

Rt Hon Michael Gove MP
Secretary of State for Levelling Up, Housing and Communities
Minister for Intergovernmental Relations
4th Floor, Fry Building
2 Marsham Street
London SW1P 4DF

21 April 2023

Our Ref: C230130A

Dear Secretary of State,

RE: Buildings Insurance Market for Multiple-Occupancy Residential Buildings

Thank you for your letter of 30 January 2023. I am writing to you to provide an update on our work on the market for multi-occupancy buildings insurance. The report we published in September 2022 found a number of issues in the market which are contributing to the high cost of insurance for residential leaseholders.

The report set out a range of remedies which we committed to taking forward, and a number of recommendations for both the insurance industry and Government to progress. Since the report was published, we have continued to work on delivering our commitments and to support others in meeting the recommendations.

Remedies that we are progressing

In the report we committed to:

- consulting on improved information disclosure for leaseholders, to tackle the lack of transparency;
- consulting on changing the way our rules require firms to consider leaseholders' interests; and
- a further review of insurance broker remuneration.

We received a very strong response to the report, with 92 individual responses. The majority of these were from individual leaseholders affected by the issues identified in the report. Leaseholder representatives also took part in roundtable discussions.

Today, we have published two documents:

- A report of the findings from our review into insurance broker remuneration.¹
- A consultation paper setting out proposed changes to our rules.²

Multi-firm review

We requested information from 16 firms about their work on multi-occupancy buildings insurance, including qualitative information on fair value assessments as well as quantitative data on relevant policies and remuneration for the period 1 January 2019 to 30 September 2022. The key findings of our work were as follows:

¹ <https://www.fca.org.uk/publications/multi-firm-reviews/multi-occupancy-buildings-insurance-broker-remuneration>

² <https://www.fca.org.uk/publications/consultation-papers/cp23-8-multi-occupancy-building-insurance>

- Absolute levels of remuneration, including commissions, have risen by nearly 40% across the period under review, despite reductions in commission percentages, with average broker remuneration per policy rising from £2,170 in 2019 to £3,010 in 2022.
- In aggregate across our sample during the period we see broker retained remuneration of £159m, a margin of £66m over the £93m of staff costs reported by these firms as being directly associated with multi-occupancy buildings insurance in the same period.
- A further £80m of commission was paid by the firms in our sample during the period to other parties involved in the insurance arrangements, including freeholders and property managing agents. This significantly affects the cost of insurance.
- Most of the brokers in our sample did not give us adequate evidence to show that they deliver fair value consistently for multi-occupancy buildings products or take into account the interests of leaseholders when assessing whether they are providing value. This is due to a range of factors including deficiencies in their product value assessment work, shortcomings in their recording and analysis of their own costs and insufficient scrutiny of the commissions they pay to others.

In light of these findings, we will take the following actions:

- Intervene using a range of regulatory tools (which may include skilled person reports) where firms have significant weaknesses in meeting their regulatory obligations (including on fair value). We will ensure firms urgently remediate and mitigate these weaknesses and any harm they are causing.
- Act to ensure that firms who need to make improvements to fully meet their regulatory obligations address these weaknesses promptly. A Senior Manager Function holder will then need to attest and evidence that the firm is delivering fair value consistently.
- Expect brokers to immediately stop paying commissions to third parties without appropriate justification in line with our rules on fair value. We will undertake further reviews across various products, and where we see this practice still occurring, we will take regulatory action.

Consultation paper

We are proposing to:

- amend our existing rules so that firms are required to ensure products are designed to meet the needs of leaseholders and provide fair value;
- introduce enhanced disclosure requirements which will provide leaseholders with information about the policy, potential conflicts of interests, remuneration of brokers, and the number of alternative quotes obtained; and
- prohibit remuneration practices which conflict with leaseholders' interests.

The consultation will be open until 9 June 2023. Once it has closed, we will work quickly to review the responses, with the aim of finalising our rules by Autumn 2023.

Recommendations for the insurance industry

In our September report we recommended that the Association of British Insurers (ABI) work with Government and the FCA to create a risk pooling solution, providing a plan for this solution and its implementation within 2 months. We also recommended that the British Insurance Brokers' Association (BIBA) engage with the design of the risk pool to limit the commission costs.

The ABI's work to develop and launch a reinsurance scheme to provide reinsurance cover for those multi-occupancy buildings worst affected by cladding and other fire safety issues is ongoing, with a planned launch date of Summer 2023. This scheme is intended to enable individual insurers to underwrite the entirety of these risks and eliminate the need for excess layer insurance to be arranged individually and at significant cost. We are supportive of this work

and urge the ABI and those they are working with to ensure that this scheme is brought into operation as soon as possible and that it is delivered in a way which maximises its impact and the benefits it brings to leaseholders. We believe there is significantly more brokers need to do to limit commission and maximise the benefits for leaseholders, as set out in our report.

On 28 February 2023 the ABI and BIBA launched a code on core risk data for multi-occupancy buildings over 4 storeys or 11 metres in height and affected by combustibile cladding or other material fire risk issues, in response to another of our recommendations. This is a voluntary code developed with insurance industry participants to support the industry in systematically collecting and recording core risk information to drive consistency and transparency. We are supportive of this initiative and encourage the ABI and BIBA to work actively with their members to ensure that firms collect and record this information on relevant buildings on a comprehensive and consistent basis. This is necessary in order that it provides a rich and high-quality data source for analysis of the market, facilitating a better understanding of key market trends as well as providing evidence of the progress being made to address some of the issues for leaseholders highlighted in our September 2022 report. We note the intention to review the code after it has been in place for 6 months and will be keen to see how the code is working and to understand the insight it provides.

Recommendations for Government

The distribution of insurance in this market is often complex. As well as authorised insurers and brokers, there are usually other parties such as property managing agents (PMAs) involved. Building freeholders are typically the policyholders, recovering their costs from leaseholders under the lease agreement. These parties are often remunerated by the insurance firms as well. Freeholders and most PMAs are not required to be FCA authorised and are not subject to our rules. For that reason, we made two recommendations for Government:

- Consider imposing a legal requirement on freeholders and property managing agents to provide information on the insurance policy to leaseholders. This would ensure that the information provided by insurers and brokers is passed on to leaseholders.
- Consider legislation applying directly to unregulated property managers and freeholders regarding their remuneration.

We welcome this and believe that if such action is taken, it will reinforce the measures we are taking and bring real benefits to leaseholders. We welcome the close work with your officials to ensure the Government and FCA interventions are aligned. We also note your 30 January announcement that you will table legislation to ban property managing agents and freeholders from taking insurance commissions, which we believe will complement the actions we are taking.

We look forward to continuing this positive engagement as we progress our respective work.

Yours sincerely,

Sheldon Mills

Executive Director, Consumers and Competition

Cc:

Sarah Cardell, Chief Executive of the CMA
Andrew Griffith MP, Economic Secretary to the Treasury.