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Polish perspective upon state support in the flood loss coverage and the role of prevention

1. The risk of flood as a state (municipality) problem

Floods are the biggest natural catastrophes that take place in Poland and are hazardous for human life and health, natural environment, cultural heritage and business activity. According to the available data, in Poland, floods have become more frequent, more violent and they cause social and economic losses of high value.

Flood risk management requires finding solutions leading to protection of both public and private property on particularly endangered. The inevitable process of developing a rational catastrophe insurance system in Poland is a long-term perspective. The property at risk of flooding is in large part public property belonging to the Treasury or municipality (*gmina*). The scope of public property insurance, as well as the one that the public sector entities are in charge of, is higher than the scope of private property insurance; it proves the higher level of flood risk management in the public sector.

2. The role of the supervisory body (Polish Financial Supervision Authority – KNF) in flood risk management

The volume of losses caused in Poland by floods, the results of supervisory actions taken by the KNF in the area of catastrophic risk management and modelling by insurance undertakings as well as the requirements resulting from Solvency II, have provoked the KNF's belief that it is necessary to create uniform standards on flood risk management. *The Guidelines on flood risk management in the insurance sector* issued on 6th December 2014 are not a binding normative act, however, they are an official didactics of the supervisory body and a way to influence the insurers and reinsurers, based on the *comply or explain* rule. The guidelines constitute a framework in flood risk management which should be applied by the insurance and reinsurance companies operating in non-life insurance sector with a significant exposure to flood risk. The insurers and reinsurers were to apply to the guidelines until 1st January 2016.

Among the guidelines, the supervisory body paid particular attention to gathering relevant information from the insured persons regarding the process of concluding insurance contract, including the subject of insurance location or its characteristics related to the flood

risk. The supervisory body indicated the need to collect properly detailed, complete and adequate damage data, and taking account of the appropriate functionality of the IT systems.

Criticising the guidelines, the Insurance Ombudsman (who has been currently transformed into Financial Ombudsman) pointed out the practice of the supervisory bodies to impose their standards on the risk assessment professionals. On the other hand, it is important to remember that this risk assessment has never been perfect. After the 1997 flood, it turned out that some of the insured properties was built polders, floodplains or even flood banks; after the 2010 flood, it turned out that two significant market players almost “drowned” – funnily enough – on the flood risks of small entities.

3. The state of protection of public property threatened by flooding

Due to the lack of comprehensive solutions concerning insurance protection, part of the public property remains unprotected, while the other part is underinsured. On the one hand, it stems from concluding numerous insurance contracts regarding respective elements of the property, based on different conditions developed by various insurers. On the other hand, covering the property with insurance protection on the basis of several contracts is the reason for frequent insurance, entailing unnecessary increase of protection costs. Each of the government and local-government administration bodies has its own right to manage insurance matters.

4. Flood hazard maps and flood risk maps

Maps (flood hazard and flood risk maps) are an important instrument of flood risk management¹. The Water Law reflects adjusting the Polish legislation to the flood directive. The legislator imposed an obligation to develop flood risk management plans embracing the initial assessment of flood risks, developing flood hazard and flood risk laws. According to the Water Law provisions, the boundaries of the areas presented in flood hazard and flood risks maps are taken into consideration in the concept of state spatial development, voivodship spatial development plans and local spatial management plan as well as decision on land development and management conditions. The maps are financed from public funds.

The information on the maps are to be useful in reactions and crisis management in the event of a flood. Developing flood hazards and flood risks maps is the basis for the development of flood risk management plans for areas with high probability of flood risk. The maps should serve as an effective tool of data collection, a basis for determining the priorities and making further decisions of technical, financial and political character concerning flood risk management. However, a question arises – how the maps can be used by the insurers.

¹ Indicating the areas of low, medium and high probability of flood and a graphic representation of each area of the predicted flood (extent, depth of the water and flow rate). Flood risk maps should illustrate the predicted negative effects of all the flood scenarios presented on flood hazard maps.

Firstly, they may influence the decision on undertaking protection of threatened property. Usage of the maps by the insurers could be difficult due to the cooperation with banks (within the bancassurance) threatening insurance coverage as a security of credit. Insurance protection in requirement of getting a credit. People do not move from the areas with high probability of flood risk and municipal executive bodies continue to issue building permits.

