

# Natural Damage Insurance: The Norwegian model

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## 1 Introduction

This article presents the natural damage insurance scheme that was established in Norway in 1979. Together with the state-financed compensation scheme for natural damage, the insurance scheme forms the central part of the cover for natural damage in Norway. In order to understand the present situation and the relationship between the two schemes, it is necessary to give a short historical overview (below 2). The natural damage insurance scheme is presented under two headings: the cover (below 3) and the organization (below 4). Criticism has been voiced against elements of the scheme; reactions and reflections on parts of this criticism are considered at the end of the article (below 5).

## 2 Natural Damage Insurance: The History

Damage caused by natural perils (“natural damage”) is today covered under two main schemes in Norway,<sup>1</sup> a private insurance scheme and a state-financed compensation scheme. Originally, up until 1979, the state took responsibility both for measures to avoid natural damage and for economic compensation to those who had suffered loss as a result of a natural damage event.<sup>2</sup>

In 1979, the previous state scheme for compensation was partly “privatized” through the introduction of an insurance scheme for natural damages. The purpose of the new scheme was twofold: (1) to secure a more extensive economic cover for those who had suffered loss due to a natural peril; (2) to relieve the state for substantial parts of its commitment to cover the economic consequences of natural damage. Demand for state support to compensate those who had suffered natural damage had shown a steady increase over the years. Simultaneously, the need for larger investments in preventive measures were seen as necessary and important to avoid the effects of natural perils. By establishing a private insurance scheme, financed by premiums paid by the public, to cover a significant part of the costs of compensating those affected by a natural damage, the state’s financial contribution could be concentrated to deal with efforts to avoid damaging effects of natural perils.

The natural damage insurance scheme was established in the Insurance Contract Act of 6 June 1930 no. 20.<sup>3</sup> Although the state compensation scheme for natural damage was upheld, it was thoroughly revised and adjusted to the insurance scheme, so that natural damage covered by the insurance scheme

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1 In addition, some «all risks» insurances include natural damage as part of their ordinary cover. *See* as examples insurances for ships, aeroplanes, cars and cargo under transport. Mention should also be made of the financial assistance offered on a case by case basis by the Norwegian state to municipalities that have had their infrastructure damaged or destroyed due to natural perils.

2 *See* Act 9 June 1961 no. 24 on protection against and compensation for natural damage.

3 *See* §§ 81a – 81d, added by Act 8 June 1979 no. 46.

would not be eligible for coverage under the state scheme.<sup>4</sup> Later legislation pursued this solution,<sup>5</sup> latest Act 15 August 2014 no. 59 on compensation for natural damage (later called NDDA).

The Insurance Contract Act 1930 was repealed in 1989 through the passing of a new Insurance Contract Act.<sup>6</sup> The provisions found in the old Insurance Contract Act on natural damage insurance were repeated almost verbatim in a new Act 16 June 1989 no. 70 on natural damage insurance (later called NDIA). After 1989, this act has been altered several times. Most of these changes are of a formal nature. The material significant changes will be commented upon below.

From the upstart in 1979 of the natural damage insurance scheme, a total amount of almost NOK 16 billion has been paid out in compensation. 1992 and 2011 are the years with the largest total amount paid, NOK 1,3 billion and NOK 2,5 billion respectively. Of the total amount paid, storms count for NOK 8,7 billion and floods for NOK 5 billion. The highest amount ever paid for storm damage was in 2011 (NOK 1,5 billion) and for flood damage in 1996 (0.9 billion).

### **3 Natural Damage Insurance: The Cover**

#### **3.1 Introduction**

Natural damage insurance in Norway is organized as a compulsory cover linked to an insurance against fire. In principle, all property which is covered against the risk of fire under an insurance will automatically be covered against natural perils as well. Although persons or companies are under no duty to take out fire insurance and thereby a natural damage insurance, experience shows that owners of most buildings and relevant chattels will in fact insure against fire. The premium charged for the natural damage cover is based on the same rate for any person or company insured, regardless of the risk of being struck by a natural peril. This solidarity principle forms an important element in the scheme established.

#### **3.2 Property Covered Under the Scheme**

NDIA § 1 first paragraph first sentence states that “property in Norway that is insured against damage caused by fire, is also insured against damage caused by natural perils, ...”. The concept “property” covers both real property (buildings) and chattels. It is irrelevant whether the chattels are covered as part of a real

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4 See alterations made by Act 8 June 1979 no. 46 in Act 9 June 1961 no. 24 § 1 no. 1 and § 7. As for measures to prevent natural damage, the regulation in the Act of 1961 were upheld.

