

Department for Environment, Food and Rural Affairs

Commentary on Proposed Flood Insurance Amendments

(to be included in part 4 of the Water Bill)

November 2013

Contents

Introduction	2
Commentary on the Amendments	3

Introduction

Since the publication of the draft flood insurance clauses for comment in September, we have continued to work on developing the full clauses to add to the Water Bill. Each clause will be introduced as a Government amendment at Committee Stage of the Bill in the House of Commons and, taken together, the intention is that the amendments will replace the current placeholder clause in Part 4 of the Water Bill.

These amendments set out our proposed legislative approach for new arrangements for flood insurance following the expiry of the voluntary agreement between Government and the insurance industry. The legal framework aims to establish:

- a) a levy-funded reinsurance pool for high risk households (known as “Flood Re”), and
- b) reserve powers to regulate the insurance industry by requiring insurers to each insure a certain share of a list of high flood risk properties (known as the “Flood Insurance Obligation”).

Flood Re would be an industry-run, not-for-profit scheme and these amendments provide the legal framework that will allow it to collect levy from all insurers who provide policies to domestic properties. The amendments also provide the legislative framework within which Flood Re would operate.

Fallback powers in the form of the Flood Insurance Obligation are needed in case Flood Re proves unworkable or does not deliver our policy goals, and if pricing in a free market proves to be unacceptable. This provision is intended to provide reassurance to households at risk that they will be able to secure affordable flood insurance over the future, one way or another. The territorial extent of these amendments is UK-wide.

We are tabling the amendments for publication in parallel with the publication of a revised Impact Assessment and this commentary to provide those with an interest with further detail on the proposed policy intention.

The commentary should be read in conjunction with the published amendments. It provides explanation of the anticipated effect of the amendments and, where needed, provides further context on issues that are not described within the amendments but which form part of the overall policy framework. In order to aid understanding, we have provided examples of how the powers to make regulations in the Bill could be exercised. The examples given are purely illustrative.

Commentary on the Amendments

The Flood Reinsurance Scheme

The Secretary of State will use regulations to designate the FR Scheme or “Flood Re”. The intention is that the FR Scheme will 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. The intention is that this will be achieved by making reinsurance for flood risk available to all insurers that underwrite household buildings and/or contents insurance policies in the UK”. The intention is that the Scheme must be managed in such a way as to provide a smooth transition to full risk reflective pricing over the period of operation of the Scheme.

This section further allows the Secretary of State to take powers to place restrictions on the premium for that part of a policy ceded to the FR Scheme, ensuring that they do not exceed an amount specified in regulations.

Scheme administrator

As was set out in the Memorandum of Understanding (MOU) published in June, the FR Scheme will be industry-owned and managed. The Government will provide the legal framework to enable the FR Scheme to operate within specified parameters including a framework to limit the Scheme’s impact on the public finances. As such, the Scheme will be administered and managed by a body which we envisage will be industry-run.

The Secretary of State of the Department for Environment, Food and Rural Affairs (Defra) will remain accountable to Parliament concerning general policy matters relating to the FR Scheme, flood insurance and wider flood issues.

The Secretary of State will use regulations to designate a body to administer the FR Scheme. This body may be a company registered under the Companies Act 2006.

Scheme funding

These amendments provide a power to make regulations to define how the FR Scheme will be funded. It allows the Secretary of State, with the consent of HM Treasury, to make regulations that will oblige insurers to pay to the FR Scheme a levy set at a certain level.

There is also provision for a second stream of funding whereby the FR Scheme administrator may request an additional amount from insurers in certain circumstances which will be set out in regulations. As set out in the MOU published in June, these top-up contributions would be needed when the FR Scheme’s income from the capped flood risk insurance premiums and the proceeds of the levy prove to be insufficient in any given year. We are in active discussions with the insurance industry regarding the financial arrangements for the FR Scheme including how these top-up contributions would work in practice.

The amendments also provides a regulation making power to deal with the position where the FR Scheme does not receive the required amounts from insurers regulations will allow recovery of those amounts as a civil debt.

This amendment provides the power to make regulations to specify conditions regarding the reserves of the FR Scheme and to provide that when those conditions are met, the FR Scheme administrator will be required to pay to the Secretary of State certain amount of reserve funds. Such regulations would be subject to consultation with the Prudential Regulation Authority to ensure that any payment made would be prudentially sound. We are in active discussions with the insurance industry regarding the circumstances when these powers would be needed. We expect that these powers would be used primarily in a situation where the FR Scheme is being wound-up or the regulations are being revoked.

Regulations pertaining to the levy arrangements will be subject to the affirmative resolution procedure.

Scheme Administration

These amendments provide the legislative framework for the running of the Scheme by the designated Scheme administrator.

