PART 5

INSURANCE

5.1 INTRODUCTION TO INSURANCE

THE LAW

The principal provisions of the Credit Act relating to contracts of insurance are to be found in Part VII. Of particular relevance to this case are sections 127, 130 and 131.

Section 127 prohibits a credit provider from requiring as a condition of providing credit under a regulated contract, that the debtor enter into a contract of insurance, except a contract of insurance over mortgaged goods or, where appropriate, a contract of insurance relating to liability in respect of death or bodily injury arising out of the use of the goods where such insurance is compulsory by law. Subsection (1) gives an extensive meaning to the term "condition".

Section 130 requires that a contract of insurance entered into in relation to a regulated contract shall contain certain particulars, including the amount for which insurance is provided or the manner in which each such amount may be calculated, the period for which insurance is provided and the risks insured against. It also requires the insurer within 14 days of a contract of insurance being entered into to give to the debtor -

(i) if the contract of insurance is between the insurer and the debtor - a copy of the contract; or

(ii) if the contract of insurance is between the credit provider and the insurer - a written notice containing the prescribed particulars which, pursuant to Regulation 20 of the Credit Regulations 1984, includes the amount for which the relevant subject matter is insured or the manner in which that amount may be determined, the period for which the insurance is provided, and the risks insured against.

Section 131 provides that where an amount payable to an insurer is included in the amount financed under a regulated contract, the credit provider shall hold the amount in trust for the insurer and within one month after the contract shall pay to the insurer the whole of the amount payable to him.

Another most important group of provisions dealing with the subject of insurance are those which have the effect of requiring the credit provider to rebate to the debtor portion of insurance premiums included in the amount financed under a contract where the contract is discharged prematurely. These provisions have a precedent in the Hire Purchase Act 1959.

The obligation to rebate arises in the following way. Section 105 of the Credit Act enables a debtor to terminate a contract at any time by tendering the net balance due under the contract. Section 103 of the Act describes how the net balance due is to be calculated and the section provides that in calculating the net balance due there shall be

deducted, where a relevant insurance contract is discharged concurrently with the loan, the amount of the statutory rebate of the insurance charges.

The combined effect of the relevant provisions of the Act and the Regulations in their application to credit insurance, is that the statutory rebate of insurance charges for credit insurance is obtained by applying what is known as the Rule of 78 to the amount of insurance premium or charges included in the amount financed as at the date at which the loan and the contract of insurance are discharged.

In addition, where a regulated contract is refinanced, the credit provider is required by section 69 to give to the debtor before the second contract is entered into a statement which sets out, amongst other things, the amount of the statutory rebate of insurance charges (if any).

It is important to note that it is the credit provider, not the insurer, who is required to make the statutory rebate of insurance charges to the debtor irrespective of the nature of the relationship, if any, that exists between the credit provider and the particular insurer. Doubtless the reasoning behind this provision lies in part in an assumption that the credit provider who has introduced the insurance business to the insurer is better placed to recoup rebates from the insurer than are the debtors. There may be additional justifications. In many cases the credit provider will have received a commission from the insurer for introducing the business. In other cases (such as the instant case) the insurer may be a related corporation of the credit provider.

THE BUSINESS OF THE HERITAGE COMPANIES

Heritage Life Insurance Limited (Heritage Life) and Heritage General Insurance Limited (Heritage General) are both wholly owned subsidiaries of HFC. The business of Heritage Life is made up of three classes of business -

(a) the sale of various types of credit insurance to borrowers from HFC;

(b) the sale of Term Life insurance to borrowers from HFC; and

(c) the sale of Term Life insurance to present and former account customers of the Myer retailing group.

The classes of business described in (a) and (b) represent by far the greater part of Heritage Life's business.

The business of Heritage General consists solely or principally of the sale of credit insurance, the risks underwritten being the accidental death of the insured borrower and the disablement of the insured borrower on account of accident or illness from being able to attend to his or her employment. The insurance does not cover loss of employment from any other cause nor does it cover the first fourteen days of any period of disablement.

The task of soliciting Heritage insurance business from HFC borrowers has never been carried out by the staff of either Heritage company.

