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Department for Environment Food & Rural Affairs

Government response to the public consultation on the Flood Reinsurance Scheme Regulations

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Contents

1. Introduction

1. This Government response follows the consultation over the summer of 2014 about the Regulations that will support the establishment and functioning of the Flood Reinsurance Scheme ('Flood Re')[1].

2. Access to affordable flood insurance is critically important to help households recover from the severe financial impacts and damage from flooding. The UK Government and insurance industry announced in June 2013 that they were taking forward Flood Re as the preferred approach to addressing the availability and affordability of flood insurance.

3. Flood Re 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. Flood Re will provide transitional support to households at flood risk over a 25 year period as part of a gradual transition towards more risk-reflective prices.

4. Flood insurance has been available in the past due to voluntary agreements between Government and the insurance industry but these agreements did not address affordability. The most recent of these agreements was the 2008 Statement of Principles which was set to expire on 30 June 2013. As part of the Memorandum of Understanding[2] which underpins Flood Re, insurers have agreed to abide by this agreement until Flood Re has been set up and is fully operational.

5. The Flood Reinsurance (Scheme Funding, Administration and Amendment) Regulations 2015 will implement Flood Re. They set the legal framework within which Flood Re will operate, covering the Scheme's funding arrangements (through levies and the level at which premiums will be ceded), and its administration, including how the Scheme Administrator must approach management of the Scheme and its resources. Separate Regulations will designate the Scheme itself and a Scheme Administrator to manage the Scheme. The consultation sought views on the proposed Regulations.

6. On 1 January 2015, the relevant clauses in the Water Act 2014 which provide for the establishment of Flood Re will commence through the coming in to force of a commencement order. This means that Government is able to bring forward the Regulations under this part of the Act for the implementation of Flood Re.

7. Alongside this consultation response, Flood Re is drafting its Scheme document. This is the document that will be designated by the Regulations and provides more detail on how the Scheme will operate. The Scheme document is referred to in this response and the draft document will be made publically available shortly.

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[1] The Flood Reinsurance Scheme – Regulations Consultation: https://consult.defra.gov.uk/flooding/floodreinsurancescheme
[2] Flood Re Proposals: Memorandum of Understanding: https://consult.defra.gov.uk/flooding/floodinsurance/supporting_documents/20130626%20Flood%20Insurance%20MOU%20June%202013%20unprotected.pdf

Devolution

8. This Government response is issued by Defra on behalf of the UK Government. Flood insurance, as a financial services matter, is a reserved area of competence for the UK Government. We have worked with the Devolved Administrations (including through regular meetings of a Working Group), to develop the policy on flood insurance and in drafting the Regulations that implement the Scheme. We have also worked closely with the Devolved Administrations and their individual data owners to enable the council tax data (and equivalents), critical to the operation of Flood Re, to be made available to the insurance industry. Specific comments on the Regulations provided by the Devolved Administrations or their agencies have been considered separately from the wider consultation responses received.

9. As part of the discussions with the Welsh Government, we have agreed to adjust the premium thresholds in Wales to take account of the revaluation of Council Tax bands they undertook in 2003. Detail on the revised approach is set out in Section 4.

2. Consultation process

Public consultation – summer 2014

10. The public consultation on the *'Flood Reinsurance Scheme - Regulations'* was launched on 22 July 2014 and closed on 16 September 2014.

11. We received 80 responses from the groups below:

Respondent group	Number of responses
Individual businesses	1
National flood action groups	6
Private individuals	22
Community groups at flood risk	7
Insurance industry	22
Local Authorities	15
Property/Mortgage sector	5
MPs and Peers	2

12. There were 134 responses that formed part of a campaign around Question 12 and the exclusion of certain leasehold and rented properties from the scope of Flood Re. Those responses have been counted as a single response in the table above in accordance with consultation guidance. Six of those responses addressed broader concerns on the Scheme's scope. The scope of the Scheme was not considered as part of this consultation as we have already consulted on this. However, the response to Question 12 responds to the information submitted by these consultees.

13. A statistical analysis of responses can be found at Annex 3 and a list of respondents at Annex 4.

Stakeholder events

14. As part of the consultation process, Defra held group discussions with insurers and with representatives of national flood action groups during August and early September. We also engaged with insurance brokers and representatives from the Lloyd's market to ensure we had a comprehensive view of the insurance sector. Additionally, we met representatives of the property and mortgage sector and small businesses to discuss commercial insurance and Government's proposals to monitor the insurance market. The general points raised at those meetings are highlighted below. Where relevant, more specific comments raised at stakeholder meetings have been included in Section 3.

15. Of greatest interest to insurers was to better understand how the funding and financing of Flood Re would work and to understand the plans for transition during the life of Flood Re. Their comments are reflected in Section 3.2. The meeting with flood action groups focused on understanding Flood Re's role in raising awareness of flood risk and managing this and what wider role Flood Re could have in relation to this. The comments from this meeting are reflected in Section 3.1.

3. Government response to issues raised in the public consultation

The analysis of responses (Annex 3) provides more details of those that agreed, disagreed or did not answer questions posed in the consultation document. The percentages presented in this section relate only to those who answered the question.

Some of the detailed aspects of the Scheme's operation are beyond the scope of these regulations, and therefore this consultation response. The ABI, and Flood Re going forward, continue to work closely with the insurance industry to develop the operational aspects of the Scheme.

3.1 Scheme administration

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)?

16. Of the 57 responses to this question, 84% agreed that these duties are sufficient in regard to the administration of Flood Re. At the stakeholder event, insurers sought further clarity on the accountability of the Responsible Officer and on the role of Government in setting the Primary Levy and premium thresholds for the Scheme.

Response

17. The proposed approach in the Regulations on the duties of the Responsible Officer, which mirrored that set out in the Water Act 2014, was supported by the majority of respondents, supporting Government's approach as both appropriate and proportionate.

18. Flood Re is designed to be industry owned and managed, as set out in the Memorandum of Understanding of June 2013 between the insurance industry and Government. It will have operational independence from the Government and there will be no Government role in the Scheme's day-to-day management. The Scheme Administrator will therefore be directly accountable to Parliament for the management of the Scheme. Given the strong expectation that the Office of National Statistics (ONS) will classify the Primary Levy as a tax, and therefore as public money, we believe it is appropriate that Flood Re, through the Responsible Officer, has direct accountability to Parliament. We have made clear in the Regulations how the Responsible Officer will be held to account and the standards by which the management of the Scheme will be assessed, by Parliament and the National Audit Office, mirroring the role of an Accounting Officer as set out in Managing Public

Money[3]. This approach has been endorsed by the comments received through the consultation.

19. The Government's role in setting the Primary Levy is set out under Question 8, which provides further detail on the envisaged review process.

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?

20. Of the 58 responses to this question, 64% agreed that the natural meanings were clear and did not need defining in the Regulations. Whilst the majority of respondents were content with the natural meaning of economy, efficiency and effectiveness, propriety and regularity, a small number of respondents expressed a variety of views on the definition of 'public interest'.

21. The majority thought it would not be sensible to define public interest in a way that restricted Flood Re's ability to operate as a normal reinsurance company or complicated the Scheme's relationship, although indirect, with individual policy holders. A small number of respondents thought that the term should be defined to capture the process of transition and the need to improve resilience, providing information to those covered by Flood Re so that they understood the nature of the policy. Separately, a minority of respondents were keen that, should 'public interest' be defined, it needed to capture requirements on the Scheme to provide value for money and for the good administration of the Scheme (this was of interest to insurers, who as levy payers have an interest in the Scheme's costs). Finally, some respondents thought a general definition would be useful as it would provide clarity for insurers and home owners whose policies are ceded to the Scheme.

22. There was a suggestion by flood action and impact groups that the Flood Re Board should include members not selected by the insurance industry to cover public interests such as transition and Flood Re's role in the wider framework of flood risk management.

