Flood Insurance in the UK

The Morpeth Model - May 2013
Morpeth Flood Insurance Working Group
Our Proposal for the Way Forward

Morpeth Flood Action Group

Morpeth Town Council

MDCT

A framework to prevent the community blight that would be caused by a risk based flood insurance model

BACKGROUND

In the UK insurance cover against flood damage is part of the package for residential customers. From the early 60's onwards it was made widely available and affordable under the "Gentleman's Agreement" between the insurance industry and the government of the day. In order to meet their commitment to availability at affordable prices, the insurance companies that have abided by The Agreement, have to date supported the properties at high risk of flooding by means of subsidy in the premiums of those at low risk. This cross subsidy has functioned as an act of solidarity on the part of one set of policy holders to another, and companies have spread the risk across their portfolios. While this agreement kept premiums affordable the floods of 2000 brought to a head the problems insurance companies were experiencing with exposure and competitiveness.

In recognition of the growing problems, in 2002 the government and the ABI acted together to introduce the Statement of Principles. This agreement guaranteed the availability of insurance to high risk properties in return for a government commitment to manage the level of flood risk in the UK. Affordability was not part of the agreement, and companies were able to charge premiums that reflected risk. Because new insurers entering the market avoided properties at high risk of flooding, and because of improvements in flood mapping, the cross subsidising of policies was found to be unsustainable in a competitive market. The current Statement of Principles dates from 2008 and terminates in June 2013. The Statement of Principles has not served the consumer well; premiums and excesses increased dramatically for those who had been affected by flooding, and those at high risk, to the extent that they have become unaffordable. The consequence of this is that there is a great likelihood of blight developing within the most vulnerable communities.

Responding to pressure from communities and concerned groups, the Labour Government agreed a summit of interested parties, charged with the task of coming up with proposals for flood insurance. Their proposals were to include affordability and availability and be sustainable going forward. The Coalition Government convened the summit and after many months of deliberation, including contributions from the Morpeth Group, the various subgoups submitted their reports. *Flood risk and insurance: A roadmap to 2013 and beyond -Final report of the flood insurance working groups* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69467/pb13684-flood-risk-insurance.pdf

THE DILEMMA

If no solution is found the insurance industry will adopt a model of risk-related premiums.

- Anticipating the demise of the Statement of Principles, some insurers have already withdrawn cover from householders completely. Other insurers, unsure of future developments, have increased premiums and excesses to reflect the level of risk that flooding represents to them.

- As a general rule new insurance companies do not offer flood insurance cover for high risk properties, and only specialist brokers will consider new business, quite often at rates that are unaffordable.

- 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 jeopardise the future prosperity of communities, if it is not resolved.

THE MORPETH MODEL
May 2013

The Morpeth Model is similar to the ABI "Flood Re" model that affordable flood insurance should be built round subsidy from within the industry. If major flood events occur in consecutive years in the early years of establishing the model there would be the need for a loan, from either the government or the insurance industry, to cover any shortfall in resources. Any such loan would be repaid from the pool as the amounts ceded to it were adjusted to match the costs of flooding events year on year.

1. A pool would be set up to help cover claims for flood damage to properties at high risk of flooding.

2. There would be a levy on all household insurance policies which would be paid into the pool. In the interest of transparency this would be called the Community Flood Levy. The levy would have to be based on the value of the property for it to be considered equitable.

3. Insurance companies would assess the flood risk portion of the premium in the usual way to produce the risk-related premium.

4. The risk-related premium would be subject to a threshold determined by the Council Tax band of the property (rateable value in Northern Ireland). The proportion of the risk-related premium above this threshold would be used to determine the contribution to the pool.

5. Only a percentage of the risk-related premium above the threshold would be paid into the pool. The shortfall in monies to cover the claims of these higher risk policies would be made up from the Community Flood Levy contributions.

6. The premium charged to the policy holder would comprise the amount for the other elements of the package together with the Community Flood Levy, the risk-related premium up to the threshold level and a percentage of the risk-related premium above the threshold.

7. The amount paid into the pool from each policy premium by the insurance company would comprise the Community Flood Levy together with the percentage of risk-related premium above the threshold.

