DEFRA Consultation

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

Response from Thames Regional Flood and Coastal Committee

Background information on earlier Thames RFCC position:

Thames RFCC has a long standing aspiration that insurance should provide incentives to reduce flood damage. Members have advocated that whatever core flood insurance model is proposed, some incentives at the margin should also be offered to help encourage flood resilience and resistance. For example, residents who live in an area of flood risk might be encouraged to:

1) Have a community and property flood plan (rehearsed annually)
2) Make contributions to a local Environment Agency/Lead Local Flood Authority flood risk management scheme fund
3) Have property level protection (certified resistance and resilience measures).

Response to the current proposals:

Thames RFCC welcomes the opportunity to comment on this consultation and congratulates government and the insurance industry on the progress that has been made in developing a long term approach to achieving more risk-reflective insurance.

Now that this package has been negotiated, we ask for a more robust suite of measures to be put in place to encourage behaviour that will reduce flood damage. Without this the desired transition to a risk-reflective approach will be harder to achieve and an important opportunity to provide incentives for actions that will result in damage reduction will have been lost. The approach of the Association of British Insurers to encouraging good practice was very disappointing at the recent Defra Stakeholder Forum.

Given the official sanctioning of cross subsidy and of levy thresholds, we also suggest it would be legitimate to scrutinise the costs and quality of service provided by the insurance industry to ensure value for money is achieved. Without Government getting drawn into regulating services provided by independent, private companies, it is reasonable for consumers to expect some commitment from the industry to driving down costs and improving service under an industry code of good practice. All too often the feedback is given that when residents flood they experience two traumas; one the flood itself, the other the trauma of dealing with sub-contracted services provided by insurers that can appear to offer poor value for money, lack accountability and drag on beyond drying out requirements. These issues arise when there is isolated flooding as well as when services are stretched during major events.

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?

No comment

Policy objective
Government's objective is to ensure that domestic property insurance continues to be widely available and affordable in areas of flood risk without placing unsustainable costs on wider policyholders or the taxpayer. 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. The Government envisages this transition taking place over the next 20-25 years.

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

We welcome the proposed transition to risk-reflective prices over time and make the following comments:

- The objective *"and to encourage flood risk reduction"* should be added to the first sentence. Incentivising risk reduction should be an overarching objective of policy rather than simply linked to a gradual transition to risk reflective pricing.

- The two elements to flood risk - likelihood and consequence – should be more explicitly recognised. Industry- led incentives for actions to limit the damaging consequences of floods are required alongside the very welcome government commitment to increase investment to reduce the likelihood of flooding.

- It will be important to put plans in place *from the outset* to achieve the transition to risk reflective prices and incentives for damage reduction. Progress should be monitored. Otherwise, there is a likelihood that addressing the challenges associated with moving to a risk-reflective approach will be deferred rather than tackled.

- The words "and will review progress at 5 yearly intervals" should be added at the end of the policy objective. Short periodic reviews would enable the Government to assess progress and review the measures required to ensure the transition is completed in the planned 20 to 25 year period.

- The objective of "gradual transition" may be more likely to be achieved through periodic step changes in thresholds and prices towards a more risk reflective approach. Five year windows before prices step up further towards risk reflective market prices will give customers and risk management authorities more realistic timescales within which to work to reduce risk.

- Care needs to be taken to ensure the approach is genuinely *risk-based.* The insurance industry takes account of *claim history* which reflects *history of events* rather than risk. A community with a lower risk may flood more frequently over a particular number of years than a community with higher risk. The influence of claim history on insurance cost should be kept under scrutiny. It could mask the transition to risk reflective price signals.

- Degree of risk should be taken into account if the stated objective, *"to increase the incentives for flood risk to be managed",* is to be achieved. Perhaps after five years a two tier Flood Re could be introduced.

- Better modelling and mapping will be required. The Environment Agency will need to be adequately resourced to provide this. Also, the industry needs to be more receptive to reflecting detailed changes in risk in prices offered.

- We suggest the Flood Summit keystone principles should continue to be given more prominence to guide and assess these proposals. Important elements risk being lost.

