

FLOODRE

INCENTIVISING HOUSEHOLD ACTION
ON FLOODING AND OPTIONS FOR
USING INCENTIVES TO INCREASE THE
TAKE UP OF FLOOD RESILIENCE AND
RESISTANCE MEASURES

March 2018



INTRODUCTION

“We believe that PFR measures are beneficial and play an important role in flood risk management. Whilst further work is required to quantify their potential to reduce loss, Flood Re believes that in relation to incentivising PFR uptake, rewarding homeowner action will be more effective than penalising a lack of action”

Flood Re was established by the insurance sector and the Government in April 2016 and operates independently of both. Its unique purpose is to promote the availability and affordability of flood insurance and to manage, over its lifetime, the transition to affordable risk reflective pricing.

Included in our first Transition Plan was a commitment to a programme of work to understand whether and how Flood Re might support and incentivise households to take action to bring the costs of flood insurance down. Looking specifically at installing property level flood resilience and resistance (“PFR”) measures, Flood Re sought the expertise from a number of sources to contribute to its thinking. However, PFR is just one aspect of better flood risk management and only one part of the scope of Flood Re’s Transition Plan.

Firstly, Flood Re worked with the University of the West of England (“UWE”) in a substantial research programme to assess the current evidence base for the merits of PFR. That research sought to answer the question: “How effective are property level resistance and resilience measures in reducing loss due to damage and time to repair resulting from flooding for UK households and their insurers?” The conclusions to date have led Flood Re to the view that PFR measures are beneficial and play an important role in flood risk management. Further work is required to better quantify specific benefits to reduce the loss arising from flood, but in the meanwhile, Flood Re considers that homeowners should be

encouraged to put PFR measures in place. In the interests of sharing this insight, we have published today Phase 2 of UWE's Evidence Review for Property Flood Resilience.

Flood Re staff have visited areas which have flooded and met with many homeowners who have suffered as a result. Insurance cover offers vital comfort, but Flood Re recognises that the emotional and practical difficulties suffered also have a significant impact. Flood Re is mindful of the Scheme's potential paradox; that whilst the Scheme enables affordable insurance, irrespective of flood risk and claims, there may be less incentive for homeowners to invest in PFR. However, it is Flood Re's view that PFR and insurance both play a part in flood risk management and that the existence of the Scheme alone should not act as a disincentive for taking up PFR.

Secondly, working with Populus, a market research organisation, Flood Re sought greater insight into the characteristics of the policyholders it is likely to see in the Scheme. In understanding their attitudes to the underlying flood risk and their views on taking preventative measures (including insurance and PFR), Flood Re is better informed about the likely obstacles to its recommendations. This research has been supplemented by insight provided to Flood Re by the financial services conduct regulator, the FCA, following extensive research it had previously carried out.

Thirdly, in order to further inform our considerations, Flood Re commissioned an independent think tank, the Social Market Foundation ("SMF") to explore policy options on how incentivisation for uptake of PFR might be achieved. Their report is also published today and we welcome it as a thorough, useful and comprehensive consideration of the issues.

Flood Re has considered at length a wide range of options for incentivisation. Drawing on all of the sources above, as well as our experience of operating the Scheme for more than 18 months, through our continued involvement with the Resilience Round Table and through our engagement with insurers, DEFRA and our other stakeholders, we now present the Flood Re conclusions in this paper.

In addition to incentivising householder action on PFR, there are a wide range of other aspects to a successful transition to affordable risk reflective pricing. These will be the focus of other streams of work within Flood Re and will be considered in future publications.

FLOOD RE'S OWN ROLE IN INCENTIVISING PFR UPTAKE

Flood Re's purpose is to promote and enable the availability and affordability of flood insurance for eligible homes and to manage over our lifetime the transition to an affordable market for household flood insurance. To both of these ends, Flood Re has an interest in incentivising households to take action to better protect their homes.

