Association of British Insurers 51 Gresham Street, London EC2V 7HQ Tel: 020 7600 3333 Fax: 020 7696 8999

BRIEFING NOTE FROM THE ASSOCIATION OF BRITISH INSURERS
Flooding and the Future of Flood Insurance

The ABI

The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

Flood insurance in the UK

1. Flooding is the greatest natural threat the UK faces, and the risk is rising. In recent years this increased risk has been reflected in the number and cost of major ‘flood events’ that property insurers cover.

2. The current flood insurance market operates under the temporary Statement of Principles (SoP) agreement which does not guarantee affordable prices for consumers and has distorted insurance. For the last three years insurance industry has been talking to the Government about a replacement for the SoP.

3. **The ABI has agreed a Memorandum of Understanding (MoU) with the Government over the industry-led Flood Re solution. The MoU establishes the foundations on which Flood Re could potentially be built to deliver affordable and accessible insurance for high risk households. It has been confirmed as the Government’s preferred option, and they intend to legislate for it in the Water Bill published today.**

4. The MoU contains a number of significant Government commitments to help prevent and mitigate the effects of flooding, including commitments on flood defence capital spending, tighter planning laws and the provision of key data to help insurers develop further flood risk mapping. These are an integral part of the agreement and a prerequisite for the insurance industry’s commitment to Flood Re.

5. While the work to develop this scheme happens, insurers will continue to meet their commitments to their existing customers under the 2008 Statement of Principles, providing MoU conditions are met.

6. To get this far has required compromise on both sides and there remain a number of meaningful issues that will need to be overcome if Flood Re is to be established; this will continue to require an unprecedented level of partnership between Government ministers and industry CEOs.

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Flood Re - an insurance-led solution

- No country in the world has a free market for flood insurance which successfully preserves widely available and affordable flood insurance for those at high flood risk without some form of Government involvement.

- The proposed Flood Re scheme is a not-for-profit flood insurance fund, owned and managed by the industry and which insurers would use to look after the flood risk component of the household insurance policies they sell to high flood risk households. The fund would be an improvement on the Statement of Principles as it would deliver a competitive market where consumers have real choice whilst ensuring homes at risk of flooding are able to buy affordable flood cover.

The fund would help ensure flood insurance for up to 500,000 properties in the UK where accessing flood insurance in an open market would be problematic. The remaining 98% of properties would continue to be covered by the industry as normal. All customers would continue to buy insurance from insurance companies in the usual way: it is the insurance company itself that will deal with Flood Re, not the customer.

- Flood insurance for those properties in the fund would be provided at a set price that varies by council tax band

Prices for flood insurance would start at no more than £210 per annum in Bands A and B, rising to £540pa in Band G. Bands H and I (Wales) would not be included in the fund.

The rest of the household insurance price for risks such as fire or burglary would be set by the insurer as normal, and the customer experience of buying insurance from an insurance company would be virtually unchanged. If a claim for flood damage was made from a property which was part of the fund, the fund would then reimburse insurers to meet the cost of the claim.

Flood Re Funding

- To make sure that the fund has sufficient money in it, insurance companies would make an annual contribution based on their level of premium income in the form of a levy raised from all household insurance premiums. On average this equates to £10.50 a year on all home insurance policies. **Homeowners already pay this, as cross-subsidy already exists between lower and higher flood risks, and they would not notice any difference to their bills.**

- The fund would also receive income from the flood premiums from the high flood risk properties in the scheme. While the losses could be smoothed through reinsurance, in the event that not enough funds had built up in the first few years to cover a major incident like the 2007 floods, there would be a deficit needing to be met. The insurance industry has agreed to cover this cost through an extra levy from Flood Re to ensure it can pay its claims. The overall effect of this on insurers would be neutral over time.

- Flood Re will be designed to fully deal with claims in at least 99.5% of years. Even in the worst half a per cent of years, Flood Re will cover losses up to those expected in a 1-in-200 year – a year that would be six times worse than 2007. Government will take primary responsibility, working with the industry and Flood Re, for distributing any available resources to Flood Re policyholders should claims exceed that level, which would be a significant national emergency.

