

Response to FCA Policy Statement on Multi-Occupancy Buildings – 29th September 2023

Overall

BIBA supports improving leaseholders' understanding of the insurance arrangements for the building in which their home is located. Considering the information needs of 'policy stakeholders' will help to achieve that. The Financial Conduct Authority's (FCA's) policy statement coincides with extensive work BIBA has commissioned to help members better demonstrate the fair value in the services they provide, as well as providing a framework for assessing the value provided where both work and commission are shared with other parties.

Wider messaging

BIBA broadly welcomes the rule changes announced by the FCA today in its Policy Statement on residential multi-occupancy buildings. In particular, we welcome the introduction of the new policy stakeholder status for leaseholders and the increased transparency requirements around insurance arrangements and remuneration, subject to the points we make below. The Statement coincides with extensive new work BIBA has commissioned to help members better demonstrate fair value for the activities and services they provide in this sector. This entails a new **Fair Value Assessment Framework** which members can adapt for their own business models to articulate, measure and evidence value for both the commission they retain and any commission they might share with Freeholders and Property Managing Agents (PMAs) for insurance related activities they undertake. It also coincides with a **new member pledge** that BIBA members are being asked to sign up to which makes important commitments around remuneration practices for residential buildings over 11m in height that have material fire safety issues. Finally, we are at an advanced stage in our work with the ABI and McGill & Partners to launch a **new Fire Safety Reinsurance Facility** later this year which will allow a group of leading insurers to deploy more risk capacity for medium and high-rise residential buildings that have material fire safety issues. The aim of this scheme is to reduce reliance on expensive excess of loss reinsurance placements which brokers need to purchase to ensure a building is fully insured and hence reduce the overall premium.

Response to FCA Policy Statement on multi occupancy buildings

We welcome the introduction of the new policy stakeholder class for leaseholders and having more transparency around insurance arrangements and remuneration for multi-occupancy buildings. We have been working extensively with members on demonstrating fair value for the activities and services they provide for both the commission they retain and any commission they might share with freeholders and property managing agents for insurance related activities they undertake. We are also working on a **new member pledge** with the Department for Levelling Up Housing and Communities around remuneration practices for residential buildings over 11m in height that have material fire safety issues.

BIBA will support its members in implementing the new disclosure requirements which arise from today's announcement. A number of our members are in fact already pro-active in disclosing their earnings to their customers.

We agree with the contents required in the disclosure which will enable leaseholders to better understand the cost of insurance, which reflects suggestions we and our members have already made to the FCA.

For complete transparency, within the information provided to leaseholders, we would encourage freeholders and property managing agents to set out how much of the service charge relates to the building insurance cost and include within that how much of that sum represents payment of Insurance Premium Tax (IPT) and Value Added Tax (VAT) so that leaseholders understand where double-taxation applies.

We consulted with our members in 2022 and shared a view that we would encourage freeholders and property managing agents to present clear information to leaseholders about the insurance related work they undertake, the value they add to the supply chain and their contributions for the cost they add to the insurance placement.

Finally, hand-in-hand with better and more transparent information relative to the insurance arrangements is the need to better educate leaseholders on the factors that affect the premium they pay. Beyond fire safety issues, there could be other reasons why premiums for a building have increased, notably:

- Inflation – the cost to reinstate a building has risen on average by over 15% in the past 12 months. The sum insured needs to be adjusted accordingly and premium will naturally increase even though the premium rate may stay unchanged.
- The cyclical nature of insurance rates – we are beginning to emerge from a ‘hard’ market whereby UK property rates across the board increased by 20% in 2022.
- Attritional losses – escape of water losses have plagued many buildings and premiums have had to increase to respond poor loss experience.

The freeholder and the property managing agent could play an important role here, supported by the broker. More appreciation of the complexity and time involved in placing cladded risks in particular would also potentially help build better understanding among leaseholders around costs associated with the placement and management of the insurance programme.

Alternative Quotes:

The requirement for brokers to disclose the number alternative quotes is welcomed and it is standard practice for a broker to canvass a number of competing insurers in order to recommend the insurer that best matches the client’s demands and needs. In some cases, the number of insurers approached will depend on the size and complexity of the risk and/or the availability of insurer capacity for the client’s specific needs. This is particularly relevant in cladded buildings where there are few insurers who are prepared to quote and there may only be one option for the broker to present.

