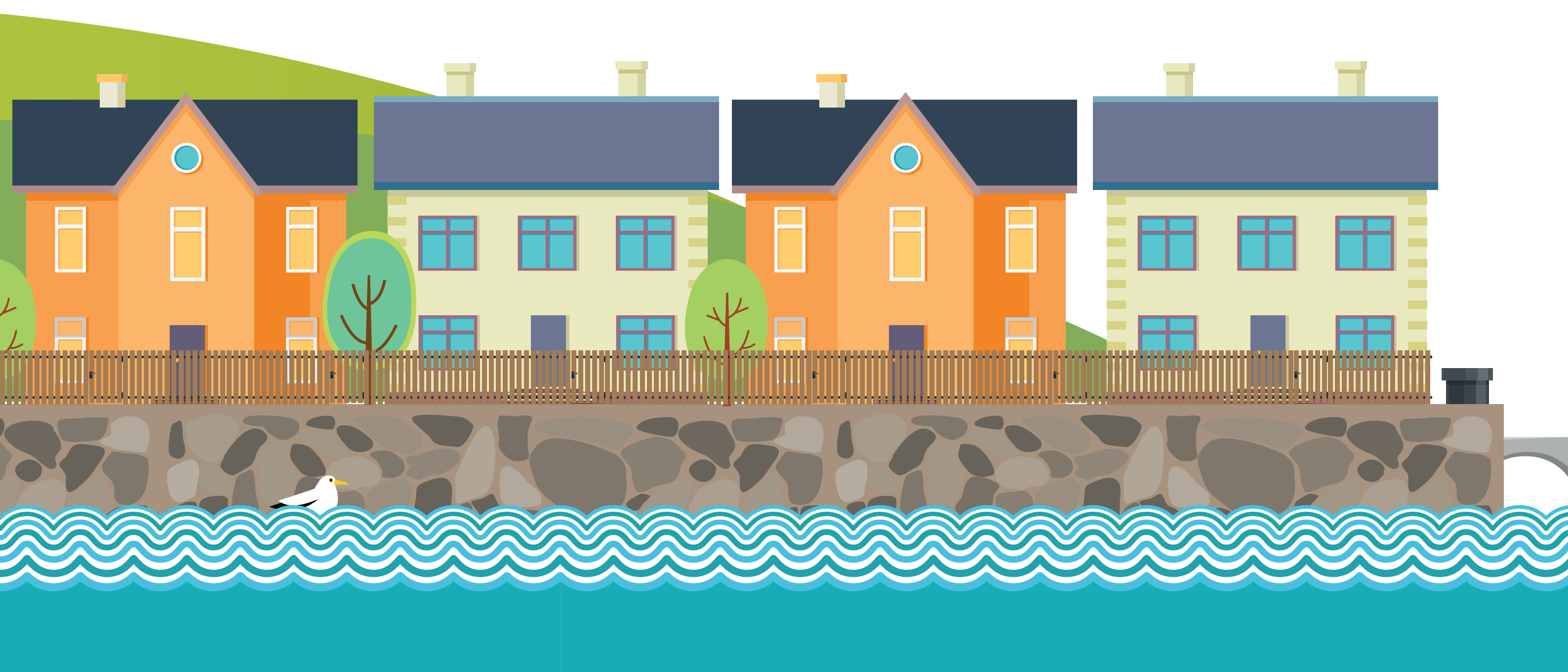
OVERVIEW OF THE DEPARTMENT FOR ENVIRONMENT, FOOD AND RURAL AFFAIRS CONSULTATION ON PROPOSED AMENDMENTS TO THE SCHEME



BACKGROUND

Flood Re submitted proposals to the Department for Environment, Food and Rural Affairs (DEFRA) through the Quinquennial Review (QQR) in July 2019. These proposals intend to improve the Scheme's efficiency and effectiveness, and support Flood Re's purpose to manage transition to a risk reflective market. Flood Re welcomes the Government's support for these specific changes to the Scheme and this consultation is a key part of the process in ensuring that they will be implemented.

Flood Re is a joint initiative between the insurance industry and the UK Government. It was established by the Water Act 2014, launched in 2016, and will run until 2039. Its purpose is to promote and enable the availability and affordability of flood insurance for eligible homes and manage over its lifetime the transition to an affordable market for household flood insurance where prices reflect the risks of flooding.

More than 300,000 households have been backed by the scheme since it was launched. Independent research shows that 98 per cent of households with prior flood claims can now obtain quotes from five or more insurers, when none could get five quotes before the creation of Flood Re. Furthermore, 4 out of 5 households with previous flood claims saw a price reduction of more than 50 per cent.

This note sets out details on the proposals included within the DEFRA consultation and how they will benefit households at risk of flooding.

Flood Re, Quinquennial Review, July 2019 https://www.floodre.co.uk/wp-content/uploads/QQR_FINAL.pdf

DISCOUNTED PREMIUMS FOR HOUSEHOLDS WITH PROPERTY FLOOD RESILIENCE (PFR)

Flood Re is proposing to offer lower premiums on policies where property flood resilience measures have been installed.

