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Risk reduction in a changing insurance climate: examples from the US and UK

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Coastal cities face a range of increasingly severe challenges as sea level rises, and adaptation to future flood risk will require more than structural defences. Many cities will not be able to rely solely on engineering structures for protection and will need to develop a suite of policy responses to increase their resilience to impacts of rising sea level. Insurance can be used as a risk-sharing mechanism to encourage adaptation to sea level rise, using pricing or restrictions on availability of cover to discourage new development in flood risk areas or to encourage the uptake of flood resilience measures. We draw on flood insurance policy lessons learned from the United States and the United Kingdom to propose risk-sharing among private insurers/reinsurers, government, and policyholders to alleviate major issues of the current programs, while still maintaining a holistic approach to managing flood risk.

The UK and the US are almost polar opposites in the way flood insurance is implemented. Flood insurance in the US is fully public and in the UK fully private; however, in both countries the participants feel that the established system is unsustainable. In the US, flood coverage is excluded from property policies provided by private insurers, and is only available through the National Flood Insurance Program (NFIP), with the federal government acting as insurer of last resort. Flood risk reduction has been part of the NFIP remit since the introduction of the program in 1968. Following massive payments for flood claims related primarily to Hurricanes Katrina and Sandy, the NFIP is approximately $26 billion in debt, prompting calls to bring private insurance back into the flood insurance business. Two major Congressional modifications to the NFIP in 2012 and 2014 have pushed the contradictory goals of fully risk-based, yet affordable premiums. The private market has not been significantly involved in a risk-bearing role, but that is changing as private insurers enter as competitors, which is likely to increase NFIP flood risk portfolio volatility and undermine the NFIP goal of integrated flood risk management and risk reduction.

In the UK, flood coverage is available only from private insurers, and is bundled with other perils in property policies. This approach is unusual in not passing all or part of the flood risk to government, with the financial costs of floods borne entirely by the private sector. Although the UK flood insurance market will change significantly in 2015 with the introduction of Flood Re, a subsidized flood insurance pool for high-risk households, flood cover will continue to be provided solely by the private sector. Flood Re does not reduce flood loss, but spreads the risk, protecting some policyholders from the costs of flooding at the expense of others. In contrast to the NFIP, Flood Re does not provide any incentives for policyholders or communities to improve the flood resilience of their properties.