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Subject: State aid SA.38535 (2014/N) – United Kingdom
State support to the flood reinsurance scheme – United Kingdom

Sir,

The Commission wishes to inform the UK authorities that, having examined the information notified on the matter referred to above, it has decided not to raise objections for the reasons set out below.

1. PROCEDURE

(1) On 18 November 2014, the UK authorities notified, pursuant to Article 108(3) of the Treaty on the Functioning of the European Union[1] ("TFEU"), the set-up of a flood reinsurance scheme ("the Scheme"), asking for that measure to be assessed on the basis of Article 107(3)(c) TFEU.

(2) A number of electronic mail exchanges took place between the Commission and the UK authorities between 31 March 2014 and 18 November 2014.

[1] OJ C 115, 9.5.2008, p. 47.

The Rt Hon Philip HAMMOND
Secretary of State for Foreign and Commonwealth Affairs
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2. DESCRIPTION OF THE MEASURE

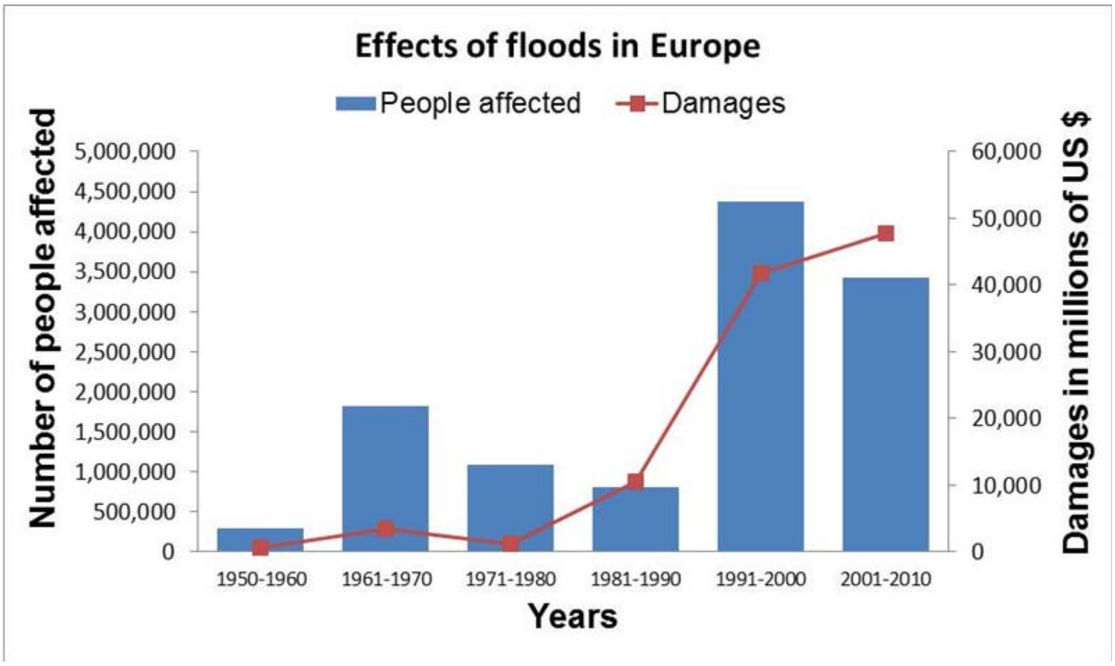
2.1. Flood risks in the UK and potential impact on risk premiums

(3) The UK authorities observe that there has been an increasing number of flood events and related damages in the UK.

(4) According to the UK authorities around 5.8 million UK properties are at some risk of flooding with around 320 000 at significant risk in England alone. The UK Climate Change Risk Assessment in 2012 suggested that frequency of river flooding and changes in rainfall patterns will increase flooding risk.

(5) The overall damages caused by flooding have increased throughout the Union. As presented in Figure 1, the number of people affected by major floods in Europe increased from a few hundred thousand in the 1950s to 4.4 million in the 1990s. Increased flooding risk affects all Member States and has an impact on the availability and affordability of insurance, leaving society vulnerable and governments potentially with large financial exposures.

Figure 1: Effects of floods in Europe since 1950[2]



(6) In the UK, over 100 000 homes have been flooded in the last decade. The recent severe flooding as a result of the highest rainfall in 250 years together with significant coastal flooding resulted in flooding of around 7 000 homes in England.

