

# Multi-occupancy buildings insurance – broker remuneration

**April 2023**

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## Chapter 1

# Executive summary

## Background

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- 1.1** The cost of buildings insurance to residential leaseholders and other property owners of multi-occupancy buildings has increased across the UK in the wake of the Grenfell tragedy. Since 2017, hundreds of thousands of leaseholders have endured the stress 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. We were asked to:
- shed light on the underlying causes of year-on-year price increases
  - assess the causes of the marked restriction in coverage available for multi-occupancy buildings
- 1.3** On 21 September 2022 we set out our findings and recommendations for measures that industry, the Government and regulators can take to achieve the goal of widely available and affordable cover for leaseholders of multi-occupancy buildings insurance.
- 1.4** One of our key findings in the broker market was evidence of some high commission rates and poor practices which were not consistent with driving fair value to the customer. These could be causing harm to leaseholders. We noted that:
- In most cases, in the observations we received and used for our analysis, the commission rate was at least 30% (they ranged from <10% to 62%).
  - In 39% of the observations, the broker paid more than half of the commission to the freeholder or the property managing agent.
  - While the commission rates in percentage terms for multi-occupancy residential buildings had fallen since the Grenfell tragedy, absolute commissions increased. This was driven by the increases in insurance premiums.
- 1.5** We were concerned that increases in absolute commission received by brokers, freeholders and property managing agents were disproportionate to increases in service costs. We noted that our rules require that the prices paid represent fair value and that we were concerned that the levels of commission and practices of commission sharing did not always represent fair value for those bearing the costs of this insurance. While leaseholders are not usually the 'customer' buying the insurance they often bear the cost. Our Dear CEO letters of 28 January 2022 to insurers and brokers made clear that firms should take leaseholders interests into consideration when designing and distributing products and determining whether they are providing fair value. Alongside this review we are publishing a consultation paper setting out our proposed rule changes

to address the issues identified. These are designed to mitigate the risks of harm by extending some of the protections afforded by our rules to leaseholders.

- 1.6** In the context of our concerns, we committed to reviewing those brokers who charge the highest commissions, publishing our findings and considering the need for further rules on remuneration.

## Our review

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- 1.7** We requested information from 16 firms about their work on multi-occupancy buildings insurance. These 16 firms (13 brokers and 3 managing general agents, hereafter collectively referred to as brokers) were included in the sample due to the levels of commissions charged. They also intermediate approximately 35% of the multi-occupancy residential buildings insurance market, based on the data we have. 12 of those firms were included in our initial review, so we considered their submissions alongside the information previously obtained.
- 1.8** We asked for qualitative information on areas such as fair value assessments and remuneration policies as well as quantitative data on relevant insurance policies and remuneration for the period 1 January 2019 to 30 September 2022. This was to allow us to review remuneration levels and practices in this market more fully and to consider the impact of this remuneration, including any part of it paid on to other parties, on the premium paid and whether this was consistent with the interests of the leaseholder who would ultimately bear the cost.
- 1.9** We carried out our review in the context of the applicable regulatory framework. This framework has evolved over the period, most notably through the rules introduced via our [Policy Statement PS21/5 – Feedback to CP 20/19 and final rules](#). The enhanced Product Intervention and Product Governance Sourcebook ('PROD') rules introduced by PS21/5 came into force in 2021. Our PROD rules require firms to ensure products offer fair value. In this context, brokers need to be able to show their distribution arrangements are consistent with providing fair value. Key fair value requirements have applied in full to brokers (as product distributors) since then with firms having a transitional period to assess their existing arrangements were consistent. In reaching our findings, we have also considered the extent to which firms are taking account of the interests of leaseholders under the applicable regulatory framework, given that they are not usually customers. We describe the applicable regulatory framework and considerations relevant to this review in more detail in Chapter 2 below.
- 1.10** Before sending out our information request, we held workshops with market participants, leaseholder representatives and other key stakeholders. These workshops helped us to consider the issues identified by the initial review and our recommendations. We used the insight from those workshops, our previous review and information from other sources (such as correspondence with Parliamentarians, and complaints) to challenge and validate the information from firms and our analysis.

## Our key findings

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### **Absolute levels of remuneration, including commissions, have risen by nearly 40% across the period under review, despite reductions in commission percentages.**

- 1.11** Our analysis of the data from the 16 firms in our sample corroborates the movements we saw in our initial review. We saw average gross written premium ('GWP') per policy rise by 56% from £7,470 in 2019 to £11,625 in 2022. Over the same period, average broker remuneration per policy rose by 39% from £2,170 to £3,010 and average broker commission per policy rose by 46% from £1,785 to £2,595. The increase in average broker commission accounts for 20% of the increase in average GWP.
- 1.12** We saw these movements in a sample where the policies arranged by the 16 firms increased by 18% from 22,464 in 2019 to 26,549 in 2021 (the years for which we have 12 months' data). The increases in gross written premium, total remuneration and total gross commission across the sample are much greater over the same period. Gross written premium increased by 82% from £167.8m to £305.1m, total broker remuneration increased by 55%, from £48.7m to £75.6m and total gross commission increased by 64% from £40.1m to £65.7m.
- 1.13** This shows that the overall level of remuneration and commission being paid across the same population of multi-occupancy buildings rose significantly between 2019 and 2021. This significantly affects the overall price paid by the purchaser of the insurance, and the cost for the leaseholders who usually ultimately bear this expense.
- 1.14** However, as in our initial review, we do see reductions in the average rates of remuneration and commission (as a proportion of gross written premium) across the period. These reduced gradually from 29.0% and 23.9% respectively in 2019 to 24.8% and 21.5% in 2021, before rising slightly back to 25.9% and 22.3% respectively in 2022.
- 1.15** The data collected for this report shows lower average rates of remuneration and commission than we saw in our initial review. This is largely attributable to a broader suite of data being collected this time (for example through including a wider range of buildings via the use of proxies), a different sample of firms and other variations. We do still see considerable variations between firms, however, with some firms' remuneration and commission up to 10% above these averages.
- 1.16** We consider the levels of and movements in remuneration and commission and the different types of remuneration in more detail in Chapter 3.

### **The number of parties involved in some distribution chains and the sharing of over £80m of commission with these parties significantly affects the cost of insurance. Brokers were often unable to articulate what insurance related services or benefits of value were provided by the parties sharing commission.**

- 1.17** The insurance distribution chain was a key focus of this work. We looked at:
- the number of parties involved in it
  - the roles these parties play
  - the extent of commission sharing by regulated brokers with other parties
  - the value delivered by these parties

- 1.18** At the simplest level, the arrangements involve a policyholder/freeholder, a broker and the insurer. In many cases however, a variety of other parties (regulated and unregulated) can be involved. This includes property managing agents, other brokers, managing general agents ('MGAs') and appointed representatives.
- 1.19** Our sample showed commissions paid to other parties within the chain totalling £80.7m over the 3 years and 9 months review period. This was 37% of the total commission figure of £216.1m and 8% of the total gross written premium figure of £968.0m. The proportion of commission paid to other parties remained broadly consistent over the period.
- 1.20** We asked brokers to explain the range of roles and activities performed by the various parties in each of the distribution chains that they were involved in. The responses varied widely, as some firms had done more than others to both understand and evidence the role of the other parties in the distribution chain. Given the amounts of commission involved, we were concerned by the often-limited consideration or evidencing of the work being done by other parties. The extent or quality of work done by intermediaries to consider and assess the extent to which these arrangements could give rise to conflicts of interest appeared similarly limited in some cases.
- 1.21** We consider the levels of and movements in commission paid to other parties in more detail in Chapter 3.

**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. 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.**

- 1.22** We asked the brokers to provide copies of their Fair Value Assessments (FVAs), required under our PROD rules, and found significant shortcomings in the work done and evidence provided by most firms. This included failures to obtain value assessments from insurers or to perform and evidence the value assessments required on their own remuneration and activities.
- 1.23** Some brokers struggled to analyse their own costs and expenses in a way which enabled them to understand or report these for this product line. This made it harder for them to consider their costs appropriately when assessing the impact of their own remuneration and activities on the value provided by that product, or to show whether they are providing fair value.
- 1.24** In aggregate across our sample from 1 January 2019 to 30 September 2022<sup>1</sup> we see:
- broker retained remuneration (including all elements of broker remuneration) of £159.4m, a margin of £66.2m over £93.2m of staff costs directly associated with multi-occupancy buildings insurance

<sup>1</sup> The remuneration figures in these bullet points do not include the 2022 remuneration and staff costs for one broker who did not provide comparable staff costs for the period. The retained commission of £124.1m plus the commission paid to other parties of £79.6m can be added to the £11.3m of retained commission and the £1.1m of commission paid to other parties for this broker in 2022 to give combined retained commissions and commissions paid to other parties figures of £135.4m and £80.7m respectively, totalling the £216.1m commission stated above.

- broker retained commission revenue of £124.1m, with the annual contribution made by broker retained commission after staff costs more than quadrupling (from £3m to £13.5m) from 2019 to 2021
- that increases in firms' commissions due solely to higher premiums are not matched by cost increases where the volume of work has not changed
- commission paid to other parties of £79.6m, giving total gross broker remuneration of £239.0m when added to the retained remuneration.

**1.25** Despite the large amounts of commission often being paid to other parties, most brokers in the sample did not provide appropriate evidence of the work they had done to assess the value being delivered by these parties. In many cases, including firms paying 50% or more of commission to another party, all that was provided was a generic or cursory list of the types of activities potentially performed by the party. These lists lacked specificity or any meaningful comparison to the level of commission being paid across to this party.

