

5.5 INCORRECT CHARGING OF PREMIUMS AND
INSURANCE REBATING ERRORS

Introduction

A consideration of the evidence and issues concerning insurance rebating errors and the incorrect charging of credit insurance premiums requires an examination in some detail of certain of the working practices and procedures of Heritage Life and Heritage General and of their consulting actuary.

By arrangement, Heritage General performs many functions on behalf of Heritage Life. For convenience the terms "Heritage" or "Heritage companies" are used to mean Heritage Life and Heritage General, Heritage General acting on behalf of Heritage Life as well as on its own behalf and, at times, merely one or other of the two Heritage companies. Wherever possible the use of the names Heritage Life or Heritage General is confined to cases where it is essential in the context to identify the particular company.

The TPF & C System

The Heritage companies have for many years retained a well known firm of Consulting Actuaries, Towers, Perrin, Forster & Crosby (TPF & C) to perform services on their behalf. TPF & C maintains a computer facility in which are recorded particulars of the issue and cancellation of Heritage policies and of premiums paid and rebates made or allowed. The keeping of such records in an accurate and up-to-date

form is an essential task in the proper management of any insurance business.

It will be recalled that Heritage credit insurance policies, other than Home Life Special policies, are issued at HFC branches. HFC branches also calculate and make rebates on early loan terminations. It is necessary that the branches notify Heritage of particulars of policies sold and rebates allowed. The branches must also account to Heritage for premiums received at the branches (which premiums in most cases are sourced from loans made by HFC to the insured borrowers) and for the rebates allowed.

The provision of those particulars and the accounting for premiums received and rebates allowed are effected twice monthly by returns made by the branches to Heritage. The returns are referred to as mid month and end month returns, respectively. Copies of relevant new policy certificates and rebate certificates are required to be included with the returns. Procedures covering every aspect of the preparation and furnishing of the returns and the accounting for premiums and rebates have, since before February 1985, been set out in the detailed Heritage insurance manuals and the Loan Office Accounting Report manual issued to HFC staff.

Upon receipt of a mid or end month return from an HFC branch, Heritage forwards the information to TPF & C which enters the relevant particulars of new policies issued and of cancellations into its computer system. That system is programmed to check the accuracy of certain aspects of each transaction. In the case of a new policy, the computer system checks that the amount of premium notified as having

been charged to the insured borrower was the amount properly chargeable according to the appropriate premium scale. In the case of a cancellation of a policy, the computer system checks whether the amount of the rebate notified as having been allowed was the correct amount. Whenever the TPF& C system detects a discrepancy between the premium charged and that which should have been charged or between a rebate allowed and that which should have been allowed, a printed report of the discrepancy is issued by TPF & C to Heritage. These reports of discrepancies, which are known within TPF & C, Heritage and HFC as "edit" reports, have been issued since 1978.

Upon receipt of an edit report Heritage staff first check, by a comparison of the edit report and the particulars which Heritage supplied to TPF & C, whether the reason for the edit report is merely that TPF & C has made an error (such as a key punching error) in the process of entering into the computer the information provided by Heritage. If that is found to have happened, the potential problem raised by the edit report has been resolved.

Where no such error has occurred, there remain two possibilities. One possibility is that the HFC branch has merely made an error in recording the particulars of the new policy or of the rebate for the purposes of the mid or end month return sent to Heritage. The remaining possibility is that the HFC branch involved has made a mistake in assessing the premium or in calculating the rebate.

In order to determine which of the two possible errors has actually occurred, Heritage contacts the HFC branch and checks whether the particulars provided in the mid or end month return were correct. If

the check reveals that the particulars in the return were incorrect, that resolves the problem. If, on the other hand, the particulars provided in the return were correct, it follows that the TPF & C edit report is validated and that the branch has miscalculated the premium or rebate.

Thus by following the procedures described, which are essentially a process of elimination, Heritage identifies the cases in which premiums have been wrongly assessed and charged and rebates have been incorrectly calculated and allowed, at HFC branches. The procedures as so described have been established for a considerable time and were in operation for the whole of the period that is relevant for the purposes of the present application.

It is now convenient to deal separately with the incorrect charging of premiums and the incorrect making or allowing of rebates.

