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deposits

DEPOSIT PROTECTION

DEPOSIT OR *no deposit* INSURANCE

WHAT WE NEED TO KNOW



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Eddie Hooker

mydeposits Chief Executive Officer



“ Tenancy deposit protection is in the spotlight.

I've run mydeposits, a successful government authorised deposit protection scheme in the UK and Jersey, for over 10 years, and have more than 20 years' experience in the insurance sector as the CEO of Hamilton Fraser. So I'd like to think I know a little about both deposits and the insurance markets.

The purpose of this document is to ask questions about how the new 'no deposit' insurance alternative products operate and also to acknowledge the important role that deposits play in the renting process. It's not intended to imply criticisms of these new products, but I think it's important to ask pertinent questions.

It is fair to say that I can see the initial allure of the alternatives to a traditional deposit.

The appeal of smaller payments at the outset of a tenancy and, in theory, a more flexible end-of-tenancy procedure make good headlines and could attract a handful of users. In fact, I have been looking at the new deposit models myself over the last 18 months – however, as you will read, I have some underlying questions that I have not been able to find clear answers to that give me the same comfort that the traditional deposit provides to the landlord and the tenant.

I want to understand what the drivers are behind the people who are promoting them. Have these new business models discovered the gold at the end of the rainbow of the Private Rental Sector whereby both parties are completely protected against end of tenancy issues with deposits deductions? Or will their business model and commercial processes see a return to the bad old days where one party feels that the system is unfair and stacked against them?

Eddie Hooker

Eddie is the longest serving CEO of all the tenancy deposit protection schemes.

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Around 4 million individual deposits are protected by tenancy deposit protection schemes



Deposits - a brief history

Tenancy deposit protection has been a legal requirement for over 10 years in England and Wales and all regional governments in the UK have subsequently adopted it. However, it's worth a quick recap on why it was introduced and its impact on the rental process.

A deposit commits the tenant:

Security deposits have long been taken by landlords as a way of ensuring that their tenant abides by the terms of the tenancy agreement, whether that be paying rent and bills on time, or to deal with issues such as damages or cleaning.

Deposits are refundable:

Security deposits are refundable. If the tenant meets the terms of their tenancy agreement then they get their deposit back, in full. Yes, the tenant has to find this 'upfront' payment but they will get the deposit money back if all goes well.

The tenancy deposit protection legislation:

In the early 2000s, there was growing evidence that some landlords (not all I hasten to add) were either unfairly withholding deposits from tenants or failing to communicate to their tenants why they would not return the deposit.

Statistics provided by the government of the time suggested that some 20% of deposits were being unfairly withheld from tenants without a proper explanation as to why deductions were made.

In an attempt to create a fair process around deposits, and to take the pressure off an already stretched legal system, tenancy deposit protection was introduced to provide transparency and fairness.

The dispute process and customer service levels of all the tenancy deposit protection schemes is laid down in the legislation and is monitored robustly by a series of key performance indicators imposed on schemes by the contracting governments.

Some 10 years on, around 4 million individual deposits are protected by tenancy deposit protection schemes and dispute levels have dropped to less than 2% of all ending tenancies. I would suggest that this is quite a success story!

But enough of the history lesson.

The rise of the *no deposit* insurance alternative products:

Since deposit protection was introduced, several *no deposit* insurance products have sprung up over the years with little impact on the sector. Now, due to technological developments, these new products are becoming more appealing thanks to simply designed apps and responsive websites. But who are these new *no deposit* insurance companies and why is it important for landlords and tenants to ensure they enter into these contracts with their eyes wide open?

Companies such as Dlighted, Flatfair, Reposit and InsureStreet all claim that one of the biggest barriers to renting is the amount of deposit that the tenant has to find at the start of the tenancy.

Let's have a look at some of their claims:

A. The value of the deposit is significantly increasing, placing more of a burden on tenants.

Government figures show that deposits have increased by about 7% in the last five years.

- 5 years ago (2012) the average deposit across England and Wales (including London and the South East) was £991.
- The average deposit protected by all three schemes currently stands at £1,070.

If the same calculation was true over the next 5 years the average value of a deposit would be just under £1,150 and in 10 years' time just over £1,220.

Deposit values are generally linked to monthly rental costs and where rents have been increasing so have deposits. Many landlords now take the equivalent of six weeks or two months' rent to insure against tenants leaving without making their last month's payment as well as other possible damages. But there is increasing evidence across the sector that rents are generally stabilising and in many areas are actually falling slightly so the outlook for deposit values are, in the short to medium term, unlikely to continue to increase significantly.

