5.3 CONTINUING ON CREDIT INSURANCE AFTER LOANS HAVE BEEN REPAID

The Heritage insurance manuals issued for credit insurance sold in connection with personal loans and retail sales contracts both instruct HFC branch staff in the following terms -

> "Premature Payouts
>
> When a loan is paid out by the borrower or competitor before the expiry date of the loan, it is classed as a Premature Payout. Company Policy is to make every attempt to convince the customer to allow the policy to continue to run. This means that even though the account is settled the benefits under the policy will continue until the original termination date. (In the event of a claim, all claim payments in these cases will be made direct to the claimant)..."

This instruction concerned the Authority for two reasons, one of which was that the credit insurance policies that the Authority had examined, namely forms of policy in use from January 1986 onwards, provided that insurance under the policies automatically ceased on the date on which the insured borrower's indebtedness is completely discharged. The only provision for the extension of the term of the insurance was applicable solely to cases where the loan was varied.

The other reason for the Authority's concern about the instruction is obvious. The insurance is credit insurance. The risk insured against is death or total incapacity for work arising from accident or sickness whilst the loan is current and the benefits payable are the meeting of the insured's obligations under the loan contract, either wholly in the

case of death or on a daily equivalent of instalments basis in the case of incapacity for work.

Thus it did not appear to the Authority that there was any risk remaining to be insured against once the loan was fully repaid and it was concerned at the possibility that the true purpose behind the instruction was to avoid rebating unearned premium but with no equal benefit being given to the former insured borrower.

Thus when the then Managing Director, Mr. Wilson, was giving evidence, the Authority put to him the terms of the instruction in the Heritage manuals and of the relevant policies. It asked Mr. Wilson whether in light of those documents it would be less than fair or honest to attempt to persuade a consumer to let the policy continue to run. Mr. Wilson replied "There is no benefit, it wouldn't be honest at all". Mr. Wilson did, however, raise the possibility "whether this policy here has been amended in B2 at some stage"; the reference to B2 being the reference to the instruction headed "Premature Payouts". However, the evidence is that the instruction remained unaltered until the manuals were replaced at the end of 1988.

Partly with Mr. Wilson's answer quoted above in mind, the Authority showed to Mr. Hood the same documents as it had shown to Mr. Wilson and put to Mr. Hood that it was nothing short of fraud to set out to convince a customer who was discharging a loan that he or she should continue to let the policy continue to run. Mr. Hood did not accept that that was fraudulent; he said that where the borrower was persuaded to let the insurance run on, Heritage would hold the borrower covered for an amount equal to the repayments in case of accident and

sickness and would pay a death claim as if the contract had not been paid out. He did, however, indicate that he did not consider the practice to be a good one.

When it was put to him by the Authority that there would never be any obligation on Heritage to make a payment, Mr. Hood responded that he thought that there was a moral obligation.

When the lack of any support in the current (ie. 1986 onwards) forms of Heritage policies for this practice of inducing borrowers to let insurance run on was put to Mr. Hood, he answered that the practice of inducing borrowers not to cancel and in lieu to continue the insurance had a long history extending back before the Credit Act to a time when Heritage wrote accident and sickness insurance through another insurer, Western Underwriters. Mr. Hood said it should have been eliminated at the time it (presumably meaning the manual) was revised to recognise the Credit Act.

Although the Authority was not aware of it when Mr. Wilson and Mr. Hood were giving evidence, it is clear from certain exhibits, being copies of credit insurance certificates issued by Heritage Life and Heritage General between February 1985 and December 1985 to borrowers who gave evidence on other matters, that the forms of policies used prior to 1986 did make provision for the continuance of insurance after the discharge of the related loan contracts.

The form of the Heritage Life Credit Life policy used in 1985 contained the following -

"The Policy provides that the insurance shall cease automatically and immediately on the earliest of the following dates:

(a) the date the Debtor's indebtedness is completely discharged;

(b) ...

(c) ...

(d) ...

(e) ...

(f) ...

(g) ...

PROVIDED HOWEVER that the insurance may be extended on such terms and conditions as may be agreed to by the parties concerned".

The form of the Heritage General Credit Accident & Sickness policy used in 1985 contained the following provisions -

"CONDITIONS

1. The Policy provides that this Insurance shall cease automatically and immediately on the earliest of the following dates.