[2] Source: www.emdat.be

(7) The average annual cost of damage to UK domestic properties and their contents due to river and tidal flooding is approximately GBP 1.5 billion (currently equivalent to around EUR 1.8 billion) and the 2007 floods in England alone caused GBP 3 billion (EUR 3.6 billion) worth of damage.

(8) The UK has benefited from a private insurance system for flood risk that has existed for over 50 years. Insurance cover for flooding is usually included as a standard part of buildings and/or contents policies for households alongside other risks such as fire, subsidence and theft. Mortgage lenders in the UK require as a condition of the mortgage that homeowners purchase buildings insurance which includes cover for flooding and other risks for the mortgaged property, which must be held for the duration of the mortgage.

(9) The take-up rate for buildings insurance is 91% for owner-occupiers in the UK and the take-up rate for contents insurance between 44%-90%. Buildings policies tend to be more expensive than those for contents because of the higher sums insured and size of potential claims. Currently, the cost of buildings insurance averages GPB 211 (EUR 252) and contents insurance GBP 174 (EUR 208), with the cost of a combined buildings and insurance policy being on average GBP 363 (EUR 434).

(10) In spite of a trend towards more risk-reflective premiums, home insurance in areas of significant flood risks in the UK largely remains subsided by low flood risk insurance buyers through Association of British Insurers ("ABI") member companies.

(11) In the past, households at differing levels of flood risk largely paid similar premiums for flood insurance based on the historically coarse nature of flood risk data used by insurers. Policyholders at low or no flood risk in effect "subsidised" the cost of policies in higher flood risk areas through their premiums. The ABI estimates, and the UK's own modelling verifies, that this cross-subsidy is worth around GBP 180 million (EUR 215 million) annually for the approximately 500 000 insured households in the UK at highest risk of flooding. This is equivalent to approximately GBP 10.50 (EUR 12.50) per combined buildings and contents policy for all insured households.

(12) Insurers use risk models to determine their overall exposure and assess the risk and potential claims from their individual customers. The price of insurance is typically the risk multiplied by the value of damages plus overheads. While some insurers use postcodes or proximity to a water course to determine the risk of flooding to a property, others use more sophisticated flood risk models alongside

data such as a policyholder's claims history. Flood mapping is improving, enabling increasingly accurate pricing at a property level. Commercial pressures and the availability of more sophisticated flood risk models are creating a trend towards insurers increasingly charging risk-reflective premiums.

(13) However, currently only 22% of home insurance buyers in areas of significant flood risk in the UK have been priced according to their flood risk.

(14) Since the 1960s, a series of agreements on the provision of flood insurance has been made between the government of the day and the insurance industry to ensure that flood insurance continued to be available. The ABI represents around 300 insurance companies which together sell around 90% of all insurance products in the UK. In 2008, the UK government and the ABI agreed to revise and extend the relevant agreement (the "statement of principles") in respect of England for one final five-year period until June 2013. The ABI entered into similar agreements with the devolved administrations in Wales, Scotland and Northern Ireland in 2008 and 2009.

(15) Under the statement of principles, ABI member companies committed to make insurance available to domestic and small business properties in areas that are not at a significant risk of flooding (defined as being at no worse than a 1.3% annual probability of flooding). For properties in significant flood risk areas, ABI members agreed to continue to offer cover to existing customers if plans were in place to reduce the risk within five years, e.g. by new or improved flood defences being built. Properties built after 1 January 2009 were not covered by the statement of principles in order to encourage new development to be built away from flood risk areas.

(16) The statement of principles was expected to be the last, since the previous UK government had agreed that by July 2013, "the conditions should be in place to enable the insurance market to be able to provide flood insurance to the vast majority of households and small businesses efficiently without the specific commitments made by either ABI members or Government".

(17) It has been made clear that, in the absence of the Scheme or alternative, members of the ABI would be unwilling to continue with the voluntary statement of principles beyond its expiry in June 2013.

(18) However, the UK government and the ABI agreed on 27 June 2013 in a memorandum of understanding to voluntarily continue the existing commitments from the statement of principles until the Scheme (or alternative) is delivered and

ready to operate, which is anticipated to be around July 2015, depending on how long the relevant legislation takes to go through the Parliamentary process and assuming a smooth setting up of the Scheme.