Response

23. In general, respondents supported the approach outlined in the consultation. In particular there was strong support that the natural meanings of the terms "economy", "efficiency" and "effectiveness" and "propriety" and "regularity" are well understood and reflect Parliament's expectations of the management of public money in accordance with the framework set out in "Managing Public Money". Given the broad support and the general consensus that the meaning of these terms in the context of Flood Re is clear, we do not propose any changes to the approach outlined in the consultation.

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[3] Managing Public Money:https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212123/Managing_Public_Money_AA_v2_-_chapters_annex_web.pdf

24. On ‘public interest’, whilst we recognise the importance to consultees of Flood Re having a role to play in terms of supporting flood resistance and resilience measures for properties ceded to the Scheme, we do not believe it appropriate to place such duties on Flood Re through a definition of ‘public interest’. ‘Public interest’ in this context is about how the Scheme is operated and managed, about how it makes the decisions it does, reflecting and balancing a wide range of interests including policyholders re-insured through Flood Re, insurers, and the wider public through the levy funding. It is also important to note that insurers will have a financial relationship with Flood Re and an interest in the Scheme’s good management. Any definition of ‘public interest’ cannot bind Flood Re so that the interests of these insurers (or requirements set by financial regulators), are overridden by other considerations. Keeping the term’s natural meaning will make sure that aspects such as supporting transition will be taken into account in the wider context of the Scheme’s statutory purpose and duties.

25. However, this does not mean the Flood Re Administrator should not consider the interests of wider stakeholders in its management of the Scheme. Government recognises the importance of the issues raised here and supports the view that Flood Re has an important role to play in preparing and supporting policy-holders for a move to risk-reflective pricing over the lifetime of the Scheme (alongside actions taken by Government and other flood risk management authorities). This is integral to the way in which we are legislating for the Scheme to work. The Regulations require Flood Re to produce a transition plan detailing the process for moving to risk reflective pricing. Separately, Flood Re will need to provide those insurers who cede policies to the Scheme with information on how household premises can find information on an individual property’s flood risk and on steps that can be taken to manage that risk. Flood Re must also provide these insurers with information on the Scheme, including its transitional nature. These are important aspects of the Scheme and the Regulations are clear as to what the Flood Re Administrator must do[4]. It will be for Flood Re to take a decision on how to act in any given circumstance, in line with its statutory powers.

26. The range of views received demonstrates the complexity of defining the ‘public interest’ to reflect a dynamic Scheme such as Flood Re. The Flood Re Scheme is designed to have a 25 year life-span. It is possible that over this period the nature of public interest and the balance between various interested parties could change. The Government’s view remains that ‘public interest’ needs to capture both Flood Re’s role in relation to those at high risk of flooding, who, through their insurers, receive subsidised insurance and to tax payers (including insurance companies) who must pay the Flood Re levy. We are concerned that providing a narrow interpretation of the term now could be restrictive in the future, either by limiting Flood Re’s ability to act in an appropriate way or Parliament’s ability to make an assessment based on the conditions of the day. We therefore continue to believe that a broad, natural definition is required and that this provides for a balanced approach, reflecting the variety of views received through the consultation and the majority support for the definitions taking their natural meaning.

27. To prevent Flood Re taking a narrow interpretation of ‘public interest’, the concept of a representative of the flood interest groups being appointed to the Board of Flood Re

[4] Transition and the provisions of information of flood risk is considered in the response to **Question 3** below.

was raised. In line with the desire that Flood Re, as a re-insurance company, should be industry-run and led, the Water Act 2014 did not provide the Government with powers to determine the composition of Flood Re's Board or to nominate a member to sit on the Board of Flood Re. To do so would blur the approach on accountability, particularly the clear line of direct Parliamentary accountability we are establishing. It is also important that Flood Re is an industry run and managed reinsurance company; the skills of the Board Members must reflect this and Board members must be authorised by the Prudential Regulatory Authority (PRA)[5].

28. Within the parameters of the enabling legislation, and in line with the industry run and managed nature of the Scheme, we are not proposing to seek a representative of the flood interest groups as a Board member for Flood Re; however Flood Re will have independent non-executive directors in line with normal expectations of good corporate governance. The PRA expects the Boards of insurers to have a mix and a balance of skills and this is reflected in the approach being taken by Flood Re.

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?

29. Of the 58 responses to this question, 69% agreed with the Government's proposed approach that the Flood Re Scheme Administrator be responsible for developing the Scheme's transitional arrangements and be bound by requirements to publish a transition plan.

30. However, some respondents suggested that stronger incentives (other than the transitional nature of the Scheme) would be needed to encourage householders to reduce their flood risk in preparation for a free market. Respondents also questioned whether the installation of flood protection products should be made compulsory. Some national flood action groups and community groups have suggested that the reserves built up by Flood Re should be used to fund household resilient repairs and also, that any savings associated with the installation of such measure should be passed on by insurers to policy holders.

31. There were a range of views on the suitability of the length of the transition period, with some respondents taking the view that a transition of 25 years is too long, and only delays the transition to fully risk reflective pricing. However, others did not agree with the transitional nature of the Scheme, feeling instead that Flood Re should be a permanent feature of the home insurance market.

32. Respondents broadly agreed that information about the transition plan and on the Scheme (including information on the amount of the subsidy and premiums being

[5] PRA rules on insurers, including the role of the Board are set out in 'The Prudential Regulation Authority's approach to insurance supervision': http://www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1406.pdf

charged) should be provided to households in Flood Re. It was felt that this would help households better manage their risk and the transition to risk-reflective pricing. Although the majority of respondents from the insurance industry agreed that information should be provided, there were divergent views as to whether Flood Re or the insurer should provide this information to customers.

Response

33. The Regulations place a duty on Flood Re to have regard to managing the transition to risk-reflective pricing for flood insurance, so that the benefits of the Scheme can be phased out gradually during the 25 year life of the Scheme. They also require it to publish a transition plan.

34. The Flood Re Scheme Administrator will be responsible for developing the transitional arrangements and will be bound by requirements to publish a transition plan within three months of the Regulations coming into force; and at least every five years thereafter, with the expectation that revisions to the transition plan will coincide with reviews of the Flood Re Scheme.

35. The PRA has noted that pricing information or projections published as part of this should be viewed as indicative only and not binding on Flood Re.

36. Therefore, we expect the first transition plan to be high level, setting the strategy intention and outlining the likely methods Flood Re will consider to help manage transition. As time goes on, and Flood Re develops, there is a strong expectation that the level of detail in the transition plan will increase. The Scheme Administrator will have a duty to update the plan at least every five years, in order to help ensure that insurers, customers and the wider public have access to information about the way that the benefits of Flood Re and the price of flood insurance might change over the remainder of its lifetime.

37. In response to questions about resilient repair, over time, we expect Flood Re to set out clear proposals on how it will create incentives for policyholders to take ownership and invest in resilience measures, including through all appropriate financial incentives. We expect the review process to provide the appropriate opportunity for Flood Re to assess the potential impact of underwriting approaches and its wider communications strategy on incentivising resilience measures.

38. In response to suggestions from the insurance industry that Flood Re could not achieve transition to risk reflective pricing independently of the other market factors at play, we have altered the wording of the Regulations to reflect these concerns. The new wording makes clear that Flood Re must produce a transition plan that publicises the work it will do to help manage the transition of the Scheme. Linked to this, we have amended the Regulations to provide Flood Re with the flexibility to react appropriately to the market conditions it finds itself operating in. We have also made drafting changes to remove the need for Flood Re to update the transition plan “at regular intervals” because we believe this is encapsulated in the requirement to update the plan “at least every five years”.

39. We agree the transition plan is an important tool for ensuring households are aware of and plan effectively for an eventual transition to risk reflective pricing. Flood Re will provide general information to insurers about the Scheme, on the transition plan and

on how policy holders can access information on flood risk. This information will be in a format that can be passed on to customers to help prepare them for the transition to free market pricing, encouraging households to take measures protecting their properties from the impacts of flooding. In response to concerns raised during the consultation, it is important to be clear that we do not expect this to require Flood Re to prepare information that is very specific to individual household risks. This is because Flood Re will not have a direct relationship with individual customers and for that reason it would not be appropriate for it to pass information directly to policy holders. It is the Government's expectation that insurers will distribute this information directly to their customers, as appropriate.

