probability of significant fire events occurring in these buildings and the potential severity and level of damage such events can cause to a building.

3.23 For some buildings with flammable cladding or other non-standard fire risks, insurers explained that since the Grenfell tragedy they have to underwrite for the possibility that a fire may destroy the entire building rather than just a small part of it, requiring them to alter their underwriting and pricing to reflect this new risk of catastrophic total loss events occurring. This risk was not priced prior to the Grenfell tragedy, as building safety standards were intended and designed to ensure that total loss of this type of building through fire was simply not possible and, in this context, insurers did not generally ask for more detailed fire safety information. Insurers are now taking a more risk averse approach and charging additional premiums for identified fire risks potentially giving rise to increased exposures until such point as they can be confident that these risks have been addressed or do not create additional exposure. Insurers and brokers noted that this was particularly applicable to buildings insured individually or in smaller portfolios, with limited or no opportunity for pooling these newly identified or increased risks.

3.24 We also heard in our workshops that building surveys and investigations undertaken since the Grenfell tragedy have identified multiple issues arising from broader problematic building practices or the use of materials no longer considered safe, indicating that some buildings are exposed to risks that were previously overlooked or under-priced, due to not having previously been fully considered or understood by insurers. Insurers informed us they are now attempting to understand these risks better through more in-depth information requests, relying on more extensive building surveys being undertaken. Flammable cladding is one risk for which insurers now seek very detailed information, alongside other factors affecting fire risk, such as compartmentation of the building, fire doors and wooden balconies.

3.25 The identified and perceived increased insurance risk has led the majority of the insurers active in this sector to reduce their appetite to cover high-risk buildings, assessing them in many cases to be outside their risk appetite due to the extent and severity of exposure arising from the potential total loss of the building. Of the qualitative responses we received from the 17 insurers included in our sample, 10 reported a reduced appetite to underwrite high-risk buildings, 3 did not respond clearly to this question, 1 had left the market entirely and only 3 insurers reported no material change to their appetite to cover high risk buildings.

3.26 Insurers noted that the increase in the assessed insurance risk due to the risk of total loss of some buildings has exacerbated the challenges already arising in underwriting residential property where, from the insurers' point of view, the profit margins in this market were already low due to attritional losses (ie multiple small losses), especially those from escape of water claims. ABI statistics[21] show that escape of water claims affecting UK commercial and industrial property insurance (the class of business that multi-occupancy residential buildings insurance falls within) rose by 8% per year across the period from 2004 to 2021, creating inflationary pressures and pressure on underwriting margins due to both the value of claims and the costs associated with handling this volume of claims.

3.27 Some insurers have exited the multi-occupancy residential building insurance market entirely since the Grenfell tragedy, further reducing choice in a market which had fewer than 20 insurer participants of any scale prior to this event. We understand from our industry engagement that these insurers exited the market either because the increased balance sheet loss exposures are outside their risk appetite, they no longer feel that they have sufficient specialist knowledge and expertise to write this product or they do not currently consider it a sufficiently profitable business line. These factors were also exacerbated by the perceived reputational risks which now accompany underwriting this line of business due to the level of government, regulatory and media scrutiny.

3.28 Where the insurer appetite to cover a building remained, the above changes to insurers' understanding of the risks and approach to underwriting have led to increased premiums for a range of reasons. We heard that premiums have increased where:

- It is now known that there is a risk of the total loss of the building through fire when this was not previously considered a possibility. This is relevant for risks with flammable cladding or where other material fire safety risks exist, such as construction flaws meaning that compartmentation[22] of the building is not effective.
- Other fire risk issues have been identified (eg the presence of wooden balconies or less severe cladding issues) which while not creating the risk of a total loss, increase the likely severity of a fire loss, requiring increased weight to be attached to this risk when pricing.
- Insurers have assessed that the probability assigned to certain risks was previously too low.
- The more in-depth information requests reveal other new, previously unknown construction or build quality issues increasing the likely risk or severity of losses arising from other (non-fire) perils such as escape of water.
- More detailed information requested by the insurers on newly identified risks is not yet available, with the increase reflecting the uncertainty around the level of additional exposure arising.

3.29 Insurers and brokers explained that premium increases due to any or all of the above factors were likely to be more significant for multi-occupancy buildings insured individually or in a small portfolio, rather than in a large portfolio where this risk could be pooled more widely.

21 See paragraph 3.76.

22 Fire compartmentation is the sub-division of a building into smaller sections or units in order to withstand and limit damage or growth of a fire by preventing the spread of smoke and fire, via the use of fire resisting construction.

3.30 In the rest of this section, we provide a closer look into how insurer appetite and policy pricing have changed since the Grenfell tragedy using information we collected from insurers and other market participants.

- Firstly, we show how insurers' appetite to insure high-risk buildings has changed since Grenfell (paragraphs 3.33-3.41). We found that most of the insurers that we approached for our review are only willing to cover buildings with flammable cladding if certain conditions apply (eg if the building was covered by the insurer previously, if the building is part of a portfolio, if the building is only clad to a limited extent). We also found that to overcome the limited insurer appetite and obtain adequate cover, insurance brokers working for freeholders and property managing agents have increasingly needed to arrange multiple layers of cover with different insurers, rather than being able to place the whole risk with a single insurer.
- Secondly, we provide a sense of the magnitude of the increases in premiums following Grenfell using building level data from insurers (paragraphs 3.42-3.55). We found evidence that premiums increased substantially since the Grenfell tragedy in the broader multi-occupancy residential insurance market for midrise and high-rise buildings, and especially for buildings with identified flammable cladding.
- Thirdly, we look into factors that were understood to mitigate the premium increases (paragraphs 3.56-3.68). Specifically, we find that pooling poorer or more complex risks (those with worse loss histories, larger exposures or requiring more underwriting input and analysis) together with better or simpler risks can help reduce premiums for the poorer or more complex risks. We also find evidence in support of cladding remediation being able to materially reduce premiums, as long as that remediation is sufficiently extensive.
- Finally, we consider insurers' claims experience, both through the analysis of the data we have collected, and by considering broader industry data and trends (paragraphs 3.69-3.89).

3.31 The analysis referred to in this section is done using our insurer data. This is because these data more accurately capture each building's exposure to flammable cladding, which according to market participants is a key factor that affected pricing since the Grenfell tragedy.

3.32 We note that the findings we present in this section should be treated with some caution due to the following limitations in the underlying data:

- Our insurer data only go back to July 2016. As such, they may not be accurately reflecting the state of the multiple occupancy buildings insurance market (eg the premiums) before Grenfell.
- The period covered in our data is fairly short. This means that we cannot empirically confirm that any trends we identify (eg premium increases since Grenfell) differ from what would be expected from a typical insurance cycle.
- We understand from insurers that their identification and recording practices have gradually become more detailed and systematic since the Grenfell tragedy. This means that information for the later years is expected to be more reliable than information at the beginning of the time series.
- As noted above, the observations used in our analysis may be skewed towards those multi-occupancy buildings insured individually or within smaller portfolios, when compared with the population of all mid-rise and high-rise multi-occupancy buildings.

Insurers have limited appetite for buildings with flammable cladding

Insurers are willing to cover buildings with flammable cladding only under certain conditions

3.33 The qualitative responses received from the majority of insurers in our sample document that the identified increases in the level of insurance risk have led them to reduce their appetite to cover buildings with flammable cladding, as these buildings represent too substantial a risk to the insurers' books.

3.34 The insurers' responses to our qualitative questions suggest that insurers are selective about the conditions under which they may provide capacity to such buildings.

3.35 In some cases documented in qualitative responses or explained in our industry and demand-side workshops, we have heard that insurers may be more willing to underwrite a property with cladding or other material fire risks where this is part of a wider property portfolio, due to the pooling effect and the ability to offset the risk against the wider portfolio. This is also supported by our data, which indicate lower premiums and smaller premium increases on average for buildings with cladding or other material fire risks when the buildings are insured within a portfolio (see paragraph 3.58), although we note that our analysis may be skewed towards buildings in smaller portfolios where insurers explained they were more likely to collect detailed information on individual buildings. We have also seen some insurers seek to create new specialist products to underwrite more challenging risks, including those with flammable cladding, within certain parameters. Brokers and demand side stakeholders noted in our workshops that this has had a positive impact for those properties which meet the relevant criteria, in terms of both availability and price of cover, but that currently these new product options were only available for a limited number of properties, and not those most severely affected by cladding issues.

Buildings with flammable cladding relied more heavily on layering to obtain adequate cover

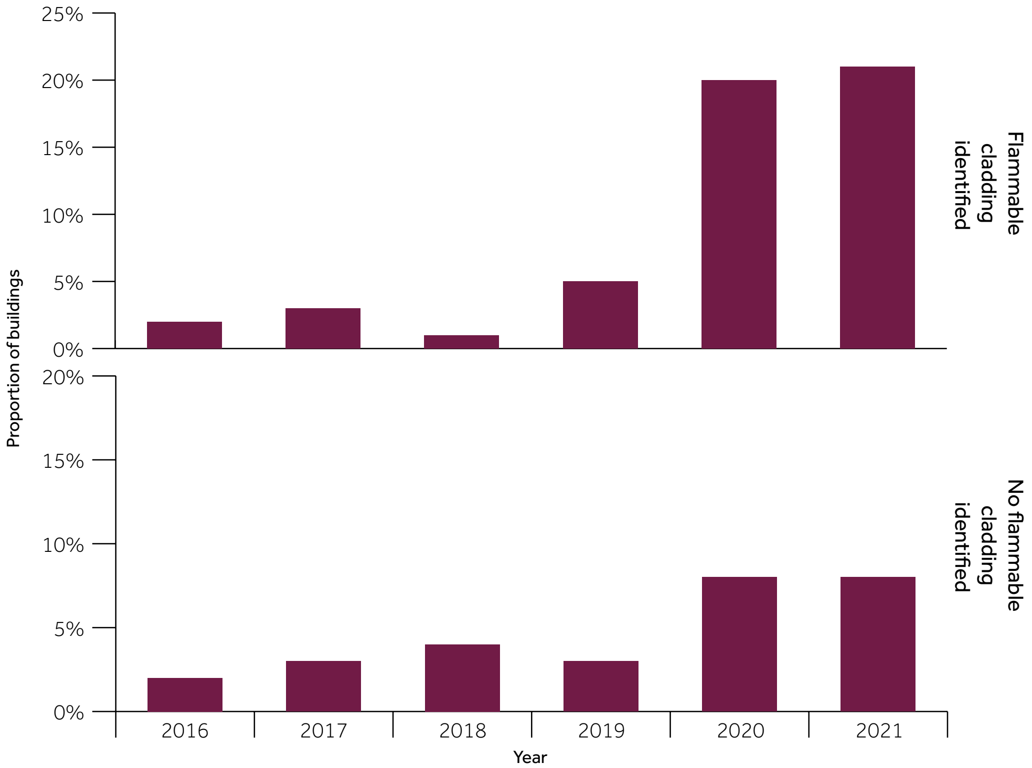
3.36 We heard from freeholders and property managing agents that the increased level of loss exposure and insurers' lower appetite for buildings with identified flammable cladding has made it very difficult for some of these buildings to obtain sufficient cover from a single insurer.

3.37 Insurance brokers working for freeholders and property managing agents have increasingly needed to find other markets to underwrite excess layers where the primary insurer is no longer able or willing to cover the entire risk. The use of excess layers means that a building is covered by multiple insurers, with the excess layer insurers providing cover for larger losses above a certain value.

3.38 The use of excess layers may be beneficial in allowing a building's owners to obtain comprehensive cover, but is likely to be more expensive than the historic position with a single insurer underwriting the whole risk, with secondary markets often only willing to underwrite cover for excess layers at higher rates, even where the risk of a claim reaching the layer of cover they are underwriting is more remote. Additionally, while placing cover in this way may be essential to getting sufficient cover, it can involve significant additional work for the insurance brokers involved and require more information to be supplied by freeholders and property managing agents (due to different insurers requiring different information). It can also result in reduced levels of cover or more restrictive terms where excess layer insurers are unwilling to provide the same level of cover as the primary insurer.

3.39 As shown in the following chart, our insurer data confirm that the use of excess layers to spread the risk has been increasing since the Grenfell tragedy for buildings with identified flammable cladding, to enable insurers to continue to underwrite the risk without exposing their individual results and balance sheets to excessive risk.

Proportion of buildings with layered insurance by cladding status, 2016-2021



Source: FCA analysis of building-level data collected from insurers

3.40 We note that until 2019, no more than 5% of the buildings with identified flammable cladding relied on insurance arrangements involving the use of excess layers in each year. This figure increased to 20% in 2020 and 21% in 2021.

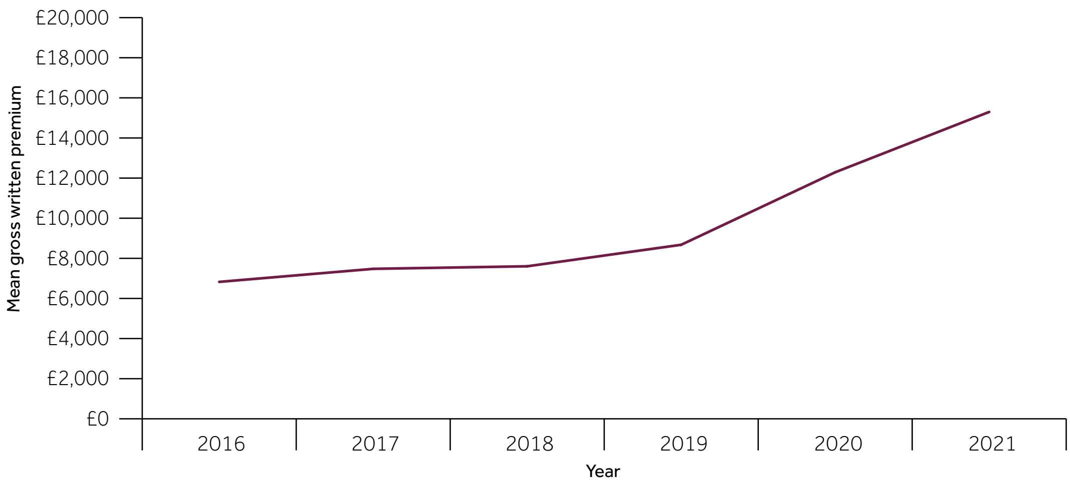
3.41 In comparison, we see that the use of arrangements involving excess layers was significantly less common for buildings without identified flammable cladding in the same period, and changed little over time (less than 5% in 2016 and -2019, and around 8% in 2020 and 2021). This suggests that the need to mitigate and diversify the risk of total loss through layering is restricted to a relatively small number of buildings presenting the most severe risks.