(19) The UK authorities submit that the increasing number of flood-related damages, coupled with developments in the pricing of flood risk by the insurance industry[3], threaten rapid and significant increases in the cost of domestic property insurance.

(20) Based on data provided by the insurance industry and an independent expert review[4], in an immediate move to risk-reflective pricing i.e. following the expiry of the statement of principles and without State intervention, around 600 000 households may see some increase in the flood risk premium. 400 000 of those 600 000 households will face price rises as a proportion of their disposable income of below 2%; around 173 000 households are estimated to face price rises of 2-5% as a proportion of income; and 28 000 households will face price rises of 5% or more of their income. The risk-reflective prices which insurers may charge in a free market are estimated to be on average 94% higher than current prices: e.g. a household in Council Tax band B would see an increase from GBP 525 (EUR 628) to GBP 1165 (EUR 1394).

(21) As a result of those predicted price rises, the UK estimates that around 40 000 high flood risk households already insured would be likely to go uninsured or spend an appreciable portion of disposable income on insurance. Out of them, around 27 000 are in the bottom three income quintiles. Assuming around 1.4% of households may experience flooding, around 600 households that choose not to insure might be expected to flood in any given year. The annual economic cost of uninsured households to the UK (i.e. which would otherwise represent a burden on State resources) would be between GBP 6-24 million (EUR 7-29 million).

(22) The Scheme is intended to allow the move towards more risk-reflective prices without the statement of principles and memorandum of understanding which are only binding on ABI members.

2.2. The Scheme

(23) The UK is setting up a flood reinsurance scheme that will create a flood risk reinsurance pool for domestic property at the highest risk of flooding.

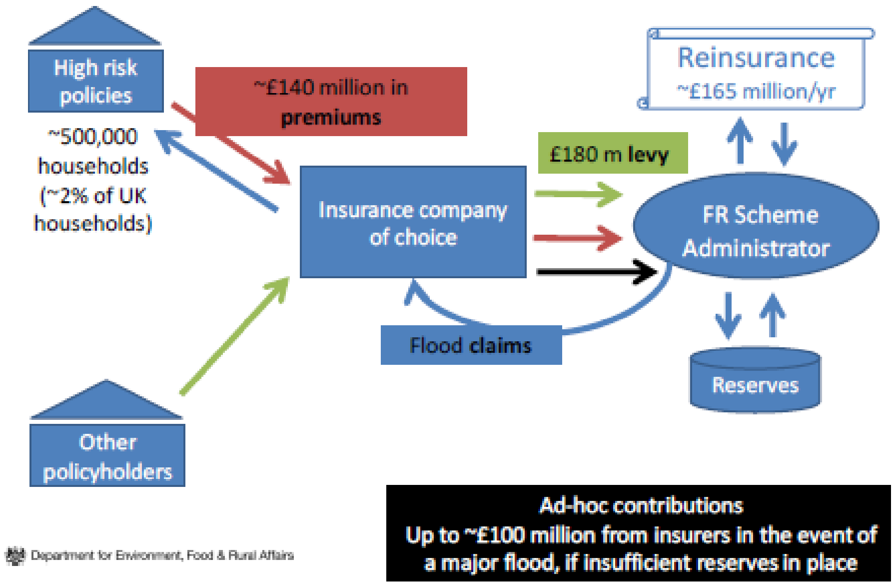
(24) Any insurance company active on the UK market established in a EU Member

3 See recital (12) above.
4 “Independent Review of Flood Insurance Analysis", Professor Stephen Diacon, June 2013.

State or within the EEA will be eligible to participate in the Scheme, irrespective of its place of establishment.

(25) Insurers will be able to transfer the highest flood risk elements of domestic property insurance policies by transferring a predefined reinsured premium (which forms part of the overall premium paid by the policy holder) to the Scheme.

Figure 2: The Scheme



(26) Through that process, high flood risk exposure would be reinsured through the Scheme, itself significantly reinsured on international reinsurance markets, up to an annual 1:200 aggregate loss scenario[5].

(27) The risks accepted by the Scheme will represent at most 2% of all UK domestic insurance policies. Around 500 000 domestic insurance policies are expected to be reinsured with respect to flood risk in that way.