Flood Summit keystone principles
1. A shared approach and engagement with local communities is the only way forward
2. Insurance cover for flooding should continue to be widely available
3. Insurance policies should reflect flood risk, including resilience and efforts by individuals to limit their own damage
4. Action by Government, communities, individuals and businesses to reduce flood risk is the best way of keeping insurance terms affordable
5. The take up of affordable insurance by low-income households should be encouraged
6. Information on flood risk should be more transparent and available to all
7. There should be a timely and transparent service for those going through a flood insurance claim
8. The link between planning and flood risk management is recognised

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

No comment

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

The Flood Re threshold could have an effect beyond insurance and become a marker the public relates to when considering flood risk. It could influence preferred standards of protection selected at the option appraisal stage of scheme development and also have an effect on conveyancing.

It should also be borne in mind that, at point of sale, potential purchasers may be as interested in whether a property was insured under Flood Re as in knowing the Flood Zone. Will Flood Re history be revealed during conveyancing?

If both Flood Re history and any measures taken to reduce risk and insurance costs were revealed during conveyancing, this could encourage property level protection. Currently, there is some evidence that householders are reluctant to install, or may even remove, property level protection to avoid deterring potential purchasers.

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

No comment

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

We agree with the move to a more risk-reflective approach, accept the need for an extended transition and see the advantages of Flood Re. We also agree it will be wise to put in place legislation for an Obligation as a reserve position.

However, we consider far more weight needs to be given to the acknowledged fact that Flood Re will *"somewhat weaken the incentives for individual households to take appropriate steps to manage their risk of flooding".* Counterbalancing proposals are required.

"The Flood Re eligibility thresholds are based on price alone. Other things being equal, households with a 1% or 10% annual chance of making a claim will pay the same price for insurance under Flood Re. This will somewhat weaken the incentives for individual households to take appropriate steps to manage their risk of flooding."

We offer two suggestions in relation to Flood Re:

1) A second tier to incentivise risk reduction.

2) The industry should play its part in driving up standards and encouraging behaviour that reduces flood damage.

1) Two tier Flood Re to incentivise risk reduction

Perhaps, after five years, a two tier Flood Re could be introduced. This would leave the simpler arrangement in place to start with but could provide an incentive for people to move their risk from say above 1 in 30 to above 1 in 100 within five years in cases where a standard of protection above the Flood Re threshold is not attainable at acceptable cost.

Under the current proposals, once over the critical Flood Re price threshold, the cost of insurance to the consumer does not reflect degree of risk. This could result in consumers having little incentive to reduce their risk - unless to a sufficient extent that Flood Re no longer applies.

Many cost beneficial and worthwhile risk-reduction measures may result in a residual risk that is still above the Flood Re threshold. For example, the Jubilee River provides a reduced risk but leaves a 1 in 20 residual likelihood for many that may be above the Flood Re threshold.

Partnership Funding has freed up decision making on schemes such that the most cost effective and appropriate standard of protection delivered by a scheme is agreed on a case by case basis between the Risk Management Authority and the community. Overall more communities benefit from some degree of risk reduction. The Flood Re threshold could usurp current project appraisal criteria as the trigger for deciding the best scheme option and even whether a scheme is pursued. Householders may not bother with individual property level resilience and resistance measures if these do not result in reduced insurance costs.

2) Encouraging higher standards and damage reduction

We propose that, If Flood Re is pursued, there needs to be some movement from the industry on the value for money and standard of service provided by insurers. The industry should also do more to promote good practice by policy holders to reduce flood damage. This may be hard to cost on a policy by policy basis compared with risk reduction measures but overall benefits - to the industry as well as to society - will be achieved from reducing the consequences of floods.

Consumer resistance to flood resilient repairs is unconvincing as a reason for inaction by the industry when so little has been done to promote good practice. If customers are asked if they have an alarm, why not be asked if they have a rehearsed flood plan?

Flood Re should be given a duty to promote flood damage reduction. This should include promotion of measures when insurance cover is taken out and of flood resilient repair when claims are made. All customers benefiting from Flood Re should be signed up to receive flood warnings and incentives should be given to promote annually rehearsed property flood plans and also property level protection survey and installation.

An industry code should be put in place to establish good practice in the industry such that insurers also advise their non Flood Re customers how to reduce their risk of damage and on how to achieve greater resilience from any repair funds arising from a claim.

