

Block insurance MPs, the RICS and industry whistleblowers are combining to fight the overcharging of tenants for block insurance. But can excessive commissions be stopped when the issue is so murky? Lucy Barnard reports

No premium put on transparency

This week, the Conservative front bench stepped into the fray to attack excessive charges for residential block insurance after the issue was raised in EG last week (3 June, p27). Theresa Villiers, the shadow chief secretary to the Treasury, has agreed to champion the issue and several other MPs, including shadow environment minister Gregory Barker and Labour MP Michael Foster, as well as the Liberal Democrat Lord Razzell, have tabled questions in parliament.

And now the RICS has decided to weigh into the issue. "It is good it has come up, and we'll fight to have absolute clarity and transparency," says RICS president in waiting Graham Chase.

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The RICS is hoping that it will be able to discourage this. Next week, it is publishing revised guidance on commercial service charges and it is also reviewing its guidance on residential service charges as well.

Both the RICS and MPs are concerned that high charges are by no means rare.

Roger Southam, the managing director of managing agent Chainbow, who has successfully negotiated rebates for tenants on their insurance premiums, has now been asked by the RICS to look into the problem across the

country. He believes that thousands of tenants are paying enormous commissions on insurance premiums, and do not even know it (see p63).

Tenants pay for the insurance of their blocks through their service charges. But as the tenants are not the policyholders for the insurance, they have no legal right to find out how the charge is made up. Unlike commercial entities, they are not entitled to find out how much of their payments is for the insurance and how much is commission



"People who don't have a transparent position on what they are charging are bringing the entire industry into disrepute"

Graham Chase, vice-president, RICS

NKDR comment:
...starting with the RICS itself which does an excellent job at bringing its own industry into disrepute

taken by their agents, freeholders and brokers for arranging insurance.

A sample of cases at the Leasehold Valuation Tribunal (see panel p62) show that some landlords charge inflated fees, some at five times the cost of the insurance premium, as a matter of routine.

In many cases, Southam says, the commission can be as little as 5%, but frequently it is much higher. "I have known commissions to run as high as 1,000% of the total insurance premium," says Southam. "The abuse of the right to take a commission is rife in the industry. And although it is legal, it is still unscrupulous. It's like a constant mugging of the leaseholders."

The issue has appealed to David Cameron's reborn Conservatives. But Theresa Villiers became involved following a two-year campaign led by Peter Rochford, the co-founder of the South East Leaseholders Commonholders and Homeowners Association (SELCHA) based in Hastings, East Sussex, which represents 180 groups of leaseholders.

Unlike Southam, SELCHA claims that the fees involved are illegal, both because they are taking money from tenants, and because, in some cases, they are taking that money offshore and therefore paying no tax on it.

Rochford claims that brokers, landlords and managing agents are raising high fees

in the name of buildings insurance from the leaseholders. After paying the real insurance premium, they send the rest of the money to offshore bank accounts, which are then split between them. As a result, neither the managing agent nor the freeholder pays tax on their earnings.

"These are secret fees which are not registered for VAT, insurance premium tax or corporation tax. They stay invisible to the people who pay them," says Rochford. "Neither the broker, the insurance company nor the managing agent will tell anyone how much the basic premium actually is. And it's happening all over the industry."

Brokers point out that this is not because of some enormous cover-up. While it may seem easy for leaseholders to compare similar buildings insurance, the actual policies vary wildly. In other words, there is no such thing as a standard basic premium.

Variation of insurance rates

Stuart Reid, chief executive of insurance broker Stuart Alexander, says: "Insurance rates go up down and sideways very dramatically year on year, but it may be that a block's broker or managing agent may want to keep their insurance with the current supplier for a number of reasons. The building could have a poor claims history, the cover could be more extensive or the new insurance company could be not as well known or respected. It's not just a question of like for like."

"Commissions vary. They could be as low as 10-15% or they could be up to 30-40% - but in those cases the broker would be expected to undertake work on behalf of the insurer, such as filling in documentation and settling claims under a small amount," he adds.

