



Department
for Environment
Food & Rural Affairs

The Flood Reinsurance Scheme – Regulations

July 2014



© Crown copyright 2014

You may re-use this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence v.2. To view this licence visit www.nationalarchives.gov.uk/doc/open-government-licence/version/2/ or email PSI@nationalarchives.gsi.gov.uk

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at

Flood Insurance Team
Department for Environment, Food and Rural Affairs
3rd Floor, Nobel House
17 Smith Square
SW1P 3JR

Telephone: 020 7238 6239

Email: floodinsurance@defra.gsi.gov.uk

Contents

Part A: Background.....	4
Consultation purpose and scope.....	4
Previous public engagement and Parliamentary scrutiny.....	5
Part B: The Legislation.....	6
Scheme Administration	6
Funding and Finances.....	12
Definitions	15
Designation	19
Part C: Impact Assessment	21
Part D: Tell us what you think	22
Who will be interested in responding?.....	22
Having your say	22
Consultation Questions	23

Part A: Background

Consultation purpose and scope

1. The UK Government (the Government) announced in June 2013 that it was taking forward the Flood Reinsurance Scheme (Flood Re) as the preferred approach to addressing the availability and affordability of flood insurance. We have taken powers in the Water Act 2014 (“the Act”) allowing for the introduction of Flood Re.¹ This consultation seeks views on the regulations the Government is introducing to enable the insurance industry to implement Flood Re next year.
2. As set out in the Memorandum of Understanding between the insurance industry and the Government, Flood Re will be established by the insurance industry as a not-for-profit entity, owned and managed by the industry.² Flood Re will be operationally independent from Government.
3. The Act sets the legal framework and parameters within which Flood Re will operate and the broad scope of the regulation making powers. The proposed regulations will cover its funding, administration and designate the Flood Re Scheme and Administrator. This consultation seeks views on the approach taken in these regulations. A short guide on Flood Re is also included alongside this consultation document. Our aim is to ensure that domestic property insurance continues to be widely available and affordable in areas of flood risk without placing unsustainable costs on wider policyholders or the taxpayer as part of a gradual transition towards more risk-reflective prices. As set out in the Act, Flood Re will:
 - (a) *promote the availability and affordability of flood insurance for household premises while minimising the costs of doing so, and*
 - (b) *manage, over the period of operation of the scheme, the transition to risk-reflective pricing of flood insurance for household premises.*
4. The Act also provides powers to introduce the Flood Insurance Obligation (the Obligation). Whilst, at this stage, we are not consulting on regulations for this part of the Act, we retain the ability to use these powers to introduce the Obligation should Flood Re prove unworkable or not deliver Government’s policy goals or pricing in an open market proves unacceptable.
5. This consultation is being conducted by the UK Government. Financial services including insurance are reserved matters; the territorial extent of this consultation covers the UK insurance market and is therefore UK-wide in scope. Details on how to respond to this consultation are provided in **Part D**.

¹ The Water Act 2014: <http://www.legislation.gov.uk/ukpga/2014/21/section/64/enacted>

² Flood Re: Memorandum Of Understanding:

https://consult.defra.gov.uk/flooding/floodinsurance/supporting_documents/20130626%20Flood%20Insurance%20MOU%20June%202013%20unprotected.pdf

Previous public engagement and Parliamentary scrutiny

6. The Government consulted in the summer of 2013 on its preferred approach for ensuring that domestic property insurance continues to be widely available and affordable in areas of flood risk.³ An Impact Assessment produced at the time set out the costs and benefits of a range of options, including the preferred option. We consulted widely, including holding several workshops which were well attended by a broad range of representatives. We received 149 formal responses to the consultation. There was widespread support for Flood Re, which is both the Government and industry's preferred option.
7. A draft of the flood insurance clauses, for inclusion in the Act, was made available for comment in September 2013, alongside a commentary setting out the policy intention for each clause.⁴ An updated Impact Assessment and a summary of the responses to both consultations were published in November 2013.⁵ Full clauses were added to the Act during its Committee stage in the House of Commons.
8. During the passage of the Act through Parliament, a number of amendments were made to the flood insurance clauses.⁶ Many of these were minor and technical amendments. However, the Government also responded to concerns raised in both Houses by introducing a new requirement for Flood Re to make information about the Scheme available to householders that are reinsured via Flood Re (via their insurers). This includes how customers can find out about their level of flood risk; a key pre-requisite for better flood risk management at property level.
9. The Delegated Powers Committee also recommended that all of the regulations establishing Flood Re should be subject to the affirmative Parliamentary scrutiny procedure, which requires a debate and vote before regulations are made and in the event that they are amended in the future. Amendments were made to the flood insurance clauses to reflect this.
10. The Government committed to setting out further details of Flood Re in regulations including on review and transition, financial governance (particularly on the additional levy or contributions from insurers), and some definitions. Details of the Act's passage through Parliament can be found on the Parliament website.⁷ The Act received Royal Assent in May 2014.