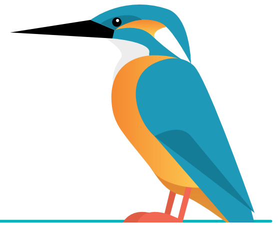
The premiums currently charged by Flood Re to insurers vary by the Council Tax Band of the insured property. Whilst the existing Regulations do not specifically prevent the introduction of different pricing levels within Council Tax Bands, there is no specific allowance for, or expectation of, alternative premiums to be charged for properties within those Bands to, for example, reflect PFR measures that householders have installed.

Flood Re has committed to promote the development of an evidence base and engage with the insurance industry to develop mechanisms to recognise the adoption of PFR by householders.

By offering discounted premiums Flood Re aims to incentivise the take up of PFR measures by householders. Through lower inward insurance premiums, Flood Re will recognise those who have taken active steps to reduce the impact and costs of future flooding events on their property. This will help to support a market for resilience products and help to change attitudes and behaviours.

Will offering discounted premiums help incentivise the uptake of PFR measures? Flood Re believes that discounted premiums should play a part along with other measures by recognising and rewarding responsible behaviour by householders. This approach has worked well in other areas of home insurance, for example, with the voluntary installation of smoke detectors and mortice locks. The success in these examples has been due, in part, to significant data held by insurers which demonstrates lower claims costs and lives saved through these installations. We believe this change will act as a nudge and lead to some people deciding to make their property more resilient and/or better able to resist flooding in future. It will not be sufficient on its own, but it has its part to play along with other initiatives by other stakeholders.

What discount should be provided? Flood Re hasn't set out a specific discount for homeowners, but within the QQR, we financially tested the impact of awarding either 50% or 20% premium discounts for properties with PFR on the existing rates.



BUILD BACK BETTER

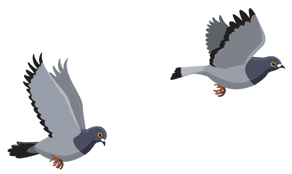
Build Back Better refers to the process of carrying out a more resistant and/or resilient repair to flooded homes. This enables changes to the Scheme to permit the payment of claims to include an additional amount for resilient or resistant repair beyond the original damage.

What are the impacts of offering Build Back Better? Flood Re believes that in order for a successful transition, the cost of flood claims and the risk of flooding must reduce. One element of that requires an increase in the number of homes in the UK with property level resistance and resilience measures in place. For its part, Flood Re cannot currently reimburse homeowners or insurers who take steps after a flood to repair their homes in a more resistant or resilient manner.

Build Back Better will help to stimulate market development, as when it comes to paying for damages in the event of a flood, the Scheme will only refund the cost of properties whose policies are ceded to Flood Re.

Will it encourage householders to consider fitting PFR measures? In addition to stimulating the evolution of the PFR market, Flood Re believes it is a positive development in starting an important conversation with householders around potential flood risk associated with their property.

Should insurers choose whether or not to offer Build Back Better? How will it encourage market competition? Flood Re cannot mandate insurers to offer Build Back Better as this is a commercial matter, but it should not stand in the way of a market development. In the competitive market that exists, if several major insurers adopt Build Back Better, then others are likely to follow suit as this would otherwise give them a competitive advantage and make them more attractive to potential customers.



LEVY I

Flood Re has proposed that Levy I is recalculated so it runs on a three-year cycle aligned to Flood Re's outwards reinsurance programme procurement. Flood Re has collected £180m via the Levy in each of its three years of operation to date.

Why should it be changed? Flood Re believes that the setting of Levy I should be more flexible to the needs of the Scheme and reflect the prevailing risk profile. Changing the levy setting cycle to three years will also align it with Flood Re's reinsurance procurement programme.

Who will benefit from the change? In the highly competitive market that exists, Flood Re expects that the savings in levy costs should be passed through to homeowners in policy pricing changes.

LIABILITY LIMIT

Flood Re has advocated for the calculation of the Liability Limit and Levy to be concurrent and assessed every three years.

The Liability Limit refers to the maximum level of gross claims in any one financial year that Flood Re is liable to pay to the market. The Liability Limit was set in April 2016 at £2.1bn plus CPI for an initial period of five years.

Is three years an appropriate setting period? Flood Re believes that the Liability Limit should be adjusted more regularly relative to the total volume and level of risk assessed for business ceded to Flood Re, rather than being fixed for another five-year period.

This will allow the Scheme to provide the intended level of protection and more dynamically respond to future changes in demand.

What are the benefits in reducing the Liability Limit? Reinsurance is the most significant area of expense for Flood Re and so ensuring the programme purchased provides the required level of security while being able to evidence managing public money is key to managing the interests of all stakeholders. There is expected to be a significant cost saving per annum as a result.