(28) The Scheme itself will seek the best available price on international markets and would run procurements or appropriate competitions for brokerage services in respect of reinsurance. After being reinsured for a risk exceeding an annual 1:200 aggregate loss scenario the Scheme will not be liable for liabilities above the 1:200 annual loss. In other words, the maximum amount to be taken in charge by the Scheme will be limited to approximately GBP 2.4 billion (EUR 2.9 billion).

5 I.e. the loss scenario likely to occur once every 200 years as a result of floods, currently assessed by the insurance industry at approximately GBP 2.4 billion (EUR 2.9 billion).

(29) Certain policies will not be within the scope of the Scheme: Council Tax Band H properties in England; Council Tax Band H and I properties in Wales[6]; properties with equivalent bands in Scotland and Northern Ireland; properties built after January 2009; properties located on the Channel Islands and Isle of Man. Properties built after 2009 are not in the scope of the Scheme since their inclusion might incentivise inappropriate housing development in flood risk areas.

(30) Insurers would pay claims to policy holders as usual on flood risk transferred to the pool and then recover those costs from the Scheme Administrator (see recital (34)). They will be free to reinsure such risk in the general reinsurance market rather than through the Scheme. Consumers wishing to purchase flood insurance (including those in high flood risk domestic properties) will not be compelled to purchase from any particular insurer, but would be free to select an insurance supplier from within the general competitive market.

(31) In case an insurer decides to reinsure its higher risked exposures through the Scheme, the transferred premium has to respect predefined pricing (thresholds). That requirement ensures that the insurer trades affordable coverage on the market.

Table 1: Premium threshold set by Council tax band

Council Tax Band	A	B	C	D	E	F	G
Premium threshold in GBP	210	210	246	276	330	408	540

(32) The Scheme will be funded entirely by the domestic property insurance industry itself through (1) levies paid by all insurance undertakings providing domestic property insurance in the UK according to market share and (2) the transfer of premiums by insurance undertakings who choose to buy reinsurance through the Scheme.

(33) There would be two levies:

1) A compulsory levy ("Levy 1") would be set at around GBP 180 million (currently equivalent to around EUR 215 million) per year for the first 5 years. It will be reviewed and adjusted at least every 5 years together with increasing reinsurance premium thresholds.

6 Council Tax bands group properties by their value. In England, band H is the highest value. In Wales, band I is the highest value.

2) In the event that the Scheme Administrator has insufficient funds to meet its operating costs and non-reinsured liabilities and still retain sufficient capital to meet its regulatory requirements, it will have the power to call for "top-up" contributions ("Levy 2") to be paid by all insurers in proportion to their market share. It is anticipated that Levy 2 will only be required in emergency situations e.g. if significant flooding occurs in the early years of the Scheme.

(34) The Scheme will be implemented and operated through a Scheme Administrator set up by the UK insurance industry for the specific purpose of operating the Scheme, i.e. collecting the levies and providing flood reinsurance. The Scheme Administrator will not be involved in competing in any other markets.

(35) The Scheme is intended to be operational by July 2015 with legislation due to come into force on 6 April 2015.

3. POSITION OF THE MEMBER STATE

(36) The UK considers that a move towards risk-reflective prices in the longer term, if based on robust flood risk data, would be helpful to reinforce the right incentives for public bodies, businesses, communities and individuals to manage flood risk. This could be through appropriate controls on spatial planning, building and maintaining flood defences and other resilience measures, individual action to protect properties and limit damages and encouraging flood resistant and resilient property design.

(37) The Scheme is intended to allow and incentivise households to adapt over time to risk-reflective pricing while putting an end to the statement of principles and memorandum of understanding that are only binding on ABI members.

(38) The UK authorities consider that without any State intervention many households may see a significant increase in their flood risk premium, forcing them out of the market and leaving them and the State exposed to the high cost of flood damage[7].

(39) The UK submits that currently non-ABI members and new entrants (representing approximately 10% of the insurance market) to the home insurance market who are not bound by the statement of principles or memorandum of understanding (and who therefore do not have legacy portfolios of high flood risk homes) have a significant commercial advantage in that they do not have to offer insurance in respect of high flood risk homes and therefore they do not face pressure to cross-

7 See recitals (19) to (21).

subsidise that cover through the premiums charged to their lower risk customers.

