

5.2 INSURANCE AS A CONDITION OF THE GRANT OF CREDIT,
SELLING PRACTICES, ETC.

Subsections (1) and (2) of section 127 of the Credit Act are in the following terms -

"127. (1) In this section, "condition" includes -

(a) a condition that is express or implied,
or oral or written; and

(b) a condition that is direct or
indirect or the existence of which
is ascertainable only by inference
from the conduct of persons or from
other relevant circumstances -

whether or not the condition has legal or equitable
force.

(2) A credit provider shall not, as a condition
of his providing credit under a regulated
contract (whether or not the condition is a
term of the regulated contract) require the
debtor to enter into a contract of insurance
other than [sic] a contract of insurance or
compulsory insurance in respect of a mortgage
relating to the contract in accordance with
section 128.

Penalty: 50 penalty units"

It was alleged by CCLS that HFC had unlawfully required borrowers to enter into contracts of insurance with Heritage Life or Heritage General as a condition of being granted credit. Prior to the introduction of AC2 into the proceedings, evidence was led by CCLS of a number of transactions, namely -

Wilson/Bradbury

Saunders/Healey

Quilty

Van Boxtel

Rigney

Rakoci

Silva

Knox

Burns

Garbett

It is the objector's case that in each of these transactions, the taking of insurance was a condition of an express or direct nature of the granting of credit. There is also an issue whether certain other conduct by HFC in quoting excessive amounts for loan instalments might also constitute a breach of section 127 but this will be examined under the heading of other selling practices (see 5.2-7).

In the Authority's opinion the evidence brought by CCLS established on a prima facie basis that the taking of insurance was made a direct condition of obtaining the loan in the Wilson/Bradbury case (a pre Credit Act matter), and in the Saunders/Healey, Van Boxtel, Knox, Burns and Garbett transactions.

However, before any evidence in rebuttal of any of the CCLS allegations was led, HFC introduced AC2 into the proceedings. Contained in AC2 is an admission that HFC made obtaining an insurance from Heritage General or Heritage Life a condition of granting credit. In the light of that admission, qualified though it was as earlier described, the Authority did not consider that any good purpose would be served by permitting CCLS to proceed with evidence of the further instances of forcing insurance on borrowers which it alleged to have occurred, nor did the Authority consider that there was any point in HFC adducing evidence which might rebut or otherwise diminish the weight to be given to the evidence brought forward by CCLS prior to the introduction of AC2.

Subsequently the Chief Executive of HFC, Mr. Wilson, gave evidence that investigations had been carried out into the instances of forcing insurance alleged in the particulars of the Objections and as a result of those investigations had concluded that insurance was forced in the Van Boxtel matter. Mr. Wilson was not, however, specific about the nature of the investigations or as to the conclusions and the reasons therefor in the other instances.

At all relevant times HFC had in force instructions to staff that insurance must be voluntary and not made a condition of granting credit. From at least February 1985 onwards all Heritage Life policies sold to HFC borrowers included a 14 day "free look" provision which entitled the borrowers to change their minds within 14 days of entering into a contract of insurance and receive a full refund of premium. That 14 day right is prominently set out on the face of the certificates of insurance given to the borrowers. A similar 14 day

"free look" provision has been included in policies issued by Heritage General since January 1986.

The Authority has given considerable weight to the evidence of Messrs. Downs and Maloney, two former Branch Managers of HFC who were called by CCLS. The effect of the testimony of both of them was that where borrowers indicated that they did not want insurance, insurance was not pressed on them.

We have described earlier the commissions and other incentives used by HFC to promote the sale of Heritage insurances by branch staff and have already indicated our view that the rates or amounts of commission payable were quite modest. It is not our view that HFC's commission arrangements were such as to lead inevitably to branch staff engaging as a practice in the forcing of insurance contrary to law and, for that matter, HFC's written instructions, even though it is very likely that such instances of forcing insurance as did occur were motivated by the desire to obtain commission. We have a similar view of the other pressures placed on HFC branch staff to sell insurances.

It is argued by the Objectors that the penetration levels achieved by HFC branch staff on the sales of various types of credit and Take 5 insurance establish, or at least make it highly probable, that the taking of Heritage insurances was made a condition of the granting of credit.

