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Mr John McGuinness TD
Chair
Committee on Finance, Public Expenditure and Reform, and Taoiseach
Dail Eireann
Kildare Street
Dublin 2

Re: Flood Insurance Bill 2016 (the "Bill")

Dear Deputy McGuinness

I am writing to you in relation to the above Bill which is currently under consideration by the Committee. The Central Bank of Ireland (Central Bank) is supportive of efforts to address the difficulties faced by property owners living in flood risk areas, one element of which is access to appropriate property insurance for those living in areas where flood relief schemes have been completed. The Central Bank has a number of observations on the Bill, bearing in mind its references to the Central Bank and noting its aim to "provide fairness in the market for property insurance".

As you will be aware, the role assigned by law to the Central Bank includes the proper and effective regulation of financial services and markets under Irish financial services legislation, while ensuring that the best interests of consumers are protected.

Under this mandate the Central Bank has, inter alia, issued a Consumer Protection Code with which insurance undertakings must comply. The Central Bank monitors and enforces this code and consumer protection rules more broadly in an assertive, risk-based manner, to ensure that consumers are protected and the stability of the financial system is safeguarded. For example, in October 2013, the Central Bank published the findings of its themed inspection of household property claims resulting from water damage[1]. In that review, we examined compliance with our Consumer Protection Code (the Code) in insurers representing approximately 90% of the market and imposed specific remedial measures on those firms who did not demonstrate compliance with the Code to our satisfaction. These findings, and our industry letter of the time[2] provide a good illustration of our role in this field. The Central Bank's actions on foot of this review addressed, inter alia, transparency in policy documentation and required improvements in outsourced claims handling. The corrective action required of firms to ensure compliance with the Code was designed to ensure that policyholders were clearer on their rights, particularly in relation to awareness of policy terms at the time of making a purchase and when making a claim.

The Bill proposes a new role for the Central Bank in the area of flood insurance. The Bank would be required to carry out an assessment of the manner in which insurers deal with applications for insurance by affected persons, including but not limited to whether an insurance policy is offered, the reasonableness of any refusal of insurance and the reasonableness of the price or terms offered. Following this assessment, it is further proposed that the Central Bank may issue a direction to the relevant insurer to take such steps, adopt such practices or cease such practices as it considers appropriate and necessary to ensure compliance by that insurer with specified provisions of the Bill.

Such a role, essentially supervising the reasonableness of commercial firms underwriting and pricing decisions and enforcing against such an assessment would represent a novel and far-

[1] https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/compliance-monitoring/themed-inspections/insurance-companies/gns4-2-1-2-info-rel-h-prop-clms-thmd-ins-241013.pdf?sfvrsn=4

[2] https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/compliance-monitoring/themed-inspections/insurance-companies/gns4-2-1-2-industry-ltr-h-prop-claims-241013.pdf?sfvrsn=4

reaching change in the approach to the regulation of insurance undertakings. The Central Bank is committed to delivering on its mandate, and will continue to do so if it changes as a result of this Bill, but we have identified a number of challenges that any such proposal would need to overcome.

Before addressing more specifically the role proposed for the Central Bank, we would note a number of potential negative consequences that would need to be weighed by legislators in considering this Bill. Insurance undertakings price based on risk and if the risk profile of the insured portfolio increases, due to inclusion of higher-risk properties, this could have the effect of increasing premiums across the broader range of insurance customers or a class of them.

While the Bill seeks to address persons with an insurable interest in property within a designated area, there appears to be a risk that, in an effort to ensure against complaints of discriminatory behaviour, insurers may review flood insurance cover they offer more widely. This could include reviewing terms and conditions such as increasing excesses or limiting sums insured or risks insured and could result in a deterioration in the quality and scope of flood insurance cover available across the Irish market. Depending on industry reaction, the proposals could result in insurers withdrawing from the flood/home insurance market and may make the Irish market unattractive to potential new entrants' thus reducing competition and consumer choice in the Irish market.

As the Central Bank's role under the Bill would be to assess and potentially override the commercial decision of an insurer to provide insurance, and the price at which to do so, it seems very likely that the Bill would be in conflict with European Law. Solvency II[3], provides that, absent general price controls, Member States may not intervene in the setting of insurance premiums or the terms and conditions associated with insurance policies. The

3 Regulation 190 of S.I. 485/2015 - European Union (Insurance and Reinsurance) Regulations 2015 which implements the Solvency II Directive in Ireland (Article 181).

conferral of a role, be it direct or indirect, on the Central Bank with regard to the pricing decisions of insurance undertakings risks contravening Solvency II.

We note that in certain other areas, where a public policy of ensuring access to financial services on reasonable terms has been determined, the adjudication role in respect of firms' commercial decisions has been given to a separate non-regulatory body. For example, in the case of access to motor insurance complaints are dealt with under the Declined Cases Agreement and, in the case of lending to SMEs, the Credit Review Office undertakes a similar function. These arrangements would appear to be a more appropriate model rather than conflating the issue of access to services with regulation of financial service providers.

Beyond the question of compliance with European law, there is the further question as to the practicability of such a proposed new regulatory mandate for the Central Bank. Section 3(b) of the Bill provides that the current risk profile of a property can be a factor in pricing provided it is reasonably justified. In the context of property insurance, location is a key driver from a pricing perspective and where flood relief schemes are involved, the risk profile may be impacted by the nature of any flood defences. The Bill provides that an insurer shall not discriminate between affected and unaffected persons, as regards the price at which an insurance policy is offered, except to the extent *"reasonably justified by the current risk profile associated with a property"*. We acknowledge that the Bill may not prevent insurers from calculating higher premiums for affected persons, due to the higher risk profile of these properties. However, the assessment of whether a price is reasonably justified is inevitably subjective and will be viewed differently from different perspectives. We find it difficult to see how we could carry out the proposed role without compromising the key requirement that the insurance market be underpinned by the accurate pricing of risk by relevant risk pricing experts operating within a competitive market.

In considering solutions to the provision of flood insurance, there may be alternatives that could be considered such as a Government established and administered insurer, reinsurer or scheme/fund to cover these types of risks. The UK established a Flood Reinsurance Scheme "Flood Re" in 2016, which is intended to promote the availability of flood insurance in the market at reasonable rates. Flood Re is a not-for-profit scheme funded by way of a statutory levy on all home insurers in the UK based on market share. Flood Re does not set prices, insurers are still in charge of overall pricing for home insurance but it gives insurers the opportunity of passing on the flood risk element of a home insurance policy at a premium that is capped. A similar scheme exists in Spain, the Consorcio, a public corporation, which effectively acts as a catastrophe insurer for certain types of insurance and perils in Spain including flood risk. The Consorcio surcharge is obligatory and is included within the premium bill for most property and personal accident insurance policies, all insurance undertakings operating in Spain have an obligation to collect the surcharges and pay them to the Consorcio.

The above examples and arrangements in other jurisdictions provide interesting operating models for further consideration. Consideration could also be given, in the context of such arrangements, to provide wider benefits by addressing access to flood insurance in flood risk areas where flood relief schemes have yet to be completed.

As noted above, the Central Bank is fully supportive of efforts to address the difficulties that certain property owners face in obtaining property insurance and the Central Bank, for its part, will continue to discharge its role in safeguarding stability and protecting consumers. However, we consider that it is important to consider fully the potential effects of intervention in the setting of premiums in the manner proposed in this Bill, with particular attention paid to the risk of unintended consequences in the property insurance market.

Yours sincerely

Gerry Cross
Director Policy and Risk

cc Mr Michael McGrath, Assistant Secretary, Department of Finance