³ Government's consultation in summer 2013, "Securing the future availability and affordability of home insurance in areas of flood risk": <https://consult.defra.gov.uk/flooding/floodinsurance>

⁴ Government's informal consultation on the flood insurance draft clauses: <https://www.gov.uk/government/consultations/draft-flood-insurance-legislation>

⁵ Government's response to the two consultations: <https://www.gov.uk/government/consultations/insurance-in-areas-of-flood-risk>

⁶ A briefing note setting out the key changes that were made to the Water Bill during its passage through the House of Lords: <http://www.parliament.uk/briefing-papers/SN06876/water-bill-201314-lords-amendments> The section on Flood Re starts on page 9.

⁷ Water Act 2014: Parliamentary Stages <http://services.parliament.uk/bills/2013-14/water/stages.html>

Part B: The Legislation

11. This section of the consultation should be read in conjunction with the draft regulations. For brevity, the draft regulations are referred to as regulations throughout. For clarity, the consultation is set out thematically, rather than following the regulations in order. Questions are set out in various sections below where there are particular issues of interest or outstanding technical and policy issues that need to be addressed. General comments on all of the regulations and the approach set out would also be welcome.

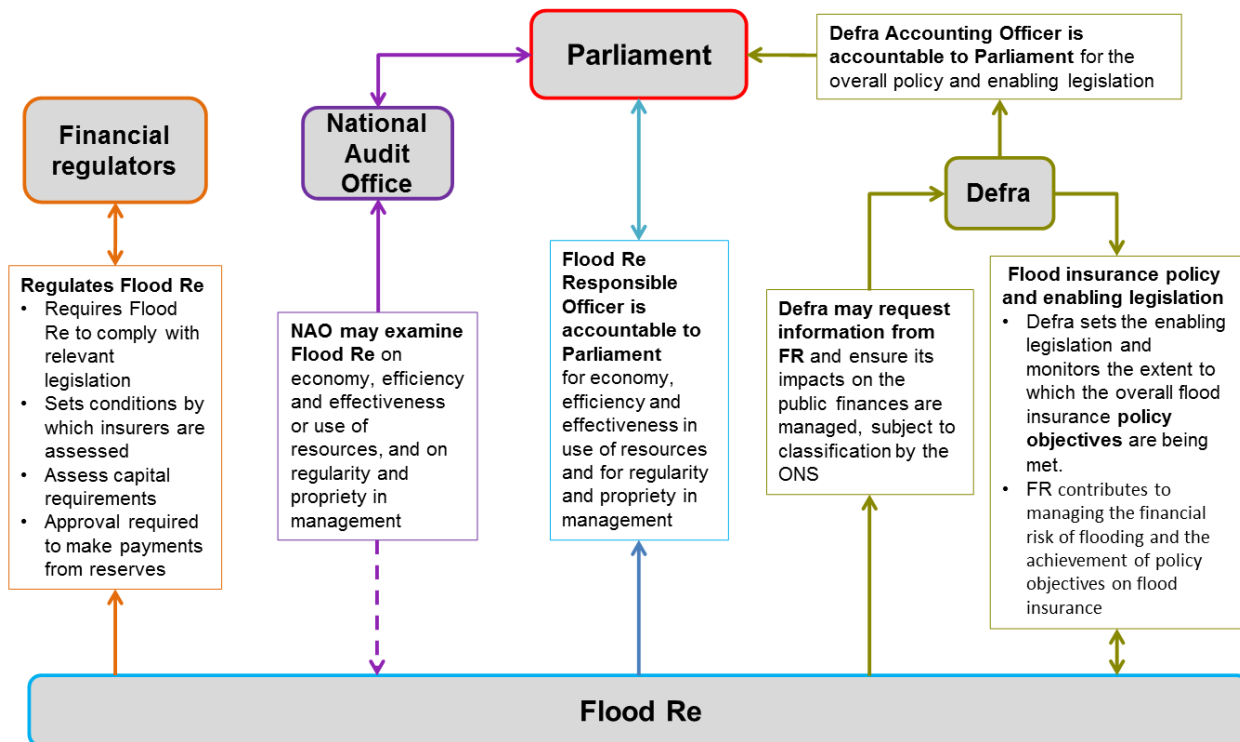
Scheme Administration

12. This section sets out how the Scheme Administration section of the regulations is intended to work (regulations 16 to 24).

Relationship between Flood Re, Government and Parliament

13. Flood Re will, as far as possible, be treated as an autonomous body with operational independence from the Government. This is reflected in the way the relationship between the Government and Parliament is presented in the regulations.
14. The Office of National Statistics (ONS) will assess the classification of the levies the Flood Re Scheme Administrator raises and the type of body the Scheme Administrator is (e.g. whether it is a public or private body and, if the former, whether it is a public corporation), once it is established. However, given the strong expectation that at least the primary levy will be considered a tax and therefore, that the Scheme Administrator will be managing public funds, we are setting in regulations certain arrangements that provide the Scheme Administrator with clear expectations of what an appropriate approach to managing public money means and the standards by which Parliament may wish to hold the Scheme Administrator to account. Flood Re also needs to obtain authorisation from the Prudential Regulation Authority (PRA) and Financial Conduct Authority before it is able to operate in the UK. Further details are set out below in the section "*Authorisation by financial regulators*".
15. The Government will retain responsibility for general policy matters relating to flood insurance, with Defra being the lead Department and accountable to Parliament for this. The Scheme Administrator, through the Responsible Officer, will be accountable to Parliament for the operation of the Flood Re Scheme. This approach was set out in the previous consultation and during the Act's passage through Parliament.
16. Regulation 16 will require the Scheme Administrator to consider value for money in discharging its functions by requiring it to take into account economy, efficiency and effectiveness in its management of the Scheme and to take into account propriety and regularity in the Scheme's operation. Regulation 16(b) will require the Scheme Administrator to take into account the need to act in the public interest when discharging its functions. We are not proposing to define these terms in the regulations because we think that it is sufficient to rely on natural meanings of these terms and precedent from Parliament's expectations on the management of public money. The regulation mirrors the powers provided in Section 67(2) of the Act.

