

Rt Hon Michael Gove MP  
Secretary of State for Levelling Up, Housing and Communities  
Minister for Intergovernmental Relations  
4th Floor, Fry Building  
2 Marsham Street  
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10 May 2022

Dear Secretary of State

In January 2022 we wrote to you setting out the FCA's planned approach to collecting information to address the concerns you raised in your letter of 28 January 2022 regarding reports of rising costs faced by residential leaseholders and other affected property owners across the United Kingdom in the wake of the Grenfell tragedy. You asked us to review the way the market for multi-occupancy buildings insurance operates, in order to:

1. Shed light on the underlying causes of year-on-year price increases; and
2. Assess the causes of the marked restriction in coverage available for multiple-occupancy buildings.

Further, you also asked us to make practical recommendations for measures that industry, government and regulators could take to achieve the goal of widely available and affordable cover for leaseholders.

As the Executive Director responsible, I am writing to you to update on the progress of our review. The full details of our work so far are set out in the Annex to this letter. In summary, our work has focused on three different areas:

- We are gathering data and engaging with the industry to better understand their approach to pricing. We have issued two data requests to a range of insurers and intermediaries to capture appropriate historical data from 1 July 2016 onwards. We have also had a series of meetings with representatives from insurers, brokers, and through their respective trade bodies. Our intention is to hold further in-depth workshops with the industry, whilst carrying out detailed analysis of pricing, fair value and looking for potentially unfair practices through both quantitative and qualitative analysis. The full details of our data gathering are in the 'Data gathering and industry engagement' section of the Annex.
- Based on our current understanding of the market we have considered the drivers of harm which could be impacting leaseholders. Price increases could be a result of insurers shying away from bidding for new business of multi-occupancy buildings, or charging particularly high premiums to insure them, due to perceived issues with building safety and quality. However, we are concerned that factors such as high commission paid to brokers and property managers, and a lack of competitive pressure on prices, could also

be leading to harm. Our views on the potential drivers of harm are set out in full in the 'Potential harms' section of the Annex.

- As well as identifying potential harms, we have begun work developing initial options for ways we could address any harms identified. For example, we are considering whether we could use our powers to improve the information given to leaseholders about their insurance, or potentially to limit the commissions which are paid to brokers. We are also considering the scope of our powers and whether some of the identified harms would be better addressed through action by others (such as industry-led initiatives or Government intervention). Our current thinking is set out in full in the 'Possible interventions' section of the Annex.

Our data gathering has now commenced, and we will continue with further industry engagements. It is too early for us to confirm the harms present in the market or to make any recommendations about how they can be addressed. We will use the information we gather from industry to further develop options for potential interventions, including where we conclude that market or Government-led interventions may be beneficial.

We are working to produce our final report within the six-month period you requested in your letter. As well as providing this final report, we will continue our regular engagements with officials in your Department.

Yours sincerely

**Sheldon Mills**

**Executive Director – Consumers and Competition**

## **Annex – Update on FCA work**

Our work over the past three months has focused on:

- Gathering data and engaging with both insurers and intermediaries to better understand their approach to pricing;
- considering the drivers of harm in the market which may be impacting leaseholders; and
- developing initial options for ways we could address any harms identified, as well as considering the scope of our powers and where harms would be better addressed through action by others (such as industry-led initiatives or Government intervention).

### **Scope of our work**

Our work is focused on identifying the potential harms to residential leaseholders from current market practices. The review will gather data from the industry and identify potential interventions we could make within the scope of our powers. In this Annex we have provided an update on the progress of our work to date and the options for intervention we are considering.

Alongside this, we are continuing to discuss with your Department its work with the insurance industry looking at other ways that premia may be reduced for leaseholders. We understand that this work is considering whether an arrangement allowing insurers to pool the risks relating to some buildings would lead to a significant reduction in premia. Government indemnification of this pool could reduce premiums further. Such an intervention is a decision for Government. In our engagements with the insurance industry so far, we have heard that building quality issues beyond just the use of flammable cladding may also be a contributing factor to the changes in premium since the Grenfell tragedy and this may be making individual insurers more risk averse. We will, of course, continue to offer our support to your Department in its work.