It is important that both the customer (freeholder) and the leaseholder know that premium competitiveness is only one determinant why a broker might make an insurer recommendation. Other factors include:

- Insurer financial strength rating
- Appetite for the nature of the risk being presented
- Specific knowledge of the client’s industry/trade sector
- Reputation for paying claims promptly and fairly
- Quality of products, notably breadth of coverage
- Standard of documentation based on past experience
- Standard of service
- Risk management engagement (survey programmes) to assist in better managing claims performance.

The final buying decision has to be made by the policyholder, not the policy stakeholder (leaseholder). Otherwise, we could face situations whereby risks are uninsured if agreement from every leaseholder is needed. Thought needs to be given to how disclosure around alternative quote will be done. How will this be managed in practice since neither the broker nor the insurer will have the names of the leaseholders to facilitate direct provision of information. Again, the Freeholder or PMA will have to play a key role to make this happen.

Inclusion of contracts of large risks.

We welcome the FCA's confirmation that commercial properties (with commercial leaseholders) that are owned by a freeholder and/or managed by a PMA are out of scope of the new rules.

Changes to how the PROD rules apply for the protection of leaseholders

We welcome the changes to how the PROD rules apply so that leaseholder interest can be taken into account and the creation of the 'policy stakeholder' status for leaseholders under the new rules. In this way, brokers will be able to demonstrate that the product offers fair value to the leaseholder as a policy stakeholder. We would argue that many brokers do this today in the design and pricing of products for this sector as evidenced in the very wide policy wordings which ultimately bring specific benefits for leaseholders, such as generous alternative accommodation limits.

Demonstrating FAIR VALUE – retained and rebated commission

The current level of retained commission (13%) would not seem unreasonable at a time when operating costs for brokers, in particular salaries, are increasing sharply. However, we accept the point that some brokers need to be more detailed in how they articulate, evidence and measure the value of the services they provide when it comes to the remuneration they retain and share with third parties on multi-occupancy buildings. To this end, we are supporting our members with a new Fair Value Assessment framework and accompanying guidance which they can adopt to better measure and evidence this aspect of their work. In early July we engaged the economics and finance consultancy Oxera to work on a project to help members better assess and evidence fair value in the distribution of insurance products and services. The output of the project is a framework for brokers to adapt to fit their individual business model together with detailed guidance. The new framework and guidance are currently being rolled out to members as part of our autumn Tour of the Regions.

Our Pledge

Recognising that leaseholders living in tall buildings that have cladding issues have faced the biggest premium increases, we have been working with DLUHC for several months on a **pledge around broker remuneration when placing risks over 11m that have material fire safety issues requiring remediation**. This builds on a pledge that first appeared in our January 2023 Manifesto and benefits from constructive bi-lateral meetings held by Minister Rowley and our leading real estate brokers. The key elements of this new pledge, which is in the process of being finalised with DLUHC, asks that our members will:

1. Commit to stop the practice of sharing commissions with third parties when they take out buildings insurance. Third parties being property managing agents, landlords and freeholders. [Note: third parties will need to determine their own charging arrangements]
2. Commit to having a cap on any retained commission for multi-occupancy buildings with fire safety issues of no more than XX% of the total premium (including work transfer payments) on buildings which have not yet been remediated or are being remediated.

3. Commit to disclosing our commissions to leaseholders in accordance with FCA regulation (as permitted to do so) if requested and work with third parties to deliver transparency on fees to leaseholders.

Why the Commission Model is relevant and important

The changes to the PROD rules imply that any increases in commissions earned by a broker because the gross premium has increased could breach the rules because the additional amount would not entail additional benefits to the freeholder or leaseholder. This would seem to be an attack on the commission model that has served customers well over hundreds of years. There is an established test that a broker may keep the commission agreed by the insurer provided that the amount and nature of the commission is usual and ordinary for the services provided.

It must be remembered that insurance is a cyclical business and periods of rate softness (for example 2003 to 2018) have historically always exceeded periods when rates are hard (a period which we have witnessed over the past 4 years in property insurance).

One of the advantages of commission-based remuneration is that the customer benefits from the advice of the broker before the risk is bound, at no cost. This is often where a lot of effort by the broker is expended – for example, on programme design and market canvassing exercises to gauge insurer interest.

Unlike other classes of commercial insurance, multi occupancy buildings create a high volume of mid-term adjustments (MTAs) including changes in value, alterations, lenders interests, lease surrenders etc. Another advantage with commission-based remuneration is that these many transactions do not attract separate charges on top of the commission earned at placement/renewal stage. Moving away from this model would entail a schedule of fees, which would inevitably be passed on the leaseholder.