Relationship between Flood Re, Government and Parliament



 Department for Environment, Food & Rural Affairs

The Role of the Responsible Officer (Regulations 19 and 20)

17. Regulation 20 provides for the Scheme Administrator to be directly accountable to Parliament for the ongoing operations of the Flood Re Scheme; this is done through the appointment of a Responsible Officer, a role that broadly mirrors the Accounting Officer responsibilities as set out in *Managing Public Money*.⁸ The Responsible Officer will be directly accountable to Parliament for the stewardship of the Scheme and the management of its finances. They will also be responsible for laying the Scheme's audited annual accounts and annual report before Parliament and accountable for managing and responding to any reports made by the National Audit Office (NAO).
18. Parliament will be able to call on the Responsible Officer and look into the management of the Scheme should they deem it necessary or in the public interest. Parliamentary Committees may also wish to assess the management of the Scheme. We have not provided for this in the regulations because the Committees have the ability to call the Responsible Officer to account without a specific power being necessary. The duties we are placing on the Responsible Officer in these regulations reflect the powers set out in section 67(6) of the Act.

⁸ Managing Public Money:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212123/Managing_Public_Money_AA_v2_-_chapters_annex_web.pdf

19. It is important that the Responsible Officer is a person with appropriate seniority and responsibility. Regulation 19 therefore requires the Chief Executive Officer (CEO) to be designated as the Responsible Officer, or, in the absence of the CEO, the officer acting as the CEO. This will ensure that there is always somebody designated as holding this office.

The Role of the National Audit Office

20. The NAO, through the office of the Comptroller and Auditor General, has been given powers to examine the administration of public money on value for money grounds and propriety and regularity in the operation of the Flood Re Scheme (as set out in regulation 21), should the Comptroller and Auditor General consider this is necessary. Regulation 22 includes provision to allow the NAO access at all reasonable times to any documents relating to Flood Re which are necessary for the purposes of carrying out those investigations.
21. Regulation 22 also sets out that, should the NAO examine Flood Re's administration, it must lay its report before Parliament, specifically in the House of Commons, which reflects the NAO's established practice for laying reports in Parliament. Together, the powers afforded the NAO closely mirror the powers provided by the Act (section 67(5)(f) and (g)) and reflect the NAO's powers in their own legislation.⁹

Question 1:

The proposed regulations will ensure that the Responsible Officer is directly accountable to Parliament for Flood Re's operation, and set out specific duties for the Responsible Officer. Do you agree these duties are sufficient (Y/N)?

Question 2:

We are not defining economy, efficiency and effectiveness, propriety and regularity or the public interest in the regulations; we believe their natural meanings are clear. Do you agree with this approach (Y/N)? If you think that these terms need defining, either in legislation or elsewhere, what factors should be considered in their interpretation?

Accounting for Flood Re's finances

22. As it is expected that at least some of Flood Re's funding will be classed by the ONS as public funds, regulation 23 provides the Government with powers to monitor the Scheme's impact on public expenditure. This is necessary to ensure the Government has the ability to monitor and understand any potential impacts Flood Re may have on public expenditure. Details as to what information will be provided and how regularly, will be agreed with the Scheme Administrator and set out in corporate documentation. We do not believe it necessary to seek information other than that necessary for Government accounting.

⁹ The National Audit Act 1983: <http://www.legislation.gov.uk/ukpga/1983/44/contents>

23. As provided by section 67(5) of the Act, regulation 17 specifies certain limits on Flood Re's cash flow. The strong expectation is that Flood Re will be making use of public funds and the intention here is to ensure that the Scheme Administrator manages these funds prudently.
24. In particular, this regulation will include a provision (currently at 17(d)) prohibiting Flood Re from adding more than £100 million to public sector net borrowing in any given financial year. We are working with Flood Re, trade bodies and the PRA to determine the extent to which this could result in potential unintended consequences for Flood Re as an authorised insurer in exceptional circumstances; and to consider what options, if any are available to the Scheme Administrator to address these, consistent with also providing sufficient protection for the public purse.
25. In addition, there are a small number of targeted financial governance arrangements aimed at limiting the amount the Scheme Administrator is able to borrow, and ensuring that it will not be able to use or transfer assets other than for the purposes of the Flood Re Scheme; for its administration; and other incidental purposes. The aim of these arrangements is to limit Flood Re's impact on the public finances, so that it can operate independently as an industry run and managed body. The consent of HM Treasury will be required under section 66(1) of the Act, to make the funding elements of the regulations.

