

# FCA tells brokers to stop paying third parties without justification



Scott McGee

🐦 @SKPMcGee

21 Apr 2023

Indicative reading time: **7 minutes**

**The Financial Conduct Authority expects brokers of multi-occupancy buildings to “immediately stop paying commissions to third parties where they do not have appropriate justification and evidence for doing so”.**

The move comes after a broker pay review, the findings of which the Department for Levelling Up, Housing and Communities called “shocking”, discovered £80.7m of broker commissions for multi-occupancy buildings was passed on to third parties in less than four years.

Today the FCA has issued a [number of proposed changes](#) to its rules to ensure brokers and insurers treat leaseholders more fairly.

## Background

Since the tragic events of Grenfell Tower back in 2017, insurance premiums have increased dramatically due to the perceived increased risk of fire and cladding.

In January 2022, [Michael Gove](#), secretary of state for Levelling-up, Housing and Communities, asked the FCA to review the way the market for multi-occupancy buildings insurance operates.

It found some evidence of high commission rates and poor practices within the broking sector. As a result, the former Levelling Up minister [wrote to the British Insurance Brokers Association](#) and the Association for British Insurers demanding immediate cooperation and change into these practices.

The minister also wrote to the FCA asking to investigate further.

The FCA sought data on relevant remuneration policies for the period between 1 January 2019 and 30 September 2022.

This work was “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.”

### **FCA findings**

The FCA’s broker review found “concerning” remuneration practices. The watchdog stated leaseholders are being treated unfairly because there is a lack of shopping around for the best deal because a freeholder might be the one who takes out the insurance, but they do not bear the cost of it – leaseholders do.

In the period of 1 January 2019 and 30 September 2022, the average gross written premium per policy rose by 56% from £7470 in 2019 to £11,625 in 2022.

Over the same period, the average broker remuneration per policy rose by 39% from £2170 to £3010 and the average broker commission per policy rose by 46% from £1785 to £2595. The increase in average broker commission accounts for 20% of the increase in average GWP.

Overall, policies arranged by the 16 firms increased by 18% from 22,464 in 2019 to 26,549 in 2021. But in that period, GWP 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.

This meant the overall level of remuneration and commission being paid across the same population of multi-occupancy buildings rose substantially between 2019 and 2021.

### **Paying third parties**

The review also found an alarming level of broker commissions being paid to a third party, often the freeholder or a property managing agent, MGA, or appointed representative.

The report also suggested freeholders enter agreements with brokers based on the level of commission potentially earned, striking deals with those brokers to recoup some of the commissions paid via a third party.

The FCA's review of 16 brokers found in that three-year, nine-month period more than £80m of broker commission was paid to these third parties, often without the leaseholder, who ultimately bore the cost, having any idea it was happening.

This was 37% of the total commission figure of £216.1m and 8% of the total gross written premium figure of £968.0m.

In some cases, the FCA found brokers were giving more than half of their commission to another party.

However, when the FCA asked brokers what responsibilities these third parties had undertaken to deserve this amount of cash, some were unable to give a detailed explanation. Some provided a list of "potential tasks" these third parties might have undertaken.

The FCA was concerned by this, stating the firms had not done enough to review their arrangements with these third parties in order to avoid a conflict of interest.

This is what happened at the Canary Riverside building, which resulted in a [tribunal ruling that £1.6m paid](#) to a third party, Westminster Management Services, by [Reich](#) was not rightly charged to the leaseholders of the complex.

The tribunal stated the occupants of Canary Riverside, owned by the Yianis Group, were unaware any money was being paid to WMS until the tribunal requested a disclosure of fees paid by Reich.

In that disclosure, it was found that since 2014, for five Yianis Group properties Reich had sorted insurance for, more than £3m of leaseholder-paid commissions were passed to WMS.

What is more, in the tribunal, neither Reich nor the Yianis Group were able to provide evidence of a contract between any of the parties.

This was the case that alerted the FCA to these poor remuneration practices and urged it to investigate further.

A Department for Levelling Up, Housing and Communities spokesperson said on the broker review: “These findings are completely unacceptable and lay bare the shocking practice of brokers fleecing innocent leaseholders.”

### **Rule changes**

As a result of the FCA’s findings, the regulator set out changes to its rules to ensure firms are considering the leaseholder more in their placing of insurance, their remuneration practices and fair value assessments.

The FCA hopes the measure it is introducing will support [leaseholders to receive clear information around the insurance in place](#), help them understand the costs surrounding that insurance, empower them to challenge unfair remunerations, and scrutinise firms more to manage conflicts of interest.

Most significant of all is how the FCA now “expects brokers to immediately stop paying commissions to third parties (including property managing agents and freeholders) where they do not have appropriate justification and evidence for doing so”.

The regulator wants brokers to be able to back up the reasoning behind payment of third parties in a more transparent way, while making that information available to leaseholders when requested.

The FCA stated this will make it “easier for leaseholders to identify and challenge poor practices by firms”.

