



Environment, Food and Rural Affairs Committee

Oral evidence: [Insurance for flooding](#), HC 1142 Tuesday 11 March 2014

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Members present: Miss Anne McIntosh (Chair); Jim Fitzpatrick, Iain McKenzie, Sheryll Murray, Neil Parish, Mr Mark Spencer

Questions [1-54]

Examination of Witnesses

Witnesses: **Graeme Trudgill**, Executive Director, British Insurance Brokers Association, **Aidan Kerr**, Assistant Director, Head of Property and Health, Association of British Insurers, and **Mark Weil**, Chief Executive Officer, Marsh Ltd, gave evidence.

Q1 Chair: Good afternoon, gentlemen, and welcome. Thank you for participating in our inquiry into insurance for flooding and our one-off evidence session. Just for the record, could I ask each of you to state your names and positions just so we have got that on the record?

Mark Weil: Mark Weil, CEO of Marsh Ltd.

Aidan Kerr: Aidan Kerr, Head of Property at the ABI.

Graeme Trudgill: Graeme Trudgill, Executive Director at the British Insurance Brokers Association.

Q2 Chair: Thank you. Obviously, we took some evidence from you at the time of the Flood Re and the draft Water Bill, working as part of the pre-legislative scrutiny. Things have moved on a little since then. Looking at the recent winter floods, how do those compare with the damage caused with the 2007 floods in terms of insured loss and damage to properties?

Aidan Kerr: It is still early days, and we are still trying to finalise the figures. We published numbers during the middle of January that suggested that for the period between 23 December and 8 January, the losses at that point—the amount that insurers expected to pay to their customers—was around £195 million, just under £200 million. Since then, we have asked our members for further data relating to 23 December right through until the end of February. Those numbers are just coming in. We are verifying that at the moment, but it looks like it will be at least double that figure for the whole period for flooding. We are expecting towards the end of this week to do a press release where we will publish

those overall numbers. As the Committee will understand, we will talk about the flood numbers, but in addition to that, there will be figures for the amounts we expect to pay to customers for storms. That will probably be a similar amount again.

Q3 Chair: Looking back to from September 2012 to March 2013, substantial parts of Yorkshire were flooded. In terms of houses, were there not more properties actually flooded in 2012-13 than in the winter floods this year?

Aidan Kerr: I cannot recall the numbers that were flooded in 2012-13. The number of homes flooded in this recent event—and I say event, but it has really been the events since December right through until February—is looking like it is getting into the high teens. That is around about 18,000 claims in total. To put it in perspective against 2007, which was devastating and had fairly significant flooding across the country, we think this is perhaps of the order of magnitude of about a fifth or a quarter of those floods.

Chair: Can you give us a ballpark figure?

Aidan Kerr: A ballpark figure would be maybe upwards of £400 million, in terms of the flood damage.

Q4 Chair: Can you give an assurance that your member companies are using normal local telephone network rates, not premium rates, when people phone in to claim insurance?

Aidan Kerr: This was discussed at the ministerial meeting that was held at the Cabinet Office a few weeks back. At the ABI, we are not able to actually make that statement because that is something that commercial entities themselves decide. However, each of the insurers who were there took away the action to look at how they approached this, so I know they are certainly looking at it.

Chair: How much have the insurance companies actually paid out so far?

Aidan Kerr: Work has started on a number of the properties, and so it is difficult to know how much has been spent on the repair work. That will be tens of millions of pounds. In emergency payments alone, insurers have paid £20 million to customers. This is stuff that they need in the immediate aftermath, such as things like clothes, toothbrushes, toothpaste, and essentials, just to get people through the immediate few days after a flood. They paid £20 million straight into people's bank accounts. In addition to that, it is between around £20 million and £30 million on alternative accommodation to date, but that is likely to continue. We estimate at the moment that there are around 2,000 households that have needed to be put into alternative accommodation. Of those, there are 1,500 still in alternative accommodation. That just underlines that this is a long-haul process. This is going to be a process that is going to take many months for many households to get back into their properties.

Q5 Chair: Are the loss assessors doing their bit?

Aidan Kerr: The loss adjusters have been out in force. We estimate that there have been around 6,500 visits from loss adjusters in the period. They have been getting out there. There are still 500 loss adjuster visits scheduled that have not happened that are only now able to take place, because it has just taken so long for the water to go down, for places to become safe and for properties to be ready to be assessed by a loss adjuster. We estimate that 6,500 visits have been made so far, with a further 500 scheduled.

Q6 Chair: You have made an announcement as an industry that you plan to invest £25 billion in infrastructure projects over the next 5 years. Would you consider investing in flood defence infrastructure as part of a new investment drive? That would certainly be a real boost to householders.

Aidan Kerr: There is no doubt that our insurers would be interested in investing in flood defence infrastructure. There is a clear link between the effectiveness of flood defence infrastructure and the chance of a home flooding. The issue for where insurers invest in infrastructure is the ability for them to get a return on the investment. That has always been the issue for flood defences: the issue of having a return possible to be received on that investment that is made.

Q7 Chair: We are going to go into Flood Re in more detail in a few moments, but could you just talk us through what the implications would be if the Government were to step in as in insurer of last resort, if the pot did not have enough money in the first two or three years under Flood Re?