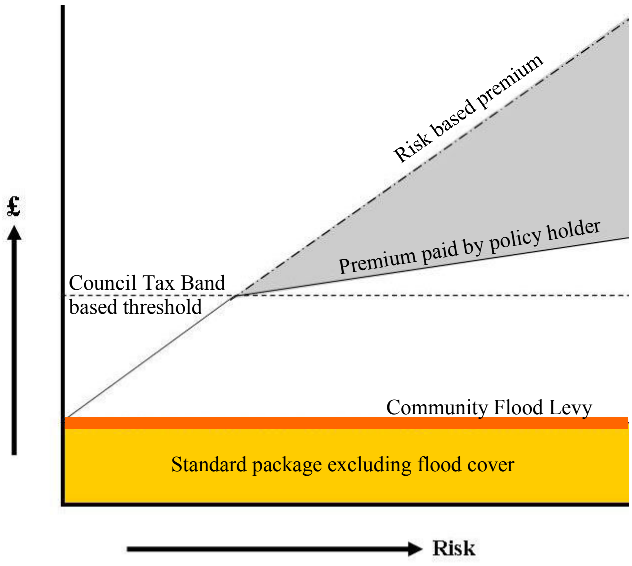
8. Since high excesses do not encourage the installation of resilience and resistance measures, they present an obstacle to progress. Insurance companies would inevitably compete to find optimum levels for excesses.

9. The insurance industry would be responsible for ensuring that the pool remained solvent and it would therefore determine the amount paid by policy holders under the Community Flood Levy, adjusting that amount in response to unfolding events.

10. The threshold premium and the proportion to be paid into the pool would be determined by the government as part of its responsibility for oversight of the whole process.

11. The pool would be managed and administered by the insurance industry.

12. A flood damage claim would be administered by the insurance company holding the policy. If the flood element of the premium was below the threshold, the insuring company would be responsible for covering the full cost of reinstatement. If there was an element of the premium above the threshold level, then the insurance company would settle the full amount of the claim. However it would be able to draw down from the pool the percentage of the risk-related premium to which it was not exposed. As an example, if half of the risk-related premium was above the threshold, then the insurance company would have half of the reinstatement costs paid for by the pool. This would ensure that the insurance industry shared the risk.



As with the “Flood Re” and “Flood Mu” proposals for the future of flood insurance after 2013, the Morpeth Model will require legislation by government.

The Morpeth Model meets all of the principles set out by the summit.

GOING FORWARD

The Model by itself does not represent a complete solution for flood insurance post 2013. It will form part of a flexible and changing framework which aims to provide a robust and sustainable future for the household insurance market. Issues will include -

- Addressing the problems of building on flood plains by keeping PPS25 in the new National Planning Policy Framework. The definition of sustainable development must include insurability against future flood events and climate change.
- Bringing resilience and resistance into the Building Regulations for England and Wales, a model for this is the Scottish Building Regulations.
- The findings of all the summit Working Groups and implementation of their recommendations.

SETTING THE THRESHOLD

Establishing a threshold that is affordable for each individual household is key to the fairness of the model. If the threshold is too high it will marginalise the most vulnerable, if too low it could distort the market. It would be impractical to introduce means testing, and therefore a simple indicator that largely correlates to ability to pay is required. Property value would provide such an indicator. There will, of course, be anomalies as with any similar simple indicator. The Council Tax band of a property is a simple and readily available indicator of its value. Age of adults and occupancy details will have been collected for other premium assessment requirements, so the anomaly of the widowed pensioner living in the large former family home, for example, can be taken into account.

NEW DEVELOPMENTS

It is inevitable that builders and planners will pursue development on flood plains and other areas at high risk of flooding. Currently the insurance industry subsidises the developers’ profits when they accept the greater exposure entailed in insuring developments on flood plains.
Developments should not be allowed to proceed if they produce dwellings that will have unaffordable insurance premiums. The threshold level of the Morpeth Model could be used as a benchmark for sustainable development. For any new build dwelling that would exceed the premium threshold, the developer would be required to pay a bond into the pool to cover possible future flood damage. This would encourage robust and sustainable design.