### **Market context**

We are responsible for the conduct regulation of insurers, as well as both conduct and prudential regulation of intermediaries distributing insurance products. Most firms involved in activities such as selling, arranging, underwriting or carrying out insurance contracts are subject to our rules. However, there are some exceptions to this which I have explained below.

The market for multi-occupancy buildings insurance is complex and has features which create unique challenges for interventions. Unlike in most home insurance, leaseholder homeowners are not party to the insurance contract and do not pay any premium directly to the insurer. Instead, their relationship is with the freeholder with insurance costs forming part of payments due under the lease agreement. As freeholders are the 'customer' of the insurer, they do not need to be authorised by us unless they are also conducting regulated activities (for example if they were to arrange rights for leaseholders to claim directly on the insurance). Property managers employed by freeholders may also not need to be authorised by us if the insurance activities they do fall within the scope of an exemption afforded to them under FSMA as members of the Royal Institution of Chartered Surveyors (RICS).

Although our data gathering is at an early stage, it is becoming clear that portfolio underwriting is common in this market, where a range of buildings owned by a freeholder (both residential and commercial properties) are covered by a single insurance policy. This may make it more challenging to identify the direct impacts on residential leaseholders where there are parties involved that are not regulated. Further work in this area may be required by Government upon completion of our review.

## Potential harms

Our work gathering data and engaging with the industry is progressing, further information on this is set out below. Our intention in our data gathering has been to identify failures in the market which may be causing harm to residential leaseholders in multi-occupancy buildings. We are concerned that there may be a number of issues within this sector causing harm. We address each of these in turn below:

### *Potential harms in relation to pricing and product supply*

1. The severity of the building safety issues that were brought to light following the Grenfell tragedy may have resulted in the following issues:
  - a. Insurers retrenching, shying away from bidding for new business of multi-occupancy buildings, or charging particularly high premiums to insure them. This could be risk-reflective, or it could be the result of inaccurate risk assessments or strong risk aversion; and/or
  - b. some insurers withdrawing from the market, limiting competition and reducing the pressure to lower prices.
2. Following the Grenfell tragedy, insurers may have also increased insurance prices for multi-occupancy buildings without cladding risks. This could be because:
  - a. The issues with flammable cladding are seen as indicative of broader issues with building quality likely to lead to higher claims (e.g. issues with plumbing systems leading to claims for escape of water throughout a building);
  - b. the elevated insurance premiums for buildings with flammable cladding acted as a reference point that also triggered higher premiums for buildings without cladding concerns; and/or
  - c. products may not be priced fairly, leading to leaseholders paying excessive prices relative to the value the policy provides to them.

### *Potential harms relating to product distribution*

3. Freeholders, property managing agents and insurance brokers may be selecting insurance policies that maximise their own remuneration (i.e. any commission or fees they receive), rather than the policy that offers the best value for the leaseholders.
4. There may be a lack of pressure on freeholders, property managing agents and insurance brokers to search for the policy that offers the best value-for-money or to switch to better-value policies or cheaper alternatives which may benefit leaseholders because:
  - a. Freeholders know they can recover their costs from leaseholders so have no incentive to look for cheaper or better value policies;
  - b. leaseholders may lack the information or the means with which to challenge service charges from the freeholder;
  - c. freeholders' property managing agents and insurance brokers may have commercial arrangements with particular insurers which benefit them but not leaseholders (such as captive reinsurance arrangements); and

- d. switching costs (e.g. long onboarding processes) may be preventing freeholders from switching to a cheaper insurer or broker.
5. Insurers may be taking advantage of the hypothesised lack of incentives to switch by charging higher prices than they would in a competitive market (e.g. by charging a loyalty penalty).

## **Data gathering and industry engagement**

Since our exchange of letters in January 2022 we have commenced work on the cost of insurance for leaseholders living in flats, with a particular emphasis but not exclusively, on those flats with cladding and other fire safety related problems.

We had already collected limited high-level data from a small number of firms. This has informed our thinking and provided a steer on what further data we would require to gain a better understand of the current operation of the insurance market for multi-occupancy buildings.

Since our exchange of letters, we have also had a series of meetings with representatives from insurers, brokers, and through their respective trade bodies. This has been at both an executive and working level.

