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SCOTTISH FLOOD FORUM

Water Bill: written evidence on flood risk insurance clauses

The Scottish Flood Forum (SFF) is a charitable organisation dedicated to supporting flood risk communities in Scotland. It helps people to recognise, understand and reduce their flood risks and also helps people to recover if they have been flooded.

In this written evidence to the Public Bill Committee, we offer comments on those draft clauses in the Water Bill currently under consideration which directly impact on communities with a high risk of flooding which the SFF seeks to support. In our view the flood insurance clauses in the Water Bill should meet the following three criteria:

1. Affordability – flood risk insurance needs to be affordable for everyone as part of household insurance
2. Accessible – insurance needs to be accessible to everyone, especially those in high risk areas
3. Social justice – those who are most vulnerable, because of the risk or because of their circumstances, such as age or disadvantage, are protected.

The Scottish Flood Forum has already responded to Defra's consultation **on Securing the future availability and affordability of home insurance in areas of flood risk,** a copy of which is appended. In this submission to the Water Bill Public Bill Committee we provide additional comments on those new clauses proposed by Defra Minister, Dan Rogerson, to be included by amendment in the Water Bill currently under consideration by Parliament which specifically relate to flood insurance (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/237133/flood-insurance-clauses.pdf) and the associated Defra Commentary on Draft Flood Insurance Clauses (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/239264/draft-flood-insurance-clauses-commentary.pdf).

We do not wish to rehearse here the protracted discussions between the Government and the ABI arising from the expiry of the Statement of Principles in July 2013 and their subsequent extension until a new system of affordable flood insurance becomes available.

But in general we commend the UK Government's proposal of Flood Re as a means whereby affordable and widely available flooding insurance can continue to be available for those in high risk areas, and we support bringing forward the alternative of a Flood Insurance Obligation should Flood Re fail.

Concerns arising from the devolved management of flood risk

Earlier concerns that the Water Bill should reflect differences in flood risk management across the UK, raised in our earlier response to the Defra consultation, have not been addressed. Whilst insurance is reserved to the Westminster Parliament, flood risk management is fully devolved to each of the Devolved Administrations and insufficient regard has been given to this, especially in Defra's Impact Assessment where many of the operational details of the proposed legislation are clarified.

In developing an assessment of the cost-benefit ratios for Option 2 (Flood Re), the Impact Assessment uses Council Tax bands and strategic flood risk assessment policies that only apply to England. Council Tax bands in Scotland differ from those in England and the delivery of flood risk assessment measures (under the Flood Risk Management (Scotland) Act 2009) is primarily the responsibility of local authorities.

The availability of flood insurance is a key measure to be factored into local authority flood risk management plans which will be in place by the end of 2015. However, the precise mix of measures within these local plans may well differ from those being proposed by flood risk authorities in England – the only ones provided for in the Impact Assessment. This is not to propose that a separate Impact Assessment should have been undertaken for each of the Devolved Administrations, but rather that some flexibility be provided in the actual implementation of Flood Re to recognise this difference and also, should the need arise, of the Flood Insurance Obligation.

We urge the Committee to consider the proposals that follow.

1. Specific regulations concerning the Council Tax bands to be used in Scotland under Flood Re will need to be drafted. We note that under the proposals in Table 4 in the Impact Assessment whilst 60% of the total subsidy is directed to Council Tax bands A-C; 40% is allocated to tax bands D-G. By way of commentary on this, para 85 states that "the targeting of lower Council Tax bands in Flood Re only just addresses the inherent regressive tendencies of a subsidised pooling option." Along with the Joseph Rowntree Trust we urge a higher allocation of subsidy to tax bands A-C to enhance the availability of insurance to the most vulnerable households. Providing this was fiscally neutral (ie did not result in any change in the allocation of the total Flood Re subsidy to Scotland vis-à-vis England), we propose that the levels of subsidy across Council Tax bands in Scotland could diverge from those being proposed for England.

2. Para 52 in the Impact Assessment argues that it is not necessary to factor in the impact of climate change on the availability of insurance as "the Environment Agency's Long Term Investment Strategy is designed to match the lower climate change scenario". Both the impact of climate change on flood risk in Scotland and the appropriate response may well differ from that likely to occur in England. Whilst the Scottish Government and SEPA

determine the national strategy for flood risk management, final decisions on capital spend within local flood risk management plans and any engineered defences are decided by 14 groups of local authorities. This decentralisation of decision-making provides a further reason for allowing Scotland flexibility in deciding the level of subsidy to be assigned to each Council Tax band in Flood Re.