(40) The UK authorities consider that levy 1 and levy 2 constitute State resources.

(41) The UK authorities do not consider that the premiums paid by insurers to the Scheme Administrator constitute State resources: there would be no imputability to the State because such premium would be paid out of the policy holders' premiums paid to their insurer.

(42) The UK authorities consider that there may be a selective favouring of the Scheme Administrator and insurers. The Scheme Administrator would be favoured in being able to collect the levies and thus offer to insurers flood risk reinsurance at prices that alternative providers of reinsurance would find difficult to match. Insurers writing domestic flood insurance policies in the UK might be favoured since the cost to them of reinsuring their flood risk in respect of high flood risk properties is subsidised by the levies collected by the Scheme Administrator.

(43) The UK authorities consider that there may be a threat of a distortion of competition and effect on intra-Union trade as some insurers are active in trade between Member States.

(44) The UK considers that the State aid is compatible with the internal market on the basis of Article 107(3)(c) TFEU.

(45) The Scheme would be aimed at a well-defined objective of common interest of mitigating a market failure by ensuring that domestic property householders in high risk of flood areas in the UK are able to access affordable flood risk insurance.

(46) The Scheme would be an appropriate policy instrument for addressing that policy objective as other policy options such a flood insurance obligation, market facilitation and directly subsidising insurance premiums would be less efficient and appropriate.

(47) The Scheme would have an incentive effect as the aid would change the behaviour of the aid recipients. Insurers would be incentivised to continue to offer affordable flood insurance to high risk households: they would be able to pass on the high risk to the Scheme but would only rely on it to the extent necessary since they must transfer the premium along with the high flood risk elements of the policy. The Scheme Administrator would be able, through Levy 1 and 2, to offer reinsurance in respect of high risk households.

(48) The Scheme would be proportionate to the problem to be tackled and the same objective could not be achieved with less aid: the amount of levies, together with the premiums on flood risk that satisfies the eligibility criteria, would be appropriate having regard to the prudent funding requirements of the Scheme in the initial period. The UK authorities already anticipate that Levy 1 would be reduced over time in exchange for an increase of reinsurance premium thresholds and eligibility criteria. The new pricing of Levy 1 and the premium threshold will be based on actuarial estimations and reviewed every 5 years.

(49) According to UK the degree to which insurers are favoured is to be the minimum necessary to provide flood insurance at affordable prices. The mechanism is designed to ensure the minimal reliance by insurers on the pool since the reinsurance premium thresholds only concern the higher risk household for which the real risk reflective price should have been higher and therefore those households may elect not to have any flood insurance.

(50) As regard to the distortion of competition in domestic property insurance markets, it would be minimised because all insurers operating within those markets would be equally able to access the subsidised reinsurance from the Scheme on the same terms. The "net favouring" effect to insurers arising from the Scheme is likely to be small, since home insurance is a product offered in a highly competitive market and the benefit of the subsidy (Levy 1 cost) is likely to be passed on to the householders in full (estimated to GBP 10.50 per household policy).

(51) As regards the Scheme Administrator, it would not be competing to supply any products or services apart from the flood risk reinsurance offered at fixed rates. Therefore, UK considers that there would be no possibility of any "net favouring" having the effect of strengthening its competitive position in any other markets.

4. Assessment

4.1. Existence of State aid

(52) By virtue of Article 107(1) TFEU "*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market*."

(53) To constitute State aid within the meaning of Article 107(1) TFEU, a measure has to fulfil four conditions. First, the aid is granted by a Member State or through State resources. Second, the measure confers a selective advantage to certain

undertakings or the production of certain goods. Third, the measure must be liable to affect trade between Member States. Fourth, the measure must distort or threaten to distort competition in the internal market.

(54) Two types of beneficiaries could be seen as enjoying State support, at two different market levels: the Scheme Administrator, which receives levies from insurers on the basis of a law and which competes with other reinsurers ("level 1") and the participating insurance companies writing domestic flood insurance policies ("level 2").

(55) The policies that can be transferred to the Scheme are limited to those that provide building and/or contents cover for household premises in the UK. The eligibility criteria for the Scheme exclude undertakings which take out insurance policies. As the policy holders benefiting from the Scheme are only individuals and hence do not constitute undertakings within the meaning of Article 107 TFEU, they fall outside the scope of State aid rules.

