

Natural damage insurance: the Norwegian model and current efforts to improve it

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1 Introduction

This article examines the natural damage insurance scheme that was established in Norway in 1979, as well as the changes made to this scheme over the years.¹ Together with the State-financed compensation scheme for natural damage, the insurance scheme form the centrepiece of the cover for natural damage in Norway. In order to understand the current situation and the relationship between the two schemes, it is necessary to give a short historical overview (see 2 below). The natural damage insurance scheme is presented under two headings: the cover (see 3 below) and the organization (see 4 below). Criticism has been voiced of elements of the scheme; a partial answer to this criticism, presented in a newly published report from an appointed law committee (NOU 2019: 4), is considered at the end of the article (see 5 below).

2 Natural damage insurance: The history

Damage caused by natural perils (“natural damage”) is today covered under two main schemes in Norway,² 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 also

¹ The present article is an enlarged and updated version of the article Natural damage insurance: the Norwegian model, published in *Insurance Law, Scandinavian Studies in Law* Volume 64 pp. 45–55, Stockholm 2018. Reference should also be made to Hans Jacob Bull and Anne-Karin Nesdam, *Naturskader og naturskadeforsikring: fortid, nåtid, fremtid*, TFEFT 2017 s. 169–203.

² In addition, some «all risks» insurances include natural damage as part of their ordinary cover, see, as examples insurances for ships, airplanes, 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, see Prop. 88 S (2017–2018) (Kommuneproposisjonen 2019) p. 77.

for economic compensation to those who had suffered loss as a result of a natural damage event.³

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; and (2) to relieve the State of 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 greater investment in preventive measures was seen as being necessary and important, in order 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 on efforts to avoid the damaging effects of natural perils.⁴

The natural damage insurance scheme was established in the Insurance Contract Act of 6 June 1930 no. 20.⁵ Although the State compensation scheme for natural damage was retained, it was thoroughly revised and adjusted to work together with the insurance scheme, such that natural damage covered by the insurance scheme would not be eligible for coverage under the State scheme.⁶ Later legislation maintained this approach,⁷ most recently in Act 15 August 2014 no. 59 on compensation for natural damage (henceforth abbreviated “NDDA”).

The Insurance Contract Act 1930 was repealed in 1989 through the passing of a new Insurance Contract Act.⁸ The provisions found in the

³ See Act 9 June 1961 no. 24 on protection against and compensation for natural damage.

⁴ See NOU 1974: 9 Erstatning for naturskader p. 10.

⁵ See sections 81a – 81d, added by Act 8 June 1979 no. 46.

⁶ See alterations made by Act 8 June 1979 no. 46 to Act 9 June 1961 no. 24 section 1 no. 1 and section 7. As for measures to prevent natural damage, the regulation in the Act of 1961 was retained.

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

⁸ See Act 16 June 1989 no. 69.

Insurance Contract Act 1930 on natural damage insurance were repeated almost verbatim in a new Act 16 June 1989 no. 70 on natural damage insurance (henceforth “NDIA”). Since 1989, this Act has been altered several times. Most of these changes are of a formal nature. The material significant changes will be commented on below.

Of the Decrees authorized by NDIA, special mention should be made of the Decree 21 December 1979 no. 3420 on instructions for the Norwegian Natural Perils Pool, last amended 24 November 2017 no. 1821. The decree is henceforth abbreviated to “Decree on instructions”.

From the beginnings in 1979 of the natural damage insurance scheme, a total amount of NOK 16.5 billion has been paid out in compensation. 1992 and 2011 were the years with the largest total amount paid, NOK 1.3 billion and NOK 2.5 billion respectively. Of the total amount paid out, storms accounted for NOK 9 billion and floods for NOK 5.2 billion. The highest amount ever paid out in a single year for storm damage was in 2011 (NOK 1.5 billion), and for flood damage in 1995 (NOK 0.9 billion).⁹

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 also be automatically covered against natural perils. Although persons or companies are under no duty to take out fire insurance and thereby natural damage insurance, experience shows that owners of most buildings and relevant chattels will, in fact, insure against fire. The premium charged for natural damage cover is based on the same rate being applied to any person or

⁹ The numbers are gathered from statistics provided by Finans Norge Forsikringsdrift, see <https://www.naturskade.no/statistikk>.

company insured, regardless of the risk of being struck by a natural peril.¹⁰ This *solidarity principle* forms an important element in the current structure of the scheme.

3.2 Property covered under the scheme

NDIA section 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 of “property” covers both real property (buildings) and chattels. It is irrelevant whether the chattels are covered as part of a real property insurance or under a separate and independent insurance. “In Norway” would encompass both mainland Norway and Svalbard.¹¹ 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.