Authorisation by financial regulators

26. Since 2001, financial services in the UK, including insurance companies, have been subject to the Financial Services and Markets Act 2000 (FSMA) and no person may effect or carry out insurance in the UK without authorisation and the relevant permission to do so.¹⁰
27. As the Scheme Administrator will be carrying out insurance related activities in the UK, it will need to seek authorisation to do so from the Prudential Regulation Authority (PRA) which is part of the Bank of England. Consent from the Financial Conduct Authority (FCA) is required as part of this authorisation. This will be required in addition to the regulations we are proposing.
28. The FCA seeks to ensure that consumers are treated fairly in their dealing with insurers, whereas the PRA's main objectives are to ensure the safety and soundness of firms and ensure that policyholders have an appropriate degree of protection.
29. In applying to the PRA for authorisation, the Scheme Administrator will need to demonstrate that it meets the respective minimum requirements of both regulators (known as Threshold Conditions) on an ongoing basis in order to be permitted to carry on regulated insurance activities. In addition to ensuring basic requirements such as its legal status are met, the authorisation process includes an assessment of whether the Scheme Administrator has appropriate financial and non-financial resources in place and is capable of being effectively supervised.

¹⁰ Financial Services and Markets Act 2000: <http://www.legislation.gov.uk/ukpga/2000/8/contents>

30. The PRA and FCA will also assess the skills and experience of key members of senior management, including the CEO, as to their suitability to perform certain roles in managing an insurance firm such as Flood Re. Formal approval from the PRA and/or the FCA (depending on the role) is required before an individual can undertake the role for which approval is sought.
31. Once authorised, the Scheme Administrator will be subject to ongoing supervision by the PRA and FCA. The Scheme Administrator will also be subject to wider regulations such as The Companies Act 2006. As safeguards on the financial management and conduct of the Scheme Administrator are already set in existing financial legislation, we do not need to introduce regulations specific to Flood Re.
32. Flood Re is accordingly engaged in discussions with the financial services regulators in relation to its authorisation.

Transition and transition plan, including the provision of information on Flood Re and flood risk

33. Flood Re is designed to operate for up to 25 years. As set out in section 67(2)(d) of the Act, the Scheme Administrator will need to manage the transition to risk-reflective pricing of flood insurance for household premises, this is set by regulation 18(1). The transition plan will need to address the phasing out of the benefits of the Scheme over the lifetime of the Scheme.
34. Regulation 18(2) sets out that the Scheme Administrator must produce a plan for managing this transition to risk-reflective pricing of flood insurance. The Scheme Administrator will be best placed to develop transitional arrangements in keeping with the industry run and led nature of the Scheme, and using industry expertise. The Scheme Administrator will be required by the regulation to publish this transition plan on its website, within 3 months of the regulations coming into force, setting out how this will be achieved.
35. Regulation 18(3) provides clarity as to what the transition plan should contain, that is:
 - Information about the steps the Scheme Administrator will take to manage transition to risk-reflective prices for flood insurance
 - and general information about the estimated impact this might have on the amount of the levy Flood Re requires and the level it sets for reinsurance premiums for policies ceded to the Scheme.
36. Under regulation 18(4), the Scheme Administrator will have a duty to update the transition plan on a regular basis, and at least every 5 years, to ensure that the industry and public have access to accurate information about how the price of flood insurance and benefits given by Flood Re might change over the 25 year period.

37. To ensure that households in Flood Re are aware of these price changes, regulation 24 sets out that the Scheme Administrator's responsibilities will include the provision of general information to relevant insurers on Flood Re, Flood Re's transition plan and on how policy holders can obtain information about their flood risk (and how this can be managed), in a format that can be passed on to customers. This will help to raise awareness and help households prepare for free-market pricing by taking steps to reduce their vulnerability to floods and the impact of floods on their properties. As the Scheme Administrator will not have a direct relationship with customers who have purchased flood insurance, this regulation requires them to provide information to insurers who can then pass it onto their customers. This requirement on the Scheme Administrator reflects the powers set out in section 67(4) of the Act.

Question 3:

Do you think that the publication of a transition plan and provision of information to insurers is appropriate for making insurers and those at highest risk of flooding aware of the transitional nature of Flood Re? If not, what other approach could help householders and insurers understand the transitional nature of the Scheme and help them prepare for the transition to risk reflective prices?

Funding and Finances

38. This section covers how Flood Re will be funded, including the governance arrangements required for the Scheme Administrator to manage public money. As with the arrangements for the reporting of information above, these are dependent on the eventual ONS classification; however we expect that the primary levy will be classed as a tax and the regulations are based on this assumption.
39. Flood Re will need to operate within boundaries set by these regulations as set out in more detail below. These regulations will place a duty for the Flood Re Administrator, in conjunction with the Secretary of State, to review the primary levy and premium thresholds at least every five years. Any changes to the amount of the levy or premium thresholds will need to be set in legislation and should bring about the transition to risk-reflective pricing over the duration of the Scheme, in line with Flood Re's purpose. In addition, regulation 26 will require the Scheme Administrator to review its financial model between these reviews, should this be needed.