Predominantly it has been the branch staff of HFC who have been the sales force and HFC has been appointed the duly authorised agent of both Heritage companies. Some insurance business is also solicited for Heritage Life by retailers with which HFC has arrangements for the provision of credit to the retailers' customers but as this comprises only a minor portion of Heritage Life's business and as no issues were raised concerning that insurance in particular, it has for the most part been disregarded in the balance of these Reasons.

As most HFC customers who agree to purchase Heritage insurance deal with HFC branch staff rather than Heritage personnel, it is from HFC branch staff that customers receive information as to the costs, the benefits and conditions and the limitations of the various types of insurance offered by the Heritage companies. Detailed manuals for the guidance of HFC branch staff have been provided at all relevant times by the Heritage companies for the various types of credit and term insurances.

The types of credit insurance in detail sold by the Heritage companies between 28 February 1985 and January 1989 were -

1. Credit Life. This is the term given to the insurance sold by Heritage Life to debtors under personal loan contracts with HFC. The risk insured against is the death of the borrower during the term of the policy which in general terms means also the term of the loan. The only exclusions are suicide within 13 months of the policy being taken out and death resulting from war or war like activities. The benefit payable is the amount

outstanding (or net balance due) under the loan as at the date of death except where the loan is more than three months in arrears in which event the excess of arrears beyond three months is not covered by the policy. This amount is payable directly to HFC. Except where the loan is more than three months in arrears, there is also payable to the deceased borrower's estate an amount equal to the statutory rebate of credit charge.

HFC are agents for Heritage Life and are authorised to enter into contracts on the insurer's behalf. The contract of insurance is entered into immediately after the loan is executed and the insured borrower is provided with a certificate evidencing the creation of the contract of insurance with Heritage Life.

The certificate sets out the essential terms and benefits of the contract but the full terms and conditions are to be found in the Group Credit Life insurance policy issued by Heritage Life to HFC.

The premium is payable by a single payment in advance and it appears to be invariably borrowed by the insured and included in the personal loan to which it relates.

Where there are joint borrowers both may take out Credit Life insurance but in the event of a double fatality only one benefit is paid.

2. Home Life Special. This is the name given by Heritage Life to credit insurance sold in connection with real estate loans made by HFC.

The basic conditions and benefits of a Home Life Special policy are similar to those of a Credit Life policy sold to personal loan debtors and the main differences are to be found in the administrative practices. Because the amount of a real estate loan and, therefore, the amount of the risk under a Home Life Special policy is normally much greater than is the case for a typical personal loan, the HFC Branch at which the real estate loan is entered into is not authorised by Heritage Life to put the insurer on risk; a proposal for insurance which includes medical details is completed by the borrower in the HFC office and remitted by HFC to Heritage Life. Premium for the proposed policy is assessed by the HFC branch staff and normally included in the amount financed under the loan but the acceptance of the proposal and formation of any contract of insurance does not take place until after the proposal and premium have been received by Heritage Life. That may be delayed if Heritage Life requires a medical examination of the proposed insured or if the proposal is defective or incomplete.

3. Combined Credit Insurance. Heritage Life sells a class of policies termed Combined Credit Insurance to persons who enter into loans of the type referred to as retail sales contracts. The risks covered by the insurance are

basically a combination of the risks covered by a personal loan credit life insurance policy issued by Heritage Life and the personal loan accident and sickness policies issued by Heritage General and are subject to similar conditions and exclusions except that in the event of the accidental death of an insured borrower only one total benefit is payable.

The policies are entered into at the offices of the retailer who is negotiating the sale of the relevant goods or services to be purchased with the assistance of a loan from HFC.

4. Take 5. Take 5 insurance is the name given by Heritage Life to the 5 year term insurance policies which it sells to HFC borrowers. Take 5 insurance is not credit insurance - it is pure term life insurance whereby the only benefit payable is the fixed sum assured in the event of the death of the insured. The premium is payable by way of a single premium in advance and the premium is frequently, though not necessarily paid by the insured by moneys lent for the purpose by HFC.

Since mid 1985 the credit provided to finance Take 5 insurances has almost always been by way of separate loans entered into for that purpose but concurrently with the principal loan contract being entered into by the borrower. In HFC terminology these separate loans are referred to as "side loans".

The administrative arrangements for Take 5 insurance are very similar to those applying to Home Life Special and the function of HFC staff is to solicit the proposal and premium from the prospective insured and forward them to Heritage Life.