The penetration levels of 85% or more that were achieved at times prior to 1988 are capable of giving rise to legitimate concern. However, in our view unusually high penetration levels would necessarily constitute evidence of a practice of forcing insurance only in the

absence of any other factors which could also result in higher than usual levels of insurance sales. In our view, other selling practices (of which there is clear evidence) combined with what we have perceived to be a relatively low degree of commercial sophistication on behalf of many of the consumers, are far more likely to have resulted in the high penetration levels achieved by HFC branch staff.

Nevertheless, it is of interest to examine what penetration levels HFC regarded as being indicative of the possibility that staff were wrongly forcing insurance on consumers and, further, how HFC acted in those circumstances.

There was evidence given by Mr. Wilson that from time to time HFC would become concerned at what appeared to senior officials in HFC to be excessively high penetration levels being achieved by a particular branch and would investigate what was happening at that branch in order to ensure that the high results were not being achieved by requiring insurance as a condition of granting credit. However, it appeared to the Authority from Mr. Wilson's evidence that this precautionary action was very rarely taken. The General Manager of the Heritage companies, Mr. Hood, told the Authority that in his view the fact that a Branch achieved 100% penetration over a month or two was not necessarily indicative of insurance being forced, particularly where the number of loan contracts entered into in that period was relatively small. As the statistical particulars of individual branch insurance sales penetration levels were provided to HFC by Heritage, we were not surprised, in the light of Mr. Hood's attitude, that investigations into possible forced selling by individual branches were rarely undertaken by HFC.

Conclusion

HFC has admitted an unspecified number of instances in which the taking of insurance was made a condition of obtaining credit but beyond that the evidence does not enable us to determine the exact extent to which that occurred in the sense of the taking of insurance being made a direct or express condition of obtaining credit.

We find that although both Heritage companies and HFC clearly strived to maximise insurance sales, nonetheless all genuinely had a policy that insurance was not to be directly forced.

We consider that the high penetration levels achieved in insurance sales by HFC staff are far more likely to have resulted from certain selling practices to which we shall turn shortly, rather than from making insurance a condition of being granted credit.

It thus follows that we find that such instances of forced selling of insurance as did occur were isolated and did not arise from a widespread practice.

We also consider the evidence indicates that only on rare occasions did the achievement of extraordinarily high penetration levels by individual branches lead to investigations by senior HFC officials. However, in our view the real position is that HFC was well aware of certain other selling practices, in particular the over-quoting practice, which were clearly capable of producing high penetration levels and accordingly would have had no reason to suspect, other than

in cases of extraordinarily high levels being achieved over a period of some months, that insurance may have been being forced.

OTHER SELLING PRACTICES

The evidence establishes that HFC branch staff employed, and were trained or encouraged by manuals, memoranda from HFC and Heritage and by more senior staff to employ a number of practices to promote the sale of Heritage insurances. Not all of those practices appear to have been objectionable but one which did attract the Authority's attention was the practice which may conveniently be described as "over-quoting".

The practice operated in the following way. When a consumer telephoned an HFC branch office to enquire about the instalments that would be required to repay a loan of a nominated amount and term, the consumer was quoted a monthly instalment figure which exceeded the true monthly instalment amount. The excess in the quoted instalment figure represented the additional monthly amount required to fund a Heritage insurance premium or premiums on the basis that the premium or premiums were also borrowed. Unless the consumer specifically asked, no inkling was given that the instalments as quoted "made room" in HFC's terminology, for the insurance. If, however, the consumer responded to the initial instalment quotation by stating that he or she had been quoted a lower repayment figure elsewhere for a loan of the same amount and term, it would then be disclosed, for obvious reasons, that the HFC quotation also covered the cost of insurance.

Where instalments were overquoted to a consumer and the consumer decided to proceed with the loan, the practice appears to have been that an appointment was made for the consumer to call at the relevant HFC branch office to sign the loan papers and receive the loan proceeds. The loan documents prepared in the HFC branch office for the consumer's signature would include in the amount financed and in the disbursements authorisation a sum for Heritage insurance premium or premiums, the premium sum being the same (or very closely approximating) that which the HFC branch originally had in mind and had taken into account when the consumer first enquired and was quoted instalments.

