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Apres mon deluge: Flood Re and creating a sustainable solution to large-scale flood risk

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- Flood Re is a flood 're-insurance' scheme to help support households at highest flood risk. It takes the flood risk element of home insurance from an insurer in return for a premium based on the property's council tax band and a £250 excess charge on the insurer on the flood part of the policy.
- No other country has sought to tackle the growing cost of flood damage in this way. There are other types of intervention to address natural catastrophes but no government or insurance sector has set up a privately funded and owned reinsurer for a single peril.
- There are two sources of income for Flood Re: a levy on household insurers of £180m per year; and a premium for each policy ceded to us which is capped by council tax band.
- By charging a fixed premium to the insurer in return for bearing the flood risk, that Flood Re will help create a competitive market as insurers are now able to compete on price, product and service knowing that Flood Re will cover the volatile flood risk.
- The arrangement has a finite life of 25 years at which point we will return to risk reflective pricing. Implicit in this is that the price of flood insurance will be affordable as well as risk reflective.
- To prepare for the end of Flood Re's mandate, the insurance sector needs to develop better methods for assessing flood risk so that spending on defences and resilience can be better targeted. Insurers and builders need to develop more cost effective ways to repair flooded homes. Flood Re can play its part with the most comprehensive map of insurers' assessment of flood risk.

CII Introduction: the negotiation of Flood Re has been regarded as one of the most important outcomes of the retail general insurance market in recent years. Albeit a slightly overdue replacement of the often-renewed Statement of Principles that had been mired in controversy of late. Its terms also serve as a signal of a government increasingly cautious about potential large-scale payouts. But as innovative as Flood Re may be, it is not meant to be a permanent solution, but rather a temporary intervention until the private insurance market could organically cope with future regularity of extreme weather events. As former Financial Secretary to the Treasury and now Chairman of Flood Re, Mark Hoban is in an ideal position to comment on how Flood Re is a test case of the role insurance plays in helping society sustainably tackle climate risk.

When Flood Re launched on 4 April, it was a world first. No other country has sought to tackle the growing cost of flood damage in this way. There are other types of intervention to address natural catastrophes but no government or insurance sector has set up a privately funded and owned reinsurer for a single peril.

This is not, though, the first time that the UK industry and government have co-operated to deal with issues surrounding flood insurance. Flood Re supersedes the Statement of Principles which helped ensure availability of insurance for householders in high flood risk properties by requiring their existing insurer to quote for flood cover. Changes in the cost of flood damage and better pricing meant that whilst cover might be available, in some cases, it was becoming increasingly unaffordable. Flood Re is the product of a partnership between the industry and government to address that problem.

Why reinsurance is so important

Changes in weather patterns, increased density of building and modern farming techniques were all factors that have increased the probability, severity and cost of flooding. The increased level of losses would, all other things being equal, simply lead to increase in the overall level of premiums as risks would be shared across the population as a whole as householders in low flood risk properties subsidised those in higher risk properties.

> ***Increased incidence and cost of flooding has led to higher premiums and five-figure excesses for those at higher risk of flooding.***

But the increase in the level of losses has been coupled with a better understanding of where those losses are likely to be. The granularity of data means that an insurer can discriminate on grounds of risk and therefore price between neighbours not just communities; in effect unwinding the subsidy that helped keep down the cost of flood cover. Increased incidence and cost of flooding together with better and more tailored data has led to higher premiums and five figure excesses for those at higher risk of flooding.

How it works

Flood Re is owned and funded by the insurance industry. Although we were set up under statute and are accountable to Parliament, no taxpayers' money is involved and – unlike Pool Re – there is no Government backstop or reinsurance. Instead Flood Re has placed one of the world's largest catastrophe reinsurance programmes with cover of up to £2.1bn.

There are two sources of income for Flood Re:

- a levy on household insurers of £180m per year; and
- a premium for each policy ceded to us which is capped by council tax band.

For a Band D property we will charge the insurer a building and contents premium of £276 and for a Band H property £1,200. It is the levy that re-creates the cross subsidy between lower and higher risk properties. Flood Re will also charge insurers an excess of £250.

Exclusions

There are some exclusions though. Let me give a few examples. Flood Re is for residential property not businesses. In part as a disincentive to building inadequately protected homes in high flood risk areas, we do not cover properties built after 1 January 2009. We will not provide buildings cover where there are more than three homes in a leasehold block, because there was no evidence of market failure when government and the industry set up Flood Re; although tenants can still shop around for contents cover backed by Flood Re.

By charging a fixed premium to the insurer in return for bearing the flood risk, that Flood Re will help create a competitive market as insurers are now able to compete on price, product and service knowing that Flood Re will cover the volatile flood risk.

The relationship between insurer and customer remains unchanged. It is insurers who will set the premium and the excess and it is to their insurer that the householder will turn to make a claim. By charging a fixed premium to the insurer in return for bearing the flood risk, that Flood Re will help create a competitive market as insurers are now able to compete on price, product and service knowing that Flood Re will cover the volatile flood risk.