With regard to that portion of the commission that is shared with the freeholder or property managing agent for insurance related work, we are conscious that DLUHC is looking to ban this practice and for it be replaced by a transparent, separate charge itemised on the service charge bill. We welcome this announcement and would urge Government to bring forward the required legislation as soon as possible. In the meantime, we will work with our members on good practice in determining value of the services provided by the property managing agent or freeholder using the Fair Value Assessment Framework noted above.

For the sake of clarity, we would strongly recommend that the FCA support our call that such a ban should not affect the established practice of wholesale insurance broking market whereby commissions are shared between retail and wholesale brokers. This has particular value in the context of impaired buildings where a retail broker may be dependent on the services of a wholesale broker to obtain additional risk capacity in the London market.

Changes to the ICOBS customer's best interest rule, and related rules

In amending the scope of ICOBS rules, we are pleased that the FCA has considered the unintended consequences that could flow from making leaseholders a customer in other aspects of current ICOBS rules and that the principle that the freeholder makes the ultimate buying decision is preserved.

Proposed changes to the SYSC remuneration rules

We envisage scenarios where the interests of the freeholder and the leaseholder do not always align. This needs to be carefully considered.

We would encourage the FCA to work with DLUHC to bring in planned legislation to end the sharing of commission with freeholders, property managing agents and landlords as soon as possible so that the need for SUP 19F.2.2 R becomes obsolete. We say this because there will always be some measure of subjectivity when assessing whether the amount of commission rebated is fair and reasonable for the services performed.

It should also be noted that brokers generally do not offer incentives to PMAs/freeholders, but instead are approached by these parties requesting a share of the commission to cover the insurance-related activities they undertake. It is important that the FCA understand where the driver for commission-sharing begins.

Comments on FCA cost benefit analysis

There is no guarantee the rule changes will lead to lower premiums for leaseholders.

This is largely because the main driver of increases in recent years is premium, not commission and there is little reason to expect premiums to fall in the near term. At a macro level, current indexation rates on buildings are circa 15% to 20%. This is a significant driver of premium increases. Couple this with the fact that pure property rates continue to increase then leaseholders must be conditioned to significant premium increases until such time as inflation subsides, and the insurance market softens.

Overall, the residential real estate sector is less attractive than commercial real estate with fewer insurers active and less competition. Insurers continue to suffer from high levels of attritional losses, in particular escape of water claims.

Looking at commissions, the average retained broker commission rate has been rapidly falling and is now 13% per the FCA report. We believe this to be an acceptable average over the market cycle.

The new Fire Safety Reinsurance Facility has been established by McGill and Partners

We do, however, hope that some multi-occupancy buildings that have fire safety issues will benefit from the forthcoming new Fire Safety Reinsurance Facility established by McGill and Partners, supported BIBA and the ABI, which will allow a group of leading insurers to deploy more risk capacity for medium and high-rise residential buildings that have material fire safety issues.

The aim behind the scheme is to offer more affordable premiums which will in turn help lessen the financial burden of leaseholders who have been caught up in the cladding crisis.

We think it will be particularly relevant to Resident Management Companies (RMCs) and Right to Manage Companies (RTM) whose blocks do not form part of a wider portfolio and are currently placed on an individual basis.

Remediation

We do know that when a building is remediated to a satisfactory standard, our members are able to negotiate significantly lower premiums. The pace of remediation remains slow, and one reason is a lack of professionals who are prepared to undertake this work because of a lack of adequate and affordable professional indemnity cover. We continue to propose a range of solutions to this problem to DLUHC.

IPT

We request Government to waive IPT on premiums for multi-occupancy residential buildings that require or are undergoing remediation to lessen the financial burden on leaseholders.

Implementation period for new rules

As BIBA has stressed to the FCA, a three months' timeframe for implementation will be challenging for firms, but will work to support our members to work to this deadline.

Insurance brokers in the main are reliant on third party software (and hardware) suppliers, known as 'software houses' (SWHs) to provide and update their operating systems. The FCA has spoken directly to these software houses in relation to previous regulatory consultations and were made aware that changes could take between nine months to one year to design, develop, programme, test and then release. The changes must also fit into an existing schedule of upgrades, bug fixes, etc, given that resources will be greatly focused on creating solutions to meet the incoming Consumer Duty requirements.

The potential consequences from rushing the implementation of the proposed changes should not be overlooked. For example, adapting existing policy wordings to contemplate the planned changes to the PROD 4 rules so that the interests of leaseholders are fully taken into account could take over a year or more to achieve.

We also wonder to what extent do leases need to be amended to reflect the changes the FCA would like to see and does the Landlord and Tenants Act need to be reformed – for example, tightening what information the freeholder needs to declare to leaseholders.