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From Dan Rogerson MP
Parliamentary Under Secretary of State for Water, Forestry, Rural Affairs and Resource Management

Dear Committee Member,

FLOOD INSURANCE: IMPACT OF CHANGING ELIGIBILITY FOR FLOOD RE

In the evidence session on Tuesday 3 December, I committed to writing to the committee setting out the Government analysis on the costs of widening eligibility of the Flood Re scheme to include a) properties built after 2009 and b) Band H properties. I am sorry for the time taken to provide the information: priorities necessarily had to be to deal with the recent East Coast tidal surge.

The details below are taken from current evidence and analysis. We are currently reviewing this evidence base in the light of the new flood risk maps, which will be published later this month, and a further exercise the Association of British Insurers is currently conducting to gather data from its members. The results of this data-gathering exercise are expected by January.

To place the figures below in context, around £55m of Flood Re's annual income is used to subsidise the cost of insurance premiums for high-risk households. The rest of Flood Re's income is used to pay claims up to the threshold for reinsurance, purchase reinsurance to cover exceptional risks, and for essential administrative costs.

Any increase in the amount of flood risk taken on by Flood Re would need to be funded by either:

a. Increasing bills for all households, by raising the levy on household insurance policies. This levy is currently set at the level (£10.50) the industry estimate will not lead to any overall increase in bills; or

b. Increasing the price of insurance for high-risk households, by raising the eligibility thresholds for a policy to be ceded to Flood Re.

Cost of including properties beyond 2009

Around 98% of UK properties were built before 2009. Strong planning policies have been in place since before 2009, and the previous Administration therefore decided in 2008 that properties built after 1 January 2009 should be excluded from the final Statement of Principles.

Responses to the recent public consultation broadly supported the exclusion of post-2009 properties, and agreed that it was important to retain a cut-off date to avoid incentivising development in areas at flood risk.

Our current estimate is that changing the cut-off date from 1 January 2009 to a later date, such as 1 July 2013[1], would add between 3,500 and 16,000 properties to the pool. This is based on the number of new developments that go ahead against EA flood risk advice; the assumption that new properties in the pool take up the same mix of contents, buildings and combined cover; and that new properties are distributed across council tax bands according to the country's average (as provided by the ONS).

Including additional properties in Flood Re will increase the pool's liability and require additional subsidy, although this will be offset to an extent by the additional premium income Flood Re would receive from more policies being ceded to the pool. Assuming that Flood Re's reinsurance costs would increase proportionately to the increase in liability being taken on, and assuming that Flood Re's administrative costs are unchanged despite taking on more policies, **based on current information we estimate that including properties built since 2009 in Flood Re would increase overall costs by between £0.9m to £3.3m.**

To fund this increase in costs would therefore require either Flood Re's eligibility thresholds to be increased by between £3 and £13, raising the cost of insurance for high-risk households; or increasing the levy paid by all households by up to 2%.

Cost of including properties in Band H

Just over 0.5% of UK properties are in Band H. Assuming that a similar proportion of Band H properties are at flood risk as for other council tax bands, have the same mix of insurance cover as average, and would receive a subsidy proportionate to that

[1] To tie in with the agreement of the Memorandum of Understanding with the Association of British Insurers

going to Band G properties[2], we estimate that including Band H properties within Flood Re could add between 1,000 and 3,800 properties to the pool.

As before, assuming that Flood Re's reinsurance costs would increase proportionately to the additional liability being taken on, assuming no change in administrative costs, and taking account of the additional premium income from more policies being ceded to the pool, **based on current information we estimate that including Band H properties in Flood Re would increase overall costs by between £1.4m to £5.4m.**

This would be the equivalent of £4.35 to £16.50 increase in the eligibility thresholds for Bands A-G, or an increase of up to 3% in the levy paid by all households. As Band H households tend on average to be more wealthy than other households, this would also be regressive and would reduce Flood Re's value for money, which is already negative.

Cost of including **both** Band H and properties built since 2009

Based on current evidence and the assumptions above, we estimate that this would increase Flood Re's overall costs by between £2.3m and £8.7m, due to the additional subsidy and reinsurance cover required.

This would be the equivalent of a £7.35 to £26.50 increase in the eligibility thresholds for Bands A-G, or an increase of up to 5% increase in the levy paid by all households.

I hope that the Committee finds this information useful. We will of course keep the analysis above under review as new evidence emerges.

Yours

Dan

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[2] This would mean that the eligibility threshold for a Band H property, for a combined policy, would be £1000