The FR Scheme will be funded primarily through a levy on insurers. The Government expects that such funding will be classified by the Office for National Statistics as a tax and therefore some or all of its expenditure as public expenditure. The FR Scheme will therefore need to be established in such a way to meet standards of accountability which are acceptable to Parliament.

Therefore, the regulation making power under this amendment is designed to secure appropriate accountability to Parliament by specifying the considerations that FR Scheme administrator should abide by in managing its funds and discharging its functions. 'Scheme administration' provides that the FR Scheme administrator should have regard to 'the need to ensure economy, efficiency and effectiveness' of its processes and operations. This specifically refers to the effectiveness and value for money of discharging its functions and does not intend it to encompass policy decisions. This section specifies the 'need to ensure the propriety and regularity' in this same context. 'Regularity' is intended to ensure the FR Scheme's ongoing operations will be lawful and 'propriety' is intended to ensure that the FR Scheme administrator must, for instance, meet the expectations set in terms of the purpose of the scheme.

The FR Scheme administrator will appoint a "Responsible Officer" who will be directly accountable to Parliament for the Scheme's operations.

This amendment intends that the National Audit Office to examine the FR Scheme administrator's accounts, scrutinise value for money and the effectiveness and efficiency, and propriety and regularity, of the operation of the Scheme.

This amendment also reinforces the need to plan the transition to risk reflective pricing of flood insurance over the period of operation of the scheme (25 years). Regulations may provide that the transition plan and the audited accounts will need to be published by the administrator and so will be open to scrutiny by Parliament.

Although not explicit within the amendments, the FR Scheme would be regulated by the UK financial regulators, as is consistent with its remit as a reinsurance company. The

regulators are the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

Information flow

Insurers, brokers and software houses will need access to Council Tax data to operate the Scheme. Therefore access to data held by the Valuation Office Agency for England and Wales will need to be made available to them strictly for the purposes of the Scheme. Regulations will set conditions regarding the sharing of the data and will create a criminal offence where data is disclosed in breach of specified conditions. In Scotland and Northern Ireland information on Council Tax banding and its equivalent is already publicly available so specific access through legislation is not needed.

Flood Re will hold information, such as the geographic location of households which insurers believe to be at particularly high levels of flood risk, which could be useful in enabling flood risk to be managed more effectively by bodies like the Environment Agency and their Devolved equivalents. Therefore the amendments allow Government to make regulations to allow the Flood Re administrator to share this information with such bodies once the Scheme becomes operational.

Replacement of the Scheme or administrator

This section provides the powers for the Secretary of State to make provision for transitional arrangements should the Scheme be replaced with a new scheme. It also provides powers to transfer property, rights and liabilities to a new FR Scheme administrator if the FR Scheme administrator is replaced.

Disclosure of information: Preparatory purposes

In preparation for the operation of the FR Scheme, it will be necessary for insurers, brokers and software houses that offer services in connection with household insurance, to access Council Tax information to prepare their IT systems. Regulations will allow data sharing and also set conditions regarding the sharing of the data. They will create a criminal offence where data is disclosed in breach of specified conditions. As this will be needed before the Flood Re Scheme is designated, this clause will be subject to early commencement.

Flood insurance obligation

These amendments relate to the Flood insurance obligation policy.

Flood insurance obligations

This section enables the Secretary of State to provide in regulations for setting quotas for the number of properties that should be insured by each relevant insurer. The subsection allow an insurer's quota to be determined on the basis of a number of factors including its share of a particular type of insurance business (for example their share of the domestic contents or buildings insurance business in the UK) and targets set by the Secretary of State. The regulations may provide for insurers to be exempt from complying with the obligation for example because of the smallness of their share of the market. The rationale

for being able to exempt insurers with a very small share of the market is to prevent compliance with these regulations becoming a barrier to entry or establishment in the UK domestic insurance market.

The amendments give the Secretary of State the ability to prescribe circumstances in which an issued policy should not count towards an insurer's quota. Such circumstances might include where an insurance policy provides grossly inadequate cover and this was not made clear to the purchaser.

The amendments also give the Secretary of State the ability to set circumstances in which an insurance policy issued by one insurer might count towards the target of a different insurer. This might arise if insurers were permitted to trade 'credits' for insurance policies amongst themselves as a way of optimising the efficiency with which insurers meet their quotas and avoid non-compliance.

Finally, this section provides for the determination of whether an insurer is a relevant insurer, whether an exemption applies and what an insurer's market share is in situations where an insurer has not provided the information required by regulations.

Flood insurance obligations: target number

This section gives the Secretary of State the ability to set collective targets for the number of homes that relevant insurers are to insure and to set the periods within which the targets are to be achieved. The targets would relate to homes on the register of premises subject to greater flood risk.. Since not every household whose property is on the register will choose to purchase insurance cover, the targets that the Secretary of State sets would be less than 100 percent of the properties on the register. Different targets can be set for insurance policies that provide different types of flood cover. For example, targets could be set for policies that provide cover against the risk of flood damage to the *structure* of a property and different targets for policies that provide cover against the risk of flood damage to the *contents* of a property.