40. In response to comments about the 25 year length of the Flood Re Scheme; the length of the Scheme is designed to provide a smooth transition to risk reflective pricing for those policy holders at high risk of flooding. It is intended that the Scheme protects those most vulnerable to a potential increase in the cost of flood insurance in the shorter term, while helping prepare those households for the management of risk in the medium to long term. The period of operation of the Scheme is set in the Water Act 2014 and reflects all consideration of this issue made at that time.

3.2 Funding and finances

Question 4: Do the funding arrangements in the Regulations (including regulation 17) achieve the right balance between operational freedom; certainty for insurers; and accountability for the handling of public money?

41. Of the 55 responses to this question, 62% agreed with the Government's proposed approach. A small number of respondents, mainly from the insurance industry raised specific issues.

42. Several insurance companies felt that the restriction on Flood Re's ability to add more than £100 million to the public sector net borrowing (PSNB) is too restrictive, because of uncertainty about the cost of reinsurance for Flood Re. It was felt that if these costs were too high; this could absorb most of the Primary Levy and premium income thereby reducing the rate at which Flood Re's reserves built up, impacting the rate at which the Primary Levy needs to be set. Insurers also wanted greater clarity on how Flood Re would capitalise itself at the Scheme's inception.

43. Both the insurance industry and wider stakeholders queried the operation of Levy II and whether Levy II contributions would be repayable. Consultees were concerned that if additional funds were required and could not be raised through capital contributions, it could impact on insurers' profitability in a way which could ultimately result in increases to the costs of home insurance for householders; or lower dividends for shareholders.

44. Whilst some respondents questioned the level at which the Primary Levy is set, most agreed that setting it at £180m per annum for the first five years of the Scheme provides insurers with certainty and that the level was sufficient to ensure that the Scheme is able to deal with flood claims in line with Flood Re's modelling.

45. A number of consultees requested more detail on what will happen if there is a large flood event exceeding the 1:200 scenario. This is considered further under Question 12.

Response

46. The consultation made clear that the restrictions on Flood Re's ability to add more than £100m to the PSNB was an area of ongoing dialogue with the industry. We have worked intensively and constructively with Flood Re and the ABI and have agreed that protection for public expenditure should instead be provided by the purchase of appropriate reinsurance. Therefore Flood Re's Articles of Association will include a provision, the effect of which will require that the Flood Re Scheme Administrator must purchase appropriate stop-loss reinsurance (or equivalent cover with the same effect) so that the Scheme does not have an impact on PSNB greater than £100m (the "loss limit") at the end of any one financial year.

47. In order to ensure that this limit cannot be changed the Government will take on a limited membership role in Flood Re itself. This will also allow Government to be able to veto the ratification of any amendment to this Article, although we have been clear that we do not expect Government to have a wider role in the day-to-day running of Flood Re, in keeping with the industry run and managed nature of the Scheme. The details of this are to be finalised.

48. The figure for the "loss limit" will be reviewed and confirmed three months prior to "go-live" (the point at which Flood Re starts accepting inwards reinsurance policies), and any changes to the relevant Article require HMG consent. Any changes to the limit will be supported by sound actuarial evidence provided by Flood Re and will need to be agreed between Government and Flood Re.

49. There has also been agreement that in certain limited circumstances (namely in the case of one of Flood Re's reinsurance defaulting) the Government will accept the impact of such an event on the PSNB. Whilst it is recognised that this could lead to Flood Re impacting the PSNB by more than £100m, the Government accepts that such an event is likely to be outside of Flood Re's control, and therefore that it should be exempt. Further details of the full agreement reached with the ABI and Flood Re are set out in Annex 1.

50. In relation to Flood Re's initial capitalisation, we have been advised by Flood Re that the industry's preferred approach to adequately capitalise Flood Re in the initial period is through a Levy II capital call. This is necessary so that Flood Re is solvent and to meet requirements set by the financial regulators. In normal circumstances, such a call would trigger a review of the Scheme, however we have amended the Regulations to allow for this, exempting Flood Re from triggering a review as it capitalises itself in year one. Because of the nature of the call, we do not expect this to impact on household bills and have sought assurances from the industry to this effect. More widely we have also introduced a new provision to make clear that nothing in the Regulations either prevents or requires Flood Re to pay back Levy II contributions, further safeguarding householders against increases in the cost of home insurance as a result of the Levy II mechanism.

51. We have also considered the issue of borrowing further, and do not believe it would be appropriate to completely limit borrowing on behalf of Flood Re. In order to operate as

a normal insurance company, Flood Re will need the ability to borrow certain amounts in the normal course of its business. We have revised our approach so that Flood Re is able to carry some borrowing over financial years, up to a limit of £25m. The interaction between this figure and the “loss limit” will be confirmed as part of the review three months prior to “go-live”. We have amended the regulation to make clear that normal transactions relating to reinsurance will not be captured within the definition of borrowing for these purposes; however it will include sums owed to trade creditors and other commercial borrowing.

52. The level at which the Primary Levy is set will be subject to the review process set out in the response to Question 8. Respondents presented limited evidence to suggest that an initial levy of £180m would not be appropriate and we are pleased to note that the majority of respondents agreed that this was the right level at which to set the Primary Levy for the first five years of Flood Re’s operation. We are therefore not proposing to change the level of the Primary Levy as set in the Regulations for the first five years, except to allow it to be pro-rated in the initial period (see “Part 4: Other Amendments”) . However, should market conditions materially change, both Flood Re and Government would wish to review the conditions that gave rise to such a change and that this could include revisiting the level at which the Primary Levy is set prior to the Scheme going live. It is anticipated that any future savings associated with reductions in the amount of levy required to fund Flood Re (in line with its transitional nature) will be passed to customers through lower bills.

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"?

53. Of the 48 responses to this question 50% supported the approach of using Gross Written Premium to calculate the levies for ‘relevant insurers’.

54. Of the remainder, whilst most comments on this question were supportive of the use of Gross Written Premiums (GWP), some respondents highlighted practical difficulties with using GWP and home insurance to calculate the levies. The concerns were mostly related to the process carried out by Flood Re for determining GWP, given normal accounting practices in the insurance industry. Respondents felt that whilst it may take time for an accurate assessment of an insurer’s GWP to be available, it would be better to wait for the finalised figures. There were also some concerns around whether add-ons (ancillaries, legal expenses, commissions etc.) should be included in the calculation of GWP. Insurance industry respondents were also concerned about the approach taken to insurers leaving or joining the home insurance market, and whether separate provision needed to be made for them.

55. It was thought that the definitions of dwellings and home insurance are helpful but that there was still more clarity needed on whether leasehold properties would be liable to pay levy but not benefit from the Scheme.

Question 6: Do you think that the approach for estimating GWP for insurers who fail to provide this information within the timeframe is fair?

56. Of the 48 responses to this question, 79% agreed that the proposed approach was fair. Some insurers questioned whether there was an unfair advantage to new entrant insurers (those that had not provide flood cover in previous years), and took the view that they should not be allowed to participate in the Scheme if they had not paid the levies. It was also commented that an arbitration process for querying GWP calculations would be needed.

Question 7: If no to either of the previous two questions, what changes to this approach should be considered and why?

57. Comments received under this question have been assigned to the relevant questions above.

Response

58. We have received a range of responses regarding the best way to calculate insurers' market share. In particular, some insurers felt that a 'per policy' basis would be more equitable than an approach based on GWP for home insurance. Having considered the issue carefully the insurance industry, through the ABI, have set out that this continues to be their preferred methodology and we therefore do not propose any fundamental changes to this approach. The Government also notes the progressive nature of this approach and notes that changes to the scope of Flood Re will go some way to addressing the concerns expressed by some insurers.

59. In relation to some of the more practical concerns relating to the process carried out by Flood Re for determining GWP, should an insurer believe Flood Re has incorrectly calculated their share of GWP, they can challenge the sum by informing the Scheme Administrator, as will be set out in the Scheme document.