This engagement has given us an opportunity to

1. Engage with senior executives to further outline our expectations and the issues identified in our Dear CEO letters sent on 28 January 2022;
2. understand challenges being faced by the market to inform our thinking; and
3. design appropriate quantitative data requests and qualitative questions to answer the issues outlined in the initial exchange of letters and the potential harms set out above.

We have significantly expedited our normal approach to designing and undertaking such significant work that may eventually result in material interventions. However, it has been important to ensure the data requests are robust enough to support any subsequent interventions. We have therefore also taken necessary time to engage with key stakeholders including the CMA, our own competition colleagues and colleagues at the PRA to plan the work programme and data requests.

An insurer data request has been issued to capture appropriate historical data since 1 July 2016. This was sent to 17 key insurers on 16 March 2022, broken down into two parts:

1. **Part 1** relates to a core question set and had a deadline of 20 April 2022; and
2. **Part 2** relates to an additional return requesting more detailed data for those buildings affected by cladding or other material fire safety risk. Due to the difficulty in firms providing this data this has an extended deadline of 11 May 2022.

We have successfully received the first suite of insurer data and are now cleansing and formatting this to undertake our analysis.

Further, a separate information request was sent to 26 insurance intermediaries on 6 April 2022 with a deadline for completion and return of 18 May 2022. (including both Brokers and Managing

General Agents that underwrite on behalf of insurers). We believe that this will give us sufficient coverage of the market to draw meaningful conclusions.

We have requested historical data and will be looking back to 2016 through to current year. That provides us with a pre-Grenfell position and allows us to follow the wider changes made by industry and market dynamics during this time. The data we are collecting is on the wider market and not just in respect to buildings with cladding or material fire risk. This allows us to consider the counterfactual and better understand how the underlying market has changed.

We will be carrying out the analysis of pricing, fair value and looking for potentially unfair practices through both quantitative and qualitative analysis. We will have collected two rich sets of market data, one from insurers and one from brokers and will need to review each individually and then also look across both data sets to understand the full impact across the whole insurance distribution chain (although this will not include information on the amount the freeholder charges to their leaseholders). We should be able to follow individual properties across the two data sets. This will be undertaken by our supervision and competition colleagues bringing two different lenses. The data should also allow a level of actuarial analysis should this prove necessary.

Following a competitive tendering process, we have engaged an independent third-party consultancy to support delivering this work at pace. The consultancy brings additional breadth and depth of knowledge on both the niche areas of multi-occupancy buildings insurance and wider property market. They will therefore help with both the analysis and with developing appropriate conclusions.

The consultancy is also assisting in the design and facilitation of appropriate industry engagement. The workshops and focus groups will be attended by insurers and intermediaries as well as trade bodies and other associated groups such as property managers and buyers. They will be designed to allow participants to contribute freely and to look backward at the current challenges but be primarily forward looking. They will seek to understand the potential impact and appropriateness of any remedy or market change should this be necessary. The first phase of workshops are scheduled for late May 2022 with a second phase considering potential interventions to take place in June 2022. These workshops will complement and run in parallel with our data analysis work.

Our early firm engagement highlighted that, unlike for retail products, some of the key data points are often not held systematically by insurers or brokers. Firms are therefore being asked to review individual files to collate the data, particularly with respect to buildings with cladding. The time being given to firms is significantly shorter than that normally considered for such large data requests requiring manual intervention.

The firm selections should ensure a representative sample and includes key market participants. However, it is important to stress that, given the large number of participants, we are unable to capture the whole broker market within this work. Additional intelligence from other sources may be needed to identify individual firms acting inappropriately.

We are continuing to engage with firms active in this market on a multi-lateral and bilateral basis throughout this work. This will be to consider both historical issues but also consider impact and consequences of any potential interventions.

It is too early to make any formal conclusions from our data work at this stage. As stated above, we have started the analysis of the first set of insurer part 1 data returns. Further analysis will be carried out in respect of insurer Part 2 and insurance intermediary data as we receive the data from firms.