INCORRECTLY CHARGED PREMIUMS

HFC has provided the following details of instances in which credit insurance premiums (other than Home Life Special) were overcharged by HFC branches -

. between 28.2.85 and 31.12.85	- 83 cases	- \$3658 overcharged
. between 1.1.86 and 31.12.88	- 140 cases	- \$5800 (approx.) overcharged

There were also a considerable but unspecified number of cases in which credit insurance premiums were undercharged by HFC branches.

It is necessary to consider the problem of incorrectly charged premiums by reference to two separate periods, namely, from 28 February to 31 December 1985 and from 1 January 1986 onwards.

Incorrectly charged premiums - from 28 February to 31 December 1985

During this period, whenever as a result of the edit reports and subsequent checking procedures that have been described, Heritage established that a credit insurance premium had been incorrectly assessed and charged at an HFC branch, Heritage would adjust the amount of the insurance cover to accord with the relevant premium scale.

Thus, for example, if a borrower purchased credit insurance in connection with a loan of \$3000 but the premium actually charged was, because of an HFC staff error, not the correct premium but in fact an amount which coincided with the scale premium for a loan over the same term of, say, \$4200, Heritage would adjust the cover to \$4200. Conversely, if the premium was undercharged the amount of the insurance cover would be reduced to the appropriate scale amount.

It was asserted that these alterations of cover were authorised under the policies issued by Heritage up until 31 December 1985.

Clause 6 of Heritage Life's credit life policy was then in the following terms -

"In the event of errors or omissions in the calculation of premiums, the amount of cover under the Policy will be limited to the amount normally permitted by the premium which has been paid"

Condition 7 of Heritage General's accident and sickness policy was very similar -

"In the event of errors or omissions in the calculation of premiums, the amount of cover under this Insurance will be limited to the amount normally permitted by the premium which has been levied"

For convenience, these provisions will be referred to as the "cover variation clauses".

Putting aside for the moment the question whether as a matter of law the alterations of the amount of cover were authorised by the cover variation clauses, there are obvious questions of fairness, to say the least, about the practice of altering the amount of cover.

It can be safely assumed that each borrower was informed at the HFC branch that he or she could purchase credit life or credit accident and sickness insurance, or both, covering the full amount of the loan for the premium sum or sums quoted by the HFC branch staff member and that the borrower agreed to purchase such insurance at the quoted rates.

It may also be the case that, for reasons dealt with elsewhere, some borrowers believed that credit insurance was compulsory but the only difference which that makes, in the Authority's opinion, is that any unfair or dishonest conduct by Heritage or HFC arising out of the incorrect charging of premium should be viewed more seriously.

It is obvious that it should not be assumed that a borrower would have wanted to purchase credit insurance for any amount other than the

amount of the borrower's liability under the related loan; it would be absurd to assume that the borrower would have wanted to insure for more than that amount. It is a matter for speculation, in situations where the premium was underassessed, whether the borrower would have wished to have paid the higher correct premium to fully insure the loan or whether the borrower would have foregone the credit insurance on the grounds of its true cost, but it is improbable that the borrower would have wanted to insure part only of his or her liability under the loan.

In this regard, the contrast with Heritage's practices with respect to Home Life Special insurance is most revealing. Mr. Hood explained that where a Home Life Special premium had been overcharged in an HFC branch, the excess amount was refunded by Heritage to the borrower. Where Home Life Special premium had been undercharged in a HFC branch, Heritage would delay issuing a policy and request the borrower to pay the additional amount of premium. If the borrower declined, the insurance proposal would be rejected and the premium paid refunded. Mr. Hood said "In the case of Home Life Special, we can't reduce the sum insured because the sum insured has got to coincide with the loan." (8446).

In the Authority's opinion Mr. Hood's statement illustrates that, the strict legalities of the cover variation clauses aside, the practice of adjusting the amount of cover on any form of credit insurance is absurd. It also suggests that Heritage was fully conscious of that, for there is no other apparent reason why, prior to 31 December 1985, Heritage did not include cover variation clauses and indulge in adjustments of cover in the case of Home Life Special credit insurance.

If Heritage had been minded to act fairly it would, in cases where the premium was overcharged, have covered the borrower for the amount of the loan and refunded the premium excess. Where the premium was undercharged, it should have informed the borrower and offered a choice of insuring for the full amount of the loan on payment of extra premium or alternatively of cancelling the insurance and having the premium paid refunded.