**1.26** In many cases there may be significant additional expenses being incurred both in the broker (other corporate costs and expenses) and in the parties sharing the commission in delivering and servicing this insurance product. However, while these are not being accurately and reliably captured and analysed in the context of the value assessment, brokers are not able to show adequately that they are delivering fair value to customers including taking account of the leaseholders who often ultimately bear the costs. Additionally, there were many other cases where there did not appear to be any services or benefits being provided in exchange for the remuneration. Given the substantial increases in remuneration and commission seen over the period, in some cases the amount of remuneration and commission being received is very unlikely to represent fair value.

**1.27** We set out our findings on fair value in more detail in Chapter 3. While this review has solely focused on multi-occupancy buildings insurance, we see that this issue may be much broader and reflect how some firms have done their FVAs. We expect all firms to consider our findings when assessing how they comply with PROD and deliver fair value, and to act if they identify they are not meeting these obligations fully.

### **Issues with availability, completeness, quality and comparability of data**

**1.28** We faced some of the same data challenges highlighted in our first review and had to make compromises in our data collection. This included allowing firms to use proxies to identify and report on the relevant population of insurance policies for multi-occupancy buildings. Additionally, some of the firms in the sample found it difficult to give us appropriate and accurate data on the expenses incurred in providing services relating to the insurance of multi-occupancy residential buildings.

**1.29** We set out the data issues in more detail in Chapter 2. These issues raise some challenges in relation to the completeness, accuracy and comparability of some of the data received. However, they did not prevent us carrying out our planned analysis, gaining insight into the distribution activities of firms in the sample, better understanding the movements in their remuneration and staff costs over the period and reaching our findings.

**The brokers in our sample appear to meet their basic Insurance Conduct of Business Sourcebook ('ICOBS') disclosure obligations to their customers (usually the freeholders), including on the nature of their remuneration. However, the quality of the disclosure varied widely, and some firms will need to do more work to produce appropriate disclosures to meet the information needs of leaseholders if the proposals in our consultation paper become rules.**

- 1.30** Brokers generally provided appropriate (if often limited or generic) disclosure to their customers. But many example disclosures gave little information about the roles and remuneration of other parties in the chain, or the nature of relationships and any potential conflicts of interest. Some brokers explained that they had shared disclosures with leaseholders on request, but others had refused to do so, or would only do so with the express permission of their customer, usually the freeholder.
- 1.31** None of the firms were producing disclosure which considered or reflected the potential information needs of leaseholders, as this is not currently required. Consequently, they do not provide much of the information which would be useful for leaseholders, including around the exact nature and amounts of remuneration, and the existence of any conflicts of interest. In some cases, firms' disclosures were of a higher quality and could readily be adapted and expanded upon to provide appropriate information for leaseholders, if required, whereas other firms would have significantly more work to do.

## Conclusions

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- 1.32** Our findings corroborate and add to our initial review findings. They emphasise the potential harm to leaseholders and the need for brokers to do significant further work and improve their practices in this area. The findings evidence the need for the FCA policy interventions set out in our consultation paper published alongside this review. They also show the need for the actions announced and being taken forward by the Department of Levelling Up, Housing and Communities ('DLUHC'), the ABI and BIBA.
- 1.33** This review shows that average per policy commission and remuneration across the sample population rose significantly between 2019 and 2022, albeit at a slower rate than average per policy premium. These increases directly affect the amounts paid by leaseholders living in these buildings, potentially causing them harm. We can also see that brokers' direct costs and expenses relating to the broking of this product increased at a materially lower rate than their remuneration and commissions across the period.
- 1.34** Most of the brokers in the sample did not provide adequate evidence to show that their arrangements and remuneration are consistent with providing fair value consistently for multi-occupancy buildings products. This is due to deficiencies in their fair value assessments allied to other data and analysis gaps. These significant shortcomings relate to the remuneration they earn and retain, the commissions they pay to others and the costs and expenses they incur in broking these products. In many cases these issues relate to limitations in the availability, completeness, quality and comparability of data they systematically collect, analyse and record.



- 1.35** Taken together, these issues emphasise the need for the interventions either set out in our initial report or subsequently announced by others. Firms need to do more work to consider and analyse both their remuneration and costs to be able to evidence that they are delivering fair value consistently and complying with our enhanced PROD rules. It is also clear that the scope of the protections granted by our enhanced PROD rules needs to be extended to explicitly include the requirement to consider the interests of leaseholders. These issues also evidence the need for greater transparency and significantly enhanced disclosures for leaseholders. These key policy interventions are being taken forward by the consultation paper we are publishing alongside this review, with the intention of introducing final rules later this year.
- 1.36** Given the prevalence, amount and impact of commission paid to other parties, the lack of transparency and absence of evidence that these payments represent fair value demonstrates the need for a significant intervention to address this issue. In this context, we understand the reasons for the action announced by DLUHC on 30 January 2023 to ban the payment or sharing of insurance commissions to property managing agents, landlords and freeholders. We will work with DLUHC to ensure that this action is fully delivered, including changing our rules if required.
- 1.37** The continuing issues with the availability, quality, completeness and comparability of the data systematically recorded for the buildings being insured re-emphasised the need for the creation and implementation of a data code. We note and welcome the work already done by the ABI and BIBA with industry participants to develop and implement this code. We note that firms will need to continue to work to deliver this code successfully.
- 1.38** The significant issues we noted on the quality of the information collected, the analysis undertaken and the evidence retained by firms to consider fair value show the importance of the introduction of both our PROD rules and our Consumer Duty. Many firms need to do much more to ensure that they are complying fully with these requirements and can evidence this. This evidence should show that a firm's value assessments scrutinise their remuneration and the value the product offers with sufficient rigour. The assessments should identify instances where remuneration is affecting the value offered by the product and the firm should be able to show they have acted to address any fair value issues identified. In this work we have focused on intermediaries, primarily acting as distributors, but this point also applies to insurers, primarily acting as manufacturers.

## Next steps and actions

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- 1.39** We have set out our key findings and conclusions above, and provided more detail on our work, the applicable regulatory framework, our findings and our conclusions below.
- 1.40** We do not see evidence for additional specific rules around broker remuneration beyond those proposed in our consultation paper and already in place under PROD, and under the new Consumer Duty when it comes into force. Instead, our focus is on ensuring firms meet these existing rules, including our PROD rules introduced in 2021. We think that compliance with PROD, enhanced to explicitly include considering the interests of

leaseholders as proposed in our consultation paper, will address the harms and potential harms identified in this review.

**1.41** In this context, we will:

- 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. If they do not, firms risk enforcement action.
- 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 take action on remuneration arrangements, including to stop paying commissions to third parties where they are unable to demonstrate these are consistent with obligations under our rules including being in line with our PROD 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. We anticipate DLUHC will table legislation to ban property managing agents and freeholders from taking insurance commissions in due course, following their 30 January announcement.
- Progress our policy interventions to enhance both the protections afforded to leaseholders and the disclosure provided to them, via our policy consultation.
- Liaise with and support the Government as they progress their policy agenda.
- Communicate our expectations of firms, both directly and via engagement with trade bodies.

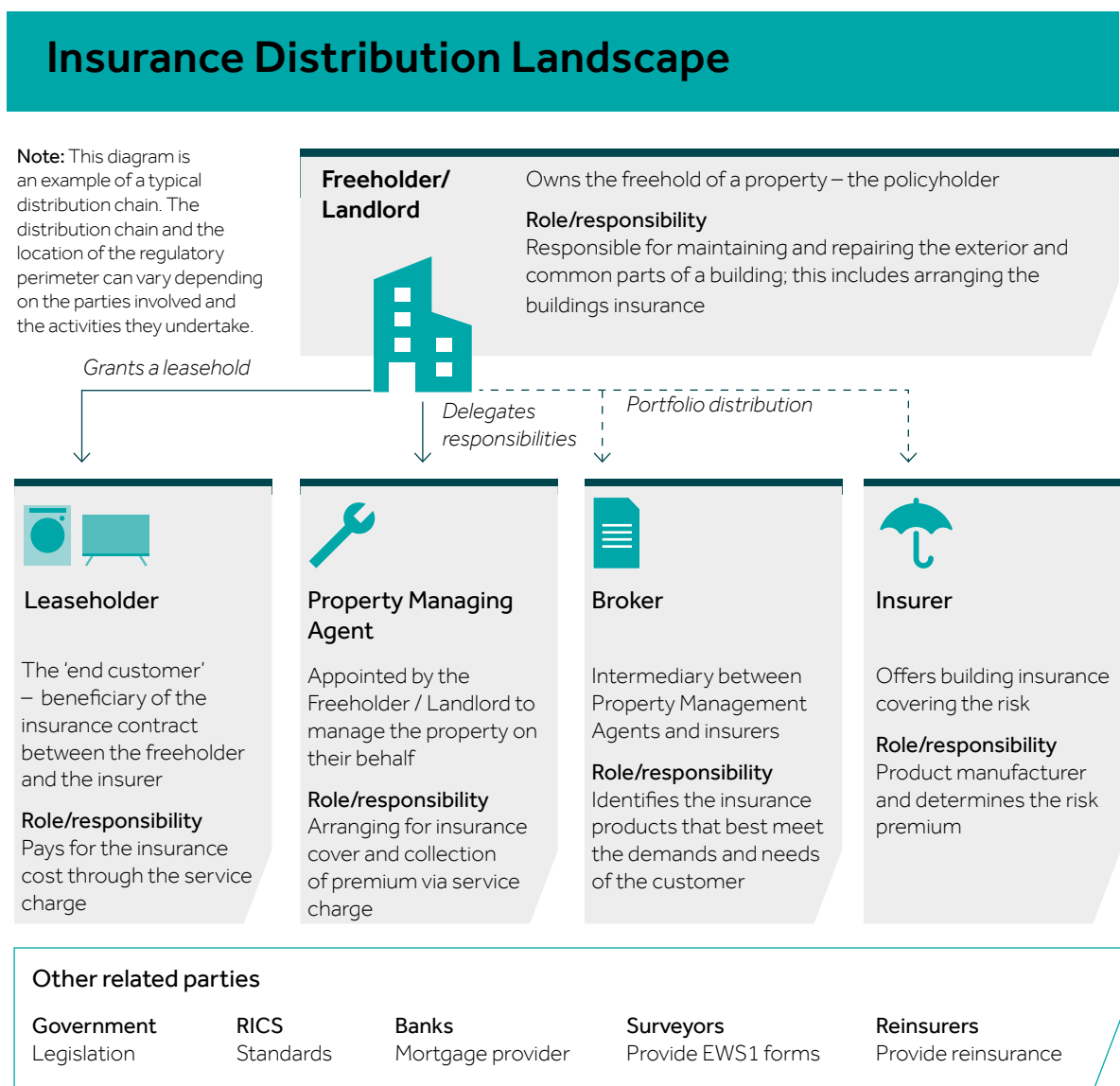
**1.42** We set out our next steps, actions and expectations in more detail in Chapter 4.