Premiums have increased since the Grenfell tragedy

Premiums increased over time

3.42 The following chart shows the mean annual gross written premiums in 2016- 2021 for all mid-rise and high-rise residential buildings for which we have building level data from insurers.

Mean gross written premium for mid-rise and high-rise buildings, 2016-2021



Source: FCA analysis of building-level data collected from insurers

3.43 The chart shows that the mean annual gross written premium for mid-rise and high-rise multi-occupancy buildings more than doubled (125% increase) in that period, from £6,800 to £15,300.[23] This suggests that premiums for multi-occupancy residential mid-rise and high-rise buildings have increased significantly since Grenfell. This is consistent with qualitative information provided by firms.

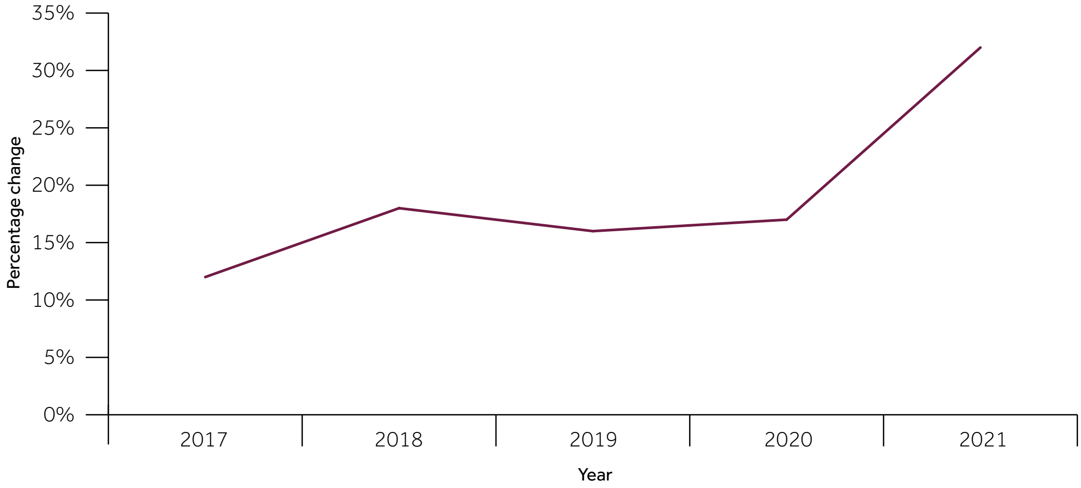
3.44 The premium increase is sharper from 2019 to 2020 and also from 2020 to 2021. In the next segment of this section, we show that this is driven by buildings with identified flammable cladding and we explain why a similarly sharp increase did not take place in 2019 and 2018.

3.45 Next, we looked at the year-on-year change in the annual gross written premium for individual buildings. This is to control for the possibility that the increase in the mean premium shown above is driven by a composition effect (eg our building sample for 2021 may consist of larger buildings than our sample for 2020, which naturally carry higher premiums, all other things remaining equal).

23 This analysis is subject to the caveats noted in paragraph 3.32 above.

3.46 The following chart shows the mean year-on-year percentage change in the gross written premium for buildings that we observe in 2 consecutive years.[24]

Mean year-on-year change in gross written premiums, 2017-2021



Source: FCA analysis of building-level data collected from insurers

3.47 In line with our analysis of mean premiums (and subject to the same caveats noted earlier), this chart shows substantial year-on-year increases since the Grenfell tragedy, with premiums increasing on average by 12% in 2017, around 15-20% each year for years 2018-2020, and by 32% in 2021.

Premiums increased more sharply for buildings with identified flammable cladding

3.48 Next, we look at the evolution of mean premiums separately for buildings with and without identified flammable cladding.

3.49 For each year we split our sample in 2 groups: (i) buildings that were identified as a flammable cladding risk in that year, and (ii) buildings which were not identified as a flammable cladding risk in that year.[25] We then calculate the mean annual gross written premium separately for each group.

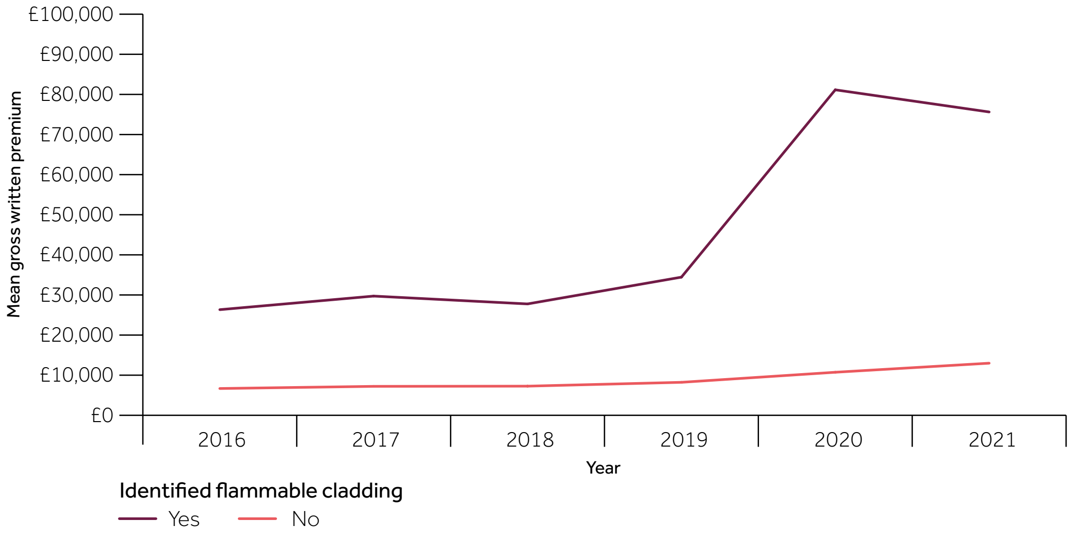
3.50 The following chart shows how the mean annual gross written premium evolved over time for each building group.[26]

24 We do not report a mean percentage change between 2015 and 2016 because 2016 is the first year in our sample.

25 Our dataset includes 46 buildings for which insurers report they identified cladding-related fire risks as early as 2016. While the risks from flammable cladding became widely known after the Grenfell tragedy, some concerns relating the combustibility of certain cladding types have been raised since at least 2005; see https://www.bbc.co.uk/news/uk-56403431.

26 Note that this analysis is subject to the caveats noted in paragraph 3.32 above.

Mean gross written premium for buildings with/without identified flammable cladding, 2016-2021



Source: FCA analysis of building-level data collected from insurers

3.51 The chart shows that following the Grenfell tragedy, the mean premium across buildings with identified flammable cladding increased to a much larger degree than the mean premium across buildings without flammable cladding. The mean premium across buildings with identified flammable cladding increased by 187% between 2016 and 2021, going from £26,300 in 2016 to £75,600 in 2021.[27,28]

3.52 This is consistent with the views we heard from insurers that flammable cladding is currently considered to expose their books to extensive risks, which require substantial increases in premiums to accommodate.

3.53 Premiums increased significantly also for buildings without identified flammable cladding, but to a lesser extent. The chart shows that the mean premium for such buildings rose by 94% between 2016 to 2021, from £6,700 to £13,000. The increase in premiums for these buildings is consistent with what we heard about the broader changes to the insurers' understanding of the risks and their approach to underwriting, which often go beyond cladding risks. For example, we understand from our roundtable workshops that the market shock arising from the Grenfell tragedy changed insurers attitudes to attritional risks such as escape of water, for which claims have been rising by 8% each year since 2004.[29]

3.54 We see that even in 2016 the mean gross written premium for buildings with cladding is substantially higher than that for buildings without identified flammable cladding. While this could indicate that insurers priced in some risk from certain cladding types even before the Grenfell tragedy, we should be cautious when comparing the absolute premium levels between the 2 building categories. Such a comparison is not reliable because buildings with identified flammable cladding are typically insured to a higher value, which typically carries a higher premium, all other things being equal. In our

27 The drop in the mean premium between 2020 and 2021 is due to a cohort effect – our 2021 sample contains buildings not observed in 2020, whose premiums are lower than the 2020 mean.

28 This analysis is subject to the caveats noted in paragraph 3.32 above.

29 ABI statistics, see paragraph 3.76.

data, the mean sum insured for buildings with identified flammable cladding is around 3 times higher than the mean sum insured for buildings without identified flammable cladding for all years 2016-2021.[30]

3.55 Finally, we notice that the impact of the Grenfell tragedy on the mean premium was gradual up until 2020. We believe this is consistent with known delays in fire risk and safety information becoming available and frictions in the adjustments to the underwriting process as:

- It takes time for insurers to develop and apply changes to their underwriting approach.
- Further risks for buildings with cladding, such as failures in compartmentation, lack of fire doors, etc, were likely revealed gradually as insurers completed their own surveys. We understand from our roundtable workshops that the capacity of appropriately qualified building surveyors was significantly constrained after the Grenfell tragedy and could not meet all the demand from the increased insurance requirements.

Pooling and cladding remediation can mitigate the reduced insurer appetite and associated premium increases

Pooling poorer or more complex risks with better and simpler risks together can reduce premiums for the poorer or more complex risks

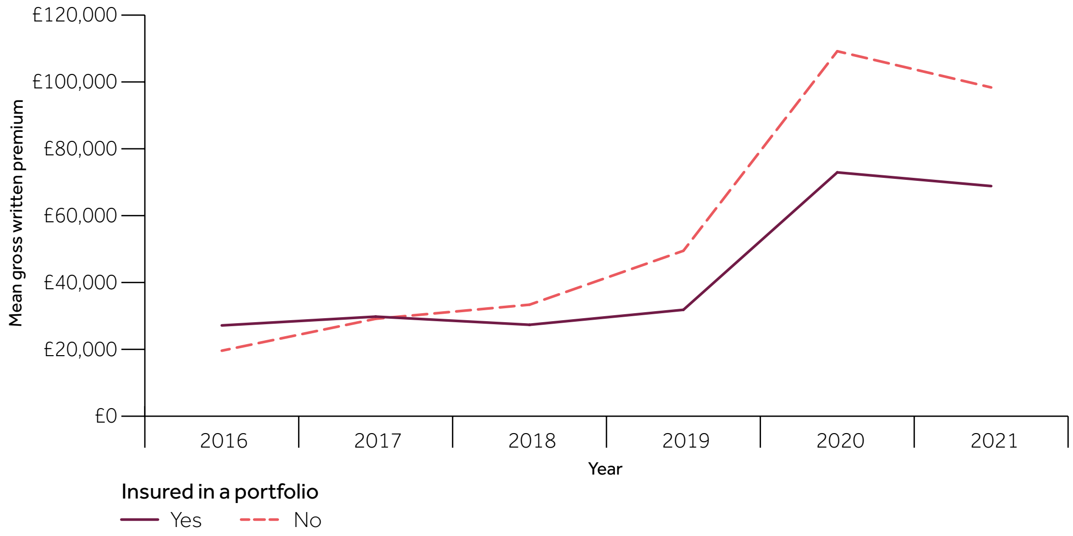
3.56 In our engagement with market participants, we heard that insurers will typically cover buildings with flammable cladding at a lower premium if they are part of a larger portfolio. This is because they can spread the increased expected claim cost from the cladding risk over multiple buildings.

3.57 To test this point, we took all buildings that were identified as a flammable cladding risk in each year and separated them into: (i) buildings that were insured as part of a portfolio in that year, and (ii) buildings that were insured individually in that year. We then calculated the mean annual gross written premium separately for each group.

3.58 The following chart shows the mean annual gross written premium for each building group in each year.

30 Buildings with identified flammable cladding may have a higher sum insured on average because these cladding types may be more common for larger buildings.

Mean gross written premium for buildings with identified flammable cladding by portfolio status, 2016-2021



Source: FCA analysis of building-level data collected from insurers

3.59 We see that in the entire period 2018-2021, buildings with identified flammable cladding that were insured as part of a portfolio (solid line) appear to have seen consistently lower premiums than buildings insured individually (dotted line). Specifically, we see that the mean premium for buildings insured as part of a portfolio was lower by 18% in 2018 (£27,300 vs £33,400), 36% in 2019 (£31,800 vs £49,500), 33% in 2020 (£72,900 vs £109,200) and 30% in 2021 (£68,800 vs £98,400).[31] As above, we note that our analysis may be skewed towards buildings in smaller portfolios, where insurers explained they were more likely to collect detailed information on individual buildings.

3.60 Our analysis indicates that premiums increased for individually-insured buildings with identified flammable cladding as early as 2018 despite the known frictions and delays to insurers adjusting their approaches. We do not know the reason for this: it could be that surveys which highlighted fire and other risks were prioritised for buildings which were known or suspected to have flammable cladding and which were insured individually. Such a prioritisation would make sense because the expected claim cost of any potential unknown risks for these buildings cannot be spread over a larger portfolio. Our data do not allow us to explore this point further.

More data are required to understand the impact of remediation on premiums. However, it is likely that extensive remediation can bring premiums down

3.61 Insurers in our roundtable workshops explained that successful remediation of the flammable cladding risk helps reduce premiums. However, the extent of the remediation undertaken, and whether it addresses the insurance risks rather than solely the risks to life, impacts upon the extent of any reductions.

3.62 We heard from market participants that remediation works are often conducted using External Wall System (EWS) ratings as a guide, as recorded on the EWS1 form. When

31 This analysis is subject to the caveats noted in paragraph 3.32 above. There may also be a composition bias: buildings selected to be in a portfolio may be different to buildings insured outside of a portfolio.

completed, market participants noted that these works typically take buildings to a B1 rating, which means that 'combustible materials are present in [the] external wall', but the fire risk is 'sufficiently low that no remedial works are required'.[32] Our review related to the period before 'PAS 9980:2022 – Fire risk appraisal of external wall construction and cladding of existing blocks of flats. Code of practice.' was published in January 2022 by the British Standards Institution.

3.63 From an underwriting perspective, insurers told us that remediation works conducted using EWS1 ratings as a guide may mitigate the risk to life (eg slow down the spread of a fire enough to permit successful evacuation) but in many cases can fall short of sufficiently mitigating the risk posed to the building itself (ie they do not sufficiently mitigate the risk of an eventual total loss of the building). Consequently, remediation to this extent may not consistently be effective in materially reducing premiums, depending on the individual circumstances and the extent to which the remedial actions taken address the issues driving the insurer's assessment of the risk of loss. We do not know the extent to which any remediation works performed using PAS 9980 as a guide will address the fire risks posed to the building itself and therefore be effective in providing a basis to materially reduce premiums.