Since the introduction of the scheme in 1979, there have been two extensions in terms of property covered. Both extensions relate to the situation where the property insured is a residential or recreational house. The first extension, from 2004,¹² incorporated natural damage to gardens, yards and access roads of such houses into the insurance scheme.¹³ The second extension, from 2017, gave owners of such houses the right to claim the value of the site in addition to the house itself, where the owner is prohibited by the municipality from rebuilding or repairing the house at the former location, due to the risk of future natural damage.¹⁴

¹⁰ See Decree on instructions section 11 second paragraph first sentence.

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

¹² See Act 17 December 2004 no. 98, which added a new third sentence to NDIA section 1 first paragraph. The area covered by this extension is limited to five dekar (about a quarter acre).

¹³ Such natural damage was previously covered by the State compensation scheme.

¹⁴ See Act 21 April 2017 no. 17, which added a new third paragraph to NDIA section 1.

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.¹⁵ In addition, certain specific types of property are excluded, whether or not the property is in fact covered under another insurance.¹⁶

3.4 Natural perils covered

NDIA section 1 first paragraph second sentence defines natural damage as being damage “directly caused by a natural peril, such as landslide, storm, flooding, storm surge, earthquake and volcanic eruptions”. The concept “landslide” (Norw.: “skred”) would also cover the collapse of part of a mountain and an avalanche.

Given the way the text is formulated, with the words “such as” placed in front of the listing, a pertinent question is whether the list of perils should be seen as being exhaustive. The alternative would be to consider them as relevant examples, enabling the inclusion under the insurance scheme of damage caused by other natural perils as well. The preparatory works make it clear, however, that the listing should be regarded as exhaustive.¹⁷ Consequently, damage due to heavy rain is not covered by the scheme,¹⁸ unless it results in the flooding of rivers, etc., which again causes damage to property.

¹⁵ See NDIA section 1 first paragraph first sentence (last part of the sentence). “All risks” insurances as mentioned in note 2 above are examples of relevant insurances.

¹⁶ See NDIA section 1 second paragraph. As examples of property falling under this exclusion, mention is made of goods under transport, cars, airplanes and ships. For such excluded property, “all risks” insurances are often available in the insurance markets, see note 15.

¹⁷ Ot.prp. no. 46 (1978–79) p. 33. It is interesting to note that the State compensation scheme, which uses exactly the same wording, is supposed to be understood differently, see NDDA section 4 first paragraph and the comments made in Prop. 80 L (2013–2014) p. 33.

¹⁸ As a general rule, damage to property caused by water overflowing into a building due to heavy rain (“urban flooding”) will be covered by the insurance companies’ ordinary

In order to be covered, the damage suffered has to be “directly caused” by the natural peril. This is the same term as that found in the State compensation scheme, but it is not as strictly construed as under that scheme.¹⁹

3.5 Who is protected under the scheme?

The rules do not impose any limitations on ownership of the relevant property under the natural damage insurance scheme, provided the property is covered by fire insurance. As a consequence, both private persons, companies, municipalities, etc. will be eligible for cover under the scheme.²⁰

3.6 The assessment of claim

The assessment of the assured’s claim in the event of natural damage will be based on the insurance conditions of the insurer who has provided 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 Perils Pool, see 4.4 below, 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 those decided by the pool rules, the insurer will have to bear the extra costs himself.

combined insurance policy on buildings, see, as an example, If’s insurance conditions for buildings (2015) section A.1.4 no. 3.

¹⁹ See, as an example of the strict interpretation under the State compensation scheme, the Court of Appeal case LF-2014-49538, where damage to a fence caused by trees falling on it during a heavy storm was not considered a natural damage, since the damage was not directly caused by the storm. Under the insurance scheme, such a damage would have been covered, see the Handbook on handling of damage, issued by the Norwegian Natural Perils Pool (under the heading *Treffskader*).

²⁰ 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 2.

In addition, relevant provisions of the Insurance Contract Act and the NDIA may come into play. As for the NDIA, reference should be made to section 1 sixth paragraph, whereby the assured's compensation for natural damage may be reduced in the event of inadequate construction or maintenance of the property being involved.²¹ Expenses incurred for preventive and safeguarding measures will not be covered, even if they may contribute to reducing the risk of future natural damage to the property.²²

The assured will have to bear a deductible for each natural damage occurrence.²³ Today, the deductible amounts to NOK 8000.

The natural damage insurance scheme operates with an absolute limit for all claims made after a single natural catastrophe.²⁴ The relevant amount today is NOK 16 billion.