The Authority considers that Heritage's practice of adjusting the amount of cover was essentially a device employed to avoid refunding excess amounts of premium where premiums had been overcharged and to avoid the risk of cancellation where premiums had been undercharged.

However, the position is that not only did Heritage fail to take those obvious steps, it and HFC compounded the unfairness by keeping the borrowers ignorant of the premium charging errors and the cover adjustments (see Shaw, 8789), doubtless to ensure that the borrowers would not demand a refund of the excess premium or cancel the policy. It did, however, notify the branch and it also took the necessary steps and established procedures to ensure that if a claim was received, the benefits would be paid in accordance with the reduced or increased amount of cover. Even then, when a claim was admitted, Heritage's letter advising of payment of the claim did not inform the borrower that the benefit had been calculated on the basis of adjusted cover (Shaw, 8838).

The failure to notify the insured borrowers of reductions in cover in cases of underassessment of premium was also unfair in that it resulted

in borrowers wrongly believing that their liabilities under the loans were fully insured.

But for the cover variation clauses, the Authority would have found that Heritage's practices in adjusting the amount of cover where premium errors were made and in failing to inform the affected borrowers of such adjustments, were dishonest. However, the Authority is prepared to accept that Heritage believed that the cover variation clauses authorised such adjustments. Accordingly, it is not appropriate to find that the conduct was dishonest but we have no hesitation in finding that it was very sharp practice, grossly unfair and deserving of the strongest condemnation.

We turn now to the legal question whether the cover variation clauses authorised variations of the amount of cover under the policies. In our opinion this is of considerably less significance than is the question of the efficacy of the practice which has just been examined.

The Authority's view is that the provisions did not authorise any increase of the cover. The ordinary meaning of the word "limited" does not include increased; if anything it conveys the opposite meaning and thus the use of the word "limited" has the effect of confining the ambit of the provisions to cases in which insufficient premium has been paid and of authorising a reduction only in the amount of the insurance cover. That is also totally consistent with the consideration that there would never have been any intention on behalf of the insured to insure for a greater sum. The Authority is thus of the view that the practice of increasing the amount of cover was invalid.

Finally there is the question whether in each case where the amount of insurance cover was adjusted, Heritage failed to comply with section 130 of the Credit Act insofar as that section requires the insured debtor to be given a statement or notice setting out the amount for which insurance was provided or the manner in which such amount could be determined.

At the time the contract was entered into, the HFC branch staff gave the insured borrower a certificate of insurance which set out not only the amount of cover originally provided, but also the relevant cover variation clause. The applicant argues that the inclusion of the cover variation clause is sufficient compliance with section 130.

The Authority does not agree. The borrower was not told of the error and of the fact that the cover variation clause has thereby become applicable. Moreover, the cover variation clause did not enable the borrower to determine the actual amount of cover; to do that the borrower also required the relevant premium scale but that was not provided.

Accordingly the Authority finds that Heritage failed to comply with section 130 on each occasion that premium was undercharged and the amount of insurance cover was reduced. As the Authority has reached the view that the cover variation clauses did not authorise increases in the amount of cover, the question of breaches of section 130 does not arise where the premiums were overcharged.

Incorrectly charged premiums - 1 January, 1986 onwards

The practice of adjusting the amount of credit insurance cover where premiums had been incorrectly assessed and charged was discontinued by Heritage at the end of 1985, apparently as a result of changes in Commonwealth insurance law. New forms of credit insurance policies were brought into use which no longer contained provisions authorising any adjustment of the amount of insurance cover.

However, HFC branches continued to make substantial numbers of errors in assessing and charging Heritage credit insurance premium. In 1986 there were 67 cases in which premium was overcharged; in 1987 there were 65 such cases. It was not until 1988 that the number of errors declined substantially (8 cases only).

Because of the TPF & C edit reports and subsequent checking processes, Heritage continued to detect errors made in HFC branches in the assessment and charging of premiums. It might have been expected, in cases of overcharging, that all excess amounts of premium would have been promptly refunded since the Heritage companies no longer felt able to use their former device of "absorbing" any excess premiums by increasing the amount of cover (or purporting to do so), but that did not happen. By the end of the taking of evidence in this Hearing in April, 1989 no refunds of the 140 amounts of premium overcharged from 1 January 1986 onwards had been made or attempted to be made.