60. In addition, should information on which levies are calculated for an insurer be poor or unavailable, we have included a regulation that requires the Scheme Administrator to rectify overpayments or underpayments made by an insurer. This will be based on revised calculations made on the submission of further information by the relevant insurer. Finally, whilst we do not believe it would be appropriate to penalise insurers for not paying levies, Flood Re will be able to pursue any outstanding amounts as a civil debt.

61. We have revised the Regulations so that 'add-ons' are not captured as part of the calculation for what counts as "home insurance"; and further that only the 'relevant risk element' (i.e. home insurance) is calculated in any policy that includes other types of cover. These changes are intended to ensure that only the relevant GWP is captured, and reflect the way that the insurance industry works in practice. Further detail on how GWP calculations and the levy setting process will work, will be set out in Flood Re's Scheme document.

62. We have also made changes to ensure that whilst new entrants will be exempt from the levies until they have operated in the market for a financial year (as defined by the Regulations); transfers of existing businesses will continue to attach to the levies. The Regulations have been revised so that the new relevant insurer taking on the business will be liable for the levies attributable to that business. This is to ensure fairness for new entrants who will not have written any home insurance on which to base their GWP until they have completed the first year of operation, but in a way that guards against avoidance.

63. The definition of home insurance in the Regulations has been amended to exempt buildings insurance policies covering two or three leasehold flats from counting towards an insurer’s share of the domestic property market (and their levy payments). This change is expected to affect a very small number of policies, so there will be no net impact on Scheme funding. It was made following feedback from the industry about additional costs that individual insurers would incur (and pass on to customers) when preparing their reports of their GWP for the domestic property sector to Flood Re. The majority of insurers classify buildings insurance policies covering more than one residential unit as commercial business. Therefore, those insurers would have to undertake additional data collection each time they reported to Flood Re to pick out these types of cover from their commercial books and add them in to their domestic GWP report. Changing their systems to reclassify these particular policy types would have been prohibitively expensive (and would be at odds with the agreed approach to create a Scheme which is easy to access and administer). Due to the small number of policies concerned, it was assessed that the most cost-effective option was to exempt them from paying towards the Scheme’s funding. A summary of the types of policies that will be expected to contribute towards Scheme funding is available at Annex 2.

64. We have also revised the definition of ‘relevant insurer’, to ensure it properly captures all insurers operating in the market, including Lloyds Market members.

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)?

65. Of the 53 responses to this question, 68% agreed with the approach of a review of the Primary Levy and premium thresholds at least every five years. However, some respondents in flood action groups and the insurance industry believed that the reviews should be made more frequently than five years as the insurance marketplace can change frequently. They suggested that the reviews should be held every year instead.

Response

66. The approach to reviewing the Primary Levy and premium thresholds reflects the need to regularly test the effectiveness of these thresholds in achieving the transition of flood insurance to risk reflective pricing. The transition plan will set out Flood Re’s approach in terms of how it will manage the costs of the Primary Levy and premium thresholds; whilst review will provide the mechanism by which Flood Re and Government will change the legislation to make those objectives achievable.

67. In line with this, the Scheme Administrator must provide at least one report reviewing the Flood Re Scheme at least 12 months before the end of each review period, or when requested to do so by the Secretary of State. The Regulations have been altered to reflect the view of some respondents in the insurance industry that were keen to see more flexibility in the ability of Flood Re to review the Scheme before the end of the review period, allowing Flood Re to review the Scheme at any time. In that report, any proposed changes to the Primary Levy or premium levels will be outlined, including the evidence supporting those proposals. Any changes to the Primary Levy or premium thresholds will need to be agreed by Government and would be made by affirmative legislation.

68. The proposed review process (held at least every five years), provides certainty to insurers and their customers about the impact of Flood Re on the price of flood insurance between review periods, while providing for a mechanism to adjust those levels in accordance with a transition to free market pricing. Addressing the concern of respondents that reviews be held frequently enough to adapt to market conditions, both Flood Re and the Secretary of State will have the ability to call reviews at any time. However, a review will require time as will the development of new legislation. As such, conducting reviews annually, as was suggested by some respondents, would not be the most effective use of resources available.

69. The Government and Flood Re have also committed to review the Scheme prior to it going live, to ensure that Flood Re is able to operate in a sustainable manner based on current market conditions and Flood Re's risk profile. The initial review, three months prior to go-live, will consider the affordability and availability of appropriate reinsurance and the "loss limit" only.

3.3 Definitions

Question 9: Do you agree that these are the right definitions for the purposes of the Scheme?

Some comments were received about the definition of "flood"; for ease of reference these are summarised and answered under Q10 (which asks specifically about flood). Comments on "relevant insurer" are summarised and answered under Q7 above. Technical comments on eligibility which relate primarily to "home insurance" and "household premises") which were provided in response to Q12 are summarised and answered under this question. Comments on the scope of Flood Re are covered under Q12.

70. Of the 57 responses to this question, 51% did not agree with the proposed definitions. Within the responses received, a number of issues were raised, which are considered further below.

71. Several respondents from the insurance industry felt that the Regulations and Scheme documentation needed to be less detailed and 'flexible' to allow the insurance industry to respond quickly to any developments in the market. It was suggested that it would be more appropriate to place definitions in Flood Re's contractual documentation. Other respondents felt that the definitions needed further explanation or asked a number of queries about how to interpret the eligibility criteria related to the definitions

of “household premises”. The need to define ‘residential purposes’, was raised by the insurance industry.

72. It was also noted that the definition of dwelling needed to be tightened, to ensure that leaseholders outside of the scope of the Scheme would not be somehow be required to pay towards the Scheme’s funding through policy premiums.

Response

73. There were diverse views on whether the definitions of “home insurance” and “household premises” needed to be more or less detailed, and whether the detail (particularly the eligibility criteria) should sit in the Regulations, the Scheme document or in contractual agreements. We considered various options and concluded that the most appropriate approach was for the definitions to remain in the Regulations and refer to the eligibility criteria within the Scheme document. The intention is for the scope of the Scheme to be fixed from the outset as this will ensure clarity and consistency to insurers and policy holders about eligibility for Flood Re (both in terms of payment of the levies and ability to benefit from the Scheme). Given the need for certainty, the scope cannot be defined in contractual agreements, which may be amended during the lifetime of the contract. In addition, not all relevant insurers may choose to enter into contractual arrangements with Flood Re. As highlighted in our consultation document, the detail in the eligibility criteria is needed to accurately define the parameters of domestic insurance market for the purposes of Flood Re.

74. We looked carefully at how to simplify these definitions and their eligibility criteria as far as possible, whilst still retaining accuracy. We have redrafted the definition of household premises to introduce two separate descriptions of a building type. ‘A ‘dwelling’ is defined as a single residential unit which is intended to cover any single freehold property unit, a single leasehold flat or mobile home, and which meets other criteria which will be set out in the Scheme document.

75. A building which includes two or three leasehold flats and which meets criteria set out in the Scheme document also falls within the definition of household premises. The introduction of these two types of property into the definition of household premises is necessary to accommodate the difference in scope of eligibility for insurance policies for payment of the levies and ceding policies. Contents policies which cover the contents of a dwelling will be eligible for reinsurance under the Scheme. Buildings insurance policies for a dwelling will also be eligible. In addition to that, buildings insurance cover for a building which contains two or three units will be eligible for reinsurance under Flood Re. For reasons that are explained under question 7, we have amended the definition of home insurance to cover only single residential units, which means that buildings insurance policies that cover two or three units will not contribute towards Scheme funding.

76. Minor amendments to the definitions of both household premises and home insurance have been made in response to questions received through the consultation. These will be covered by the Scheme document. We have amended the eligibility criteria to make explicit that executor(s) (such as of a will), and policies issued with more than one name (such as a cohabiting or married couple) will be in scope. The statement, *“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)”* has been revised as below:

"the holder of the policy, or their immediate family, must live in the dwelling for all or some of the time (whether or not with others) or the dwelling must be unoccupied."