3. The proposal that the regulations on the Flood Insurance Obligation register "can specify what information is contained in the register … and allow for properties where construction was completed after a certain date to be excluded" is commended. We suggest that this flexibility be extended to the Flood Re regulations and that the date for excluding new properties from Flood Re in Scotland could differ from 2009 which is proposed for England. This would enable the effectiveness of post 2007 Scottish Planning Policy inhibiting development on flood plains to be reflected in the date set.

4. Arising from the above comments, we make two specific recommendations designed to reflect the different approach to flood risk management in Scotland from that envisaged in the Water Bill:

Recommendation 1: That the Bill be amended to require the Secretary of State to consult with Scottish ministers on the level of subsidy to be allocated to flood insurance premiums for Council Tax bands in Scotland.

Recommendation 2: That the Bill be amended to require the Secretary of State to consult with Scottish ministers on the date for excluding new properties from Flood Re in Scotland.

Issues when scrutinising the Bill

In scrutinising the Water Bill, we invite the Committee to reflect on the following points that will arise once the flooding insurance clauses of the Bill are enacted.

1. Flood Re will increase the current availability and affordability of flood insurance – an outcome that the SFF warmly welcomes. But there are hidden consequences which will require careful management. The most significant of these is the danger that Flood Re de-incentivises beneficiaries from undertaking further measures to reduce flood risk in their properties. This runs counter to two key policies embedded in current flood risk management legislation across the UK – increasing personal ownership of managing flood risk and promoting installation of measures to prevent water entering a property (resistance) and reducing the damage should water find a way in (resilience). As recently noted by the Climate Adaptation Sub-Committee of the UK Committee on Climate Change, each £1 invested in property protection measures (door guards, air bricks and vent covers) yields benefits of £5 or more. Furthermore, at present, roughly 20% of current customers at significant risk of flooding have higher premiums than those with a low risk. This encourages higher risk customers to make use of flood warning schemes and property protection measures in order to reduce that risk. Flood Re, as currently envisaged, will remove these incentives. As noted by the Climate Adaptation Sub-Committee, a case can also be made for not fully subsidising the risk in high risk locations, as a means of encouraging households to take additional measures themselves to reduce insurance premiums. But on the grounds of

social justice this reduction in subsidy should not be extended to properties at risk in Council Tax bands A-C.

2. The Water Bill also provides an opportunity to promote a more joined up approach by insurers and public bodies who seek to reduce the overall risk of flooding:

a. The installation of property level protection measures should attract reductions in premiums and excesses. This will require certification of both individual products and their installation to meet legitimate concerns of the insurers. But just as the installation of burglar alarms and neighbourhood watch schemes reduce household insurance premiums so, in principle, correctly installed property protection measures and/or the existence of a local flood warden scheme should also reduce the cost of household flood premiums.

b. Raising awareness of householders who live in high risk areas is a major challenge in reducing the overall risk of flooding. Hitherto, data sharing between the insurers and public bodies has not proved possible because of competition regulations. But under both Flood Re and the Flood Insurance Obligation, such data sharing should become possible. This could provide a valuable additional input to local authorities as they develop their local flood risk management plans.

3. There is still a lack of clarity in terms of what will happen should there be a shortfall in the funds held by Flood Re to meet claims arising from a catastrophic flood which affects a large part of the country and exhausts the assets in the pool. In this situation, would the UK government become the insurer of last resort? If not, what alternative will be put in place?

Prof Alan Werritty (Company Secretary SFF)
1 December 2013

Annex 1: Securing the future availability and affordability of home insurance in areas of flood risk

The Scottish Flood Forum is a charitable organisation dedicated to supporting flood risk communities in Scotland. It helps people to recognise, understand and reduce their flood risks and also helps people to recover if they have been flooded.

The Scottish Flood Forum (SFF) welcomes the opportunity to comment on the proposals that have emerged following the June 2013 Memorandum of Understanding between the UK Government and the Association of British Insurers on Flooding and Insurance. Our overall response to the consultation, which we share with the National Flood Forum, is underpinned by the following three criteria:

1. Affordability – flood risk insurance needs to be affordable for everyone as part of household insurance
2. Accessibility – insurance needs to be accessible to everyone, especially those in high risk areas
3. Social justice – we must ensure that those who are most vulnerable, because of the risk or because of their circumstances, such as age or disadvantage, are protected.