The Applicant put a number of matters to the Authority in connection with premium overcharging which took place after 1 January, 1986. Its first submission raised a question of the law of contract and it is

convenient to set out the terms of the written form of that submission

"43.2 The Applicant submits that in law this is a matter of simple contract. It is no different as a matter of pure contract law from the situation where a customer goes into a local milk bar for a can of pet food, is told of its price by the shopkeeper, the customer buys the can, and the shopkeeper later realises that he has given to the customer the "wrong" price. All the elements of agreement, offer and acceptance are there. Similarly we assume that most, if not all, of these premium "errors" occurred as a result of the HFC employee giving the borrower the "wrong" figure. However, the Applicant decided that as a matter of fairness and justice in such a situation, where premiums had been "overpaid", it should refund the overpayment."

As to that, the Authority does not consider that the analogy drawn is entirely apt. The charging of incorrect premium resulted principally, if not solely, from errors made by HFC branch staff in using or applying Heritage premium scales. HFC is the duly appointed agent of the Heritage companies. HFC's branch staff are instructed by HFC to offer to its borrowers Heritage insurances at the rates set by Heritage. If the argument put by the Applicant is accepted, then it follows that the borrowers were induced by HFC branch staff to enter into binding contracts of insurance at rates of premium greater than those which Heritage required. On that basis, the Authority considers

that the failure by HFC to recompense the borrowers for the losses suffered as a result of the negligence of its staff was unfair.

It is, however, clear and the Applicant has never suggested otherwise, that neither HFC nor Heritage were relying upon, or were even aware of, the legal argument set out above in the conduct of their businesses between January 1986 and the end of 1988.

The task with which the Authority is faced in these proceedings is that of determining whether it believes HFC would, if licensed, conduct itself efficiently, honestly and fairly. Accordingly whether or not the Applicant's argument based on the law of contract is correct, it remains appropriate to examine as a guide to HFC's future conduct how, in the recent and immediate past, it and its subsidiary insurance companies discharged what they believed to be their obligations with respect to insurance premium overcharges.

For that purpose, there are two matter which require examination -

- (i) why the problem of failing to refund first arose; and
- (ii) why, after the problem had arisen, action was not taken to remedy it.

Why the problem first arose

At the beginning of 1986, Heritage had just abandoned its practice of adjusting the amount of insurance cover where premium charging errors had occurred. It was obvious that premium charging errors would continue to occur. It, therefore, must have been obvious to Heritage

at the beginning of 1986 that new procedures were required immediately to ensure the refunding of excess premiums.

There were two courses open to Heritage; it could make the refunds itself directly to the borrowers or it could institute procedures in conjunction with HFC by which the branches of HFC which had made the errors in premium assessment would make the refunds on behalf of Heritage.

It did not take the first course. No reason has been advanced for that. The problem of Heritage being uncertain that it had the borrowers' current addresses (which Mr. Hood stated made it impracticable for Heritage to make repayments directly to borrowers on account of refunds outstanding for long periods) would not have applied if refunds had been made as soon as the overcharges were detected. The borrowers' addresses, if not included on Heritage's copies of insurance certificates, were obtainable from HFC's head office; those addresses were included in section 1 of branch Loan Office Accounting Reports - see Ex. A156, Vol. 8, Tab 36, page 15.

Interestingly, the solution adopted by Heritage at the end of 1988 as set out in its new insurance manuals is to make refunds direct to the borrowers - see AC 228, page 15.

Heritage having chosen not to make refunds of overcharged premiums direct to the borrowers, the question remains whether Heritage and HFC attempted to take the other course of having the refunds made by the branches. To put it another way, were the 132 cases of failure to refund that occurred in 1986 and 1987 due to unanticipated deficiencies in procedures that had been adopted in a genuine attempt to have HFC

branches effect the refunds on Heritage's behalf or were those cases simply the result of a failure to make such an attempt?

The Authority considers that the evidence strongly suggests the latter. From 1 January 1986 onwards Heritage continued to inform HFC branches by memoranda of insurance premium errors. It would have been a matter of the utmost simplicity for Heritage to have included in those memoranda directions to the branches to refund the excess premiums. It would also have been a matter of the utmost simplicity for the subsequent accounting between the branches and Heritage for refunds so made to have been dealt with in the mid month and end month returns made by the branches to Heritage.