Aidan Kerr: First of all, it is important to say that these floods are of the order of magnitude of maybe a quarter or a fifth of the severity of those in 2007. We estimate that Flood Re would be able to deal with a year that is some six or seven times worse than 2007. We all know how severe the flooding has been over the last few months. It has been dramatic and it has been traumatic for the householders, but it is still way away from anything that would trouble Flood Re's ability to deal with it. The way Flood Re is set up is that it will deal with losses in any given year up to what we refer to as a one-in-200-year. I can take a few minutes to explain what that means.

Chair: I think you will have the opportunity in a moment.

Aidan Kerr: Because of the Prudential Regulation Authority's requirements, insurers under Flood Re will need to have enough capital—money set aside—to be able to pay claims up to a one-in-200 event. There will be implications for insurers to make sure they have capital aside and implications for Flood Re. They are working on that at the moment though, and we are working with the PRA. Certainly, the indications are that this is a novel piece of work, but that will not be a showstopper to making it work.

Q8 Chair: Do you believe, Mr Weil, that the reinsurance industry had any part to play, given that this was apparently an event that we had not seen the likes of since 1766 in terms of water fall?

Mark Weil: I want to start by stating an interest. My sister company will be party to a bid to support Flood Re. I will just put that on the table.

Chair: To support—?

Mark Weil: Flood Re, through the reinsurance programme. There will be a public tender that they will be bidding for. Reinsurance is required. You are setting up a pool. That pool will carry risks. It looks like an insurer and it requires reinsurance. That reinsurance has to come from somewhere. In the design, up to the one-in-200 it will largely be coming from the private reinsurance markets. As I understand it, there will be some slightly unspecified Government backstop in more extreme circumstances.

Q9 Sheryll Murray: I am sorry to take you back to the question about premium rate telephone numbers? For every premium rate telephone number, the line is accompanied by a

local number. Would it not be very simple and not cost a lot for the insurance companies to actually publish that number during events such as we have seen? Would it be possible for them to perhaps to investigate that?

Aidan Kerr: Yes. We can only speak for the ABI members, as you will understand. I will go away and see the extent to which the numbers that they can call is made clear to the customers. You understand that, as a trade body, we cannot actually start to decide how different insurers carry out this sort of thing. In feedback from the discussions that we have had with ABI insurers, they often tell us that the numbers that are called by people who are making claims have call-back facilities, so the amount of time they spend outward calls is very short anyway. They are looking at this, though. It is an action they are taking away and we have the next ministerial meeting with Oliver Letwin and other Ministers in a couple of weeks' time. They will report back what they have done since that meeting.

Q10 Neil Parish: Will the new financial measures announced by the Government as part of the current response to the winter floods help to provide better long-term property protection and resilience? What do you think of the amount of money being put forward by the Government?

Graeme Trudgill: We think that, overall, the real time costs of Government spend are actually reducing. If you look at the real cash terms, for 2012-13 compared to 2013-14, there is a £1 million increase, but that equates to a £10 million decrease. That is a concern. Certainly the repair and renew £5,000 budget offered is very positive. We like that. We think it should, if possible, be made available more long term, to help people who are flood victims to make their properties more resilient. Then they are easier for us to insure as well.

Overall, when we look at *The ENDS Report*, and what the Chief Executive of the Environment Agency, Dr Paul Leinster, is saying, he is saying that, due to falling funding, the Environment Agency has to cut 15% of its staff—from 11,400 to 9,700—by next October. He said it is going to be painful and a significant change, that it could hit our performance, and that it is difficult. The flooding staff will be reduced by 557, from 3,732 to 3,175, and he says flood risk maintenance will be further impacted. That is a concern. We have been out speaking to people whose homes have been affected and saying, “How has the experience been for you?” They have basically said, “It has been bad. We have not have anyone from the Environment Agency contact us. We have not had our river dredged for many years. Things have not been maintained properly.” With the cuts announced here, there is a long-term concern that it could be harder to insure some of these properties in the future.

Q11 Neil Parish: It is not only about the staffing levels within the Environment Agency, of course; it is also about the capital schemes and the maintenance. Are you not looking for Government to put money into that in particular?

Graeme Trudgill: Very much so, and I think that the partnership funding is a good idea to get large insurance institutions to contribute, but we would not want the Government to reduce their spend. We think it would be of concern to shift the cost from Government to the industry. Absolutely, when we look at what the Government scientists say, they say that spending on flood defences needs to increase by over £1 billion a year by 2035 due to climate change and situation that they see. We think there needs to be a review and greater investment from Government in flood defences.

Mark Weil: I will make a general comment at this point that goes back to comments I made at my last appearance at this Committee. I think it is important the Government participates in this. Flood Re, as proposed, leaves the burden heavily within the industry. A concern we raised at the time was where does the Government participate and are more macro defences required, but insurers are there to insure houses, not to build them. If betterment is required in properties, that seems to me a good area for Government to participate. Individual insurers obviously have a time horizon problem—they insure for a year and this is expensive capital work that needs to be amortised over several years. It feels to me that that is an area where Government needs to be encouraging and pushing people to make their homes more flood resistant.

Q12 Neil Parish: The second part of my question or another question is this: to what extent will the cost of insurance premiums be impacted by the new financial measures? I think the whole idea of Flood Re was to build up a fund to start with, wasn't it? I suspect one of the problems with this year's floods is that that pot is going to be called upon. Have you done any figures as to how the pot is building up?

