Building Societies Association

York House
23 Kingsway
London
WC2B 6UJ

Telephone: 020 7520 5900
Fax: 020 7240 5290
www.bsa.org.uk

# Securing the future availability and affordability of home insurance in areas of flood risk

## Response by the Building Societies Association

### Introduction

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 45 UK building societies. Mutual lenders and deposit takers have total assets of nearly £380 billion and, together with their subsidiaries, hold residential mortgages of over £250 billion, 20% of the total outstanding in the UK. They hold nearly £260 billion of retail deposits, accounting for 21% of all such deposits in the UK. Mutual deposit takers account for 30% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

### Summary

2. Mortgage lenders must have certainty that the security for their loans (ie the home) can be sufficiently insured against all types of risk. We therefore welcomed the announcement that government and the Association of British Insurers (ABI) had reached an agreement on a replacement to the Statement of Principles – a system which had worked well in the past. Although not perfect, we view Flood Re as a workable solution and the best alternative of the options presented.

3. We have some concerns over the wide-ranging exclusions from Flood Re and believe that properties in council tax band H, as well as properties built after 2009 should be included within the scheme.

4. Flood Re is a useful medium-term solution, however we have concerns over moving to risk-based pricing after 25 years if an insurance market is not in place to underwrite these risks, or if there has been a number of significant flooding events in the meantime. We believe that government should consider the option to retain Flood Re into the long-term if concerns remain that some households may not be able to obtain insurance against flooding.

5. In the short-term, we hope that insurers will continue to honour the previous Statement of Principles on an informal basis until Flood Re can be brought into effect.

### Consultation questions

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

6. We do not have any evidence of businesses experiencing difficulty obtaining flood insurance as this type of cover is often included within the business rates. There may be a problem which is currently being hidden due to the ‘packaged’ nature of the rates which businesses pay, however we view this as a lesser problem than in the residential sector as businesses have a greater ability to self insure and pass increased costs on to consumers.

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

7. We agree with the first part of the policy objective; that domestic property insurance should continue to be widely available and affordable in areas of flood risk without placing unsustainable costs on wider policyholders or the taxpayer. The assurance that lenders' security (ie the property itself) can be adequately insured against all types of risk is fundamental to the availability of mortgage lending in the UK. If areas at a high risk of flooding become unable to obtain insurance, this could jeopardise mortgage lending in that particular area, meaning that house prices could fall or properties become accessible to cash purchasers only.

8. However we fundamentally disagree with the second part of the policy objective; that over time there should be a gradual transition towards more risk-reflective prices, based on robust evidence of local risk, to increase the incentives for flood risk to be managed whilst allowing time for choices to be made and appropriate action to be taken. Whilst we agree that there could be a greater element of risk-reflective pricing on flood insurance, withdrawing government intervention after a 25-year period could lead to a risk that certain households may be unable to obtain any flood insurance. Furthermore, the management of flood risk is fundamentally easier for government than individual households, who are unlikely to be able to access the sort of resources needed to prevent or manage flooding. If a move towards risk-reflective pricing for consumers is to work, government needs to substantially increase spending on new flood defences and maintenance of existing measures now, to ensure that their effects can be taken into account in insurers' pricing models in the medium to long-term.

**3. Do you agree with the approach taken to analysing the different potential solutions in the Impact Assessment? 4. Do you agree with the evidence presented in the Impact Assessment? 5. Do you have any further evidence which has not been considered in the Impact Assessment?**

9. We agree with the approach to and evidence within the Impact Assessment and have no further evidence to add.

**6. Do you support the Government's proposed approach?**

10. We are broadly supportive of the proposed approach and believe that the Flood Re solution is the best option of the alternatives considered, however our main concern is surrounding its time-limited nature. We also have some concerns surrounding the exclusions, covered later in this response. In general though Flood Re is a good solution to ensuring the availability of flood insurance for the majority of consumers in the medium-term and the property industry will take comfort in the fact that there is not the imminent threat of large portions of the country's houses becoming uninsurable.

11. The proposed approach could be improved by retaining the option to extend the Flood Re programme at the end of the 25-year period if a risk-reflective specialist insurance market has not developed. One concern is that global events could affect the amount of premium that consumers pay to insure their homes which could put flood insurance cover beyond the means of some households. So for example wide-spread domestic flooding could push up the premiums of the flood-specific aspect of the insurance policy, but it is important to bear in mind that global events can also push up the cost of insurance as was seen in the aftermath of the September 11 terrorist attacks. In conclusion, it is difficult to plan for what will be happening in the domestic insurance market in 25 years time and it would seem prudent to retain the option of extending the Flood Re scheme at this point if it is deemed necessary by market conditions.

**7. 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?**

12. We believe that the critical factor will be any conditions imposed by the EU to meet State Aid requirements. We believe that the flood insurance obligation option could work, however it would take a long time to implement and there could be a lengthy period ahead of it coming into force where consumers would be unable to access flood insurance; an outcome which should be avoided. We would consider the flood insurance obligation to be a more long-term solution if a risk-reflective market does not develop during the period when Flood Re is in force.

