Flood insurance in times of rising risk – An assessment of UK approaches

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Overview

- What is flood insurance?
- Why is it relevant ?
- The current situation in UK
- Results from our analysis 'Flood insurance in England- An assessment of the current and newly proposed insurance scheme in the context of rising flood risk' (**Surminski and Eldridge, in press Journal of Flood Risk Management**)
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What is flood insurance?

- a mechanism where risks or part of a risk are transferred from the insured to the insurer in return for a premium payment.
- can be provided by private insurers or by the state; can be mandatory or voluntary; can be limited in scope or all-encompassing; can be low take-up or limited availability; can make economic sense or can be waste of money

An interesting study object?

- Insurance as a financial risk transfer;
- Insurance as 'risk sharing';
- Insurance as a compensation mechanism;
- Insurance as a price signal for risk;
- Insurance as a tool to trigger risk awareness and risk management;
- Insurance as a disincentive for adaptation;
- Insurance as adaptation;
- Insurance as a convenient way of getting flood losses off the public balance sheet;
- Insurance as a mechanism to put pressure on government to increase resilience;
- AND MORE…

Flood risk in the UK

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- Insured losses substantial:
  2013: £451m (ABI, 2014) [including winter storms: £1.091bn]
  2012: £1.9bn (ABI, 2013)
  2009: £174m (ABI, 2010)
  2007: £3.2bn (EA, 2010)
  2005: £272m (ABI, 2010)
- Concerns about surface water flooding, impact of climate change, and development on the floodplain

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- 100% private market solution;
- Government commits to risk management (partnership approach) – but effective???;
- High penetration levels, but not mandatory;
- Part of the standard home-insurance package;

But:

- Customers concerned about unaffordability;
- Insurers concerned about commercial viability;
- Government concerned about possible public liabilities

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Flood insurance – the Statement of Principles

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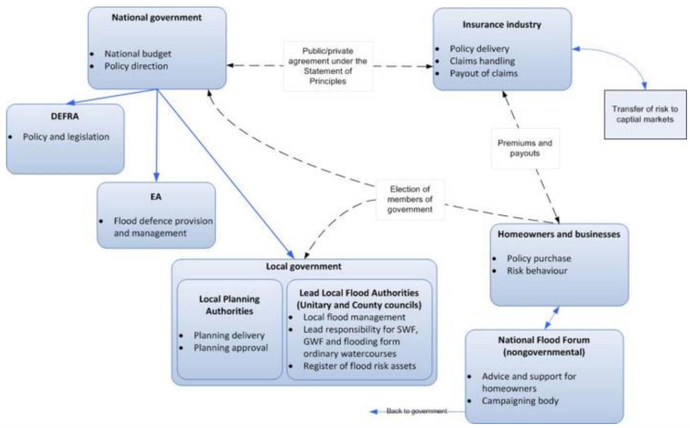
- Statement of Principles ended on the 30th June 2013



How to design new flood insurance?

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Principles

1. Insurance cover for flooding should be widely available.
2. Flood insurance premiums and excesses should reflect the risk of flood damage to the property insured, taking into account any resistance or resilience measures.
3. The provision of flood insurance should be equitable.
4. The model should not distort competition between insurance firms.
5. Any new model should be practical and deliverable.
6. Any new model should encourage the take up of flood insurance, especially by low-income households.
7. Where economically viable, affordable and technically possible, investment in flood risk management activity, including resilience and other measures to reduce flood risk, should be encouraged. This includes, but is not limited to, direct Government investment.
8. Any new model should be sustainable in the long run, affordable to the public purse and offer value for money to the taxpayer.

Source: Defra (2011) 'Principles for flood insurance'

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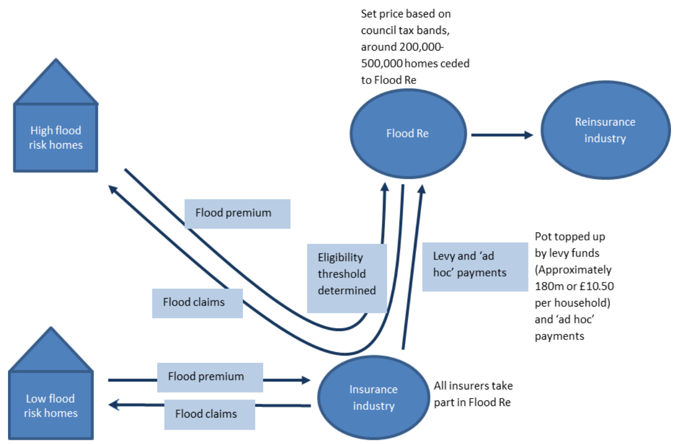
Future flood insurance- Flood Re

- Flood Re due to start summer 2015



What is the impact on moral hazard and risk reduction efforts???

Evaluating the schemes

- Seven criteria evaluated:
  - Increase awareness and knowledge through flood risk information
  - Build capacity for risk reduction through risk reduction measures
  - Provide financial incentives for policyholders towards mitigation investment
  - Promote resilient reinstatement techniques
  - Incentivise public flood risk management
  - Require compulsory risk reduction
  - Incentivise not developing in flood risk areas
- Formal versus informal approaches

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Do the schemes address risk reduction?

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Does the insurance system:	Current insurance system (SoP)	Future flood insurance system (Flood Re)
Increase risk awareness and knowledge of risks through flood risk information provision?	✓	✓
Build capacity for risk reduction through advice on risk reduction measures?	✗ Only advisory guidance	✗ Informal approaches are present
Provide financial incentives for policyholders towards mitigation investment	✗ Risk reflective pricing has emerged	✗ Will transit to risk reflective pricing over duration of scheme
Promote resilient reinstatement techniques after a flood loss	✗ Information is provided by insurers voluntarily.	✗
Incentivise public flood risk management policy	✓	✓
Require compulsory risk reduction	✗ for policy holders ✓ for government	✗
Incentivise not developing in flood risk areas	✓	✓

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Observations on flood insurance and risk reduction

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- Link is recognised in literature, but little evidence present for how this actually works within schemes (for working examples please see Surminski and Oramas-Dorta, 2013)
- How is moral hazard affected by risk reduction incentives?
- The strength of the government's role to flood risk management has yet to be seen – note recent budgetary spending and political will
- Flood Re (and the existing SoP) does not cover properties built after 2009, this assumes the planning system is working but is this the case?

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Future work

- Understanding the dynamics of public private partnerships in the wake of rising risk levels (ENHANCE)
- Measuring moral hazard implications of an insurance scheme
- Feasibility of incentives for property level risk reduction
- Measuring effectiveness of risk reduction efforts
- Innovation ??? (beyond index and long-term insurance)

Thank you for your attention.

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