²¹ Both the assured and the insurer may ask the Appeals Board of the State Natural Damage Compensation Scheme to decide whether the criteria are met for reduction or refusal of the compensation, see NDIA section 2 first paragraph first sentence. Under the same provision, the Appeals Board may also decide whether the criteria are met for natural damage under NDIA section 1 first paragraph. The decision of the Appeals Board is final in both instances.

²² See Decree on instructions section 3 second paragraph.

²³ See NDIA § 3 first paragraph, which gives the King (in reality the Ministry of Justice and Public Security, see Decree 15 December 1989 no. 1241) the right to stipulate the amount in a decree, see Decree 15 December 1989 no. 1335 section 1, last amended 11 February 2005 no. 125.

²⁴ See NDIA section 3 second paragraph, with authorization for the King (in reality the Ministry of Justice and Public Security, see note 23) to stipulate the amount. This has been done in Decree 15 December 1989 no. 1335 section 2, last amended 23 November 2017 no. 1828. It follows from NDIA section 3 fourth paragraph that the Appeals Board (see note 21) has the authority to make the final determination on whether one or several natural catastrophes have occurred. If the stipulated amount is exceeded, the assureds will have to accept a proportional reduction in their claims, see NDIA section 3 fifth paragraph.

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.²⁵ The pool is an equalization mechanism, whereby claims and costs incurred are distributed between the member companies in proportion to their market share.²⁶

4.2 Members of the pool

NDIA section 4 first paragraph first sentence requires that “[a]ll non-life insurance companies that indemnify natural damage according to section 1 shall be members of a common claims pool.”²⁷ All insurers providing cover against fire in Norway are obliged 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. Today the pool has around 100 members. Membership will automatically begin when the insurance company starts signing contracts for fire insurance in Norway and will end when the company is no longer liable for the claims and costs incurred under the natural damage cover.²⁸

The legislator has considered it important to ensure that a fire insurance contract can only be established with a (foreign) insurance

²⁵ In December 2017, the Ministry of Justice and Public Security appointed a Law committee to look into certain aspects of the natural damage insurance scheme, inter alia the Norwegian Natural Perils Pool. The committee presented its report (NOU 2019: 4 Organisering av norsk naturskadeforsikring – Om Norsk Naturskadepool, henceforth abbreviated NOU 2019: 4) in February 2019.

²⁶ See NDIA section 4 second paragraph second sentence.

²⁷ See also Decree on instructions section 1.

²⁸ See NOU 2019: 4 section 11.2.2 for further details.

company where it is a member of the pool, thereby making certain that the premium stipulated by the pool for the natural damage cover has in fact been paid. NDIA section 4a first paragraph prescribes that if an insured party enters an insurance contract with an insurance company that is not a member of the pool, he “shall pay a fee to the pool”, which “is determined on the basis of the sum on the fire insurance coverage”.²⁹ The fee shall be distributed to the member companies in accordance with the distribution formula, see 4.5 below.³⁰ Payment of the fee to the pool does not give the assured a right to claim compensation from the pool in the event of natural damage occurring. 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.³¹ 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”.³² Today’s rate is 0.07 promille (per thousand) of the sum of insurance for the relevant property under its fire insurance. Over the years, the rate has varied, from 0,25 promille to 0,07 promille.³³

The premium payable by each separate assured is collected and retained by the individual insurance company.

²⁹ The provision was added to NDIA by Act 24 June 1994 no. 40. The provision is supplemented by Decree 25 November 1994 no. 1026.

³⁰ See Decree on instructions section 11 a.

³¹ See Decree on instructions section 11 second paragraph first sentence.

³² See Decree on instructions section 11 first paragraph.

³³ The rate 0,07 promille was set in 2012 and has been constant since.

4.4 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.³⁴ The reinsurance program has been expanded over the years. As from 1 January 2018, the program offers coverage for NOK 16 billion in two layers, with a retention of NOK 1.5 billion. The first layer gives cover between NOK 1.5 billion and NOK 3.5 billion, and the second between NOK 3.5 billion and NOK 16 billion. The total reinsurance premium paid in 2018 under these two layers amounted to NOK 87 million and NOK 151 million respectively, with 100 per cent reinstatement premium.³⁵ The reinsurance program must be placed with reputable companies with an acceptable rating, with the board stipulating the minimum rating requirements.³⁶ As 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, provided they satisfy the rating requirements.

4.5 Settlement of claims

As already mentioned in 3.6 above, each insurance company regulates and settles the natural damage claims reported by their policy holders.³⁷ The settlement will be based on the terms and conditions agreed in the individual insurance contract.

Having settled the claims with the assured parties, the insurance company reports the claims to the pool on a monthly basis.³⁸ The pool has a separate set of standard conditions for use between the member companies and the pool.³⁹ These conditions will decide to what extent

³⁴ See Decree on instructions section 12.