77. The effect of this is that properties that are rented out, such as those covered by landlord insurance, will not be included.

78. Following feedback from a respondent from the property/mortgage sector, we have amended the definitions to clarify that tenement properties in Scotland would be eligible for Flood Re for both buildings and contents insurance, provided the policy covered a single unit. We can clarify that commonhold buildings insurance is also eligible for Flood Re provided that it covers a single residential unit. Insurance taken out on the whole block is out of scope. This will be reflected in the Scheme document.

79. A definition of mobile home has been added to the Regulations to ensure that there was clarity on the difference between park homes and caravan parks. Park homes will be eligible for Flood Re as they are a permanent residence, whereas mobile homes that are in caravan parks would be out of scope as they are rented out for commercial income[6].

80. It was not felt to be necessary to define "residential purposes" as was suggested; we believe the term is one which is well-understood and does not need clarification. An insurer asked whether an industry-wide definition of alternative accommodation and limit should be included for the purposes of Flood Re. This has not been specifically defined because Flood Re will pay claims according to the terms of the individual insurance policy held in each case.
81. We have provided a summary at Annex 2 of the eligibility of different policy types for both reinsurance and payment of the levies to reflect some clarifications to the definitions. Changes to the scope of Flood Re are covered in under Question 12. Flood Re will provide insurers with detailed guidance to help them determine whether to cede policies to Flood Re in its corporate documentation.

Question 10: Do you agree it is necessary to provide more detail on the definition of flood in the Scheme Document (Y/N)?

82. Of the 55 responses to this question, 75% agreed that more detail is needed on the definition of flood, with many respondents feeling that the definition of 'flood' needs to be made more specific. There were a range of reasons cited; most respondents wanted there to be as much clarity as possible on what would and would not be regarded as flooding, and a few respondents wanted clarity because flooding can have many causes, e.g. weather or river mismanagement. Respondents suggested that the definition used in the Flood and Water Management Act 2010 should be used. Also, several respondents specified that groundwater flooding should be covered under Flood Re (though other respondents thought that 'gradual rising of the water table' should not be covered by Flood Re).

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[6] You can find out more information about the distinction made under the law, by visiting: http://parkhomes.lease-advice.org/advice-guides/introduction-to-park-homes-2/

83. Some respondents felt that the term ‘substantial and abnormal’ was subjective and asked whether properties that flooded regularly would be excluded because flooding could be said to be ‘normal’. Several respondents noted that the definition of flood published by the Financial Ombudsman Service is different from that proposed for Flood Re and highlighted the need to ensure that this does not lead to disputes on claim recovery and misunderstandings by customers.

Response

84. We have carefully considered the wide-ranging comments. A typical household insurance policy covers a range of perils, including storm damage and internal flooding, such as leaks from appliances. Flood Re has been created to reinsure (and pay out claims for) only the flood risk element of a household policy and its definition must fit this specific purpose. Claims for types of risk which aren’t specifically covered by Flood Re, but which are covered by the household policy, will still be paid by the insurer.

85. The definition of flood specifies that any source of flooding which is *external* to a building should be covered under Flood Re. It further specifies that *internal* flooding, and storm damage such as rain entering the property through cracks in walls before it hits the ground, is not intended to be covered by Flood Re. The majority of domestic insurance policies cover these types of water damage under different perils, so the customer would still be protected.

86. The definition of flood risk used in the Flood and Water Management Act 2010 (FLOWMAN) was not considered appropriate for use in the context of insurance for several reasons. As is set out above, the definition of flood for Flood Re, unlike that under FLOWMAN, needs to cover flooding from the sewerage system and from a burst water main and needs to exclude internal flooding. Also, Flood Re’s definition needs to exclude flooding to property not contained within buildings, such as gardens and hedges, as this is not covered by a standard domestic insurance policy.

87. It was suggested that the definition of flood should include explanation of risk levels and thresholds used when determining flood risk. This is an interesting suggestion but would not be compatible with the way Flood Re has been designed to operate. It is up to an individual insurer to determine whether a particular policy should be ceded to Flood Re. The insurer will consider a range of factors, such as the size of the property, risk modelling, and claims history; if it estimates that the cost of insuring the property for flood risk is higher than the reinsurance premium offered by Flood Re, the insurer is likely to cede it. If the estimated cost is lower than the reinsurance premium, the insurer is likely to choose not to cede.

88. There are some types of risk that are not covered by the majority of insurers operating in the UK market and are therefore not covered by Flood Re. This is reflected in the definition of flood for the operation of the Scheme. In general, insurers do not consider water damage which occurs gradually over time to be a ‘flood’. The term *‘substantial and abnormal’* is regarded in the insurance industry as standard terminology. To assist with the interpretation of the term, we have clarified that *‘gradual seepage or percolation of water into a building such as rising damp’* is not a flood in the context of Flood Re or domestic insurance policies, because it occurs gradually over time. Another example of a type of water damage not typically covered by insurers is fluctuating levels of the water table which causes basement flooding on a seasonal

basis because lower parts of the property are situated at the level of the water table. However, groundwater flooding following a period of particularly heavy rainfall would be covered under Flood Re as it can be traced to a particular weather event.

89. We have included a fuller definition of flood in the Regulations and we do not now believe it is necessary to provide more detail in the Scheme document.

90. Each claims case for water damage would be considered on its own merits by loss adjusters. If necessary, customers can refer their case to the Financial Ombudsman Service (FOS).

Question 11: Do you agree that definitions for "buildings only policy", "contents" and "combined policy" are needed (Y/N)?

91. Of the 51 responses to this question, 94% of respondents agreed that definitions for "buildings only policy", "contents only policy" and "combined policy" are needed. It was suggested that word "only" should be removed from "buildings only policy" and "contents only policy" because this becomes illogical once definition of "combined policy" is included. The need to make the definition of buildings insurance less prescriptive and to define 'fine art' was also raised by the insurance industry.

Response

92. We have retained the definitions and taken on board the suggestion to remove the word "only" from "buildings only policy" and "contents only policy". The description of "buildings policy" has also been made less prescriptive by using the term "which may include", in line with the wording of "contents". We do not think it is necessary to specify the definition of 'fine art' in Regulations as this is best suited to Flood Re's underwriting manual, where it can be refined if necessary to reflect any changes to the market over the 25 year lifespan of the Scheme.

3.4 Designation

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?

93. Of the 59 responses to this question, 56% thought the Scheme should cover other areas. Whilst this consultation did not consider the scope of the Scheme (on which we have previously consulted), and focused only on the enabling Regulations, given the large number of responses on this issue and interest in the Scheme's scope we have summarised the responses received below.

Scope of Flood Re

94. The majority of respondents took the opportunity to comment through this question on the scope of Flood Re. 134 responses were received as part of a campaign on leasehold properties and were counted as one response in line with standard

consultation procedure. Nearly all of these comments called for groups, currently out of scope, to be included within Flood Re.

95. Respondents proposed that the following should be covered by the Scheme: large-scale leaseholders, small businesses, properties in Band H or equivalent, properties built after 1 January 2009 and the private rented sector.

96. On large-scale leaseholders, key issues were the concern that prices would become unaffordable once the Statement of Principles[7] came to an end and the lack of influence of leaseholders on the insurance premiums that their freeholders took out on their behalf.

97. On Band H, the key concerns were that households may not be able to afford increases in premiums in high flood risk areas, particularly in areas where property values had increased rapidly moving the property into a higher band; and that their contribution to the Scheme would be disproportionately high compared to other bands.

98. For the private rented sector, concerns were primarily that if landlords in high flood risk areas could not afford premiums, this would lead to abandonment of property, a reduction in housing stock and impacts on local housing markets.

99. On properties built after 1 January 2009, the key concern was it was unfair this group was excluded and yet had to pay towards the Scheme's funding.

100. Comments were received about the differing valuation dates for Council Tax bandings in England and Scotland and those in Wales. It was felt that Band H and I in Wales should be included to take account of the Welsh re-banding exercise undertaken in 2005. This is covered in the next section.

