



Association of British Insurers

BARKER REVIEW OF LAND USE PLANNING: RESPONSE BY THE ASSOCIATION OF BRITISH INSURERS

The Association of British Insurers (ABI) is the trade association for insurance companies operating in the UK. It represents over 400 members who, between them, account for over 94% of the general insurance business of UK insurance companies and hold 17% of equities on the Stock Market.

Summary

The land use planning system can capture intergenerational benefits and costs in a way that markets (including insurance) cannot. Consequently the ABI and its members are keen to see the planning system strengthened to deliver sustainable development through a risk-based assessment, balancing current and future benefits and costs to all of the affected parties. At the same time insurers as businesses recognise the need to minimise transactional costs and so, where risk is low, consider that a fast-track system could be adopted to speed the development process and realise economic, social and environmental gains as quickly as possible.

Sustainable development is dependent on a long-term perspective and equitable treatment of vulnerable communities, which are often at greatest risk. There are particular problems in the assessment and management of low probability, high consequence events. The planning system has a crucial role in dealing with these on behalf of wider society.

Introduction: the role of insurance and its inter-relationship with the planning system

Insurance provides risk transfer services across the full spectrum of economic activity as well as to individual householders. As such it translates economic, social and environmental risks into financial instruments. Insurers define risk as a function of probability and consequences.

The monetary signals provided by insurance premiums and conditions (such as deductibles and specific exclusions) encourage risk management (i.e. avoid moral hazard or perverse incentives). The efficient transfer and management of risk enable activities (such as the formation of new businesses) that would not occur if the individual or business had to bear the whole risk. As such, insurance has the theoretical potential to deliver strong incentives for sustainable economic and social enterprise.

Case study: London's tidal risk - the role of planning in sustainable development

Heavy aggregations of value such as those found in London offer particular challenges for insurers where these are affected by a single event such as tidal surge, as experienced in 1953. Insurers typically use reinsurance to manage the impact of this aggregation of risk and this, combined with a very high current standard of tidal defences (designed to a 1:1000 chance or 0.1% annual probability), enables insurance to be offered so long as each insurer manages its exposure.

Significant changes to risk profiles such as those which will result from new developments in Thames Gateway, prompt insurers to assess their willingness to accept new risks. An ABI study revealed that development in the sites proposed within the four growth areas designated by the government would increase national flood risk by 5% p.a., whilst adding less than 1% additional housing capacity. This additional risk could be almost completely eliminated in three of the growth areas by the strict application of existing guidance on development in the floodplain, and halved within Thames Gateway by applying the sequential approach, using lowest risk sites first.

However, insurers (and the Financial Services Authority) are also concerned about extreme events, as these have the potential to threaten solvency. The proposed developments in the Thames Gateway alone would add around £5bn in increased potential damages if an extreme flood event were to occur¹, over and above the £12-16bn of assets already exposed in London.

As climate change increases natural catastrophe losses, such as those arising from US hurricanes and Japanese typhoons, global capital markets may be unwilling to provide the additional capacity to support this cover, or the cost of such capital may increase, leading to high insurance costs². Rising annual insurance costs would impact disproportionately on regeneration projects and households on low incomes, many of the latter already struggling to buy insurance³. One of the key aims of the Thames Gateway project is to address regeneration and poverty and so may be frustrated by these medium-long term effects.

A sustainable planning system would anticipate the likely changes in risk during the lifetime of developments and would site them in lower risk areas. Indeed, economic efficiency concerns alone would point to lower risk areas being more appropriate for development unless the use of higher risk sites led to higher returns net of insurance costs. In high risk areas the planning system should also look to provide community benefits less vulnerable to flood damage, such as green spaces, re-instating brownfield sites as necessary to achieve improved biodiversity and other desired benefits⁴.

¹ Making Communities Sustainable. ABI, 2005

² An ABI study, The Financial Risks of Climate Change (2005), showed that annual global windstorm losses could increase by two thirds to US\$27bn by the end of the century due to climate change. In years with severe events losses could be as high as \$100-150bn for US hurricanes and \$25-34bn due to Japanese typhoons. In 2005 worldwide natural catastrophe losses were more than twice the previous record, reaching US\$78bn, largely due to hurricane damage, according to Swiss Re.

³ According to the ONS Family Expenditure Survey only 45% of households in the lowest income decile and 58% of the second decile purchase Home Contents insurance, the remainder carrying all the risk of any fire, crime, accident or natural event affecting their possessions.

⁴ See Adaptation to climate risks by cities. To be published shortly by the London Climate Change Partnership. This study provides examples of sustainable flood risk management techniques being adopted in other world cities.

Insurance operates in a world where theoretical assumptions may not apply or may act imperfectly. For example, neither insurer nor customer has a perfect knowledge of the risk applying in a specific set of circumstances, or of the market offering competing risk transfer services. Distribution processes abbreviate available risk information further as the market balances risk pricing needs and transaction costs. Customers seek solutions to broad risk portfolios, or wish to accommodate business practices that may mean insurers are only notified of actual exposure (and so apply final charges) at the end of a contract.