It is essential that the final detailed agreement between the UK Government and the Association of British Insurers addresses all three criteria. Our responses to specific questions not only reflect the views of the SFF but also the views of Community Flood Groups in Scotland.

In general we endorse the levy and pool model which forms the basis for Flood Re and view the alternative Flooding Insurance Obligation as a poor second best option. But crucial to the success of Flood Re will be its detailed implementation. Many of the responses to specific questions below invite Defra to revisit key details in the Flood Re proposal.

Responses to specific questions posed in the Consultation

Q1. Do you have an evidence of small businesses experiencing difficulty with the availability and affordability of property insurance due to the risk of flooding?
An issue requiring clarification is the status of small businesses which are based in domestic accommodation. These might include Bed and Breakfasts and companies whose registered office is also a domestic residence. Will such properties be included in the Flood Re option?

Q2. Do you agree with the Government's policy objective for flood insurance?
Overall we welcome the approach taken by the UK Government in seeking to ensure the continued availability of flood insurance. We also endorse the approach taken by both the UK and Scottish Governments in promoting a more sustainable approach to managing flood risk as exemplified by the Flood Risk Management (Scotland) Act 2009. But crucial to delivering flood risk management is effective and efficient flood insurance in which due regard is given to the installation of resistance and resilience measures. Property level protection lies at the heart of strategies to encourage householders to better manage their individual flood risk. See answer to Q6 below.

Q3. Do you agree with the approach taken to analysing the different potential solutions in the Impact Assessment?
The Impact Assessment usefully summarises the monetised impacts of flooding under the four options. But there is no attempt, in a separate analysis, to assess the social impacts of flooding under each of the four options. Given the recent emphasis in much UK and Scottish Government flood risk management policy to include social costs in impact assessments this is a major omission. Well-attested social impacts include deterioration in physical and mental health, loss of memorabilia, stress of the flood itself, stress of dealing with loss-adjusters, insurers and builders, stress of having to relocate, and worry about future flooding.
Q4. Do you agree with the evidence presented in the Impact Assessment?
Yes: but as noted above, the evidence presented solely addresses economic impacts.

Q5. Do you have any further evidence which has not been considered in the Impact Assessment?
Reference in the Impact Assessment could have been made to Defra's own *Climate Change Risk Assessment for Floods and Coastal Erosion Sector* (Defra Project Code GA0204)

Appendix 6 (Social Vulnerability Checklist) and other attempts to assess social vulnerability. The recent Joseph Rowntree Foundation reports (O'Neill J and O'Neill M, 2012 Social justice and the future of flood insurance: Lindley S *et al*., 2011 Climate Change justice and vulnerability) summarises much of the most recent work in this area. In terms of evidence specific to impacts in Scotland, the CREW report by Ball *et al*., (2012) commissioned by the Scottish Government *Flood insurance provision and affordability: beyond the Statement of Principle: implications for Scotland* (available from www.crew.ac.uk) has useful data on affordability.

Q6. Do you support the Government's proposed approach?
Yes. In general the SFF supports the Government's overall approach subject to the qualifications noted below in answer to specific aspects of Flood Re. We strongly endorse the proposal that all insurers will have to be included under both Flood Re and the Flood Insurance Obligation. This should reduce, and ideally remove, the practice of 'cherry-picking' households by smaller insurers who are not members of the ABI.

Whilst generally welcoming Flood Re as a replacement for the Statement of Principles, there is a danger that it may lead to policy-holders being disinclined to undertake property level protection measures to reduce flood risk. Given capped premiums and excesses (<£500), there would be little incentive to invest in resistance and resilience measures. This runs counter to attempts across the UK to encourage investment in such measures as part of the shift to householders taking direct personal responsibility for reducing flood risk. The solution that property level measures be made mandatory for homes covered under Flood Re is too draconian. The alternative that insurers offer a reduction in premium once property level protection measures have been installed to an agreed technical standard, would retain some incentive primarily in terms of reducing the impacts of future floods.

Q7. If the remaining challenges associated with Flood Re prove too difficult to overcome, what factors do you think should be taken into account ahead of any decision on whether or not to introduce the Flood Insurance Obligation?
Many of the issues related to eligibility and affordability commented on below in terms of implementing Flood Re will apply to the Flood Insurance Obligation.