# Chapter 2

## Overview

### Market context

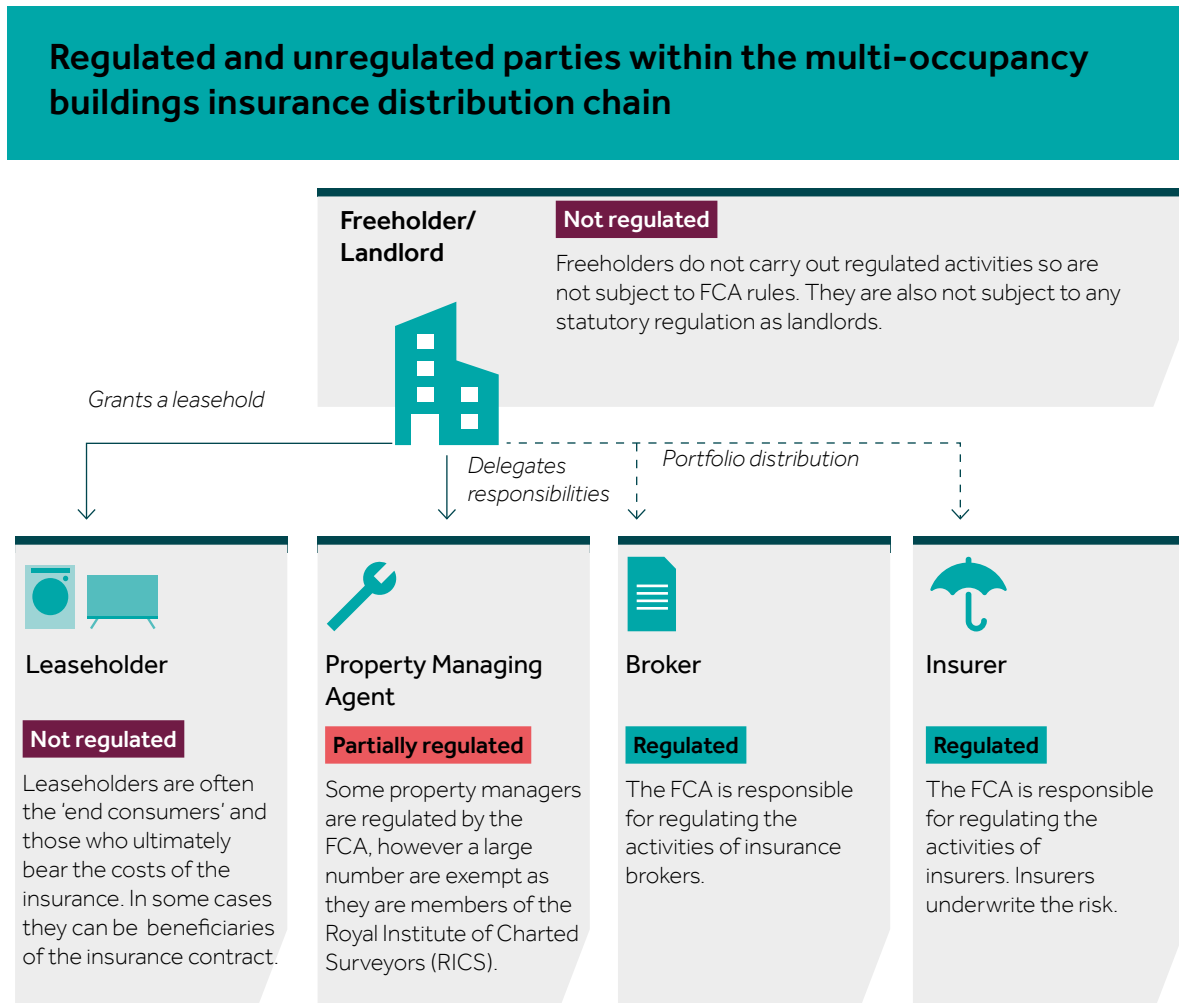
2.1 In our September 2022 report we set out the insurance distribution landscape of multi occupancy buildings insurance, and we have included this again below for reference:



2.2 This diagram sets out a typical distribution arrangement for a single commercially owned multi-occupancy residential building and identifies the different parties involved in this typical chain. This review focuses on the role of the broker, their remuneration (including elements shared with other parties) and whether this remuneration is

consistent with delivering fair value in relation to the products and services being provided.

**2.3** Our September 2022 report also included a diagram showing the regulatory status of the parties in this typical distribution chain.



**2.4** This shows that brokers deal with, and in some cases share commission with, a mix of FCA regulated, Royal Institute of Chartered Surveyors (RICS) regulated and non-regulated parties.

## Applicable regulatory framework

**2.5** We have considered the information brokers have provided against the suite of existing rules that applied to the manufacture and distribution of multi-occupancy buildings insurance during the period under review, including those that were introduced and implemented during the period. Details of the rules most relevant to this review, including a brief description of their evolution during the period where applicable, are set out below.

## 1. The Principles of Business (PRIN)

PRIN are obligations all authorised firms must comply with. The following Principles are particularly relevant to the work we have been undertaking:

- **Principle 2:** 'A firm must conduct its business with due skill, care and diligence'.
- **Principle 3:** 'A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems'.
- **Principle 6:** 'A firm must pay due regard to the interests of its customers and treat them fairly'.
- **Principle 8:** 'A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client'.

## 2. Senior Management Arrangements, Systems and Controls (SYSC).

SYSC is concerned with how firms organise and control its affairs effectively, with adequate risk management and senior management accountability. SYSC also includes relevant rules (SYSC 19F.2.2 R) relating to the way distributors are remunerated and the need to ensure their remuneration arrangements do not conflict with their duty to comply with the customer's best interests rules.

## 3. Insurance: Conduct of Business sourcebook (ICOBS).

ICOBS rules are a set of overarching conduct requirements that firms must adhere to. This includes firms having to act honestly, fairly and professionally in the best interests of their customers (including their remuneration practices) as well as ensuring clear information disclosure. ICOBS also includes rules on how individual policies are handled in respect of the marketing and sales of policies to customers.

## 4. Product Intervention and Product Governance sourcebook (PROD)

PROD rules require firms to have adequate product governance arrangements in place including to ensure the product delivers fair value. They act as an important protection to ensure firms consider whether commission levels are consistent with delivering fair value. We have carried out a significant amount of work on product governance and the value customers receive from their products and distribution arrangements. Our PROD rules derive in part from the Insurance Distribution Directive (an EU directive which came into effect via Handbook rules implemented in 2018) but have evolved significantly during the period of this review.

In November 2019 we introduced guidance following a review of the General Insurance Distribution Chain (FG19/5) to provide clarity to firms about our expectations, in particular on the design and distribution of insurance products and the requirement to act in accordance with the customer's best interests rule.

On 28 May 2021 we published our [Policy Statement PS 21/5 General insurance pricing practices market study - Feedback to CP20/19 and final rules setting out our final rules on insurance pricing and enhanced product governance](#). This was designed to improve competition and ensure firms offer fair value products to consumers.

The enhanced product governance rules in PS21/5 came into effect on 1 October 2021 and replaced the guidance previously set out in FG19/5. These new rules were aimed at ensuring firms focused on providing fair value to customers. A one-year transitional period to 1 October 2022 was granted for firms to identify whether existing products met these rules, including the performance of fair value assessments for all in-scope products. We allowed distributors an additional 3-month extension to 1 January 2023 to complete their fair value assessment work, following delays observed during 2022 in some manufacturers completing their fair value assessments.

