



## Flood Insurance in the UK

### Our Proposal for the Way Forward

**Morpeth Group - June 2010**



## **Scope of the Proposal**

Our case has been written to highlight the problems associated with the current system of insuring against flood risk in the UK, in particular the way in which communities are becoming blighted following a flood event. The current system no longer represents a viable solution for the years to come and the authors have sought to identify a workable alternative.

We have drawn on our experiences in dealing with the aftermath of a flood which inundated our town on 6 September 2008. Those experiences are typical of so many other communities throughout the country.

## **The authors**

We are a group comprising representatives of Morpeth Town Council, the Morpeth & District Chamber of Trade and the Morpeth Flood Action Group.

Morpeth is the county town of Northumberland and is located on the banks of the River Wansbeck 16 miles north of Newcastle upon Tyne.

## **The flood event in Morpeth**

The rain which fell on Morpeth and the catchment area of the River Wansbeck between 4 and 6 September 2008 was unprecedented. An Environment Agency press release stated:

*"The flooding experienced by Morpeth ..... was the most severe ever recorded for this location, with more than three times the long-term average rainfall for the whole month - more than 150 millimetres - falling on the town in less than 48 hours. The normal monthly average rainfall is 50 millimetres."*

One thousand properties were affected with hundreds of homes and businesses flooded at depths sometimes exceeding 5 feet. Public buildings suffered major damage including the library, the leisure centre, St George's Church, the Chantry, a large local health centre and the local ambulance station.

## **1 Flood risk in the UK and the current system of flood insurance**

- 1.1 The risk of flooding in the UK is growing and there have been major flood events across the country during the last ten years. The reason for the growing risk, whether it be climate change and global warming or some other cause, is beyond our remit. We simply say that rainfall is falling with increasing intensity.
- 1.2 The Environment Agency published its latest assessment of flood risk in 2009<sup>1</sup> from which the following extract is taken

*“2.4 million properties at risk of flooding from rivers and the sea in England. Our preliminary assessment of surface water flood risk also suggests that one million of these are also susceptible to surface water flooding with a further 2.8 million properties susceptible to surface water flooding alone. In all, around 5.2 million properties in England, or one in six properties, are at risk of flooding. The expected annual damages to residential and non-residential properties in England at risk of flooding from rivers and the sea is estimated at more than £1 billion”*

- 1.3 In the face of the growing flood risk, the UK relies almost entirely on the resources of private insurance companies to fund the repair and rebuilding of damaged communities. The cost of flood damage in 2007 alone was £3 billion.
- 1.4 In July 2008 the UK Government reached an agreement with the Association of British Insurers (acting for the majority of the insurance industry) for the extension until 30 June 2013 of the existing Statement of Principles on the Provision of Flood Insurance. The renewed Statement appears as Appendix 1.

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<sup>1</sup> [http://www.abi.org.uk/Publications/Revised\\_Statement\\_of\\_Principles\\_on\\_the\\_Provision\\_of\\_Flood\\_Insurance1.aspx](http://www.abi.org.uk/Publications/Revised_Statement_of_Principles_on_the_Provision_of_Flood_Insurance1.aspx)

There are four principal commitments in the Statement of Principles

- existing insurance policies for properties at flood risk will remain in force until 30 June 2013
- existing insurance policies for properties at significant risk of flooding (1 in 75 years or worse) will remain in force only if the Environment Agency has firm plans to reduce that risk within the next five years. Without firm EA plans, the policies can be withdrawn by the insurer immediately
- premiums and excesses “will reflect the level of risk presented”
- the Statement **will not necessarily** remain in force until 2013, as it is subject to annual review