USE OF FLOOD RE FUNDS

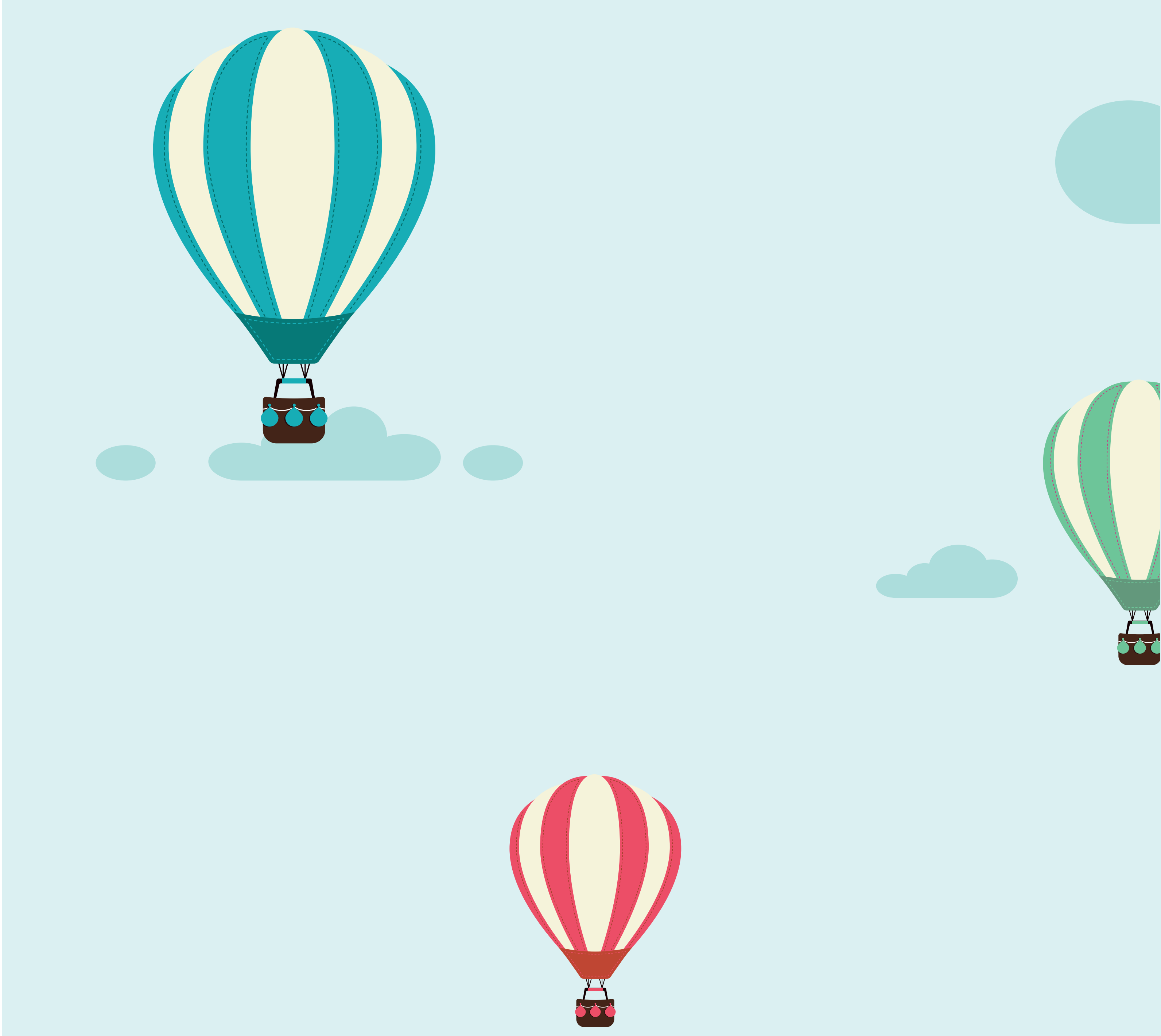
Flood Re's cash reserves help to ensure that the Scheme is in a strong position to support households at risk of flooding in the years to come. Flood Re shouldn't directly fund the uptake of PFR measures, but has been supporting, encouraging and funding initiatives to build the evidence base, promote innovation and provide thought leadership.

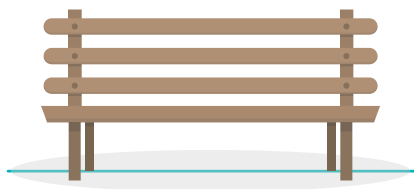
We are also seeking to incentivise householders to make their homes more resilient by introducing reduced premiums and supporting Build Back Better.

FLOOD RE PREMIUMS

Flood Re was designed to promote the affordability of home insurance for those at risk of flooding and the current premium thresholds are progressive; charging the most to high Council Tax Bands and the least to low Council Tax Bands. It is important to note that these are the premiums Flood Re charges the insurance companies for ceding the flood risk element of a policy.

What is the impact of changing premiums? Flood Re regularly reviews premiums that it charges and announced a reduction in 2019 following a review. However, it can take a significant amount of time to carry out qualitative and quantitative impact analysis. Although reducing the cheapest premiums charged could be beneficial to householders, we believe that the introduction of reduced premiums for PFR measures and Build Back Better will ultimately be more beneficial as they reduce the overall flood risk.





FLOOD RE