However, no such instructions were included in the memoranda. Nor does it appear that any other instructions were given directing the branches to make refunds. An examination of all the relevant material, namely the pertinent insurance manuals, the Loan Office Accounting Report manual and the two folders of miscellaneous memoranda and bulletins (all of which are contained in Ex. A156) fails to reveal any reference to, let alone instruction concerning, the refunding of excess premiums.

A further indication that no instruction was given is to be found in a Heritage Bulletin of 19 December 1985 which dealt with the new forms of policies to be issued on and after 1 January 1986 for credit insurance sold in connection with retail sales contracts. Those policies had previously contained cover variation clauses similar to those described earlier. Paragraph 6 of that Bulletin reads as follows:

"There is no change in rate charge, in procedures for mid and end month batches in accounting procedure or in relation to rebates, so coming to grips with the new form should be no problem."

The Authority finds that no action was taken at the commencement of 1986 to ensure that refunds of excess premiums would be made as and when overcharges occurred and were detected, notwithstanding that neither Heritage nor HFC believed that they had any legal entitlement to such excess premiums.

The failure to take action after 1 January 1986

After 1 January 1986, the TPF & C edit reports and subsequent checking procedures continued to reveal to Heritage that errors in premium assessment and charging were occurring in HFC branches. Thus members of Heritage staff who received those edit reports and undertook or supervised the subsequent checking processes became aware almost immediately after 1 January, 1986 that premium overcharging was still occurring in HFC branches. Mr. Hood was clearly aware of the problem in 1986.

The very latest that the most senior management of HFC could have been aware of the premium overcharging problem was at the beginning of February 1987 when Mr. Wilson received a copy of HFC's Corporate Attorney's advice to Ms. Jaworski which dealt, amongst other things, with the obligation to refund any overpayment of premium to the customer. (0389).

In mid 1987 Mr. Hood remained concerned that premium overcharges were still occurring and not being refunded. He caused Ms. Jaworski to compile some further statistics of premium overcharging errors and, believing that the problem was essentially one for HFC to address (or at least one in which HFC's co-operation was required), referred Ms. Jaworski's material to Mr. Shaw. Mr. Shaw undertook to check some of the apparent premium overcharges and concluded, after checking some 20 or 30 apparent errors that there was a system problem in the TPF & C error detection process and, therefore, there was no overcharging problem or none of any consequence. This latter conclusion was incorrect as the statistics for premium overcharging errors clearly demonstrate. After that Mr. Hood did nothing further until April or May 1988 when he again caused the matter to be raised.

There were only eight cases in 1988 where excess premiums were charged or, having been charged, were not refunded and only one of those occurred after February 1988. It, therefore, appears that Heritage and HFC had all but eliminated the problem of further errors by February, 1988. However, there still remained the problem of making refunds to the borrowers who had been overcharged premiums in 1986 and 1987 and to whom refunds had not been made at the time that the overcharging was detected.

The evidence establishes that HFC and Heritage had considerable difficulty in 1988 in ascertaining exactly how many cases of premium overcharging had occurred in the previous two years. The cause of the difficulty was that during 1986 and 1987 Heritage did not maintain a separate list in readily retrievable form of the premium overcharging errors that had been notified to the branches.

The evidence also establishes that HFC regarded this problem as being one of low priority by comparison with the other matters with which HFC was faced - see Mr. Wilson's reply of 14 September, 1988 to paragraph 6 of Corporate Attorney Sidaway's memorandum of 31 August, 1988 (Exhibit A315) which did not even advert to the premium overcharging aspect of Mr. Sidaway's memorandum.

The Authority does not dispute that by the latter part of 1988 HFC was heavily occupied with the present application and with its substantial section 85/86 applications to the Credit Division of the Small Claims Tribunal, but that is little comfort to the borrowers who had been overcharged in 1986 and 1987.

It is not clear to the Authority from Mr. Miller's evidence on 17 April, 1989 (9102) whether HFC intends to refund excess amounts of premium charged, together with interest, to the borrowers at the same time as it makes refunds of certain underpaid rebates, that is by 30 June 1989, or whether the Applicant considers that some or all of the cases where premiums were overcharged have to be made the subject of Section 85/86 applications to the Credit Division of the Small Claims Tribunal. However, the Authority has no reason to doubt that HFC will take one of those courses as a result of which the borrowers affected will ultimately be satisfactorily recompensed.

Was the failure to refund excess premiums dishonest?