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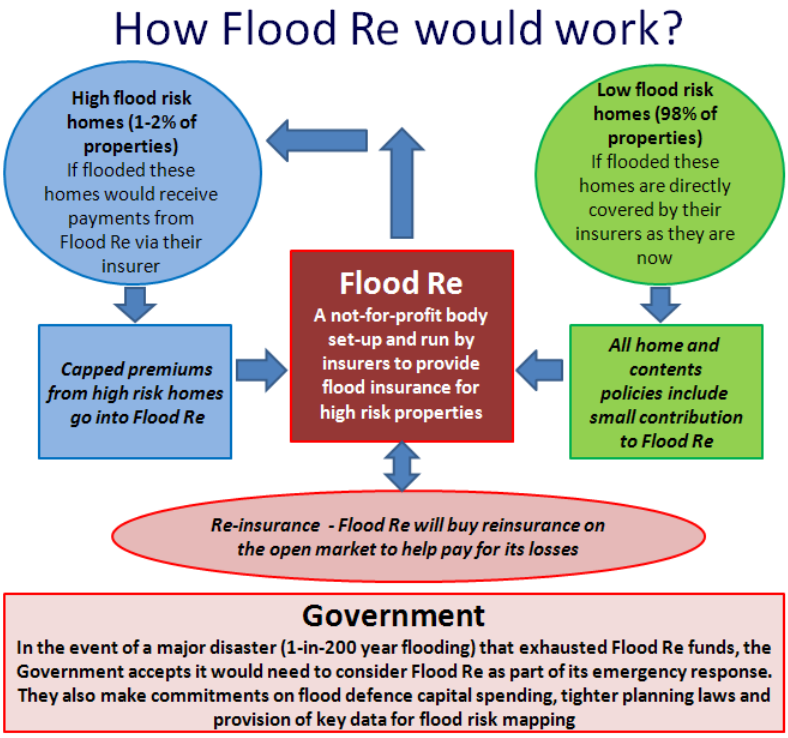
Comprehensive Spending Review – Flood defences

- The Comprehensive Spending Review outcome for flood risk management was positive. An increase in flood defence spending was a key element in the insurance industry agreeing the Government's requirements of Flood Re and this has been recognised with an increase in capital expenditure on flood defences and a trajectory that will continue this at least until 2020/2021.
- Government commitments on flood defence spending, tighter planning laws and making key data available to help insurers develop further flood risk mapping are an integral part of the agreement and delivery of them by Government is a prerequisite for the insurance industry commitment to Flood Re.



Alternative Options

- The only realistic options on the table besides Flood Re are market regulation or an open market. An open market would see at least 200,000 homes across the UK struggling to access affordable insurance. The insurance industry does not believe that this is a good outcome for consumer
- In the Water Bill the Government will be consulting on regulation, which could make insurance compulsory. This option would be counter–productive as it would likely lead to less consumer choice as some insurers might choose to leave the market. It would not address the affordability issue, which Flood Re does, and is not the Government's preferred option.

Association of British Insurers - June 2013

We would be happy to brief Parliamentarians in more detail about Flood Re.
To arrange a meeting please contact:

Matthew Jupp
Parliamentary Affairs Office
Matthew.jupp@abi.org.uk
020 7216 7327

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Frequently Asked Questions – Flood insurance.

How much of a risk is flooding?

Flooding is the biggest natural threat facing the UK and flood risk is increasing, because of climate change, unwise development and the gradual deterioration of flood defence assets thanks for decades of under investment. In the 1990s, there were two 'flood events' with a claim cost of over £150 million for insurers. In the first decade of this century, there were five such events, including the 2007 floods which saw insurers pay out £3 billion in claims and the 2012 floods which resulted in flood claims paid of £594 million.

According to the Environment Agency, in England and Wales:

- One in six homes is at flood risk.
- Over 2.4 million properties are at risk of flooding from the rivers and the sea. Of these around 500,000 are at 'significant' risk. A further 2.8 million properties are at risk of surface water flooding alone.
- Over 5 million people live or work in flood risk areas.

Floods devastate people's homes and livelihoods and insurers understand how important it is that consumers are able to rebuild their lives after a flood. The damage caused by a flood typically results in a claim of between £20,000 and £40,000. While we recognise home insurance can be costly for some, it reflects both the increased risk and high cost of flooding.

What happens at the moment – and why doesn't it work?

Flood insurance in the UK is currently provided under the Statement of Principles (SoP). The SoP was a temporary agreement reached in 2000 between the insurance industry and the UK Government and the Devolved Governments that set out the insurance industry's commitment to providing flood insurance as a standard feature of home insurance for properties at some risk of flooding, and to continue to offer flood insurance to properties at a significant flood risk. The Government, in return, promised to build flood defences in those areas at significant risk within five years, and made a number of other commitments on the provision of flood data, the planning system, and flood risk management more broadly.

It has been renewed on several occasions, most recently 2008. It was originally due to expire in June 2013, but earlier this year the ABI wrote to the Secretary of State for Environment, Food and Rural, the Rt Hon Owen Paterson MP to agree that insurers would continue to meet their commitments until the end of July while the Flood Re negotiations were concluded.

The SoP ensured that unlike in most other countries, private flood insurance in the UK remained widely available as a standard feature of domestic property insurance, although it did not guarantee affordability. The SoP was only ever meant to be a temporary 'sticking plaster'. It is not appropriate for the long-term, for the following key reasons:

- Customers typically tend to have no choice of insurer;
- Affordability is not safeguarded;
- New entrants to the home insurance market start from a position where they have no commitments under the agreement. This gives them a significant commercial advantage over those insurers who signed up to the Statement of Principals in 2000.