³⁵ See NOU 2019: 4 section 10.1.1.

³⁶ See NOU 2019: 4 section 10.2.1.

³⁷ See Decree on instructions section 4 first paragraph.

³⁸ See Decree on instructions section 5.

³⁹ Terms for settlement through the Natural Perils Pool, to apply from January 1 2019, revising the terms that applied from 1 January 2016, as revised 1 January 2018.

claims settled between the member company and the insured party will be allowed to be equalized in the pool.⁴⁰ The pool will also cover and equalize the costs which a member company incurs in settling the insured party's claim.⁴¹

The pool will make a separate settlement and distribution for all loss and damage that has occurred during a single calendar year (the claim year).⁴² When all claims pertaining to the claim year have been settled, final settlement and distribution is made.

For the claim equalization, the relevant amount to be equalized is the total allowable compensation paid by all the member companies for natural damage claims under a claim year, including interest and settlement costs, together with the administrative costs of the pool itself. The costs of the reinsurance program administered by the pool, see 4.4 above, and possible reinsurance settlements received from the reinsurers, are also taken into consideration when assessing the relevant amount for claim equalization.⁴³

The basis used for the settlement between the member companies (the distribution formula) is the aggregated sum insured for fire insurance across all the member companies as of 1 July of the relevant claim year.⁴⁴ The claim settlement for each separate claim year is made on a quarterly basis, based on the payment statements received from the member companies.⁴⁵ 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 relevant claim year.

⁴⁰ The previous terms from 1 January 2012, named the 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.

⁴¹ See Decree on instructions section 10, with detailed provisions on the types of settlement costs covered.

⁴² See Decree on instructions section 6.

⁴³ See Decree on instructions section 7.

⁴⁴ See Decree on instructions section 8.

⁴⁵ See Decree on instructions section 9.

4.6 Allocations

The rules regulating the insurance companies' allocations in their accounts regarding possible future claims for natural damage fall into two categories. *First*, each insurance company is required to allocate "in the normal manner" its proportionate share of the overall claims reserve for unsettled claims to be regulated through the pool, as well as an ordinary premium reserve based on the natural damage insurance premium.⁴⁶ *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 must be allocated to a special natural damage account within the member company.⁴⁷ The natural damage account belongs to such company⁴⁸ and may only be used to cover future natural damage claims.⁴⁹

4.7 The internal organization

The pool's highest authority is the annual meeting.⁵⁰ At the annual meeting, each member company of the pool has voting rights cor-

⁴⁶ See Decree on instructions section 11 third paragraph. During the period 2010–2017 these allocations varied considerably, from NOK 5 million in 2010 to NOK 400 million in 2017, see NOU 2019: 4 p. 78 note 2. The large allocation amount in 2017 was due to extensive flooding with several claims made late in the year, which had not been settled by the end of the year.

⁴⁷ See Decree on instructions section 11 fourth paragraph. The natural damage account was previously called the "natural damage fund", see NOU 2019: 4 p. 31 note 23. The terminology was changed by Decree 19 February 2016 no. 163, as the previous wording might leave the impression that a central "fund" existed, separated from the insurance companies' ordinary equity.

⁴⁸ The Decree on instructions section 11 fourth paragraph had a new last sentence added to it by Decree 19 February 2016 no. 163, which expressly stated that the natural damage account belonged to the member company.

⁴⁹ The Decree on instructions § 11 fifth and sixth paragraphs provide rules for the situations where a member company either transfers its fire insurance business to another company or else ceases operations. Whereas, in the first instance, the accumulated natural damage account will be transferred to the other company, in the second instance the account will be transferred to the pool without compensation being paid, for onward distribution among the other member companies.

⁵⁰ See Decree on instructions section 14.

responding to the distribution formula explained in 4.5 above. The four biggest non-life insurance companies operating in Norway have accounted for between 65 and 75% of the aggregated sums insured for fire insurance of all the relevant member companies during the last ten years.⁵¹ Consequently, they have a dominating position in the annual meeting, provided they advocate a shared view. The annual meeting adopts the pool's annual report and accounts, elects the board and its chairman and deputy chairman, as well as the auditor, and deals with other matters on the agenda.

The board⁵² consists of eight members with personal deputies. Members serve for a period of two years. The four largest member companies of the pool are always represented on the board. The companies' policy holders 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 to the insured parties and to enter into reinsurance treaties. As for claims settlement, the board has a supervisory function.

The claims committee⁵³ 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 initiatives to coordinate the treatment of large claims, where more than one company and/or the State natural damage compensation scheme are involved.