The remaining questions are whether the failure to take action firstly at the beginning of 1986 and secondly, thereafter, to ensure that excess amounts of premiums were duly and promptly refunded was dishonest. In that regard the Applicant has submitted that because Heritage acted differently in connection with the overcharging of Home Life Special credit insurance premiums and Take 5 term life insurance premiums, it would be inappropriate to categorise Heritage's other conduct as dishonest.

It will be recalled that Home Life Special credit insurance and Take 5 term life insurance policies were not issued at the branches. Rather in each case the insurance proposal was completed at the relevant HFC branch, premium was assessed and collected and the proposal and premium remitted directly to Heritage. Heritage would assess the information set out in the proposal form and check whether the premium was correct. If the premium that had been charged in the branch was excessive, the excess was refunded by Heritage directly to the borrower.

The argument that the Applicant makes is that it would be wrong to find that Heritage acted dishonestly in failing to refund the excess of ordinary credit insurance premiums because it acted honestly with respect to excess Home Life Special and Take 5 insurance premiums.

The Authority does not accept the Applicant's argument. At best it seems to illustrate that in connection with two classes of insurance business the quality of Heritage's conduct was higher than it was in other classes, but whether that in itself assists the Applicant is

equivocal. On one view, it only serves to highlight the adverse nature of the conduct which the Authority has been examining.

The Authority has also had regard to Mr. Shaw's evidence referred to earlier that in mid 1987 he tested some 20 or 30 apparent premium errors disclosed by TPF & C edit reports and found that there was some flaw in the TPF & C edit reporting system.

As to that three points must be made. The first is that some 18 months had passed since 1 January 1986 before this check was made and accordingly it is irrelevant to the failure to take action during those 18 months. The second point is that it was a very small sample and, moreover, one of the conclusions drawn from it was wrong. The third point is that the results of the check are really only relevant to the point under consideration if they induced in Mr. Shaw's mind a reasonably based conviction that the branches were infallible in assessing premiums and that, therefore, the need to refund excess premiums could not arise. The evidence establishes that such a belief could not be reasonably formed; it is necessary only to recall in this regard the incidence of errors in 1985 on which Heritage had taken action by way of adjusting the amount of insurance cover and of which Mr. Shaw, having been General Manager of Heritage General in 1985, was aware.

The Authority does not suggest that the evidence establishes that at or about 1 January 1986 or at any time thereafter Heritage or HFC took a formal decision never to refund excess amounts of premium. In the Authority's opinion it is sufficient to constitute dishonesty for it to be shown that, at the commencement of 1986, knowing that premium errors

would continue to occur, neither company took steps to ensure that excess premiums would be refunded and further that thereafter as evidence of excess premiums being charged continued to come forward, neither company took any action to implement the necessary procedures to ensure prompt refunding.

Ultimately, it seems to the Authority that the requirement to adopt new procedures at the commencement of 1986 to deal properly with excess amounts of premium was so obvious, and the measures needed to be taken so simple, that the failure to do so can only be regarded as conscious and thus dishonest.

As to the failure after 1 January 1986 to institute procedures to prevent the continued occurrence of excess amounts of premium not being refunded, the Authority also finds that to have been conscious and thus dishonest.

CREDIT INSURANCE REBATING ERRORS

By the end of the taking of evidence in this matter in April 1989 it had been established that between 28 February 1985 and 31 December 1988 there had been 1710 instances in which the amount of rebate made or allowed on credit insurance (other than Home Life Special insurance) upon the early termination of loans was less than that required by the Credit Act. The aggregate of the amounts by which the refunds made were less than required was in excess of \$20,000. The amounts were still unpaid and owing to the borrowers at the conclusion of the hearing in April, 1989.

The Authority does not consider that there was anything particularly serious or remarkable in the calculation errors which led to under-rebating of credit insurance premiums. The evidence was that most of the errors were caused by staff unintentionally selecting the wrong rebate factor from the Rule of 78 rebate factor chart supplied to them.

The real issue was why, after incorrect rebates had been made, action was not taken to make second refunds or rebates of the amounts originally under rebated. It is to be remembered that the TPF & C edit reporting system and the subsequent checking processes that have been previously described informed Heritage of all cases where the amounts of rebate made or allowed in HFC branches were apparently less (or greater) than the correct amounts.