(i) the date on which the Debtor's indebtedness is completely discharged. Provided however that this cover may be extended to the date of the expiry of the Contract in accordance with Clause 5 hereof.

(ii) ...

(iii) ...

(iv) ...

(v) ...

"5. In the event of a Debtor terminating the Contract a refund of portion of the single premium paid in respect of such Debtor will be made. The amount of the refund shall be determined by the Insurer unless the Debtor wishes that this Insurance continues for the contracted term maintaining the same benefits and conditions under the Policy".

It thus appears that until the end of 1985 there was some contractual basis for the "continuance" of insurance after the discharge of the loan contract and it may well be that basis to which Mr. Wilson was intending to refer when he raised the question whether there may have been some change in the instruction. It is curious though that Mr. Hood, the General Manager of both Heritage companies, did not allude to these provisions in the policies issued up until the end of 1985.

From 1986 onwards the position is very different. As mentioned earlier, the policies contained no provision for the continuance of the insurance beyond the discharge of obligations under the loan contract. It seems that, whenever a consumer was persuaded at the time of discharging a loan contract entered into after 1986 to "continue" a Heritage credit insurance policy written in conjunction with the loan contract, there are two possibilities. In our view the most likely possibility is that no legally enforceable arrangement arose in which event the meeting of any "claims" would be dependent upon an act of grace by the relevant Heritage company.

The other possibility is that from each continuance a new contract of insurance arose, but for which none of the terms and conditions were in writing. It is arguable that there is a breach of section 130 of the Credit Act involved in each case in that there is some relationship between the new insurance arrangement and the discharged loan contract, for it is by reference to the notional obligations under the discharged loan contract that the insurer's liability is to be ascertained; but the main criticism which the Authority makes is that former borrowers are not given any policy document which informs them of their entitlements.

However, for present purposes it seems sufficient to proceed with any further examination on the assumption that the arrangement arrived at when a consumer agreed to let the insurance run on was an informal one creating only moral obligations, for that is Mr. Hood's understanding of it and thus we assume, in the absence of evidence to the contrary, also the understanding of the Heritage companies of which Mr. Hood is General Manager.

It should be recalled that at the time both Mr. Hood and Mr. Wilson gave evidence the Authority was only aware of the terms of policies issued from 1986 onwards, and that Mr. Hood rejected the proposition that the practice of inducing consumers to continue to let their policies run was fraudulent on the basis that Heritage assumed a moral obligation to meet "claims" on the same basis on which claims would have been met had the loan contracts not been discharged.

The Authority indicated a degree of scepticism at Mr. Hood's assertion that Heritage would honour claims where insurance had been continued on

or after the discharge of the relevant loan contract and asked would it be possible to produce documents which substantiated the payment of claims in such circumstances. Mr. Hood said that he believed that Heritage could find some such documents.

Some three months later Mr. Hood produced documents from a Heritage insurance file which showed that Heritage had made payments in certain circumstances where it had no legal obligation so to do. In that particular case a consumer had entered into two loan contracts with HFC, the second of which refinanced the first contract which was thereby discharged. Heritage credit insurance had been taken out in connection with both contracts but possibly through an oversight no rebate of insurance premium from the first insurance contract was made or allowed for when the first loan contract was discharged and refinanced by the second loan contract.

The policy conditions for the first insurance contract did not provide for the possible extension of the insurance beyond the discharge of the related loan contract.

During the course of the second loan contract the consumer contracted a disease and became permanently incapacitated for work. The documents on the Heritage file indicate that after a claim was made for credit insurance benefits under the second insurance contract, it was brought to Heritage's notice that no rebate of credit insurance premium for the first insurance policy had been allowed when the first loan contract was discharged and refinanced. The documents further indicate that Heritage had then proceeded to make payments to the debtor as if the first contract of insurance was still in force, such payments being in

addition to the benefits that were being regularly and properly paid under the second insurance contract.