3.64 At this stage it is not possible for us to form a clear view on the pricing of multi-occupancy buildings insurance post-remediation due to the very small number of buildings in our sample that insurers identified as having completed remediation works (see paragraph 3.67 below). Additionally, there is currently a lack of long-term claims histories for remediated buildings and limited information on insurers' underwriting methodologies for such buildings. However, as remediation works are completed on more multi-occupancy buildings, using either EWS1, PAS 9980 or other fire safety risk assessment criteria, and insurers' claim data develop, there will be a clearer basis to assess whether insurers are pricing these risks fairly and consistently.

3.65 At present, firms do not explicitly record whether remediation has been undertaken on a building, and the standard such remediation achieved. In order to attempt to identify remediation in our insurer data, we looked at all buildings which were characterised as a flammable cladding risk at any given year (eg 2020), and checked whether they were also characterised as a flammable cladding risk in the following year (eg 2021). If a flammable cladding risk is identified in one year but not in the following years, we consider it evidence that the building's cladding was remediated to a degree deemed sufficient by the insurer.

3.66 Our approach will not be able to capture all remediation instances in our data. Specifically, we may not be capturing instances where a building switched to a different insurer after remediation. This is for 2 reasons:

- there are inconsistencies in the way different insurers record building addresses in our data, which make it hard to track individual buildings that switch to a different insurer within our sample
- we cannot observe the flammable cladding status of buildings that switched to an insurer outside our sample

3.67 Our approach identifies only 4 mid-rise/high-rise buildings whose flammable cladding was remediated. In contrast, DLUHC reports 309 completed remediations as of

32 https://www.rics.org/contentassets/4c00574e95844684a483e7e645baa444/ews1-form-version-3_interactive.pdf

February 2022 for high-rise buildings as part of their Building Safety Programme.[33] We expect that part of the disparity is due to the limited coverage of our insurer data sample. The timing difference also has an impact, in that our data for 2021 covers buildings underwritten during the entire period from 1 January to 31 December 2021. Many of those buildings remediated at February 2022 would not have been fully remediated, or identified as such, at the point in 2021 when the insurance was being arranged and placed. Another possible factor is that our approach may not be identifying remediations in some instances where buildings switched to a different insurer after the remediation was completed, as tracking buildings across multiple insurers in our data is challenging. However, the disparity may also be because insurers consider some of the remediation works to fall short of sufficiently mitigating the claims and loss risk posed to the buildings and therefore still record buildings as presenting a significant fire risk due to cladding issues even where the building has undergone sufficient remediation works to mitigate the risk to life. While this is a point that insurers and brokers repeatedly raised in our workshops, the information available to us from insurers does not allow us to independently confirm that their pricing approaches for remediated buildings and the premiums resulting are fair and reasonable.

3.68 Given the lack of observations, primarily due to a lack of data being available, we have not placed any significant reliance on remediation data. As shown in the table below, post-remediation premiums fell in all 4 instances that we identified, dropping by more than 60% for 2 of these buildings. While such a small data set limits our ability to draw firm and reliable conclusions, it suggests that remediation, where it is sufficiently extensive to address key fire risks to the building as well as risks to life, can effectively reduce premiums.

Gross written premium before remediation	Gross written premium after remediation
£9,600	£8,500
£276,100	£85,200
£47,000	£33,600
£63,100	£22,300

Source: FCA analysis of building-level data collected from insurers

Findings in relation to the claims experience and profitability for insurers underwriting multi-occupancy buildings insurance – All multi-occupancy buildings

3.69 In conjunction with third-party consultants, we have reviewed insurer policy and claims data received further to our information request to consider the extent to which the premium increases identified in relation to multi-occupancy residential buildings are supported by and consistent with the loss and claims experience of the insurers underwriting these policies.

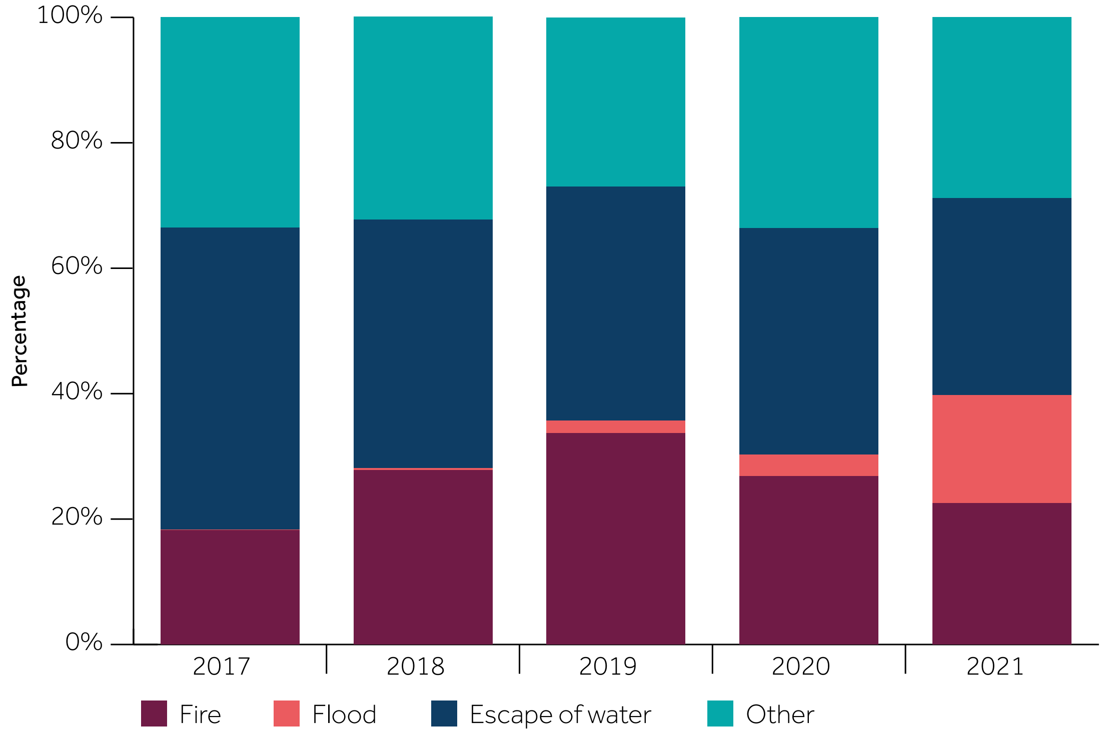
3.70 The analysis was performed on a data set containing 12,400 policies across the period from 2017 to 2020, amounting to £621.6m of gross written premium and £393.2m of gross incurred claims, having excluded those policies where we did not have complete or reliable premiums and claims data. 2016 data were excluded as we only

33 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1061347/Building_Safety_Data_Release_February_2022.pdf

had 6 months data and the availability and quality of data was lower. 2021 data were excluded as claims would be at an earlier stage of development, with ongoing exposure beyond the reporting date and case estimates for recently incurred claims subject to change. Although this is not a complete data set it remains a significant one, and one that we consider is representative of the key trends and features characterising the underwriting of multi-occupancy buildings insurance during the period under review.

3.71 Whilst the driver for this review is the impact on the availability and affordability of multi-occupancy buildings insurance post the Grenfell tragedy, fire risks are only one of the perils being covered when insurers underwrite insurance for multi-occupancy residential buildings. Other key perils which lead to material losses and claims for multi-occupancy buildings include escape of water, storms and flooding. The chart and table below show how the claims recorded in the data we have received, cleansed and analysed from insurers split between the main perils.

Percentage split of total annual claims values by peril type, 2017-2021



Year	Fire	Flood	Escape of water	Other
2017	18.2%	0.1%	48.2%	33.5%
2018	27.8%	0.3%	39.7%	32.3%
2019	33.7%	2.0%	37.3%	27.0%
2020	26.8%	3.5%	36.1%	33.6%
2021	22.5%	17.3%	31.4%	28.8%

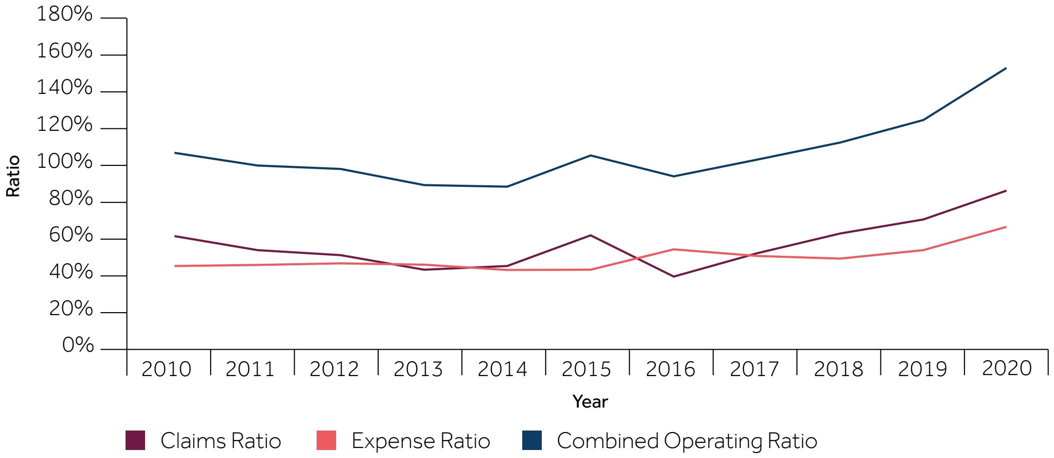
Source: Third-party analysis of claims data collected from insurers

3.72 We have then compared the information contained within our data set to broader premiums and claims trends identified within the ABI UK Commercial and Industrial Property index, which is the insurance market segment which multi-occupancy buildings insurance is captured within. This is to identify if there are any obvious discrepancies between what our data shows and these trends.

3.73 We have also considered the information received and insight gained from our workshops and stakeholder engagements, both with insurers and brokers, and with demand side stakeholders and their representatives.

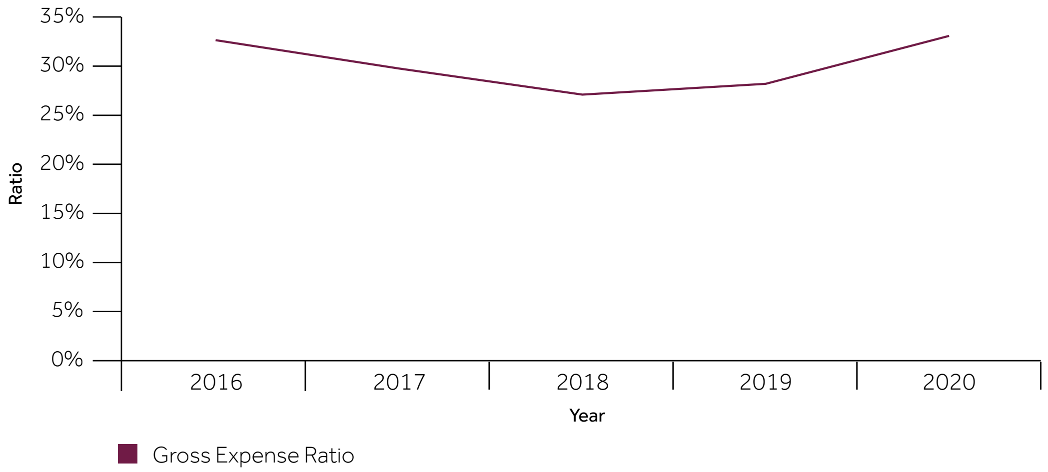
3.74 The weighted average loss ratio identified for our data set over the period from 2017-2020 was 73%, with this figure being 64% for 2020, the most recent and least developed year from a claims perspective. If an illustrative expense ratio of 30% (based on the gross expense ratio from the ABI data for Commercial and Industrial Property insurance) is applied, this implies a combined ratio of 103% across the period, indicating that this may well be a loss-making line of business for some or most of the insurers who underwrite it (given that a combined ratio of 100% indicates break-even point for the underwriter). This is based on the assumptions set out, and we are not able to test this in more detail and definitively prove whether it is true at either an aggregated or individual insurer level with the data available to us.

UK Commercial and Industrial Property operating ratios, 2010-2020



Source: Third-party analysis of ABI industry data for UK Commercial and Industrial Property insurance – Income Outgo Data, copyright retained by ABI

UK Commercial and Industrial Property gross expense ratio, 2016-2020

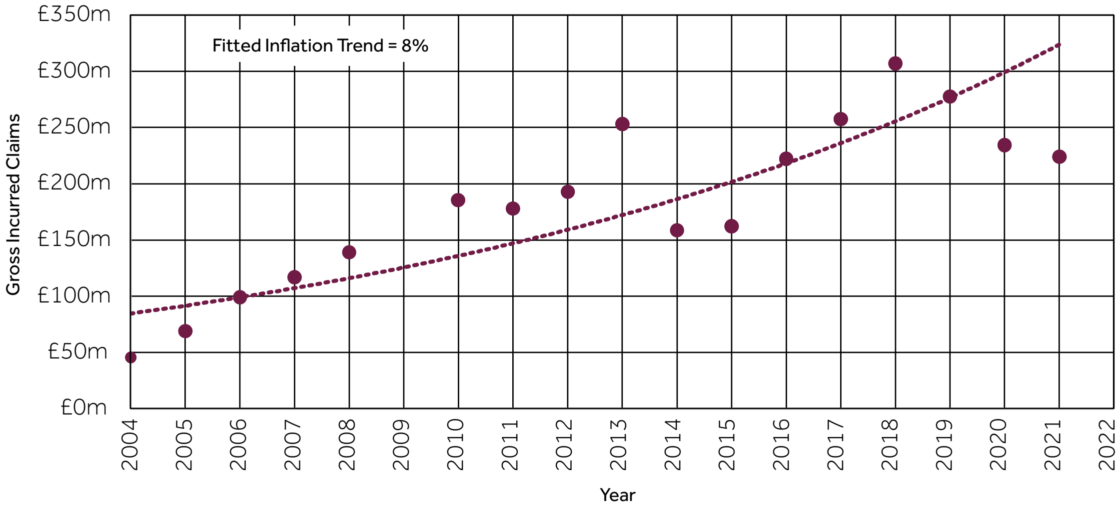


Source: Third-party analysis of ABI industry data for UK Commercial and Industrial Property insurance – Income Outgo Data, copyright retained by ABI

3.75 We have not found evidence which is indicative of insurers making excessive profits. On the contrary, while our evidence is mixed, on some analyses it suggests that some insurers' activities may be at break-even level or loss-making in this market given the claims experience and expected levels of expenses. While our data is not comprehensive, limiting our ability to draw reliable conclusions, the loss ratio observed and implied combined ratio does not suggest profiteering on the part of insurers during the period, looking at the sector as a whole.