So my question is: what evidence do these alternative companies have that show deposits significantly increasing especially in light of the announcement that the government is looking to cap deposits to a maximum of one months' rent?

B. Dispute levels are low so the risk to the insurer is low – hence no deposit insurance premiums will remain low.

Let's try and dispel this myth immediately! Dispute ratios are the **WRONG** statistics to use.

No deposit insurance providers continuously quote evidence of disputes running at less than 2%. What they fail to consider is that these statistics (released by tenancy deposit protection schemes over the past few years), only take into consideration problems where the landlord and tenant cannot agree on the deductions and so use the scheme's formal dispute resolution service to intervene. They do not take into consideration what happens if there is NO dispute.

The reality is that some 46% of deposits are returned to the tenant **with** a deduction that is **agreed** by the tenant.

So in 46% of all the cases using a *no deposit* insurance product, the landlord would have to make a claim against the insurance policy in order to get their money.

Let's think about that for a minute.

Put crudely, if every deposit currently protected by a traditional tenancy deposit scheme was replaced with an insurance product there would be more than 1.8 million claims that would need to be processed. Processing claims costs money, however you cut it. And claim costs get added to the overall cost of premiums.

And on the subject of premiums, those charged by the *no deposit* insurance products are generally based on a percentage of the monthly rent paid by the tenant. If InsureStreet is right, in 2026 the average deposit in London will be in the region of £2600, which means that the premium for one of these products will be around £600 plus insurance premium tax. And that's without insurance premium inflation or changes in the IPT rate. I say again, at least the traditional deposit is refundable.

C. Tenants will repay the deductions directly

The *no deposit* products state that having firstly paid an insurance premium the tenant will willingly repay the landlord at the end of the tenancy for any loss incurred as a result of their tenure in the property. Therefore, the theory extends to suggesting that the landlord will be recompensed faster and receive exactly what they are owed. Will they?

What happens to the 'financially distressed' tenant that can't find the money at the end of the tenancy? What happens to the tenant who finds himself in a financially challenging circumstance that they couldn't envisage 18 months prior? Will a tenant not feel that the premium they've paid for one of these insurance products covers the monies owed in the first place? Could we even go so far as to say that these new schemes are misrepresenting their products to a vulnerable section of the market?

But wait, the new model has a solution. To circumvent this potential issue the *no deposit* providers can simply deduct the money from the tenant's credit or debit card! Or set the debt collectors loose. Or even black mark the tenant's credit history! It's either this or take on a large book of potential bad debt and I can assure you, as CEO of an established insurance brokerage, these new players will struggle to keep afloat at the volumes they are targeting.

D. The new *no deposit* schemes help navigate around compliance hurdles

We've discussed why the legislation surrounding deposits was brought in already and I applaud the progress the industry has been making since then. Letting agents must now join external redress schemes, landlords and tenants will benefit from mandatory Client Money Protection in the near future and there seems to be a growing swing towards landlord licencing to ensure all stakeholders are suitably protected.

Therefore I find it uncomfortable to hear that a selling point of a *no deposit* scheme is that it removes the need to register with a body designed to protect the public and replace it with an insurance policy. As part of the deposit protection process landlords and agents are legally required to issue a document called the "Prescribed Information". This document explains the end of tenancy and deposit release processes in layman terms and ensures all parties operate on a level playing field. Without this informative element the most vulnerable stakeholder, the tenant, is effectively handing over their protection.

Similarly, the three Deposit Protection Schemes will only have their contracts renewed by the relevant governments if they meet very specific Key Performance Indicators (KPIs) designed to provide an excellent service and superior protection to agents, landlords and tenants. There will be no obligation or government KPI for the insurers or a requirement for them to release statistics that will show how these new *no deposit* insurance products compare to traditional deposit schemes.

E. Charging Tenants for raising a dispute will end spurious claims

Quite bluntly, charging tenants (or landlords for that matter) for challenging a claim or an adjudication decision monetises vulnerability. The point of tenancy deposit schemes was to create a fair environment that protects the ultimate consumer. Charging for challenging a claim at any point contradicts this aim. If a tenant fails to successfully argue their defence to any charges made by the landlord should they then pay for challenging the claim as well as the damages? Knowledge of this risk may put some tenants off challenging in the first place in fear of having to find additional monies. Having seen countless claim forms and dispute forms over the years, let me tell you that a good percentage are not prepared or argued in a robust way even though you know that they are genuine.