The Flood Re Scheme funding mechanism

40. The Scheme Administrator will collect a primary levy from all relevant insurers in order to formalise the existing cross-subsidy present in the market. Regulation 5 requires all relevant insurers issuing domestic household insurance in the UK to pay a levy which will be collected on a quarterly basis. In line with the Memorandum of Understanding reached between Government and the ABI in 2013, regulation 5 also sets the total annual levy at £180 million for the first five years after which it will be reviewed at least every five years (see paragraph 50 below). The formulae for how each insurer's proportion of the annual levy will be calculated is outlined in more detail in paragraph 43 below.
41. As set out in the previous consultation, the Scheme Administrator will purchase reinsurance to cover insurance liabilities (the risk associated with ceded policies). Should the directors of Flood Re consider it appropriate for the prudent management of the Flood Re Scheme, regulations 10 and 11 provide Flood Re with the ability to call additional amounts from all relevant insurers, using the same calculation as for the primary levy. These additional amounts may be called as contributions (of up to a total of £100 million in any one year), or as a levy (which has no annual limit and can be called upon if insurers choose not to pay contributions), based on a mechanism set out by the Scheme Administrator. As set out during the Water Act's passage through Parliament, this £100 million limit is needed to manage Flood Re's impact on the public finances.
42. To safeguard public finances, regulations 12 and 17(c) ensure that funds collected either through the primary levy or through additional calls for funding may only be used for the purposes of the Flood Re Scheme and the administration of the Scheme, including the potential repayment of contributions and other incidental purposes. As set out during the passage of the Water Act through Parliament, nothing in these regulations prevents Flood Re from making these repayments, as and when it might be appropriate to do so.

Question 4:

Do you agree that the funding arrangements in the regulations (including regulation 17 above) achieve the right balance between operational freedom; certainty for insurers; and accountability for the handling of public money (Y/N)?

Calculating payments for relevant insurers

43. The amount of the primary levy and any further calls for funding, by way of additional levy or contribution, will be calculated for each relevant insurer by the Scheme Administrator, in proportion to each relevant insurer's share of the home insurance market. The formula for this calculation is set out in regulation 5 and 11(c). This formula uses a definition of "Home Insurance" as the basis for the Gross Written Premium on which the levy is calculated and is set out in section 3 (Definitions) below.
44. To enable the Scheme Administrator to calculate the levy amounts, regulation 9 requires each relevant insurer to, within 30 days of being formally asked, provide the Administrator with information required to calculate the levy, including the Gross Written Premium (GWP) of home insurance policies issued in the UK in the previous calendar year. This amount of GWP currently includes commissions (for further details please see the definitions set out in the regulations). Each insurer's share of the domestic market would then be calculated based on their percentage share of the UK GWP for the previous calendar year.
45. Should a relevant insurer fail to provide the information required within the timeframe outlined in regulation 9, or, if, for example, should a new entrant not be able to make this information available, regulation 6 enables the Scheme Administrator, for the purposes of calculating the levy for that relevant insurer, to estimate their Gross Written Premium for that year.

Question 5:

Are there any practical difficulties with the approach of using Gross Written Premium and "Home Insurance" to calculate the levy for "relevant insurers" (Y/N)?

Question 6:

Do you think that the approach for estimating GWP for insurers who fail to provide this information within the timeframe is fair (Y/N)?

Question 7:

If no to either of the previous two questions, what changes to this approach should be considered and why?

Failure to pay (civil debt recovery)

46. Should relevant insurers fail to pay either levy after 30 days following a request, regulation 13 provides for the Scheme Administrator to recover the amount through the courts as a civil debt.

Premium Thresholds

47. The upper limit to the premiums that the Scheme Administrator will charge insurers to purchase reinsurance will be set for the first five years of the Scheme. These premium thresholds (the amount relevant insurers will pay for reinsurance and previously

referred to as eligibility thresholds) will be set based on an individual property's Council Tax (valuation) band within England, Wales and Scotland, and the relevant equivalent valuation bands in Northern Ireland. From April 2016 these prices will be updated on an annual basis by the Consumer Price Index for the previous financial year. It is the Government's intention that the savings associated with the effective limit on premiums will be passed on by insurers to policy holders. As such it is not expected that commissions should be payable on these amounts. This expectation will not be set out in regulations, but is part of the 2013 Memorandum of Understanding.

48. The premium thresholds for the Scheme are set in regulation 14 and the accompanying tables in the Schedule.
49. Should policy holders feel that the cost of their insurance policy does not reflect their policy's eligibility to be ceded to Flood Re, they should query this with their insurers and shop around for the best price. If they do not feel that their query/complaint has been treated fairly and they would like to pursue the matter, they can contact the Financial Ombudsman Service, which offers a free dispute resolution service for people who wish to complain about how their insurance company has treated them.

Review of Flood Re transitional funding and financial model

50. Regulation 25 provides for the amount of the primary levy and the reinsurance premium thresholds to be reviewed every five years, or sooner if required, by the Flood Re Administrator. The Scheme Administrator, 12 months prior to the end of the review period, must provide to the Secretary of State a report which outlines the proposed changes to the levy and premium thresholds and the evidence which supports this, in line with Flood Re's published transition plan. The Secretary of State has the ability to commission an independent actuarial review of the recommendations of the report should this be required.
51. Any proposed changes to the level of the levy or premium thresholds will need to be agreed by the Secretary of State (in consultation with relevant Departments), and will be made by affirmative regulations, meaning Parliament will have the opportunity to debate them. The Scheme Administrator must then re-publish the transition plan in light of any changes. This requirement is set out in regulation 18(4) and (5).