The evidence strongly suggests that the practice of over-quoting was widespread for a considerable period of time. It was specifically commended to all branch managers and all executives by Mr. Hood, in his capacity as General Manager of Heritage Life, in a Bulletin of 3 August 1984. The practice is again endorsed in a Bulletin from Mr. Hood of 30 August, 1985. There is no evidence to suggest that the practice was in any way discouraged until October 1987 when staff were formally instructed to discontinue it.

There is also an abundance of evidence both from former employees of HFC and from consumers that loan documents with provision for insurance already included were typed and prepared ready for signature when consumers attended at HFC branch offices to finalise loans.

In the Authority's view the practice of over-quoting in itself constituted deceptive and dishonest conduct. It is also necessary to examine what consequences adverse to consumers flowed from the

practice. To do that, it must be recalled that in the typical case of over-quoting, when the consumer attended at the HFC branch office to finalise the loan he or she was presented with loan documentation which, without any prior disclosure to or request or authorisation by him or her, also provided for the borrowing of premium or premiums to be paid for Heritage insurance. But, of course, the monthly instalment was, as a result of the over-quoting, exactly what the consumer had expected it to be.

The seriousness of the consequences of the over-quoting and the inclusion of the insurance premium amount in the loan documents depended upon what actually occurred at the branch office; in considering that we are specifically excluding the possibility that the consumer was told that he or she must take the insurance in order for the loan to be granted.

If a consumer was informed prior to signing the loan documentation that the insurance set out in the loan documentation was optional - in other words that the loan could still proceed even without the insurance being taken - it is clearly possible that the consumer would have regarded the loan and insurance package as something of a bargain because its total cost was exactly the same as he or she had believed without the insurance. In such a case, the effect of the practice would have been to lower the consumer's resistance, the consumer having first been deceived about the true cost of the loan instalments.

If, on the other hand, the consumer was not clearly informed prior to signing the loan documentation that the insurance was optional, it is highly probable that the consumer believed that the loan and the

insurance were integral elements of the transaction that HFC had agreed to enter into with him or her and thus believed that the taking of the insurance was a condition of the loan being approved.

There was no direct evidence which established that, in any particular case or cases where over-quoting had taken place, consumers were not informed at the loan sign-up stage that insurance was optional. Thus it might be said that it is equally likely that consumers were so informed in which event the effect of the over-quoting would have been merely to lower the consumer's resistance to purchasing insurance. There is, however, evidence which assists in determining which of those possibilities is the more probable.

If the practice had been to inform the consumer that the insurance was optional and thus to present the consumer with a clear choice as to whether insurance was wanted or not, it is unlikely that the formal loan documentation would have been prepared in the form and at the stage described but rather the staff would have had working examples of various levels of instalment payments prepared for discussion with the consumer. In that regard we note that this is exactly the practice which HFC is currently recommending to its staff with the new insurance election form whereby it has been suggested to staff that they calculate and pencil in on a working draft election form the costs of the various options.

Of more weight, however, is a memorandum sent by Mr. Wilson to Mr. Hood, and copied to senior executives of HFC on 20 October 1987. The terms of the memorandum were -

"Will you please make certain when operating bulletins are sent to Branch Offices on insurance sales that you have a disclaimer somewhere in the text advising insurance is not a condition to obtain finance with HFC Financial Services.

"Would you also follow up with L. H. Kalas to ensure that his check list contains an area in which he covers this with Branch Office staff and that they have a clear understanding insurance is not a condition to obtain finance."

The terms of that memorandum, particularly the second paragraph, make it highly unlikely that there was in place within HFC branch offices prior to October 1987, a practice of routinely informing potential borrowers that insurance was optional.

Our conclusions are -

- (i) that while it was at all relevant times HFC's policy that staff were not to state or otherwise directly represent that insurance was mandatory, it was also the practice and impliedly the policy of HFC until October 1987 that staff were not required to inform potential borrowers that insurance was optional except in response to enquiries made by borrowers of their own initiative;

(ii) that as a consequence of HFC's deceptive practice of over-quoting and subsequent inclusion in loan documentation of insurance without any request or authorisation by, or even discussion with, proposed borrowers, it is highly probable that an unknown but substantial number of consumers purchased insurance from HFC believing the taking of insurance to be a condition of the loans being granted.