5. Accident & Sickness Insurance. Accident and Sickness insurance is sold by Heritage General to borrowers from HFC, normally in connection with a personal loan contract being entered into at the same time.

There are two risks insured against -

(a) accidental death - in which event the net balance due under the loan, except arrears in excess of three months, is paid by the insurer to HFC; and

(b) total disablement from engaging in employment arising from an accident or sickness - in which event the insurer pays to HFC for each day of disablement after the first 14 days of any period of disablement, the daily equivalent of the insured borrower's monthly instalments. If there are two or more borrowers only one will be permitted to insure.

There are many more exclusions than those applicable

to Credit Life Insurance. The principal exclusions are -

(a) sicknesses or diseases contracted before the commencement of insurance; and

(b) death or disablement resulting from -

(i) deliberately self inflicted injuries;

(ii) being under the influence of intoxicating liquor or of a drug other than one taken on medical advice; and

(iii) engaging in professional sporting activities.

HFC branch staff have authority to enter into contracts on behalf of the insurer and a group policy plan exists between the insurer and HFC. The insured is given a certificate evidencing his/her insurance contract by the HFC staff attending to the principal loan.

6. Credit Insurance for Revolving Credit Contracts

Each of the types of credit insurance described in paras 1, 2, 3 and 5 are sold in connection with fixed term loan contracts. Heritage companies also offer credit insurance in connection with revolving credit contracts.

As revolving credit contracts are normally formed as a result of negotiations which take place at a relevant retailer's premises, it is the retailer's staff and not HFC branch staff who have the opportunity to solicit this type of credit insurance business.

Very little evidence was taken concerning credit insurance for revolving credit debtors but it is important to appreciate that there are fundamental differences in the way in which these contracts are structured as compared with the insurance contracts offered to debtors under fixed term loan contracts.

The most important difference is that because a revolving credit contract is of indefinite duration and because also the amount of the debtor's liability at any particular future date cannot be predicted, the credit insurance is structured on a month by month basis with premium being charged monthly and billed in the monthly statement issued under the revolving credit contract. It is important also to note that the debtor does not become committed to any period of insurance in excess of one month. The amount of risk insured against during any particular billing cycle period is calculated by reference to the total indebtedness as at the end of the immediately preceding billing cycle.

The Authority was given to understand that similarly structured credit insurance arrangements would be adopted

in Victoria for revolving lending when HFC embarked on that type of lending.

INTRODUCERS' COMMISSIONS

No commission is paid by Heritage Life to HFC for the introduction or sale of credit life policies. Commissions are payable to retailers for the sale of combined credit insurance, the maximum rate of commission being 25%. Commissions are paid at the rate of 30% to HFC by Heritage General upon the sale of Accident & Sickness insurance.

STAFF INCENTIVES AND OTHER MEASURES TO PROMOTE INSURANCE SALES

For most of the period since the Credit Act came into operation, Heritage and/or HFC have provided financial incentives to HFC branch staff to promote the sale of Heritage insurances. In paragraph 24 of his statement to the Authority, Mr. Wilson says that branch managers may have received on average up to $1200 per annum by way of commissions for selling insurances.

The principal incentive was the payment of commission to branch managers for the sale of Take 5 term insurance. The commission, referred to as "award credits" in HFC and Heritage terminology, was paid at the rate of 5 per centum of the Take 5 premium paid by the insured, although it appears that for at least part of the period for which this particular commission was being paid as the sole or major commission on the sale of Take 5 insurance, a certain level of insurance sales had to be achieved in order for branch managers to qualify for the commission.

Commissions based on branch sales of Take 5 insurance were also paid to the relevant district managers and area managers. Mr Hood said that district managers received $1^{1}/2\%$ commission and area managers $^{3}/4\%$ commission. Thus district and area managers had a direct financial interest in encouraging the branches for which they were responsible to achieve high levels of Take 5 sales.

In addition to commissions, other bonuses were paid to branch managers for meeting and exceeding pre-set targets for sales of Take 5 insurance. Mr Hood told the Authority that the bonus amounts were $25 for meeting the branch target and $50 for achieving 150% of target. It is to be noted that Take 5 insurance benchmarks or targets were set in terms of average Take 5 premium sold per loan made, whereas credit insurance benchmarks or targets were set in terms of the percentage of loans for which related credit insurance was sold. These percentages are referred to as penetration levels.