101. It was also suggested that the scope of the Scheme should be re-considered at the first review of the Scheme. This is considered under the response to Question 8.

Flood Re liability

102. Responses voiced concerns over the limited liability of the Flood Re Scheme as they were unclear what the term 1 in 200 meant in practice. This centred on whether the 1 in 200 loss scenario relates to a single event and who defines when and where the scenario has been met. We have set out in more detail what this means in the response below. How Flood Re would be able to respond to climate change was also raised.

Response

103. Responses to this question capture a wide range of issues. We have set out the Government position on each below, following the order of the summary above.

[7] The Statement of Principles: https://www.abi.org.uk/Insurance-and-savings/Topics-and-issues/Flooding/Government-and-insurance-industry-flood-agreement

Scope of Flood Re

104. Defra has commissioned research into how the domestic and commercial insurance market is currently operating and will continue to monitor the market throughout the lifetime of the Scheme. If evidence emerges of a widespread problem, we will consider options with the industry.

105. We have considered carefully the concerns raised through consultation responses and via workshops and meetings. We have been clear that contents insurance will remain available for leasehold properties. There remains insufficient evidence of a systematic problem with leasehold buildings covering more than three residential units. Therefore there have been no changes to the policy on the leasehold sector; except that some leasehold flats are no longer expected to contribute towards Scheme funding (these particular flats remain eligible for Flood Re). More information on this change has been set out under Question 7 above.

106. The position on the inclusion of small businesses has not changed. Overall there is insufficient evidence to justify Government intervention in the provision of insurance cover for small businesses. Flood Re has been designed to cover the domestic rather than commercial sector. However, we recognise the challenges that some small businesses could face in areas of high flood risk. We have committed to work with the ABI and other stakeholders to monitor the insurance market for small businesses and consider the issue with the industry if the situation were to change significantly.

107. We have considered the concerns raised about the impact on households in Band H properties of paying towards the Scheme and facing high insurance premiums in flood risk areas. The insurance industry has provided assurances that the inclusion of Band H properties would not affect the £180 million Primary Levy on the industry and that properties in lower Council Tax bands would not be subsidising Band H properties. The Government has agreed that provided these conditions are met the policy can be changed and Band H properties will now be eligible for Flood Re.

108. The cut-off date for eligibility for Flood Re will remain 1 January 2009, in order to maintain consistency with the Statement of Principles and avoid any potential incentives to build homes in areas of flood risk.

109. The position remains that it would not be appropriate for Flood Re to provide cover for landlord insurance, which is more extensive than standard home insurance, with at least some elements of commercial insurance included. We have been assured by the industry that the majority of landlords would be able to find a more competitive rate outside of Flood Re. Contents insurance will remain available through Flood Re for tenants of rented properties.

110. There were several questions about eligibility for various forms of property rental. In general, properties rented on a permanent basis are not eligible for Flood Re. No properties where the insurance cover is commercial in nature are eligible for the Scheme.

111. A number of questions were asked about specific scenarios on property rental and the answers are set out below:

- A room which is rented out under the 'Rent a room Scheme'[8] would not mean the property is excluded as the policy holder still lives in the property and would be able to take out a domestic home insurance policy.

- If the tenants of a property move out, its insurance policy is only eligible provided a domestic policy is taken out in the place of the commercial landlord insurance; once the property is covered by landlord insurance it becomes out of scope again.

- If a family home is rented out for a short period , or as a holiday home, and covered for that period by landlord cover, it would be out of scope for that period, but would come back into scope provided domestic insurance is reinstated once it returns to family use.

Flood Re liability

112. The 1 in 200 loss scenario does not relate to flood risk, but Flood Re's financial liability, its exposure to insurance claims. It is a calculation (based on modelling) of the total value of claims from households reinsured through Flood Re that, during the course of a year, actuaries would not expect to be exceeded in 99.5% of years (or in other words, are 99.5% confident that the limit wouldn't be exceeded in any one year).

113. To put this in perspective, a 1 in 200 loss scenario is comparable to six times worse than the 2007 floods. Under European law (the Solvency II framework), all insurers must be in a position to respond to flooding (the payment of claims), up to an event of this scale. In the UK, financial regulators ensure that all approved insurers (including Flood Re) have appropriate reserves in relation to their liability.

114. The Memorandum of Understanding (MoU) between Government and the ABI sets out what happens in a 1 in 200 scenario:

> "*The market participants in Flood Re will not be liable for any liability to Flood Re above the 1:200 annual loss. Should claims on Flood Re exceed a 1:200 level, the Government of the day would take primary responsibility, working with Flood Re and representatives of the insurance industry, for deciding how any available resources should be distributed to Flood Re customers. This will form part of a wider Government action to respond to such a national emergency in order to minimise loss of life and support the provision of essential services, as judged appropriate by the Government of the day. In the event that flooding in any year is on a sufficiently serious scale for Flood Re to consider a breach of the 1:200 level to be very likely, Flood Re would notify the Government of the day, triggering discussions between industry and the Government*".

115. Should flooding occur on a scale greater than this, Flood Re and the Government will decide how to best respond, as part of a wider response to what would be a national emergency. We cannot set out what actions would be taken with regard to Flood Re

[8] Rent a room Scheme: The Rent a Room Scheme lets householders earn up to a threshold of £4,250 per year tax-free from letting out furnished accommodation in their home. For more information, see: https://www.gov.uk/rent-room-in-your-home/the-rent-a-room-scheme

as such decisions will be for the Government of the day. However, we have been clear that Flood Re does not retain any contractual liability in such a scenario, which will pass back to insurers who will continue to pay out claims in line with the terms of the insurance policy.

116. As set out in the MoU, the Government will reaffirm the position on Flood Re's liability in a letter to the insurance industry (through the ABI).

Climate change

117. Flood Re has been designed to be flexible and able to respond to changing flood risk. Whether a policy should be ceded to Flood Re will be a decision for individual insurers, dependent on their assessment of a property's flood risk. There is no barrier (aside from the eligibility criteria), on the number of properties that can be ceded to the Scheme. This provides Flood Re with flexibly over its 25 years of operation in terms of providing support to properties in the face of changing flood risk.

4. Other amendments to the regulations

Welsh properties

118. Following concerns raised about the differences in the Council Tax banding between those in England and Scotland and those in Wales, (due to the revaluation of Council Tax bands for properties in Wales back in 2003), we have agreed that Welsh Council Tax bands C and above will be moved down by one band in setting the thresholds for reinsurance premiums for Flood Re.

England and Scotland Council Tax Band	**A and B**	**C**	**D**	**E**	**F**	**G**	**H**
Wales Council Tax Band	**A, B & C**	**D**	**E**	**F**	**G**	**H**	**I**
Premium Threshold	£210	£246	£276	£330	£408	£540	£1200

119. In addition to any changes highlighted in the Government response so far, and to the eligibility of Welsh properties, a number of minor drafting amendments have been made to the Regulations.

120. We have included reference to the Financial Services and Markets Act and wider EU legislation in relation to Flood Re's prudential obligations. We have set out that the total that Flood Re may request by way of additional amounts may only be up to an amount which is necessary to meet obligations under FSMA or other directly applicable EU legislation.

121. We have introduced a new concept of 'initial period' to distinguish between the first year of Flood Re's operation, which may not be a full financial year, and years following this (a 'financial year'). Linked to this, we have reduced the amount of Primary Levy in the initial period to effectively pro-rata it in Flood Re's first year of operation (the 'initial period').

122. We have amended the Regulations to provide Flood Re with some flexibility to determine the timescales in which levy payments must be made. Separate to the Regulations, we have made clear to Flood Re that they will need to set this out clearly as insurers will expect certainty on the timings of payments.

123. In line with the June 2013 Memorandum of Understanding (MoU) Flood Re has the discretion to make Levy II calls in the form of contributions from insurers that are members of the Flood Re Scheme. We have amended the Flood Re Regulations so that they do not prevent such contributions being made through the Scheme, nor prevent (or require) their repayment. We have also added a definition of contribution to clarify what is meant by this term.