The claims committee is responsible for the ongoing contact between the pool and the State natural damage compensation scheme.⁵⁴ 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

⁵¹ See NOU 2019: 4 section 3.7 tables 3.1 (2009) and 3.3 (2017). Of the four, two (Gjensidige Forsikring ASA and SpareBank 1 Skadeforsikring AS) are Norwegian-owned and two (If Skadeforsikring NUF and Tryg Forsikring) are foreign-owned. SpareBank 1 Skadeforsikring AS and DNB Forsikring AS have recently (2019) merged their activities in non-life insurance into a new company called Fremtind.

⁵² See Decree on instructions section 15.

⁵³ See Decree on instructions section 17.

⁵⁴ See Decree on instructions section 18.

interest. The committee, consisting of three members from each party, is required to meet at least every four months.

The general manager of the pool is Finans Norge,⁵⁵ the Norwegian financial services association. The general manager has responsibility for the day-to-day settlement of claims.

5 Criticism and challenges

5.1 Lack of inducement to take preventive measures

Over recent years, criticism has been voiced of 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 to reduce the economic losses suffered after a natural peril has struck.⁵⁶ Various steps have been suggested to overcome the problem. One would be to use the insurance to secure a higher quality and standard when repairing or replacing buildings, after natural damage has occurred. Another would be to differentiate the deductible dependent on the risk for natural damage, or else to earmark a part of the premium paid by the insured for use in preventive measures.

⁵⁵ Se Decree on instructions section 16.

⁵⁶ See as examples of such criticism NOU 2010: 10 Tilpasning til et klima i endring, p. 153, NOU 2015: 16 Overvann i byer og tettsteder, p. 226 and NOU 2018: 17 Klimarisiko og norsk økonomi, pp. 130–131.

5.2 The Norwegian Natural Perils Pool: Activities and organization

5.2.1 NOU 2019: 4: Background and mandate

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

In December 2017, The Ministry of Justice and Public Security appointed a Law committee⁵⁷ to look into certain aspects of the natural damage insurance scheme. The committee submitted its report (NOU 2019: 4 Organiserings av norsk naturskadeforsikring. Om Norsk Naturskadepool) in February 2019.

The mandate for the committee expressly stated that the committee should not evaluate or propose changes to the basic principles of the scheme. Consequently, both the solidarity principle,⁵⁸ as well as the present regulations regarding the compensation to be claimed by the insured party under the scheme, were left outside the committee's remit for consideration.⁵⁹ This limitation in the committee's mandate had the effect that the criticism voiced regarding the lack of prevention in the present scheme⁶⁰ has not been addressed by the committee.⁶¹

⁵⁷ The committee had six members. Three represented 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), were appointed in their own capacity.

⁵⁸ See section 3.1 above.

⁵⁹ See NOU 2019: 4 section 1.1.

⁶⁰ See the references cited in note 56.

⁶¹ The reason for the ministry's reluctance to start such a full review is perhaps a fear that such a review might bring up questions that could have detrimental effects on the

The committee's mandate was accordingly limited to looking into the activities and organization of the Norwegian Natural Perils Pool.⁶² As for the *activities* of the pool, the mandate specified five distinct matters to be examined and evaluated:

- (1) The way in which premiums are set today;
- (2) The mechanism for distributing the payment of claims 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 in determining 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 was made of the need to examine and evaluate the pool's relationship with the public as regards openness, insight and control.

Based on its findings and evaluations, the committee was asked to present proposals for possible changes to the natural damage insurance scheme, together with proposals for changes to both the Act on natural damage insurance and the related Decrees.

5.2.2 The committee's main findings

The majority of the committee (the only dissenter being the member representing Finans Norge) accepted two central elements in the criticism raised against the pool arrangement.⁶³ *First*, the majority emphasized that the way in which the premium rate has been set over the years, does not conform with the standard laid down in the Decree on instructions section 11 first paragraph ("the total premiums shall *over time* correspond to the NP's and the individual company's amount of loss and damage

very basis of the scheme. 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 the article referred to in note 1 by Bull and Nesdam, at pp. 195–203.

⁶² See NOU 2019: 4 section 1.1.

⁶³ See NOU 2019: 4 section 4.3.4.

and administrative expenses”, my italics). The financial accounts for the member companies of the scheme reveal that during the period 1980–2017 the premium rate has been administered so as to give the companies as a group a “surplus”, totalling approximately NOK 8.5 billion. The yearly surplus has been allocated across the individual members’ natural damage accounts, depending on each member’s market share for that year.