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tion of Residential Managing Agents, agrees that increased commissions represent the extra work undertaken by managing agents or brokers. In a letter to *EG* (p72) he says: "Rates of commission paid by insurers in this marketplace are in my experience in the order of 35-40%. But this represents the total cost of the distribution and claims handling activity undertaken by insurance brokers and managing agents."

"In my experience, the figure is split in a proportion reached by agreement between the brokers and the agent, according to their respective roles and the strength of their bargaining positions," he adds. "The proportion of the commission that brokers are willing to rebate to managing agents typically equates to 15% or 20%."

But Nigel Wilkins, chairman of CARL, the Campaign for the Abolition of Residential Leasehold, argues that this is avoiding the point. "The issue is the lack of transparency, and it is getting worse. The bigger managing agents get portfolio cover for a raft of different properties quite cheaply. But these things are kept under wraps so that the leaseholders can never find out how much that cover really costs," he says.

"In the past two years, we have seen that insurers are happy to simply pass on their logo to the managing agent, and leave them to fill

in the blanks, as it were. The insurance companies turn a blind eye to how much managing agents actually charge leaseholders."

Some are calling for regulation but as the RICS's Chase says, the institution cannot regulate anyone who is not a chartered surveyor. The responsibility for that lies elsewhere.

Critics have complained that the FSA has done nothing to curb excessive insurance commissions since it took over the task of regulating insurance intermediaries in January 2005. "There is an issue around buildings insurance because the premiums are charged to the leaseholder and yet the policyholder is the freeholder," says an FSA spokesman. "It's an issue we have started to look at but at the end of the day we work on a cost/benefit basis and we don't want to add extra costs by way of extra regulation if we can possibly help it."

Moreover, the FSA adds, most people simply do not wish to know the detail of the charges they are paying. "We had a long consultation period before the new rules came into practice last January. The overriding reason for not making it compulsory to declare retail commissions was that research we carried out with customers showed they were not interested in commission levels, so long as the overall cost was low enough. "The FSA is not an economic regulator and believes that the market should be allowed to set the ultimate rates," says the spokesman.

Conservatives pouncing on the issue

It is unlikely that the FSA will be able to ignore the problem for long, however, as the Conservatives are pouncing on the issue with renewed zeal. "This issue is just breaking in government circles at the moment," says Peter Rochford. "Until two years ago, the government thought this extra charge was part of the insurance premium and therefore came under the tax levied for that. However, since then the FSA has agreed that that isn't actually the case and that it's a very widespread problem indeed."

Shadow environment minister Gregory Barker has already asked more than 10 parliamentary questions this year in relation to the matter but has so far been given short shrift by the government economic secretary to the Treasury, Ivan Lewis. But now, Theresa Villiers has taken up Rochford's cause, and the Tory front bench has been briefed on the issue.

But the matter is already urgently overdue for reform, according to CARL's Nigel Wilkins. "With the government's plans to build thousands more homes in the South East, many of which will be built as flats in leasehold blocks, this problem is likely to get worse," he warns.

Hard evidence from Leasehold Valuation Tribunal cases

In 2004, Rother District Investments, the landlord for Marine Court, St Leonards-on-Sea, East Sussex, admitted that between 2003 and 2004 it had sent a total of £16,823 of commissions on insurance premiums to a company called Chase Longman (Jersey) Ltd. The LVT ordered Rother to pay the offshored money back to tenants.

In 2004, KFT Investments Ltd, the freeholder of 5 Embassy Court, Portsmouth Road, Surbiton, Surrey, also admitted to sending monies from insurance commissions offshore to Jersey.

In two cases - Camberley, Beaconsfield Road, West Bromwich in May 2005 and 79-81 High Street, Carvey Island, Essex - the landlord, the insurance broker and the managing agent were all part of the Hercules group of companies. In a decision on 6 April 2005 regarding the Essex case, the LVT said the managing agent's fees "were not a matter

for scrutiny by the landlord but a source of profit for the Hercules Group". The same was found, with a different company, in March 2003 at 78 Sweyn Road, Cliftonville in Kent.