Question 8:

Do you agree with the approach as set out, of a regular review of the primary levy and premium thresholds (at least every five years or sooner as required (Y/N)? If no, what changes to this approach should we consider?

52. To provide Government with assurance that Flood Re remains financially sound, Regulation 26 requires the Flood Re Administrator to evaluate the financial model which underpins Flood Re, should the total amount collected by Flood Re as contributions exceed £100 million at any given time. The Flood Re Administrator must provide to the Secretary of State a report which sets out the conclusions of this evaluation and makes recommendations on any action to take.

Definitions

53. We have defined various terms for the purposes of the regulations and for the purposes of the Act. These are set out in regulations 2 and 3. Details of the key definitions are provided below.
54. The regulations define “flood” broadly for the purposes of sections 64 to 69 of the Act. The definition of “flood” links to the meaning of “flood insurance”, which is defined in section 64(5) of the Act, as insurance in respect of risks arising from a flood. Further detail, which may be needed for underwriting purposes, could be set out in the Scheme Document. **Box 1** below sets out potential parameters of a more detailed definition for the Scheme Document, which the regulations could cross refer to.
55. The Secretary of State will designate the scheme, through ‘The Flood Reinsurance Scheme Designation Regulations 2015’.¹¹ Once designated, the Scheme Document cannot be amended. Should the FR Scheme Administrator wish to amend the Scheme Document, then the Secretary of State would need to revoke the original designation regulations and make new designation regulations designating the new amended Scheme.
56. If a “relevant insurer” issues “home insurance”, as defined in the regulations, then that insurer will be required to pay levies under regulation 5, and any additional amounts under regulation 10. “Home insurance” is defined to cover any “dwelling” (as defined) that is covered by an eligible insurance policy.
57. “Household premises” defines those properties which will be eligible to be reinsured under Flood Re. It is based on the definition of “home insurance” and applies further conditions. The regulations set out the definitions of “household premises” and “home insurance” by cross-referring to specific sections of the Scheme Document. This is necessary because of the complexity of the definitions, which need to reflect the way insurers treat domestic and commercial policies in underwriting terms. **Box 2** and **Box 3** below set out the definitions as we envisage they will be set out in the Scheme Document. For further details on how they will be implemented by the industry in practice, see the “Flood Re Scope Note”.¹²
58. We would welcome views on the definition of “relevant insurer” (the term ‘insurer’ having already been defined in the Act), to ensure it includes all those organisations that should be required to pay the levies and contributions to the Flood Re Scheme, without unduly penalising overseas insurers. This is also relevant in relation to the definition of “gross written premium” and “home insurance” which form the basis for the calculation of the levies and contributions.

¹¹ For more on the Scheme Document please see the **Designation section** below.

¹² Water Bill: Part 4 - Flood Insurance Scope of Flood Re:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/292353/water-bill-flood-insurance-scope-flood-re.pdf

59. The terms “buildings only policy”, “contents”, and “combined policy” are underwriting terms which have been defined for the purposes of the Scheme. However, in setting specific definitions, we would want to avoid any wider implications for the home insurance market of defining these terms, given the extent of variation in practice between individual insurers.

Question 9:

Do you agree that these are the right definitions for the purposes of the Scheme (Y/N)? If not what changes would you suggest?

Question 10:

Do you agree it is necessary to provide more detail on the definition of flood in the Scheme Document (Y/N)? If not, please give details of what should be changed on the approach taken for “flood”?

Question 11:

Do you agree that definitions for “buildings only policy”, “contents” and “combined policy” are needed (Y/N)? If not, please explain why not.

Box 1: Potential parameters for the term “flood” for Scheme Document

(1) “Flood” as currently defined in the draft regulations, means water from any source external to the property which enters the property at or below ground level:

and

(b) does so with a volume, weight or force which is substantial and abnormal.

“Flood” includes water which enters the property above ground level as outlined in (b), where part of the body of such water is at ground level, including as a wave rising from ground level or via a main, drain, sewer or pipe which is wholly or partly connected or adjacent to the property and is wholly or partly at or below ground level at the point nearest to the property.

(2) The following descriptions of water do not constitute a flood –

(a) rain water which enters the building before falling to ground level; and

(b) water escaping from a main, drain, sewer, pipe or other thing inside the building, unless such escape was solely the consequence of a flood as defined in (1)

(3) In cases where the ground level of the domestic property concerned is below sea level, references in this regulation (except in paragraph (2)(a) above) to ground level are to be taken as references to sea level.

Box 2: Definition of “household premises”

“Household premises” is defined as *“a dwelling which is covered by a **home insurance policy** and that meets the criteria set out in BB of the Scheme:*

The criteria set out in section BB of the scheme, are as follows:

The criteria for household premises are:

- 1. Properties in Council Tax Band A-G (or equivalent valuation band)*
- 2. Added to the Council Tax valuation list (or equivalent)¹ before 1 January 2009.*

Only household premises are eligible to be reinsured under the FR Scheme.