Aidan Kerr: Not yet. Just to quickly go back to the investment and funding question, I want it to go on record that from our perspective, we think the Environment Agency does an incredible job in very difficult circumstances. It is not just about building defences and maintaining them. It is about the infrastructure around the Flood Forecasting Centre—warning people saves people's lives. It is a real worry where you have a threat to funding for things like flood warning systems and the Flood Forecasting Centre. In terms of questions about Flood Re's climate change credentials, it is built with climate change in mind, but it can only be as effective as the other climate change policies around it. That is around building defences, maintaining them and having a zero tolerance policy to the inappropriate development in areas at risk of flooding. It is about warning people and forecasting flooding.

Spending money on flood and coastal risk management, from my perspective, makes absolute economic sense for the country when you have, for the flood defence schemes, £8 of damage avoided from every £1 invested. That really is a no-brainer from my perspective. In terms of how Flood Re would build up the pot, we estimate that it would start in June 2015. That is the start date. From that point, Flood Re would collect the levy and it would start building up the pot from that point on.

Chair: We are coming on to Flood Re in a moment.

Q13 Neil Parish: Right, so it has not already done that then?

Aidan Kerr: No, that is right. We actually estimate that around 30% of the flood risk in the UK would be in Flood Re. That again just gives a flavour what impact on Flood Re the floods across the UK would have had.

Q14 Neil Parish: What is the impact on the premiums at the moment, as we stand, on the residents?

Aidan Kerr: The first thing to say is that insurers provide, and reserve, for events exactly like this. It is very early to say what the impact on premiums is from this current flooding. Insurers will assess all sorts of factors to come up with what premium is right to charge. It remains a competitive market, but we understand that it is very worrying for people being able to access affordable cover. That is really the basis for developing Flood Re.

Q15 Neil Parish: Does the Statement of Principles remain in place until Flood Re comes in?

Aidan Kerr: It does, yes.

Q16 Sheryll Murray: I actually come from an insurance background, and I know that people do get reduced premiums now for having burglar alarms and that sort of thing fitted to their properties. To what extent will insurers reflect flood prevention measures being installed by individual households? We have already heard about community schemes, but not all households can be beneficiaries of the community schemes. Do you see recognition, for instance, for fitting the lockable gates?

Graeme Trudgill: Yes, our members do give recognition. We have specialist flood brokers within BIBA membership, and if a property is in a particularly high-risk area—perhaps they have been flooded before—then one of the conditions almost of trying to insure them going forwards will be that they try to co-operate, and then look to perhaps have a survey done, perhaps have some air-brick covers and door shields in place, and sign up to the Environment Agency flood alert, so that when the warnings do come, they can protect their home. That is absolutely taken into account. Evidence we have given previously to this Committee showed how we were able to keep excesses lower and premiums more competitive, and have more markets available, where that effort has occurred.

Aidan Kerr: I can add to that. As a general statement, insurers will do whatever they can to assess risk as best they can because that is how they get the business. If they can price it accurately then they will basically have the most viable business. The issues with the resilience and resistance, as we see it, are twofold. First, the evidence base for how effective the variety of resilience and resistance measures are in keeping water out or in, allowing the damage to be reduced, is not there yet. The Environment Agency and DEFRA—along with the ABI and BIBA—developed a template that allows surveyors to assess this sort of thing. That evidence will hopefully start to build up, and that can only help insurers take account of these sort of measures when they are assessing risk.

The second point is about scale. The British Damage Management Association has assessed that in some cases, you would increase the claims cost by up to 30% or 40% to really make a property more resilient. When an average flood claim is about £30,000, that is a significant amount of money, and it is significantly greater than the £5,000 in the Government grant, for example. From our perspective, if you have these sort of measures in place you can get back in your property more quickly—so, there is an absolute cast-iron benefit there—and, in some cases, it can actually help you access insurance. To really start making a massive difference to price, though, the evidence basis for how effective such measures are needs to be improved.

Mark Weil: The only comment I would add to that is to note that, obviously, your comment on it was whether insurers reflect that the tariff system being proposed. It is obviously hard to directly reflect it in the price, so work needs to be done on some other mechanism for encouraging people to make those kinds of improvements.

Sheryll Murray: Can I just ask one supplementary? I heard you mention about dredging and that sort of thing. Could I just ask your views about storms? A lot of my constituency suffered from the recent storm damage, and homes got flooded in that way. Do you envisage that the lack of funding to perhaps build sea defences—

Q17 Chair: We are actually coming on to that momentarily. Could I just stick with resilience for one moment? Locally, I have seen that where a house has been flooded, the householders do not want to have resilience measures put in place, such as tiles on the floor in place of carpets, and the electric plugs halfway up the wall, because they do not think it looks very nice when they have visitors and because they do not think they will be able to sell the house. Is that a factor with your members?

Aidan Kerr: It is. You have to remember, as everyone here will know, the emotional trauma that happens when you have suffered from flooding. It is a very understandable human reaction to just want to forget about it—to want to have your property back to the way you have decorated, designed and built it. The thought of having a different type of plaster, different types of flooring and sockets further up the wall, can be quite difficult for many people to take. Ultimately, it is a customer choice; customers choose how their property is repaired, and insurers will, by default, pay for returning the property back to how it was before the flood happened. That is what insurance is for, but that is more that can be done. One thing we are trying to do with Flood Re, which I know we are going to come on to, is to think about how we can get that kind of repair work built in to the claims process for people who are in Flood Re.

