EXPLANATORY MEMORANDUM TO

THE FLOOD REINSURANCE (AMENDMENT) REGULATIONS 2022

2022 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before both Houses of Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations designate a new Flood Reinsurance Scheme ("the FR Scheme") improving the efficiency and effectiveness of the existing FR Scheme and to promote the uptake of property flood resilience (PFR) measures in households, helping the United Kingdom to become more resilient to the changing climate. The Regulations will amend the figure for the levy (the FR Scheme's primary income, raised from UK household insurers based on their market share) from £180M to £135M.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales, Scotland and Northern Ireland.

4.2 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland.

5. European Convention on Human Rights

5.1 Rebecca Pow MP, Parliamentary Under Secretary of State at the Department for Environment, Food and Rural Affairs has made the following statement regarding Human Rights:

"In my view the provisions of the Flood Reinsurance (Amendment) Regulations 2022 are compatible with the Convention rights."

6. Legislative Context

6.1 The FR Scheme was established in 2016, under the Water Act 2014 ("the Act"), to provide reinsurance to relevant insurers in respect of such risks to household properties arising from a flood and promoting the availability and affordability of flood insurance for UK household premises. Flood Re is a time-limited scheme lasting until 2039 and must also manage the transition to risk reflective pricing for household flood insurance over the lifetime of the scheme.

6.2 The FR Scheme came into existence, in exercise of the powers conferred by the Act, through the Flood Reinsurance (Scheme and Scheme Administrator Designation)

Regulations 2015 (S.I. 2015/1875) and Flood Reinsurance (Scheme Funding and Administration) Regulations 2015 (S.I. 2015/1902).

7. Policy background

What is being done and why?

7.1 In 2019, Flood Re (the scheme administrator) published their first Quinquennial Review of the FR scheme. This is a statutory requirement. Flood Re made a number of recommendations to government. A number of proposals have since been considered and consulted on, leading to the changes set out in this document.

7.2 These Regulations designate a new FR Scheme with technical changes to the FR Scheme to improve the efficiency and effectiveness of the FR Scheme. The Regulations also introduce a change to the FR Scheme to promote the uptake of property flood resilience (PFR) measures in households, helping the nation UK to become more resilient to the changing climate. The regulations revoke the designation of the Scheme Document dated 22nd June 2015 and designate a new Scheme Document dated 19 January 2022. The Scheme document is available on legislation.gov.uk.

7.3 <u>Levy 1</u> (Flood Re's primary income, raised from UK household insurers based on their market share) – This statutory instrument (SI) will amend the figure for the levy from £180M to £135M. The Scheme will allow Flood Re to propose a new levy every three years instead of every five and reflects the government's assurance process. The revised levy amount will be subject to parliamentary approval. This will allow Flood Re to obtain better value for money in purchasing reinsurance, to be more dynamic to their needs and potentially changing risk profile and ensure the total levy (a form of tax) is not higher than it needs to be.

7.4 <u>Liability Limit</u> (sets the maximum amount of claims Flood Re is liable to pay to insurers in any one financial year) – The Scheme document will allow Flood Re to set the Liability Limit every three years instead of every five. This will align it with the levy setting cycle and afford Flood Re greater flexibility to respond to the Scheme's changing income needs and risk profile. The Scheme document also reflects the government's assurance process.

7.5 <u>Surplus funds at scheme wind up</u> – The Scheme document clarifies that Levy 1 funds will be returned to government when the scheme ends, in line with the agreed position between the Government and Flood Re.

7.6 <u>Build back better</u> – The Scheme document will allow Flood Re to pay claims which include an amount of resilient repair (build back better) up to a value of £10,000 over and above the cost of like-for-like reinstatement of actual flood damage. Resilient repair will enable homeowners to return to their homes more quickly following a flood and reduce the cost of future claims.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act 2018.

9. Consolidation

9.1 This instrument does not consolidate any legislation.

10. Consultation outcome

10.1 In February 2021, the government published a consultation on changes to the FR Scheme to improve the efficiency and effectiveness of the scheme and to aid Flood Re's transition to a risk reflective insurance market in 2039 when the scheme ends. There were 119 responses from a range of organisations including academics, flood groups, insurers and flood resilience companies with a strong majority of support for the proposals. Over 85% of respondents agreed that Flood Re should be able to pay claims which include an amount of resilient repair (build back better) to policies ceded to the FR Scheme. The main reasons given were that it will reduce future costs for homeowners, the insurance sector and risk management authorities and will improve flood resilience of properties by reducing flood risk. There was positivity towards moving from a five-year to a three-year Levy 1 setting cycle with 50% agreeing and a further 24% taking a neutral position. Respondents noted the value of increased flexibility that moving to a three-year cycle would provide enabling Flood Re to better respond to dynamic risks and changes in the market. 52% of respondents agreed that three years is an appropriate setting period for the liability limit with 80% of respondents in the insurance sector supportive. The main reasons given was consistency with the Levy 1 setting cycle, increased flexibility and efficiency of the operation of Flood Re and improved management of financial risk.

10.2 In July 2021, the government published a summary of responses and committed to implement the changes described in section 7 by April 2022. The summary of responses can be found at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1006738/flood-re-consultation-summary-of-responses.pdf

11. Guidance

11.1 There is no supporting guidance for these legislative changes. Flood Re have and will continue to engage with insurers through their usual communication structures.

12. Impact

12.1 There is no significant impact on business, charities or voluntary bodies.

12.2 There is no impact on the public sector.

12.3 A full Impact Assessment has not been prepared for this instrument because of the negligible impact on businesses. A Regulatory Triage Assessment has been completed. Most impacts on business are anticipated to be neutral or positive. These changes will affect all insurance companies offering household insurance in the UK. There is no change in the mechanics of collecting the levy but in the actual amount, which insurers are already aware of. We don't expect that insurers will need any additional resources at all over those currently used to calculate or pay the levy. All insurers offering home insurance in the UK already pay towards Levy 1 that funds Flood Re. For those properties ceded to Flood Re, Flood Re have undertaken modelling and confirmed that the powers to enable them to pay claims to build back better should not increase the cost to insurers as they will be met by Flood Re's funds and levy income. Participating in the build back better proposal will be on a voluntary basis. However, if insurers choose to participate in build back better, they will be encouraged by Flood Re to offer this to their entire customer base. Therefore, insurers will be liable to fund Build Back Better (BBB) for flooded properties not ceded to

Flood Re out of their own capital reserves. Some familiarisation costs will be associated with upskilling staff on best practice when reinstating a house to be more resilient following a flood, however, these costs are deemed to be negligible. Builders and PFR manufacturers will see increased demand for their products.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The FR Scheme administrator can review the total levy amount and the liability limit every three years in accordance with the assurance processes set out in the Scheme document. The FR Scheme administrator is also required to undertake a review of the scheme every five years in accordance with regulation 27 of the Flood Reinsurance (Scheme Funding and Administration) Regulations 2015.

14.2 The instrument does not include a statutory review clause.

15. Contact

15.1 Ross Jones at the Department for Environment, Food and Rural Affairs. Email: ross.jones1@defra.gov.uk can be contacted with any queries regarding the instrument.

15.2 David Cooper, Deputy Director for Flood and Coastal Erosion Risk Management at the Department for Environment, Food and Rural Affairs can confirm that this Explanatory Memorandum meets the required standard.

15.3 Rebecca Pow MP, Parliamentary Under Secretary of State at the Department for Environment, Food and Rural Affairs can confirm that this Explanatory Memorandum meets the required standard.