It is useful to set out a chronology of the evidence concerning the incidence (as distinct from the causes) of the insurance rebating problem -

- (i) Incorrect insurance rebates were first mentioned in the AC2 proposal document introduced in June 1988. There it was admitted that HFC had failed to provide the proper rebate of credit insurance upon the early termination of a loan contract and it was stated that the rebate allowed by HFC in relation to credit insurance where a loan contract was paid out early will be checked. No indications of the number of contracts involved or of the possible causes of incorrect rebating were given;

(ii) The matter next arose when Mr. Wilson was giving evidence in October, 1988. In his written statement tendered at that time, Mr. Wilson said that 568 relevant accounts had been identified in Victoria but that it had since become apparent that the identification was suspect because of a faulty data base. In his evidence, Mr. Wilson also said that there was reason to think that the list (of 568) overstated the problem. Mr. Wilson did not give evidence in any detail concerning the problem.

(iii) The next witness to give evidence on the insurance rebate problem was Mr. Shaw, who first gave evidence between 30 November 1988 and 6 December 1988.

In that evidence Mr. Shaw said -

(a) in March or April 1988 Mr. Hood had ordered a complete listing from TPF & C of the rebate errors standing uncorrected on its records. The list so produced in May contained 1746 apparent errors.

Groups of officials, referred to as field teams, then conducted examinations of HFC branch records in order to determine which of the 1746 apparent errors were actual errors. As a result of the examination, which was completed in June 1988, there were said to be only 568 actual errors rather than the original

possible 1746 errors - hence the figure referred to by Mr. Wilson;

(b) In mid October, very shortly after Mr. Wilson had given evidence, HFC and Heritage officials had met to discuss differences of opinion about the accuracy of the estimate of 568 actual errors. It was decided that a totally new investigation was warranted. TPF & C was instructed to print a new list showing all apparent outstanding rebate errors from 28 February 1985 to 30 September 1988.

(c) The second TPF & C print out listed 2063 apparent rebate errors. An extensive investigation of branch records was then commissioned to be commenced in December 1988 under the supervision of Arthur Andersen & Co. The ambit of the proposed investigation (which was to extend well beyond the problem of incorrect rebates, to the problem of total failure to give rebates, the charging of close out fees and other matters) and its methodology were explained to the Authority.

(iv) The matter was next raised in February 1989 when Mr. Shaw and also Mr. Hood (but principally Mr. Shaw) gave further evidence about the incorrect rebating problem. Mr. Shaw explained the various results of the investigation supervised by Arthur Andersen & Co. which indicated, inter alia, that there were 1593 cases in which rebates

had been underpaid. However, even by then it was known that the figure of 1593 was not absolutely correct in that preliminary testing had shown that some of the cases listed as rebate errors were actually cases of total failure to rebate. The reverse was thought also to be likely.

Accordingly the applicant sought additional time to make further checks of the accuracy of the various results of the investigation that had been supervised by Arthur Andersen & Co.;

- (v) On 6 April 1989 Mr. Shaw gave evidence for the third time and produced the results of the final checking which disclosed a final figure of 1710 cases in which rebates had been underpaid on the early termination of personal loan contracts and retail sales contracts. There were also 43 cases of underpayment of rebate on early termination of Home Life Special insurance taken in connection with real estate loans.

In summary, the effect of the evidence at various stages of the hearing was -

- 1 - As at June, 1988 - rebating problem admitted, extent not indicated. (AC2).
- 2 - As at mid October - 568 cases of under rebating - possibly overstated (Wilson)

- 3 - As at end November early December - 2063 apparent errors between 28.2.85 and 30.9.88 on TPF & C list - investigation of branch records ordered to find number of actual errors. (Shaw).

- 4 - As at early February 1989 - 1593 actual errors established out of the 2063 apparent errors - further checking required as figure of 1593 known to be incorrect. (Shaw).

- 5 - As at 6 April 1989 - 1710 actual errors established for incorrect rebates on credit insurance for personal loans and retail sales contracts, 43 actual errors on Home Life Special insurance. (Shaw).

Mr. Shaw gave a great deal of evidence about the underpaid rebate problem but much of it does not now require comment either because it was concerned with the methods of the investigations carried out in 1988 and 1989 or because it was effectively supplanted by later evidence as the results of the investigations progressively became available. Mr. Hood also gave some evidence on this matter but his evidence did not add anything of real consequence to that of Mr. Shaw. Particular parts of Mr. Shaw's evidence do, however, warrant careful consideration as they dealt with the causes of the failure by HFC and Heritage to make refunds or second rebates after the initial rebating errors had occurred.