Box 3: Definitions of “dwelling” and “home insurance”.**Definition of “Dwelling”**

The definition of dwelling provides a very broad description of the type of properties which may be covered by home insurance policies in the UK (should they fit the criteria set out in the scheme).

“**Dwelling**” means any land and building in the United Kingdom that is held by the occupier for private, domestic and residential use (whether or not with others), including a house or other single dwelling; and any property which forms part of, or is enjoyed with, the dwelling.

Definition of Home “insurance”

An insurer who is liable to pay the levy or any additional amounts by way of levy or contribution is called a “relevant insurer”.

In order to fall within the definition of relevant insurer, an insurer must effect (or provide) “home insurance”.

“**home insurance**” is defined in the Interpretation provisions set out in regulation 2, and means a contract of insurance covering any risk of damage, loss or destruction to the whole or part of a dwelling and its contents, and which meets the criteria set out in [AA] of the Scheme.

The criteria set out in section AA of the scheme, are as follows:

Either:

1. *An insurance policy covering the contents of a **dwelling** which is purchased individually in the name of an individual or in trust for an individual.*

And/or:

1. *An insurance policy covering the structure of a **dwelling** including fixtures and fittings, swimming pools, permanently fixed hot tubs, tennis courts, patios, terraces, service tanks, drains, septic tanks, pipes and cables, central heating fuel storage tanks, driveways, footpaths, garden walls, hedges, gates and fences; provided the following additional conditions are all met:*
 - a. *The property is used for residential purposes,*
 - b. *The property is insured on an individual basis,*
 - c. *The property must be owned on a freehold or commonhold basis. If the property is owned on a leasehold basis, either the terms of the lease must specify that each dwelling purchases its own buildings insurance; or the property must:*
 - i. *include no more than three separate residential units,*
 - ii. *be insured by the freeholder, or by an owner of a share of the freehold, and*
 - iii. *the freeholder or owner of a share of freehold must live in one of the residential units of the building.”*
 - d. *The holder of the policy, or their immediate family, must live in the property, or the property must be unoccupied (properties that are rented out are not in scope).*

Designation

60. This section covers The Flood Reinsurance Scheme Designation Regulations 2015 & The Flood Reinsurance Scheme Administrator Designation Regulations 2015.
61. The Act provides the Secretary of State with the powers to designate the Flood Re Scheme and its Administrator, which is the purpose of these regulations. They will also be subject to the affirmative procedure in Parliament.
62. Before the regulations are laid for debate, the Secretary of State will need to determine the suitability of the Scheme and its Administrator for meeting the policy objectives (as set out in Flood Re's purpose in **Part A**) as well as that it is constitutionally fit for purpose and can look after any public funds to the required standard. The Secretary of State will also take advice on the probability that the Scheme will be authorised by the financial services regulators and approved by the European Commission for the purposes of State Aid.
63. A key document in the designation process will be the Scheme document, setting out the scope and purpose of the Flood Re Scheme. This will set out how the Scheme will work, taking account of the Flood Re regulations. The document will be developed by Flood Re and provided to the Secretary of State for designation.
64. We expect the Scheme document to include those elements set out in **Box 4**. It is expected that the Scheme will set out the eligibility criteria for the payment of the levy and for those policies that may be ceded by the Scheme which will be consistent with the approach we have described in section 3 on Definitions above. The document may also cover wider issues, but this is for industry to decide.
65. We will also designate the Scheme Administrator who will manage the Scheme. In order to do this the Administrator will need to have been incorporated under the Companies Act 2006 and have commenced the authorisation process required by financial regulators.

Question 12:

Government expects the Scheme to cover all of the areas set out in Box 4. Do you believe the Scheme should cover any other areas (Y/N)? If so, what would you wish to see?

Box 4: The Flood Re Scheme

The Scheme Document should set out the parameters within which Flood Re operates. That is:

- i. **Scheme Purpose:** The provision of reinsurance to relevant insurers (whose policies are eligible for the Scheme), in order to promote the availability and affordability of flood insurance for household premises while minimising the costs of doing so and managing, over the period of its operation, the transition to risk reflective pricing of flood insurance for household premises. This should be consistent with what is set by the Act.
- ii. **Scheme Scope:** this should set out what policies are eligible for the Scheme and may set out further detail on the definition of flood for underwriting purposes. Those policies that are for properties in Council Tax Band H (and the equivalent in Devolved Administrations), and those built after 1 January 2009 will not be eligible. Only policies for domestic properties will be eligible for the Scheme. Further information is provided in the “Definitions” section of this consultation.
- iii. **How Flood Re will work in practice.** This should cover the technical process for the collection of the levy, ceding policies to the Scheme and the paying of claims. It will explain how the requirements set by the regulations will work in practice. It should also cover restrictions on excesses that insurers can set on policies that have been ceded to the Scheme. This will be within £250-£500 as set out in the Memorandum of Understanding.
- iv. **Flood Re’s limits of liability** which are not greater than the equivalent of a 1 in 200 loss scenario. The 1 in 200 level is the minimum level up to which insurers are required to hold capital under European law. To put this in perspective, a 1 in 200 loss scenario is comparable to six times worse than the 2007 floods. There is no Government liability for Flood Re
- v. **How Flood Re’s governance will work in practice**, providing detail on how the Scheme will be managed, including its approach to corporate governance and accountability and linking to more detailed information provided by Flood Re’s corporate documents. This section of the Scheme should reflect the requirements set by regulations 16, 17, 19 and 20.
- vi. It should detail how the Scheme will **provide information** to insurers on flood risk and the nature of the Scheme as required by regulation 25 (and set out in the Scheme Administration section of this consultation).