The LVT has also ruled in many cases that charges for insurance premiums were "excessive". In the case of Audley Road, Hendon, NW4, which came before the London LVT in February 2006, the tribunal reduced the landlord's claim for insurance from £2,911.59 to £1,000 on the grounds that BLR, part of the Erinaceous Group, had left the insurance "entirely in the hands of the brokers" and had taken no steps to ensure that the lessees got the best value for money.

There are also a number of cases where insurance premiums were again called into question, after it emerged that the valuers, insurance brokers and managing agent involved were all firms within the same group of companies.

Roger Southam, managing director of managing agent Chainbow, urges the industry to play fair with tenants

Overcharging for insurance does managing agency no service

Why would anyone care how much money is extracted from flat owners by the exorbitant mark-ups in their insurance premiums? After all, it's someone else's money and it is taken like candy from a baby. Particularly since most tenants do not even realise it is happening.

At the risk of sounding moralistic, I for one feel that managing agents should earn their money. They should not seek to profiteer from mark-ups to the detriment of providing a service.

The real problem is that the vagaries of the insurance market allow landlords and agents to manipulate matters to get the income they want. I have come across some brokers who will "make" the premium whatever the agent wants it to be. As long as the insurers get their share, they are happy to add on whatever figure is desired by the landlord or agent.

This must be wrong in anybody's eyes. If nothing else, it cannot be right when this cost is passed on to tenants to pick up.

One simple solution would be to require the building's insurance summary to disclose the amount of commission that is being paid, and to whom. Chainbow has always operated on the basis of negotiating the lowest possible insurance premium and receives 10% commission. This surely has to be the way that the industry as a whole should operate.

Large commissions added

Why should tenants be ripped off when there is no need? Independent Insurance, for example, took on an incredible amount of business by allowing third parties to add very large commissions to all their premiums – as large as the agents wanted. The company went bust in 2002, which resulted in tenants having to pay twice for premiums to cover the period from the time of going bust to renewal.

These practices are not unusual. In one instance, we acted for a parade of shops in the north of England. We billed out the insurance premium for the buildings policy placed by us, which amounted to £100 per unit. We then received phone calls from tenants asking what period this premium covered. Was our invoice,

which stated 12 months, incorrect? Was it to be billed monthly? When we confirmed that £100 was the annual premium, the tenants told us that the previous owners had been charging £1,000 pa.

For a very long time, commissions have been the best way to make money out of owning residential ground rents. In some cases, this is even being factored in when sale prices for ground rents are calculated. There is an argument that high levels of commission are needed to compensate for the work undertaken in dealing with the policy and the handling of claims. But this is a complete red herring. Invariably, the freeholder will try and keep the commission and not pass it on to the agent. This means the agent has to handle the insurance matters within their normal fee.

An almighty shake-up needed

The alternative is that managing agents improve the professionalism of their service, in which case tenants would be prepared to pay a fair price for a fair job. However, this means managing agents not seeking to do the minimum amount they can get away with. It will take an almighty shake-up to clean up the sector and improve standards.

The government has produced reams of legislation for residential property, but none of it tackles the root problem and it remains easy to do things badly and rip people off. Handing insurance regulation to the FSA tackled the wrong part of the problem, as it has no intention of enforcing transparency.

What is needed is for the amounts of commission to be exposed, and to give leaseholders the right to choose to insure themselves or to obtain quotes that must be matched by the managing agent.

At the moment, commission has to be disclosed if requested by the insured, but not by the tenant. Even so, not many people know about this. Instead, tenants are usually given weasel words. But isn't it about time the industry started behaving responsibly and looked after its stakeholders?



Southam: calling for transparency on the commissions paid to managing agents

NKDR comment:
Absolutely right - and the current RICS leadership does not have the capability to do it

NKRD comment:
- Congratulations for your perseverance Mr Rochford
- Well done Mr Southam. It takes courage
- Thank you Estates Gazette for publishing this article