(56) The Scheme Administrator will buy reinsurance on international reinsurance markets seeking cover at the best available price by running procurement or competition for brokerage services in respect of reinsurance (as described in recitals (26) to (28)). Therefore, the Commission considers that no advantage can be granted by the Scheme Administrator to other reinsurers. There is no State aid to the other reinsurers.

4.1.1. Existence of State aid to the Scheme Administrator

(57) As regards the Scheme Administrator, it is an undertaking and thus falls within the scope of State aid rules. Therefore, it is necessary to determine whether the Scheme can be considered as containing State aid in its favour.

(58) Firstly, the Scheme relies on compulsory levies imposed by the UK legislator. Furthermore, the amount of the levies will be revised every five years by the State. Therefore, there are sufficient elements to consider the levies collected by the Scheme Administrator are State resources and are imputable to the State as the UK authorities themselves consider.

(59) The premiums ceded to the Scheme represent the flood risk part of the policy holders' premiums and have to be paid to the Scheme only if the insurers chose to reinsure the risks through the Scheme Administrator. Therefore, payment of those premiums to the Scheme Administrator is not imputable to the State and does not constitute State resources.

(60) Secondly, the levies are only paid to the Scheme Administrator. With those levies, the Scheme Administrator will be in a position to offer to insurers flood risk reinsurance at prices that alternative providers of reinsurance would find difficult to match. The Scheme may therefore be viewed as providing a selective advantage to the Scheme Administrator.

(61) Finally, the Scheme Administrator will have cross-border activities as it will itself reinsure its own risk on international reinsurance markets and it will compete with other non-UK reinsurers in providing flood reinsurance to UK insurers. Therefore, the Scheme may distort competition and affect trade between Member States insofar as it selectively favours the Scheme Administrator.

4.1.2. Existence of State aid to the insurers

(62) As regards the insurers, they are undertakings and thus fall within the scope of State aid rules. Therefore, it is necessary to determine whether the Scheme can be considered as containing State aid in their favour.

(63) Firstly, the Scheme relies on compulsory levies imposed by the UK legislator, albeit collected by a private entity, the Scheme Administrator. The Scheme Administrator is designated by the State in legislation. Furthermore, the amount of the levy is established by the State and will be revised every five years. Therefore, there are sufficient elements to consider the levy collected by the Scheme Administrator as State resources.

(64) Secondly, the Scheme covers only non-life insurance companies providing dwelling insurance and participating in the Scheme. The Scheme may therefore be viewed as selective.

(65) Thirdly, the Scheme provides to such participating insurance companies an advantage as it allows them to continue selling dwelling coverage as they are able to limit the impact of the losses stemming from highest flood risks which may in some cases save them from bankruptcy. Furthermore, and as demonstrated by the UK authorities, no market operator is prepared to offer flood insurance cover of that amount against floods events, particularly since the risks and costs are largely unquantifiable.

(66) Furthermore, it is possible that the Scheme could have an impact on the own funds that participating insurance companies are required to hold, particularly under the Solvency 2 Directive[8] that is due to be transposed by 1 January 2016. However, an

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8 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the

impact on own funds under the current regulatory framework is unlikely (assuming no relevant floods event materialises), since the approach of the current framework is based on past experience of the insurers and capital requirements hence do not depend on potential future risks (high flood events).

(67) The impact of the Scheme on the own funds necessary to operate the business under Solvency 2 depends on the implementing measures adopted pursuant to the Solvency 2 Directive. In principle, if the loss event that insurers are required to withstand for regulatory purposes is less than the risk they retain under the Scheme, there should be no effect on the amount of own funds the participating insurance companies are required to hold. If on the other hand the risk retained is lower than the loss event that insurers are required to withstand, there could be some reduction in the capital requirement of participating insurers to reflect the fact that some of their risk has been reinsured by the Scheme. In conclusion, any reduction in capital requirements for insurers under the new framework depends on both the level of risk retained by participating insurers at any given time and the methodology for calculating the loss that insurers are required to withstand for an event such as a flood. Therefore, it cannot be excluded that the Scheme could have a marginal effect of reducing the amount of own funds that participating insurance companies are required to hold under the Solvency 2 framework. However, any advantage is likely to be limited by:

1) the Levy 1 paid by all the insurers entitled to carry out home insurance in the UK and,

2) the fact that the Scheme will is limited to 2% of the UK household market.