Q18 Chair: Mr Trudgill, do you agree?

Graeme Trudgill: Yes. Obviously, if it is someone's choice not to do that then that is their decision. It will mean that it will be harder to access insurance, because they are unfortunately not co-operating to do that. It is all to do with risk management, and they are not managing that risk by doing that. It is positive that the insurance industry, when it does repair a property, is prepared to repair it in a different way to make it more resilient in future. That is something that we are prepared to do, on the whole. Obviously, if it costs more than the original then you would expect the policyholder to source that additional income, but if it is not costing any more then we can do it. However, if they are not prepared to do it then it is something that our brokers would find it harder to place elsewhere.

Q19 Iain McKenzie: It seems to me that is almost a situation of preparing for disaster rather than preventing disaster and limiting the effects. What you are talking about—those steps that would be taken in the house—would be when the last line of defence would be breached. From what you are asking them to do, it would seem that they are being asked to put all these bits in place in the knowledge that they will be flooded.

Graeme Trudgill: It depends on the degree of risk that is presented to them. If they are in very significant area of risk—if they have been flooded several times before—then it would be very sensible for them to repair in that way. Now obviously, as we have already said before, every £1 spent on defences has an £8 benefit. We would want money spent on defences to stop the claim happening in the first place. If it is a vulnerable house that is at high risk and has been claimed before, then for the insurance industry to want to insure it going forward, it would be beneficial for them to make some compromises if they want to continue to live in that high-risk home and have affordable and accessible insurance.

Q20 Iain McKenzie: The Committee heard in a recent evidence session that about £40 million of the £148 million partnership funding is expected from the private sector. Does the method of securing this money from private sector funding for flood defences need to be improved?

Aidan Kerr: The issue with partnership funding, as illustrated by those sorts of numbers, is that the majority either comes from contributions from the local levy in local areas, or from local authorities. Local authorities have had similar funding constraints as those experienced by DEFRA. The £40 million related to projects—such as those in Sandwich in Kent, and the Upper Mole, where Gatwick Airport contributed towards it—where there are specific companies that could benefit from it, is all good, and I think has a very important place. The more that can be received from companies who will directly benefit from the flood defence, the better.

There must be an issue with monetising the benefits though, because you have an eight-to-one benefit/cost ratio for a flood defence and for some reason the companies that should contribute to these sorts of defences are not seeing the value to them. Whether that is because it is not being sold enough or whether they are unable to actually realise the benefits when they are deciding where to invest their money, I do not know. However, I certainly think that if only £40 million of the £148 million is coming from the private sector, then something needs to change with how that is being sold to those private sector companies that are contributing towards flood defence projects.

Q21 Iain McKenzie: Would you say the insurance industry has a part to play in the partnership fund?

Aidan Kerr: I would say that it does, but I suppose it almost illustrates what is likely to be the issue. When an insurer is looking to see where it invests its capital, if it invested in any kind of infrastructure, it would look to see a return on that investment. Whereas a flood defence would result in £8 of damage avoided for every £1 spent, that is not actually a cash flow coming back to the investor. That has always been the issue with flood defences: unless you create some kind of levy where you charge those benefiting from the flood defence, it is difficult to see how the cash flow can go back to prospective investors.

Q22 Chair: How would you be paid if insurance companies are prepared to invest this £25 billion into flood defences? You would presumably need some return. We might argue that the return would be that you have to pay out less in insurance claims. Would you consider leveraging some money into flood defences from the insurance industry?

Aidan Kerr: Yes. Some of our bigger insurers are considering how you could put some of that investment funding into flood defence infrastructure, because you are absolutely right that there is clearly a link between a flood defence's effectiveness at reducing claims. Increasingly, what insurers are looking to do is to think how they can help the UK to look at its infrastructure, thinking about climate change in the future. Certainly, they will be looking at flood defences just as they will be looking at any kind of infrastructure that would help to mitigate the effects of climate change, rather than help with the adaptation to climate change.

Q23 Chair: Is it actively being looked at?

Aidan Kerr: It is being considered by individual companies, yes.

Chair: That is helpful, thank you.

Q24 Mr Spencer: Turning to maintenance, can you give us any examples of where something was not maintained, was not inspected, or should have been serviced, and as a direct result of that lack of maintenance, led to flooding?

Aidan Kerr: I am afraid I cannot give you specific examples of that. Our members may be able to, but we are not aware of any at the Association of British Insurers are not aware of any. We are concerned about the amount of funding going into maintenance spending, though. I think a presentation in 2012 from the Environment Agency forecast that the amount of money for maintaining defences and watercourses will reduce by around about 30% in that period in cash terms. Now, that has been amended since then, as a result of the recent floods. None the less, maintaining flood defences is a key part of investment in flood defences. If you have an increased amount of funding going towards building flood defences, but less money going into maintaining them, then increasingly you are only going to be able to maintain those highest-risk assets.

Q25 Mr Spencer: Yet if you cannot give us any examples of that, how do we know that it is actually having an impact? You could make the opposite argument that actually, then, it had no impact whatsoever and it would be a waste of money maintaining them.

Aidan Kerr: Yes, perhaps. I have not got any examples of where it has gone wrong. In terms of maintenance, you would set out an asset management plan over a 100-year period in some cases, so you would only really understand the impact of this over a longer term, but there are no specific examples on my side.