## 5. Consumer Duty

Our policy statement PS22/9: A new Consumer Duty was published in July 2022 and introduces a new Consumer Principle "Principle 12" which states a firm must act to deliver good outcomes for retail customers. The Duty will apply to all new products and services, and all existing products and services that remain on sale or open for renewal from the end of July 2023. It replaces and goes further than Principles 6 and 7, for retail customers focusing on customer outcomes and requiring firms to put customers' interest at the heart of their activities. The duty also acts to develop and amplify the standards of conduct the FCA expects from firms. The new rules require firms to act in good faith (2A.2.1 R), avoid causing foreseeable harm (2A.2.8 R), and enable and support retail customers to pursue their financial objectives (2A.2.14 R). It applies across existing FCA Handbook rules and guidance.

## 6. Implication of leaseholders not being customers

Our existing suite of rules currently apply in a more limited way to leaseholders than they do to freehold property owners, because leaseholders are not usually the customer or policyholder. In January 2022 we set out in a Dear CEO letter how the existing rules require firms to take account of leaseholders when meeting their obligations.

## 7. Proposed changes to the applicable regulatory framework and our consultation paper

Our September 2022 report set out possible changes we could make to our rules to provide leaseholders with better protection and posed several questions to seek feedback on the issues identified and the potential changes. We received 114 responses to these questions from a wide range of stakeholders including leaseholders, property managing agents, leaseholder representatives and action groups, insurers, brokers and trade bodies.

We have since drafted proposed rule changes for consultation, taking into account the feedback received. The rule changes we are now consulting on would require significantly increased and enhanced information disclosure by insurers and brokers on insurance for multi-occupancy buildings, including on the remuneration arrangements in place for all parties in the distribution chain. We are also consulting on proposed changes to our PROD rules so that they more explicitly require firms (both manufacturers and distributors) to consider leaseholders' interests. Our

consultation paper has been published alongside this report with a 7 week period for consultation responses, closing 9 June 2023.

## Our review – Why we did it, what we did and data limitations

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- 2.6** We were concerned about the risk of harm to leaseholders due to the high levels of remuneration and commission we saw in respect of some multi-occupancy buildings insurance products. Leaseholders usually have no ability to influence the choice of broker or insurer (and associated levels of premium and remuneration) but ultimately pay for the insurance.
- 2.7** Customers buying financial services products, and those bearing the costs of those products, should be able to expect that they provide fair value and the remuneration of those distributing them is consistent with this. We were concerned that commissions may not be consistent with delivering fair value and the distributors obligations under SYSC 19F.2, and also whether any payments to freeholders and property managers are consistent with the interests of leaseholders.
- 2.8** This review has therefore focused on the levels of remuneration and commission for multi-occupancy buildings insurance products. We have particularly considered whether firms can evidence that levels of remuneration and commission represent fair value for customers and is consistent with the interests of those who ultimately bear the costs of this insurance. This is to enable us to assess the need for additional regulatory actions and interventions.
- 2.9** Our work was focused on intermediated multi-occupancy building insurance policies placed with commercial insurers. The scope of our work did not include direct business or consider policies placed with captive insurers.
- 2.10** As set out above we requested information from 16 brokers. 12 of those brokers were in our initial review and we added a further 4 brokers to our sample based on insurer data from our initial review and other information available to us.
- 2.11** We asked firms for the following information relating to insurance for mid-rise and high-rise multi-occupancy residential buildings:
- Qualitative and documentary information on areas such as fair value assessments and remuneration policies.
  - Quantitative data on the total number of relevant policies and the associated premium and remuneration for the period 1 January 2019 to 30 September 2022.
- 2.12** We made a request for supplementary information in January 2023 to ensure all firms were able to give us complete information on the value assessments they had performed for these products, given that we allowed product distributors until 31 December 2022 to complete these assessments.
- 2.13** Our first review looked at the data brokers were able to provide for all individual risks within scope. For this review, we requested premium and remuneration data at total account level for all multi-occupancy buildings insurance business placed in 2019, 2020,

2021 and the first 9 months of 2022. We asked for some data broken down between business placed with individual insurers and via different types of distribution chains, accompanied by information about the role, activities and remuneration of the parties involved in these distribution chains. Alongside the premium and remuneration data, we also requested equivalent information about the costs and expenses that brokers incurred in distributing and servicing this product.

- 2.14** Our request also asked brokers to set out what information they disclose (including about their remuneration) and who they disclose it to (including whether there are any restrictions on the level of information they can provide to leaseholders).
- 2.15** We additionally asked brokers to provide copies of their Fair Value Assessments (FVAs) including all the detailed information required to be made available by the manufacturer under PROD 4.2.29R and any information on remuneration and services provided. We also asked for evidence to support the broker's compliance with PROD 4.3.6AR.
- 2.16** In requesting and receiving data, we again faced issues with the availability, accuracy, completeness and quality of data for some firms. We learned during our initial work that many brokers could not readily or systematically identify buildings above 3 storeys and 11m high within the population of properties they broke. In this context we allowed firms the option to use one of two proxy measures to identify the relevant population of policies within their books, these being either sum insured of over £2.5m or premium over £5,000 to identify these risks from their systems. This is less precise and means that it is not always possible to make direct comparisons between the data submitted by firms for this review and our initial review, or between the firms in this review, as in some cases they have been prepared and submitted on a different basis. Where we have more specific concerns with the quality of data, or we have had to adjust the data or make any assumptions this is noted in the relevant Chapters of our findings below.
- 2.17** Additionally, some firms found it challenging to provide us with appropriate and accurate data on the expenses they incurred in relation to the insurance of multi-occupancy residential buildings. This is because they were not able to reliably identify or calculate the expenses relating to the people involved in broking this product, given it is a component part of the wider commercial property class, rather than constituting a separate class of business. We were nevertheless able to use data from all of the 16 brokers in our analysis, but many of the brokers provided qualifications regarding the accuracy and reliability of the data in the context of our request and intended use of the data. This included explaining the assumptions they had needed to make to produce the data and highlighting potential shortcomings in terms of its completeness or accuracy.
- 2.18** We note that further to our recommendation made in our September 2022 report, the ABI and BIBA have recently developed and published an industry code for collecting data in relation to multi-occupancy buildings affected by cladding and other material fire safety issues. We welcome this work and would expect relevant industry participants to ensure that they implement this code as soon as possible.



## Chapter 3

# Our findings

- 3.1** We have completed our review of the information received from the 16 firms selected for this work in the context of the relevant Handbook requirements and guidance applicable at the time of the review. Our analysis focused on the levels of remuneration and commission for multi-occupancy buildings insurance products given our concerns that this could cause harm to leaseholders. We have particularly considered whether firms could evidence that levels of remuneration and commission represented fair value for customers and is consistent with the interests of those who ultimately bear the costs of this insurance.
- 3.2** We have set out below what we found, its implications and what our expectations are for firms to address the issues identified.

### A. Remuneration

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- 3.3** Our September 2022 report set out how the cost of buildings insurance to residential leaseholders and other property owners of multi-occupancy buildings had increased in the wake of the Grenfell tragedy, with premium rates more than doubling between 2016 and 2021. As commission is usually based on a percentage of the premium we also saw significant increases in the amount of commission brokers received over the same period.
- 3.4** Our initial review identified rates of commission of 30% or higher for 58% of the observations in our broker data. This included commission levels of 40 to 49% for 23% of observations and of over 50% for 2% of observations. These were the gross commission figures received by brokers, including any elements paid onto the freeholder or property managing agent. Commissions do not always represent the total remuneration received by brokers given instances where there are fees for other services (such as work transfer fees), fees are paid in lieu of commission or there is profit related remuneration.

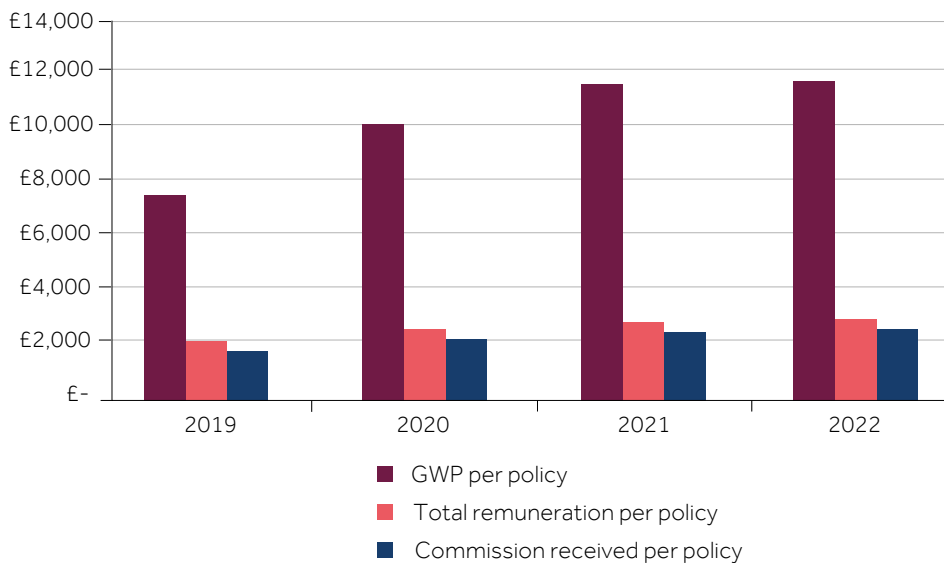
## Overall commission and remuneration rates

**3.5** The data received from the 16 firms within our sample shows a significant rise in absolute amounts of remuneration and commission across the period. The average per policy GWP, broker remuneration and broker commission are set out in the table below:

Year	Average GWP per policy (£)	Average broker remuneration per policy (£)	Average broker commission per policy (£)
2019	7,470	2,170	1,785
2020	10,040	2,595	2,230
2021	11,490	2,850	2,475
2022	11,625	3,010	2,595

**3.6** This shows that average GWP per policy, average remuneration per policy and average commission per policy increase by 56%, 39% and 46% respectively, between 2019 and 2022. These movements can be seen in the following chart:

### Average GWP, remuneration and commission per policy 2019-2022



**3.7** We have taken the average per policy figure to adjust for the effects of increasing numbers of relevant policies broked by the firms in the sample over the period, but it is also important to consider the total figures and impact, to understand the magnitude of the amounts involved.

