Department for Environment, Food and Rural Affairs

Water Bill: Part 4 - Flood Insurance

Scope of Flood Re

March 2014

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Introduction

This note sets out details of the proposed scope of Flood Re. It also sets out how it is envisaged that insurers would distinguish between domestic and commercial policies for the purposes of determining eligibility for Flood Re. It has been jointly written by Government and the Association of British Insurers.

Flood Re is designed to cover the 1 to 2% of households at the greatest risk of flooding, who would otherwise find it difficult to find affordable insurance cover in an open market. The majority of homes will not need to be in Flood Re because they will be able to secure flood insurance at prices lower than those offered through Flood Re.

Flood Re will be funded by a levy on the insurance industry which replicates the existing cross-subsidy in the market and which industry advises equates to £10.50 per policy. An important principle underlying the policy is therefore that Flood Re will have a minimal impact on wider bill payers.

Flood Re is also designed to be progressive, with the benefits targeted towards lower income households, to help promote affordability for those who are least able to pay. It is for this reason that Band H properties (and equivalents in the Devolved Administrations) are out of scope from Flood Re. Analysis suggests that, relative to other bands, a move to risk reflective pricing would have a limited impact on affordability of a combined insurance policy for Band H households.

New housing development should be located to avoid flood risk, or where development in a flood risk area is necessary, it should be designed to be safe, appropriately resilient to flooding and not increase flood risk elsewhere, in line with the national planning policies in place. For this reason, properties built after 1 January 2009 will be excluded. This carries forward the position under the “Statement of Principles” agreement between Government and the Association of British Insurers, on behalf of their members (which guaranteed continuing insurance cover in specific circumstances).

Flood Re has been designed to address the specific problems that have been identified in the domestic insurance market, where a move to the open market at the end of the existing “Statement of Principles” could have created issues of affordability. It has therefore not been designed to cover commercial insurance, where the cross-subsidy is not as clear and the market more complex and bespoke. The Government also does not believe it is appropriate for consumers to subsidise commercial insurance.

Leasehold houses will be in scope of Flood Re, provided that the owner (or its immediate family) lives in the property and purchases the buildings insurance in their own name. Buildings with three flats or fewer, for example maisonettes or converted houses, will also be in scope, provided the freeholder lives in one of the units (or if the insurance is purchased by one of the leaseholders that has a share of freehold).

Leaseholders in larger blocks of flats will be excluded because freeholders will be responsible for buying building insurance for their leaseholders, and this insurance is on commercial rather than domestic terms, and therefore not covered by Flood Re.

The ABI has written to assure Government that they do not believe that small businesses or those leasehold properties excluded from Flood Re will have problems accessing affordable flood insurance. The Government and the ABI have committed to monitoring the market for small businesses and the residential leasehold sector. Should significant evidence emerge of a systemic market failure in these sectors, the Government and the ABI have agreed to discuss the way forward.

What criteria will be used to determine if a property is eligible for Flood Re?

Only the top 1-2% of properties at highest risk of flooding will need to be considered for inclusion in Flood Re as others will be able to access flood insurance on the free market.

The definition of "household premises" will be set out in the secondary legislation provided for by clause 69 of the Water Bill. The criteria that the insurance industry will use to distinguish between domestic and commercial policies for Flood Re are:

1. Properties are insured in the name of an individual or in a trust for an individual;
2. Properties have a Council Tax band;
3. Properties are used for residential purposes;
4. Properties have an individual premium; and
5. Properties are occupied by the policyholder or their immediate family.

In addition to meeting all of the criteria above, the property must be within Council Tax Bands A-G (or its equivalent in the Devolved Administrations) and must have been added to the Council Tax valuation list (via a Notice of Completion) before 1 January 2009. Any existing property that has been converted to residential use after this date (for example a commercial building being converted to residential use) would not be eligible for Flood Re.

Small businesses, in general, will be out of scope for Flood Re. However, the categories of micro-businesses detailed below because they operate from domestic premises, and hold a policy which is classified as domestic by the insurance industry, will be eligible.

Flood Re's Scheme Rules will set out the eligibility requirements to ensure that the industry maintains a consistent approach. Details on how the Scheme will operate will be set out and considered as we implement Flood Re. The instruments designating the Scheme will be subject to affirmative procedure.

Which contents policies are in scope?

- All domestic contents insurance policies (apart from those relating to properties in Council Tax Band H or their equivalents or properties built after 1 January 2009).
  - *This includes all types of residential occupancy, including rented, social rented and leasehold tenancies.*

- *The only exceptions anticipated would be contents policies that are block purchased commercially for tenants, for example insurance with rent schemes, as these would not be purchased in the name of an individual.*
- *Contents policies typically cover anything that is not part of the fabric of the building. For example, fitted kitchens and fitted wardrobes tend to be covered by buildings insurance policies whereas personal belongings, soft furnishings, furniture and food would typically be covered by contents insurance policies.*

Which buildings insurance policies are in scope?