It became apparent before Flood Re was established that the frequency and severity of flooding, accompanied in some cases with an increase in the costs of insurance, were not enough on their own to prompt a change in behaviour by people to make their homes more flood resistant and resilient. Understanding the reasons for this has been an initial priority for Flood Re and it is now clear that a combination of factors are now relevant. For example, based on insights from both the SMF report and our research with Populus, evidence suggests that household decision-making may be significantly hindered by the fact that there are currently few credible sources of information that they can use to understand the likely efficacy of flood protection measures. It is also clear that homeowners are not always aware of the true flood risk that they face. Thirdly, it is important to note that it is not only the messages about flood protection that matter, but also, that the communication comes from the right people or trusted voices. Our research suggests that it is unlikely

that messages from the Government or insurance industry will be the most effective route. By contrast, trusted local tradespeople and agencies such as the Fire Brigade have been successful in communicating about flood protection. Setting up local flood groups can also be effective.

Flood Re itself is also identified as being a potentially effective channel to try to influence behaviour. Being independent, having a clear statutory purpose and being a centre of flood risk expertise, places Flood Re in a unique position. Whilst we currently have a limited role in communicating directly with consumers, there could be value in doing so if it were shown to be an effective way to shape household decisions.

Therefore, Flood Re will undertake further work to understand specifically which channel, or combination of channels, work best in communicating messages about taking up PFR measures. We will consider local agencies including the Fire Service, insurers, Government, local flood groups and Flood Re itself.

HOW THE SCHEME MIGHT BE USED TO INCENTIVISE UPTAKE

Suggested changes to the Scheme have broadly fallen into two categories: those that seek to dis-incentivise householders from relying on Flood Re alone (in effect, punishing them for not taking up PFR), and those that seek to incentive positive action (in effect, rewarding those who choose to take up PFR).

Currently, more than 142,000 homes in the UK are benefiting from an insurance policy backed by Flood Re and our influence on the home insurance market means that many more than this number have access to affordable flood cover. Given our success, we have been looking at ways in which the parameters of the Flood Re Scheme could be adapted to encourage the take up of PFR.

As a very large number of properties could benefit from PFR measures, the SMF report correctly identifies that any strategy of incentivising the uptake of PFR needs to look beyond only those properties that are ceded to the Flood Re Scheme.

Methods of Dis-incentivising Reliance on the Scheme Alone

In relation to the first, “disincentivising” category, the most obvious method for Flood Re to encourage change would be to increase the level of its premiums over time (like an escalator), so that premiums would move ever closer to the risk-reflective price. In theory, this should incentivise households to take up resistance and resilience measures, so that the risk associated with their property is reduced and their premiums remain lower.

However, we agree with the SMF’s analysis that, whilst in principle the simplicity of this approach seems attractive, the evidence suggests that in practice it is unlikely to be either simple or successful. Prior to Flood Re existing, households faced higher premiums and excesses and this did not increase the uptake of PFR measures. There is also a broader point, that increasing premiums over time

in this way would not be consistent with the public policy purposes of Flood Re. The Scheme was set up to promote the availability and affordability of flood insurance, so increasing premium prices would explicitly work counter to this ambition.

The second proposal in the “dis-incentivising” category is the so-called “three strikes and you’re out” method. This idea was considered whilst Flood Re was being set up, suggesting that if flooded households did not take up PFR, they would be prohibited from having their policy ceded to Flood Re after the third time they were flooded.

However, as with the escalating premiums proposal above, we believe that the “three strikes and you’re out” method would explicitly undermine and counter our public purpose of promoting the availability and affordability of flood insurance. The SMF report correctly points out that the impact of such a disincentive would be, at best, marginal. Furthermore, as Scheme Administrators for almost two years, our experience is that the practical barriers and complexity of implementing such a proposal are likely to be insurmountable both for insurers and for Flood Re.

Methods of Incentivising Positive Uptake

In relation to the second, “positive incentives” category, there is currently almost no link between the action of

individuals in protecting their properties against floods and the insurance premium which they are charged by insurers. In principle, establishing such a positive link is an attractive approach, as it would provide a direct incentive for households to invest in PFR.

Whilst we recognise the challenges and limitations of this approach highlighted by both the UWE research and the SMF report, we do believe it has some potential. Reduced premiums should play a part along with other measures, if not by encouraging, then at least by recognising and rewarding responsible behaviour by householders. It is also an approach that has precedents in other areas of home insurance for example, with the voluntary installation of smoke detectors and mortice locks. The success in these precedents has been due, in part, to significant data held by insurers which demonstrates lower claims costs and lives saved through these installations. Flood Re’s access to insurer data is currently limited, but greater insight would be gained from access to flood claims on policies which are not covered by the Scheme. Work to raise awareness of the flood risk that households face will also need to continue for this method to be successful.