With a traditional deposit the law is clear: the deposit remains the property of the tenant until proven otherwise. I believe it is immoral to create additional financial obstacles for both the landlord and the tenant to access the claim challenge process. This creates an uneasy balance of power, especially against the tenant who will only ever be able to respond to the claim. Current tenancy deposit legislation recognised this from the outset and schemes are not allowed to charge a penny for dealing with their customers disputes.

Does the *no deposit* model improve the industry?

This is what it all boils down to. Does the *no deposit* alternative actually improve the industry and the experience of the stakeholders?

I have addressed the loud claims made by the new entrants to the market, however I feel it is time we turn the spotlight on how the new model works and whether it can stand the test of time. I have my concerns, as outlined below, but I invite these schemes to rebuke my comments. As I've mentioned, my team and I are as active in pushing the status-quo in the lettings industry as much as the new generation of firms emerging.

So here are my primary concerns:

A. How will these *no deposit* insurance schemes impact landlord and tenant relationships?

The issue of landlord and tenant behaviour should not be ignored. I refer back to the 20% of unfairly withheld deposits statistic I quoted earlier. Pre 2007 and deposit protection, deposit related issues between landlords and tenants were significantly higher than they are today. Will deposit deduction discussions between landlords and tenants (which can be an emotive subject!) via an app or through an insurer really be the best way to resolve problems and improve relationships?

With dispute levels at just 2% and agreed deductions to deposits at around 46%, surely this is proof that landlord/tenant communication has improved because of deposit protection. Why go back to a process that isn't transparent?

B. Insurance premiums rise too, not just deposits.

The principle of insurance is that the premiums of the many pay the claims of the few, but this relies on the premium pool being large enough to pay the claims and costs of administration of the product. If 46% of all policies sold result in some form of claim (which is usual behaviour according to the deposit protection schemes), it is hard to see how premiums will not continue to rise.

That does not even take into consideration the rising costs of insurance tax and general rent inflation – remember premiums for these *no deposit* products are based on weekly rental costs and will rise at the same rate as the deposits they are replacing.

Many local authorities, housing associations and charities now run deposit loan schemes for the most vulnerable tenants. Ironically the once common deposit guarantee schemes or deposit replacement bonds in the social sector, where an organisation 'underwrites' the tenant's obligation have all but disappeared - what did they know that the *no deposit* insurance schemes have yet to learn? Is it fair to assume that the cost of the bond/insurance rose to un-manageable levels?

C. Loss of transparency and service levels

Another benefit that the existing tenancy deposit protection legislation brings is transparency via the Prescribed Information requirements and formal dispute resolution that is monitored by government-set timescales. *No deposit* insurance products remove these safeguards, leaving landlords and tenants to rely on the insurer's terms and conditions (not legislation) with no recourse or penalty if the organisation fails to adhere to their promises. I have some issues.

In the insurance world there is a simple concept laid down by the Financial Conduct Authority called 'Treating Customers Fairly'. Suppliers of insurance products are required to be transparent with their customers, provide information about their products that tells then what is covered and more importantly what is not. Without exception, every *no deposit* provider I have looked at fails to provide this information without the tenant, landlord or agent having to 'sign-up' or provide personal information to obtain the detail. It all feels very 'headline' and 'sensationalist' with their websites criticising the current processes but failing to inform people on their products. Why the secrecy? What do they not want the general public to be aware of?

Some *no deposit* providers now claim that they don't offer 'insurance' so are not required to be regulated by the FCA. This scares me more than anything else. What are they offering and who is monitoring them? It is true that tenancy deposit protection schemes are not regulated by the FCA (as they do not sell insurance) but they are scrutinised at government levels on a quarterly basis by senior civil servants, treasury committees and legal departments and ultimately the work performed is governed by a robust contract with consequences if we fail to adhere to these contracts and documented exit strategies if the contracts are revoked. What is to stop these new operators from shutting down at a moment's notice, when they run out of money, leaving unhappy and concerned consumers with worthless contracts with no recourse to deal with the fallout?

And what are they doing with your data? How secure is it? Where is it stored? Who has access to it? How do you get hold of them? Who is reporting on their performance, financial stability and challenging their service standards. The questions keep coming.