- Owner-occupied residential freehold properties (apart from properties in Council Tax Band H or their equivalents or properties built after 1 January 2009).
- Owner-occupied residential leasehold houses or bungalows
  - *Leasehold houses or bungalows that are insured via an individual residential policy, by the leaseholder or their immediate family would meet the criteria and would be in scope.*
- Owner-occupied residential leasehold flats, provided that:
  - *the terms of the lease specify that each dwelling purchases its own buildings insurance (currently, a very small proportion of domestic leaseholds fall into this category); or*
  - *the buildings policy covers a block of three flats or fewer, and the freeholder(s) lives in one or more of these flats. This means that small blocks (for example converted Victorian homes) where the owners of the flats share the freehold, or where one of the flat owners is the freeholder, will be eligible.*
- Owner-occupied residential commonhold flats
- Sheds, garages and summerhouses
  - *Most domestic policies would cover outbuildings such as sheds, garages and summerhouses and are therefore in scope (this would be set out in the definition of 'Buildings' within the policy documentation).*
  - *However, large outbuildings which are covered under a separate non-residential policy, such as farm barns, would be ineligible.*
- Farmhouses
  - *Provided that the policyholder or immediate family lives there and the rest of the above criteria are met.*
  - *If the farmhouse was included in a commercial policy for a large commercial operation, it would be out of scope. There may be cases where two policies are held on a farm, one covering the residential risk of the farmhouse, and one covering commercial risks, and here the insurer could cede the domestic policy to Flood Re.*
- Bed and Breakfasts (B&Bs) with a Council Tax band

    - *Under circumstances where a B&B pays both Council Tax (or the equivalent) and business rates, it would hold two separate policies. The B&B would be eligible for Flood Re for the policy that is residential and ineligible for the policy that is commercial in nature. However, it is not anticipated that many B&Bs would hold two separate policies.*

- Residential buy-to-let home that has not yet been rented out
    - *Once rented, a property must be covered by landlord insurance, which is out of scope. Note that a property purchased with a Buy-to-Let mortgage can be covered by domestic home insurance up until the point at which it is rented.*

- Owner-occupied static caravans
    - A static caravan would be eligible provided that it is covered by a domestic insurance policy.

- Unoccupied properties, provided they are for residential use and have a Council Tax Band (apart from those relating to properties in Council Tax Band H or their equivalents or properties built after 1 January 2009).

Which buildings insurance policies are out of scope?

Buildings policies which are generally classified as commercial by the insurance industry are out of scope. Specific examples are given below.

The following types of properties are out of scope primarily because they are not used solely for residential purposes:

- Residential properties which are used as a business;
    - *Homes that are registered as a business would generally need to be insured via a commercial insurance policy, and would therefore be out of scope.*
    - *On the other hand, homes that are used by the occupant for work, but are not the registered business address, would be in scope provided they were insured through a domestic policy.*
    - *Factors such as the duration of time working from home would not affect eligibility. It is the type of insurance policy that determines eligibility.*
- Pubs (including pubs where residential accommodation is above the premises);
- Post Offices (including where residential accommodation is above the premises);
- Premises of microbusinesses, small businesses, charities or co-operatives.

The following types of properties are out of scope primarily because they are **not used primarily for residential purposes** and are also **not in possession of a domestic Council Tax band**.

- Bed and Breakfasts (B&Bs) paying business rates
    - *Often, B&Bs will not be insured under a domestic policy as they tend to purchase an insurance package that includes public liability, employer's*

liability, and potentially business interruption cover. This may also be true of B&Bs that have a Council Tax Band.

The following types of properties are primarily out of scope because they are **not insured in the name of an individual** or **under an individual premium**:

- Mixed use properties – for example:
    - A block of residential flats with shops or businesses on the ground floor,
    - A block of residential flats with some individual flats being used as a business address.
- Large commercial residential buildings portfolios, such as social housing, Housing Association properties, retirement homes
- Commercially managed blocks of residential flats
- Owner-occupied leasehold flats, where the freeholder is an external party, or the block of flats contains four or more units
    - *The building would normally be covered by a single commercial policy covering multiple dwellings, purchased by the freeholder or managing agent. The terms of the leases for most residential buildings would generally specify that the freeholder purchases the buildings insurance on the behalf of the leaseholders.*

The following properties are out of scope **because they are not occupied by the policyholder or their immediate family**:

- Properties that are rented out (these should be covered by landlord insurance)
    - Landlord insurance typically includes protection against the same perils as normal home insurance and additionally provides the landlord with liability cover for accidents (for example if the tenant is injured) or non-payment of rent. However, in some cases landlord insurance can be purchased as a commercial add-on to a residential buildings policy.
    - But in both cases, landlord insurance is more extensive than standard home insurance, with at least some elements of commercial insurance included which is why it is treated as such by the industry.
- Holiday homes if they are let out and an income is received (these should be covered by a landlord's insurance policy.)
- Rented static caravans
    - *Insurance for the holiday/caravan park itself would also be out of scope*
- Farm outbuildings, including if occupied by tenants
- Publicly owned buildings used for residential purposes

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