5 See Act 25 March 1994 no. 7, particularly §§ 1, 3, 4, 5 and 6 as regards compensation to be paid.

6 See Act 16 June 1989 no. 69.

property insurance or under a separate and independent insurance. “In Norway” would encompass both mainland Norway and Svalbard.<sup>7</sup> The insurance against fire could be a separate insurance; however, most often the cover against fire constitutes an element in a combined insurance, including several different perils.

After the introduction of the scheme in 1979, there has been two extensions as regards property covered. Both extensions relate to the situation where the property insured is a residential or a recreational house. The first extension, from 2004<sup>8</sup>, incorporated natural damage to gardens, yards and access roads of such houses into the insurance scheme.<sup>9</sup> The second extension, from 2017, give owners of such houses a right to claim the value of the surrounding land in addition to the house itself, where the owner is prevented by the municipality to rebuild or repair the house at the former spot, due to the risk of future natural damage.<sup>10</sup>

### **3.3 *Property not Covered Under the Scheme***

There are important limitations regarding property included in the cover. First and foremost, the scheme will not be called upon to cover natural damage, which is already covered by another insurance.<sup>11</sup> In addition, certain specific types of property are excluded whether or not the property is covered under another insurance.<sup>12</sup>

### **3.4 *Natural Perils Covered***

NDIA § 1 first paragraph second sentence contains a listing of relevant natural perils: “landslide, storm, flooding, storm surge, earthquake and volcanic eruptions”. The concept “landslide” (Norw.: “skred”) would also cover the falling out of a part of a mountain and an avalanche.

The way the text is formulated, with the words “such as” placed in front of the listing, a pertinent question is whether the listed perils should be seen as exhaustive. The alternative would be to consider them as relevant examples, enabling the inclusion under the insurance scheme of damage caused by other

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7 The concept “Svalbard” is defined in Act 17 July 1925 no. 11 on Svalbard § 1 second paragraph, and includes more than the Spitsbergen islands.

8 See Act 17 December 2004 no. 98, which added a new third sentence to NDIA § 1 first paragraph. The area covered by this extension is limited to five decares (about a quarter acre).

9 Such natural damage was previously covered by the state compensation scheme.

10 See Act 21 April 2017 no.17, which added a new third paragraph to NDIA § 1.

11 See NDIA § 1 first paragraph first sentence (last part of the sentence). “All risks” insurances as mentioned in note 1 above are examples of relevant insurances.

12 See NDIA § 1 second paragraph. As examples of property falling under this exclusion, mention is made of goods under transport; cars; aeroplanes; ships. For such excluded property, “all risks” insurances are available in the insurance markets, See note 11.

natural perils as well. The preparatory works make it clear that the listing should be regarded as exhaustive.<sup>13</sup> Consequently, damage due to heavy rain is not covered the scheme,<sup>14</sup> unless flooding of rivers, etc. is a result, which again causes damage to property.

In order to be covered, the damage suffered has to be “directly caused” by the natural peril. Court practice shows that this term is strictly construed.<sup>15</sup>

### 3.5 *Who is Protected Under the Scheme?*

The rules do not prescribe any limitations as to ownership of the relevant property under the natural damage insurance scheme, as long as the property is covered by a fire insurance. As a consequence, both private persons, companies, municipalities, etc. will be eligible for cover under the scheme.<sup>16</sup>

### 3.6 *The Extent of Cover*

The extent of the assured’s claim in case of a natural damage will be decided by the insurance conditions of the insurer who has taken out the assured’s fire insurance. Differences in cover may consequently occur between the insurance companies. However, this is not seen as a practical problem. The rules of the Norwegian natural damage insurance pool, see below 4.4, establish to what extent a claim incurred by an insurance company may be accepted for distribution under the pool arrangement. If the insurer has given the assured better conditions than the pool rules decide, the insurer will have to bear the extra costs himself.

In addition, relevant provisions of the Insurance Contract Act and the NDIA may come into play. As for NDIA, reference should be made to § 1 sixth paragraph, whereby the assured’s compensation for natural damage may be reduced in case of inadequate construction or maintenance of the property involved.<sup>17</sup>

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13 Ot.prp. no. 46 (1978.79) p. 33. It is interesting to note that the State compensation scheme, which uses the exact same wording, is supposed to be understood differently, *See* NDIA § 4 first paragraph and the comments made in Prop. 80 L (2013-2014) p. 33.

14 As a general rule, damage to property caused by water overflowing into a building due to heavy rain (“urban flooding”) will normally be covered by an ordinary combined insurance policy on buildings.