Flood insurance obligations: information and Flood insurance obligations: further provision

The first of these amendments provides powers to make regulations that require insurers to provide information about the amount, value and type of insurance business of a prescribed description they have issued in a given period, about whether they are within scope of the Obligation and whether a relevant exemption applies to them. This information would be collated and used to publish information about the total size of the market to enable individual insurers to determine, by reference to their own market share, what fraction of the properties on the register they are required to insure.

The second of these amendments contains powers to enable these requirements to be enforced by Defra through civil sanctions. The policy intention is that Defra would enforce compliance with duties on insurers to provide information and produce documents. Separate provision is made in *Functions of the FCA* to enable the Financial Conduct Authority (FCA) to take enforcement action if an insurer persisted in non-compliance or if an insurer provided information that was not true or documents that were not correct.

Register of premises subject to greater flood risk and the Register: further provision

These amendments provide for a register of properties in the UK subject to greater flood risk to be developed and for the four bodies with principal responsibility for flood risk management in each part of the UK to be responsible for creating and maintaining the register. The regulations can provide for the Environment Agency to have an additional role coordinating with the other bodies.

Regulations can specify what information is contained in the register. They also allow for properties where construction was completed after a certain date to be excluded and for information held by the Valuation Office to be disclosed to relevant bodies for that purpose.

The amendments enables the Secretary of State to sub-divide the register into different bands according to the risk of flooding and to set a different target for each band . Before making regulations under these powers the Secretary of State is required to consult Ministers in the Devolved Administrations.

The amendments allow for the regulations to specify what is done with the information contained in the register (whether it is published or certain parts of it are made available to certain people) and to set conditions on what people can do with the information. Penalties could apply if the conditions were broken.

The amendments allow the Secretary of State to limit the persons who can apply for a property to be added to the register or request its removal to the person with the 'qualifying interest' in the property. The qualifying interest will be defined in regulations and we expect that this is likely to be the person with the greatest financial interest in the property. Requests to remove a property from the register will be automatically granted, so long as the person requesting it can demonstrate the qualifying interest in the property.

The Register: reviews and appeals

If a decision is taken that a property is not eligible for inclusion on the register, the person with the qualifying interest can request an internal review of that decision, and if they are still dissatisfied with the outcome they can appeal to the First-tier Tribunal in England and Wales; the sheriff in Scotland; or the Water Appeals Commission in Northern Ireland (depending on where the property is located).

The register: expenses of relevant bodies

This section provides that the Secretary of State may, with the consent of the Treasury, make regulations for the purposes of raising a levy from insurers to cover the costs incurred by the Secretary of State and the relevant bodies in the creation and maintenance of the register of premises subject to greater flood risk.

Compliance Reports

This section enables the Secretary of State to make regulations requiring insurers that are subject to the Obligation to report the extent to which they have complied with their regulatory requirements for a prescribed period.

Functions of the FCA

Under this amendment HM Treasury can make regulations which provide for the FCA to monitor and enforce insurers' compliance with the requirements imposed on insurers by regulations made under '*Flood insurance obligations*' and '*Compliance reports*'. The regulations can also provide for the FCA to take action for enforcing compliance under '*Flood insurance obligations: information*' where Defra has already taken enforcement action under '*Flood insurance obligations: further provision*' without securing compliance or where an insurer is suspected of failing to comply by providing information that is not true or producing a document that is not correct.

Reports by the FCA

Regulations made under this section can provide for the FCA to make a report of its enforcement activities and for that report to be given to the Secretary of State and published.

Intervention by the FCA or the PRA

Since the insurance industry is a complex market, provision has been made under this clause for regulations to give the two principal financial services regulators, the Financial Conduct Authority and the Prudential Regulation Authority, the means to temporarily dis-apply the Obligation for a particular insurer should wider regulatory concerns indicate it is necessary. The regulations can specify that the regulators have to notify the Secretary of State before using their powers.

Sections which apply to both the FR Scheme and the Flood insurance obligation

Interpretation

This clause would allow the Secretary of State to use regulations to define certain terms.

Period of operation

It is anticipated that the transition to risk reflective pricing for household flood insurance is likely to take up to 25 years. However it may be possible that this will be achieved in a shorter time period and the regulations allow the period of both the FR Scheme and the Obligation to be shortened by affirmative resolution. This section also ensures that suitable arrangements can be put in place to ensure Flood Re is properly wound up in terms of the transfer of property, rights and liabilities of the Scheme.

Regulations and orders

There are various powers to make regulations in the amendments. They are exercisable by the Secretary of State or, where the FCA or PRA are affected, by HMT. Most are subject to the negative resolution procedure. The exceptions relate to the levies, the application of provisions in FSMA 2000, and shortening of the period of operation.

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