Each occasion on which a consumer purchased insurance as a result of a belief, induced by HFC's conduct, that insurance was a condition of the loan being granted probably constituted a breach of section 127 of the Credit Act. However, it may well be that neither HFC or Heritage considered that to be so at the time and accordingly we are not prepared to find that HFC indulged in these practices knowing that they were prohibited by section 127. We do, however, have no doubt that HFC and Heritage were both fully aware of the deceptive nature of the conduct and that both were aware of the consequences likely to flow from that deception.

IGNORANCE OF ESSENTIAL CONDITIONS AND BENEFITS UNDER

HERITAGE ACCIDENT & SICKNESS POLICIES

As indicated earlier, accident and sickness insurance underwritten by Heritage General contained significant exclusions. That insurance does not cover disablement arising from sickness or disease contracted prior to the date on which the insurance is taken out. Further, the contract

of insurance is expressly subject to a condition precedent that the insured borrower is aged 18 and under 60 years, is in regular employment and is in good health and unaware of any illness, disease or physical defect which could result in a claim.

There is evidence that on occasions insured borrowers were not made aware of these limitations at the time they agreed to enter into Heritage credit insurance contracts and indeed there is evidence that HFC staff sold insurance to persons known to be suffering from disqualifying ailments or otherwise in circumstances which rendered the insurance of little or no value to them. In a memorandum of 5 November 1985 from an officer of Heritage General to Mr. Wilson the following was said -

"However, the point is that this type of occurrence is not totally uncommon and some branch staff are aware of pre-existing conditions. We do in fact have current claims on file relating to loans which have been taken out for ... "MEDICAL EXPENSES"! Should that reason not "ring a bell" when consideration is given to charging an Accident and Sickness Life premium to cover monthly instalments?".

"It is not a suggestion that the HFC Financial Services Limited branch staff "do Heritage's work" however, in our present "Consumer-Protection-Orientated-Society" we cannot afford to collect insurance premium from an applicant who will inevitably have a claim denied on the basis of a pre-existing condition of

which the HFC branch (being the Insurance intermediary) is aware".

Heritage Life Bulletin No. 1 of 1987 from Mr. Hood to all Branch Managers, Operating Executives and Departmental Heads of HFC indicates that there is still a problem with the sale of credit insurance to people whose claims would be most unlikely to be admitted.

Only one particular instance of this kind was the subject of direct evidence during the hearing. It involved a Mr. Silva who purchased Heritage General Accident and Sickness credit insurance in connection with a loan from HFC made in October 1986.

Mr. Silva had been unfit for work for some period when the loan was negotiated and concluded and did not return to work for some months thereafter. His condition was well known to the HFC branch which negotiated the October 1986 loan; indeed his application for the loan had originally been refused on account of his absence from work and the loan subsequently proceeded only after Mr. Silva threatened HFC with proceedings before the Equal Opportunity Board. The insurance certificate form given to Mr. Silva to sign at the HFC branch office was in the standard form and was expressed to be subject to the condition precedent referred to earlier.

The evidence does not assist in determining what were the real causes of the instances in which accident and sickness insurance was sold to persons to whom the insurance was of little or no benefit. It is possible that it was sold to those persons dishonestly by HFC branch staff who were fully aware of the circumstances of the consumers and of

the effect that those circumstances would have on the worth of the insurance to the consumers. It is, however, also possible that the branch staff, though aware of the circumstances of the particular consumers, did not turn their minds to the consequences that those circumstances would have on the value of the accident and sickness insurance to the consumers. Even in Mr. Silva's case the Authority does not rule out that possibility.

One relevant complication which the HFC staff had to grapple with was that credit life insurance was often sold concurrently with accident and sickness insurance but the circumstances which negate or reduce the worth of accident and sickness insurance do not have any impairing effect on the form of credit life insurance sold by Heritage.

Accordingly, we do not believe that the evidence establishes that HFC through its branch staff acted dishonestly in the sale of accident and sickness credit insurance to persons for whom that insurance was inappropriate or of limited value, although clearly the best that can be said for HFC in this matter is that its staff were inefficient and that the conduct on occasions impacted unfairly on the consumers.

