ICNZ Insurance Council of New Zealand

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Committee Secretariat
Local Government and Environment
Parliament Buildings
Wellington

Emailed to: LGE@parliament.govt.nz

Dear Committee Members,

RE: ICNZ submission on the Residential Tenancies Amendment Bill (No 2)

Thank you for the opportunity to submit on this Bill. We represent 26 general insurers who insure about 95 percent of the New Zealand general insurance market, including over half a trillion dollars' worth of New Zealand property and liabilities.

Our members offer separate insurance products for landlords as well as for tenants. Landlords' insurance primarily covers the landlord for accidental or malicious/intentional damage to the rented property. Tenants' insurance primarily covers the tenant for loss or damage to their contents, but also covers the tenants' legal liability for damaging others' property. That includes the landlord's property, as well property belonging to other third parties.

We make five submissions on this Bill:

1. Tenants should remain liable for their gross negligence and recklessness.
2. The Bill should clarify whether the cap applies to third party property.
3. Section 49C(2) is redundant and shows a fundamental misunderstanding of insurance.
4. A cap of four weeks' rent is too low to incentivise tenants to take care of others' property.
5. Subrogation rights are essential to keep insurance costs down.

We set out our views below. Please contact either Nick Mereu (nick@icnz.org.nz, (04) 495 8008) or Terry Jordan (terry@icnz.org.nz, (04) 495 8002) if you have questions or if we can provide any further information.

We would like the opportunity to appear before the Committee to provide an oral submission.

The Bill should clarify who is liable for gross negligence and recklessness

Section 49B(1)(a) should be amended to say that a tenant is not excused from liability if the damage was intentional, grossly negligent or reckless.

The Bill proposes to draw a line between "careless" damage and "intentional" damage, with the tenant liable up to the cap for the former, and fully liable for the latter. But negligent acts and omissions that cause property damage comes in a broader spectrum of forms. We say the Bill should specifically recognise those forms to give clearer guidance to the Tenancy Tribunal, landlords, tenants and insurers.

Recklessness and gross negligence are at the more culpable end of the negligence spectrum, and sit closely alongside intentional damage. To illustrate, a recent Tenancy Tribunal case involved a Foxton tenant who let her dogs urinate inside. The tenancy agreement in that case said no pets were allowed. The Tenancy Tribunal found the tenant was not liable to pay for the damage because the damage was not intentional. The District Court reversed the Tribunal's decision on appeal, finding the damage was intentional. This case is, in our view, a clear case of intentional damage, but if it is not, it is at very least grossly negligent or reckless on the tenants' part, and should not be subject to a liability cap.

Recklessness as a concept is well-developed in case law. How it applies in particular cases should be straightforward for tenancy adjudicators to apply to the facts of new cases, and for higher court judges to do the same. The Bill should, at least, clearly state whether recklessness is included with careless, capped damage or intentional, uncapped damage. We say that recklessness should be included in the uncapped intentional damage exclusion from the cap in section 49B(1)(a). If it is not, insurance costs may increase because the incidence of tenant damage will increase (since the cap is too low to incentivise due care of others' property) and because insurers will not be able to recover damages from negligent tenants by way of subrogation. These issues are dealt with in more detail below.

The Bill should clarify whether the cap applies to third party property

The Bill should explicitly say whether tenant liability cap is intended to include damage to third party property caused by the tenant's carelessness.

A tenant's liability in negligence for damage caused to third party property is not explicitly mentioned in the Bill. The Bill is about apportioning liability for damage between landlord and tenant and presumably, therefore, the proposed tenant liability cap does not disturb the tenants' liability at law to third parties. However, the Bill awkwardly describes the tenant's responsibility for damage by referring to damage to "the premises", and "premises" is defined in section 2 of the Residential Tenancies Act 1986 to include "any part of any premises", rather than the landlord's premises.

For clarity, we submit that the wording of the Bill should be amended to explicitly leave tenants' liability for careless damage to third party property untouched by the tenants' liability cap in sections 49A-49E.

Section 49C(2) should be deleted

Section 49C(2) is redundant and should be deleted. It shows a concerning misunderstanding of insurance. First, the section is unclear and needs amending to clarify its intent. As we read it, the section could mean either:

- an insurer cannot take damage by the tenant below the tenants' liability cap into account when setting the landlord's premium, or
- an insurer cannot deduct payments made by the tenant to the landlord under the tenants' liability cap from a claim payable by the insurer to the landlord.

We expect the second interpretation is intended, but would appreciate clarification of this point.

Either way, we submit that the section should be deleted.

If the first definition is intended, we say that not allowing insurers to factor in the risks of damage occurring to property completely ignores the fundamentals of insurance and defeats its utility. Insurers risk rate, meaning higher premiums are charged for risks with a higher probability of loss, and lower premiums are charges for risks with a lower probability of loss. Without risk rating, the entire population of people who buy insurance will pay more for the uncertainty of who is a good risk and who is a bad risk. This would be a needlessly inefficient constriction on the insurance market and should not be imposed by legislation.

If the second definition is intended, we object on the basis that the section is nonsense because:

- If the landlord's insurance excess is less than four weeks' rent, that excess is the cap on the tenants' liability. In this case, the insurer would not be able to recover any amount of that tenant liability up to the cap/excess. Excesses are self-insured, meaning the insured landlord bears the risk of losses below or equal to the excess, and insurers' liability to pay claims and subrogate losses does not kick in until the loss is more than the excess. Insurers can never subrogate amounts below the excess, because they do not insure amounts below the excess.
- If the landlord's insurance excess is more than four weeks' rent, then the four weeks' rent is the cap on tenant liability. But the problem from the above bullet point remains. The excess is more than the liability cap, and the insurer cannot recover amounts below the excess.