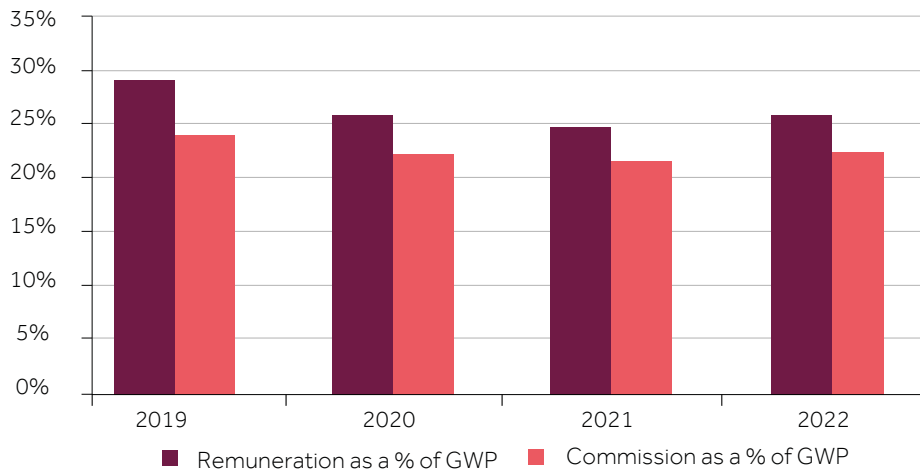
**3.8** The number of relevant policies arranged by the firms in our sample rises from 22,464 in 2019 to 26,549 in 2021, representing an 18% increase from 2019 to 2021 (the years for which we have 12 months' data). The brokers in the sample attributed this increase to a combination of factors including organic growth, consolidation of this business to specialist firms and acquisitions. Over the same period, we see much greater increases in gross written premium (82%), total broker remuneration (55%) and total broker commission (64%) across the sample, based on the figures in the table below:

Year	Policy count	Total gross written premium (£m)	Total remuneration for sample (£m)	Total commission for sample (£m)
2019	22,464	167.8	48.7	40.1
2020	25,017	251.1	64.9	55.8
2021	26,549	305.1	75.6	65.7

**3.9** This demonstrates that the overall level of remuneration and commission being paid across the same population of multi-occupancy buildings increased significantly. This is consistent with what we found in our initial review with initial gradual increases in absolute commission amounts between 2016 and 2019 followed by steeper rises from 2019 to 2021. These increases all impact the overall price paid by the purchaser of the insurance, and then usually passed on to the leaseholders.

**3.10** However, as in our initial review, we do see reductions in the average rates of remuneration and commission across the period, with these moving as follows, expressed as a percentage of gross written premium. We have chosen to show this (despite other types of remuneration not usually forming part of the gross written premium) as they nevertheless still form part of the insurance costs paid by those insuring the property and often ultimately borne by leaseholders.

**Total remuneration and commission as a percentage of GWP 2019-2022**



**3.11** This shows lower average rates of remuneration and commission than we saw in our initial review, which is largely attributable to a broader suite of data being collected this time (for example through including a wider range of buildings via the use of proxies), a different sample of firms being included and other variations. However, there are outliers with the gross remuneration of 5 firms averaging over 40% in 2019 and 4 firms still averaging over 35% in the first 9 months of 2022 (both expressed as a percentage of gross written premium).

**3.12** As with our previous work and shown in the above chart, we identified that some brokers had actively reduced their commission arrangements with insurers, in percentage

terms. However, these reductions in percentage terms were more than offset by the significant increases in insurance premiums, hence the increase in the total commission amounts brokers received.

- 3.13** Brokers are responsible for ensuring that the remuneration they receive is consistent with the aim of providing fair value as part of their assessment of distribution arrangements, including ensuring that it does not adversely affect the value provided by the product.
- 3.14** However, the role of the insurer is also significant in agreeing commission rates and other remuneration, given their obligations as product manufacturers to ensure that fair value is being delivered by their products. Some of the levels of remuneration seen in this review raise concerns in this respect, including where insurers are providing intermediaries with net rated products, where the net premium is set by the insurer but the final commission levels applied to each policy are determined by the broker.
- 3.15** 4 of the 16 firms had net pricing arrangements in place with some insurers. Manufacturers must ensure that distribution arrangements avoid or minimise the risk of negatively impacting the fair value of the insurance product (PROD 4.2.14NR). This includes implementing adequate controls, monitoring and oversight to avoid or reduce the risks arising from allowing other parties to set the final price, to ensure commission levels remain within acceptable and agreed parameters. We saw limited evidence to indicate that this was happening. Very few firms could provide any evidence (for net rated or standard commission arrangements) that regular reviews and discussions took place around the level of commission and whether these arrangements are consistent with providing fair value, despite us specifically requesting any such evidence. Without such controls it is hard to see how firms can state that their products and distribution arrangements are offering fair value.
- 3.16** Some firms advised us that some insurers had recently been reducing commission levels, but there was little in the way of evidence to show what discussions had taken place, the reasoning for the level of reduction that had been agreed, or what consideration had been given to fair value when making those decisions.
- 3.17** One of the reasons some brokers gave for taking higher levels of commission for multi-occupancy buildings insurance policies was the amounts that were frequently being paid to other parties involved in the distribution chains, including freeholders and property managing agents. The data we analysed showed 8 firms paying over half of their commission to a third party. We have considered this in more detail in the Chapter below focussing on the distribution chain.

### Other forms of remuneration

- 3.18** Alongside commission some firms had negotiated work transfer fees. These payments are generally agreed by insurers where specific additional tasks are undertaken by the broker on the insurer's behalf. We have some potential concerns over the payment of work transfer fees, as some firms in the sample did not set out any additional activities they carried out beyond their normal broking role.

- 3.19** Work transfer fees across the population rose by 70% from £3.4m in 2019 to £5.8m in 2021, which is broadly consistent with the rise in other types of remuneration over the period. 11 of the 16 firms received work transfer fees in relation to some of their policies. For 4 of those firms this represented c10% of the total remuneration they received and there was one firm who received over 40% of their total remuneration via work transfer fees. In this case this appeared to have taken the place of elements of commission, with the firm taking lower commission percentages than other firms in the sample. However, as with all forms of remuneration, we expect this to be received for work being undertaken by the broker and for this to be appropriately considered (by both the insurer and the broker) when assessing whether fair value is being provided.
- 3.20** In a more limited number of cases, we saw brokers being remunerated via fees in lieu of commission. Sometimes this occurred when the premium had increased significantly due to fire safety issues or other complex risks and the broker had agreed to reduce their remuneration to make cover more affordable, despite the amount of work required to place the risk.
- 3.21** In a small number of cases, we also saw brokers being remunerated via a profit share payment from insurers, but this was not significant for firms in our sample and amounted to less than 0.5% of their aggregate retained remuneration over the review period.

### Remuneration policies and commission capping

- 3.22** Our data request asked firms to provide their formal remuneration policy to evidence their remuneration arrangements, processes, and controls. Only half of the firms in the sample provided a formal remuneration policy applicable to this product line. When reviewing those policies we did receive we saw significant differences in firms' approach to commission and to setting caps on commission levels. We saw some examples of firms capping commission to levels under 25%, but then other examples where a higher level was set, sometimes more than 40%. It was not always clear whether or how firms' formal remuneration policies and capping arrangements were properly taken into account and assessed as being consistent with our rules on providing fair value.

### Examples of better practice

- 3.23** While reviewing the information submitted we did see some examples of better practice. These are set out below as examples to firms of ways in which they may be able to work towards evidencing their consideration of fair value or adjusting their remuneration where it may not be consistent with our rules:
- Some firms had moved to a lower fee-based transaction in lieu of their normal commission arrangements, particularly where there was a significant increase in premium at renewal due to specific fire risks or other factors making it hard to obtain cover.
  - Some firms provided evidence of an escalation process if commissions reached a certain level. One of those firms had introduced that process via a system warning and had a process to review that individual risk where this was triggered.

## Conclusions

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- 3.24** As detailed above many brokers have benefited from considerable increases in remuneration related to multi-occupancy buildings insurance during the review period. Some brokers appeared to have limited governance and oversight in place surrounding their remuneration arrangements. In this context, it is not clear to us whether many brokers have reviewed their remuneration arrangements and considered whether the level of remuneration received is consistent with our rules (for example, to consider if it is commensurate with the actual work undertaken and value provided).
- 3.25** We also saw limited evidence of challenge from or interaction with insurers in relation to the levels of remuneration and the movements in these.
- 3.26** Commission is the largest component of remuneration, but these issues are relevant to all elements of broker remuneration.
- 3.27** Given the combination of the large increases in remuneration for this product seen over the review period and the recent implementation of our enhanced rules on product governance and fair value it is disappointing that many firms have not given more consideration to the appropriateness of their remuneration.

