

FLOOD RE PROPOSAL: MEMORANDUM OF UNDERSTANDING

The purpose of this note is to set out a joint understanding of how Flood Re might operate in order to help progress the development of the Government's policy in this area. This should not be construed as a legally binding agreement or as a step taken towards such an agreement and does not entitle the ABI, the Government, or any other legal entity or individual to take any enforcement action with respect to this MOU. The model for policy development is as follows.

1. The industry will establish Flood Re as a not-for-profit entity, owned and managed by the industry itself, with the aim of providing affordable flood insurance to households at high flood risk. As it is expected that the Office of National Statistics will classify some of Flood Re's funding as tax, there are implications for Flood Re's operational arrangements and governance to provide accountability for public resources which would in turn be likely to affect whether Flood Re is classified as a public or private sector entity for the purposes of compiling the national accounts. Flood Re will be a transitional measure, with its benefits for high flood risk households phased out within 20-25 years.
2. Insurers will be able to put into Flood Re domestic flood risk policies that they assess as having a technical flood risk premium greater than the appropriate 'eligibility threshold'. It will be entirely a matter for Flood Re itself to decide how Flood Re reinsures these policies. The Flood Re organisation will need to work with Government to agree arrangements to limit the impact of Flood Re on the public finances. Flood Re will also need to be established in such a way that it meets standards for accountability which are acceptable to Parliament.
3. The 'eligibility thresholds' will initially be indexed to CPI. The industry will ensure that the flood risk element of prices paid by consumers for a combined policy ceded to Flood Re will not exceed, in 2013 money: Council Tax Band A £210pa, Band B £210 pa, Band C £246 pa, Band D £276 pa, Band E £330 pa, Band F £408 pa and Band G £540 pa. Band H properties¹, properties built after January 2009 and genuinely uninsurable properties will be excluded from Flood Re. The industry will also ensure that there will be a standard flood excess in the range of £250 to £500 for policies ceded to Flood Re.
4. Flood Re will charge each of its member firms an annual charge totalling £180 million, which will notionally equate to £10.50 in respect of each household provided with combined home insurance by that member firm. According to the ABI's best estimates, the proposed levy is in accordance with the existing cross-subsidy for the 500,000 households expected to be ceded to Flood Re. Therefore this measure will formalise the existing cross-subsidy between low and high flood risk policyholders within the market, and can be introduced without impacting bills in general.
5. The levy will remain fixed for 5 years. It will thereafter be re-negotiated between the government of the day and the industry.
6. If and to the extent that the combination of
 - a. the capped flood risk insurance premiums paid by customers whose flood insurance policies are placed within Flood Re and
 - b. the proceeds of the levy

turn out in any given year to be insufficient to fund Flood Re, then Flood Re will charge each of its member-firms an additional amount from their own resources to fund the shortfall, according to principles that will be agreed between them, using a mechanism

¹ The industry's proposal would also exclude Band I properties in Wales from Flood Re

that will be consistent across the home insurance market, does not add to public borrowing or debt, and will ensure that the overall effect on insurers is neutral over time.

The Government understands the requirement for insurers, on behalf of their shareholders, to minimise the potential volatility this could cause to the accounting treatment of member firms, and has committed to working with the industry in their efforts to find a solution to this.

7. The Government, will:

- a. Introduce legislation in the Water Bill to ensure the industry levies in paragraphs 4 and 6 are paid by all participants in the home insurance market, and to compel any insurer offering home insurance to participate in Flood Re (thereby curing the 'free-rider' problem), provided that Flood Re is established on the basis described in points (1) to (6) above;
- b. provide two letters of comfort to the industry, (a) stating the Government's commitment to long term expenditures on flood risk management, committing to a specified level of flood defence expenditure for 2015/16 following the Government's spending round in June 2013; and to the policy set out in the National Planning Policy Framework, supported by the accompanying Technical Guidance, that inappropriate development in areas at risk of flooding should be avoided; and (b) recognising that Flood Re's aggregate annual liability collectively to insurers would be capped at a monetary level equivalent to a 1:200 year loss scenario (i.e. the cost of claims in the worst 0.5% of years, as established by independent actuarial modelling at the start of each year; current modelling suggests claims of around £2.5bn). The market participants in Flood Re will not be liable for any liability to Flood Re above the 1:200 annual loss. Should claims on Flood Re exceed a 1:200 level, the Government of the day would take primary responsibility, working with Flood Re and representatives of the insurance industry, for deciding how any available resources should be distributed to Flood Re customers. This will form part of a wider Government action to respond to such a national emergency in order to minimise loss of life and support the provision of essential services, as judged appropriate by the Government of the day. In the event that flooding in any year is on a sufficiently serious scale for Flood Re to consider a breach of the 1:200 level to be very likely, Flood Re would notify the Government of the day, triggering discussions between industry and the Government. Following the signing of this MoU, and before the establishment of Flood Re, the Government and the industry will agree and establish an appropriate process to ensure that the Government/industry discussions, once triggered, are conducted in an orderly and effective manner. The Government and ABI member firms will also work with regulators to design the implementation of Flood Re in a way that does not require insurers to hold any additional capital to cover any liabilities for customers with policies ceded to Flood Re, beyond that currently being held in the market;
- c. provide an address level council tax band database for England in an appropriate format to any insurer writing home insurance in the UK, and provide updates when appropriate, free of charge. Without this, Flood Re cannot operate in its current form. Similar arrangements will need to be agreed with the Devolved Administrations for Flood Re to be implemented across the UK;
- d. provide to insurers a surface water flood map for England by December 2013 and a combined map showing all sources of flooding for England by December 2015, and make available to insurers data showing, at address level, developments

going ahead against Environment Agency advice. It is hoped that similar arrangements can be agreed with the Devolved Administrations. In return, the ABI will maintain and provide Government, free of charge, with a national database of individual property-level flood claims (whether policies have been ceded to Flood Re or not) by January 2014. In accordance with standards of public accounting, Government will also agree an open data access protocol with Flood Re;

- e. work jointly with the insurance industry to seek the necessary State Aid approval from the European Commission;
- f. work with Devolved Administrations and the ABI towards delivering a UK wide flood insurance solution; and
- g. work with the ABI and the insurance regulators to ensure that Flood Re meets the requirements of prudential regulation of the insurance market.

If Flood Re is agreed and an implementation plan set out, ABI members and Government agree their commitments from the 2008 Statement of Principles will be voluntarily rolled over until Flood Re is delivered and ready to operate (which we expect to be around June 2015), subject to satisfactory reviews of progress at designated 'project milestones' throughout the implementation of the model.