Second, the majority agreed with the group of some of the later established and smaller insurance companies⁶⁴ that the distribution of the natural damage accounts among the companies had put them at a disadvantage. Statistics showed that the surplus and building-up of natural damage accounts in the member companies was particularly prevalent in the first thirty years of the scheme. Since 2005, and even more profoundly since 2012, the results of the Norwegian natural damage insurance business have been negative for many of these years. In these situations, newcomers to the fire insurance market have had to eat into their equity in order to cover the deficit. In contrast, the well-established companies have been able to draw on their natural damage accounts in such years of deficit.⁶⁵

The dissenting member of the committee did not accept the criticism.⁶⁶ According to her, the reported surplus of NOK 8.5 billion did not amount to a real surplus, once the administrative and capital costs related to the companies’ natural damage insurance business were taken into consideration.⁶⁷ Accordingly, in her opinion the insured parties had not paid more for their natural damage cover than was to be expected, and the newcomers of the fire insurance business had not been placed in an unjust position in their competition with the well-established companies.

⁶⁴ The group has been referred to as the Fairfond group, and consists of companies representing about 10 % of the pool’s membership.

⁶⁵ In addition, these companies had the advantage of being free to use the return on their natural damage accounts as they deem fit, see NOU 2019: 4 section 3.7.

⁶⁶ See NOU 2019: 4 section 15.12.

⁶⁷ See the calculations made in NOU 2019: 4 section 15.12.6, where “real natural damage capital” is calculated as being NOK 130 million, by contrast to the reported number of NOK 8.5 billion.

Over the years, proposals have been made to try to overcome the criticism put forward. A central element in these proposals has been to establish whether and to what extent the natural damage accounts with (some of) the insurance companies may be used to cover other companies' share in the deficits suffered in the natural damage insurance business.⁶⁸ Following an amendment in 2016,⁶⁹ the Decree on instructions section 11 fourth paragraph now states explicitly that the natural damage account in each separate company belongs to that company. Although voices have been raised to the effect that the status of the accounts has not been finally settled through this provision,⁷⁰ the committee chose unanimously to base its discussions and proposals on the assumption that the provision validly decided the status of the accounts.⁷¹ This assumption had the effect that the capital on these accounts could only be used to cover the share of possible deficits falling on the respective company itself, and not the share of the deficits suffered by other companies.

5.2.3 A central natural damage fund

The committee's majority (all members except the one representing Finans Norge) tried to accommodate the criticism raised by proposing a compromise solution, consisting of a permanent and an interim arrangement. The aim of the compromise was to provide a fair and equitable solution for all interests involved, through the imposition of a robust and lasting regime. It was important to ensure that the insurance companies would not be in a position to continue the build-up of large natural damage accounts. Accordingly, the premiums should be stipulated in a better way than previously, see 5.2.5 below. In addition, any future surplus on the natural damage insurance business should be allocated to a new joint (central) fund to be administered by the Norwegian Natural Perils Pool,

⁶⁸ See NOU 2019: 4 section 5.2.

⁶⁹ See 4.6 above at note 48.

⁷⁰ Or through statements made by the Ministry of Justice and Public Security over the years, see NOU 2019: 4 section 5.2.

⁷¹ See NOU 2019: 4 section 5.3.

instead of being allocated proportionately to each member company's natural damage account. The fund may then be used to stabilize the future premium rate.⁷² In addition to the accumulated future surplus, such a fund would include the return on the fund's capital.⁷³ The fund should aim for a total size of NOK 4 billion.⁷⁴ In years where there is a deficit on the natural damage insurance business, all the insurance companies would be able to draw on the fund to cover their part of the deficit.⁷⁵

The majority accepted that it would take time for the central fund to reach a magnitude of NOK 4 billion.⁷⁶ Consequently, the majority introduced an interim solution for the period until the fund reached the intended size.⁷⁷ In years with a surplus on the natural damage insurance, the surplus would be allocated to the central fund, in the same way as under the permanent solution.⁷⁸ In years with a deficit, companies

⁷² See proposed Decree section 3-1 second paragraph subparagraph 2b).

⁷³ See NOU 2019: 4 section 7.1, cf. section 6.2 and proposed Decree section 7-3. The dissenting member did not support the proposal of a joint fund, operated by the Norwegian Natural Perils Pool. She suggested that for the future, surplus on a company's natural damage insurance business should be treated in the same way as any other surplus on the company's insurance business, and no longer be allocated to a special natural damage account in the company (see 4.6 above), see NOU 2019: 4 section 15.12.4 and other places in section 15.

⁷⁴ See NOU 2019: 4 section 7.3, where the discussions and the calculations made to establish the correct size of the fund are found in section 7.3.1 and the proposal in section 7.3.2.

⁷⁵ See NOU 2019: 4 section 7.4, particularly section 7.4.2.5 first sentence and proposed Decree section 7-4.