## B. Distribution chains and commission sharing

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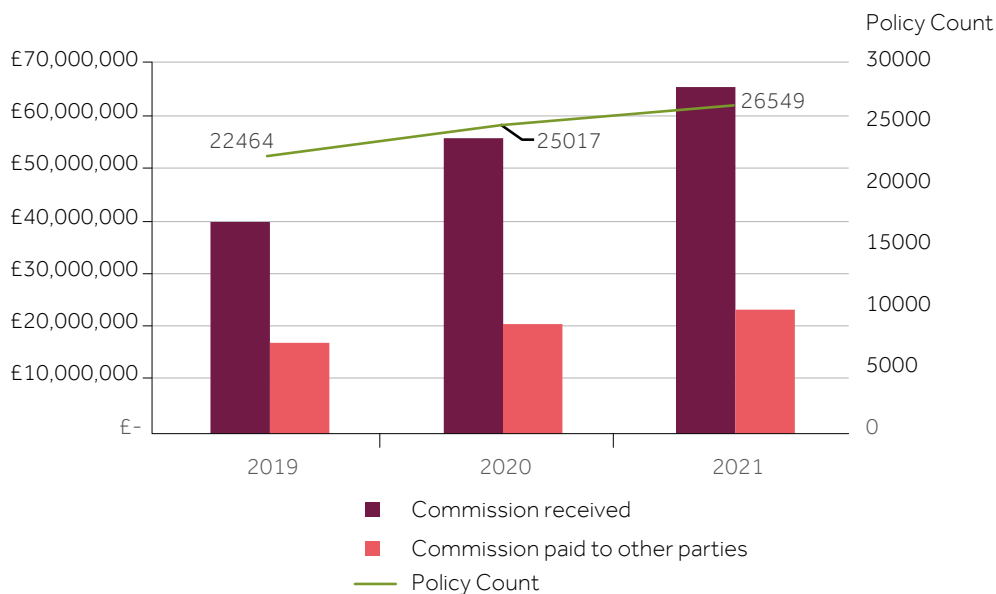
- 3.28** The information we obtained from the sample of brokers showed a wide variety of different distribution chains, often with multiple parties involved. At the simplest level, the chains consist of the policyholder/freeholder, a broker and the insurer. In many cases however, a variety of other parties can be involved, including property managing agents, other brokers, managing general agents ('MGAs') and appointed representatives.
- 3.29** We asked the brokers in the sample to set out the range of different types of distribution chain they were involved in for this product. The 6 main variants of intermediated distribution chains they reported were:
- 3 parties – policyholder/freeholder, broker and insurer
  - 4 parties – policyholder/freeholder, property managing agent, broker and insurer
  - 4 parties – policyholder/freeholder, sub-broker/broker, broker/placing broker and insurer
  - 4 parties – policyholder/freeholder, property managing agent, managing general agent (MGA) and insurer
  - 4 parties – policyholder/freeholder, appointed representative, broker and insurer
  - 5 parties – policyholder/freeholder, property managing agent, sub-broker/broker, broker/placing broker and insurer
- 3.30** We also asked the brokers in the sample to report the levels of gross written premium associated with the different types of distribution chains they use. We did not receive this data from all the firms, but the data received suggested that two most common variations are the first two variants set up above, and that these two types of chain account for the large majority of business.

**3.31** Arrangements where significant amounts of broker commission are paid to other parties in the distribution chain are very common in this market. Broker commissions are most frequently shared with the freeholder, but payments were also made to property managing agents, appointed representatives and other brokers. The data we analysed showed 8 firms paying over half of their commission to a third party.

**3.32** We asked brokers to explain the range of roles and activities performed by the various parties in each of the distribution chains that they were involved in. The range of responses varied widely, as some firms had done more work than others to understand and evidence the role of the other parties involved, the rationale for the remuneration paid to them and therefore to assess whether this was consistent with products (and distribution arrangements) providing fair value. We are concerned that the quality of this assessment and the evidence relating to it was so varied. The extent or quality of work done to consider and assess the extent to which these arrangements could give rise to conflicts of interest appeared similarly limited based on the information submitted by some firms.

**3.33** However, all the brokers within the sample were able to provide us with details of the total amounts they paid to other parties within the chain. The total figures for commission paid to other parties by year from 2019 to 2021 are set out below, plotted against the number of policies included within our sample and the gross commission figures:

***Commission received, commission paid to other parties and policy count***

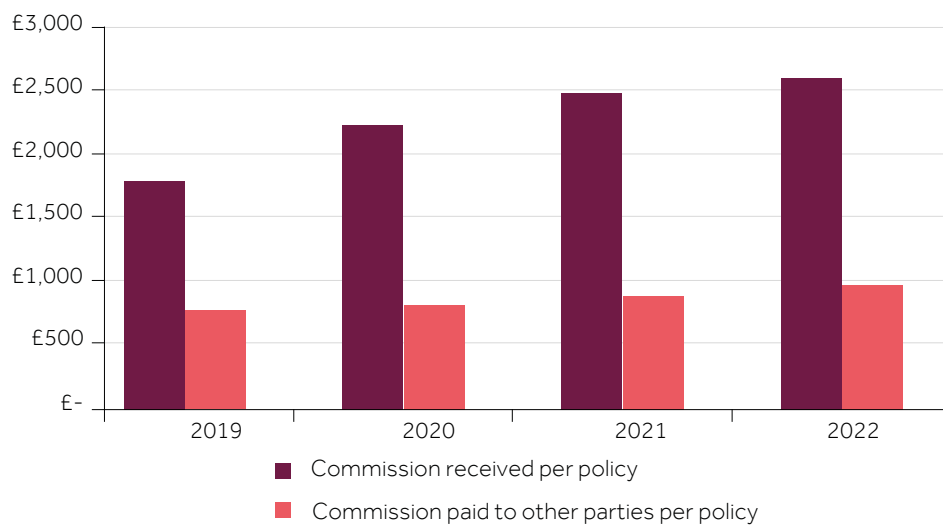


**3.34** This shows the very significant amounts of insurance commissions brokers paid across to other parties in the distribution chain during the period, with this amounting to £80.7m for the brokers in our sample for the 3 years and 9 months covered by our review. This amount clearly impacts the premiums paid to insure multi-occupancy buildings, and the level of costs for the leaseholders who often ultimately bear this expense, hence our significant concerns regarding the varying extent to which brokers

appeared to have considered the rationale and justification for paying this amount of commission to other parties.

**3.35** We have also considered the changes in the average amount paid to other parties per policy across the period, alongside the equivalent average per policy commission figures across the period, and set this out in the chart below:

***Average commission received per policy vs average amount paid to other parties per policy***



**3.36** This shows that the average amount per policy paid to other parties has increased broadly in line with the increase in average per policy commissions over the period, with these payments amounting to 42% of commissions in 2019, 36% in 2020, 35% in 2021 and 37% in the 9 months to 30 September 2022. The overall amount of commissions we saw being paid to other parties rose from £17.0m in 2019 to £23.1m in 2021, representing a rise of 36% over the period, which is broadly consistent with the increase we saw in gross commissions.

**3.37** Commission was most commonly being shared with the freeholder, a property managing agent or an introducer. Freeholders were usually unregulated parties whilst the majority of the property managing agents were either FCA regulated, an exempt professional firm under RICS regulation or exempt as an Appointed Representative. Freeholders received up to 30% of the commission under the arrangements we saw, with activities commonly mentioned including collating risk information, involvement in the claims process, collecting premiums and liaising with broker and leaseholders. Property managing agents received up to 50% of the commission under the arrangements we saw, with activities commonly mentioned including collating risk information, arranging building surveys, involvement in the claims process, collecting premiums, liaising with broker/freeholder on policy terms/renewals and liaising with leaseholders. Introducers usually received lower amounts, but we did see some cases where introducers received over 20% of the broker commission solely for the introduction.



- 3.38** While most firms in the sample were able to provide a generic list of activities that these parties were involved, most also did not evidence that they had a full understanding of what those parties were doing to warrant the payments involved or had assessed the value those parties were providing.
- 3.39** However, we did see some examples of better practice from firms. One firm had undertaken a proactive and detailed assessment of the parties involved in their distribution chains, including the activities they were carrying out and how those parties were being remunerated.

## Conclusions

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- 3.40** Distribution chains for multi-occupancy buildings insurance often involve multiple parties including various brokers, property managing agents, managing general agents (MGAs), freeholders and Appointed Representatives. It is common for significant amounts of broker commission to be shared with these parties, particularly property managing agents and freeholders. The amounts of commission shared with these parties rose during the review period in line with the increases in broker remuneration and commission.
- 3.41** Many of the firms in the sample provided limited evidence that they had considered the role and activities undertaken by these parties and assessed appropriately the level of commission being shared with them in this context. Given the large amounts of commission involved in many cases and the regulatory focus on value this lack of consideration is very disappointing.

## C. Fair Value

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- 3.42** In our September 2022 report we found evidence of some high commission rates and poor practice which were not consistent with providing fair value to the customer. We also identified that the increases in absolute commission earned by brokers, freeholders and property managing agents may be disproportionate to increases in service costs.
- 3.43** Our PROD rules require firms to ensure products meet the needs of an identified target market, and that the product, including considering the constituent parts of the total price, offers fair value. 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 service provided. In this context, brokers need to be able to demonstrate their distribution arrangements are consistent with providing fair value. This includes considering the relationship between the firm's level of remuneration and their contribution, level of involvement or the benefit added by them.
- 3.44** We asked all of the brokers in the review to provide copies of their Fair Value Assessments ('FVAs') including:

- the information they had obtained from the manufacturer (per PROD 4.3.1R) to understand the intended value of the product and what they may need to take into account when considering their remuneration and services provided
- the evidence of the work they had undertaken (per PROD 4.3.6A) to identify intended value, understand the target market and benefits of the product and assess whether their distribution arrangements and strategies (including the associated remuneration) are consistent with providing fair value

**3.45** We found significant shortcomings in the work done and evidence provided by most of the brokers to meet these requirements. In relation to their arrangements in place to obtain necessary information from manufacturers (per PROD 4.3.1R):

- Some brokers were unable to provide all the manufacturers' FVAs and others only submitted generic target market statements from the manufacturer. Therefore, it was hard to see how brokers had the information needed to undertake their own assessments.
- Where brokers had manufacturer FVAs, it wasn't always clear how they embedded the information from the manufacturer's FVA into their own assessments.