EXCESSIVE INSURANCES

CCLS alleged that HFC required or encouraged debtors to purchase excessive insurance. Later in these Reasons the Authority examines a practice carried on by HFC until 31 December, 1985 whereunder if credit insurance premiums were accidentally over-assessed by HFC branch staff, Heritage would increase the amount of the insurance proportionately.

It is clear that it was not that practice to which the Objectors were referring in this particular allegation. In any event whatever might be said of the subsequent increasing of the insurance, it is clear that the initial over-assessment was unintended and thus not relevant to an allegation that "HFC required or encouraged" excessive insurance.

Apart from the matter referred to above, there is no evidence that HFC required debtors to effect credit insurance for amounts exceeding the debtors' liabilities under their loans. Nor is there any evidence, even where debtors were encouraged to take both credit life and credit accident and sickness insurances, that there was any significant duplication of risks under both policies for which the debtors could be said to be paying twice. There is an element of double indemnity in the life cover provided under credit life and accident and sickness insurance but in our view this is neither unusual nor objectionable.

Accordingly, we do not consider that the evidence establishes that HFC required or encouraged debtors to purchase excessive credit insurance.

So far as Take 5 insurance - the 5 year term insurance - is concerned, it seems to the Authority that in order to substantiate any allegation that HFC had encouraged consumers to take excessive Take 5 insurance it would have to be shown in the case of any particular insured borrower that the term life insurance was excessive to his or her needs having regard to the full circumstances of that borrower, including other insurances and superannuation entitlements, the need to make provision for dependants and the extent of liabilities. No evidence of that nature was adduced and accordingly the allegation is not made out.

EXCESSIVE PREMIUMS

CCLS also alleged that the premiums charged by Heritage companies and included in loans by HFC were excessive. It sought to obtain and introduce evidence of the loss ratios of Heritage Life and Heritage General but the Authority ruled during the course of the hearing that it would not receive evidence as to those matters.

It seems to the Authority that if there have been no misrepresentations as to the pricing of the insurance and no misrepresentations as to the benefits payable under the policies, then the reasonableness of the levels of premium is not a matter to be considered by the Authority in these proceedings.

The Authority is aware that legislation exists in many States of the United States and in Canada which requires insurers to limit premiums charged for credit insurance to levels which will ensure pre-determined minimum loss ratios. It is the Authority's view that the levels of premium charged for credit insurance is a matter which can be controlled by legislation if that is thought desirable. In our view, in the absence of extraordinary circumstances, which we do not believe have been shown to obtain in this matter, the levels of premiums charged should not be taken into account in determining an application for a licence.

REMEDIAL ACTION - INSURANCE SALES PRACTICES

HFC has taken a number of steps to eliminate various deficiencies in its past practices concerning the sales of insurance.

On 30 October 1987 staff were instructed to quote loan instalments both with and without insurance. This instruction, if adhered to, would put an end to the practice of over-quoting.

In March 1988 the amount of commission payable for the sale of Take 5 insurances ceased to be subject to increment upon the achievement of pre-set levels of credit insurance sales. From September 1988 or shortly thereafter no commission or other like benefit has been payable to HFC staff directly by reference to Take 5 insurance sales.

It was, however, announced by HFC in April 1989 that HFC branch staff and district and area supervisors will be eligible for bonus payments based on factors which include net gains in loan outstandings. To the extent that such outstandings are contributed to by premiums for Heritage insurances financed by HFC, some financial benefit may accrue to HFC branch and other staff as a consequence of insurance sales efforts.

Other measures taken in 1988 are directed at ensuring the voluntariness of insurance and the better understanding on the part of consumers of the costs and essential benefits and conditions. Those include -

- (i) the display of signs in "sign-up booths" which state that insurance is optional;

- (ii) the use of an insurance election form that must be completed by borrowers before being asked to enter into a binding contract for insurance;

- (iii) the provision of a booklet setting out the benefits and conditions of the various types of insurance and the issue of instructions requiring every borrower to be given a copy and asked to read the booklet before the borrower can be asked to commit to any insurance.

HFC has also stated that more effective audit and post-sale monitoring are proposed so that any future malpractices will be readily detected.