⁷⁶ In NOU 2019: 4 section 9.2.3, two scenarios are presented to illustrate how and with what speed the fund may be expected to grow. From the illustrations it would seem unrealistic to expect the fund to reach NOK 4 billion in less than fifteen years.

⁷⁷ See proposed Decree section 7-5. If the fund drops below NOK 3 billion during its first ten years of existence, once having reached the size of NOK 4 billion, section 7-5 provides for the interim rules to be reintroduced until the fund has once again reached the size of NOK 4 billion. This "reserve solution" is not expected to have any great significance in view of the relatively short period where it will apply. It should be noted that one member of the majority, representing *Næringslivets Hovedorganisasjon* (see note 57 above), did not support the inclusion of the "reserve solution" in section 7-5, see NOU 2019: 4 section 7.4.2.5. In her opinion, this solution would have the effect of meaning that very little of the natural damage accounts in the established companies would in fact be used to cover future deficits in the natural damage insurance business.

⁷⁸ See NOU 2019: 4 section 7.4.2.1 first sentence.

would be treated differently, depending on whether or not there is a natural damage account on their books. Companies with such an account would have to cover their part of the deficit by drawing on the account,⁷⁹ whereas companies without such an account would be allowed to draw on the central fund for their share of the deficit.⁸⁰ The effect of this arrangement for the interim period is threefold. First, it will support the effort to increase the size of central fund as fast as possible. In years with a surplus on the natural damage insurance business, the relevant surplus from all the companies will be allocated to the fund, whereas in years with a deficit, only the share of the deficit from the (smaller newcomer) companies without an account will be charged to the fund. Second, it will help companies with no natural damage account from having to exploit their equity in years where there is a deficit. Third, it will serve to ensure that (larger well-established) companies with a natural damage account will continue to use this account in line with the prescription in the present Decree on instructions section 11 fourth paragraph second sentence: “This fund ... shall be used exclusively to cover future natural insurance damage claims”.

In reaching its compromise solution, the committee’s majority were careful to ascertain that the solution did not conflict with the principles laid down in the Norwegian Constitution section 97⁸¹ or in the European Convention on Human Rights, first Protocol article 1.⁸² The majority also concluded that the solution prescribed for the interim period, being that only companies with no natural damage account could draw on the central fund in case of a deficit on their natural damage insurance

⁷⁹ See proposed Decree section 7-5 first and second paragraph and NOU 2019: 4 section 7.4.2.1.

⁸⁰ See proposed Decree section 7-5 first and third paragraph. If the central fund is not large enough to cover such deficits, these companies will have to cover the deficits themselves by drawing on their equity, see fourth paragraph.

⁸¹ No law must be given retroactive effect, see the discussion in NOU 2019: 4 section 7.4.2.2.

⁸² The right to peaceful enjoyment of one’s possessions, see the discussion in NOU 2019: 4 section 7.4.2.3.

business, did not conflict with the EEA agreement article 61(1) on state aid.⁸³

5.2.4 Stipulation of premium

The committee was in full agreement on several points regarding how the premium rate for the natural damage insurance should be stipulated in the future. To overcome the challenges seen in the previous history of the pool, where the premium charged did not correspond with the goal set by the Decree on instructions section 11 first paragraph, see 4.3 above, the committee suggested that more exact criteria should form the basis for the stipulation of the premium rate.

The starting point was taken as being what was described as a “risk-correct” premium, according to an actuarial calculation.⁸⁴ This calculation, based on well-established methods and principles, should take into consideration the amounts made out for natural damage over the years, including costs incurred in establishing the damage, as well as costs for reinsurance.⁸⁵

In addition, the committee agreed that two other items should be included in the stipulation of the premium rate. The first item comprises the administrative costs of the pool and the insurance companies’ payment for settling the natural damage claims of the insured parties.⁸⁶ The second item covers four different elements, where anticipated future risk increases, such as climate changes, would probably be the most important.⁸⁷

⁸³ See the discussion in NOU 2019: 4 section 7.4.2.4.

⁸⁴ In Norwegian, «en risikorett premie ut fra en aktuariell beregning», see proposed Decree section 3-1 first paragraph.

⁸⁵ Since at least 2012, this method has been used as the starting point for the stipulation of premium. The actuarial calculation for 2018 resulted in a risk-correct premium of 0,0578 promille (per thousand).

⁸⁶ See proposed Decree section 3-1 second paragraph subparagraph 1, where such costs have been set to 0,003 promille (per thousand) of the member insurance companies’ total fire insurance sums as per July 1.