15 *See* as an example the Court of Appeal case LF-2014-49538, where damage to a fence caused by trees falling over it during a heavy storm, was not considered a natural damage, since the damage was not directly caused by the storm.

16 Municipalities and companies owned by them are excluded from the State compensation scheme, with the effect that their infrastructure (roads, bridges etc.) will not be covered under either of the two established schemes. Cover for such natural damage may be sought by a municipality under the state arrangement mentioned in note 1.

17 Both the assured and the insurer may ask the Appeals Board of the State Natural Damage Compensation Scheme to decide whether the criteria for reduction or refusal of the compensation are met, *See* NDIA § 2 first paragraph first sentence. Under the same

The assured will have to bear a deductible for each natural damage occurrence.<sup>18</sup> The deductible amounts today to NOK 8000.

The natural damage insurance scheme operates with an absolute limit for all claims made after a single natural catastrophe.<sup>19</sup> The relevant amount today is NOK 16 billion.

## **4 Natural Damage Insurance: The Organization**

### **4.1 *The Norwegian Natural Perils Pool***

The Norwegian Natural Perils Pool (Norw.: Norsk naturskadepool) was set up in 1980 as a consequence of the enactment of the private insurance scheme. The pool is an equalization mechanism whereby claims and costs are distributed between the member companies in proportion to their share in the pool.<sup>20</sup>

### **4.2 *Members of the Pool***

NDIA § 4 first paragraph first sentence prescribes that “[a]ll non-life insurance companies that indemnify natural damage according to § 1 shall be members of a common claims pool”.<sup>21</sup> All insurers providing cover against fire in Norway are directed to be members of the pool, regardless of where they have their head office, see second sentence. Both Norwegian and non-Norwegian insurance companies will consequently be members of the pool.

The legislator has considered it important to secure that a fire insurance contract will not be established with a (foreign) insurance company that is not a member of the pool, thereby avoiding to have to pay the premium stipulated by the pool for the natural damage cover. NDIA § 4a first paragraph prescribes that in case an insured party does enter into such a contract, he “shall pay a fee to the pool”, which “is determined on the basis of the sum on the fire insurance

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provision, the Appeals Board may also decide whether the criteria for a natural damage under NDIA § 1 first paragraph are met. The Appeals Board’s decision is in both instances final.

18 See NDIA § 3 first paragraph, which gives the King (in reality the Ministry of Justice) the right to stipulate the amount in a decree, se Decree 15 December 1989 no. 1335 § 1, as amended 11 February 2005 no. 125.

19 See NDIA § 3 second paragraph, with authorization for the King to stipulate the amount. This has been done in Decree 15 December 1989 no. 1335, See § 2, as amended 23 November 2017 no. 1828. It follows from NDIA § 3 fourth paragraph that the Appeals Board (See note 17) has the authority to decide finally whether one or several natural catastrophes have occurred. In case the stipulated amount is exceeded, the assureds will have to accept a proportional reduction in their claims, se NDIA § 3 fifth paragraph.

20 See NDIA § 4 second paragraph second sentence.

21 See also Decree 21 December 1979 no. 3420 on instructions for the Norwegian Natural Perils Pool, last amended 24 November 2018 no. 1821, § 1.

coverage”.<sup>22</sup> The fee shall be distributed to the member companies in accordance with the distribution formula, see below 4.4.<sup>23</sup> Payment of the fee to the pool gives the assured no right to claim compensation from the pool in case of natural damage event. The provisions on fees do not seem to have played a central role in practice.

### 4.3 Premium

An important point in the natural damage insurance scheme is that the premium rate charged for the cover is the same for all insurance companies offering fire insurance and for all relevant assureds, regardless of the individual risk. The rate is stipulated by the board of the pool, “taking into account that the total premiums shall over time correspond to the NPs and the individual company’s amount of loss and damage and administrative expenses”.<sup>24</sup> Today’s rate is 0.07 pro mille of the sum of insurance for the relevant property under its fire insurance. Over the years, the rate has differed, from 0,25 pro mille to 0,07 pro mille.<sup>25</sup>

The premium charged from the assured is collected and retained by the individual insurance company to cover natural damage claims and the company’s own administrative costs.

### 4.4 Settlement of Claims

As already mentioned in 3.6 above, each insurance company regulates and settles the natural damage claims reported from their policy holders.<sup>26</sup> The settlement will be based on the terms and conditions agreed in the individual insurance contract.