During 1987 an extra element of commission (referred to as "extra award credits") was added to the basic 5% commission scheme. Under the extra award credits scheme further increments of 1% of Take 5 premium were payable for achieving or bettering each of the following benchmarks:

- average Take 5 premium per loan of $60
- joint Credit Life (on personal loans) penetration of 40%
- overall Credit Life (on personal loans) penetration of 85%

- Credit Accident & Sickness (on personal loans) penetration of 85%

A further 1% could be earned by achieving all of the above four benchmarks, thus giving a maximum extra award credits total of 5%. In all, therefore, a maximum of 10% commission upon the sale of Take 5 insurances could be earned by branch staff but of that 10 per centum 4% was dependent upon achieving minimum levels of sales of Heritage credit insurances. It was said, however, by Mr. Hood that while individual branches earned the full 10% from time to time, the highest level of extra award credits paid "across the board" to all branches was 3% from which it follows that the highest average commission paid to branches did not exceed 8%.

Until March 1988 commissions paid to branches were payable to the branch managers only and there was no formal requirement for the managers to share the commission with assistant branch managers or other subordinate staff. However, branch managers were permitted to reward staff for their efforts by the issue of gift vouchers paid from the managers' commissions.

From 1 April 1988, HFC and Heritage abolished the payment of any bonus or commission based on credit insurance sales. Accordingly the "extra award credits" scheme was withdrawn from that date.

With effect also from 1 April, 1988 the basic 5% commission on Take 5 sales was increased to 7.5% to be divided between the branch manager and the assistant manager. Where there was no assistant branch manager the manager was to receive the full 7.5%.

In AC2, HFC announced that with effect from 1 September 1988 the payment of insurance based commissions and bonuses of any kind would be abolished.

Other pressures to sell insurance

HFC did not rely on commissions alone to induce its staff to sell Heritage insurances. Memoranda from HFC or Heritage Head Offices were written to all branch staff stressing the importance of insurance sales to HFC's profits. Area and district managers exhorted branch managers in their "strings" of branches to lift insurance sales efforts. The terms of some of the communications such as Mr. Ezzy's letters of 8 August 1986 to District Manager Sandy and 21 November 1986 to District Manager Alexander were clearly such as to place considerable pressure on district managers and branch managers to produce improved insurance sales.

The Authority does not consider there is anything inherently wrong with the practice of remunerating staff by way of commissions or like incentive schemes. It does not accept that such arrangements invariably lead to the recipients breaking the law or acting dishonestly or unfairly in order to maximise commissions earned.

Any particular commission or incentive scheme must be examined in its full context. Relevant factors may include the magnitude of the commissions and the extent to which the recipients are dependent on commission to achieve reasonable remuneration for skills, effort and time used. But even where employees or agents are remunerated principally by commissions or like incentive schemes, it does not

necessarily follow that the commission or incentive arrangements will lead to unacceptable conduct by the employees or agents.

It is a matter for the employer or principal party to monitor the conduct of the employees or agents and, if necessary, to employ measures such as auditing or monitoring processes that will promptly bring to notice any misconduct on the part of the recipients. One might expect that the more the employees or other recipients are dependent on commission, the more the employer or payer of the commissions should anticipate the likelihood of misconduct and take precautions accordingly.

The various commission arrangements employed by Heritage/HFC seem to have been quite modest in amount. They appear to have constituted on average of something less than ten per centum of salary. The other non-commission type incentives such as the flat sum bonuses which we have described and some sales competitions between branches for which holidays or entertainment or the like were offered as prizes, were even less significant.

In our view none of the commissions or other benefits paid to HFC branch staff were, in themselves, such as to create unreasonable pressures to boost the sales of Heritage insurances by unlawful or unethical conduct.

As for the memoranda and other communications urging staff to improve their insurance sales, some are clearly unobjectionable. With respect to the others which chastised staff for inadequate insurance sales or appear to have threatened dismissal unless sales are improved, the

position is that there is no evidence as to the circumstances of the branches concerned, especially as to the levels of sales then being achieved.

Accordingly it is not appropriate to find that the communications were directly or indirectly applying pressure to raise sales to levels which could only be achieved by the forcing of insurance. Finally, there is, of course, no suggestion in the letters that forcing should be resorted to to improve sales.