The final incentive in this category that we have considered at this time is the “build back better” option. This is relevant when, following a flood, an insurer renovates and restores a property, known as “reinstatement”. Currently under the Regulations governing the Scheme, a claim can only be made for a

property to be reinstated to the same standard as before the flooding occurred. The cost of any “betterment” would need to be met by the homeowner or insurer and would not be refunded by the Scheme. The method of “building back better” would allow for reinstatement to exceed the value of simple like for like replacement, and improve the property, but only insofar as the improvements made the property more flood resistant or resilient in the future.

The SMF has rightly noted that Flood Re’s adoption of the “build back better” approach would be insufficient to upgrade the whole of the UK housing stock that is at risk. However, we believe, through our engagement with insurers and observing innovations currently taking place within the industry, that there is an important role for “building back better”. This approach would also be significantly improved if Flood Re had access to claims data relating to policies which are not covered by the Scheme.

Furthermore, we believe that “building back better” could potentially have much broader benefits. It could help to change social attitudes towards and the acceptability of flood resilience measures in homes, stimulate demand for products, develop trade skills, encourage innovation in the resilience industry, model innovations for the insurance industry, quantify the benefits of PFR and help all stakeholders understand more about effective installation.

In this vein, Flood Re welcomes the recent announcement of one UK Home Insurer that proposes to offer PFR when dealing with flood claims. Whilst the Flood Re Scheme cannot at this time cover such claims, we are encouraged by their decision to fund this.

On the basis of our work, it is Flood Re’s view that positive methods of incentivisation are more likely to be effective than penalising a lack of action. Therefore, Flood Re will not be proposing a change to the Scheme to allow for either a premium price “escalator” approach or a “three strikes and you’re out” approach to incentivise the update of PFR measures. Instead, as part of our preparations for the quinquennial review of the Flood Re Scheme, we will continue to build a sound evidence base and engage with stakeholders to develop mechanisms to recognise the adoption of PFR by householders and investigate ways to practically support a “build back better” approach.

HOW FLOOD RE CAN WORK WITH OTHER STAKEHOLDERS

Flood Re recognised in its first Transition Plan that delivering affordable risk reflective pricing by 2039 would, by necessity, involve actions, innovations and initiatives by a wide range of stakeholders beyond Flood Re itself.

Flood Re is uniquely placed to continue to work with others to develop and implement a package of measures that could be adopted over the course of the next 20 years. Whilst Flood Re may not be able to take certain direct steps itself, it will, when appropriate, advocate that others take steps instead. On the basis of its current understanding, Flood Re will support efforts to:

- Reform Building Regulations to ensure that (at a minimum) low cost and negligible cost resilience/resistance measures are undertaken on a mandatory basis whilst properties are being reinstated post-flooding and also, that resistance and resilience measures are rolled out to all new and renovated properties.
- Improve and extend the existing flood resistance and resilience grant scheme to cover more households and introduce clearer rules on co-payment (means testing). Those changes might include administering the grant scheme centrally through Flood Re.
- Increase household responsibility for resilience action and reduce the negative signalling effects of action, by requiring at-risk households to have a “resilience survey” that leads to the creation of a Flood Performance Certificate. Working with surveyors and estate agents, this could be mandatory when properties are sold, rented or built and voluntary otherwise. This could help to frame such measures as a mitigating flood risk rather signifying it. If they are seen as improvements then this could help offset the potential adverse impact on house prices.

Flood Re considers that these options offer exciting possibilities which Flood Re will explore further within its next Transition Plan, along with ideas about improving the collective view of flood risk and facilitating best practice.

Next Steps

Flood Re's focus on the role of property level resistance and resilience will continue as part of its transition activities. We will be looking at how we can take forward the principles we have set out above in practical ways to work towards affordable risk reflective pricing in our update to our plan to be published in July. In the meanwhile, we will continue to build an evidence base through the next phase of our collaboration with the University of the West of England, with our focus specifically on measuring the effectiveness of PFR in reducing loss. We will also continue to understand better how to communicate the right messages effectively to bring about behavioural change. To that end, we are undertaking qualitative and quantitative market research to better understand households at risk of flooding and how to incentivise, both financially and non-financially, proactive and post-flood adoption of PFR. Flood Re will continue to use its unique position to the greatest advantage to cooperate independently with other organisations working in flood risk management.

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