The Authority accepts that the case brought forward by Mr. Hood is a case where Heritage proceeded to make insurance payments in respect of events which occurred after the formal term of the insurance cover had expired. But it seems to the Authority that there are some very significant differences between that case and the cases where borrowers were persuaded to let insurance run on -

(i) the case brought forward by Mr. Hood was not a case where HFC staff had persuaded a borrower to let credit insurance run on - rather it was a case where HFC had failed to rebate, presumably through oversight;

(ii) in the case brought forward by Mr. Hood, there was an on-going relationship between the borrower and both HFC and Heritage beyond the time at which the first loan contract and the related insurance had come to an end. In the cases which concern the Authority the very opposite situation must exist because the instruction to persuade a borrower not to seek a rebate of credit insurance but in lieu thereof to let the insurance run on is only applicable to situations where the loan contract is being discharged prematurely and is not being refinanced. The Authority sees

serious practical difficulties for borrowers and their representatives as being likely to arise as a consequence.

(iii) In the particular case brought forward by Mr. Hood there were other reasons for which HFC would, if it had been fully aware of all the facts, have been anxious to see that Heritage "honoured" the first insurance contract. By failing to make allowance for the statutory rebate of insurance at the time of the discharge of the first loan contract and the refinancing thereof in the second loan contract, HFC overstated the amount financed in the second contract. It is strongly arguable that HFC thereby lost its entitlement to credit charges under the second contract and consequently it might well be seen to be in HFC's interest to ensure that the borrower was treated by it and Heritage in the most favourable way in order to put HFC in the best possible light in any subsequent proceedings in which HFC might seek to become re-entitled to those credit charges. Unfortunately Mr. Hood's case example concerned a contract in another State and no evidence was given about the state of awareness of either HFC or Heritage of possible irregularities in the second loan

> contract although a letter from Heritage to the insured debtor of 5 August, 1988 indicates that the failure to rebate the first insurance had been brought to Heritage's attention rather than being detected by Heritage itself.

For those reasons we do not regard the case example brought forward by Mr. Hood as evidencing the willingness of Heritage to make payments in cases where the instruction in the Heritage manual has been followed by HFC staff.

We are thus left with Mr. Hood's more general but nonetheless unequivocal assurances that such payments are made. In Mr. Hood's words "They're not frequent but then they're not infrequent". He also said that they were not regarded as exceptional.

Even accepting Mr. Hood's assurances that whenever called upon, Heritage was prepared to pay benefits under insurance policies carried on beyond the date of discharge of the related loan contracts, there are practical considerations which make the practice undesirable. The first practical difficulty is the extent of the former borrower's understanding of his "entitlements" and in particular their duration, since the period for which Heritage is prepared to treat the cover as being extended ends on the date on which the discharged loan was originally scheduled to be fully repaid.

The second practical difficulty is that HFC no longer has any direct interest in the matter and certainly does not have the incentive of the

insurance benefits being applied to repay the customer's debt due to it; Mr. Hood gave evidence that in normal cases this is a major factor motivating HFC staff to assist insured debtors with their claims. Furthermore it is likely that the more time that has elapsed between the discharge of the loan contract and the happening of the accident or illness, the more substantial those difficulties will prove to be.

However, in the Authority's view the most serious aspect of this practice would arise in situations where the former insured debtor dies. HFC, on which the Heritage companies principally rely for communication and dealings with insured debtors, is unlikely to be aware of the death because it is no longer receiving instalment payments. It seems to the Authority to be highly unlikely that the executor or personal representative of the deceased debtor would be or become aware of an "entitlement" to press Heritage for payment.

We believe that all of these difficulties are so obvious as to have been well understood by both the Heritage companies and HFC.

Conclusions

1. The Authority considers that the practice, as it applied during the period 28 February 1985 to 31 December 1985, of inducing borrowers who discharged their loans prior to the scheduled terms not to seek a rebate of insurance premium but in lieu thereof to let their insurance continue to run on, was unfair notwithstanding that the policies contemplated such a continuance of insurance cover.

The Authority considers that the practical difficulties likely to be experienced by borrowers in understanding the duration of the extended cover and by their personal representatives in even becoming aware that the extended cover existed would at all times have been obvious to the Heritage companies and to HFC.

2. The Authority considers that the practice as carried on from 1 January 1986 onwards was even more unfair in that the former insured borrowers were being induced to forego a rebate to which they were legally entitled in exchange for a benefit to which there was no enforceable entitlement.

3. Because in terms of the policies issued from January 1986 onwards, the insurance ceased upon the discharge of the related loan contracts, on each occasion that HFC failed to make a statutory rebate and induced a borrower to let the insurance "continue", such failure to rebate was in breach of the Credit Act.