(68) Fourthly, as some insurers are active in cross-border trade, the favouring of such undertakings may distort competition and affect trade between Member States.

(69) Furthermore, the UK admits that the Scheme contains State aid to the Scheme Administrator and the insurers.

(70) For the reasons set out in recitals (57) to (69) above, the Commission concludes that the Scheme contains State aid within the meaning of Article 107(1) TFEU in favour of the Scheme Administrator and the insurers involved.

4.2. Compatibility with the internal market

(71) The Commission has assessed the compatibility of the aid on the basis of Article

taking-up and pursuit of the business of Insurance and Reinsurance, OJ L 335, 17.12.2009, p. 1.

107(3)(c) TFEU.

(72) Article 107(3)(c) TFEU provides that "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*" may be considered compatible with the internal market.

(73) Further, any potentially compatible State aid has to satisfy the general criteria of appropriateness, necessity, proportionality and minimisation of competition distortions.

4.2.1. Applicability of Article 107(3)(c) TFEU

(74) There are no existing guidelines for assessing compatibility of the Scheme with the internal market. For that reason, the Commission will assess its compatibility directly under the TFEU.

(75) The objective of the Scheme is to ensure, for reasons of public policy, that affordable insurance against flood risk is available in the UK market. The Commission considers that it is a legitimate aim of public policy to provide protection to citizens that in the event of a flood disaster they will receive some compensation for their losses suffered.

(76) The Commission recognizes that the core of the insurance business is the quantification of the risks covered and the setting aside of adequate capital resources to absorb such risks. Consequently, the estimated amount of economic capital required by insurers to protect themselves against the highest flood risks will most likely lead to either the refusal of the insurance companies to cover such risks or to significantly increase the flood risk premiums. If mis-priced, the losses coming from floods events could significantly impact insurers' financial shape making them becoming insolvent.

(77) Following the risk-reflective pricing performed by the UK government around 600 000 households may see some increase of their flood risk premium without specific agreement allowing the mitigation of the risk over the country. Flood risk premium may increase by 94% compared to current prices. As a result around 40 000 high flood risk household already insured might become uninsured or spend a significant portion of their income on insurance.

(78) The Commission, based on the review of the impact assessment on risk of

flooding published by the Department for Environment, Food and Rural Affairs ("DEFRA")[9], agrees with the view that there are difficulties to offer flood coverage for the entire UK household market at an affordable price. The Commission therefore concludes that non-life insurance companies will not be in a position to provide insurance cover for the higher flood risk households and therefore are liable to exclude such coverage from their policies. As a result, it accepts the contention of the UK authorities that a market situation without risk mitigation over the market does not provide a satisfactory solution to their objectives.

(79) The Commission concludes that the Scheme favours the provision of insurance cover in an area where potentially no cover would be available or at significant prices in the absence of State intervention and that as such the compatibility of the aid may be assessed under Article 107(3)(c) TFEU.

4.2.2. Appropriateness and necessity of aid

(80) State aid must be targeted to generate a material improvement that the market cannot deliver itself by remedying a market failure.

(81) The Scheme is aimed at ensuring that private insurers can provide ex ante coverage at affordable prices and, as a consequence, the financial burden of covering damages ex post can be better managed. In that way, the UK authorities aim to promote a functioning free market in flood insurance.

(82) As the risk of an event affecting households at the highest risk of flooding can involve significant costs to the insurance companies, any scheme which would force insurance companies to provide cover without any recourse to a last resort could ultimately lead to the failure of stakeholders which cannot be viewed as an acceptable outcome.

(83) In the absence of a reinsurance scheme mitigating the risks, prices would increase significantly and individuals would be left responsible for all the losses resulting from a flood event, which is also not an acceptable approach.

(84) The Commission notes that, several features of the Scheme are designed so that the level of advantage granted to insurers is minimal, commensurate with inducing them to provide flood coverage. Firstly, Levy 1 of GBP 180 million is paid by all the insurers entitled to carry out home insurance in the UK. Secondly, the premium ceded within a defined threshold will be agreed by the Scheme to represent around

9 http://www.parliament.uk/documents/impact-assessments/IA13-27.pdf

2% of all the domestic insurance policies. Finally, in the event that the Scheme has insufficient funds, it will have the power to call another contribution (Levy 2) to be paid by all the insurers entitled to carry out home insurance in the UK.