### **Possible interventions**

In our [Dear CEO letters](#), we reminded firms that our rules require insurers to ensure the design of their products takes account of the needs, objectives, characteristics and interests of customers in a defined target market and provide fair value to those customers. This includes the price having a fair relationship to the benefits provided by the product. Intermediaries must ensure they do not take action that undermines the fair value of products, such as commission which does not reasonably reflect the costs incurred or the benefits provided. Firms must only offer customers products that meet their needs and must not be influenced to act against customers' best interests by commission or other remuneration, for example proposing a policy based on higher commission levels where the policy is not otherwise in a customer's best interests.

Although the freeholder is usually the 'customer', our letters stated that freeholders owe obligations to leaseholders, and leaseholders are likely to pay for the policy and get the ultimate benefit from it. We said that, even if the freeholder is the only 'customer' for the purposes of our rules, their duties to their leaseholders should be taken into consideration when firms design their products and determine whether they are providing fair value.

If our industry data gathering identifies that firms are not complying with our rules, we will take appropriate action using our regulatory tools.

In addition, as part of our work we have developed some initial options for ways we may be able to address the harms within the scope of our existing powers. As our data analysis is ongoing, it is too early to assess the effectiveness of these options. This is something we will do as part of our ongoing work and we will aim to provide further details in our later updates:

1. We are considering whether leaseholders may benefit from enhanced information disclosure. This could include information about the freeholder's insurance policy (where costs are passed on to leaseholders), and possibly also information about other policies which were available to the freeholder but not purchased. The aim of this would be to address harm 4 above by increasing transparency for leaseholders and potentially making it easier for them to challenge unfair insurance costs.
2. Our rules currently apply in a more limited way to leaseholders than they do to freehold property owners purchasing insurance for themselves, because leaseholders are not the customer of the insurer. We are considering ways in which we could extend the protections offered by some of our rules to leaseholders. This could include putting obligations on insurers and brokers to ensure that the products they offer provide fair value directly to leaseholders, and that commission should not conflict with leaseholders' interests. This would be aimed at addressing harms relating to product distribution by limiting the impact of remuneration on prices.
3. If commission paid to brokers and others is identified as being a significant cause of harm to leaseholders, we could consider rules to limit commission. This could include capping the level of commission that can be paid or prohibiting certain practices (such as commission being based on a percentage of the premium). This would also be aimed at addressing harms 3 and 5.

Any such intervention would be significant, with potential for adverse unintended consequences, and would require a strong justification in order to meet our statutory objectives. If Government wished us to pursue this it may be beneficial to provide a specific statutory power or duty to intervene on remuneration (similar to those in the high-cost short-term credit and claims management sectors).

A key aspect of our data analysis work is examining the way that insurers are assessing risk for multi-occupancy buildings. If our work finds that price increases are a legitimate reflection of increased risk it is unlikely we will wish to intervene, given that it is not the actions of authorised firms that is causing harm, but the underlying increase in the risks being insured. If an accurate assessment of risk is the main driver of increased prices, this may require action across the industry and, potentially, Government intervention. I understand that industry stakeholders are considering whether options such as pooling risks across multiple insurers could lead to a more significant reduction in premiums. We will continue to support the work your Department is conducting on this.

We will be in a stronger position to intervene where price increases are being driven by distribution costs and other 'non-risk' elements of pricing. However, there are some challenges in this sector which could limit our ability to intervene.

1. **Charges imposed by the freeholder.** It is possible that unregulated freeholders may add their own administration fees onto the insurance cost before it is passed on to leaseholders. Insurers and brokers typically have no relationship with leaseholders and have no control over how the freeholder opts to pass costs on to their leaseholders.
2. **Difficulties in providing information.** Similarly, the insurer or broker can produce additional disclosure documents and provide them to the freeholder to pass on to leaseholders, but they would have no way of ensuring the freeholder does so.
3. **Exempt firms.** Our rules do not apply to property managers who are members of RICS.
4. **Dispute resolution mechanisms.** As leaseholders are not customers of the insurer, they are not eligible to bring complaints to the Financial Ombudsman Service. Instead, disputes would need to be brought through the existing court process. I am aware that your Department is looking at issues with the current dispute process for leaseholders.

Whilst implementing options such as risk-pooling across multiple firms would be outside of our statutory remit, we will also continue to engage with Government and the insurance industry to support the development of these ideas.