FLOOD RE

A lifeline for flood victims drowning in premium?

Flood cover has been a part of the UK insurance industry since the 1920s. Coincidentally, this was around the time when insurers in the USA began to refuse to cover flooding because it was not profitable. That led to the USA's National Flood Insurance Act and the creation of the National Flood Insurance Programme in the 1960s. The UK's approach also changed at around this time.

The North Sea floods of 1953 had revealed the limitations in flood cover provided by insurers. A "gentlemen's agreement" in 1961 made Her Majesty's Government ("HMG") responsible for the flood defence infrastructure as a result of which the insurance industry agreed to offer flood insurance at affordable rates, not based on risk level.

In 2000, Britain saw one of the wettest autumns on record. 10,000 homes and businesses were flooded in 700 locations. £1 billion worth of damage was caused. The "gentlemen's agreement" was reconsidered. HMG and the Association of British Insurers (ABI) established instead the Statement of Principles. Again, the insurance industry agreed to provide homeowners and small businesses with flood insurance for properties which had previously suffered, or were considered to be at high risk of, flooding.

The Statement of Principles was always intended to be a temporary measure while attempts were made to agree something more permanent. It came to an end in June 2013. So from then, previously protected properties were subject to insurance premiums in line with actual flood risk. This left around 350,000 households unable to afford flood insurance.

This led to the establishment of "Flood Re"; a reinsurance company formed to reimburse insurers for claims paid to insureds who live in high-risk flooding areas.

The public was first consulted on the issue of Flood Re in summer 2013. An Impact Assessment was produced. The Department for Environment, Food and Rural ("Defra") received 149 formal responses to the consultation. There was widespread support for the scheme.

The Water Act 2014 was given Royal Assent on 14 May 2014. That summer, HMG carried out a further consultation about regulations implementing Flood Re. Responses showed a primary concern was the impact on small and medium-sized enterprises, certain leasehold properties and the private rented sector, which would not be eligible for protection under Flood Re. HMG responded that it would monitor the market for those sectors and the industry generally to ensure that Flood Re achieved its aims overall.

Flood Re is now governed by (a) the Flood Reinsurance Scheme Funding and Administration Regulations 2015, (b) the Flood Reinsurance Scheme Administrator Designation Regulations 2015 and (c) the Flood Reinsurance Scheme Designation Regulations 2015. The scheme will expire in 2039.

Other apprehensions relating to the information available to customers to enable them to understand their level of flood risk and enable better flood risk management led to a requirement for Flood Re to make information about the scheme available to insureds through their insurers.

The Impact Assessment produced by Defra in June 2014 noted that premiums "have been generally affordable because a lack of information on flood risk has meant that there is an informal cross subsidy between customers at low risk of flooding and those at high risk. With recent advances in flood mapping, insurers are increasingly able to set premiums that are more reflective of risk. Whilst ultimately, more risk-effective premiums are economically efficient, if the transition is too rapid those living at higher flood risk may face increases in premiums which are not compensated by reduction in other costs (e.g. mortgages). There is therefore rationale to improve equity and reduce transitional costs as part of a transition to risk reflective premiums." It followed by saying that the objective would be to ensure availability and affordability of flood insurance by providing assistance to the disadvantaged.

The Water Act 2014 also provides powers to introduce the Flood Insurance Obligation - a protective measure which, should Flood Re fail to meet its objectives, would ensure that owners of high-risk homes will still be able to obtain affordable insurance. If this were to happen and the Obligation were to be introduced, high-risk properties would be

placed on a register and insurers would be allocated a quota of high-risk properties from this register to cover. The intention is that insurers would compete with each other for business in order to meet targets, ensuring good deals for homeowners of high-risk properties.

Costs of the cover provided by Flood Re will be met in two ways:

1. Insurers who are part of the pool will collect capped premiums from high-risk households. They will cede the flood risk element to Flood Re. Premiums in this regard will be based on Council Tax bands, subject to maximum limits on a per policy per annum basis.

2. In order to meet the shortfall produced by lower than market premiums and excesses, low-risk customers will pay slightly higher premiums to raise an annual levy.

Claims will as usual be made by insureds on their insurer, who will pay the claim direct before being reimbursed by Flood Re. Whilst Flood Re's income is calculated to meet all claims on the flood business ceded to it, its exposure is limited to £2.1bn per financial year.

The European Commission approved Flood Re in January 2015 declaring it "a great illustration of how the Commission and Member States can work together to design effective aid measures that contribute to important public policy goals".

The scheme has been subject to some criticism. The Committee on Climate Change argued that it departs from governmental spending rules and offers no permanent solution to flood risk. It has been suggested that the money should be spent on securing better flood defences for high risk properties.

Furthermore, many properties are not covered by the scheme. A property will only be eligible if:

1. It is covered by an insurance contract which is held in the name of, or on trust for, one or more individuals or by the personal representative of an individual;
2. The holder of the policy (or his/her immediate family) lives in the property for some or all of the time or the property is unoccupied;
3. It is used for private, residential purposes;
4. It is a single residential unit or a building comprising two or three residential units;
5. It is insured on an individual basis or has an individual premium;
6. It was built before 1 January 2009; and
7. It is located within the UK (excluding the Isle of Man and the Channel Islands).

Notably, all commercial properties are excluded from the scheme. The rationale is that (a) there is already a competitive market of insurance for business and (b) consumers should not subsidise the insurance of corporate entities. However, this leaves small businesses without the protection they had under the Statement of Principles. Further, the definition of "business" is potentially wide and means that many could miss out, arguably unfairly, such as homes which are also used as business premises and charities. Even homes with a shop or business below them could miss out.

Blocks of more than three residential flats also fall outside the scheme's scope, as do farm outbuildings, public buildings used for residential purposes and buildings which are rented out.

The eligibility criteria under Flood Re are much more stringent than before. HMG has tried to pre-empt some of the difficult issues: further guidelines have been published. For example, if a homeowner lives in a property for part of the year but rents it out at other times, the property will still be eligible for the scheme as long as it is being used for private residential purposes.

Flood Re launched on 4 April 2016. At that time, 16 insurance providers had signed up to the scheme. Within ten weeks insurer support had increased by 125%. After six months, that figure rose to 156%, with 41 insurers signed up and 53,000 home insurance policies being backed by Flood Re.

In November 2016, Flood Re released a case study to demonstrate the effect of the scheme. The customers said that, following floods in July 2007, the cost of flood insurance in the area had risen tenfold. Following Flood Re, rates have dropped from thousands of pounds to a few hundred, making a difference to the interest in property purchase in the area and the community in general. However, The Times recently reported that many owners of high-risk properties have found that errors in the listing of addresses have denied them the insurance backed by Flood Re.

Those at Flood Re continue to be optimistic, with Chairman Mark Hoban saying "*we look forward to continuing our conversations* with *Defra and working with the department and insurers to inform householders about the financial benefit they gain from the operation of Flood Re*."

Flood Re is a short to medium term (23 year) remedy. Improvements in flood defences and the flood-proofing of properties, and adjustments in property values, during that period are meant to bring the market into balance by the time the scheme ends. It is evident, however, that building in the flood plain and climate change both continue, bringing worsening of the problem. Without the spur of higher premiums, it is questionable whether home-owners will actually have the incentive fully to flood-proof their properties or values will in fact adjust. Whether HMG will actually have the will and/or the money to improve the flood defences to the necessary extent must be doubtful. The suspicion must be that in 2039 another short to medium term fix will be required. Rien de dure comme le provisoire.

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