**3.46** In relation to PROD 4.3.6A:

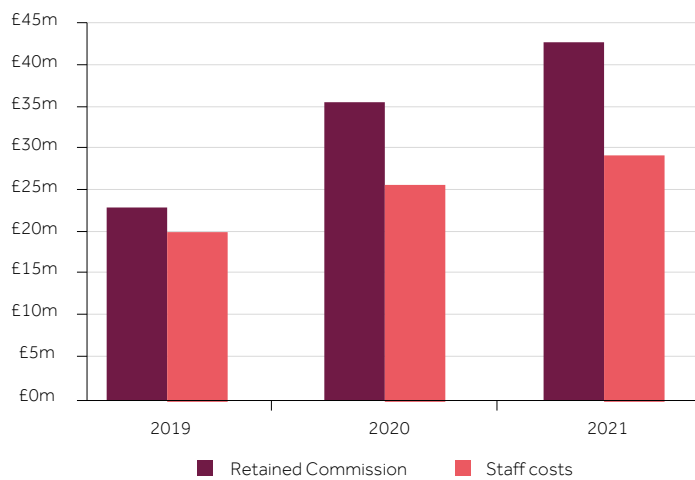
- Not all brokers submitted their FVAs, with some instead just providing a statement confirming their compliance with the PROD rules.
- Many of the FVAs we saw were very high-level, referring broadly to factors considered (such as target market and remuneration) and mentioning relevant rules or publications (such as PS 21/5, PROD and Treating Customers Fairly), but without setting out any evidence of the work done to assess fair value.
- Some brokers stated that they are satisfied that the level of commission is fair without providing any context or the detail of any work carried out to support this assessment.
- Even where there was no evidence of an understanding of the role of third parties within the distribution chain or consideration of the remuneration shared in the context of the activities performed, some brokers still concluded that they were providing fair value.
- Many brokers have said that they do not usually disclose commission to other parties, and it is unclear what information they do provide. This does not provide assurance that the manufacturer had sufficient information on all of the elements of the price to carry out a full assessment of fair value.

**3.47** One of the factors we observed preventing some brokers from performing the required fair value assessments appropriately on their own remuneration and activities is the limited data they had in relation to their own costs and expenses. The quantity, quality and utility of the data we received in relation to brokers' costs and expenses varied across the sample, and it was apparent that some of the brokers in the sample do not record their costs and expenses with sufficient detail or in a way which enables them to readily understand, analyse or report on these in relation to particular product lines. In the context of this review, this meant that those brokers were making significant estimates or assumptions in relation to the costs and expenses incurred in relation to this product line. Where firms are not able to identify, analyse, report and evidence their

own costs and expenses readily this clearly makes it very difficult for them to carry out appropriate work to assess the impact of their own remuneration and activities on the value provided.

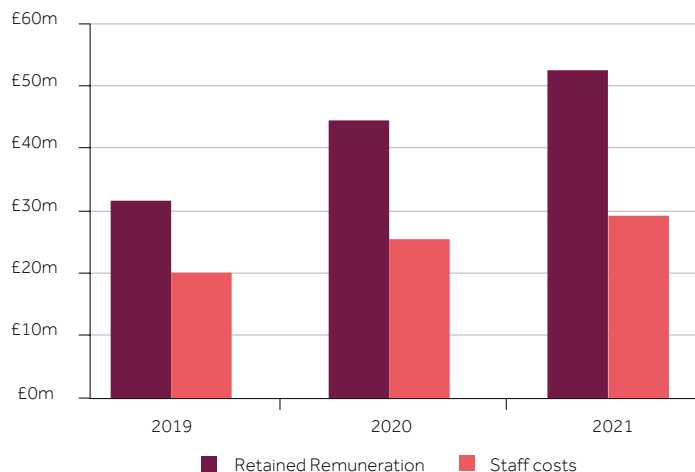
**3.48** However, despite the varied quality of the data received and the limitations and assumptions accompanying it, we were able to perform some basic analysis which showed that in aggregate the sample of brokers earned substantially more in commission each year than the associated direct costs and expenses. The aggregate figures across the period are shown below:

**Broker retained commission vs staff costs 2019-2021**



**3.49** When the revenue figure is adjusted to include other retained broker remuneration (including items such as work transfer fees, fees in lieu of commissions and profit related remuneration) we can see a significant excess of aggregate insurance related remuneration over the period was £159.4m for these brokers compared to direct costs or expenses of £93.2m.

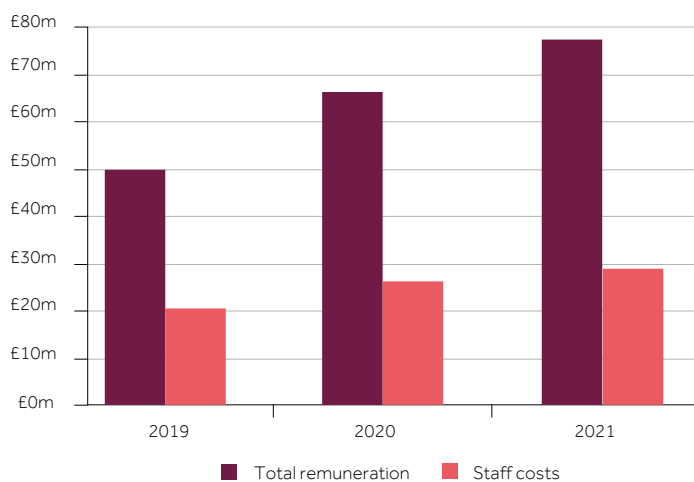
**Broker retained remuneration vs staff costs 2019-2021**



**3.50** Additionally, the value assessment work of brokers on this product must also consider the commission paid to other parties, and the relationship between this remuneration and the activities performed and benefits delivered by those parties. Most of the brokers in the sample did not provide appropriate evidence of the work they had done to assess whether the value being delivered was affected by sharing remuneration with other parties. In many cases, including where firms were paying very significant amounts of commission to another party, all that was provided was a generic list of the types of activities potentially performed by the party, which lacked specificity or any meaningful comparison to the level of commission being paid across to this party. Given that £80.7m of commission was paid to other parties by the firms in our sample over the period from 1 January 2019 to 30 September 2022, firms need to do much more to assess and scrutinise their remuneration sharing arrangements and ensure they are consistent with providing fair value.

**3.51** When the broker remuneration figure is adjusted to reflect total insurance related remuneration (including commissions retained, commissions paid to other parties and other broker earnings) we can see a significant excess of aggregate insurance related remuneration over the period of £239.0m compared to direct costs or expenses of £93.2m.

**Gross broker remuneration vs staff costs 2019-2021**



**3.52** There will usually be significant additional expenses being incurred both in the broker (non-direct and corporate costs and expenses) and in the parties sharing the commission. However, we saw that these are often not being completely, accurately and reliably captured and considered in the context of the value assessment. Therefore, it is difficult for intermediaries to show that they are delivering fair value to customers, and that the level of broker remuneration is consistent with the interests of the leaseholders who often ultimately bear the costs of this insurance.

**Examples of poor and better practice**

**3.53** One firm provided limited information on their policies on remuneration and fair value. While they referred to a cladding strategy, there was little evidence of how this was implemented or monitored. This firm's commission rates averaged almost 35% across

the period. On average, over 40% of broker commission was paid to other parties. We saw no substantive evidence that the firm had considered whether the level of remuneration received by these parties was commensurate with their contribution or consistent with delivering fair value. The firm's fair value assessments were high level, with little substance or analysis. This did not provide assurance that the firms had adequately considered value to the end customer including whether this remuneration was consistent with the interests of the parties bearing the costs.

- 3.54** Another firm submitted a comprehensive Fair Value Assessment which was in line with our PROD rules. This firm monitor and report on fair value on a monthly basis. They had lower levels of remuneration than most of the other firms in the sample, with their remuneration and commission rates averaging 20% and 12% respectively over the period covered by our review. Overall, the data shows that the firm's average remuneration rate for this product line decreased over the period. For those buildings experiencing a significant increase in premiums due to cladding or other fire safety issues the firm has applied a range of specific measures including cutting commission to zero, charging a fee and rebating the work transfer fee in the form of a risk management fund to be used by the leaseholders to help mitigate the costs.