## **2 Why the current system of flood insurance does not work**

- 2.1 How communities become blighted because of the lack of suitable flood insurance cover – flood insurance blight - the Morpeth experience
  - 2.1.1 In the period after the Morpeth Flood, some insurance companies revised and are continuing to revise policy terms for many residents and business owners in the flood plain area. Annual premiums have increased and substantial policy excesses in the region of £5,000 to £10,000 are becoming more commonplace. The authors recognise the signs of insurance blight gradually affecting Morpeth.
  - 2.1.2 Reluctant to abide by the commitments contained in the Statement of Principles, some insurers have withdrawn cover from householders. Other insurers which adhere to the Statement have increased premiums and excesses. They have done this to reflect the level of risk that flooding represents to them.
  - 2.1.3 A trawl of the price comparison websites reveals that no new insurance company offers flood insurance cover for Morpeth town centre and only specialist insurers will consider new business, usually at rates that are unaffordable. It is now apparent to residents, business owners and those considering investment in the town that central Morpeth is becoming an area where new flood insurance is no longer available at affordable rates - if it is available at all.
  - 2.1.4 There is a dilemma here, caused by the natural and conflicting interests of private insurance companies on the one hand and the needs of residents and property owners on the other. This conflict will jeopardize the future prosperity of the town, if it is not resolved.

2.1.5 The effects of insurance blight would be multiplied, if Morpeth experienced another similar or worse flooding event. The town is unlikely to recover fully a second time. With so many homes and businesses within the town now subject to high insurance excesses, the owners would be unable to fund the cost of repairs a second time round, leaving the community blighted by derelict properties in the flood affected areas, which include the town centre and other core areas of the town. Existing businesses would move away, unable to survive a further interruption of trade or absorb future risks of flooding following the withdrawal of insurance cover. New businesses would be deterred from entering the town centre and the related core areas for the same reasons.

2.1.6 There is evidence that insurance blight continues in Carlisle<sup>2</sup> even though the Environment Agency has completed the construction of 1 in 200 year flood alleviation scheme. Major insurance companies are still refusing to offer new cover in previously flooded areas.

## 2.2 Distortion of the housing market

2.2.1 The insurance blight referred to in paragraph 2.1 has an immediate impact on the housing market in a flood risk community. The housing market becomes distorted, dividing the housing stock between the hundreds of unsaleable homes located on the flood plain and the properties on higher ground which will rise in value as a consequence of a decline in the total number of houses on the market.

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<sup>2</sup> [http://www.cumberland-news.co.uk/news/flood\\_hit\\_carlisle\\_homes\\_still\\_CANNOT\\_get\\_insurance\\_cover\\_despite\\_new\\_defences\\_1\\_661186](http://www.cumberland-news.co.uk/news/flood_hit_carlisle_homes_still_CANNOT_get_insurance_cover_despite_new_defences_1_661186)

2.2.2 There are 5.2 million properties at risk of flooding in the UK. The distortion of the property market nationally on the scale outlined above would result in many towns and villages becoming two tier communities, and the resulting threats to social cohesion could be considerable.

2.3 Competition issues

2.3.1 The current system for providing flood insurance in the UK prevents competition on several levels. The benefits and efficiencies that competition brings do not exist in important sectors of the market.

2.3.2 The longer established insurance companies (Aviva, Royal Sun Alliance, Prudential, for example) have historically offered flood insurance in high risk areas and they retain those liabilities within their overall portfolio. New insurance companies are entering the UK market and are declining cover in flood risk areas. Not constrained by flood liabilities, these new entrants to the UK insurance market can undercut long established players and as a result competition based on price and quality of service becomes distorted. There is no longer a level playing field.

2.3.3 An extremely large number of property owners and other residents, whose properties have been flooded or are at flood risk – a number potentially running into hundreds of thousands in the UK – also feel the effects of a market distorted by lack of competition, because there is no competition for their business. In this situation they have no choice other than to stay with their existing insurers, because other insurers, having regard to their own legitimate needs in a competitive market, are not inclined to assume additional flood liabilities. Unable to seek flood insurance elsewhere, property owners and residents in that situation have no alternative but to accept the premiums and excesses that their flood

insurers demand, and are prevented from shopping around in a competitive market.