Other measures proposed by the FCA include:

- Introducing a new section in ICOBS 6A requiring insurers and intermediaries to produce and provide information in relation to all multi-occupancy buildings insurance policies intended for leaseholders.
- Insurers must provide a summary of the features of the policy so a leaseholder may be able to understand it.
- Insurers should supply clear pricing information for leaseholders to understand how the policy premium is made up.
- Intermediaries must disclose information that covers potential conflicts for the benefit of leaseholders.
- Intermediaries need to share the number of alternative quotes they obtained, and offer a brief explanation of why they have proposed or recommended the policy is in the interests of both the freeholder and leaseholders.

At the moment, leaseholders will not be considered ‘customers’, as the regulator recognised this would raise some challenges, which is why the regulator has made these other changes to ensure firms are being more considerate to the needs of the those who ultimately pay the premiums.

The FCA is currently consulting on its findings of the report and the proposed changes, and wants the insurance industry to provide feedback by 9 June 2023.

Sheldon Mills, executive director of consumers and competition for the FCA, said: We want to give leaseholders more rights and the information they need to exercise them. Importantly, under our proposals those selling multi-occupancy insurance will have to act in leaseholders’ best interests.

“Our review revealed large commissions paid by some brokers to freeholders and third parties, like managing agents, with little evidence of any value added to justify these payments We are taking action against these practices and we won’t hesitate to take further action if brokers don’t comply with our rules.”

## Response

These changes could have a huge impact not only within the multi-occupancy building sector but also for the entire broking sector, according to Michael Sicsic, formerly of the FCA and now founder and managing partner of Sicsic Advisory.

Sicsic said this is “big news” for insurance brokers with big leaseholder property portfolios, but it is bigger news for the entire broking sector.

“A number of interventions could change the fundamentals of brokers’ business models,” he said.

“This is the introduction of commission disclosure. Today it is just for leaseholders, but it sets a precedent for intervention where the FCA finds harm. And it is something that general insurance brokers have until now avoided.

“It is the first time the FCA has looked at fair value assessments and acted where they come up short.

“It is a warning about opaque supply chains, and a reminder that all parts must be satisfied with the value of the others.

“For leaseholders, this is a comprehensive intervention to end spiralling costs and conflict of interests of those choosing the insurance that they ultimately pay for. It is the end of property managing agents, freeholders and landlords taking an unjustified cut.”

Biba has come out in support of four of the new measures, which are:

- the interests of leaseholders (and others in similar positions) are properly considered when firms design their products
- prices are fair value to leaseholders as well as freeholders
- remuneration of all parties involved in insurance distribution has a fair relationship to the benefits provided to leaseholders
- leaseholders have sufficient information to challenge poor practices and unfair costs passed on to them.

Biba has however, made points on certain recommendations which it said it will work with the FCA and its members to finalise.

## Not enough, reparations needed

However, some still think these measures aren't enough.

A spokesperson for the Residents' Association of Canary Riverside said the acknowledgement of poor practice by brokers is "long overdue", but realistically, these measures "do nothing".

They said: "While the proposals might improve the situation in years to come, they do nothing to compensate leaseholders, like those at Canary Riverside, for the thousands of pounds they have already – unwittingly – paid in secret commissions hidden within the insurance premiums included as part of a flat's service charge.

"Having finally acknowledged that leaseholders have not been getting 'fair value', the FCA needs to recognise that retrospective justice is required and set about securing this. The hidden commissions scandal should be recognised as being on a par with the PPI mis-selling scandal. It needs to be fully investigated by the FCA, with fines imposed and leaseholders compensated."

Harry Scoffin, co-founder and co-director of Commonhold Now, a grassroots organisation campaigning for a Bill in the next King's Speech this autumn to abolish leasehold, said the current system is "broken" and radical change and reparations are needed.

"It's clear that the existing system is broken and in desperate need of radical reform, and ultimately a mass shift to fairer, resident-controlled commonhold.

"However, fixing the system alone is not enough. The affected leaseholders have suffered enough and deserve reparations and compensation for the harm caused to them. It's time for the FCA and the UK government to take bold action and hold those responsible accountable for their actions."

But more action could be on the way, as Sicsic explained. He said:

"While insurance brokers may be relieved that this stops short of [a cap on commissions](#), this could yet follow from the DLUCH.

“Insurance brokers should make no mistake – the FCA is serious about fair value and it didn’t like what it saw here. They should be reviewing all their remuneration arrangements – for all products – and ensuring that they can have the framework to assess and justify their part in the value chain to the regulator’s expected standards.”

The DLUHC spokesperson added: “While the measures outlined by the FCA are a welcome first step, these don’t go far enough to protect leaseholders. We will be urging them to take immediate enforcement action on the unreasonable practices highlighted in this report.

“We are determined to better protect and empower leaseholders and have already announced we will ban property managing agents, landlords and freeholders from receiving commissions on building insurance.”

---

Copyright Infopro Digital Limited. All rights reserved.

You may share this content using our article tools. Printing this content is for the sole use of the Authorised User (named subscriber), as outlined in our terms and conditions - <https://www.infopro-insight.com/terms-conditions/insight-subscriptions/>

If you would like to purchase additional rights please email [info@postonline.co.uk](mailto:info@postonline.co.uk)