Graeme Trudgill: We have got some examples. A couple, Colin and Jenny Chandler, highlighted that a lack of drainage ditches contributed towards flooding. By the parish council's own admission, it had not been dealt with or cleared out for two years. That, they felt, was a direct cause. They also had a pipe which drained from a field that had not been maintained, and the pipe was not big enough. If it had been attended to, their home would not have been flooded on Christmas Eve and we would not have had to spend £2,000 on pumps and getting that equipment out.

Q26 Mr Spencer: I suppose the challenge is that we do not know whether their house may have avoided that flooding, but one further downstream would have been impacted because the water would have moved to another location.

Graeme Trudgill: I think in their case, the way it ran off the fields was specific to them. Also, we were in Wraybury and the local residents there were saying how there used to be a dredger that regularly dredged the river and that that had not taken place for 10 years. In fact, the dredger was sold on and they could see what was going to happen; it did happen and they have been out of their house for more than five weeks. It is quite clear from some of the information that we are receiving back from home owners that the £15 million a year cut in the maintenance budget is having a negative effect on them.

Q27 Sheryll Murray: Now I am now going to ask about storms. Clearly, we are seeing continuous storm damage. Obviously, people's homes get flooded in the same way. Do you think that we should be looking at perhaps putting in more resilient coastal defences in certain areas, to protect those properties?

Graeme Trudgill: Yes. It is something that we support. Obviously if it protects those homes then absolutely, yes; fundamentally, yes.

Aidan Kerr: I agree. The economic rationale for a coastal defence is at least as strong as the rationale for building a defence that protects from fluvial flooding, because you have the additional loss-of-life risk from coastal flooding. So, not only will it protect the houses, but the severity and the depth of flooding you get from coastal flooding can be altogether more serious. It is more of a danger to human life, all else being equal, than river flooding,

so I think you are right. Whether it is river defences or coastal defences, we need to look at all these defences and assess how much money as a country we need to be spending in the right areas because climate change tells us that we can expect more and more of these sorts of events.

Q28 Sheryll Murray: Mr Weil, have you got anything to add?

Mark Weil: No, nothing to add.

Q29 Chair: Are you concerned that even if you look at the DEFRA funding for flood defence per se—we debated this in the House in the context of our reports from the Committee on managing flood risk—when you delve down, some of the money that is allocated to new flood defences is actually being spent on shoring up and maintaining existing flood defences? Do you think we need to have a much greater understanding of the budget between what is being spent on flood defences and the point of regular maintenance in whatever form?

Aidan Kerr: I agree with that. There absolutely does need to be more clarity between the two types of spending.

Q30 Chair: Are you doing anything yourselves to try and seek that greater clarity?

Aidan Kerr: On the back of the Memorandum of Understanding agreement last June, the Government agreed to increase the amount of funding for capital spending, which was obviously welcome, but we also need there to be a similar trajectory for maintenance spending. As Graeme said, there have been reductions in recent years. There need to be increases in both types; it needs to be targeted in the right place; and, for the local residents, there needs to be clarity on where that is happening.

Q31 Mr Spencer: We touched on Flood Re earlier, and you were talking about how this year's floods may have had an impact, but if they are one-in-200-year floods, we can cope. I suppose I am just trying to gauge the impact in my constituency, for example. Last year we had four or five one-in-30 year floods. To what extent is that going to chip away at the ability of the scheme to work?

Aidan Kerr: If the Committee would like, I can maybe start to talk about what a one-in-200 year means. I know this is a fairly difficult topic. I can try and do that, and apologies if I fail, because it is quite a complicated area. When you are modelling the risk of a pool—and by pool we mean, for example, 500,000 homes—you will think, “Well, what is the damage caused in a year in regular, same-year-on-year flooding?” It would be a certain amount of money. Then you would think, “Well, what is the damage caused if you have a flood with a 10% chance of happening in a year?” That would be quite severe and that would be a certain amount. What we have done with Flood Re in the modelling to date is, for the highest risk 500,000 households, do that analysis all the way up to what damage would be associated with the worst year in 200. That would have a 0.5% chance of happening. We have assessed that to be around about £2.4 billion for Flood Re. In the worst year in 200, it would cost you £2.4 billion.

If you then think back to 2007, we assessed that Flood Re would have suffered between £300 million and £400 million-worth of damage, based on the households that we assessed to have been in Flood Re that would have been affected by the 2007 floods. For the biggest peacetime recovery effort since World War II, you would need to have something that is six or seven times worse than that to start to push up against this one-in-200 year.

Q32 Mr Spencer: I understand that, but what I am saying to you is: if you get more regularly half of that amount, what impact will that have?

Aidan Kerr: For the sake of argument, if you had two one-in-50 events, as long as the overall damage in the year is lower than the amount of money that you assess against the 1-in-200, then Flood Re copes with it. If you have a series of events—so, heaven forbid, say you have eight 2007 events in one year—that takes you over that £2.4 billion. Flood Re deals with all claims up to that level, but then, as in the Memorandum of Understanding, Government would come in and use available resources to see how people can be got back on their feet. Just to be clear, if you had that happening, flooding is one in a list of issues for this country, because you are talking about an absolutely catastrophic event for the country.

Q33 Neil Parish: Do any adjustments need to be made to the Flood Re model to take into account the recent flooding events? In a way, I asked you a bit of that question to start with. Is it going to be robust enough?