124. Aside from the amendments setting out the revised policy position on Band H properties and Welsh properties (Band H and I), more generally we have made some minor amendments to the section setting out the premium thresholds which Flood Re will charge. These are drafting amendments clarifying the approach taken and do not

impact the policy position. We have also revised the formula used to calculate changes in the premium thresholds so that it properly captures increases in the consumer price index.

125. For clarity, we have revised the regulation setting out the need for Flood Re to provide the Secretary of State with information for the purposes of Government accounting so that only information reasonably needed for these purposes can be requested. This provides Flood Re with greater certainty on the nature of the information the Secretary of State can request.

5. Next steps

126. The primary legislative framework for Flood Re has been put in place through the Water Act 2014, which received Royal Assent on 14 May 2014. The provisions of the Water Acht 2014 relating to Flood Re will be commenced with effect from 1 January 2015. The Flood Re Regulations will put in place the secondary legal framework around the Flood Re Scheme, its funding and its administration. The Regulations are being revised to take account of the changes made as a result of this consultation. The Secretary of State needs to be content to designate the Scheme and the Scheme Administrator prior to the Regulations being laid. Once the Regulations are laid they will be debated in both Houses and if approved, will be made and come into force after that date.

127. Flood Re is a complex scheme and it is important we get it right before it starts operations. We continue to work closely with the insurance industry in developing and implementing the detail and have made good progress since the Water Act received Royal Assent including:

- Provision of initial council tax data to the industry
- Brendan McCafferty, Flood Re's CEO has been appointed and is already working alongside the ABI team on setting up the body
- Further key appointments have just been announced, with more due to be made shortly
- The procurement of the managing agent who will carry out the day to day administration of Flood Re is in its final stages
- The procurement of the reinsurance broker is in its closing stages enabling further progress to be made on the reinsurance strategy
- The ABI and Flood Re team are working with the financial regulators to ensure that Flood Re will meet its requirements for regulatory authorisation. This will need to be completed before it can commence trading and accept ceded business.
- The State Aid process has been formally notified and the Commission will make their decision by the end of January 2015.

128. There is still significant work to do to enable Flood Re to fulfil its role within the insurance market. Plans are for Flood Re to be established in July 2015; insurers will then need time to test and implement their systems to link up with Flood Re before it can be fully operational.

129. This work is being delivered alongside the regulatory authorisation process and once the appropriate authorisation is in place, households at high flood risk will have access to affordable flood insurance.

Annex 1: HMG agreement with the ABI and Flood Re

Flood Re financial controls and miscellaneous issues

1. This sets out a joint understanding of the issues that have been outstanding between HM Government (HMG), the Association of British Insurers (ABI) and Flood Re which require resolution before the secondary legislation and Scheme is finalised. Nothing in this document is intended to give rise to any legal rights or obligations between the parties in relation to this matter.

Financial controls on Flood Re

2. As an industry owned and managed entity which will be funded at least partially by what we expect will be classified by the Office for National Statistics as public money, some controls are required to manage Flood Re's potential impact on public expenditure as well as ensuring the overall effect on insurers is neutral over time.

Reinsurance losses

3. Flood Re's Articles of Association will include a provision, the effect of which will require that the Flood Re Scheme Administrator must purchase appropriate stop-loss reinsurance (or equivalent cover with the same effect) so that the Scheme does not have an impact on public sector net borrowing (PSNB) greater than £[100m] (the "loss limit") at the end of any one financial year.

4. Flood Re agrees to call on its reinsurance if required in all circumstances unless agreed with HMG in advance.

5. The figure for the "loss limit" will be reviewed and confirmed 3 months prior to "go-live" (the point at which Flood Re starts accepting inwards reinsurance policies). This review will be conducted on the basis of a report provided by Flood Re's directors, which will be informed by information from Flood Re's reinsurance broker.

6. On the basis that Flood Re will provide HMG with Articles which reflect the position above, the current wording about limiting the impact on PSNB will be removed from the regulations.

7. Flood Re directors will, on an annual basis, issue a report to its members that discloses its agreed risk appetite for the forthcoming year.

Reviews

8. The initial review 3 months prior to go-live will consider the affordability[9] and availability of appropriate reinsurance and the "loss limit" only. All the other financial parameters for the Scheme (primary levy, and premium thresholds) will remain as set out in the Flood Re regulations.

9. For subsequent "loss limit reviews", whilst noting that reviews may be called at any time and at least every 5 years, there is a shared expectation that there will be a review after 3 years of operation. (The amount of primary levy and the premium thresholds will however be fixed for the first 5 years of operation).

10. The review steps will include:
    a) Flood Re preparing a report and recommendations for HMG based on an agreed set of data. This is expected to include the price and availability of reinsurance at the existing "loss limit"; the impact of changing premium thresholds on the price of reinsurance; and the effect (including value for money) of changing the "loss limit" on the price of reinsurance. The contribution to managing the transition to risk reflective prices should also be considered.
    b) HMG will consider the report and recommendations, which may include:
        i. changing the "loss limit",
        ii. (after the first 5 year period) changing the level of Levy I,
        iii. (after the first 5 year period) changing the premium thresholds, based on what is considered 'affordable' (as defined) and available within the report.
    c) HMG will then make a decision within an agreed review timetable to allow cost effective procurement of the appropriate reinsurance to commence in accordance with relevant procurement processes and propose amendments to the regulations for approval by Parliament. Processes and timescales for any amendments to the Articles of Association will also be considered.
    d) Where there is disagreement between the HMG and the Directors of Flood Re, an independent expert may be appointed to express a non-binding professional recommendation.

HMG membership of Flood Re Ltd

11. HMG will have a special membership interest (with specific and limited voting rights) in Flood Re Ltd, which will enable it to veto any changes to any relevant Articles about the purchase of appropriate reinsurance, or any ratification of a breach of it. In addition:

    a) there would be a clear expectation that Flood Re Ltd would not at any point be able to act in conflict with this provision, or introduce further provisions or other changes that undermine the principle; and

[9] The definition of affordability is to be agreed, but in principle will reflect that Flood Re will need in normal years to maintain the solvency capital requirement as agreed between Flood Re and the Prudential Regulatory Authority, plus an appropriate and normal capital buffer to be agreed between Flood Re Directors and HMG expected to be in the region of 20-25%.

b) an agreed and final version of the Articles of Association would need to be completed and registered with Companies House before regulations are laid in Parliament.

Losses arising from legal challenge

12. Flood Re will create an insurance liabilities reserve in line with accepted accounting standards and provided the creation of that reserve does not result in an impact on the profit and loss in excess of the "loss limit". The insurance liabilities reserve will be used to draw down funds should Flood Re incur losses as a result of successful or ongoing legal challenge against the company and will ensure that these losses will not affect the profit and loss to the extent that the reserve is available. The provision will be recapitalised by relevant insurers in the normal way. However, should any loss be significantly higher than the provision and affect the agreed "loss limit", HMG and Flood Re would review that matter in good faith.

13. To mitigate the risk of successful legal challenge, particularly to reinsurance contracts, Flood Re will structure its reinsurance to maximise the benefits from a portfolio effect and put in place an appropriate level of legal assurance. The reinsurance programme will be subject to approval by the PRA.

14. Reinstatement of appropriate reinsurance to limit Flood Re's impact on PSNB would take place as soon as possible after any default.

Operating costs

15. Flood Re Ltd and relevant insurers will be responsible for any operating costs greater that £15m per annum. These costs will be subject to review during the life of Flood Re.

Investment and banking strategy

16. Flood Re will invest only in UK gilts and hold cash in the Government Banking Service[10]. This will be reflected in the documents submitted to the PRA as part of Flood Re's application for authorisation.

Borrowing

17. The limit on borrowing will be £25m. The definition of borrowing has been agreed and is reflected in the regulations. The interaction between borrowing and the loss limit will need to be considered during the reviews.