(85) Therefore, the Commission views the aid embedded in the Scheme as appropriate and necessary to provide a sufficient mitigation of the flood risk ensuring an affordable pricing to policy holders and to incentivize insurance companies to provide cover up to the maximum possible extent.

(86) Therefore, the Commission concludes that the Scheme is appropriate and necessary.

4.2.3. Proportionality

(87) Firstly, the Commission notes that the Scheme will only cover losses up for the 2% of the household market which is riskier. A specific eligibility process will be designed to ensure that the risk is confined to the maximum authorized. The amount of Levy 1 will be reviewed every five years assuring a consistent mitigation of risk over the UK market. The exclusion of predefined category of houses[10] also ensures that the risk transferred to the Scheme is consistent with the level of Levy 1 raised.

(88) Secondly, the Commission notes that the amount of premium transferred to the Scheme has been limited to an affordable level for each Council Tax band. The thresholds will be reviewed at least every 5 years and will be adjusted to take account of inflation as measured by the UK's Consumer Price Index. The level of Levy 1 paid by insurers allow premium thresholds to be set lower than the real risk of household while maintaining the cash flow and capital required to run the Scheme.

(89) Thirdly, in case the cost of risk exceed the planned cost and the reserves booked by the Scheme an additional contribution (Levy 2) will be called by the Scheme Administrator and paid by insurers. The amount raised will correspond to the effective cost of the flood events reinsured.

(90) The Commission concludes that the aid is proportional to the objectives of the Scheme.

4.2.4. Minimisation of competition distortions and negative effects on trade

[10] Council Tax Band H properties in England; Council Tax Band H and I properties in Wales; properties with equivalent bands in Scotland and Northern Ireland; properties built after January 2009; properties located on the Channel Islands and Isle of Man.

between Member States

(91) The State aid must imply no or very limited risk of crowding-out.

(92) The Commission notes that the Scheme is open to all non-life insurance companies entitled to effect and carry out home insurance in the UK. All participants contribute to the payment of the premium and will be included in the calculation of the Levy.

(93) The Commission notes Levy 1 paid and the premium thresholds ceded to the Scheme Administrator will be recalculated every five years. Therefore, Levy 1 and the premiums will be regularly adapted to the risk covered.

(94) Furthermore, the Scheme is set as a transitional measure with a phase-out period estimated to 20-25 years. During that period of time, the UK authorities commit to long-term expenditure on flood risk management, with a specific level of defence for the years 2015-2016. The UK authorities will also implement a specific flood policy will be to avoid inappropriate development in arrears at risk of flooding. To facilitate insurers reflecting flood risk management a standard flood risk report template will be provided to insurers with information on the benefit of resistance and resilience measures. And to promote the reflection of actual flood risk in premiums UK authorities will provide householders with detailed flood maps or confirmation of the actual flood risk covered by insurers.

(95) The Scheme will be managed by the Scheme Administrator, a not-for-profit entity owned and managed by the industry itself. The Scheme Administrator will pool flood risk relating to high flood risk properties across all domestic property insurance policies and will not be involved in competing in any other market. In that way the design of the Scheme ensures that the Scheme Administrator as a new reinsurance company is not replacing private market operators, which ensures that the distortions of competition are minimized.

(96) On that basis, the Commission considers that the impact of the Scheme on competition is limited.

4.2.5. Conclusion on compatibility with the internal market

(97) Based on the assessment set out in recitals (74) to (96) above, the Commission views that the State aid provided to the Scheme Administrator and insurers in the context of the Scheme favours the provision of the insurance cover against floods, that the aid provided is appropriate, necessary and proportional and that has limited negative impact on competition and trade between Member States. As such the

Commission considers that aid as compatible with the internal market pursuant to Article 107(3)(c) TFEU.

5. CONCLUSION

The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) of the Treaty on the Functioning of the European Union

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter, in the authentic language, on the Internet site:
http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 Brussels
Belgium

Fax No: +32 2 296 12 42

Yours faithfully,
For the Commission

Margrethe VESTAGER
Member of the Commission