2.3.4 The supply of flood insurance policies in high risk areas is haphazard, uneven and lacking consistency. It does not exhibit any features of a truly competitive market in that wide variations or anomalies exist on a house by house, street by street basis. One householder may have a £50 excess with one company when his next door neighbour has a £10,000 excess from another company, that pattern being repeated the length of the street.

#### 2.4 The future of the Statement of Principles

The renewal of the Statement of Principles in 2008 afforded a limited degree of protection for policyholders, but there is now a widely held belief in the industry that the Statement will lapse in 2013. Senior ABI personnel have, in the presence of the authors, voiced the opinion that the Statement will come to its natural end in 2013, at which point insurers will adopt a risk based approach to underwriting flood insurance. Such a change of approach will coincide with the publishing by the Environment Agency of accurate flood prediction maps, enabling insurers to identify higher risk properties and providing them with the option of abandoning existing policyholders whose properties have already been flooded or are at risk of flooding.

### **3 An alternative model for flood insurance**

- 3.1 In a situation where continuing climate change has the potential vastly to increase the flood related losses of private insurance companies year on year – the cost of covering flood damage was £3 billions in 2007 - the market led approach to the financing of flood risk in the UK no longer works. It does not provide viable solutions for significant numbers of properties in need of flood insurance. Without government involvement the prevailing culture of laissez is unsustainable.
- 3.2 Private insurance companies and their shareholders cannot be expected to bear the rising losses in the years to come. In order to protect their reserves, insurers will be forced to withdraw cover for those properties most at risk, vastly inflate premiums and excesses for others, and place yet others outside the market because they cannot afford the cost of flood insurance. The result will be blighted communities across the UK.
- 3.3 One sixth of properties in the UK is at risk of flooding. The problem is an historical one caused when our ancestors first settled on waterways at a time when they were the most efficient method of transport. Climate change has rendered that settlement pattern no longer sustainable, but it is not economically or socially viable to relocate large sections of the population to higher ground.
- 3.4 The Proposal
  - 3.4.1 Compared with many European countries there is already a high take up of flood insurance in the UK, and that risk is bundled together with other perils in standard property insurance policies. Those policies will remain the basis of the new model with competing private insurers continuing to collect premiums, administer policies and settle claims in the normal way.
  - 3.4.2 A public/private partnership is created whereby reinsurance of flood risk is mandatory. A portion of annual premiums, in effect a levy, passes

from the private insurance companies to a reinsurance agency, to be established by government and backed by a government guarantee, and administered by a group designated by the private insurance industry.

- 3.4.3 That agency administers liability for flood claims only.
- 3.4.4 This means that all flood risk is reinsured and that private insurance companies do not have to differentiate between properties based on the likelihood of flooding when assessing premiums and excesses. Therefore the only factors determining premiums and excesses for flood damage are the size and value of the property at risk. Premiums and excesses charged for all other risks covered by the property policy are subject to the free competition between private insurance companies in the normal way.
- 3.4.5 Access to the Government backed flood reinsurance fund is available only to those who hold valid property insurance policies at the time of the flood.
- 3.4.6 Acting as a guarantor of uniformity of treatment, at its inception the new reinsurance agency will establish the codes of practice and accreditation schemes it deems necessary for the proper handling of flood claims and the reinstatement of damaged properties.
- 3.4.7 Monitored by government and backed by a Government guarantee of its viability, the new reinsurance agency will ensure that its reserves are sufficient to meet the demands of likely flood risk in the coming year, and will set the rate of its levy annually.
- 3.4.8 Participation in the flood insurance scheme is mandatory for all private insurance companies. This ensures that risk is spread evenly
- 3.4.9 The authors have considered a variety of solutions adopted by our closest neighbours in Europe. The scheme outlined above is not an original

concept as it adopts elements from the Caisse Centrale de Réassurance<sup>3</sup> created by the Law of 13 July 1982 in France, following serious flooding the previous year and the Consorcio de Compensacion de Seguros in Spain. Both countries have similarities with the UK in that there is already high market penetration for flood insurance.