CONSUMER CHOICE

Successive governments have adhered to the notion that consumer choice drives competition and helps keep prices down. It is therefore clear that owners of properties at high risk of flooding need the benefit of that consumer choice. That choice is available under the Morpeth Model.

By comparison the Flood Re model fails to maintain a competitive market for high risk properties because it cedes them to a subsidised pool to produce affordable premiums. Ceding to a high risk pool will produce a two tier system.

CONCLUSION

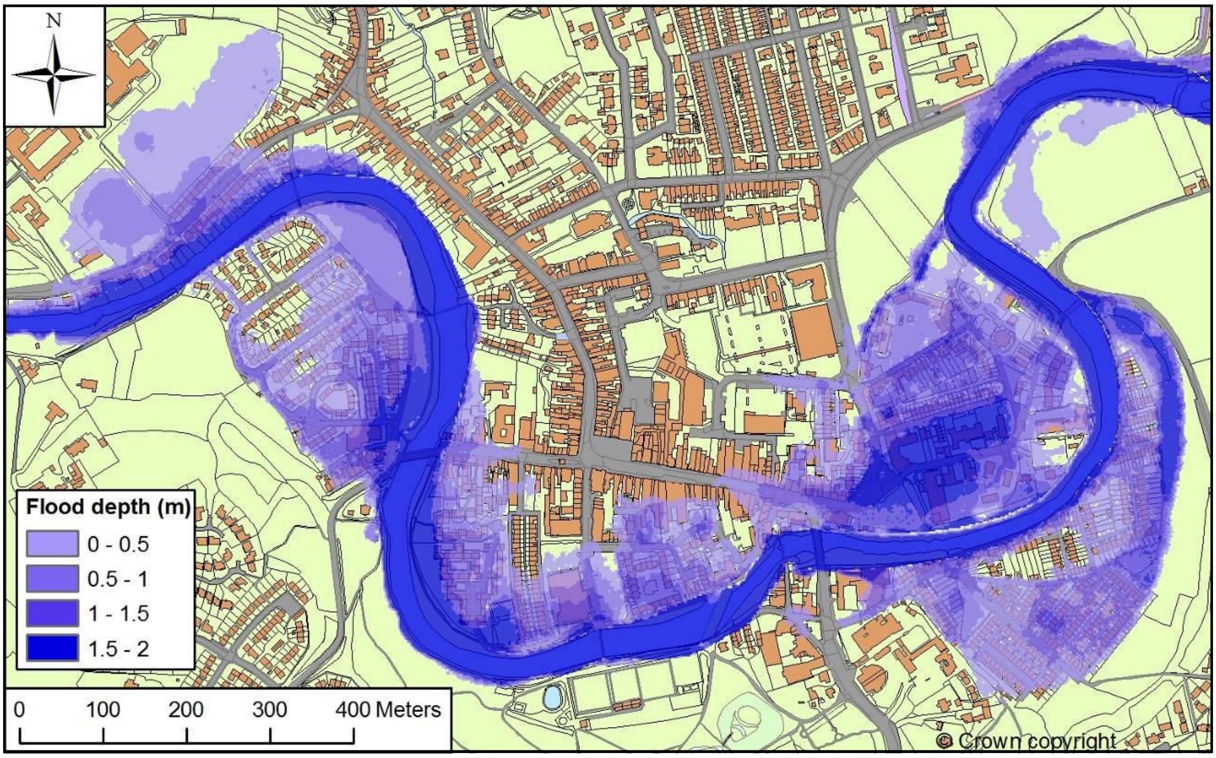
The Morpeth Model provides a possible new market-based model for the provision of flood insurance that is both affordable and available to owners of high risk properties. It significantly reduces the possibility of property blight, and the consequential community blight, that risk-related, high insurance premiums would bring. It is equitable, practical and deliverable.

The authors

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

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

Morpeth is the administrative headquarters of Northumberland, and is located on the banks of the River Wansbeck, 16 miles north of Newcastle upon Tyne.



Extent of flooding at 5pm 6th September 2008 courtesy of School of Engineering and Geosciences Newcastle University

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.

Contact details

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