Even where risk is known at the outset, it may change due to the economic cycle, new legislation or developments in common law leading to changed liabilities, emerging knowledge for example on the causation of diseases, or a shift in environmental factors such as climate change. Capital requirements and costs may drive insurers to limit exposure to certain types or levels of risk or to ration cover at certain locations.

These market inefficiencies lead insurers worldwide to rely to some degree on risk management measures imposed through statute, the primary aim of which is to internalise the costs of unwanted social, environmental or economic impacts on wider society. Building control and land use planning are classic examples of where statutory requirements offer insurers assurance that the risk will be “no worse than X”.

Insurers may impose additional risk management conditions where individual circumstances justify greater limitations, or where statutory measures focus on one aspect of risk (e.g. safety of life in Fire regulations), but ignore financial consequences. Where these improvements cannot be achieved (or where the insured is unwilling to implement them), cover may be withdrawn either for the specific hazard (or peril, in insurance terms) or in total. For example, business customers may have specific perils like flood cover excluded where the risk (probability and/or consequences) is considered too high or unmanaged. As a result they bear the full risk themselves and as a consequence may not be able to survive a flood event, or may choose to relocate in order to avoid this unwanted exposure.

We believe that the most economically efficient approach to land use planning is to incorporate a comprehensive assessment of risk, ensuring appropriate risk ownership and management. The alternative would encourage inappropriate development from which insurance cover would, sooner or later, have to be withheld or priced at a level that cannot be sustained by the economic or social activity in question, with the attendant waste of resources and economic and/or social dislocation. Insurance, even in a competitive market, will be unaffordable if the risks associated with the insured activity are greater than the potential returns from activity at the location.

Whilst the availability of insurance does not necessarily imply that a development is sustainable (since insurance markets can only accurately assess current or short term changes to risk), the unavailability of affordable insurance can be taken as an indicator of unsustainability.

Is the planning system sufficiently flexible and responsive to the right signals given the changing economic circumstances due to globalisation, demographic change, natural resource pressures and environmental change? If not, what policy measures might help deliver this flexibility?

Planners are, understandably, concerned not to expose planning decisions to legal challenge. They therefore tend to be conservative in approach, aligning decisions and processes with established interpretation of statute and guidance. Changes to central guidance, such as those set out in new planning policy statements or guidance are adapted partially and piecemeal as a new body of precedent is established. The recent Environment Agency report 'Development and flood risk'⁵ noted that, although four years after the publication of PPG25, of the 12 adopted development plans on which the EA had been consulted in 2004/05, only one made reference to the precautionary approach and two to the sequential (i.e. risk based) test. Early case studies should be disseminated amongst the planning community following the introduction of new guidance, giving a clear indication of new precedents.

Planners, in effect, act as monopsony suppliers of new development land. As this market for development does not work through market pricing, planners must consider the calculation of relative risk and return in a theoretical economic framework. Without a reactive planning system, decisions on where to develop may distort other competitive markets, such as where to locate businesses. This may slow overall economic growth as the cost of operating a business in some areas will be higher due to the underlying risk characteristics of the area.

The system also has a good deal of built-in inertia. Past decisions and development consents continue to be valid long after policy changes have been instituted. Where these changes are consequences of an improved understanding of risk, the planning system should act to internalise those risks by requiring site use, building design and resilience measures to offset unacceptable levels of risk, even where development consents cannot be withdrawn.

Do you have views on the scope of plans at the different spatial levels in England which are now emerging following the introduction of the new system in 2004? Does the current system strike the right balance between central direction and regional and local discretion?

The ABI supports a hierarchy of national guidance being applied to shape regional, strategic plans which in turn provide the framework for local elaboration. Some issues can only be resolved at the site level. We consider that properly assessed, risk-based regional plans could enable fast-track local processes to apply in low risk areas, achieving both sustainable development and a flexible and business-friendly environment.

This would, however, be reliant on good central guidance on the chief sources of hazard which should include: industrial hazards such as explosion, release of

⁵ High Level Target 5: Development and flood risk 2004/05. Environment Agency, 2006

hazardous substances and pollution, and mining subsidence; natural and environmental hazards such as coastal erosion and slope instability, coastal and river flooding and groundwater problems, and; possible social hazards such as terrorism.

This should be combined with a toolkit to analyse likely pathways (aerial, overland, waterways etc) and impact range, together with the expected impact on receptors, (people, buildings, infrastructure, jobs, services). This process would align with local authorities' responsibilities for emergency planning under the Civil Contingencies Act, Fire Authorities' Integrated Risk Management Plans, and consolidate wider sustainable development objectives. It could build on community consultations undertaken as part of these processes.

The result would be a comprehensive assessment of relative risks applying in different parts of a region which could direct further planning activity into low risk areas. Similarly activities with similar risk profiles could be clustered. It should also communicate site risks widely to support the development of an efficient market where the value reflects societal appetite for risk.