Flood Re
Q8. Do you agree that setting the eligibility thresholds according to council tax bands (or their equivalents in the Devolved Administrations) will help ensure Flood Re support is targeted towards those households who need it most, without requiring significant administration? Is there a better method?
The use of council tax bands to set eligibility thresholds is generally equitable and has the merit of being relatively simple to administer. However, council tax bands for England differ from those for Scotland (which are significantly lower), and this will need to be taken into account when Flood Re is implemented. The council tax bands in Scotland (based on an assessment of property values in April 1993) are currently:
A: below £27,000. B: £27,001 to £35,000. C: £35,001 to £45,000. D: £45,001 to £58,000. E: £58,001 to £80,000. F: £80,001 to £106,000. G: £106,001 to £212,000.

Q9. Do you have any views on the proposed initial "eligibility thresholds" within Flood Re (table 1 above), which would effectively cap the technical flood risk premium paid by high risk households?

The maximum price for the flood insurance component of £210 for Band A and Band B households is too high and the maximum prices for Bands C (£246) to G (£540) too low. The CREW report *Flood insurance provision and affordability: beyond the Statement of Principles: implications for Scotland* (available from www.crew.ac.uk) provides evidence in support for higher subsidies for households in Bands A and B.

Based on a postal questionnaire sample of 157 households in high flood risk areas in Scotland, the average premium for buildings and contents was £398. Lower-income households from this survey (<£11,000) reported that, in terms of 'willingness to pay', an increase in the annual premium of £100-200 per year for buildings and contents and £100 for contents only would be 'difficult'. The typical 'overall price of £650 charged to the policy holder' under Flood Re in Council Tax Bands A and B represents an increase of nearly £250 over the current average cost for buildings and contents cover of £398.

The subsidy for households in Council Tax Bands A and B could be increased by EITHER decreasing the level of subsidy for Council Tax Bands C to G, OR by increasing the levy of £10.50 from non-eligible policy-holders to, say, £12, OR by a combination of both changes. We invite Defra to remodel the eligibility thresholds using both these revised criteria.

Q10. Do you agree that the following should be excluded from Flood Re:

a. Band H properties?

Whilst in general, householders in Band H will be more affluent than those in lower Bands, there will be vulnerable asset-rich and income-poor property owners for whom some mitigation of increased insurance costs is necessary. Such measures could include assistance from local authority social services to identify such householders, participation in any local community projects to reduce flood risk and support in undertaking property level protection and identifying the lowest insurance premiums.

b. New homes built after January 2009?

In general we endorse this exclusion which is consistent with the need to discourage development in high flood risk areas. But we note that planning regulations vary across the four UK administrations and due regard should be given to this.

In Scotland (under the current Scottish Planning Policy 2010) all potential developments in flood risk locations (defined as being within the 1 in 200 flood outlines in SEPA's Indicative River and Coastal Flood (Scotland) Map must be vetted by SEPA staff who can consent, consent subject to conditions, or object to a given proposal. Local Planning Authorities must then take into account such advice in line with their overarching statutory obligation to reduce overall flood risk. Although the effectiveness of this procedure has yet to be formally demonstrated, it appears to provide a more robust method for discouraging development in high flood risk areas than is currently operative under comparable planning procedures in England.

At present, high flood risk areas in Scotland exclude properties subject to surface water flooding and groundwater flooding for which hazard maps have yet to be published. These maps, due by December 2013, will identify additional post 2009 high risk properties ineligible for Flood Re.

c. **Genuinely uninsurable properties? If so, how would you define these in a consistent way that insurance companies can apply?**
Genuinely insurable properties will require precise definition presumably based on the probability of flooding – once every one to two years on average?

Q11. Should other exemptions also apply?
We do not recommend any other exemptions.

Q12. Do you agree that Flood Re should apply to both buildings and contents insurance?
Flood Re should include all three forms of insurance cover (buildings, contents and buildings and contents). Low income groups are often reluctant to take out any form of flooding insurance, especially if they live in rented accommodation. We strongly urge both the UK and Scottish Government to promote more vigorously "Pay with Rent" schemes available via some providers of social housing. This should be seen as policy initiative to accompany the roll out of Flood Re in 2015.