Why Flood Re benefits homeowners

This is a marked change from the current Statement of Principles that caused the market to seize up where sometimes householders have had simply no choice but to accept the premium and excess charged by the current insurer because no one else will cover them. Now consumers can shop around for a better deal. Flood Re will facilitate increased choice and competition which is good for both consumers and insurers and over time we will see prices and excesses fall as these changes work their way through the market.

This all sounds rather technical, but as Brendan McCafferty, the CEO of Flood Re, and myself have found from visiting flood affected areas and talking to people who have been out of their homes for months, there is a very human side to Flood Re's work.

Not only do those who live in low flood risk homes have to cope with the devastation of being flooded, but they have have then faced the prospect of high excesses and premium when it comes to renewal time.

Those of us who live in low flood risk homes take for granted the peace of mind that comes from being able to insure our property at a reasonable price. It is a salutary experience to listen to those who have flooded. Not only have they had to cope with the devastation of being flooded, but they have have then faced the prospect of high excesses and premium when it comes to renewal time. I have met people who have chosen not to claim for flood damage simply because they would rather pay for flood damage themselves than risk having to pay much higher premiums and be charged a higher excess. Flood Re will not just facilitate lower premiums and excesses, but it will given them the reassurance that when they are flooded, they will be able to make a claim and still benefit from the impact of Flood Re.

The benefit to consumers is clear: we will enable insurers to charge lower premiums and excesses and give them the comfort that if they have to make a claim that they will still be able to buy cover at a reasonable price.

Flood Re's 25-year lifespan

Flood Re has a finite life of 25 years at which point we will return to risk reflective pricing. Implicit in this is that the price of flood insurance will be affordable as well as risk reflective. Flood Re is under an obligation to publish a transition plan that sets out the path towards risk reflective pricing. In our first plan, published in February, we highlighted some of the actions that householders, the Government, local authorities and the industry could take to reduce the cost of flooding to deliver risk reflective pricing. This could cover areas such as flood risk management, making properties more resilient and reducing the cost of repairs.

The road to reflective pricing

Whilst Flood Re can provide a route map to risk reflective pricing, we have few tools at our disposal to deliver that goal. Decisions about flood defence spending are a matter for the Government and the Environment Agency. The insurance sector needs to develop better methods for assessing flood risk so that spending on defences and resilience can be better targeted. We need insurers and builders to develop more cost effective ways to repair flooded homes. Flood Re can play its part with the most comprehensive map of insurers' assessment of flood risk based on properties they reinsure from us. We can also flex both the levy and the premium we charge to shape the market subject to consultation and agreement by the Government. So it is only by working together that we can return to a properly functioning market with affordable risk reflective pricing.

Bringing down the cost of flooding

Bringing down the cost of flooding and ensuring that premiums remain affordable beyond 2039 will require a collective effort:

- making individual properties more resilient to reduce the cost of flood damage;
- strengthening flood defences to reduce the incidence of flooding, and when it does happen, reduce its severity; and
- only granting planning permission to developments that don't add to flood risk or, even better, reduce flood risk through design and imaginative use of s106 agreements.

The challenge of delivering this is already significant. It could become even greater if one of the conclusions of this winter's weather is that we have seen a permanent change in weather patterns rather than simply a one-off event. Whatever the magnitude of the problem, bringing down the cost of flooding and ensuring that premiums remain affordable beyond 2039 will require a collective effort. By making individual properties more resilient you can reduce the cost of flood damage. By strengthening flood defences, you can reduce the incidence of flooding and when it does happen reduce its severity. By only granting planning permission to developments that don't add to flood risk or, even better, reduce flood risk through design and imaginative use of s106 agreements, you reduce the risk of flooding. Homeowners, insurers, central and local government and the Environment Agency and its counterparts in the devolved administrations can all make a contribution.

The statutory obligation to set out how we will return to risk reflective pricing in 2039 is an important dimension to Flood Re's work. It requires us to play an active part to the debate on reducing the cost of flooding and over time we will set out in greater detail our strategy for engaging in this vital debate.

Flood Re as a partnership

Everyone in the insurance industry should be proud of Flood Re. It is an innovative solution to the challenge of increasingly unaffordable flood cover for high flood risk properties. Over time, we expect about 350,000 homes to benefit from the lower premiums and excesses that Flood Re will enable insurers to offer. This unprecedented intervention in the insurance market has opened it up to competition leading to better outcomes for insurers and their customers. But we should also recognise that this is not a permanent solution, in 2039 we need to return to a risk reflective market where flood cover is affordable without a subsidy. To achieve that goal, just as Flood Re is a partnership between government and industry, then we will all need to work together to reduce the cost of flooding so the subsidy is no longer necessary to keep premiums and excesses low.

Mark Hoban was appointed as the first Chairman of the Board of Directors for Flood Re in February 2015. He was previously the Member of Parliament for Fareham, and served as Minister for Employment from 2012–2013 and previously Financial Secretary to the Treasury from 2010–2012. While in Opposition, he was Shadow Financial Secretary to the Treasury (2005-2010) and Shadow Minister for Schools (2003-2005). Mark is a Chartered Accountant and worked for PricewaterhouseCoopers and its predecessor firms between 1985 and 2001. He studied Economics at the London School of Economics.

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