Aidan Kerr: We believe so. We do not believe that the events—tragic as they were and as terrible for those who flooded as they were—changed how Flood Re needs to be designed. In actual fact, it just underlines exactly why Flood Re is so important. No, we do not believe any changes need to be made to Flood Re.

Q34 Neil Parish: Are you confident that you are going to be able to offer insurance at an affordable rate across the country?

Aidan Kerr: Yes. In fact, the design of Flood Re hardwires that in—that you have a set figure for the flood part of someone's home insurance, set at what is deemed as an affordable level.

Q35 Neil Parish: How does Flood Re incentivise the Government to invest in cost-effective flood defences? Because one of the arguments is, of course, that the fund will have to be much greater if not enough flood defences are done.

Aidan Kerr: Something that was a key part of a Memorandum of Understanding agreement last June was that, in order for Flood Re to be taken forward by the industry, Government needed to make a clear statement of intent around the investment in flood defences. We welcomed the announcement that flood defence spending would increase between now and 2020. Flood Re has review points on a five-year basis, where we review all aspects of how that would work. I foresee a part of those discussions to be around what is happening in terms of flood risk, and what Government's plans are to manage flood risk. Clearly, if Government took on the risk above one-in-200, there is more skin in the game in that case. However, that did not happen. We have been saying to Government that Flood Re is viable only to the extent that every other part of flood risk management policy is managed properly: building defences in the right place, maintaining them, and not building properties in the wrong places.

Q36 Neil Parish: Hopefully this will not be the case after 2015, but if I had constituents who were covered by Flood Re but were still not able to get insurance, what would I be able to do about it?

Aidan Kerr: I would hope that would not happen, because if the reason why an insurance company feels unable to offer one of your constituents in that situation insurance is because of the flood element, then they are able to both pass the flood risk plus a premium at a set amount to Flood Re. If there are other reasons why that property would struggle to

get insurance—either fire, or subsidence, or whatever it might be—then that is a different matter altogether. If flooding is the only reason that that property struggles to get insurance then the competitive market that exists in home insurance will mean that that should not be an issue.

Q37 Iain McKenzie: Can you tell us what progress has been made on the implementation of Flood Re? Is it on course or on track for that implementation in 2015?

Aidan Kerr: Yes. Being on course and on track—it changes on a daily basis because it is such a complicated project. We have got some 350 different work packages, as anyone with a project management background would understand, some 60 of which have been achieved. Those work packages range from registering at Flood Re's website, which is very easy, right through to the public procurement process for the reinsurance package that Mark referred to at the start of the session.

They range from very easy to very complicated. I would say there are around five or six critical path items of Flood Re. Those are: running the procurement exercise for the reinsurance and for the delivery body; getting state aid approval; getting data from Government in a consolidated way that shows the council tax band for households across the UK; ensuring insurers' IT systems and Flood Re's IT systems and processes are all in place and ready for summer 2015; and getting approval from the regulators—the Financial Conduct Authority and from the Prudential Regulation Authority. In each of those critical path items, everything needs to land perfectly well for us to deliver in summer 2015. We have a team fully resourced now at the ABI. We have got some 30 or 40 insurance industry representatives helping to deliver this, and DEFRA have got a big team delivering it as well. This is a very tough project. It is complicated and a world first, but we are still working hard and believe we can achieve a delivery in summer 2015.

Q38 Iain McKenzie: Let's take it back to one of those critical steps—state aid. Are you aware of that approval being submitted?

Aidan Kerr: We believe it has been submitted. We believe that DEFRA have started those discussions now with the European Commission.

Q39 Chair: How long do you expect that procedure to take?

Aidan Kerr: I am afraid that I do not know how long that will take. I think the initial estimate was that it could six to nine months or so from start to finish.

Q40 Chair: It is just that it is quite key. You responded to Mr Parish that we are expecting the statement of principles to last until Flood Re comes into effect and we are expecting Flood Re to come into effect in 2015. If it is longer than six or nine months, then is there going to be a—

Aidan Kerr: Just to reassure the Committee: we do not expect there to be any issues with state aid approval with Flood Re as it is currently constituted. We do not believe that there is going to be an issue to get state aid approval. From our perspective, the processes that we are putting most of our attention on are the PRA approval and the procurement approaches that will make Flood Re work. I believe it is around six to nine months, but from talking to DEFRA about this, state aid approval is not foreseen to be an issue.

Q41 Sheryll Murray: Given that Flood Re will cover losses up to those expected in a one-in-200 year equivalent, are the insured losses for the current flooding events that we

have seen this year likely to exceed the monetary level equivalent to a one-in-200 year loss scenario?

Aidan Kerr: No. The flooding we have seen over the last three months we think is going to be of the order of magnitude of maybe a quarter or a fifth of 2007. The Environment Agency assessed 2007 to be around about a one-in-30 or one-in-35 year loss. You would have to have something very significantly worse than the flooding we have had over the last few months to start to make Flood Re think it is going to start to get to its limit.

Q42 Sheryll Murray: Is it possible that Flood Re's aggregate annual capped liability would have been exceeded this year if Flood Re had already been in place?

Aidan Kerr: If we had the same sort of flooding that we have had over the last two or three months for the rest of the year—heaven forbid—then we would start to think, “Well, what kind of year is it looking like?” No, the sort of flooding that we had is well within the capacity of Flood Re to deal with, and I would not perceive Flood Re having any issues at all dealing with that level of flooding.