Initial capitalisation

18. Provision has been made within the regulations to allow for initial capitalisation of Flood Re not to trigger an automatic review during the initial period. This initial period will be confirmed prior to the laying of the regulations.

[10] Or another AAA rated location, subject to a full feasibility study

Miscellaneous Issues:

19. Band H properties (and Band I in Wales) will be included within the Scheme on the proviso that costs for other householders do not increase. The premium thresholds will be £1200 for a combined policy, £800 for buildings policy and £400 for contents policy.

20. As a result of a revaluation of their Council Tax bands in 2005 adjustments are needed to ensure equal treatment for Welsh properties. Bands A, B and C will be integrated for Wales and each of the remaining bands will be "stepped down" (e.g. D becomes C). HMG will provide the data adjusted for this Wales amendment, and in an appropriate format to the Managing Agent.

Annex 2: Eligibility for reinsurance and contribution to Scheme funding by policy type

The table below provides an overview of insurance policy types that are eligible for contributions towards Flood Re's funding and reinsurance by Flood Re. This list is not intended to be exhaustive. Where reference has been made to the owner living in the property, this should be taken to include the owner's immediate family.

Description of policy category	**Will contribute towards scheme funding via levy**	**Flood element of insurance policy eligible for reinsurance through Flood Re**
Contents insurance policy		
1. Contents insurance, regardless of tenancy type or property type, provided the property was built **before** 1 January 2009.	Yes	Yes
2. Contents insurance, regardless of tenancy type or property type, if the property was built **from** 1 January 2009 onwards.	Yes	No
Buildings insurance policy		
3. Owner-occupied freehold house, bungalow, or static caravan, provided it was built **before** 1 January 2009.	Yes	Yes
4. Property **built from 1 January 2009** onwards, whether owned on a freehold, leasehold, commonhold or Scottish tenement basis. Note that if the property is rented it out it would not contribute towards scheme funding.	Yes	No
5. Owner of a leasehold property, provided the insurance can be taken out on a **single unit** or dwelling and the owner lives in the unit.	Yes	Yes
6. Commonhold unit owner, if insurance is purchased for a **single unit** by the owner (or their immediate family) and the owner lives in the unit.	Yes	Yes

7. Owner-occupier of tenement property, if they take out insurance on their **single unit**	Yes	Yes
8. Freeholder of a block of **2 or 3 units**, that live in one of the flats, provided the building is all residential use	No	Yes
9. Block of **2 or 3 units**, where **one or more** of the people that own a share of the freehold live in the building, provided the building is all residential use	No	Yes
10. Commonhold association buildings insurance (taken out on behalf of, or by, the residents within **a block**)	No	No
11. Freeholder insurance covering a block of **4 or more units,** whether or not the freehold is being managed by a commercial company	No	No
12. Insurance taken out collectively on **more than one unit** of a tenement property (this applies whether it is a management company or the owners as a group)	No	No
13. Social rented, housing association, corporately owned property, retirement homes, publicly owned buildings (whether or not they are used for residential purposes)	No	No
14. Buildings insurance covering a block with **mixed residential and commercia**l use – e.g. a block of residential flats with shops or businesses on the ground floor, or with some individual flats being used as a business address.	No	No
15. Home used by the occupant for **work**, provided the property is not the registered business address. Factors such as the duration of time working from home would not affect eligibility. It is the type of insurance policy that determines eligibility.	Yes	Yes
16. Home registered as a business	No	No
17. Landlord insurance (insurance covering rented property, whether owned freehold, leasehold, commonhold or as a tenement).	No	No
18. Premises of microbusinesses, small businesses, charities or co-operatives (e.g. pubs and Post Offices).	No	No

This includes residential accommodation above the premises (unless the terms of the lease allow the buildings insurance to cover the individual residential unit).		
19. Bed and Breakfast, paying business rates	No	No
20. Bed and Breakfast, with a Council Tax band	Yes	Yes
21. Static caravans that are rented out. Insurance for the holiday or caravan park itself would also be out of scope.	No	No
22. Sheds, garages and summerhouses, provided that the home insurance policy includes cover for these as standard. Note that large outbuildings that are covered under a separate non-residential policy, such as farm barns, would be ineligible.	Yes	Yes
23. Farm outbuildings, including if occupied by paying tenants	No	No

Annex 3: Statistical analysis of consultation responses

The analysis of the responses does not include campaigns or responses from the Devolved Administrations.

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?

Key	Option	Total	Percent of All
A	Yes	48	60%
B	No	9	11%
C	Not Answered	23	29%

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?

Key	Option	Total	Percent of All
A	Yes	37	46%
B	No	21	26%
C	Not Answered	22	28%

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?

Key	Option	Total	Percent of All
A	Yes	40	50%
B	No	18	22.5%
C	Not Answered	22	27.5%

Question 4: Do you agree that the funding arrangements in the Regulations (including regulation 17) achieve the right balance between operational freedom; certainty for insurers; and accountability for the handling of public money?

Key	Option	Total	Percent of All
A	Yes	34	43%
B	No	21	26%
C	Not Answered	25	31%

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"?

Key	Option	Total	Percent of All
A	Yes	24	29%
B	No	24	31%
C	Not Answered	32	40%

Question 6: Do you think that the approach for estimating GWP for insurers who fail to provide this information within the timeframe is fair?

Key	Option	Total	Percent of All
A	Yes	38	47.5%
B	No	10	12.5%
C	Not Answered	32	40%

Question 7: If no to either of the previous two questions, what changes to this approach should be considered?

There is no statistical analysis to this question, 30 responses were received.

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)?

Key	Option	Total	Percent of All
A	Yes	36	45%
B	No	17	21%
C	Not Answered	27	34%

Question 9: Do you agree that these are the right definitions for the purposes of the Scheme?

Key	Option	Total	Percent of All
A	Yes	28	35%
B	No	29	36%
C	Not Answered	23	29%

Question 10: Do you agree it is necessary to provide more detail on the definition of flood in the Scheme Document?

Key	Option	Total	Percent of All
A	Yes	41	51%
B	No	14	18%
C	Not Answered	25	31%

Question 11: Do you agree that definitions for “buildings only policy”, “contents” and “combined policy” are needed?

Key	Option	Total	Percent of All
A	Yes	48	60%
B	No	3	4%
C	Not Answered	29	36%

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?

Key	Option	Total	Percent of All
A	Yes	33	41%
B	No	26	33%
C	Not Answered	21	26%

Annex 4: List of respondents

Above Derwent Parish Council

AIG Europe Limited

Andover Town Council

Association of British Insurers (ABI)

Aviva

AXA UK

BIBA

Braunton Parish Council

British Marine Federation

Brokerbility Ltd

Calderdale Metropolitan Borough Council

Cherish Insurance Brokers Limited

Chew Valley Flood Forum

Chubb Insurance Company of Europe SE

CII New Generation Broking Group 2013

City of York Council

Committee on Climate Change

Consumer Council

Cottingham Flood Action Group

Council of Mortgage Lenders

Direct Line Group

East Peckham Flood Group

Flood Re Limited

Friends of Shoebury Common

General Insurance Company

Gloucestershire County Council

Grantham Research Institute, London School of Economics and Political Science

Green Heat Ltd

Hartlepool Borough Council

Hiscox

Individuals at flood risk

Institution of Civil Engineers Wales Cymru

Inverclyde Council

Landlords

Lark (Group) Limited

Lincolnshire County Council

Lloyds Banking Group

Lloyd's of London

Mfh lettings

Morpeth Flood Wardens

National Farmers Union

National Flood Forum

NFU Mutual Insurance Society Ltd

North Wales Local Resilience Forum

Parliamentarians

Private individuals

Prospect Insurance Brokers

Residential Landlords Association

RICS

RSA Insurance Group

Sedgeberrow Flood Group

Severn Parish Council

South Somerset District Council

South Woodham Ferrers Community Safety and Flood Forum

Sterling Insurance Group

Stratfield Turgis Parish Meeting

The Law Society

The Metropolitan Glasgow Strategic Drainage Partnership (MGSDP)

Wraysbury Parish Council

Zurich