

Department for Environment, Food and Rural Affairs

# Securing the future of flood insurance

## An introductory guide

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# Securing the future of flood insurance

Insurance against flooding is critically important to protect households from the devastating impacts of heavy rainfall. Flooding can cause tens of thousands of pounds of damage and mean having to live elsewhere for months while properties are dried out and can be refurbished. Suffering a flood is distressing enough even with insurance in place. Without it households can also find themselves in severe and lasting financial hardship.

Flood insurance has been widely available up to now as a result of voluntary agreements in England, Wales, Scotland and Northern Ireland with members of the Association of British Insurers (ABI). These agreements, called the 'Statement of Principles' on flood insurance, are about to expire. Without them, there is concern that many hard-pressed households in flood risk areas will no longer be able to access the level of insurance cover they need. We have worked hard with the ABI to agree a way forward and we will be seeking new legal powers to be able to take action. These powers will be sought in the Water Bill, introduced to Parliament today. The Government proposes to provide help with affordable flood insurance over the next twenty to twenty-five years. This will allow time for choices to be made and flood risk to be managed.

In the long term, preventing flooding from taking place will be the best way of keeping insurance affordable. Households can take action now to avoid future bills increasing. Managing the risk of flooding is a significant, long-term challenge that calls for bold action. Despite the over-riding need to pay down the deficit, tackling flood risk whilst avoiding inappropriate new development in the flood plain remains at the top of the Government's priorities. In England, £2.3 billion is being spent over the four years to 2015 to protect households and businesses against flooding. It has now been announced that more and more will be invested in new and improved flood defences over the following six years to 2021. The investment means that 165,000 households in England will be better protected by 2015, and a further 300,000 will be better protected by 2021. This will bring the overall level of risk down and help to secure affordable insurance for people in the long-term.

## 'Flood Re'

A new approach to flood insurance in the short to medium term – called Flood Re – has been put forward by the insurance industry. This would effectively cap the most that high-risk households should have to pay for the flood component of their home insurance. The maximum amounts would differ by council tax band so that those in smaller properties don't have to pay as much for flood insurance as those in larger houses. The approach means that people could know the maximum they might be asked to pay and would no longer need to be worried about not finding affordable insurance. The level of excess in the event of a flood claim would also be controlled. The maximum prices charged under Flood Re would increase each year so that households can adjust gradually.

Flood Re would be an industry-run, not-for-profit scheme that would support up to ~500,000 of the highest-risk households in the UK. It would only become involved if customers were unable to find an insurance company willing to offer flood insurance at a price below the agreed maximum for their home. If a high-risk policyholder needed to claim for flooding, their insurer would pay the claim directly and Flood Re would then reimburse them. Policyholders would always manage their claims via the insurer and would never need to contact Flood Re.

### Projected end prices to high-risk policyholders for a combined buildings/contents policy

Council Tax Band	A	B	C	D	E	F	G	H
<b>Maximum price for flood component of policy via Flood Re</b>	<b>£210</b>	<b>£210</b>	<b>£246</b>	<b>£276</b>	<b>£330</b>	<b>£408</b>	<b>£540</b>	<b>No cap/not eligible</b>
Typical price for other insurance components (fire, theft, etc.)	£180	£180	£186	£204	£222	£252	£390	
Insurer overheads, and profit	£260	£260	£288	£320	£368	£440	£620	
<b>Typical overall price charged to policyholder</b>	<b>£650</b>	<b>£650</b>	<b>£720</b>	<b>£800</b>	<b>£920</b>	<b>£1,100</b>	<b>£1,550</b>	
Compared to what might be charged without Flood Re	£1,140	£1,165	£1,185	£1,290	£1,430	£1,560	£1,850	

To fund Flood Re, a new industry-backed levy would be introduced. All UK household insurers would have to pay the levy. This levy is likely to be set at £180 million per year for the first five years. This is the equivalent of around £10.50 for each UK household with both contents and buildings cover in place. Although the cost of the levy would be passed on to customers, spreading risk across policyholders is a widely used model for insurance, and lower risk households are already subsidising those at higher risk of flooding to approximately this level. The insurance industry believes it should be possible to introduce this measure without pushing up the price of insurance in general.

## The Flood Insurance Obligation

There is still a lot of detail to work through on Flood Re and so we also intend to seek powers in the Water Bill to enable the Government to stand ready to regulate if Flood Re can't be made to work for consumers and insurers can't otherwise keep prices down. These powers would require insurers to take on their share of high flood risk households

or face penalties. This would create a strong incentive for insurers to keep prices affordable for high-risk customers.