The cap is too low to incentivise tenants to take care of others' property

For clarity, we are not arguing for a higher cap, and would like to make this point to note for the Committee what we think the likely impact of the Bill will be on tenants' behaviour.

If a low cap is set, landlord insurance premiums will become less affordable over time because insurers will not be able to offset their losses by recovering from tenants who cause damage negligently.

If a high cap is set, landlord insurance premiums will be relatively lower, as insurers will be able to recover their losses. Either way, insurers can offer a product to the landlord insurance market for a price, and if that price becomes uneconomic for insurers and/or landlords, then insurers may withdraw from providing cover in that market.

Landlords' insurance excesses vary from insurer to insurer, but are usually around $400 per claim. Likewise, four weeks' rent varies from place to place, but would be substantially higher in Central Auckland (approximately $2,000-$3,000), for example, than in Southland ($600-$800). At the current level of rents nationwide, it is still more likely that the landlords' insurance excess will be less than four weeks' rent. Landlords can volunteer to set a higher excess, so it is possible for an insurance excess to be thousands of dollars, and therefore higher than four weeks' rent in Central Auckland. Even so, we doubt a cap of a few thousand dollars would incentivise tenants to be mindful of and take due care of landlord property.

A cap for tenant liability at the lower of the landlord's insurance excess or four weeks' rent will not be an effective financial incentive for tenants to take care of their landlord's property. The cap would fail to meet government's intended policy objective. It is a cap based on political compromise between tenant and landlord interests, rather than a robust policy based on careful analysis of tenant behaviours and how financial incentives affect those behaviours. Our view is that across a population, tenants' behaviour is far more likely to be shaped by considering a worst-case scenario of a multi-million-dollar liability for negligence, than a worst-case scenario of a few hundred dollars.

We note the cost of insuring a rental property is already about 15 percent higher than the cost to insure an owner-occupied property. The higher cost is simply to account for the fact that the incidence and cost of damage is higher for tenanted property than owner-occupied property. This happens for two reasons. Tenants have less incentive to take due care of their landlords' property, than owner-occupants have of their own property. And compared to owner-occupiers, tenants also tend to notify

damage to their landlord late, resulting in higher repair costs than if the home had been occupied by the observant owner. Insurance premiums are unfortunately higher to account for these increased costs of tenant damage.

The Bill is government's response to *Holler v Osaki* [2016] NZCA 130. *Osaki* reversed everyone's understanding of tenant liability. Before *Osaki*, landlords, tenants and insurers operated on the basis that the tenants' liability for negligent damage to the landlords' property was uncapped. This uncapped arrangement did not pose any policy problems requiring government intervention.

We expect the flow-on effects of this policy to be:

- Without an incentive to take care of landlord property, the incidence and cost of damage caused by tenants and their guests will increase over time.
- The cost of the increase will be borne by landlords, either because they cannot recover the actual cost of damage from the tenant and they do not have insurance for the portion of the loss between the tenant's liability cap and the excess of their insurance policy, or because their insurance premium costs increase, because insurers are facing an increase in claims for tenant damage from their insured landlords, and/or because insurers cannot recover from the negligent tenant.
- With the increased incidence and cost of tenant damage being borne by landlords, landlords (and their insurers) are likely to increase their scrutiny and selectiveness of who can tenant their property. This risks creating a larger population of tenants who cannot be housed because of the frequency with which they damage landlord property.
- A reduction in the number of tenants taking out contents insurance policies. Some tenants only buy contents insurance to protect themselves from liability to their landlord, and this incentive to buy insurance will be reduced with a low cap. But contents insurance also covers a tenant for damage to their own property, and for their liability for causing negligent damage to other third parties' property aside of the landlord as noted above. Fewer tenants buying contents insurance means a population of tenants that has a greater exposure to risk and less resilience recovering from events that insurance is designed to cover.

Limiting an insurer's right to subrogate will increase the cost of insurance

The Bill limits insurers' ability to pursue subrogated claims (section 49C(1)). We do not object to this particular limitation of subrogation rights in this particular bill, but we must note, as a matter of principle, that Parliament should be especially cautious when proposing any limitation on insurers' subrogation rights in future.

Subrogation is a critical stabilising factor for the cost of insurance. It is a legal right allowing a person ("A") to step into the shoes of another person ("B") to recover losses relating to a legal liability that a third party ("C") owes to person B. An efficient insurance market is predicated on allowing insurers (person A, in the instance above) to promptly pay valid claims to their insured (person B), so that the insured (person B) can recover from their loss efficiently and effectively and move on, and leave the insurer (person A) to worry about recovering the loss from the negligent third party (person C).

Subrogation allows insurers to keep their losses down. The lower an insurer can keep its losses, the lower an insurer can keep the premiums it charges its populations of insureds. Conversely, if an insurer cannot minimise its losses, then, all else being equal, it will need to charge insureds more in premiums to cover its costs. Limiting an insurer's right to subrogate will increase the cost of insurance, making it less affordable for people who need to use it to manage the risks they face.

Subrogation also benefits the individual insured who has granted a right to subrogate to his or her insurer. The insurer may refund the individual insured's excess and take the recovery into account in determining the insured's future premiums. These actions help to minimise the financial exposure faced by the insured.

We urge the Committee to note these points, and to note that Parliament must exercise caution when considering limitations on insurer subrogation rights in future.

Yours sincerely,

Nick Mereu
Legal Counsel and Regulatory Affairs Manager