3.76 Further to the above, the ABI industry data for Commercial and Industrial Property Insurance provides additional insight into one of the key drivers of this loss experience and lack of profitability in multi-occupancy buildings insurance, with these data showing increases of 8% per annum across the years from 2004 to 2021 for Escape of Water gross incurred claims. Escape of Water is also the largest single peril constituent of the gross claims incurred for the multi-occupancy buildings insurance policies we have analysed within our cleansed data set across the period from 2017 to 2021, accounting for between 36% and 49% of the gross claims in each of these years (as shown in the chart tables at 3.71 above).

Escape of Water claims trend, 2004-2021



Source: Third-party analysis of ABI industry data for UK Commercial and Industrial Property Insurance – Claims data, copyright retained by ABI.

3.77 Additionally, we note that the level of both escape of water claims and the inflation in these claims is likely to be higher in relation to multi-occupancy residential buildings than in the broader ABI Commercial and Industrial Property Insurance class. This is because of the nature of these buildings and the potentially wide-ranging effects and high costs of Escape of Water events in a building with multiple residential properties spread across a number of storeys.

3.78 Corroborating evidence of the potentially higher rate of inflation in Escape of Water claims is provided in our dataset across the years from 2017-2020, with an average cost per policy increase of 16% per annum for Escape of Water claims across this period, which may be indicative of a more severe trend for these properties.

Findings in relation to the claims experience and profitability for insurers underwriting multi-occupancy buildings insurance for buildings affected by flammable cladding and other fire safety risks

3.79 Whilst our analysis of the broader claims experience and profitability for underwriters in relation to multi-occupancy buildings insurance does not provide indicative evidence of material excess pricing or profiteering by insurers, there is a further question in relation to properties affected by flammable cladding and other material fire safety risks. This is because, as described above, these properties have frequently seen much steeper and larger levels of increase in premiums over the period under review, particularly where insured individually rather than as part of a portfolio of properties. Insurers have told us that this, at least partly, reflects the need to generate additional margins on buildings affected by cladding and other material fire safety risks to shield their balance sheets against the much larger and potentially catastrophic losses that they now believe can arise for these buildings.

3.80 Due to the limitations in the data provided by insurers and their ability to consistently identify and record properties affected by flammable cladding or other material fire safety risks during the period under review, the number of policies available to consider in this analysis is considerably smaller, amounting to 304 policies. For these policies alone, the weighted average loss ratio over the period from 2017 to 2020 was 56%, which is a lower loss ratio than that observed over the broader population. We note that the premium levels for these properties against which this loss ratio is calculated will on average be higher than for the broader population. Once again applying an illustrative expense ratio of 30% (based on the gross expense ratio from the ABI data for Commercial and Industrial Property insurance), this implies a combined ratio of 86% across the period. On the face of it this is again not a loss or combined ratio that is indicative of excessive pricing or profitability on this group of properties though this needs to be treated with a significant degree of caution given the small number of policies and relatively short time period upon which this figure is based.

3.81 Our review of the qualitative information received from insurers indicates an evolving situation in terms of the approaches that insurers are applying to underwriting properties affected by flammable cladding and other material fire safety risks. This appears to reflect both the amount and quality of information about fire safety risks available to insurers in relation to individual multi-occupancy buildings, which has continued to develop throughout the period, and changes in insurers' own risk appetites and their application of these risk appetites to individual scenarios.

3.82 We also note some evidence contained both within our data and in other information received into the FCA (for example, through complaints made to the FCA about firms and correspondence from MPs) which shows very significant rises in premium being experienced for a relatively small number of multi-occupancy buildings most affected by flammable cladding and other fire safety risks. These are often properties which are individually insured rather than being included within property portfolios, and therefore do not derive any savings or risk mitigation effect from being pooled with other lower risk properties. In some cases the level of premium increase identified across the period does appear to go beyond the insurers' own documented pricing approach or methodology, and to involve an additional level of risk premium, sometimes a very material risk premium, being added.

3.83 In the context of the above, we note that the Grenfell tragedy crystallised insurers' identification of a risk that, although it had previously been present, insurers had not previously understood or collected sufficient information to assess and price when underwriting and setting premium levels for multi-occupancy buildings. In the period since the Grenfell tragedy there has been an ever-evolving situation in terms of the level and type of fire safety information being sought by insurers, what is available to them, and in their understanding of the risk and pricing implications of this fire safety information. In many cases the relevant fire safety risk information remains incomplete throughout the period of the review. We further note the limited number of insurers able and willing to underwrite the insurance for such properties and the lack of established mechanisms in this business line for pooling risks with more significant potential exposures, such as the total loss of a large multi-occupancy building to fire.

3.84 Given all of the above factors, the data available to us at this point in time are not sufficient for us to reliably and definitively conclude whether the level of premium being charged in all cases is fair and appropriate for the risks being underwritten or genuinely reflective of the existing claims experience or evolving understanding of the risks being underwritten, for multi-occupancy residential buildings affected by flammable cladding or other material fire safety risks.

3.85 The range of variables and evolution in the information around building fire safety makes it highly probable that there are a range of outcomes being experienced by those who own multi-occupancy buildings and/or bear the costs of paying for their insurance. These factors mean that insurers are adapting their underwriting and pricing approaches on an ongoing basis, and also in some instances deciding to charge additional level of risk premiums due to the uncertainty surrounding some of these elements. Furthermore, in some cases the newly identified risk of total loss of the building to fire, even if remote, will take underwriting the entire risk outside of the risk appetite of the insurer, necessitating the involvement of secondary markets to underwrite the excess layers, often at an additional risk premium.

3.86 Taken together, the above factors mean that whilst we have seen no evidence of either insurers in general or of any individual insurer seeking to overprice multi-occupancy buildings insurance for properties with flammable cladding or other material fire safety risks or generate excessive profits from underwriting this insurance, there may be instances where the premiums being charged are not consistent with or supported by the previous claims experience or the actual level of risk posed by the fire safety risk factors identified. In this context, insurers must ensure that they are complying consistently with applicable regulatory obligations in relation to product governance and delivering fair value when setting premiums for multi-occupancy buildings. If we become aware of cases where insurers appear to have caused harm through breaching their regulatory obligations in relation to product governance and fair value, we are prepared to use the full range of our regulatory tools to assess this and consider any remedial actions required.

3.87 It should also be noted that there is a very significant amount of complexity and expertise involved in underwriting these risks, with this increasing in the context of the fire safety risk issues identified following the Grenfell tragedy. This means that to fully understand the extent of any 'excess' risk premium being charged and whether this should be regarded as unfair, it would be necessary to undertake very significant additional work and analysis, potentially looking at risks on an individual basis, encountering all of the same challenges which the insurers themselves are working through when underwriting these policies and forming a view regarding some of the underwriting and pricing judgments being made.

3.88 The presence of significant risk premiums for uncertainty and the unpalatable level of exposures associated with the potential total loss of the building do, however, drive the likelihood that the overall level of premiums being charged for properties with flammable cladding and other material safety risks is above the level that would be being experienced if there were effective pooling mechanisms in place to diversify this risk away from individual insurer balance sheets. This appears to be most applicable to buildings insured individually and means that there may well be scope for savings to be achieved if such mechanisms were identified, potentially driving reduced prices for those individual risks currently worse affected by flammable cladding and other material fire safety risks, and the consequent impacts on premium levels.

3.89 As explained above, our review does not find, based on the data collected, that insurers are making material excess profit. However, our rules require insurers to ensure the design of their products takes account of the needs, objectives, characteristics and interests of customers in a defined target market and provide fair value to customers. We recognise there is a need for firms, in a limited number of scenarios, to insure risks that go beyond their standard pricing approach or methodology. In these cases our expectations are that the product remains of fair value to the customer.

Findings in relation to product distribution

The role of brokers, property managing agents and freeholders

3.90 In the typical insurance procurement journey, the insurance broker is employed by the freeholder to search for appropriate insurance cover for the building or property portfolio and place this insurance. The freeholder has ultimate responsibility for instructing the placement of the insurance to cover the building or property portfolio, as the owner of the asset.

3.91 The insurance broker will act on the instructions of the freeholder, obtain appropriate risk information and present the risk (either a building or property portfolio) to the available insurers to seek quotes. In some cases, the broker may approach multiple insurers and in others they may only seek a quote from the incumbent insurer. Where the broker is unable to find cover for the entire risk with a single insurer, they may seek alternative markets to cover excess layers. Throughout the process the insurance broker will liaise between the freeholder and/or property managing agent and the relevant insurer or insurers, facilitating the flow of risk information and documentation between the parties.

3.92 The property managing agent may also play a role in arranging the insurance, following the instructions of the freeholder in liaising with the broker. Both brokers and property managing agents also frequently play a role in delivering after sales services, including those related to claims.

3.93 There are several possible variations to the distribution arrangement described above. These include arrangements for buildings owned by housing associations or public sector bodies, when there may be no property managing agent and/or insurance broker involved, as well as instances where the freeholder may not use a property managing agent or where leaseholders have a greater role through right-to-manage or other mechanisms.

3.94 In the rest of this section, we provide a closer look into how the distribution side works using the qualitative and quantitative information we collected.

- Firstly, we describe and provide some summary statistics on the remuneration that brokers, freeholders and property managing agents obtain for arranging insurance (paragraphs 3.97-3.107). In most cases the insurer who underwrites the policy pays a commission to the broker. The broker may then share this commission with the freeholder and the property managing agent. We found that commissions often exceed 30%. In 39% of the observations in our data, the broker passes more than half of the commission to the freeholder or the property managing agent, which is concerning given the lack of transparency that leaseholders have on this remuneration.
- Secondly, we look into how commission rates and absolute commission values changed since the Grenfell tragedy (paragraphs 3.108-3.124). Our analysis found that the commission rates of brokers and freeholders/property managing agents for buildings with identified flammable cladding have fallen since the Grenfell tragedy. However the absolute commissions have increased, driven by the increases in insurance premiums evidenced in the previous section.
- Finally, we look into the factors that drive the freeholders' and the property managing agents' choice of insurance (paragraphs 3.125-3.142). The qualitative responses we received indicate that the main factors are the premium and the breadth of coverage, with commission playing only a secondary role. However, our data did not allow us to confirm this empirically. While we found no obvious switching costs, we found evidence that the market is fairly sticky, with more than 75% of the buildings being renewed with the same insurer in each year. We also find some evidence that renewals to the same insurer are associated with higher premiums, although our evidence is not conclusive.

3.95 With the exception of the analysis on renewals, all analysis in this section is done using our broker data. This is because these data contain information on the split of commissions between brokers and freeholders/property managing agents, which is not available in the insurer data the insurer data only report the combined commission.

3.96 Our findings in this section should be treated with some caution due to limitations in the underlying data.

- Our broker data only go back to January 2016. As such, they may not be accurately reflecting the state of the multiple occupancy buildings insurance market (eg the absolute commissions) before the Grenfell tragedy.
- The period covered in our data is fairly short. This means that we cannot empirically confirm that any trends we identify (eg increases in absolute commissions since Grenfell) differ from what would be expected from a typical insurance cycle.
- We understand from brokers that their identification and recording practices have gradually become more detailed and systematic during the period since Grenfell. This means that information for the later years is expected to be more reliable than information at the beginning of the time series.
- As explained in paragraph 3.12, our analysis may be skewed towards buildings insured individually or buildings insured in smaller portfolios, where brokers explained they were more likely to collect detailed information on individual buildings. This may mean that the remuneration in the observations used in our analysis is more heavily commission-driven than across the whole population of mid-rise and high-rise multi-occupancy buildings.

- The information that the broker data provide on the buildings' exposure to flammable cladding is not always clear or easy to interpret as it was manually compiled in a free-text field, due to the lack of consistent data recording in this regard. Therefore, the identification of buildings with flammable cladding within our sample is likely imperfect.

Remuneration of brokers, property managing agents and freeholders

3.97 For its services, the broker is typically paid a commission by the insurer who underwrites the policy. This is usually calculated as a percentage of the premium and constitutes part of the gross premium. While in some cases customers may be aware of the amount of commission being paid, there is no general level of transparency or standard reporting regarding levels of commission.

3.98 In some cases the broker may be paid a set fee rather than a commission. We understand from market participants that this is more common for larger risks or portfolios, although we were not able to reliably quantify this with our data.

3.99 Additionally, the broker could be paid additional remuneration in the form of work transfer fees for activities they undertake on behalf of the insurer.

3.100 Where brokers are paid commission, they may then share a proportion of this commission with the freeholder or the property managing agent. In our roundtable workshops, brokers explained that they share their commissions with freeholders and property managers to remunerate them for the support they provide to procure insurance and then to deliver elements of post-sale service (eg to provide necessary evidence on the buildings' features, instruct survey work, administrative services).

3.101 Nevertheless, the fact that freeholders and property managing agents receiving a share of the insurance commissions could in some cases be weakening their incentive to choose a policy that gives the best value to the leaseholders. Instead, it may give some freeholders and property managing agents an incentive to take account of the impact on their own remuneration when selecting the insurance policy. Our discussions with insurers and brokers and the brokers' responses to our qualitative questions suggest that commission rates are typically not a central factor to freeholders' and property managing agents' choice of insurance. We would have liked to also empirically confirm this, but our data do not permit the required analysis, as

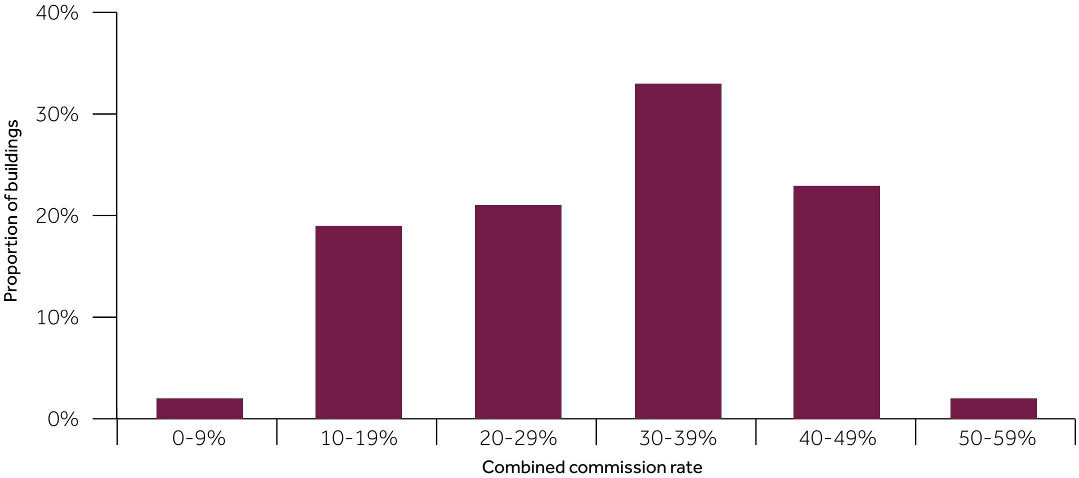
- they do not give us visibility on what alternative policies the freeholder could select instead of the policy they chose
- they do not allow us to adequately control for all the factors that may be driving the choice of insurance (eg non -cladding risk factors, excesses, exclusions)

3.102 Freeholders and property managing agents also sometimes receive amounts relating to non-commission-based broker remuneration, such as work transfer fees.

