Department for Environment, Food and Rural Affairs

Water Bill

Flood Insurance

November 2013

This is one of a series of briefing notes on the Water Bill. This note explains in detail what the Government are doing on flood insurance in the Water Bill and why. Further detail on the Water Bill can be found in other briefing notes

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Why do we need new arrangements for flood insurance?

Insurance against flooding is critically important to protect households from the devastating impacts of heavy rainfall. Flooding can cause tens of thousands of pounds of damage and mean having to live elsewhere for months while properties are dried out and can be refurbished. Suffering a flood is distressing enough even with insurance in place. Without it households can also find themselves in severe and lasting financial hardship.

Flood insurance has been widely available up to now as a result of long standing voluntary agreements in England, Wales, Scotland and Northern Ireland with members of the Association of British Insurers (ABI). These agreements, called the 'Statement of Principles' expired at the end of June and we have been working hard with the industry on future arrangements.

What is the Government's proposed approach?

The Water Bill will bring forward measures to address the availability and affordability of insurance for those households at high flood risk and ensure a smooth transition to the free market over the longer term. Government announced the proposed approach in June and consulted on the proposals and the draft clauses. We intend to add clauses to the Water Bill by Government amendment to provide powers to establish Flood Re and reserve powers to provide for the Flood Insurance Obligation, if regulation proved necessary.

'Flood Re'

Flood Re would effectively limit the most that high-risk households should have to pay for the flood component of their home insurance. The maximum amounts would differ by council tax band so that those in smaller properties do not have to pay as much for flood insurance as those in larger houses. The approach means that people could know the maximum they might be asked to pay and would no longer need to be worried about not finding affordable insurance. The maximum prices charged under Flood Re would increase each year so that households can adjust gradually. Under Flood Re, insurers would only charge excesses between £250-500.

Flood Re would be an industry-run, not-for-profit scheme that would support around 500,000 of the highest-risk households in the UK. If a high risk policy had been ceded to Flood Re and the policyholder needed to claim for flooding, their insurer would pay the claim directly and Flood Re would then reimburse the insurance company. Policyholders would always manage their claims via the insurer and would never need to contact Flood Re.

It would be up to insurers to decide whether to cede a policy to Flood Re. If an insurer calculates that the technical flood risk insurance premium for a household exceeds the eligibility threshold for their council tax band they can seek to have the policy covered by Flood Re. This means that if another insurer calculates the price is lower it could still offer insurance directly – without having to use Flood Re. This mechanism will keep membership of Flood Re to only those that need it.

Projected end prices to high-risk policyholders for a combined buildings/contents policy

Council Tax Band	A	B	C	D	E	F	G	H
Maximum price for flood component of policy via Flood Re	£210	£210	£246	£276	£330	£408	£540	No cap/not eligible
Typical price for other insurance components (fire, theft, etc.)	£180	£180	£186	£204	£222	£252	£390	
Insurer overheads, and profit	£260	£260	£288	£320	£368	£440	£620	
Typical overall price charged to policyholder	£650	£650	£720	£800	£920	£1,100	£1,550	
Compared to what might be charged without Flood Re	£1,140	£1,165	£1,185	£1,290	£1,430	£1,560	£1,850	

To fund Flood Re, a new industry-backed levy would be introduced. All UK household insurers would have to pay the levy. This levy is likely to be set at £180 million per year for the first five years. This is the equivalent of around £10.50 for each UK household with both contents and buildings cover in place. Although the cost of the levy would be passed on to customers, spreading risk across policyholders is a widely used model for insurance, and the industry estimates that lower risk households are already subsidising those at higher risk of flooding to approximately this level.

Flood Re will pay out on reinsurance claims up to the limit equivalent to a 1 in 200 year level of claims. A 1:200 loss scenario is comparable to six times worse than the 2007 floods. We are discussing with the ABI how best to help affected households if annual flooding exceeds this level but we are clear that there is no Government liability for Flood Re.

Flood Re will be industry-managed and run. It is proposed that it will be established as a private sector reinsurance company and as such will be regulated by the financial services regulators. The Government intends for Flood Re to be directly accountable to Parliament for its operations, and the powers which will be added to the Water Bill will set out how we see those arrangements working in practice.

Who will be eligible for Flood Re?

Domestic properties in council tax bands A – G and some micro-businesses would be eligible. Other businesses would not be included since our evidence suggests that the majority of businesses are not finding it difficult to get suitable insurance and therefore we are concentrating the scheme on domestic properties.

We are currently not planning to include properties in council tax band H, which are typically valued at £900,000 or more, because we believe that their owners are most able to afford to pay a bit more for their cover.

Properties built after January 2009 were excluded from the 2008 Statement of Principles and it is proposed will also be excluded from Flood Re. We believe a cut-off date is needed to maintain the signal to planning authorities that all development must be appropriate and resilient to flooding, and still believe that 2009 is the most appropriate date based on our current understanding of flood risk.

We consulted on whether the highest risk households should be excluded from Flood Re and received a variety of views. We propose that such properties would not be excluded at first, but over time Flood Re may develop an approach for properties that flood very frequently that will help to reduce the impact of their claims on the scheme's affordability. For example if action was not taken to reduce the cost or likelihood of these properties being damaged by flooding, Flood Re could set higher premiums or excesses. Only in the most extreme cases would exclusion from Flood Re be considered.

What will happen to customers before Flood Re starts?

We would bring Flood Re into operation as soon as possible after the new legislation is agreed by Parliament. We expect that it might take until 2015 to introduce Flood Re because of the need to get final agreement from insurers, Parliament's agreement, and approval of the public funds involved (as a 'State Aid') from the European Commission. Until then, insurers have agreed to continue to abide by their commitments under the Statement of Principles agreement.

The Flood Insurance Obligation

There is still a lot of detail to be worked out for Flood Re and many aspects of that policy need to be agreed with Parliament, the insurance industry and the European Commission. Should Flood Re fail to meet its objectives for any reason, and free market pricing prove unsatisfactory, we want to make sure that households at higher flood risk can still access affordable insurance, through regulation if necessary. Taking both sets of powers now will reassure households that, whatever should happen, we will be able to do this.

If we were to implement the Obligation, we would work with the Environment Agency and its counterparts in the Devolved Administrations to create a UK-wide register of properties at a higher risk of flooding. Work to develop the criteria for inclusion on the register is on-going, but we expect at least 500,000 properties in England to be able automatically to benefit from inclusion on the register, if they wished. Householders would be able to opt out from the register and we would also set out clear criteria for opting in, so that households at genuine risk of flooding can benefit from access to affordable insurance. Members of the public would also be able to query the register to identify whether their home – or a home they were considering buying or renting – was included.

Each insurer would be allocated a quota of higher-risk properties to cover from this register (its ‘obligation’), based on its market share. To ensure public confidence in the function of the obligation, we intend to make the Financial Conduct Authority responsible for supervising the scheme and taking action against insurers who don’t meet their quotas.

The Flood Insurance Obligation would force insurers to compete with each other for the business of higher-risk households in order to meet their targets. This should help customers to shop around to get a good deal.

This regulatory option is another approach to formalising the existing cross-subsidy of the market and, accordingly, would be unlikely to impose significant additional costs on the insurers.

This document/publication is also available on our website at:

https://www.gov.uk/government/policies/reforming-the-water-industry-to-increase-competition-and-protect-the-environment/supporting-pages/reform-of-the-water-market-the-new-water-bill

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