I have tried to engage with these new operators at various levels but I continue to be frustrated by their lack of transparency. I have even offered to assist a couple of them with advice and support on the dispute processes to try and prevent them falling into the same traps that tenancy deposit protection scheme encountered all those years ago – just to ensure that they don't bring the whole private rented sector and deposit management into disrepute.

D. Renting is complicated so have they considered the anomalies?

I asked the National Landlords Association for their view. Whilst the concept of no insurance products would be interesting to some, they advise landlords to consider whether such schemes would work for them. For example:

- Is the cover provided by the policy sufficient, and are you confident the policy will pay out when required?
- Does it cover the consequences of actions by “uninsured third parties” (visitors or unauthorised sub-tenants)?
- Does it properly incentivise the tenant to maintain the property, and to end the tenancy correctly?
- If the scheme is collecting and paying rent, does it have adequate client money protection insurance in place?
- What right of appeal do you have to dispute a decision not to pay out?
- Are you convinced the scheme will be able to drive a sufficient volume of users to the site in order to be able to rely on the ratings it generates, and do your tenancies turn over often enough for the ratings to give a fair view of you as a landlord?

Ultimately from my experience of the insurance sector, the financial viability of these *no deposit* schemes can only be assured if they employ very selective underwriting criteria and aggressive claim handling. The NLA points out that such schemes can never cater for everyone as there will inevitably be tenants who are deemed uninsurable, for whatever reason. Furthermore, what will happen if, during the tenancy, a change to a tenant’s circumstances moves them in to this category - will this then put them in breach of the policy, and what are the landlord’s options?

Whatever its flaws, the traditional deposit offers greater flexibility.

Adjudication vs Claim Handling – which would you prefer?

Through my knowledge of dealing with deposit disputes for the last 10 years, I can safely say that no two disputes are ever the same. A dispute is often complicated and can involve multiple issues sometimes stretching over the course of the tenancy, which might be several years.

The adjudication process by the deposit protection schemes:

Complex deposit deduction disputes require an understanding of the law – not just Housing Law but Consumer Law and Agency Law.

- The adjudicators employed by the deposit protection schemes have formal legal backgrounds, they must be impartial and their decisions are binding for both parties - overturned only by a court of law.
- The dispute resolution process must be fair and work for both parties, whatever the value of the claim.
- Disputes raised through the deposit protection schemes are free to both landlords and tenants.

Insurance claims handling process by the *no deposit* products:

In my experience of insurance companies, they generally operate on a least cost basis i.e. is the cost of dealing with a claim more expensive than actually paying it. Decisions become all about the value of the claim rather than who should be entitled to the award.

The timescales quoted by *no deposit* insurance providers to make a claim are shorter and more onerous than those operated by the deposit protection schemes. Is it because tenancy deposit protection schemes take more time to consider all aspects of a dispute to ensure a fair outcome, whilst the attitude for *no deposit* products is to ‘fix the problem quickly and move on to the next one?’

Remember, any charge a landlord wishes to make against the tenant (46% of the time!) has to be raised and justified before the money is handed over by the insurer. If the *no deposit* products are to be genuine alternatives that are fit for purpose I’d explore them to address my concerns:

- How can anyone, particularly the tenant, be sure that the dispute claim is being looked at fairly?
- Could a landlord be required to provide evidence at an unspecified point in the future when the tenant challenges an insurer's recovery process?
- What right of appeal does the landlord have to dispute a decision not to pay out?

Chasing the tenant for payment

All insurance products reserve the right to subrogate their losses from the party responsible.

I would like some transparency as to how the *no deposit* insurance schemes plan to deal with the money paid out in claims.

In my experience, the deposit amounts in dispute are relatively small and thanks to deposit protection schemes are improved thanks to higher quality documentation and inventories, through to more control on contentious issues like fair wear and tear and betterment.

