Response to the Defra consultation

Securing the future availability and affordability of home insurance in areas of flood risk - June 2013

Submission by the Joseph Rowntree Foundation

August 2013

The Joseph Rowntree Foundation (JRF) is one of the largest social policy research and development charities in the UK. For over a century we have been engaged with searching out the causes of social problems, investigating solutions and seeking to influence those who can make changes. JRF's purpose is to understand the root causes of social problems, to identify ways of overcoming them, and to show how social needs can be met in practice. The Joseph Rowntree Housing Trust (JRHT) shares the aims of the Foundation and engages in practical housing and care work.

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Introduction

Thank you for inviting us to respond to the consultation on the future of flood insurance.

This submission has been prepared by Katharine Knox, Programme Manager, Joseph Rowntree Foundation, with input from Martin O'Neill, University of York. We also acknowledge the work of John O'Neill, University of Manchester on this topic. The submission draws on O'Neill and O'Neill's work for JRF, *Social Justice and the Future of Flood Insurance* (2012) and Sarah Lindley, John O'Neill et al, *Climate Change Justice and Vulnerability* (2011).

The JRF has been conducting research on climate change and social justice since 2009. In this context we have been considering social vulnerability to flooding in the UK and examining the future of flood insurance as an important safety net for people who may be affected by flooding.

Our overall view is that we need to ensure that future flood insurance is affordable and accessible, and that the policy approach that is followed takes proper account of issues of social justice (in particular to consider issues of social vulnerability, poverty and disadvantage and to develop equitable policy responses that take account of this).

JRF's Viewpoint report, *Social justice and the future of flood insurance* (O'Neill and O'Neill 2012) highlights the limitations to allowing a market based approach to future flood insurance to be applied and the negative potential outcomes for social justice of moving towards fully risk-reflective pricing for flood insurance.

As such, we are therefore concerned that the proposals suggest a Flood Re model as a short term solution, with the intention of moving to a market based risk reflective pricing model in the longer term.

We are concerned that the options outlined have not considered the potential for a stronger state role, such as that applied in many other comparable countries (e.g. France, Spain, Iceland, etc.). In particular we would be interested in raising the issue of whether the chosen approach, which relies heavily on funding reinsurance, offers good value for money, when compared to other models, which are able to take advantages of the savings of scale and coordination that can be made possible by giving a larger role to the state.

In spite of these reservations, we recognise that the preferred model of Flood Re is an attempt to provide a collective response to support those households at highest flood risk. We welcome this development, as this supports our view that we need a solidaristic approach to dealing with vulnerability, in order to avoid potential housing blight in areas of highest risk, and resulting social problems, if flood insurance becomes unaffordable.

We recognise that of the models proposed, this is likely to have the greatest buy-in and provide the best short term solution.

However we have a number of reservations and would like to see certain issues below addressed if this model is to be followed.

Q1. Do you have any evidence of small businesses experiencing difficulty with the availability and affordability of property insurance due to the risk of flooding?

This is not an area where JRF has specific evidence to offer. However we are aware that in York where we operate, there are a number of small businesses that have been subject to repeated flooding. We are concerned about how repeated exposure could affect insurance premiums for businesses. We suggest further research is needed to understand the scale of problems faced by businesses of risk reflective pricing. We would also suggest consideration is given to the implications of costly insurance for the future operation of businesses in high risk areas, especially in small communities, where they may not only provide an important economic function but are also central to the functioning of the community. There may also be a case for considering small businesses distinctly from larger businesses which may be able to manage differential premiums across sites more easily. The issue of the relationship between excesses and premiums will also be important in recovery for small businesses. In relation to the proposed approach here, we are unsure how some small businesses may be treated, such as self-employed households working from home, or bed and breakfasts and whether they will be able to access Flood Re.

Q2. Do you agree with the Government's policy objective for flood insurance?

We agree with the objective to ensure that domestic property insurance continues to be widely available and affordable in areas of flood risk. We also recognise the need to avoid unsustainable costs for the taxpayer. However we are concerned about the ultimate goal of moving to risk reflective pricing, for all the reasons outlined in the JRF Viewpoint report, *Social justice and the future of flood insurance* (O'Neill and O'Neill 2012).