Part C: Impact Assessment

66. The revised Impact Assessment published alongside this consultation document sets out an updated analysis of Flood Re. For analysis of other options considered please see the earlier Impact Assessment issued in November 2013.
67. The main changes from the previous Impact Assessments include:
- a. A new estimate facilitated by the industry of the number of households being covered by Flood Re. The number of households that industry expects to be covered under Flood Re has changed from 500,000 to 356,000. This new estimate is based on a more robust sample of 218,000 households, in comparison with the previous estimate which was based on a sample of 36,000 households.
 - b. A more robust estimate of the likely overall liability of the pool. A leading risk model provider estimates this risk to be around £121m whereas in the previous impact assessment it was £192m as obtained from a single sample of risk reflective prices.
68. Both of these factors lead to changes to our previous estimates which merits a revision of the Impact Assessment.
69. We continue to believe that Flood Re provides the best option for meeting the wider public interest in securing the availability and affordability of home insurance in areas of high flood risk. It will reduce the uncertainty facing individuals and communities in areas of high flood risk and the wider social and economic impacts that uncertainty could have, for instance on the housing market. However, the value for money calculation included in the impact assessment shows that the quantifiable costs are greater than its estimated benefits. As a result, and as we set out in the passage of the Act through Parliament, a Ministerial Direction will be required.

Part D: Tell us what you think

Who will be interested in responding?

This is a public consultation and it is open to anyone with an interest to provide comments. The consultation should be of particular interest to people living in areas of flood risk, local authorities, insurance industry representative bodies, individual insurers and brokers, the property sector, mortgage lenders and those with an interest in flood risk management including flood risk mapping and modelling service providers and flood protection product manufacturers. It also has wider relevance for taxpayers and the general public. The proposed regulations will apply to the United Kingdom.

Having your say

If you wish to respond, please submit your comments by **16 September 2014**

You can respond in one of three ways:

- Online by completing the questionnaire at <https://consult.defra.gov.uk/flooding/floodreinsurancescheme/>
- Email to: floodinsurance@defra.gsi.gov.uk
- Post to:

Flood Insurance Team
Department for Environment, Food and Rural Affairs
3rd Floor, Nobel House
17 Smith Square
SW1P 3JR

Our preferred method is online because it is the fastest and most cost-effective way for us to collate and analyse responses.

Unless you specifically request your response to be treated confidentially, responses may be made publicly available.

Consultation Questions

Question 1:

The proposed regulations will ensure that the Responsible Officer is directly accountable to Parliament for Flood Re's operation, and set out specific duties for the Responsible Officer. Do you agree these duties are sufficient (Y/N)?

Question 2:

We are not defining economy, efficiency and effectiveness, propriety and regularity or the public interest in the regulations; we believe their natural meanings are clear. Do you agree with this approach (Y/N)? If you think that these terms need defining, either in legislation or elsewhere, what factors should be considered in their interpretation?

Question 3:

Do you think that the publication of a transition plan and provision of information to insurers is appropriate for making insurers and those at highest risk of flooding aware of the transitional nature of Flood Re? If not, what other approach could help householders and insurers understand the transitional nature of the Scheme and help them prepare for the transition to risk reflective prices?

Question 4:

Do you agree that the funding arrangements in the regulations (including regulation 17 above) achieve the right balance between operational freedom; certainty for insurers; and accountability for the handling of public money (Y/N)?

Question 5:

Are there any practical difficulties with the approach of using Gross Written Premium and "Home Insurance" to calculate the levy for "relevant insurers" (Y/N)?

Question 6:

Do you think that the approach for estimating GWP for insurers who fail to provide this information within the timeframe is fair (Y/N)?

Question 7:

If no to either of the previous two questions, what changes to this approach should be considered and why?

Question 8:

Do you agree with the approach as set out, of a regular review of the primary levy and premium thresholds (at least every five years or sooner as required (Y/N)? If no, what changes to this approach should we consider?

Question 9:

Do you agree that these are the right definitions for the purposes of the Scheme (Y/N)? If not what changes would you suggest?

Question 10:

Do you agree it is necessary to provide more detail on the definition of flood in the Scheme Document (Y/N)? If not, please give details of what should be changed on the approach taken for "flood"?

Question 11:

Do you agree that definitions for “buildings only policy”, “contents” and “combined policy” are needed (Y/N)? If not, please explain why not.

Question 12:

Government expects the Scheme to cover all of the areas set out in **Box 4**. Do you believe the Scheme should cover any other areas (Y/N)? If so, what would you wish to see?