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What is Flood Re?

The proposed Flood Re scheme is a not-for-profit flood insurance fund to insure the flood risk component of a home insurance policy for high risk households. It would work by UK insurers ceding the flood risk premium of a home insurance policy for a high risk household into a special not-for-profit fund, called Flood Re. The pool would also be funded by a levy on the UK insurance industry which would be equivalent to the existing cross-subsidy paid by non-high risk households under the current arrangements. This would ensure normal householders would not see any difference to their bills under Flood Re, nor would they deal with it: they would continue to insure their property with an insurer not Flood Re.

Flood Re would ensure that home insurance is *available* and *affordable* to people in high-risk households. It will:

- Give customers a choice of insurers in a functioning market.
- Provide for more affordable long term insurance by introducing caps to the cost of the flood insurance cover they are buying.
- Keep insurance primarily as an insurance industry responsibility without the Government having to get involved in subsiding the provision of flood insurance or paying claims.

How much will it cost and would it be permanent?

To set up and run Flood Re will cost £10 million annually which the insurance industry would pay for. The cost to each customer will vary according to council tax band with prices set to ensure maximum help for customers in the Bands A-D bracket. The cost of home insurance for non-risk households will not be affected. Flood Re would not be permanent but it would provide a more stable long term framework than we have at the moment. We envisage Flood Re being operational for 20-25 years.

When will this scheme be operational and what is planned for the interim?

Today’s announcement sets out the foundation for the scheme and there will now be discussions and work on implementation. There are many significant issues still to be overcome, including regulation approvals, system design and ensuring appropriate accounting treatment for Flood Re’s relationship with insurance companies. Subject to agreement on these and satisfactory progress at key milestone review periods, we envisage it being ready for business in summer 2015. ABI members will continue to meet their commitments under the previous Statement of Principles, and will continue to offer cover to existing customers on terms that reflect the flood risk.

Why does the Government need to be involved?

No country in the world has a free market which preserves available and affordable flood insurance without some kind of government involvement. The UK is an island very significantly exposed to flood risk and that risk is rising. It is therefore in society’s interests that the Government and the insurance industry are working together to provide a solution for the vast majority of citizens. The UK Government has a key role to play in *preventing* flood risk by investing in flood defences and enforcing a sensible planning framework which does not allow development on flood plains. Under Flood Re, Government would not be responsible for any losses by the scheme except in the event of a catastrophic national emergency but it has a key role to ensure on-going investment in flood defences and the prevention of development in flood risk areas.

Aren’t more flood defences the answer?

Yes, targeted investment in flood defences where most needed continues to be important, as does adequate planning controls against unsuitable developments in flood risk areas. The UK continues to pay a high price for many decades of underinvestment in flood defences and unwise development in flood risk areas. Before the latest Comprehensive Spending Review, the Environment Agency estimated that an additional £20 million per annum (in real terms) was needed for investment in building and maintaining flood defences each and every year between 2011 and 2035 to keep flood risk at current levels (an 80% increase in funding). An increase in flood defence spending was a key element in the insurance industry agreeing to Flood Re and this has been recognised in the Comprehensive Spending Review.

- Original capital funding for 2014/15: £259m; (announced in 2010 Spending Review)
- Revised capital funding for 2014/15 after November 2012: £344m;
- Announced funding for 2015/16 to 2020/21: £370m per annum, increasing in real terms each year

Are commercial properties to be included in this framework?
As has been extensively flagged, Flood Re is only designed to cover the household market. The priority is to ensure available flood insurance to homeowners, whose homes could be at risk without it. The individual nature and assessment of business risks means that availability and affordability of flood insurance is a more complex question for commercial customers than domestic ones. Clear rules would be established by Flood Re for 'borderline' cases such as 'Bed and Breakfast' properties.

Why should someone at lower flood risk have to pay the additional levy so that someone at higher flood risk can get affordable flood cover?
This agreement formalises the existing cross -subsidy that has always existed in the market. Today our increased knowledge of flooding shows that most people are potentially at risk of flooding (flash floods, which accounted for half of the flood claims from the 2007 summer floods) not just those who live close to a river.

Is Primary legislation needed?
Yes. The current Statement of Principles is a voluntary agreement but Flood Re would need to be established by primary legislation to compel all insurers selling home insurance in the UK to take part. This is agreed by the UK insurance industry. We have proposed to Government that Flood Re would present the Efra Select Committee with an annual report on its operation so its workings would be fully transparent and open to scrutiny by Parliamentarians.

What does it mean for devolved administrations?
Scotland, Wales and Northern Ireland have their own Statements of Principles, and these also come to an end in 2013. Like the UK Government they will have to put an alternative in place and we hope that an agreement can be reached that can be signed up to by all the Governments of the UK. We remain in close contact with all the Governments of the UK on this matter.