While we recognise a shift to risk reflective pricing should act as an incentive for reducing risk, we are unclear whether this need to reduce risk will be addressed sufficiently for the 500,000 homes identified as potential users of the Flood Re pool over the period of the proposed transition of 20-25 years. We recognise that the direction of policy has been to move away from a focus primarily on engineering of flood defences to one of sustainable flood risk management and for an increasing expectation that communities and individuals will take steps to manage their own risk (Ball et al, 2013). However we note the continued development of new homes in floodplains in England (Adaptation Subcommittee, 2012) and question whether the planning system and associated regulations could be strengthened to avoid continuing new building in risky areas (O'Neill and O'Neill, 2012). There is also a need to increase resilience of existing housing developments in high risk flood areas (Houston et al 2011).

We are also concerned about how far different solutions will be developed and applied at different levels (household, community, state) to reduce risk, particularly as climate change is expected to increase flood risk and we are concerned that it may be inappropriate or inadequate to rely on property level protection in some instances. The difficulty of addressing pluvial flooding in particular, where the risks of exposure are less well understood than in relation to fluvial (river) flooding, needs further consideration. The government needs to clarify how risks will be reduced over the 20-25 year period of Flood Re.

We wonder if there is a need to do more to support area based solutions (noted in Option 1) alongside Flood Re, based on an analysis of where there is high social vulnerability to flood risk and a high risk of exposure (for example see Lindley et al 2012). This would require identification of the priority areas which may need further interventions to reduce risk, taking account of existing initiatives, including the Defra resilience pathfinders. This could help to reduce risk for the communities of most concern over the period of the Flood Re arrangement, although any approach would also need to be alive to changing patterns of risk.

Q3. Do you agree with the approach taken to analysing the different potential solutions in the Impact Assessment?

The impact assessment summarises the monetized impacts of flooding for the proposed options. However it does not fully account for the social impacts of flooding, or their distribution, and the associated costs this implies, suggesting it may underestimate the full implications of different options.

The JRF's recent research by Lindley et al summarises some of the important social impacts of flooding and how it may affect people's overall well-being, considering people's ability to go about their daily lives as well as the issues of concern over health and mental health impacts, stress and anxiety linked to the event and dealing with recovery and insurance, possible disruption to children’s education, the need to relocate, potential impacts on family relationships and so on.

There is also a need to recognise the different levels of social vulnerability in different communities and localities which will affect how far flooding may lead to a loss in people’s welfare.

Notably the potential for property blight linked to unaffordable insurance and inability to sell homes does not appear to be costed in the assessment. The implications for housing markets and wider communities of a lack of access to affordable insurance could be substantial and should not be underestimated in terms of the impacts this could present for the future of particular localities and communities.

Q4. Do you agree with the evidence presented in the Impact Assessment?

See above comments Q3.

Q5. Do you have any further evidence which has not been considered in the Impact Assessment?

The Government's own UK Climate Change Risk Assessment work on flooding and annex on social vulnerability should be considered. In addition, as noted above, JRF research by Lindley et al (2011) *Climate Change, Justice and Vulnerability* identifies the factors which cause social vulnerability to flooding and maps UK neighbourhood vulnerability and exposure to flooding and the Viewpoint by O'Neill and O'Neill *Social justice and the future* *of flood insurance,* outlines what a socially just approach to flood insurance involves (2012). JRF has also identified the breakdown between income and council tax bands across the UK which should be considered in the affordability of the eligibility threshold proposals (unpublished, available on request). See also work in Scotland on affordability of insurance (CREW report by Ball et al 2012).

Q6. Do you support the Government's proposed approach?

We are concerned that the approaches outlined have not given more consideration to a greater role for the state, whether through subsidy, or as acting as insurer or reinsurer of last resort. As O'Neill and O'Neill (2012) have discussed, the UK is unusual internationally in the limited role of the state in flood insurance, when compared with countries such as the Netherlands, Iceland, France and Spain. Notably in other work to address safety nets for home owners, JRF work has suggested a partnership insurance scheme where borrowers, lenders and the Government each make a contribution to a pooled fund to cover struggling homeowners' mortgage costs to prevent repossessions and provide an effective safety net – there may be some read across of ideas here (Stephens and Williams 2012).