3.103 Our analysis in this section focuses on commissions, as this is the largest component of remuneration across the data available for our analysis and our data on non-commission remunerations are limited.

3.104 The following chart shows the distribution of combined commissions across all mid-rise and high-rise buildings observed in our broker data. The combined commission is the gross commission figure received by insurance brokers, including the elements that may then be paid onto the freeholder or property managing agent, but will not be the total remuneration in instances where fees are paid in lieu of commission or where there are fees for other services, such as work transfer fees.

Distribution of combined commission rates

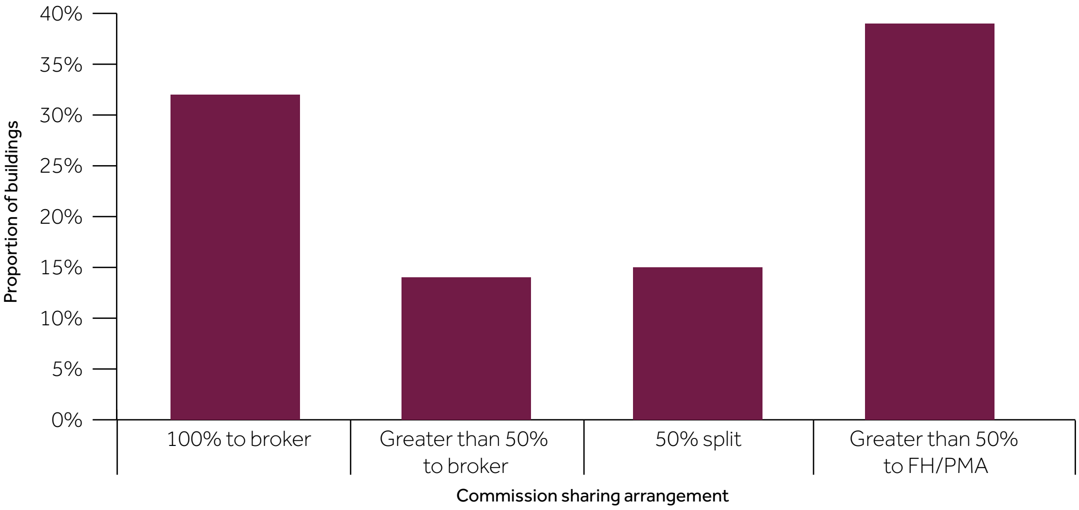


Source: FCA analysis of building-level data collected from brokers

3.105 We see that the combined commission is 30% or higher for 58% of the observations in our broker data. For 614 of those observations, (c. 2% of our sample) we see commissions at 50% or higher. Our data also report a combined commission of 62% for one observation. This is omitted from our graph for easier exposition of the overall distribution.

3.106 The following chart shows how the combined commission is split between the broker and the freeholder or the property managing agent. Note that our broker data do not allow us to reliably distinguish whether the party that the broker shares the commission with is a freeholder or a property managing agent.[34]

Distribution of commission sharing arrangements



Source: FCA analysis of building-level data collected from brokers

34 The terms FH and PMA in the bar chart refer to freeholders and property managing agents, respectively.

3.107 We see that the commission sharing arrangements between the brokers and the freeholders/property managing agents are very diverse. The broker retains the entire commission for 32% of observations in our data, but passes more than half of the commission on to the freeholder or the property managing agent 39% of the time. The latter is concerning given the lack of transparency that leaseholders have on the remuneration paid to freeholders and property managing agents.

Evolution of commissions

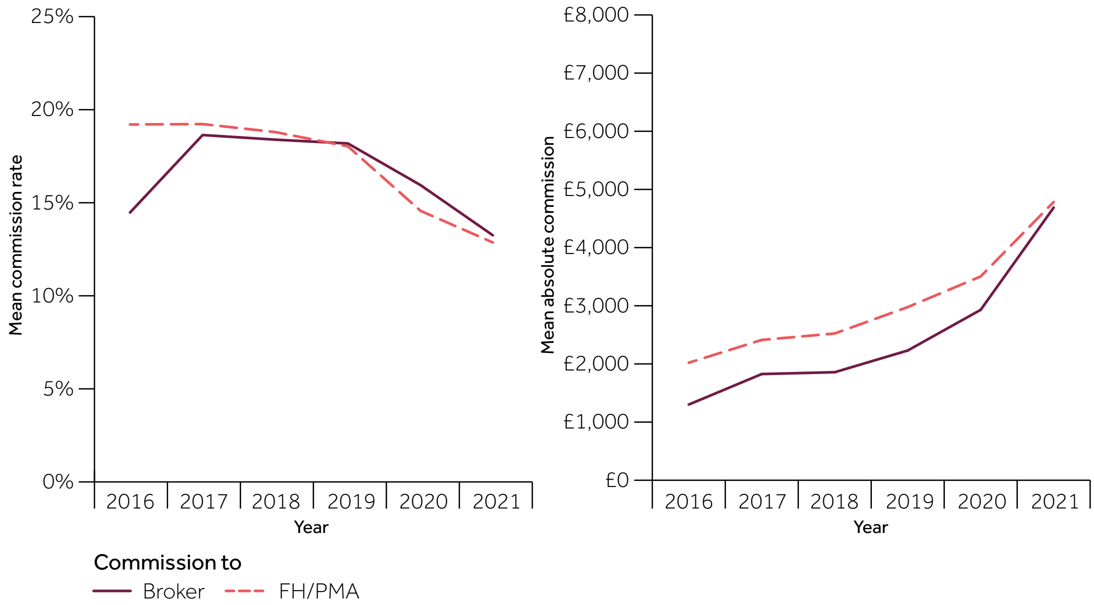
Since the Grenfell tragedy commission rates have fallen but absolute commissions have increased

3.108 In our roundtable workshops we heard of a downward trend on commission rates since Grenfell, especially for policies covering building with flammable cladding or other severe risks. We heard that this is in part because certain insurers have placed caps on the commissions they are willing to pay, and in part because many brokers and freeholders/property managing agents are now asking for lower commissions of their own volition. In either case, we were told that the aim has been to mitigate the increasing insurance costs for leaseholders to avoid reputational harm.

3.109 However, a decrease in the commission rates does not mean that the absolute commissions earned by brokers and freeholders/property managing agents also fell. On the contrary, we heard from market participants that the commission-based remuneration that brokers and freeholders/property managing agents earn has in many cases increased since the Grenfell tragedy, driven by the large increases in insurance premiums.

3.110 Our data confirm these 2 opposite trends for buildings with flammable cladding, as shown in the following charts.[35,36]

Mean commission rates and absolute commissions for buildings with identified flammable cladding, 2016-2021



Source: FCA analysis of building-level data collected from brokers

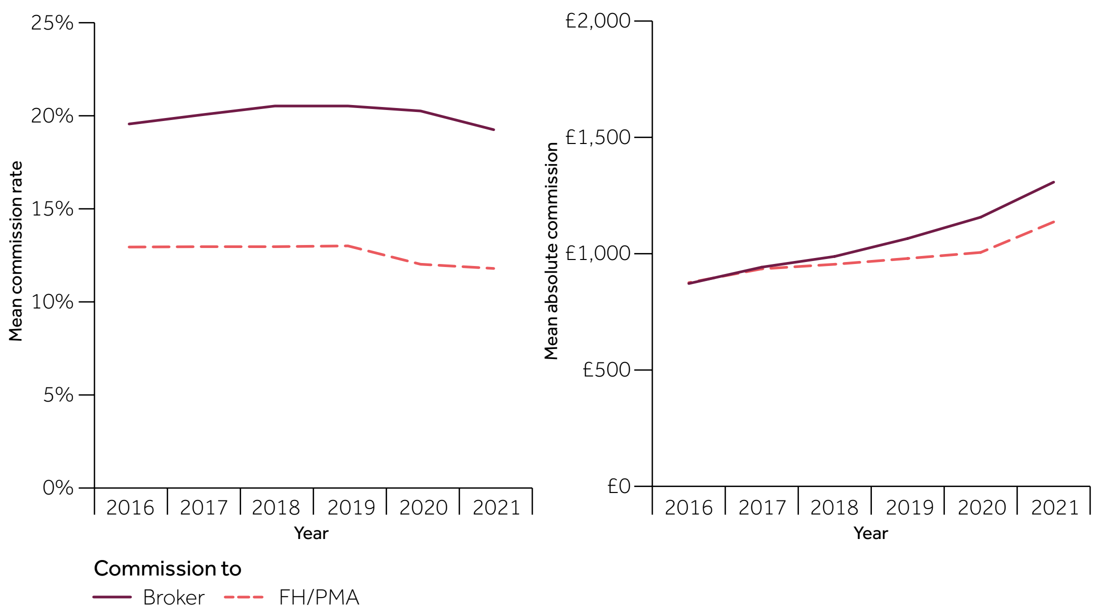
35 This analysis is subject to the caveats noted in paragraph 3.96 above.
36 The terms FH and PMA in the legend refer to freeholders and property managing agents, respectively.

3.111 The chart on the left-hand side suggests that the mean commission rates of brokers and freeholders/property managing agents decreased over the period 2016-2021 for buildings with flammable cladding. Specifically, after an increase of 5 percentage points between 2016 and 2017[37], the mean commission rate retained by the broker (solid line) fell from 19% in 2017 to 13% in 2021. The mean commission rate received by the freeholder/property managing agent (dotted line) saw a similar decrease, from 19% in 2016 and 2017 to 13% in 2021.

3.112 The chart on the right-hand side suggests that, despite the lower commission rates, the absolute commissions earned for buildings with identified flammable cladding has increased substantially since the Grenfell tragedy. The mean absolute commission earned by brokers (solid line) for buildings with flammable cladding more than tripled in the same period, from £1,300 in 2016 to £4,690 in 2021 (261% increase). The absolute commission earned by freeholders/property managing agents (dotted line) similarly saw an increase, as it more than doubled in the same period, from £2,020 in 2016 to £4,780 in 2021 (137% increase).

3.113 The following 2 charts investigate the same trends for buildings without identified flammable cladding.[38,39]

Mean commission rates and absolute commissions for buildings without identified flammable cladding, 2016-2021



Source: FCA analysis of building-level data collected from brokers

3.114 The chart on the left-hand side suggests that the decreases in commission rates were significantly milder for buildings without identified flammable cladding. The commission rate retained by the broker stayed around 19% to 20% in the entire period. The commission rate received by the freeholder/property managing agent fell from 13% in years 2016-2018 to 12% in 2021.

37 Our understanding of the market dynamics cannot explain this observed increase in the mean commission rate. However, we note that it is the result of a composition effect in our data – our 2017 sample includes buildings that are not identified as having flammable cladding in 2016. We observe no material increases in the commission rates earned by brokers between the two years for buildings that are identified as having flammable cladding in both years.

38 This analysis is subject to the caveats noted in paragraph 3.96 above.

39 The terms FH and PMA in the legend refer to freeholders and property managing agents, respectively.

3.115 This chart suggests that the incentive of insurers, brokers and freeholders/property managing agents to reduce commission rates is weaker for buildings without flammable cladding. This could be because the insurance premiums – and therefore the leaseholder burden – for these buildings increased less substantially than for buildings with flammable cladding since the Grenfell tragedy. As above, our data did not allow us to verify this explanation or to explore other potential driving factors.

3.116 As expected in light of the increases in premiums after the Grenfell tragedy, the chart on the right-hand side shows that brokers and freeholders/property managing agents earned higher absolute commissions for these buildings. The mean absolute commission earned by brokers gradually increased from £870 in 2016 to £1,310 in 2021 (51% increase). Similarly, the mean absolute commission earned by the freeholders/property managing agents gradually increased from £880 in 2016 to £1,140 in 2021 (30% increase).

3.117 The more limited increase in absolute commissions for buildings without cladding compared to buildings with cladding (compare paragraph 3.113 to paragraph 3.110) is consistent with the fact that these buildings faced significantly milder increases in premiums in that period.

3.118 Freeholders and the property managing agents appear to be taking a larger portion of the combined commission when looking to insure buildings with flammable cladding compared to buildings without flammable cladding.

3.119 Our analysis finds no clear justification for this. One possible explanation, which we were not able to test with our data, is that buildings with flammable cladding may also be associated with higher claims for other attritional losses. This is consistent with information we heard from our engagement with insurers that attritional losses (especially escape of water) are more pronounced in modern constructions, which are also more likely to feature ACM cladding. Freeholders and property managers may need to be more actively involved in the insurance process because of such attritional losses. For example, they may be required to provide insurers with additional claims history information or other documentation. Freeholders and property managers may be requesting a higher share of the commission rate as remuneration for this additional work they need to undertake.

Increases in absolute commission may be disproportionate to increases in service costs

3.120 Brokers, freeholders and property managing agents were unable to quantitatively demonstrate how the increased cost of their commission was providing additional value to their customers.

3.121 In roundtable workshops we heard from brokers, freeholders and property managing agents that in many cases their increased commission earnings after the Grenfell tragedy represent remuneration for the additional work they need to undertake to secure comprehensive insurance for their clients. They pointed out that the work they must undertake to find cover for buildings increased significantly since the Grenfell tragedy, especially for buildings with flammable cladding. They attributed this in part to the insurers' decreased appetite, which has made it harder to find insurers willing to provide cover for high risk buildings, in some cases requiring brokers to find multiple markets to place excess layers where the primary insurer is unable or unwilling to underwrite the whole risk, and in part to the more detailed information requested by most insurers.

3.122 However, insurers and leaseholder representatives told us that in some cases the commissions and overall level of broker/freeholder/property managing agent remuneration appeared to have increased disproportionately to the additional workload required. This was also acknowledged by some brokers within our workshops, including noting instances where they had declined to be involved in certain arrangements or transactions for this reason, but where other brokers had been prepared to act on this basis.