⁸⁷ See proposed Decree section 3-1 second paragraph subparagraph 2. The four elements could form the basis for an increase or a decrease in the premium stipulated, but a

The member of the committee representing Finans Norge proposed that the administrative costs and the capital costs of the insurance companies should also be taken into consideration when stipulating the premium.⁸⁸ The majority of the committee disagreed.⁸⁹ Under the present system, the companies are not compensated for such costs, and there was little reason to make changes on this point for the future. Companies with a natural damage account would be compensated for such costs through the yield on capital placed on this account. Although the solution would continue to put companies with no natural damage account at a disadvantage in the future, this disadvantage was at least partly compensated for by the advantages these companies were given in the interim period.⁹⁰

5.2.5 Reinsurance

The insurance companies and Finans Norge had argued that it would be a better solution to let the participating companies arrange their own reinsurance. Each separate company would thereby be given the possibility of connecting its natural damage risk with the company's total risk exposure and its risk appetite as an insurance company.

The majority of the committee (all except for the member from Finans Norge) thought differently. They proposed to continue the current solution with a joint reinsurance arranged by the pool.⁹¹ Such an arrangement would suit the solution advocated by the majority, where the pool had its own natural damage fund. This fund would first and foremost be at risk in the event of a large natural damage event, and, consequently, would be in need of protection through reinsurance.

possible increase has been expressly limited to 0,01 promille (per thousand) of the member companies' total fire insurance sums as per July 1.

⁸⁸ See NOU 2019: 4 section 15.19 and 15.20.

⁸⁹ See NOU 2019: 4 section 8.4, with conclusion in section 8.4.5 and proposal in section 8.6.

⁹⁰ See proposed Decree section 7-5 third and fourth paragraph and above 5.2.3.

⁹¹ See NOU 2019: 4 section 10.1 and the dissenting opinion in section 15.22.

Detailed rules as regards the establishment of a reinsurance program for the pool and the conclusion of the relevant reinsurance contracts are laid down in the proposed Decree.⁹²

5.2.6 The internal organization

The committee did not propose any changes to the basic set-up of the pool. All insurance companies providing fire insurance on relevant property in Norway will still need to be members of the pool.⁹³

As for the annual meeting, an important change has been suggested.⁹⁴ Although it is expressly stated that the annual meeting is the “highest authority” in the pool, the possibility for the meeting to instruct the board or overturn its decisions has been precluded in respect of three important areas:

- 1) Stipulation of the premium rates;
- 2) Reinsurance principles and reinsurance program;
- 3) Principles for management of the pool’s natural damage fund.

The background for this proposal is to protect the interests of the insured community. Although policy holders are represented on the pool’s board, where they have been given a decisive role regarding the three above-mentioned subjects,⁹⁵ they are not represented in the annual meeting.

In the proposed Decree, the board has been reduced to six members, and specific rules have been provided as to representation on the board. Two seats are reserved for members representing policy holders and one seat for a member representing companies with a small member share in the pool, leaving three seats for the other (larger) companies. The members of the board representing the policy holders have been

⁹² See first and foremost section 3-3, named Reinsurance. Rules on the tasks and composition of the reinsurance committee are to be found in section 2-6 first paragraph.

⁹³ Proposed Decree section 2-1.

⁹⁴ Proposed Decree section 2-2 first paragraph.

⁹⁵ See proposed Decree section 2-3 fifth paragraph and the text below.

equipped with a veto in the three areas mentioned above. At least one of representatives must be present in the board meeting for the board to have a quorum, and to reach a valid decision, one of them must vote in favor.⁹⁶

The proposed Decree also secures membership for a representative of the policy holders of all the committees of the pool, whereas the companies with a small membership share in the pool are given representation on the most important committees, i.e. the claims committee and the reinsurance committee.⁹⁷

The committee agreed with the criticism being voiced that the pool was too much of a closed shop, with little possibility for public insight. The proposed Decree requires the pool to have “the utmost possible degree” of openness regarding its activities, in order to secure insight and control.⁹⁸

5.2.8 The way forward

NOU 2019: 4 is presently undergoing a public consultation procedure, with the deadline for comments set as 2nd September 2019. For practical reasons, potential new rules will need to come into operation from the commencement of a new year. Since the interval between 2nd September and 1st January 2020 is short, it is not expected that the Ministry of Justice and Public Security will be in a position to act on the proposal in 2019, with the effect that the possible new rules will enter into force on 1st January 2021, at the earliest.

⁹⁶ On both the last two points, the committee member from Finans Norge dissented, see NOU 2019: 4 section 15.23. The majority felt that a new, general rule on abuse of power, see proposed Decree section 2-7, would prevent unwarranted misuse of power given to the representatives of the policy holders.

⁹⁷ Proposed Decree sections 2-5 and 2-6.

⁹⁸ Proposed Decree section 2-9.