We do support the collective response proposed in Flood Re to support the highest risk households. However as noted earlier we are concerned about whether this temporary solution, before a shift to risk reflective pricing, is simply postponing the problem, which appears to be a real danger with current proposals.

We believe all insurers need to be included in the Flood Re obligation, and Flood Insurance Obligation if this is used, to avoid cherry picking in relation to insurance provision.

It would be helpful to understand more clearly how far the calculations of the number of high risk households have been derived. We are also unsure whether the proposed costs for high risk households actually will deliver affordability for those on low incomes.

We also note the substantial costs for reinsurance required in Flood Re (£180m is to be raised from the levy while £165m is needed to meet annual reinsurance costs). We wonder if this offers better value for money than the government acting as an insurer of last resort, and would advocate that more work be done to assess the possible cost-savings of giving a broader role to the state. The assessment itself notes that 'Reinsurance may also be more expensive than other forms of covering liabilities, e.g. through general insurers or Exchequer reserves, if the general level of return on capital which reinsurers seek is higher (e.g. because they hold the reserves in place of the customer).'

Q7. If the remaining challenges associated with Flood Re prove too difficult to overcome, what factors do you think should be taken into account ahead of any decision on whether or not to introduce the Flood Insurance Obligation?

We think the critical issues to consider include the long term sustainability of the proposals, accessibility and affordability for households and social justice - to take account of issues of social vulnerability, poverty and disadvantage, and also the future implications for risk of climate change. There will also be practical questions about feasibility and buy in to deliver the system.

Flood Re

Q8. Do you agree that setting the eligibility thresholds according to council tax bands (or their equivalents in the Devolved Administrations) will help ensure Flood Re support is targeted towards those households who need it most, without requiring significant administration? Is there a better method?

We recognise that there is no easy solution to targeting support to take account of insurance affordability for different households without greater clarity from insurance providers about who is categorised as at highest risk in setting premiums.

The council tax threshold link provides a practical approach to seeking to take account of affordability linked to the housing context of different households.

We have some reservations about current council tax bandings and their link to house values as the bandings are very out of date. In other work, JRF has called for council tax bands to be updated reflecting the increase in house prices since 1991 as well as wider concerns about its role as a tax in the housing market (Stephens and Williams, 2012).

However we recognise this may be the best practical solution which can be applied which is feasible to administer.

Q9. Do you have any views on the proposed initial “eligibility thresholds” within Flood Re (table 1 above), which would effectively cap the technical flood risk premium paid by high risk households?

We suggest there needs to be greater clarity about how the threshold numbers have been arrived at and that the proposals may need to be refined to ensure policy delivers its objectives on affordability. In particular more consideration may be needed about how council tax bands relate to income and possibly also tenure.

Data analysis for JRF shows that across the UK there are low income households in all council tax bands but with particularly high numbers of people in the lowest income deciles (deciles 1 and 2) living in Bands A-C: over 2 million low income households are in Band A, over 1 million in Band B and just under 850,000 in Band C (unpublished data analysis for JRF). Without understanding the income situation of those households who are most at risk and who will fall into the pool it is difficult to assess how affordable the proposed premiums will be for any household. However this analysis suggests there are substantive low income households in all these three council tax bands, not just Bands A and B, an issue which should be considered in premiums set.

Research for the Scottish government has also indicated that average premiums across a survey sample of 157 households for buildings and contents insurance combined were just under £400 but that low income households (on under £11,000) were concerned there may be affordability problems if premiums increased by up to £200 (Ball et al 2012). The proposed overall price of at least £650 for council tax band A properties is an increase of nearly £250 on the average premium found in this survey and substantively more than average figures identified in the impact assessment.

Based on this analysis we question whether the premiums set are necessarily affordable for low income households.

The analysis suggests:

- There may be a need to review the thresholds for council tax bands A to C and to consider whether figures can be adjusted to reduce premiums in order to increase affordability to protect low income households
- Consideration should be given to whether a small increase in the proposed levy could make a major difference to increase affordability for these groups. If the levy were to be increased by, say, £2-5 and the balance redistributed to Bands A to C categories, what impact would that have?
- Options include either decreasing the subsidy to higher council tax bands or increasing the levy from other householders or a combination of both.