The new deposit alternative schemes could halt this progress and the positive impact of tenancy deposit protection on the sector:

- The underwriters may either realise that the cost of recovery is prohibitive to the return. This sends a clear message to tenants that they can misbehave and get away with disregarding their obligations; after all they have no stake in the agreement and nothing to lose. The landlord may not initially care as they have received the insurance payment on their claim, but at what stage does the insurer say enough is enough and starts to refuse cover or increase the premium?
- Alternatively, the insurer may employ debt recovery firms and issue threats of legal action against tenants, who may not have been afforded a fair hearing on whether they are responsible for the claim or not. This could be awful for the private rented sector, with tenants being pursued by a debt that they may not owe. Red letters, black lists and court judgements are not the way to build a healthy and vibrant private rental sector. Remember that it is the tenant who is paying the insurance premium. Of course, *no deposit* providers will say that this will never happen and that there are safeguards built into their products. What are these safeguards? The tenant could also face possible spurious charges made against their credit card rating, causing more unhappiness and resentment.
- And once landlords get wind that to save costs insurers will just 'pay out', what is the incentive for them NOT to make a deduction at the end of the tenancy? After all, it's the insurers problem to recover the money from the tenant.

There is a suggestion that some of the *no deposit* schemes will use user ratings and "good" behaviour" rewards, with good tenants being able to fast track into another property. On this particular subject the NLA remains unconvinced that *no deposit* schemes will be able to overcome the issue of driving a sufficient volume of users and ratings to the site in order to produce representative ratings. Furthermore, it points to the fact that the average tenancy length is now almost 4 years, which means it could take decades before landlords who use such schemes will be able to build up a true and accurate representation.

Delays in returning money for deposit claims

No deposit providers challenge the current deposit schemes, claiming that they are slow to return money for tenants to use for their next rental property. The reality is that deposits can be returned within a single day if both the tenant and landlord agree. The main delays for return of the deposit in custodial schemes is caused by the tenant not contacting the landlord or authorising the deposit return with their scheme. In fact, with current insurance-backed deposit protection schemes the landlord can give the money back to the tenant immediately as they are holding the money at the end of the tenancy.

Having looked at these new *no deposit* insurance products it is clear to me that it will probably be the landlord that will experience the delays in getting money in order to deal with essential repairs or outstanding payments when the tenant is slow to engage with the provider or challenges the charges claimed by the landlord.

Summary



“ Landlords and agents should have choice. I welcome choice.

I encourage my staff to innovate and create new and exciting products for the private rented sector. I also welcome the use of technology that makes people's lives easier. Almost weekly I am approached by a new online renting app that wants to interact with our tenancy deposit protection scheme and that is good from everyone's perspective.

As I have already said, I have met, or communicated, with many of the *no deposit* providers and most of them are genuinely decent people who want to change the rental sector for the better. I applaud this. I am also happy to engage with them to provide expertise and advice in dispute management and end of tenancy problems and offer market education, whether that be through mydeposits or via one of my other regulated companies.

As the debate regarding traditional deposits verses no-deposit insurance starts to accelerate, I notice with interest the recent announcements by the government in the Queen's Speech relating to the capping of security deposits. Clearly some effort is now being directed to trying to reduce the financial burden on tenants as the number of households living in rented accommodation continues to rise - again I welcome this. The Homelet Rental Index May 2017 has average monthly rents in the UK standing at £901. Capping deposits at no more than one months' rent will immediately shave a large chunk off of what the tenant needs to find at the start of the tenancy. This puts further commercial pressure on these new alternative products to keep premiums or fees as low as they can in order to maximise their 'affordability' argument.

There will always be some that say that one months' rent deposit equivalent will not be sufficient to cover damages when the tenant skips the property owing the last months' rent (which is why many landlords take 6 weeks equivalent) - therefore making *no deposit* insurance products more attractive. There may be some merit in this conclusion. But there are no accurate statistics available relating to the number of landlords that experience this problem. Assuming for a minute that this is a relatively common occurrence, are these tenants the type of people that insurers actually want buying their products? Will these new alternatives not create a new problem for the sector - those tenants who are financially vulnerable pay a deposit and those who are better off don't? How is this fair?

And I remain concerned that some of the new no-deposit organisations are pitching to the letting agent market to sell their products as a way of generating income to replace that which will be lost by the forthcoming tenant fee ban. Will this approach create a new 'mis-selling' culture where the driver is commission for the agent rather than the right product for the consumer?

The market needs choice and I welcome choice, but only if that choice is robust, fair and transparent. I have produced this paper not because I am being protectionist or scared of competition, but because I am concerned for the market when so much positivity has come from the formal protection of deposits. Should this paper stimulate no debate or challenge at all I will still continue with my search for my own answers. Who knows, perhaps one day we will launch a deposit alternative that delivers against these concerns whilst retaining the drive towards better standards and communication between the parties.



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The mydeposits website is packed full of guides and videos on how to comply with deposit protection and more details on alternative dispute resolution process.

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