Q13. Do you have any comments on this proposed way of managing Flood Re's exposure to large losses?
It is unclear what will happen should a truly catastrophic flood (>1 in 200 year probability) occur at a national scale, akin to the 1953 East Coast storm surge, generating claims that exceed the funds held by Flood Re. Would this be seen as a national emergency triggering a response by the UK Government of providing flood relief to individuals as well as to local authorities under the existing Bellwin Scheme? If so, how would this be defined and managed?

Q14. Do you think a levy equating to around £10.50 per UK household, which the ABI estimate is equivalent to the current cross-subsidy, is acceptable to help address the problem of securing affordable flood insurance for high risk households?
Given that existing policy holders are already providing a cross-subsidy of £10.50, this is an acceptable levy to help reduce the premiums in high flood risk areas. See also answer above to Question 8 where we recommend that increasing this to, say, £12 could assist with improving affordability for Council Tax Band A policy-holders.
At present insurers treat the whole of the UK as a single market with premiums in lower risk areas providing a subsidy for premiums in higher risk areas. If, in the future, the insurers segmented the UK market reflecting differential levels of aggregate risk and/or performance in managing flood risk by the four administrations, then the level of subsidy and the operation of thresholds for Flood Re would have to be revisited.

Q15. Do you agree that Flood Re will secure the availability and affordability of household flood insurance in the UK?
Availability: The inclusion of all insurers under Flood Re is welcomed and crucially important. But, as noted in the answer to Q1, there is a lack of clarity as to whether some types of home-based businesses will be included.
Affordability: This has already been commented upon in the previous answer to Q9 and the need to increase the level of subsidy for Council Tax Band A households. But because the Impact Assessment has been based entirely on economic criteria (see answer to Questions 3 and 5), issues of social justice have been neglected. More work is needed on assessing the impacts of Flood Re on socially vulnerable groups as defined in the Joseph Rowntree Foundation reports by O'Nell and O'Neiil (2012) and Lindley *et al*., (2011).

Flood Insurance Obligation
Q16: Do you agree that the Flood Insurance Obligation has the potential to meet the policy objective?
Yes, but it is likely to prove very cumbersome to make operational (see answer to Q19)

Q17: Do you agree that the Secretary of State should have the power to exempt some firms operating in the UK domestic insurance market from the Obligation, e.g. those with market share below a de minimis?
No, unless some effective mechanism can be identified to prevent these insurers form 'cherry picking' and distorting the market.

Q18. Do you agree that at this stage Ministers should have the option of applying the Obligation to both buildings and contents insurance?
All types of cover should be included under the Obligation.

Q19: Do you agree that the Environment Agency should be granted powers to act as a "lead administrator", working with the devolved administrations to compile a UK-wide register that lists by address each domestic property at high risk of flooding?
Yes, but this poses a number of major challenges:

- the proposal that SEPA help compile a property register will require considerable extra resources
- The outcome of the Scottish independence referendum in 2014 may also have implications for the UK-wide nature of the proposed arrangement.
- Under Flood Re, the selection of properties deemed to be eligible for inclusion in the scheme will be left to individual insurers. How would properties be identified for subsided premiums under the Flood Insurance Obligation given that the methodologies for defining 'high risk' for floods of varying origins vary across the four UK administrations?
- How will challenges to the register be handled if it can be demonstrated that the modelled data for the same category of high flood risk (river, coastal, surface water or groundwater) vary across the four UK administrations?

- How will the register be updated 2015-2040 given climate change impacts, population growth and changes in urbanised areas? The methods used for updating the register may also vary between the four UK administrations making a consistent definition of high flood risk problematic.

Q20. Do you agree with the broad duties envisaged for the regulator? Is anything missing?
Yes.

Q21. Which of the above approaches to supervising compliance with the Obligation do you believe is best suited to delivering the policy objective whilst minimising the burden on businesses and consumers? Is there another approach not considered here?
No response.

Q22. Which of the above approaches to imposing sanctions for non-compliance with the Obligation do you believe is best suited to delivering the policy objective whilst minimising the burden on businesses and consumers? Is there another approach not considered here?
No response

Q23. Do you agree with our preference that the Financial Conduct Authority should supervise compliance with the obligation, and be responsible for taking regulatory action against insurers who fail to meet their obligation, or should it be or the Environment Agency?
Agreed that the regulator should be the Financial Conduct Authority given its expertise in financial regulation.

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