We would work with the Environment Agency and its counterparts in the Devolved Administrations to create a UK-wide register of properties thought to be at a high risk of flooding. The criteria used to develop the register would be agreed in due course, but we currently expect at least 500,000 homes to be listed, if they wish. Each insurer would be allocated a quota of high-risk properties to cover from this register (its 'obligation'), based on its market share. To make sure that insurers abide by the obligation, we intend to make the Financial Conduct Authority responsible for supervising the scheme and taking action against insurers who don't meet their quotas.

The Flood Insurance Obligation would force insurers to compete with each other for the business of high-risk households in order to meet their targets. This should help customers to shop around to get a good deal.

## What happens next?

The UK Government has published details on the proposed approach for public consultation. Views are invited from anyone that has an interest in this issue from across the United Kingdom. The public consultation runs until Thursday 8<sup>th</sup> August 2013 and more details can be found at: <https://consult.defra.gov.uk/flooding/floodinsurance>.

Following the consultation period, the Government will present final proposals to Parliament later this year.

## Q & A

### **What does this announcement mean for households at high risk of flooding?**

- Flood Re would effectively limit the amount that high-risk households would pay for flood insurance. The price of the flood insurance component of a high-risk combined buildings and contents policy would be about £720 for a Band C household. Whilst this might be higher than high-risk households are paying at the moment, without Flood Re, prices could rise to well over £1,000.
- These prices would only apply to the 2% of households at greatest risk, and are reasonable given flood claims on combined policies from households at high risk average £55,000.
- The prices to be paid by Flood Re customers are estimated to be 20-35% higher than those currently paid on average by high risk households. Some high-risk households could see the costs of insurance fall because of Flood Re.
- Policyholders would continue to manage their claims via their insurer and would never need to contact Flood Re.
- If regulation ultimately became necessary, insurance companies would have a legal responsibility to insure their share of high-risk customers. Creating competition to attract high-risk properties would help to keep prices down.

### **What does this announcement mean for other policyholders?**

- Most customers at low or no flood risk already pay a bit extra as part of their premium to support higher risk households.
- Spreading risk across policyholders is a widely used model for insurance. Flood insurance currently works on this principle, as does car insurance.
- The Association of British Insurers has assured us that it does not expect to see bills rising for ordinary households under Flood Re. This is because the proposed industry levy has been set at a level which the ABI says reflects the existing level of cross-subsidy for high-risk customers.
- There could be slight price rises for customers of insurance companies who have not been signed up to the current Statement of Principles.
- Under the Flood Insurance Obligation there would also be a degree of cross-subsidy – as at present. This would be needed to allow companies to offer discounts and compete effectively for the business of higher-risk households.

### **I'm about to renew my home insurance. What will happen before Flood Re starts?**

- We would bring Flood Re into operation as soon as possible after the new legislation is agreed by Parliament. We expect that it might take until 2015 to introduce Flood Re because of the need to get final agreement from insurers, Parliament's agreement, and approval of the public funds involved (as a 'State Aid') from the European Commission.
- Until then, insurers have agreed to continue to abide by the current Statement of Principles.

- We've published a guide to help people at high flood risk to shop around and get the best deal ([www.gov.uk/government/publications/obtaining-flood-insurance-in-high-risk-areas](http://www.gov.uk/government/publications/obtaining-flood-insurance-in-high-risk-areas)).
- If people feel that their insurance company's assessment of the flood risk to their property is inaccurate, the Environment Agency can provide households in England with a detailed flood map or a letter setting out the flood risk for the area of their property which they can send to the insurer. More information is available from the Environment Agency website ([www.environment-agency.gov.uk/homeandleisure/floods/31644.aspx](http://www.environment-agency.gov.uk/homeandleisure/floods/31644.aspx)).
- In England, households can apply via their local council for grants for property-level protection that can help secure better insurance terms. Up to £4,750 is available to protect households in deprived areas.
- The National Flood Forum has also produced a guide giving advice to people about how they can flood-proof their homes (<http://nationalfloodforum.org.uk/wp-content/uploads/Ready-for-flooding.pdf>).

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This document/publication is also available on our website at:

<https://www.gov.uk/government/policies/reducing-the-threats-of-flooding-and-coastal-change>

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