EXPLANATORY MEMORANDUM TO

THE FLOOD REINSURANCE (AMENDMENT) REGULATIONS 2025

2025 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 Parliament by Command of His Majesty.

2. Declaration

2.1 Emma Hardy, Parliamentary Under Secretary of State at the Department for Environment, Food and Rural Affairs confirms that this Explanatory Memorandum meets the required standard.

2.2 Laura Lutkoski, Deputy Director for Flood and Coastal Erosion Risk Management at the Department for Environment, Food and Rural Affairs confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Sunil Parekh at the Department for Environment, Food and Rural Affairs, Telephone: 020 3025 3302 or email: sunil.parekh@defra.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument will amend Regulation 8(2)(a) of the Flood Reinsurance (Scheme Funding and Administration) Regulations 2015 to allow for the total levy figure to be increased from £135 million to £160 million.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 Flood Re's primary income known as Levy 1, is raised from UK household insurers based on their market share. This statutory instrument (SI) will amend the figure for the levy from £135M to £160M. The Scheme allows Flood Re to propose a new levy every three years and reflects the government's assurance process. The revised levy amount will be subject to parliamentary approval in both Houses. 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.

5.2 Flood Re collect a levy from insurers to help provide flood insurance for those who cannot get it. Flood Re are the reinsurers and have flood risk ceded to them. Flood Re is under an obligation to protect itself against losses up to £3.2 billion and to protect against the potential for Profit & Loss Account losses greater than currently £100m in any one operating year.

5.3 Given reinsurers' experience in global natural catastrophe claims, higher inflation and their lower profitability, both price and reinsurance capacity they need to increase the levy to keep operating.

5.4 The cost of increasing the Levy 1 will be indirectly passed on to the customers of the insurance companies, who are members of the Flood Re Scheme. Flood Re estimate the scale of the increase at around £1.60 per policy.

What was the previous policy, how is this different?

5.5 The previous policy was to reduce the levy in 2022 from £180m to £135m, with a review every 3 years. This allowed 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) and not to be not higher than it needs to be.

5.6 Failure to increase the levy in 2025 will limit affordable and or available reinsurance at the top and bottom ends of Flood Re's reinsurance programme in this next procurement. We would be concerned that Flood Re would not be able to operate and their schemes would close, leaving high risk households without flood insurance.

6. Legislative and Legal Context

The previous revised levy amount

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). Amendments were made to S.I. 2015/1902 by the Flood Reinsurance (Amendment) Regulations 2022 (S.I. 2022/383).

7. Consultation

Summary of consultation outcome and methodology

7.1 For the Flood Reinsurance (Amendment) Regulations 2022 (S.I. 2022/383), 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.

7.2 In July 2021, the government published a summary of the responses which can be found online.[1]

7.3 The consultation mentioned above followed the publication of Flood Re's first Quinquennial Review (QQR), which made changes to the Flood Re scheme and did not include a consultation on the changes to the levy.

7.4 For the Flood Reinsurance (Amendment) Regulations 2025 there has been no consultation undertaken on changes to increase the levy from £135M to £160M, as this is not a statutory requirement in the Water Act 2014 for the Secretary of State for Environment, Food and Rural Affairs.

8. Applicable Guidance

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

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because of the negligible impact on businesses and the legislation solely focuses on amending the levy and is exempt from the better regulation framework. 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.

9.2 A proportionate analysis was conducted by the Government Actuary's Department (GAD) in December 2023 and they agreed that an increase in the levy was warranted.

Impact on businesses, charities and voluntary bodies

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

9.4 There is no significant impact on the public sector.

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

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 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.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 Emma Hardy, 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 2025 are compatible with the Convention rights."

13. European Union Withdrawal and Future Relationship

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