Local planning decisions could then be made within this framework, avoiding nugatory activity by developers and others involved in the planning process, and offering the potential for fast track decisions in low risk areas. Consideration could still be given to higher risk sites where sustainable technical solutions could manage or reduce risk, providing that performance in extreme events is understood adequately.

Decisions at the regional level should also ensure that developments such as large industrial plants with the potential to cause explosive damage and/or releases of hazardous materials are kept within isolation zones, whilst leaving local planning authorities to determine the detailed health and safety and environmental requirements associated with a given site.

Sustainable development is the core principle underpinning planning. Does the current system achieve the right balance between economic and other goals, including improving the quality of design of buildings?

Planning appears to have a limited role in achieving improvements in the quality of building design in so far as this delivers sustainability. The Building Regulations are more important in this area but there is currently too little interaction between the two processes. Greater integration would enable a truly risk-based approach that delivered sustainable development.

Do planning authorities have the skills and resources to promote sustainable economic development?

Shortages of experienced planners may impede the promotion of sustainable economic development as less reliance is placed on judgement and a more mechanistic approach adopted. In previous planning reviews some have questioned

whether elected members always have sufficient knowledge and understanding to discharge their roles effectively. Overall, better training together with acknowledgement of existing sources of expertise is needed. In particular there is poor understanding of risk (meaning a function of probability and consequences). Where ODPM already proposes a risk-based approach, such as for developments in floodplains, some of the reasons for rejection of Environment Agency advice demonstrate little understanding or regard for consequences in low probability, high impact situations.

For example, economic necessity is still cited as a reason for approving planning applications in flood risk areas. This is despite sustainable development principles and, in the long run, economic efficiency dictating that such critical developments for the local economy should be re-directed to lower risk sites or sites with appropriate strategies for managing flood risk.

What is the impact of planning on encouraging or impeding business investment? Are the recent reforms increasing the transparency of the system and providing greater certainty? What further reforms, if any, are desirable?

The planning system does not currently encourage development or business investment and recent changes to make the process more transparent have not improved the process significantly. In many instances there are a multitude of public bodies involved in the planning process, each with its own agenda.

A more strategic and integrated approach to risk assessment which identifies low risk, fast-tracked zones for specific types of development would enable insurers as investors to identify opportunities and manage their portfolios. It should also enable a more co-ordinated approach to planning by the authorities, particularly for larger redevelopment and regeneration projects.

Planning applications for major projects will typically take a considerable time to work through all the necessary stages. Does the system put too much emphasis on speed or is it too slow? What are the negative consequences from either?

If the planning system shifted to a risk-based approach the processes could reflect the risk profile of both locations and proposed developments. This would capture both the benefits from light touch assessments of low risk activities in low risk locations and more detailed scrutiny, possibly resulting in imposition of specific planning requirements, of high risk activities and/or development at higher risk locations.

The three pillars of sustainability would then be integrated with, for example, economic and social gains being realised most rapidly where environmental costs are identified as low. Potentially high social or environmental disbenefits would be avoided by more elaborate evaluations to identify appropriate risk management where an economic activity is associated with potentially significant hazards (such as frequent or persistent minor damage or remote likelihood of very high impact

events). Likewise for locations with high risks of environmental hazards, careful scrutiny and appropriate risk management would minimise social and economic costs.

Are the new arrangements for stakeholder engagement in the plan-making process succeeding in engaging those representing economic interests, including SMEs? If not, what is the best way to ensure that resources match the challenges the system faces?

Many stakeholders successfully engage at the local and regional level. However, others, particularly sectoral business bodies, struggle to interact beyond the national level. It should be possible to capture the views of these groups at a national level and make them available to consultations at the regional or local level. Whilst this may not address some questions specific to the local area it would at least improve understanding of business concerns and attitudes. Where significant conflicts or concerns were identified these could be pursued pro-actively by planning authorities with the relevant business organisation.

Are there ways that the incentive structure for decision-makers and local communities can be improved so that a balance is achieved between local and wider community interests?

The planning system seeks to combine technical assessments aimed at maximising public good through delivering benefits to developers and the wider community, or at least minimising the disbenefits to the latter, and democratic processes to ensure accountability. However, any decision gives rise to a wide range of winners and losers, some of whom may be distant from the development. For example, carbon-neutral electricity generation benefits wider UK and global society by reducing emissions growth whilst enabling economic growth and social development.

However, in this type of development most beneficiaries do not or cannot engage in the planning process whereas experience shows that those immediately neighbouring the proposed development site and who consider themselves adversely affected are likely to be very vocal in their opposition. Those who perceive little advantage or disadvantage are likely to remain silent as even for those likely to benefit, the cost of intervention is greater than the small benefit available. Whilst technical assessments may capture the true balance of benefits and disbenefits, it may be much more difficult for the democratic process to do so when only aggrieved stakeholders engage.

A mechanism needs to be found to reconcile these tensions without resorting to lengthy and/or costly appeals procedures. This may require central direction presuming in favour of certain types of development where these are demonstrably supportive of wider sustainability goals and where risk assessments otherwise support development on the site.

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