Q43 Chair: Mr Kerr, earlier you said that you just assumed that people would stop building in inappropriate places. I do not think the Committee has been taken with much evidence of that. Do you think this has finally been a wake-up call?

Aidan Kerr: Sorry, I do not recall saying that I assumed that that would happen. My view is that one of the biggest flood risks in this country is where we build our properties—where we build our homes and places of work. The sophistication of the mapping that exists at both a national and a local level means that there is a very good chance that you can make the right sort of decisions about where you build and how you build properties. The view of the industry is that there needs to be zero-tolerance approach to inappropriate development in areas at risk of flooding. That is one of the things that we have put into Flood Re because what we do not want Flood Re to become is something that incentivises that inappropriate sort of development.

Q44 Chair: Does the industry or any part of the industry engage with developers and actually talk them through this?

Aidan Kerr: Increasingly, I think that that is happening, but to date, it probably has not happened a great deal. The industry position on this has been that the Environment Agency, as a statutory consultee to planning authorities when they are looking at developments in areas at risk of flooding, give advice about whether something should not be built in a certain area or, if it has to be built, how it should be built. That advice needs to be followed because if it is not followed there is a risk that those developments might not be able to get insurance, because they will need to get insurance in the open market. If they have been built in the right ways in the right places there is nothing to suggest that insurance will be a problem for them.

Q45 Chair: When the Water Bill was being looked at here before the Committee, we expressed concern about some of the exclusions. We were told it was like a package. If you take some of the package out, then it makes funding the rest of the package a little unsafe. Yet we hear that the Prime Minister has ordered a rethink of the policy as regards band H properties because they came perilously close to London and the shires. Do you have a view on whether you can take exclusions out one by one? Are you working with the Government to extend Flood Re to cover band H houses?

Aidan Kerr: At the moment the scope of Flood Re is exactly as it was. The exclusions that I spoke to the Bill Committee about and that were debated are still in existence.

Q46 Chair: Would you be expected to be consulted on any major review of the exclusions?

Aidan Kerr: Absolutely. The intention is that Flood Re is an industry-led and industry-run body. The insurance industry needs to be a partner. They have been a partner in the discussions about what is—

Q47 Chair: So far, have you have been consulted on any band H exclusions?

Aidan Kerr: There has been no indication as yet that we have received from Government that band H needs to be included in Flood Re.

Q48 Chair: What evidence do you have that small businesses will be able to access affordable flood insurance on the open market in market towns across the country?

Aidan Kerr: Within the ABI, we have got between 80% and 90% of the property insurance market. When we thought about the development of Flood Re, we thought, “Well, how can we get evidence to say what Flood Re needs to be focused on?” The evidence that we have got from our members says that Flood Re needs to focus on where there is a specific issue and where there is likely to be a market failure, which is for homes that have access to a very homogenous product and would struggle to get affordable cover under a free market. In consulting with those same members, there is absolutely no evidence that the same issue exists for SMEs. That is why Flood Re is limited to households.

Q49 Chair: There is one household, of course, that is going to be in an extremely unfair situation. I have to declare an interest—it is where we lived for a couple of years in the constituency: Riverside Mews, Topcliffe. The constituents have contacted me and we have had written evidence from the Council of Mortgage Lenders on this very point that leaseholders and tenants will be placed in a very unfair situation. Leaseholders and private landlords will be facing the full market pricing as soon as Flood Re is introduced rather than a gradual move to risk-reflective pricing via Flood Re at a date 20 years hence. This was put to us as well and I am sure we raised this at the time of the draft Water Bill when we did pre-legislative scrutiny. Does that not seem very unfair to you that that category of leaseholder who owns the property is going to be faced with prohibitive insurance levels?

Aidan Kerr: The issue with blocks of flats, in a similar way to SMEs, is that we have no evidence that suggests that there will be a market failure for the way that insurance is provided to such blocks. In general, you have insurance provided to a management company on behalf of a block of flats or block of residences, and that will be provided through a commercial policy. The fact that it is a commercial policy rather than a domestic policy is not something to pay too much attention to. That is simply the way that the market has developed for such properties. For leasehold properties like that, in a similar way to SMEs, we have absolutely no evidence that there will be a market failure for that kind of insurance.

Q50 Chair: If we produce the evidence for you, would you be kind enough to look at this?

Aidan Kerr: In actual fact, out of a ministerial meeting, Ministers asked the British Property Federation and the Council of Mortgage Lenders to produce evidence to say that there would be affordability issues in these sorts of markets. It is worth noting that, in the

consultation around the Water Bill and in the consultation that immediately followed the Memorandum of Understanding, evidence was asked for at that point as well and no evidence came forward, either from when the ABI asked for it or where Government asked for it. We at the ABI, as part of our role, monitor the market and we will continue to do that across the property insurance market.

Graeme Trudgill: Can I just add that BIBA will be doing a survey of our members and small businesses to establish if there are any concerns or not. Then obviously we will act on them and work with the appropriate people if there are issues. At the moment, because a statement of principles still exists, then availability is there, so it would be difficult to get evidence of problems of availability. On affordability, that is something we will look at as well and we will report back to Government if there are any concerns that we think we need to act upon.

Q51 Chair: Thank you. Could we just look at the levy? The evidence the ABI gave the Committee at pre-legislative scrutiny stage was that the levy would be in the order of £8. It has now gone up to £10.50. The first question is whether we can rest assured that it will remain at £10.50. There is also this question that has come in written evidence from Hiscox of whether there is an element of not passing the test of natural justice here, as many owner-occupied homes will be paying the levy and are not going to be in a position where they can access the benefits. Does that seem unfair?