## Conclusions

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- 3.55** Our analysis of the information we received from firms has provided clear evidence of significant increases in overall broker remuneration and commissions for multi-occupancy buildings insurance during the period from 2019 to 2022. We see similar significant increases in the average per policy remuneration and commission. These increases are despite reductions in the average commission rates for this product line across our sample, with these small rate reductions more than offset by the larger increases in average premiums for multi-occupancy buildings.
- 3.56** Our review of the information received from firms on staff costs directly related to this product line show that these have not risen at the same rate as the remuneration and commissions over the same period. Therefore, the contribution of broker retained commissions on this line of business after staff costs has risen significantly over the period, even before taking into account other types of broker retained remuneration.
- 3.57** We have also seen large amounts of commission being shared with other parties in the distribution chain, with these amounts increasing in line with the rises in overall remuneration and commission levels during the period.
- 3.58** All these increases in remuneration and the large amounts of commission being extracted through the distribution chain have a significant impact on the price of insurance for multi-occupancy buildings and the costs for leaseholders and others who ultimately bear this expense.
- 3.59** In the above context and given our focus on value through the recent changes to our PROD rules and introduction of the new Consumer Duty, we would expect all brokers to have considered appropriately whether their distribution arrangements are consistent with products providing fair value to their customers. This includes

considering the impact of their remuneration on value, and whether their arrangements and remuneration are consistent, as we've explained previously, with the interests of leaseholders and others who ultimately bear the costs of this insurance. However, we saw significant shortcomings in the value assessment work undertaken by many of the brokers in relation to this product line. These issues encompass the consideration of their own remuneration, their analysis of their own expenses and their consideration of the role and remuneration of the parties they share commission with.

**3.60** Taken together, it appears that some of the brokers in the sample are not meeting their regulatory obligations under PROD and are not able to provide appropriate evidence that they are providing fair value in relation to this product. Brokers need to comply fully with our product governance rules including considering whether the remuneration they receive is consistent with delivering fair value. Where the firm receives a level of remuneration which does not bear a reasonable relationship to the firm's actual costs, or their contribution, level of involvement or the benefit added by them in distributing this product this can show the firm is breaching PROD 4.3.6AR. We expect firms to consider the relevant elements of their distribution arrangements including the level of remuneration, the services they provide and the costs they actually incur in providing services. They need to do this to identify if their arrangements and remuneration are adversely affecting the value of the products they are distributing including taking into account the interests of leaseholders who pay for this as explained above.

**3.61** Our findings and conclusions evidence the need for our proposed changes to our PROD rules to ensure firms take account of the interests of leaseholders and to afford leaseholders appropriate protections, as set out in our consultation paper published alongside this report. They also evidence the need for additional scrutiny and for regulatory interventions where firms do not appear to be meeting their obligations.

## D. Disclosure

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**3.62** Our initial review highlighted the lack of transparency for leaseholders, with many cases where they are unable to obtain details of the insurance process, the markets approached or the breakdown of the premium, despite ultimately paying for the insurance cover.

**3.63** Leaseholders often do not have any input to the choice of insurer or broker and we are concerned about freeholders or property managing agents making decisions in their own interests, including based on the levels of remuneration available, without the firms involved taking account of the interests of leaseholders. These issues are exacerbated by the current lack of transparency, explicit leaseholder focused regulatory protection or easy access to effective recourse.

**3.64** Most of the brokers in our sample appear to provide appropriate (if often limited or generic) information about the policy and nature of their remuneration to their customers (the freeholders). However, it wasn't always clear whether firms' practices were fully compliant with ICOBS 4.3 in disclosing the nature and type of the remuneration in good time before the conclusion of the contract.

- 3.65** Most of the firms explained that they would only disclose the amount of remuneration to their customers where this was requested by their customer, in line with ICOBS 4.4.
- 3.66** Brokers were not generally providing any form of disclosure for leaseholders as they are not their customers, though some did provide leaseholders with access to their Terms of Business Agreements (TOBAs) setting out their remuneration arrangements at a more generic level. Where leaseholders requested more information, including about the renewal process or remuneration, some firms were providing this information, but others noted that they would only do so when and if given express permission to do so by the policyholder (often the freeholder).
- 3.67** Overall, the quality of the disclosures produced by firms varied widely and none of the examples we reviewed are designed to provide information suitable for leaseholders as this is not currently required. Consequently, the disclosures do not usually include the information which would be useful for leaseholders, including the exact nature and amounts of remuneration, and whether there are any conflicts of interest. Some firms already have most of this information, prepare higher quality disclosures and appear well positioned to adapt and expand upon these disclosures to provide appropriate information for leaseholders, if required to do so. Other firms seem less well prepared to do this.

## Conclusions

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- 3.68** While firms generally seem to be complying with their ICOBS disclosure obligations, this does not usually result in disclosure which would be useful for leaseholders being prepared or provided to leaseholders, either directly or indirectly. This emphasises the need for the policy interventions to address the lack of transparency for leaseholders on multi-occupancy buildings insurance we first discussed in our September 2022 report.
- 3.69** Our policy proposals are set out in the consultation paper published alongside this report, and are designed to provide specific disclosure requirements for multi-occupancy buildings insurance that will apply to all such policies, regardless of the size and status of the customer (usually the freeholder). If introduced following the consultation, this would place new requirements on insurers and brokers to provide this disclosure to freeholders, with an instruction to pass it on to leaseholders. Firms with higher quality disclosures who already systematically collect and record the required information are likely to be able to do this relatively easily if our proposals become rules. However, other firms within the sample will have much more work to do to meet any such obligations.
- 3.70** In the longer term, our rules are intended to work alongside any actions that the Department of Levelling Up Housing and Communities may take to improve leaseholder information on buildings insurance, by ensuring that freeholders have appropriate information to pass on to leaseholders.

## Chapter 4

# Next steps, actions and expectations

- 4.1** We have set out the findings and conclusions from our work above, in the context of the applicable regulatory framework and our ongoing and proposed actions, as well as those of DLUHC, the ABI and BIBA.
- 4.2** This review has provided more comprehensive evidence of the issues relating to broker remuneration previously identified, including the significant average increases between 2019 and 2022 in the amount of remuneration being received for broking the same multi-occupancy buildings policies. These increases encompass the commission retained by brokers, the commissions paid to other parties and other types of remuneration received and retained by brokers.
- 4.3** Additionally, however, this review has identified significant shortcomings in the work being done by some brokers to consider and assess whether their remuneration is consistent with providing fair value for customers and those bearing the costs of paying for these multi-occupancy buildings insurance policies. This provides evidence that some brokers may not be meeting their regulatory obligations fully, particularly those under PROD. Given the amounts of remuneration being earned from broking multi-occupancy buildings insurance and the impact of these amounts on those ultimately paying for this insurance, this is very concerning and disappointing.
- 4.4** However, the review has shown that average commission rates are lower than those identified in our initial review, and that both average commission rates and remuneration percentages as a proportion of gross written premium have been reducing over the period. Additionally, we can see significant variance between the firms within the sample, with some firms receiving lower levels of remuneration and performing good quality value assessments in line with their PROD obligations. The review also revealed the wide range of levels of work undertaken by brokers in relation to multi-occupancy buildings insurance. Taken together, we did not see evidence of the need for additional rules around broker remuneration at this point beyond those in our Handbook under SYSC, ICOBS, and PROD, given the proposed changes to offer clearer protections for leaseholders set out in our consultation paper together with the Consumer Duty (when it comes into force). Instead, our focus is on ensuring firms meet these existing rules, including our PROD rules implemented during 2022. We believe that compliance with PROD will address the harms and potential harms identified in this review.
- 4.5** In this context we will take the following actions in relation to our findings:
- Where we assess that firms have material weaknesses in meeting their regulatory obligations, including in delivering fair value, we will use a range of regulatory tools, which may include skilled person reports, to urgently remediate and mitigate identified weaknesses and any harm these are causing. We will focus on firms earning higher rates of remuneration who we judge have not put in place appropriate systems and controls to comply with PROD. These firms need to act to ensure they are delivering fair value to their customers including, given their



obligations, considering the interests of those who bear the costs of insuring multi-occupancy buildings, including leaseholders.

- Firms we assess as needing to make improvements to meet their regulatory obligations will need to address these weaknesses as a matter of urgency, and a Senior Manager Function holder attest and evidence that the firm is delivering fair value and considering appropriately the interests of those who bear the costs of insuring multi-occupancy buildings, including leaseholders.
- Progress our proposed policy interventions to enhance leaseholder protections and the disclosure provided to them, including by ensuring that they are more explicitly included within the scope of the protections in PROD and other Handbook rules. We are publishing our consultation paper setting out our policy proposals for these new rules alongside this report.
- Support and liaise with the Government as they progress their policy agenda, most notably their work to ban the sharing of insurance commissions with property managing agents, landlords and freeholders, the need for this action and intervention having been further evidenced by the findings of this review.
- Set out and communicate our expectations of firms, both directly and via engagement with trade bodies. In particular, we expect firms involved in manufacturing and distributing multi-occupancy buildings insurance to carefully consider our findings and undertake appropriate work to ensure that they are complying fully with PROD and are able to evidence why they believe they are providing fair value to their customers. If we find that firms do not act promptly to comply fully with PROD then we will intervene where necessary and reassess the need for additional rules around remuneration.
- Feed the findings of this review into our risk assessment and planning processes, particularly when considering and scoping our upcoming work to assess insurance sector compliance with PROD and readiness to comply with the new Consumer Duty. Consider the need for additional work on areas of ongoing concern outside the scope of this review, including the role of captive insurers in providing insurance for multi-occupancy residential buildings.
- Liaise and coordinate with the ABI and BIBA as they take forward:
  - the implementation of the standard code for recording risk data relating to multi-occupancy residential buildings developed with industry participants
  - the work to create and implement a reinsurance scheme to offer reinsurance cover to the primary insurers of multi-occupancy residential buildings affected by cladding and other material fire risks.