3.123 Our data do not allow us to either definitively evidence or rule out the possibility that the absolute commissions have increased disproportionately relative to the work involved. However, where commission percentages have been retained or only marginally reduced on buildings with flammable cladding for which premiums are now multiple times their level prior to the Grenfell tragedy, these increases in the absolute level of commission appear very high. As noted above, our analysis may be skewed towards individual buildings and those in smaller portfolios. This may mean that the commission rates in the observations used in our analysis differ from those across the whole population of mid-rise and high-rise multi-occupancy buildings.

3.124 We note the obligations of regulated insurers and brokers in relation to product governance and delivering fair value, which they are required to consider in relation to their manufacturing and distribution activities. We lack the level of data on broker, freeholder and property managing agent service costs that would be required to formally test the reasonableness of commissions and remuneration empirically on a widespread basis. However, if we become aware of cases where insurers or brokers appear to have caused harm through breaching their regulatory obligations in relation to product governance and fair value, we are prepared to use the full range of our regulatory tools to assess this and consider any remedial actions required.

Choosing insurer and broker

Factors driving the selection of insurer and broker

3.125 We heard from insurers and brokers (both in the workshops and via their qualitative responses) that the main factors driving the freeholders' and property managing agents' choice of insurance are the premium and the breadth of coverage. This is consistent with the duty and wish of the freeholder to appropriately protect their asset, or them instructing their property managing agents to do the same. However, there are inherent conflict of interests where commission payments are being made to multiple parties, and where there is a lack of transparency to all parties as to who is receiving what in any given transaction. It is not clear that there are appropriate levels of management of these conflicts of interest by parties in the distribution chain.

3.126 As noted earlier, we are conscious of the fact that freeholders and property managing agents receiving a share of the insurance commission could be giving them an incentive to take account of the impact on their own remuneration when selecting an insurance policy or considering switching to a different insurer or broker. In their responses to our qualitative questions, brokers told us they understand that the commission rate is a secondary factor or irrelevant in most freeholders' choice of insurer, although it may play a role in their choice of broker among other things (eg quality of service). A broker noted that some freeholders may be more likely to be commission driven than property managing agents, as they are comparatively less accountable to the leaseholders.

3.127 We also heard in our roundtable workshops that certain brokers may steer the freeholders or the property managing agents instructed by the freeholder towards specific insurers with whom they have a close commercial relationship, formal or otherwise. This may well be for entirely appropriate reasons relating to the access this broker has to the insurer, the price being offered, and the coverage being provided. However we cannot also rule out the possibility that certain brokers may steer the freeholders/property managing agents to a specific insurer even when that insurer does not offer the best deal.

3.128 We heard from brokers that the main factor driving the choice of broker selection is the quality of service the broker provides both at point of placement and beyond. For example, being able to obtain appropriate cover and responding quickly to enquiries and claims requests. We recognise that this information may not be reliable, as the brokers are expected to have a strongly biased view on this point. However, they also noted that the sharing of the commission between the broker and the freeholder/property managing agent can indeed influence in some cases the choice of which broker to employ. Our data do not allow us to confirm either point empirically.

Switching to a different insurer or broker

3.129 From our engagement with market participants, we understand that there are no obvious barriers preventing freeholders or property managing agents from switching to a different insurer or broker.

3.130 However, there can be risks and frictional costs associated with doing so or attempting to do so, especially in a hard market and with limited underwriting capacity. For example, to the extent that there are alternative insurers willing to write a risk, getting another quote requires that the freeholder supplies all necessary information to the insurer and the insurer analyses it. We heard from market participants that the costs to this process are not negligible and can limit how often freeholders consider alternative providers.

3.131 We heard that sticking with the same insurer may sometimes result in a better product offering. For example, we heard that some insurers may be more likely to continue to underwrite a poorer or more complex risk where they have retained this risk for a number of years, or to accept certain claims for which it is not clear they are liable if these claims are made by a loyal customer. In their qualitative responses, brokers suggested that underwriters can quote better terms if they can keep a risk for a longer period. From those responses it is not clear to us to what extent freeholders/property managing agents may be opting into formal long-term agreements in order to obtain discounted premiums.

3.132 While policies typically provide cover for a year, market searching exercises are undertaken less frequently. Most brokers note they take risks to the market once every 3 years unless there is a dramatic change in the market conditions or the renewal premium.

3.133 We heard from market participants that since brokers are approaching the same limited market, switching to a different broker does not always produce premium savings. However in their qualitative responses brokers note that, as far as they are aware, freeholders and property managing agents sometimes seek quotes from rival brokers. One large broker explained that larger freeholders and property managing agents conduct formal tender exercises for broker services on a 3-5 year cycle.

3.134 The above factors and frictions associated with marketing and pricing risks that renewals to the same insurer are likely to be common. Our insurer data confirm this, suggesting that more than 75% of all buildings in the period 2016-2021 were renewals to the insurer that covered the building in the previous year.

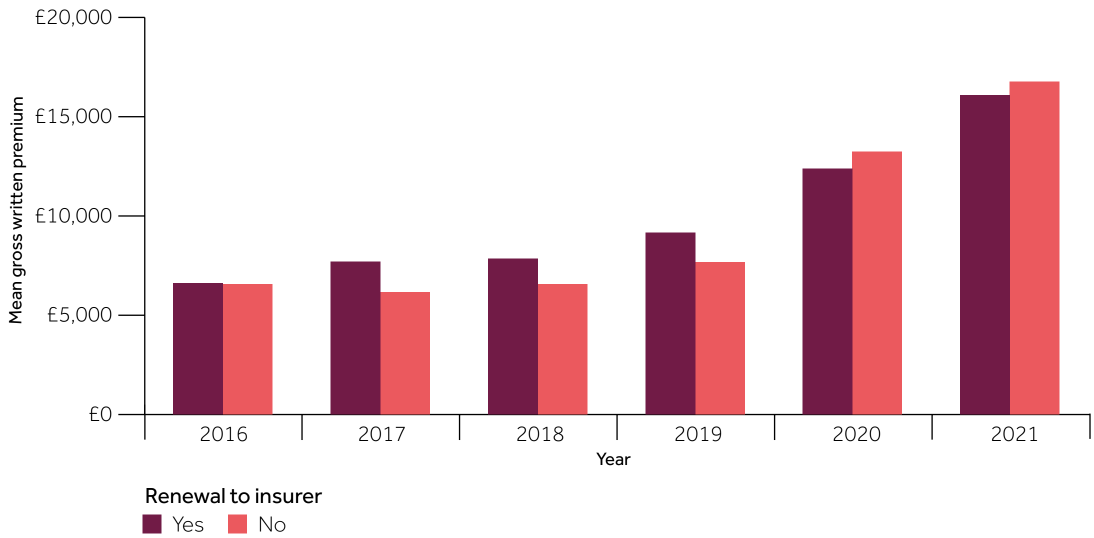
3.135 These frictions can be weakening competition in the market for multi-occupancy buildings insurance, as they do in other markets. Below we investigate this by looking at whether buildings that renew with the same insurer pay higher premiums. However we recognise that our analysis has limitations, as the decision to search for alternatives or to switch to a different insurer may be dependent on policy elements other than the premium.

3.136 Our data find some evidence that renewals are associated with higher premiums. However, these are not conclusive. Data limitations prevent us from obtaining a more complete picture:

- Our data do not allow us to test whether the renewals may be associated with a worse or a better product offering in terms of features other than the premium, such as excesses or exclusions.
- The available building-level data also do not allow us to control for risk features other than flammable cladding (eg escape of water) or to account for differences in the severity of the flammable cladding risk.
- The short period covered by our data does not allow us to investigate whether our results are indicative of a longer trend, or whether they reflect a temporary pattern caused by the market shock due to the Grenfell tragedy.

3.137 The following chart compares the mean gross written premiums in each year for buildings that renewed with the same insurer (purple bar) against that for buildings that switched to a different insurer (red bar).

Mean gross written premium by renewal to insurer, 2016-2021



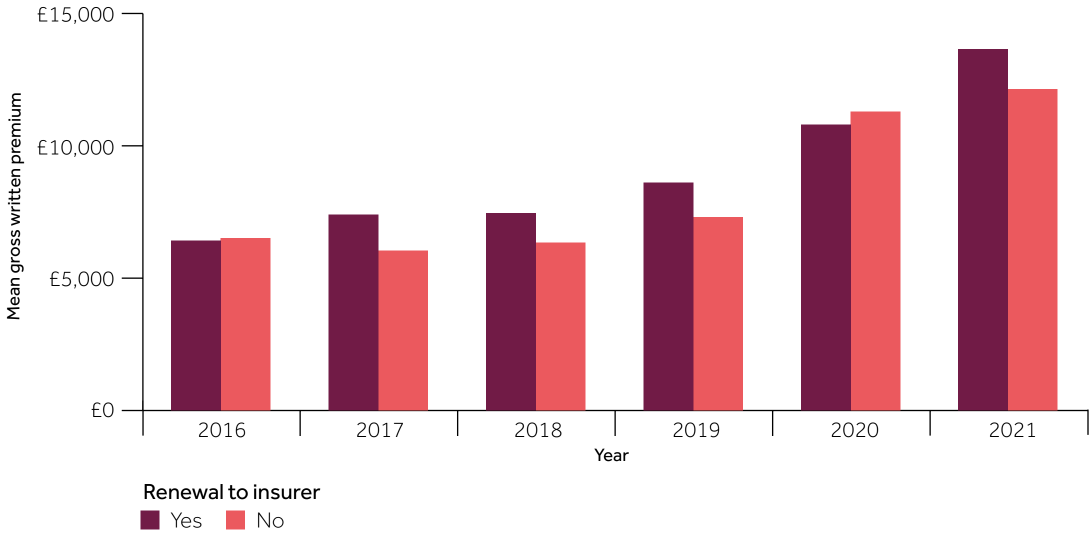
Source: FCA analysis of building-level data collected from insurers

3.138 The chart provides some support to the hypothesis that renewals are associated with higher premiums. It shows that buildings that renewed with the same insurer had, on average, a higher mean gross written premium in years 2017 (by 25%), 2018 (by 19%) and 2019 (by 19%) than buildings that switched to a different insurer. However the evidence is not conclusive: we also see that the mean gross written premium for renewals was, on average, lower than that for new customers in 2020 (6%) and 2021 (4%), while we see almost no difference in premiums in 2016.

3.139 Next we check whether a clearer relationship between renewals and premiums could be masked by the presence of buildings with identified flammable cladding in our sample. We expect that buildings with flammable cladding could be having a significant impact because the identification of the increased fire risk and the associated increase in premiums could be precisely the factor driving the decision to shop around and buy cover from a different insurer.

3.140 In the following chart we compare renewal and switching premiums only for buildings without identified flammable cladding.

Mean gross written premium for buildings without identified flammable cladding by renewal to insurer, 2016-2021



Source: FCA analysis of building-level data collected from insurers

3.141 The chart finds further support for the hypothesis that renewals are associated with higher premiums. Consistent with the findings in paragraph 3.137, it suggests that, once buildings with cladding are removed, renewals are associated with higher premiums in years 2017 (22%), 2018 (18%) and 2019 (18%), but also in 2021 (12%).

3.142 As explained earlier, the commission that is passed on to the freeholder and the property managing agent could be influencing to some degree their decision to renew with the same insurer or switch to a different provider. Our insurer data do not allow us to investigate this possible relationship as they do not contain information on the commissions passed on to freeholders and property managing agents.

4 Recommendations and potential remedies

4.1 We set out our key findings in Section 1 of this report. In this section we consider potential remedies that may address the harm or concerns from those findings. We welcome views on these recommendations or potential remedies. The details of how to respond are provided in the final section of the report. As well as considering the responses we receive, we will continue to work with Government and industry on the issues in the report. If we think that changes to our rules are required, we will consult on them in due course.

4.2 Before setting out our recommendations and potential remedies in detail, we set out the current rules that are relevant to this report.

Our current rules

4.3 Our rules for insurers and brokers cover the manufacture and sale of multi-occupancy buildings insurance products. Our Dear CEO letters for insurers and brokers reminded firms that our rules require insurers to ensure the design of their products takes account of the needs, objectives, characteristics and interests of customers in a defined target market and provide them with fair value. Intermediaries must ensure they do not take action that undermines the fair value of products. Fair value means a price that has a reasonable relationship to the costs incurred (the cost to serve) by the firm and the benefits that the customer receives from the product. Firms must only offer customers products that meet their needs and must not be influenced to act against customers' best interests by commission or other remuneration.

4.4 Although the freeholder is usually the 'customer', our letters made clear that firms should take leaseholders into consideration when designing their products and determining whether they are providing fair value.

4.5 Where prices increase, we expect insurers to ensure they are a fair reflection of the risk exposure. In Section 3 of the report we set out that insurers' understanding of the risks and approach to underwriting have led to increased premiums. Insurers must act fairly when assessing risks and ensure they do so with appropriate skill and accuracy.

4.6 Non-risk pricing elements, such as remuneration to others in the distribution chain, needs to be taken into account when identifying if the insurance product provides fair value. Remuneration is ultimately paid by the leaseholders as it is included in the overall price. If the remuneration of parties in the distribution chain does not have a reasonable relationship to benefits provided by them, it is likely to be in breach of our rules.

4.7 Distributors, such as brokers, need to be able to demonstrate their arrangements are consistent with providing fair value. This includes considering the relationship between the firm's level of remuneration and the actual costs, or their contribution, level of involvement or the benefit added by them, to the product's distribution arrangements. There is a responsibility on firms both paying and receiving remuneration to ensure this. Firms should be conscious of situations where remuneration increases, either as a proportion of the premium or in absolute terms, without any commensurate change in the costs or benefits provided in the distribution arrangement. This could mean that fair value is no longer being provided and indicate a breach of our rules.

4.8 There is a particular risk of harm to leaseholders where commission is paid onwards from the broker to the freeholder or property manager. We have seen evidence in some cases of commissions being set at significantly higher levels to deliver this. We are concerned that freeholders and property managers may be receiving money from brokers but not providing any additional benefits. Such arrangements are unlikely to be permitted by our rules where the commission paid is not a genuine reflection of additional work done by the freeholder or property manager for the benefit of leaseholders. We note that some authorised firms have specifically chosen not to make any commission payments to freeholders and property managers. In this context, we will undertake a multi-firm review of those brokers who charge the highest commissions in this market. We intend to publish the outcomes of this review in the first half of next year.

