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UK Insurers facing flooding challenge

Scott Vincent examines whether flooding will remain insurable in the future in the UK amid warnings of increased risk due to climate change.

The UK government shocked the insurance industry last year when it cut the budget for flood defence and mitigation measures.

The decision was surprising as it came at a time when warnings of an increased risk of flooding were rife. And although there have been no major floods since windstorm Erwin caused inundation of Carlisle in January 2005, the potential for flooding is gathering more media attention than ever before.

In late December, the Department for Food and Rural Affairs (DEFRA) announced that the £14m ($27m) flood-defence budget cuts implemented in 2006 had been restored. A spokesman for the Environment Agency (EA) says the 2007 – 08 budget for flood defence spending has risen to a record £435.7m, 8m more than the previous year.

"We are still a long way short of what we believe we need to fully meet our environmental goal of reducing flood risk" says the EA spokesman. "We are now in the process of planning expenditure against this budget and will be putting final proposals to our board in March".

But as the EA calls on the government to provide a 20-year investment programme for flood-defence spending, a leading insurer warns that in real terms, this year's flood defence budget is actually less than it was in 2006.

Royal and Sun Alliance property development manager, Alan Gairns, explains: "DEFRA made a play that it had restored last year's cut in budget, but it focused on the amount of money being given to the Environment Agency rather than the money being given to the local authorities and drainage boards. If you include this, we seem to be continuing with a reduced figure from what we had in 2006"

Agreement continues

Gairns, alongside Zurich group property underwriting manager, Gregor Elrich, says the agreement between the Association of British Insurers (ABI), insurers and government to maintain existing flood defence cover continues, but questions how long this will be the case if flood defence spending is not adequate to manage the risk.

"The key will be the spending review later this year. If we don't see the level of spending needed, then the question has to be asked as to how long we can continue to carry that risk on our books" Gairns says.

“We may have to consider our position,” admits Elrich. “There may also be issues regarding the availability of reinsurance going forward. For that reason, collection of data relating to flood is increasingly important”.

Elrich says insurers have now become more sophisticated about how to underwrite flood risks thanks to new technological developments and improved modelling. But the debate continues as to the insurability of new developments in floodplains, such as the planned Thames Gateway development in south-east England.

“There has been a lot of discussion about the Thames Gateway with varying degrees of intensity” he says. “The Thames Gateway is an ongoing issue, in terms of where buildings are being built, the type of buildings and the surrounding infrastructure”.

London remains at considerable risk of flooding, but the launch of a new risk map for the city later this year is set to enhance insurers’ ability to manage their exposure.

Justin Butler, managing director of Ambiental, the firm launching the risk map, says the aim is to provide building-level flood risk models.

“Our London flood risk map is still at the development stage – we are currently taking orders – but it is providing detailed analysis downs to a resolution of one or two metres. We are looking to complete within six months,” Butler told Insurance Day.

“Most of our work to date has focused on the UK” he says. “We’ve identified 135 major towns and cities at risk of flooding in the UK, including London, York, Edinburgh and Bristol. Most, if not all, of the UK’s low-lying coastal cities are at risk to some degree.

“We have been looking at the impact of storm surge and sea-level rise” he continues. “A number of studies have suggested there could be an increase in sea levels of up to five metres during the next 100 years as a result of abrupt climate change”

Huge risk concentration

Butler warns that London has a huge concentration of risk. “London is home to 7.5 million people and it is estimated that one million of these and 300, 000 properties are at risk from tidal flooding. In London, the dominant type of flood risk is storm surge”.

The latest Intergovernmental Panel on Climate Change (IPCC) report warns of sea level rises with a knock-on effect of increased flooding. Risk Management Solutions chief research officer, Robert Muir-Wood, is one of the report’s authors.

“I believe there is a difference between this IPCC report and the last” he says. “Last time round, the impression given was that an increase in catastrophe costs could threaten the insurance industry, as it would increasingly do unprofitable business. I always felt that this was not correct.

“Insurers structure contracts annually, and price annually. The real problem is if insurers price themselves out or move out. Governments would be forced to step in and this would mean insurers would become increasingly unpopular" he continues.

Muir-Wood believes UK insurers should look at the current political crisis surrounding property insurance in Florida before making any radical decisions about withdrawing cover.

"Insurers can rapidly rewrite risk and pricing, and the consequence is a political backlash," he says. "That's what has happened in Florida. The problem for insurers was that they had not thought this through. What has happened in Florida has played out all these events, and the insurance industry should have a moment of reflection now.

Muir-Wood says a repeat of the Florida situation could easily happen in the UK if flood cover is withdrawn.

"Florida is a state under stress from climate change – and whatever your view there has been climate change in the sense that the climate of hurricanes has changed" he says. "The increase in catastrophes has led to a big increase in insurance costs. This became the number one political concern of people in the state, and the new governor made sorting out the insurance crisis his number one priority. This led to much greater government involvement in the insurance industry.

"I've got the impression the insurance industry has behaved pretty poorly. If they'd known this would be the outcome, they wouldn't have behaved the way they did", he says.

"If the UK flood was big enough and insurers withdrew cover in the floodplains, the insurance industry would become a political whipping boy. In anticipation of this, insurers should be leading risk reduction on floodplains"

Political Issue

"Insurers say climate change means more risk but they may not be in charge of the situation when it becomes the number one political issue," he says.

The uncertainty that surrounds the future of UK flood cover will not go away. The EA is now putting together plans for a 20-year investment programme, but early indications are that this will not meet levels called for by the insurance sector.

The ABI has called for increased flood defence spending from government, saying an extra £8bn needs to be spent during the next 25 to 30 years to improve coastal defences along the East Coast.

According to the ABI, the government's flood defence spending needs to rise to £750m each year by 2011. Based on the budget's provided by DEFRA in 2006 and 2007, this seems unlikely.

A major flood would cause political pressure that could make an investment increase more likely. Insurance cover remains in place … for now, but without more investment a major flood may cause the insurance industry to have a radical rethink that could leave its reputation in tatters.