**8. 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?**

13. Imposing thresholds which target the benefit received to those who need it most is a creditable objective, however using council tax bands is a crude measure for doing so as they relate to a historic value of the property rather than household income. The benefit of using council tax bands is that they are publicly available and therefore an administratively easy measure to use. On balance, we believe that the benefits of using council tax bands to target support outweigh their downsides.

**9. Do you have any views on the proposed initial "eligibility thresholds" within Flood Re, which would effectively cap the technical flood risk premium paid by high risk households?**

14. We agree with the proposed initial eligibility thresholds within Flood Re to cap the flood premium paid by high risk households. This is a sensible way of directing benefit to households whilst continuing to charge a reasonable premium.

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

- **a) Band H properties**
- **b) New homes built after January 2009**
- **c) Genuinely uninsurable properties? If so, how would you define these in a consistent way that insurance companies can apply?**

15. We believe that removing the top eligibility threshold – which excludes Council Tax Band H – should be removed in order to include these properties within Flood Re. Less benefit could be directed towards those in band H homes, however homeowners should not be excluded from the Flood Re scheme entirely, based solely on a historic value of their property. Mortgage lenders need assurance that all properties can obtain flood insurance, and excluding some properties from the scheme will require lenders to undertake an extra level of checking which they do not currently do, potentially incurring large costs to changes systems. We strongly believe that band H properties should not be excluded from Flood Re.

16. We believe that new homes built after January 2009 should be included within Flood Re. We understand that the objective of excluding new homes is to discourage building on flood planes or in areas at a high risk of flooding, however the exclusion should not apply retrospectively. If government wish to exclude new homes from Flood Re, the exclusion should be from the same date at which Flood Re comes into force.

17. We agree that genuinely uninsurable properties would place too high a burden on the Flood Re pool and should be excluded, however it is very difficult to put in place a blanket definition for which households this would apply. If government is minded to exclude genuinely uninsurable properties, we believe that this assessment would need to be made

on a case-by-case basis with properties entered onto a database and a mechanism for appeal by householders.

**11. Should other exemptions apply?**

18. We believe that Flood Re should apply as widely as practicably possible to residential properties and therefore no other exemptions should apply.

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

19. Government resources would be better directed towards ensuring an insurance market for buildings insurance only. Contents insurance is a substantially different market and consumers are more likely to be able to self-insure the value of their possessions than they would be the value of their home. Given the limited resources available to government, we believe that these should be applied to the systemic issue of buildings insurance.

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

20. We agree that the method proposed appears to be a sensible way of managing any large losses incurred by Flood Re, however government should also focus on avoiding these large losses in the first place by increasing spending on flood defences.

**14. 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?**

21. We believe that £10.50 is a reasonable levy for ensuring that flood insurance is available to UK households.

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

22. We believe that Flood Re will secure the availability and affordability of household flood insurance in the UK in the short to medium-term, however more consideration needs to be given to maintaining its availability once Flood Re comes to an end.

**16. Do you agree that the Flood Insurance Obligation has the potential to meet the policy objective?**

23. We believe that the Flood Insurance Obligation has the potential to meet the policy objective in the longer-term, however it is likely to take some considerable time to legislate for and bring into force. This could lead to an extended period when flood insurance is unavailable for consumers creating difficulties for mortgage lenders in knowing whether their security is insured and potentially leading to pockets of dropping house prices.

**17. 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, eg those with a market share below a *de minimis?***

24. Setting a de minimis level below which firms operating in the insurance market are exempt sets a dangerous incentive for insurers to keep their market share artificially lower than they might have otherwise done. It would be preferable not to set a de minimis level and require all insurers to be part of the flood insurance solution.

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

25. Similar to our response on Flood Re, we believe that resources would be better directed towards buildings insurance than contents insurance.

**19. 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?**

26. We believe that the Environment Agency should be granted powers to act as a 'lead administrator' and should hold details of which properties are at a high risk of flooding. We do have concerns over who should be able to access the high flood risk database and believe that this should be restricted to property professionals and not available to the general public. A list of high risk flood properties could lead to those properties becoming blighted and values dropping as a result.

**20. Do you agree with the broad duties envisaged for the regulator?**

27. We agree with the duties envisaged for the regulator.

**21. 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?**

28. We believe that a self-regulatory regime is unlikely to work in the long-term and a centrally administered scheme could become expensive, therefore we would favour a hybrid approach combined with regular audits.

**22. Which of the 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?**

29. We would favour a model which provides the regulator with a toolkit of enforcement options, which could be set out in guidance with discretion as to how these are applied. This provides both clarity for industry and discretion for the regulator.

**23. 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 the Environment Agency?**

30. The FCA has more experience in regulating financial firms and insurers and therefore would be the more appropriate choice to supervise compliance with the obligation.

**Further information and contact**

31. This response has been prepared in consultation with our members. Comments and queries should be addressed to Colette Best (colette.best@bsa.org.uk).

7 August 2013