Aidan Kerr: On the levy first of all, I think it was probably over a year ago when we were looking at the analysis. That is when we assessed that the levy would be £10.50 rather than £8. It has been £10.50 for some time. You are right though that it did change from £8 to £10.50. There is a lot of uncertainty with a lot of this sort of work—it is a very complicated area—but the £10.50 per household is now set as is. It will actually be charged at 2.2% of gross written premium to insurers, but it is equivalent to £10.50 per household. The five yearly review process for Flood Re sets that figure for the first five years. The Committee can be reassured that that is set at a given level.

In terms of the written evidence from Hiscox, it is worth noting that the band H exclusion was something that was driven mostly by Government's wish for Flood Re to be progressive to ensure that you do not have the more deprived households in the country subsidising band H properties. The inclusion in Flood Re of band H properties from an economics perspective would be marginal. It would not make a lot of difference to either the risk or the levy within Flood Re. In terms of the extent to which the levy should be imposed on those who may not get a benefit from it, I believe that that is more of a Government decision than the ABI's decision.

Q52 Chair: Thank you. Mr Trudgill and Mr Weil, are you broadly supporting Flood Re as is?

Graeme Trudgill: We think that Flood Re is a great solution for all those 500,000 people who are in it, with the availability, affordability and capping the excess. Obviously, it remains to be seen how those that are not in it will fare. At BIBA, we are doing everything we can to try and get commercial facilities in place. We will be doing a survey, as we said. We would like band H included and we would like to have a solution for small businesses if one is needed. We will be working closely with everyone in the industry and the Government to try and make sure that all customers, whether they are businesses or private individuals, can have access to insurance at an affordable rate going forwards.

Mark Weil: I have a few comments. The first one I will make is for those who have read *The Economist* article on this. I think it misses the point, which is that there is a market failure here, not in the sense that the risk is so large, which was the focus of some of the questions, nor in the sense that it is uncertain. It is quite the opposite. It is the certainty of it. We know there are certain areas that are now high risk. That tends to mean that insurance breaks down because people can then act to avoid it. It is like genetic information on health conditions.

You need to have some kind of pool arrangement and we have been supportive of Flood Re throughout. It is the right kind of structure. To echo some of the points that Aidan made, there are some future questions that need to be thought of in the operation of it. One that I absolutely endorse is the point about exclusions attached to, for example, build location or build date because, with a low set tariff, there is a developer incentive to abuse that to build in the wrong locations. We need to make sure that we do not pursue the American model of having a lot of development in high-risk coastal areas, for example. I know that that is part of the design.

The second is the incentive for betterment, which I mentioned earlier. If you make the cost of flooding low from an insurance point of view, you then have to think about how you encourage or motivate people to make house improvements. That is again subject to the evidence that the right improvements are made and that they work. Somewhat attached to that, as a third observation, is the Government participation point. With some of the questions raised about, “Couldn’t the insurers fund flood defence because they now have skin in the game?” you will start to pass the whole buck to the insurance industry if you are not careful. Again, in the end, a lot of this is a civic problem: insurance is there to insure not to cover the whole shooting match. There is still scope for asking how committed the Government is, both in aggregate defence and then in relation to things like betterment programmes, to make sure that they play their role. With those three addendums, we are supportive.

Q53 Chair: Do we have the figure on how many homes will be excluded if we stick to the post-2009 figure?

Aidan Kerr: We think that it is single-figure thousands. I think one ballpark estimate was that it will be around about 7,000 or so as a result of the exclusion of both band H and post-2009 homes. There was evidence that both the ABI and DEFRA submitted to the Bill Committee on the Water Bill that gave the exact numbers. I think it is of that order of magnitude.

Mark Weil: If I may just also add to that answer another point. One of the earlier questions was about how many houses are excluded, and that some houses are funding others that are not participating. That is slightly the nature of pool arrangements. We are trying to spread a known risk across a large population here to make it more affordable. If everybody benefited or if you just limited it to the flood-prone houses, it would not be much of a pool. It needs to be funded by the many for the benefit of a few who are in those high-risk areas.

Q54 Chair: Finally, on the flood insurance obligation: is this a welcome fallback option should Flood Re prove unworkable? Mr Kerr, you said yourself that it is very difficult to explain, so I imagine that it is going to be very difficult to implement.

Aidan Kerr: Flood Re is complex. It is a world first, but it is possible to do. We are focused and geared, as are Government, on making it work, and it will work. I am confident that when it is successfully up and running other countries will look to how we do this and think it is a model for them to help manage and pool the flood risk in their countries too.

Quite simply, the flood insurance obligation we do not believe is workable. We have very little confidence that it has been thought through in any way, shape or form as a solution. If it is put in there as an incentive to make us deliver Flood Re successfully then perhaps it has been successful, although we are driven to deliver Flood Re because we know how good it will be for our customers.

Graeme Trudgill: We do not support the idea of the obligation. The concern is that it could put the market off from entering into particular home insurance products. No, it is not something we would like to see.

Chair: Thank you very much indeed, gentlemen, for being so generous with your time and in answering our questions. We wish Flood Re, obviously, the very best possible success. Thank you for being with us this afternoon.