Having settled the claims with the insured parties, the insurance company reports the claims to the pool on a monthly basis.<sup>27</sup> The pool has a separate set of standard conditions for use between the member companies and the pool.<sup>28</sup> These conditions will decide to what extent claims settled between the member company and the insured party will be allowed to be equalized in the pool.<sup>29</sup> The

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22 The provision was added to NDIA by Act June 24 1994 no. 40. The provision is supplemented by Decree November 25 1994 no. 1026.

23 See Decree on instructions § 11 a.

24 See Decree on instructions § 11 first paragraph.

25 The rate 0.07 pro mille was set in 2012 and has been constant since.

26 See Decree on instructions § 4 first paragraph.

27 See Decree on instructions § 5.

28 Terms for settlement through the Natural Perils Pool, to apply from January 1 2018, revising the terms that applied from 1 January 2016.

29 The previous terms from 1 January 2012, named Common terms and conditions for all insurance cover against natural damage, applied as an independent set of insurance terms and served as a minimum cover for the insured party.

pool will also cover and equalize the costs which a company incur in settling the insured party's claim.<sup>30</sup>

The pool will make a separate settlement and distribution for all loss and damage that have occurred during a single calendar year (the claim year).<sup>31</sup> When all claims pertaining to the calendar year have been settled, final settlement and distribution is made.

For the claim equalization, the relevant amount to be equalized is the compensation paid by all the member companies for natural damage claims under a claim year, including interest and costs, and with additions/deductions for the costs and reinsurance settlement of the pool.<sup>32</sup>

The basis used for the settlement between the member companies (distribution formula) is the fire insurance amounts in all the member companies as of 1 July of the claim year.<sup>33</sup> The claim settlement for each separate claim year is made on a quarterly basis based on the payment statements received from the member companies.<sup>34</sup> Because it will take time before the distribution formula for each claim year is ready, the amounts as of 1 July of the previous year are used for these quarterly settlements. When calculating the annual settlement in January, the amounts already paid in the quarterly settlements will be adjusted, according to the distribution formula for the claim year as of 1 July the preceding year.

#### **4.5 Allocations**

The rules regulating the insurance companies' allocations in their accounts regarding possible claims for natural damage fall into two categories. First, each insurance company shall allocate "in the normal manner" its relative share of the claims reserve for unsettled claims to be regulated through the pool, and in addition an ordinary premium reserve based on the natural damage insurance premium.<sup>35</sup> Second, if the accrued premium exceeds the company's share of the compensation payments to be made through the pool and the claims reserve for unsettled claims, the difference shall be allocated to a special natural damage account in the company.<sup>36</sup> The natural damage account belongs to the company and may only be used to cover future natural damage claims.<sup>37</sup>

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30 *See* Decree on instructions § 10, with detailed provisions on the types of settlement costs covered.

31 *See* Decree on instructions § 6.

32 *See* Decree on instructions § 7.

33 *See* Decree on instructions § 8.

34 *See* Decree on instructions § 9.

35 *See* Decree on instructions § 11 third paragraph.

36 *See* Decree on instructions § 11 fourth paragraph.

37 Decree on instructions § 11 fifth and sixth paragraphs provide rules for the situations where a company transfers its fire insurance business to another company or ceases operations, respectively. Whereas the accumulated natural damage fund will be transferred to the other



#### 4.6 Reinsurance

Reinsurance is arranged through the pool. The board makes the necessary reinsurance arrangements in accordance with the reinsurance principles approved by the annual meeting.<sup>38</sup> The reinsurance program has been expanded over the years, and as from 1 January 2018 offers coverage for NOK 16 billion, with a retention of NOK 1.5 billion. From 1996, member companies of the pool have had the opportunity to act as reinsurers under the program, with a share equal to their share in the pool.

#### 4.7 The Internal Organization

The pool's highest authority is the annual meeting.<sup>39</sup> At the annual meeting, each member company of the pool has voting rights corresponding to the distribution formula found explained in 4.4 above. The four biggest non-life insurance companies in Norway have more than 75% of the total fire insurance amounts of all the relevant member companies. Consequently, they have a dominating position in the annual meeting as long as they advocate the same view. The annual meeting adopts the pool's annual report and accounts and elects the board and its chairman and deputy chairman, as well as the auditor.

The board<sup>40</sup> consists of eight members with personal deputies. Members serve for a period of two years. The members of the board are appointed from the largest member companies of the pool, plus a representative of the foreign insurance companies active in Norway. The insured community or the public at large will not have representatives on the board. It is for the board to stipulate the premium rate to be charged from the insured parties and to enter into reinsurance treaties. As for claims settlement, the board has a supervisory function.