3.4.10 A community cannot prosper as a whole if sections of it are rendered unsaleable or uninhabitable. The concept of pooling resources and sharing costs is a fundamental principle of insurance and is evident in many areas of British life – one person subsidises the NHS medical treatment of their neighbour, another person contributes to the cost of the education of their neighbour's children and a town dweller subsides the cost of a postal delivery to someone living in a remote area. The proposal for a flood reinsurance scheme follows the same principle.

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<sup>3</sup> <http://www.ccr.fr/index.do?fid=1566517819374305701>

## **4 Benefits of the new model**

- 4.1 The flood reinsurance scheme has immediate benefits for the following groups
  - 4.1.1 Those people who cannot afford to insure after flooding
  - 4.1.2 Those who can afford to insure after flooding but are unable to sell their properties because potential buyers find the premiums and excesses on their properties unpalatably high
  - 4.1.3 Those people who wish to purchase a property in a previously flood affected area and who discover that they either cannot buy any insurance to protect them from potential flooding or that the premiums and excesses are prohibitive
  - 4.1.4 The insurance companies who want to continue selling insurance in the normal way in the competitive market, but who regard the risks inherent in insuring against flooding as too great and for all practical purposes uninsurable
- 4.2 Other benefits
  - 4.2.1 Flooded communities will have the knowledge that a single, fair and even handed code of practice would operate in their areas. There will be far greater transparency in the resolution of their issues than is currently the case.
  - 4.2.2 Currently many people are unaware that in the long term their communities are becoming blighted after flooding. As the notion dawns on them that their own communities and their own property prices may be adversely affected by flooding they will come to appreciate the value of our proposal.

- 4.2.3 The flood reinsurance scheme removes the barriers to competition highlighted in paragraph 2.3 above. The insurance market will remain fully competitive in all areas other than flood risk. There will continue to be strong competition on price and quality of service. The role of the agency overseen by government will be restricted to that part of the market which becomes uninsurable because of flooding.
- 4.2.4 A new flood reinsurance agency does not require a large staff to administer it. Premium collection, policy administration and claims handling will remain with the existing private insurance companies.

## **Appendix 1**

### **REVISED STATEMENT OF PRINCIPLES ON THE PROVISION OF FLOOD INSURANCE**

The Government and the insurance industry have agreed that the conditions should be in place to enable the insurance market to be able to provide flood insurance to the vast majority of households and small businesses efficiently and without the specific commitments below from 1 July 2013. Thereafter, the industry will continue to work with existing customers to explore insurance options for domestic property and small business customers where the flood risk is significant and no public plans are in place to defend the property.

Until 30 June 2013, ABI members commit to:

Continue to make flood insurance for domestic properties and small businesses available as a feature of standard household and small business policies if the flood risk is not significant (this is generally defined as no worse than a 1.3% or 1 in 75 annual probability of flooding).

Continue to offer flood cover to existing domestic property and small business customers at significant flood risk providing the Environment Agency has announced plans and notified the ABI of its intention to reduce the risk for those customers below significant within five years. The commitment to offer cover will extend to the new owner of any applicable property subject to satisfactory information about the new owner.

It is important to note that:

The premiums charged and policy terms will reflect the level of risk presented and are not affected by this commitment.

This commitment does not apply to any new property built after 1 January 2009: the ABI encourages developers and customers purchasing a property in a new development to ensure that it is insurable for flooding. The ABI intends to publish guidance on insurance for new developments in autumn 2008.

This commitment is subject to annual review that will consider progress in resolving the areas of continuing work and implementing the Government's commitments and to additional review in the event of any significant external shocks, such as a reduction in the availability of flood reinsurance or major changes in the UK insurance market.

**July 2008**