Secondly, maps should form the basis for calculating insurance premiums. In order to determine the premium rates, the conclusions drawn from implementing flood risk management concerning the extent of the flood and the flood wave directions are very significant. The list of areas with potential retention, principles of water and land management as well as conditions of spatial planning and land use, conclusions resulting from the embraced forms and methods of nature protection in the process of preventing and eliminating the effects of floods should be useful. Particularly the areas that are planned to be used as so-called controlled flooding areas in the event of the flood is important. These are the areas that are at 100% probability of damage.

Thirdly, public information should be a helpful tool to develop general insurance conditions. The insurers should differentiate the scope of protection depending on the legal status of the areas that the insured property is located, based on flood risk maps. In some places, for example in Świnoujście, whole municipalities (80% of *gmina*) are threatened by flood waves. It resulted in the necessity of changing the local plan for the whole municipality (*gmina*) and to charge almost all real estates with the flood risk. This, in turn, caused or may cause the decrease of the value of the estates located on the flood risk areas.

Maps may influence the reinsurance but the problem is way of compensation flood losses by the reinsurers. Typically they cover losses caused by the wave during 24 hours.

5. Crop insurance as a model of public-private partnership

Flood risk management by the administration bodies is not limited to the property within their remit. The effects of the flood on private property is also public entities problem, as a territorial community. Removing them generates public expenses and is an important disturbance in state economy, the results of which are long-term and lead to the reduction of the income from public tributes as well as generate further expenses as part of broadly understood state aid.

Extending the scope of protection in private sector would involve introducing proper financial incentives from the state. The EU legislator imposed legal solutions characterising crops insurance, which may be a pattern of spreading the financial burden of insurance protection over the insured and the state. Its aim would be to popularising the protection and limiting state aid in the form of compensating flood damages as a significant share in public expenses.

An economically rational solution is the endowment from the insurer's budget at the stage of insurance risk sharing (by subsidies to insurance premiums) and/or at the stage of AIDA Climate & Catastrophic Events WP 7th AIDA Europe Conference (12-13 April 2018), Warsaw

loss indemnification (by appropriate designated subsidies) in exchange for using specific reserves of the state budget for direct support for the victims – interim aid, often inadequate (overestimated or underestimated) which does not solve the problem systematically, but significantly burdening the public finances. In the aforementioned crop insurance, the subsidies to insurance premiums are paid from the Polish state budget by the administrator of the relevant part of the budget (minister in charge of agriculture). An agreement between a given insurer and the minister in charge of agriculture is a basis and a *sine qua non* for the pay-out of the subsidies. Currently, five insurers have signed such agreements. The subsidies are a proper part of the insurance premium due to the insurer who is entitled to demand its payment – not the insured agricultural producers. In accordance with the Act on agricultural crops insurance, the subsidies may range to 65% of the insurance premium, while their amount for a given year is ultimately determined with a regulation of the Council of Ministers. Their payment in a given amount depends on keeping the tariff rate on a proper level by the insurer. The legislator imposes maximum tariff rates which are expressed as a percentage of the sum insured and depends on the type of insurance subject. The protection of the policyholders against too high premiums was the aim of introducing maximum rates limits. They also indirectly constitute a factor enabling the estimation of the amount of subsidies paid out of budget funds.

Another form of state financial support in creating a common catastrophe insurance system is designated subsidies from the state budget to cover part of the compensation caused by the natural disaster. Such a solution was adopted in the crops insurance in relation to the risk of drought - reluctantly covered with insurance by the insurers. All insurers concluding crop insurance contracts are entitled to such subsidies. They are granted by way of decision of a minister in charge, at the insurer's request, in the amount specified according to the provisions of the aforementioned act, depending on the proportion between compensation paid by the insurer and the premiums collected on the basis of generically same insurance contracts. The amount of the subsidy is 60% of the difference in the collective amount of compensation paid in a given calendar year as a result of drought damage and 90% of the amount of premiums paid in a given calendar year as a result of concluding such drought risk insurance contracts.

Public-private partnership implying the state intervention on the market supports its systematisation. The subsidies to the premiums may be of percentage (as in the aforementioned agricultural insurance) or a flat rate. The endowment rules depend on the adopted premises, they may apply to all insurance contracts or only the ones concluded by specific entities, for example those earning income below a certain level.