4.9 We expect firms to carefully consider our findings, and to ensure that their products are manufactured and distributed in a way that provides fair value taking account of the position of leaseholders, and to be able to evidence this. We will use the full range of tools available to us to achieve this and ensure a holistic approach to tackling our concerns in these markets.

Our approach to potential remedies

4.10 Our findings indicate that competition is not working in the supply of insurance of multi-occupancy buildings, specifically those with flammable cladding, and there is a lack of the available and affordable insurance. We are concerned that the insurance market, in conjunction with freeholders and property managing agents, is not delivering good outcomes for leaseholders and those who bear the costs of multi-occupancy buildings insurance. We want to ensure that firms focus on fair value and treatment of those who benefit from and pay for products. Value is driven not only by price but also by the quality of the product and service sold. Our rules place obligations on both product manufacturers and distributors to ensure products provide fair value.

4.11 As well as ensuring firms comply with existing rules, we are also considering a range of industry-wide measures to help reform this market so it works better for consumers in the future. We discuss the potential remedies that could do this, and the benefits and challenges of implementing them, below. We are seeking feedback on these remedies and ask a number of questions about them.

4.12 We note that our powers and rules generally only apply to firms we authorise. Freeholders and property managing agents are usually outside the scope of our rules. For example, where they are not carrying on regulated activities or are doing so relying on an exemption that permits them to carry on these activities under the regulation of their Designated Professional Body. FCA authorised firms typically have no relationship with leaseholders. For that reason, this section is split into different parts. We separately consider potential remedies which we are considering involving FCA authorised firms and our recommendations for actions that others, such as Government or industry, should consider.

Risk pooling

4.13 We have found that competition is not working well in the market and there is a very limited appetite among insurers to cover buildings with flammable cladding, especially where the freeholder is seeking insurance for a single building. Cover may only be offered on a layered basis. Where only a single insurer is willing to underwrite the policy, the price can be very high, due to the loss exposure that taking on a risk of this size creates for the insurer.

4.14 We consider that an effective way to address this would be the creation of a cross-industry risk pooling arrangement where the risk of covering certain higher-risk buildings can be shared across multiple insurers. Higher-risk buildings in this context are those severely affected by flammable cladding or other material fire safety risks creating the risk of total loss of the building. This may spread the capacity and alleviate extreme volatility, particularly if also considered from a reinsurance perspective. Equally, some stakeholders have suggested for the risk pooling scope to include all risks within these buildings, not just covering cladding and fire-related risks. Risk pooling may have the following benefits:

- Limiting the amount of risk an individual insurer is required to take on such higher risk properties may increase availability by making it more feasible and attractive for insurers to quote for and underwrite these properties, ultimately increasing competition.
- Some stakeholders told us that risk pooling may not increase the amount of insurers operating in this sector. However, they felt it could help by spreading the risk and reducing the most extreme prices for higher risk properties which don't already benefit from the pooling effect of being part of a larger portfolio of buildings.
- Other stakeholders suggested that a risk pooling arrangement could facilitate additional insurance capacity being introduced into this market, including from insurers or reinsurers who have not previously been active in this market.
- We have found that spreading the risk across a portfolio of buildings can reduce individual premiums for higher risk properties. However, it should be noted that our findings are based on the effect of insuring higher risk buildings in a portfolio with lower risk buildings. Combining only higher risk properties together may have a more limited impact on premiums.

4.15 We are not in a position to estimate the impact that risk pooling across the industry could have on prices, as it would depend on how the pool were to operate. However, the constrained appetite amongst individual insurers to cover multi-occupancy buildings, especially those with flammable cladding and insured as individual buildings rather than benefitting from pooling as part of a portfolio, means that risk pooling is likely to have a greater impact in reducing prices than other remedies.

4.16 Establishing a risk pool is outside of the scope of this review. It is vital that insurers continue to work closely with us and Government to develop a risk-pooling scheme which can, quickly, address these challenges and reduce prices for leaseholders.

4.17 We note that in our work with stakeholders there was support for the idea of risk-pooling across the industry, and the ABI, BIBA and the industry have been working on proposals for some time. Insurers told us that further work was required to understand how buildings are affected by construction issues, the scope involved how quickly it could be set up before it can be determined if pooling would be viable and what impact it would have on premiums. **We recommend the ABI (on behalf of insurers) continue to work with Government and us to design a risk pooling arrangement to enable insurers to share the risks of properties impacted by flammable cladding and an implementation plan for this arrangement within the next 2 months. This includes considering the issues of scope and impact set out above and setting out the estimated impact on premiums for eligible properties.** Were there to be insufficient progress made by the industry, we stand ready to consider, subject to FCA Board approval, launching a Market Study. If the evidence from this process, in conjunction with the work we have undertaken to date, indicates that there may be features of this market that prevent, restrict or distort competition, we also stand ready to consider consulting on a market investigation reference to the CMA.

4.18 There may be competition law implications to be considered. Where possible, we will also share data with the industry to support them and anticipate that the Government will want to do the same.

4.19 As most policies in this sector are placed through intermediaries, it is important that brokers are involved in the industry work on creating a risk pooling arrangement. Some of the higher commissions brokers currently charge are due to the increased amount and complexity of their work in placing risks for multi-occupancy buildings affected by flammable cladding and other material fire safety risks, where these often need to be placed with multiple insurers. The creation of an effective risk pooling arrangement is also likely to reduce the amount of work required of brokers and other parties when placing these risks; especially if the current layering is no longer needed. This should result in a corresponding reduction in commissions, and we would expect this to be passed on to leaseholders. **We recommend BIBA, on behalf of the insurance broking industry, engage with the design of the risk pool, and give strong consideration to how to ensure commission reductions can be reflected in the amount paid by leaseholders.** As in paragraph 4.17, if we were to find insufficient, timely progress made by the broker market, we stand ready to consider, subject to FCA Board approval, launching a Market Study. If the evidence from this process, in conjunction with the work we have undertaken to date, indicates that there may be features of this market that prevent, restrict or distort competition, we also stand ready to consider consulting on a market investigation reference to the CMA.

4.20 An industry-led risk pool may have some beneficial impact on prices for higher risk buildings most severely affected by cladding or other material fire safety issues. However, stakeholders have suggested it may be unlikely to lead to significant decreases as some insurers may still be unwilling to accept any risk involving the highest risk properties. Industry figures have suggested that this could be addressed by Government providing backing to cover these properties beyond the appetite of insurers. This backing could be provided on a temporary basis while ongoing remediation work is carried out, although the qualitative view from insurers, and based on our limited data, is that it is possible remediation of flammable cladding may not lead to significant reductions in premiums as it is understandably focused on reducing risk to life rather than risk of building loss. There may also be a case for considering it on a permanent basis. At present, we are unable to estimate the impact this could have due to the data constraints that are set out in Section 3. **We recommend DLUHC consider whether Government backing of a risk pooling arrangement could lead to quicker and more substantial reductions in premium for these buildings and the costs paid by leaseholders.**

Remedies that the FCA will progress

Increased transparency for leaseholders

4.21 Our review has found:

i. there is a lack of transparency for leaseholders around the component pricing of insurance;
ii. leaseholders are unable to proactively exercise choice, or provide meaningful input into decisions that materially impact the price they pay; and
iii. there is a lack of ability for leaseholders to provide pricing pressure on the distribution chain due to their lack of agency in the process.

4.22 Our engagements with stakeholders also showed broad support for increasing disclosure of information, especially about remuneration. Many felt that leaseholders had a right to know about this information as they are the ones who pay for the insurance. Our findings suggest that high/unjustified levels of remuneration may be being paid to some parties in a minority of cases.

4.23 We consider that requiring greater levels of disclosure and transparency of all aspects that make up the total price of insurance will help ensure that leaseholders are aware of the costs that go into the charges for their insurance. This should make it easier for leaseholders to understand that costs of their insurance and to challenge them if they are unfair, putting greater pressure on providers in the distribution chain. It will also provide a greater incentive for participants in the chain to demonstrate the value of their contribution to the product or service offered ultimately to the leaseholder. This might put pressure on them to either justify this cost or reduce their remuneration.

4.24 We will consult on improved information disclosure for leaseholders, as leaseholders could benefit from clear and objective information. We expect this to include important information about the policy and distribution arrangements, such as:

- information about the price of the insurance policy and also information about other policies which were available to the freeholder but not purchased
- full disclosure of all remuneration paid to all parties in the distribution chain
- information concerning potential conflicts of interests, such as tied relationships between brokers and property managers, or connections between freeholders and captive insurers

Q1: **What additional information do you think would most benefit leaseholders?**

Q2: **Do you have views on how this information should be provided to leaseholders?**

4.25 Although we think there are limits to what could be achieved through enhanced disclosure alone, we consider that it could help to underpin and facilitate other interventions. To put pressure on firms to improve their practices around product selection and remuneration, leaseholders need an effective, cheap and timely mechanism to challenge costs passed on to them. Without that, giving them additional information is unlikely to lead to any significant benefit.

4.26 Any enhanced disclosure rules we implement would only apply to FCA authorised firms. As these firms rarely have a direct relationship with the leaseholders, it would rely on freeholders to pass information onto leaseholders, and to disclose any remuneration which they add to the insurance costs. A similar situation already exists in our rules on group policies, where authorised firms need to give the main policy holder information that can be passed on. As we cannot make rules applying to unauthorised parties, we have set out a recommendation below to Government to ensure freeholders must pass the information on to leaseholders.

Making leaseholders customers within our rules

4.27 Our rules currently apply in a more limited way to leaseholders than they do to freehold property owners buying insurance for themselves, because leaseholders are not the customer of the insurer. This could be seen as anomalous because leaseholders are retail consumers similar to freehold property owners. We will consult on changes so that leaseholders would always be specifically included as 'customers' within our rules. This would place an obligation on authorised firms to comply with our rules for both the freeholder and the leaseholder. There are different rules where we could make this change:

- Product Intervention and Product Governance sourcebook (PROD) – The PROD rules require firms to ensure products meet the needs of an identified target market, and that the product – including constituent parts of the total price – offers fair value. These rules already apply to multi-occupancy buildings insurance products. However, we consider there may be benefit in making leaseholders 'customers' within those rules as this would put an explicit obligation on insurers and brokers to ensure products provide fair value to a target market of leaseholders. This would mean that firms would have to demonstrate and have clear records to show how their multi- occupancy buildings insurance products are ensuring fair value expressly to leaseholders.
- The application of rules to contracts of large risks – currently, some policies for multi-occupancy buildings are likely to be classed as large risks within the meaning of our rules. Some of our rules do not apply to policies covering large risks. We could amend this so the rules would in future apply to multi-occupancy buildings insurance products.
- Insurance: Conduct of Business sourcebook (ICOBS) – Many of the ICOBS rules are concerned with how individual policies are marketed and sold to customers. This includes information disclosure, and how firms ensure a policy meets the needs of individual customers. Making leaseholders 'customers' in the ICOBS rules would mean they are treated the same way as other retail consumers buying an individual policy from a firm. This could make it clearer for firms how they would have to consider the needs of leaseholders - including for fairly priced buildings insurance.
- We could apply the new Consumer Duty so that the protections extend directly to leaseholders who would not already benefit from it.

4.28 We set out our view in the Dear CEO letter earlier this year how existing rules would require firms to take account of leaseholders when meeting their obligations. However, we consider that there may be benefits in extending some of our rules to specifically include leaseholders. For example, requiring firms to take account of leaseholders as members of the target market for these products would mean that firms in the distribution chain would expressly have to demonstrate any remuneration they received or paid is consistent with the fair value that is intended for both freeholders and leaseholders. We expect this to result in lower remuneration for parties in the distribution chain and, ultimately, lower prices for leaseholders.

4.29 Any change we make would need to recognise the limits of what FCA authorised firms can do. The multi-occupancy buildings insurance market is different from the retail home insurance market because those who pay for the insurance are not usually party to the contract and typically have no direct relationship with the insurer or broker. This is a feature of leasehold property ownership and is not something we can change. There are also practical difficulties with applying some of our rules in this sector; notably the ICOBS rules. For example, where a single insurance policy is covering properties owned by a large number of leaseholders, it may not be practical to make the insurer or broker responsible for assessing whether the policy meets the needs of each individual leaseholder. These challenges may be less significant in relation to the PROD rules.

Q3: **Do you have views on how our rules should be amended to include leaseholders as customers?**

Q4: **Are there any potential unintended consequences we should consider if we include leaseholders as customers within our rules?**

Rules concerning remuneration

4.30 Insurance products should provide fair value to those who pay for them. Fair value means there is a fair relationship between the price paid by the customer – including the costs incurred (the cost to serve) by the firm and the quality of the product and/or service provided, eg the benefits that the customer receives from the product. Prices which are excessive compared to the cost to serve, or which are not commensurate to the benefits customers receive, are unlikely to be providing fair value.

4.31 We have seen that for most buildings included within our analysis the combined commission ranges between 30% and 49%, although we found a few instances of commissions exceeding 50%. Although we have seen evidence that commission percentages have decreased in recent years, the increase in premiums has meant that commissions have increased substantially in absolute terms across the observations used within our analysis. This remuneration is ultimately paid by the leaseholders because it is part of the costs passed on to them. As noted above, our analysis may be skewed towards individual buildings and those in smaller portfolios. This may mean that the remuneration and commission rates in the observations used in our analysis differ from those across the whole population of mid-rise and high-rise multi-occupancy buildings.

4.32 Nevertheless, these findings are significant and raise material concerns around the overall value provided to the leaseholder. We are concerned that parties in the distribution chain may not be consistently providing any benefits to leaseholders in return for the remuneration they are receiving, or the remuneration may be too high relative to the benefits they provide. We have also found that remuneration is often calculated as a proportion of the premium. That means a firm's remuneration increases when the premium increases. We are concerned that these increases may not reflect any commensurate increase in cost to serve or in benefits provided by the firm. Finally, while we have not been able to find definitive evidence of this, we are conscious that if the freeholder or the property managing agent is also receiving remuneration from the insurance policy, eg a share of the commission paid to the broker, this could influence their decision over which policy to select and conflict with their duties to their leaseholders. We are concerned there could be significant conflicts of interests which may not be being managed appropriately.

4.33 As we set out above, our rules already limit the remuneration practices of authorised firms. This includes structures where remuneration increases without a commensurate increase in costs incurred or benefits provided by firms. It may be that additional rules could benefit leaseholders by removing some potentially harmful practices:

- Preventing authorised firms from paying any commission or other remuneration to freeholders, property managers and other unauthorised parties in the distribution chain. This could limit such parties to fees paid to them directly by leaseholders.
- Prohibiting remuneration calculated based on the percentage of the overall premium, and instead requiring remuneration to be set in monetary terms.