The claims committee<sup>41</sup> is appointed by the board and has five members, each serving for a period of three years. The committee shall perform the necessary review of the claims submitted by the member companies for distribution. It shall also take necessary initiative to coordinate the treatment of large claims, where more than one company and/or the state natural damage compensation scheme are involved.

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company in the first instance, the funds will be transferred to the pool in the second instance for distribution between the other member companies.

38 See Decree on instructions § 12.

39 See Decree on instructions § 14.

40 See Decree on instructions § 15.

41 See Decree on instructions § 17.

The claims committee is responsible for the running contact between the pool and the state natural damage compensation scheme.<sup>42</sup> A special liaison committee has been established between the two entities, which is responsible for dealing with matters where the two parties have a common interest. The committee, consisting of three members from each party, will meet at least every four months.

The general manager of the pool is Finans Norge,<sup>43</sup> the Norwegian financial services association. The general manager has the responsibility for the day-to-day settlement of claims.

## 5 Criticism and Challenges

During the last years, criticism has been voiced against the natural damage insurance scheme. One set of criticism has focused on the lack of elements in the scheme to induce the assureds and the insurers to take measures to prevent natural damage or reduce the economic losses suffered after a natural peril has struck.<sup>44</sup> Different steps have been suggested to overcome the problem. One is to use the insurance to secure a higher quality and standard when repairing or replacing buildings after a natural damage has occurred. Another is to differentiate the deductible dependent on the risk for natural damage, or earmark a part of the premium paid by the insured for preventive measures.

Another set of criticism hits the organization of the Norwegian Natural Perils Pool and its activities. The scheme, as a semi-compulsory arrangement with a fixed premium rate for all properties regardless of the risk involved, is seen as hampering competition. The way the premium rate is set, by the insurance companies through their membership in the pool, the policyholders and their organizations have no influence or insight. It is argued that this arrangement leads to higher premiums than necessary to cover the score of natural damage.

In December 2017, The Ministry of Justice and Public Security appointed a Law committee<sup>45</sup> to look into certain aspects of the natural damage insurance scheme. The mandate expressly states that the committee should not evaluate or propose changes to the basic principles of the scheme, such as the solidarity principle (the same premium rate to apply for all insurance companies regardless of who the insured party is or where he lives) and the present regulations regarding the compensation to be claimed by the insured under the scheme. The effect of this limitation in the committee's mandate is that the criticism voiced

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42 See Decree on instructions § 18.

43 See Decree on instructions § 16.

44 As for examples, See NOU 2010: 10 Tilpasning til et klima i endring p. 153, and NOU 2015: 16 Overvann i byer og tettsteder, p. 226.

45 The commission has six members. Three represent the insurance industry (Finans Norge), the larger companies insured (Næringslivets Hovedorganisasjon) and the financial supervisory authority (Finanstilsynet) respectively, and three, including the chairperson (the author of this article), are appointed in their own capacity.

regarding the lack of prevention in the present scheme will not be treated by the committee.<sup>46</sup>

Instead, the committee is ordered to look into the activity and the organization of the Norwegian Natural Perils Pool. As for the activity, the mandate specifies five distinct matters to be examined and evaluated: (1) the way premiums are set today; (2) the mechanism for distributing claims paid between the participating insurance companies; (3) the companies' duty to allocate the difference between accrued premiums and claims paid or accrued to a separate natural damage account in the company; (4) the rules to apply as to how the yield from such an account may be used; (5) the way reinsurance is organized. As for the organization and management of the pool, special mention has been made for the need to examine and evaluate the fund's relationship to the public as regards openness, insight and control.

Based on its findings and evaluations, the committee is asked to present proposals for possible changes in the natural damage insurance scheme, together with proposals for changes in the Act on natural damage insurance and the relevant Decrees. The committee is supposed to finish its work by the end of 2018.

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46 In this author's opinion, there is clearly a need for a full review of the present Act and the supplementing Decrees, as the present regulation is unsatisfactory both formally and materially. It is suggested that the reason for the ministry's reluctance to start such a full review is a fright that such a review might bring up questions that could have detrimental effects on the very basis of the scheme, and that this explains why the ministry prefers to keep the scheme as it is. For a discussion on the need for a review of certain elements of the scheme, based on the underlying principles in the present Act, *See* H.J.Bull & A.K. Nesdam, *Naturskader og naturskadeforsikring: fortid, nåtid, fremtid*, Tidsskrift for erstatningsrett, forsikringsrett og trygderett 2017 pp. 169-203, at pp. 195-203.