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 agree that great care would be needed in setting the obligation and above all would be concerned at the possibility of the Environment Agency getting drawn into servicing this model. This would distract scarce resources, including management focus, from the much-needed priority of delivering and sustaining risk reduction measures.

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 agree that council tax bands provide a practical basis although we recognise these do not necessarily strongly correlate with a homeowner's ability to pay for insurance. The case for a supplementary threshold based on ability to pay, should be kept under review to ensure the most vulnerable households are adequately targeted.

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?

See comments under 10a.

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

a. Band H properties?

The majority view among members is that no properties should be excluded from Flood Re at the outset given the objective of improving the availability of flood insurance and raising awareness of risk reduction measures. It is recognised that careful structuring would be required to bring Band H within the scheme in a way that reflects ability to pay and avoids this band drawing disproportionately on funds.

b. New homes built after January 2009?

Members support excluding new homes with effect from the start of Flood Re in 2015. The launch of Flood Re should be accompanied by extensive publicity so that people buying new homes after this date:

- are fully aware of the level of risk,
- can ensure the property was built in accordance with the National Planning Policy Framework and has appropriate resilience where appropriate and
- realise securing insurance may be problematic, where applicable.

Members do not support a 2009 cut off because the logic behind this date - that those buying, building and giving permission for new homes should have been fully aware of the degree of flood risk from this date - is not widely appreciated. It takes time and events for policies such as those introduced in Planning Policy Statement 25 to change behaviour and become more generally understood.

Members are concerned a retrospective 2009 cut off will be perceived as penalising the unaware rather than encouraging wise decision making and good practice in future.

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

There is a concern that, if insurance companies were able to decide which properties are uninsurable, very high risk areas could be 'red zoned', perhaps linked to events rather than risk.

Some members consider no properties should be excluded from Flood Re initially. If this approach is taken, as with Band H properties, careful structuring would be required to bring extremely high risk properties within the scheme in a way that avoids this category drawing disproportionately on funds. Inclusion could be conditional on installing risk reduction and resilience measures.

Whether extremely high risk properties are excluded from Flood Re or included as a special sub category, a consistent risk based cut off for identifying these properties will be required. If the highest risk band mapped by the Agency is to be 1 in 5, special mapping of extremely high risk properties will be required.

A suggested possible approach could be to commission work to identify extremely high risk areas and the properties affected to provide an informed basis for establishing the limited number of genuinely uninsurable properties. For the properties on the margins of that definition, it may be appropriate to make Flood Re insurance conditional on implementing risk-reduction and resilience measures. The principle of conditionality is already common in mortgage loans, such as a requirement to do certain types of property improvement.

Q11. Should other exemptions also apply?

In view of the recent revisions to Change of Use requirements, we suggest homes *converted to residential* should also be excluded from Flood Re, with effect from the start date of Flood Re. This would help to ensure flood risk is taken into account when the new freedom to convert property from business to residential use is exercised.

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

Yes

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

No comment

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?

Yes if:
1) there is a commitment from the insurance industry to keep down costs and to improve standards in line with keystone principle 7 for the flood summit;
2) the industry does more to promote efforts by individuals to limit their own damage; and
3) there are periodic reviews of progress in achieving risk reduction and resilience.

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

There should be advantages for availability and affordability of insurance from adopting the approach favoured by the industry but these are not the only criteria.

Currently, not enough is being done to promote damage reduction through resilience measures, property level protection, community and property flood plans and incentives for householder contributions to risk management schemes.

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

As a reserve option.

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*?

Members consider the Obligation should apply to all insurance companies – a level playing field.

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

Agree

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 there need to be clear limits to this role. There should be a presumption against the Agency undertaking any role other than compilation of the register and charging for this service. The concern is that the Agency would get drawn into monitoring and providing evidence relating to enforcement. It will be important to set this up in a way that recognise there is an element of uncertainty in assessing the level of flood risk and the interplay of types of flood risk.

The register of properties at high risk should not replace Flood Maps published by the Environment Agency and Lead Local Flood Authorities for the benefit of the community.

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

Value for money and standard of service
General environmental duties

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?

No comment

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?

No comment

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?

It should not be the Environment Agency.