4.34 We consider there are significant conflicts of interests and risk of harm in the current situation where authorised firms can pay commission to freeholders and property managing agents. However, we are mindful of the challenges we may have in making rules to address these risks:

- Some brokers have told us that the reason they share commission with unauthorised parties is that those parties undertake valuable work as part of arranging the insurance. For example, property managers may be involved in organising required building surveys. Such work will continue to be necessary and prohibiting commission sharing may simply mean that the broker is required to undertake more work and so retain more commission.
- As we do not regulate freeholders and most property managers, we cannot prevent them from taking remuneration from leaseholders in other ways which are outside the scope of our rules, such as directly through increased service charges.
- We have limited information on the detailed role played by freeholders and property managers in arranging insurance, because they are outside the scope of our information gathering powers under FSMA. Any further investigation on this may require use of powers under the Enterprise Act.

4.35 An alternative may be for a legislative solution where Government acts to limit the ability of freeholders and property managers to be remunerated for their insurance activities. That would avoid the potential difficulties, and potential consequences for other insurance markets, in trying to deliver this outcome through our rules.

> **Q5:** **Do you have any views on whether we should prohibit authorised firms from paying remuneration to freeholders and unauthorised property managing agents?**

4.36 We recognise limiting the remuneration models firms can use would be a significant intervention and would need to be supported by robust evidence. We stated above that we will undertake a review of those brokers who charge the highest commissions in this market. This review will consider firms' compliance with our current rules and enable us to understand whether broker practices are leading to fair value in this market.

4.37 In our update, we said we may consider interventions such as capping the level of commission firms can pay. We have not ruled out further work on this but note that, at this stage, the evidence base we have is focused on a smaller range of buildings. We note that the percentages charged as commissions are decreasing rather than increasing, although absolute commissions are increasing as a result of premium rises. This would indicate that a straightforward fee cap might not necessarily result in benefit to leaseholders. Therefore, our review will examine the practices of brokers in this market and determine whether there are further recommendations or solutions which can tackle the harm identified. We remind firms that failure to comply with their obligations to ensure that remuneration is consistent with fair value could lead to enforcement action at a future point.

4.38 Any rules we implement would need to ensure that firms are able to continue making a profit and are not disincentivised from participating in the market. An intervention which capped or limited the remuneration would be likely to have significant impacts and our findings do not currently suggest it would be justified, although we will consider that further as our work progresses. We anticipate that the introduction of a risk pooling arrangement would lead to a reduction in commission as the work required of brokers to place insurance for eligible buildings would reduce. We would expect this to lead to price decreases for these buildings.

> **Q6: Do you have other views on potential remedies concerning remuneration set out in the report?**

4.39 While we can make rules on remuneration paid to or by authorised firms, we could not affect the charges that unregulated freeholders make to their leaseholders. Where commission levels decrease, we cannot require freeholders or property managing agents to make corresponding reductions in their charges to leaseholders. To be fully effective, any rules we implemented may need to act alongside restrictions on the actions of freeholders, property managing agents and other unregulated parties.

Remedies and actions we are not considering further

4.40 There are a range of options for tackling the harm we have identified. Those we are focusing on are set out above. There are some options we do not currently propose to focus on in the next phase of our work. This is because we have not seen evidence that they will be as or more effective in addressing harm than the remedies set out above. These are set out below.

Sandbox to encourage new entrants

4.41 We have considered creating a regulatory sandbox to facilitate new entrants. This could assist by removing or simplifying regulatory barriers to entry. We do not think this would address the harms we have seen because we have no evidence to indicate that regulatory considerations are a barrier to firms entering the sector. We also note that no firms in this sector have applied to join existing FCA sandboxes. Some stakeholders also had concerns that a sandbox could encourage entry into the sector by non-specialists who lack sufficient expertise.

FCA mandating universally agreed criteria on assessing risk

4.42 We have considered whether there would be benefit in our mandating a standardised approach to assessing fire risk for multi-occupancy buildings. If agreed between surveyors and insurers, this could provide clarity on how the market assesses risk and may reduce the likelihood of information gaps leading to last minute quotes. We do not consider this would be likely to affect prices in the short term but it may help to ensure that remediation work serves to reduce prices and to facilitate competition by reducing some of the frictions of seeking alternative cover. However, we do not believe that it is appropriate for us to seek to prescribe the way the market operates to this extent, given the potential risks this poses, including to competition. Introducing such criteria would be outside of our remit but increased standardisation around underwriting and broking approaches, and the recording of risk data, is something that we recommend that the ABI and BIBA should take forward, as set out below. This should make it easier for industry, Government and us to properly assess the impact that remediation work and other remedies (such as risk pooling) would have on prices.

Access to the Financial Ombudsman Service

4.43 We have considered the option to expressly include leaseholders as a category of *eligible complainants* within our DISP (Dispute Resolution: Complaints) rules. This would mean that they could make complaints directly to authorised firms, and potentially also bring complaints to the Financial Ombudsman Service about premium increases, regardless of whether they were customers of the firm – under which circumstances they can already complain. There was strong support for this from leaseholder representatives. However, we do not consider that this would be likely to affect the insurance premiums leaseholders are ultimately bearing the cost of, where the price of the insurance reflects the insurance risk. This is because that is ultimately related to the approach taken by the freeholder in selecting the policy and the insurer's risk pricing approach. Additionally, the Financial Ombudsman Service remit is limited to considering the actions of financial businesses, rather than also encompassing the actions of those in the property market who are affecting the costs borne by leaseholders. It may be that the Financial Ombudsman Service could consider other complaints from leaseholders, such as how the product was sold or how claims are handled, but these would be unlikely to lead to reduced prices.

A market study

4.44 We will continue to keep the option of a market study under close review. We recognise that leaseholders need action now and that a market study and a market investigation reference to the CMA could take some time. We believe that our report has identified some key harms. The recommendations set out here to industry specifically and the actions we will take quickly should help alleviate some of these harms. Given that context, we do not consider that a market study is necessary at this stage. Should we see any delay or inaction from the industry, we will work with the CMA to decide whether such a study should be launched. We expect the industry to respond to our recommendations and to move forward at pace.

Q7: Do you agree with the potential remedies we are not proposing to take forward?

Q8: Are there any other potential remedies we should consider?

Our recommendations for others

4.45 In this section we set out recommendations for further actions which Government and the insurance industry may want to consider.

Improving transparency and dispute resolution for leaseholders

4.46 In the section on potential remedies for us to implement, we discussed the option of increasing information provided to the leaseholder, with the aim of putting pressure on firms to improve their practices around product selection and remuneration. We can introduce rules requiring insurers and brokers to provide greater disclosure to the freeholder. But we have no powers to require an unregulated freeholder to provide information to the leaseholder, nor can we compel unregulated property managing agents to provide information. So, it would be desirable for any enhanced disclosure rules we introduce, such as on product information or remuneration, to be matched with a corresponding obligation on unregulated parties to provide information to leaseholders.

4.47 For that reason, **we recommend that the Government considers imposing an enhanced legal requirement on freeholders and property managing agents to provide minimum information on the insurance policy to leaseholders. This could include passing on the information which regulated insurers and brokers provide to them**. We recommend the Government considers requiring disclosure of:

- full information about the insurance policy, the coverage, limitations and excesses
- information on potential conflicts of interests, such as relationships between parties in the distribution chain
- a breakdown of how the insurance costs for each leaseholder are calculated, including remuneration and any other incentives paid to all parties involved in arranging the insurance

4.48 If we were to amend our rules to require insurers and brokers to provide information to freeholders, Government could mandate this information be passed on by the freeholder to leaseholders.

4.49 As we noted above, we consider that disclosure is only likely to have an impact where there are mechanisms to ensure freeholders comply with the law and to allow leaseholders to challenge costs passed on to them. Without that, a duty to provide additional information is unlikely to lead to any significant benefit. Currently the process for leaseholders to challenge the actions of their freeholder is through the courts. Leaseholder representatives told us that this is expensive and time-consuming, and that it is difficult to meet the legal standard required to bring a successful claim. **We recommend that the Government considers ways to give leaseholders a straightforward and easily accessible route to challenge insurance costs passed on to them by freeholders, with one option being an independent alternative dispute resolution mechanism.**

4.50 We have also considered whether there should be an obligation on freeholders to conduct a tender exercise at certain policy renewal points. Its purpose would be to ensure the freeholder is routinely seeking the most appropriate cover for leaseholders. Disclosing the results of that exercise to leaseholders may increase pressure to act in their best interests and make it easier for them to challenge costs passed on to them. However, based on the data we have seen we do not think such a requirement would be beneficial. The current constrained market capacity means it is difficult to obtain multiple quotes for comparison. This is the case even if a different broker is used, as those brokers will typically approach the same insurers. We also note that there can be benefits to remaining with the incumbent insurer. For example, we heard that some insurers may be more likely to continue to underwrite a poorer or more complex risk where they have retained this risk for a number of years, or to accept certain claims for which it is not clear they are liable if these claims are made by a loyal customer.

4.51 If new entrants come into this sector in the future, a mandated tender process may deliver more benefits at that time.

4.52 Finally, it was suggested to us that Government, regulators, trade bodies and others should do more to educate leaseholders about how insurance policies are priced. At present, there is limited information available to leaseholders, and we have seen examples of leasehold groups having extreme difficulty in getting information from parties in the distribution chain. We consider that greater leaseholder 'education' would only become relevant once leaseholders are provided with adequate information on the insurance policies for which they pay.

Remuneration of freeholders and property managers

4.53 In paragraphs 4.33–4.34 above we discussed the risks arising from freeholders and property managers receiving remuneration from authorised firms. While we could introduce rules to address this, there are challenges to us doing so and any rules we introduce may not fully address the risk of harm. An alternative option may be for Government to legislate to limit the amount of money paid by leaseholders taken as remuneration by other parties in the distribution chain, notably those outside of our regulatory remit. This may be a more effective way to deliver this change and reduce the costs borne by leaseholders.

Addressing concerns over the current structure of contracts

4.54 Leaseholder homeowners are not party to the insurance contract and do not pay any premium directly to the insurer. Instead, their relationship is with the freeholder with insurance costs forming part of payments due under the lease agreement. Leaseholder representatives told us this separation between the insurance policy and the person paying for it may be exacerbating a lack of value leaseholders receive.

4.55 The current legal structure of insurance contracts, with freeholders as the policyholder, is a consequence of the wider legal position of freeholders as the owner of the building, and the relationship between them and the leaseholders. Insurers and brokers have told us they consider the freeholder their customer and generally do not consider themselves able to engage directly with leaseholders. During our engagements with stakeholders, it was suggested that leaseholders should be named as interested parties in the insurance contract, allowing them to contact the insurer directly, for example, to make a claim.

4.56 Amending the current structures is a matter for Government. It will require detailed consideration to ensure that the changes are practical and that there are no unintended consequences. For example, it may be difficult for freeholders to provide or maintain an accurate list of all interested parties throughout the term of the insurance contract and doing so may increase administration costs. As an alternative, and as recommended above, Government may prefer to look at options to improve ways that leaseholders can enforce current rights and obligations in a straightforward and cost-effective way.

4.57 Related to this, we heard suggestions that greater awareness should be raised of the right to manage option where available. However, the data we received suggest that it may be harder to get insurance for an individual building, including where this is managed by leaseholders, compared to a building insured as part of a portfolio. As such, we do not consider that raising awareness of right to manage would be likely to reduce prices. If taking the right to manage option involved exiting a larger property portfolio it may also have a negative impact on prices for some leaseholders.

Improved data quality and impact of remediation

4.58 Our ability to provide robust analysis and solutions was significantly hampered by the quality of the data available – both in terms of buildings insured and how it was priced by the different parts of the insurance chain.

4.59 **We recommend that the ABI and BIBA work with industry participants to establish a common code for the core pieces of risk information to be systematically collected and recorded for multi-occupancy buildings affected by flammable cladding or other material fire safety issues.** We recommend that this code is designed and communicated by the end of 2022, and implemented by the industry by the end of February 2023.

4.60 There is a lack of clarity about the impact remediation has on insurance premium for these buildings. We accept that there is a difference between the total loss of a building and remediation which serves to protect life. However, we would expect that any form of remediation would have some impact in reducing prices. We will do further work to ensure industry are adopting appropriate, and transparent, processes and procedures to assess buildings where some remediation has occurred.

4.61 The lack of consistent data has meant it has not been possible for us to make observations in this report on the impact remediation of these issues has on the insurance premium charged for these buildings. We would expect any data collected to also record remediation information so we can measure the impact on the cost of insurance to leaseholders.

Building remediation and surveyors

4.62 The relatively slow speed of remediation actions and delays to this point in funding remediation were mentioned by participants in both the industry and the demand-side workshops.

4.63 The lack of appropriately qualified surveyors and building fire safety experts was also identified as having delayed insurers' efforts to better understand the risks being underwritten. In some cases, this resulted in or perpetuated uncertainty in a way which resulted in insurers increasing prices or being unable to lower them where risks had been addressed or were less than initially understood. It was noted that the number of appropriately qualified surveyors and building fire safety experts had increased over the period, and many more buildings had now had much more detailed fire safety assessments performed, so the impact of this issue was now less.

4.64 It is not our role to comment on remediation programs and their funding, or on the number of, or need to train, surveyors and building fire safety experts.

5 Conclusions and next steps

Questions on which we welcome views

5.1 This report sets out our findings, and the potential remedies we are focusing on in the next phase of work. We welcome stakeholder feedback on the following questions:

Q1: What additional information do you think would most benefit leaseholders?

Q2: Do you have views on how this information should be provided to leaseholders?

Q3: Do you have views on how our rules should be amended to include leaseholders as customers?

Q4: Are there any potential unintended consequences we should consider if we include leaseholders as customers within our rules?

Q5: Do you have any views on whether we should prohibit authorised firms from paying remuneration to freeholders and unauthorised property managing agents?

Q6: Do you have other views on potential remedies concerning remuneration set out in the report?

Q7: Do you agree with the potential remedies we are not proposing to take forward?

Q8: Are there any other potential remedies we should consider?

5.2 Comments can be sent by email to multioccupancybuildings@fca.org.uk. We are asking for your feedback by 31 October.

Our next steps

5.3 We plan to conduct further analysis of the issues highlighted in this report to inform our thinking. We will continue to work alongside Government, industry and other stakeholders. Where we think that the harms identified can be addressed through changes to our rules we will consult on them in due course.

5.4 We will undertake a review of the activities of brokers receiving higher rates of commission to ensure they are complying with our rules and report our findings next year.

5.5 We will provide an update on progress against the potential remedies and recommendations in 6 months.

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