We suggest further work is done to review the thresholds to see if it is possible to increase affordability across Bands A to C.

Q10. Do you agree that the following should be excluded from Flood Re:

a. **Band H properties?**

The disproportionate impact of including Band H properties in the Flood Re proposal is understood. Our analysis suggests there are only around 14,000 households in the two lowest income deciles who live in Band H properties across the UK suggesting a very small number of asset rich income poor households overall in this council tax band. It is unclear how many if any of these households might live in areas of high flood risk and therefore likely to be in the pool but we can assume that it would only be a small proportion of this number.

Overall across the bands, however, there will still be asset rich, income poor people, who may be vulnerable for other reasons, for example, elderly people, so mitigation may need to be considered.

As noted earlier there may be a case for area/community based interventions to address high social vulnerability to flooding, including possible affordability problems with insurance and seeing how high risk households who are most vulnerable can be supported via different means including through local flood risk management strategies. Interventions could include support to gain the best insurance deal, participation in community approaches to reduce flood risk, support with property level protection if applicable or other measures which could reduce flood impacts.

b. **New homes built after January 2009?**

We recognise there may be a case for encouraging risk reduction in building of new developments in flood risk areas and that the Environment Agency's role as a consulted in the planning process should support effective decisions. However, we are concerned that the Adaptation Sub Committee of the Committee on Climate Change reported in 2012 that:

Development in the flood plain increased by 12% (210,000 properties), compared to 7% in the rest of England over the past ten years. One in five of these properties were built in areas of the floodplain at greatest risk of flooding.

They also suggest that four times as many households and businesses in England could be at risk of flooding in the next twenty years if further steps are not taken to prepare for climate change (ASC, 2012). We need to better understand how far planning authorities are ensuring risk reduction in the light of potential future climate change impacts in planning decisions. We suggest further monitoring through the Adaptation Subcommittee of the Committee on Climate Change, to assess and understand the extent to which new developments are still occurring in high risk areas, what flood resilience works are being undertaken and the nature of households affected. This should consider issues of both pluvial and fluvial flood risk. For instance we need to understand how far potentially more vulnerable, low income households may be ending up living in these developments in social or affordable housing. We understand that planning regulations in Scotland may be stronger than in England in reducing risky development and there may be lessons to learn on this (O'Neill and O'Neill 2012).

There are still questions about how evolving evidence and data for instance on surface water flooding is being taken into account or how future climate change or population growth may affect risk patterns over time.

c. **Genuinely uninsurable properties? If so, how would you define these in a consistent way that insurance companies can apply?**

We are unclear of the benefits of excluding any particular properties as this appears to enable insurance companies to make decisions not to offer provision which goes against the principle of ensuring insurance remains available and affordable. If such an approach is taken we suggest very clear definitions are applied and agreed with appropriate input from communities not just the insurance industry.

Q11. Should other exemptions also apply?

We are not aware of a case for any other exemptions.

Q12. Do you agree that Flood Re should apply to both buildings and contents insurance?

Yes. It is important that it applies to all three scenarios, combined and separate insurance for buildings and contents to take account of needs for support across tenures. Affordable contents insurance is needed for those who are in social or private rented accommodation where insurance take up is already low (O'Neill and O'Neill, 2012). Indeed there may be a case for further encouraging take up of flood insurance among renters, particularly noting the growth of the private rented sector as well as scope to work with social housing providers to encourage rent with insurance schemes (Houston et al 2011).

Q13. Do you have any comments on this proposed way of managing Flood Re's exposure to large losses?

The issue that has not been addressed is how to apportion funds to deal with a year where there are extremely high losses if the pool is exceeded. There are issues here of how vulnerability and particularly heavy impacts in specific locations would be addressed.

We assume the Government would apply the Bellwin scheme to support local service providers in the event of catastrophic flooding but are unclear if additional support would be needed for particular communities and, if so, how this might be addressed.

Q14. Do you think a levy equating to around £10.50 per UK household, which the ABI estimate is equivalent to the current cross-subsidy, is acceptable to help address the problem of securing affordable flood insurance for high risk households?

We note that this rate simply reflects what is estimated to be existing cross subsidy. From the information provided, it is not clear what difference raising the cross-subsidy by a small amount, say £2-5, would have in supporting affordable premiums particularly for those in Bands A to C which contain significant numbers of low income households. It may be that such an approach would be appropriate. These ideas could be subject to public testing of acceptability.

Q15. Do you agree that Flood Re will secure the availability and affordability of household flood insurance in the UK?

Generally the approach does support accessibility, noting the exclusions previously stated above and the temporary nature of the Flood Re solution. There remain questions about the inclusion of home based businesses. There is also some uncertainty about the distinctive position of small landlords and how they might be treated under these arrangements - in light of the ongoing growth in the private rented sector this might need further consideration.

We are as yet unclear whether the approach will deliver affordability for lower income households as noted in earlier sections, and suggest there is a need to have a greater understanding of the relationship between council tax bands, income, tenure and risk, considering whether Bands A to C thresholds are appropriate.

In addition while the approach uses council tax bands as a proxy for considering affordability it does not address wide social vulnerability factors. JRF research suggests flood vulnerability is affected by other issues including individual characteristics, the nature of the built environment and people's adaptive capacity (Lindley et al 2011). The elderly, those with poor access to services, transient populations and others may all have greater vulnerability in relation to flooding. This needs looking at more carefully to see if targeted mitigation is needed over and above the proposals. As noted above, a greater focus on area/community based responses to reduce risk in areas of high levels of social vulnerability and exposure to flood risk may be important.

Flood Insurance Obligation

Q16: Do you agree that the Flood Insurance Obligation has the potential to meet the policy objective?

Yes, but with some qualifications:

a. It will be open to judicial review

b. Gaming is a potential issue, where insurers may pick off the "best of the worst" to minimise their risk

c. The quality of the policy would need to be defined to ensure that there was a level playing field.

Q17: Do you agree that the Secretary of State should have the power to exempt some firms operating in the UK domestic insurance market from the Obligation, e.g. those with market share below a de minimis?

We think if the policy is to ensure equitable approaches for all households then all companies would need to comply, otherwise there may be competition issues within the industry.

Q18. Do you agree that at this stage Ministers should have the option of applying the Obligation to both buildings and contents insurance?

Yes

Q19: Do you agree that the Environment Agency should be granted powers to act as a „lead administrator", working with the devolved administrations to compile a UK-wide register that lists by address each domestic property at high risk of flooding?

Yes. But this also raises questions:

- How will high risk be defined (including across the devolved administrations of the UK) to ensure consistency?
- How frequently will the register be updated to take account of changes in risk?
- How will it cope with changing circumstances – including changing risk due to population growth, climate change, patterns of development (eg infill development in urban areas)? Note that JRF research suggests that by 2050, 3.2 million people in urban areas could be at risk from pluvial flooding, an increase of 1.2 million. This increase is composed of an additional 300,000 due to climate change and 900,000 due to population growth. (Houston et al 2011).
- Will there be a mechanism to allow challenge by households?

- How will members of the public be able to access the register? Will both tenants and landlords be informed if they are on it? When and how will this happen?

Q20. Do you agree with the broad duties envisaged for the regulator? Is anything missing?

We have no particular suggestions here.

Q21. Which of the above approaches to supervising compliance with the Obligation do you believe is best suited to delivering the policy objective whilst minimising the burden on businesses and consumers? Is there another approach not considered here?

We have no particular suggestions here.

Q22. Which of the above approaches to imposing sanctions for non-compliance with the Obligation do you believe is best suited to delivering the policy objective whilst minimising the burden on businesses and consumers? Is there another approach not considered here?

We have no particular suggestions here.

Q23. Do you agree with our preference that the Financial Conduct Authority should supervise compliance with the obligation, and be responsible for taking regulatory action against insurers who fail to meet their obligation, or should it be or the Environment Agency?

We have no particular view on this, although we recognise the need for understanding of financial regulation which may be better placed with the FCA and in a body separate from the EA if the EA were to administer the register.

References

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