During his evidence on 30 November, 1988 Mr. Shaw explained that at that time there were 2063 apparent cases of under rebating. On the same day Mr. Shaw also explained the TPF & C edit reporting system by

which Heritage was informed of all apparent rebate errors made in HFC branches and that Heritage conducted checks that would reveal whether an edit report was itself wrong because of an input error or for some other like reason.

Mr. Shaw was then questioned about the practice that was followed where Heritage had established that an apparent error was in fact an actual rebating error -

Mr. Bingham: "What was supposed to happen if a person had not been given enough rebate?"

Mr. Shaw: "If the person had not been given enough rebate, a refund was supposed to be made."

Mr. Bingham: "Are you saying that happened?"

Mr. Shaw: "I know that it did happen in some instances."

Mr. Bingham: "In some instances it happened but in some instances it did not?"

Mr. Shaw: "...We won't know that until we review all of the 2063 cases of cancellation errors." (6957)

Thus the Authority understood, as at 30 November 1988 -

- (i) refunds were supposed to be made where rebate underpayments had been detected;

(ii) refunds had been made in some instances;

(iii) it was not conceded that there were any cases in which
refunds had not been made after errors had been detected.

But by 1 December 1988, the next sitting day, Mr. Shaw seemed more prepared to acknowledge that it was likely that rebate underpayments had not been followed up by subsequent refunds.

Mr. Bingham: "When you were in charge of Heritage, what procedure was in place regarding the edit reports?"

Mr. Shaw: "The procedure that should have been followed was that if they - an error showed up on the report, the people in Heritage were to try and resolve that error by contacting the branch and trying to establish what the reason for the error was. The resolution of that would either be that the TPF & C system would be adjusted or that the branch would be required to make a refund."

Mr. Bingham: "You say that was the procedure that was supposed to be followed. I take it that what you are saying is that that was not followed?"

Mr. Shaw: "Well, it appears not because as we've already heard we have some 2000 accounts which need to be investigated."

Mr. Bingham: "So when you were in charge of Heritage General, did you ever check that the procedure was being followed?"

Mr. Shaw: "No, I did not."

Mr. Shaw gave further evidence in February 1989. On 6 February he explained that the investigations of the 2063 apparent rebate errors had revealed that there had been 1593 cases in which the rebates of credit insurance allowed were less than the required amounts and in which no further refunds had been made to the borrowers. It was put to Mr. Shaw by Mr. Bingham that it was dishonest of HFC to have failed to repay the amounts by which rebates had been underpaid.

Mr. Shaw would not accept that it was dishonest and said that there had been a breakdown in procedures basically at the Heritage level where only some rebates were followed up and advised to the HFC branches and that there were a lot that were not followed up. (8134).

Mr. Bingham asked Mr. Shaw - "So you say there were two problems, one is that Heritage did not inform the branches on some occasions and on other occasions if Heritage did inform the branch it was not certain that the refund would be made?" Mr. Shaw answered "I don't know whether those refunds have been made or not." (8157).

The Authority asked Mr. Shaw "What have your investigations revealed about what happened in those cases where branches were notified by Heritage of rebating errors?" and Mr. Shaw answered "We haven't investigated that as yet..." (8228).

Mr. Shaw said that it was possible that the branches, having been notified of errors by Heritage, might have made refund adjustments

without reporting that to anyone (8229) and that the only way to ascertain the cases in which that had happened would be by examining the branch records. Mr. Shaw also said that if a branch, having been notified of a previous rebate underpayment, had proceeded to make a refund, the branch would fill out a rebate certificate which would be treated as if it were a normal rebate and would flow through the accounting records. However the TPF & C records do not enable such refunds or second rebates to be identified (8230).

Thus when Mr. Shaw finished giving evidence in February, 1989 the Authority considered that his evidence was to the effect that -

- (i) HFC had not acted dishonestly in failing to refund amounts originally short rebated;
- (ii) the failure to make refunds was attributable to a breakdown in procedures;
- (iii) some of the failures were caused by Heritage failing to notify the branches of rebating errors that had been reported to Heritage on the TPF & C edit reports;
- (iv) where Heritage had informed branches of rebating errors, it was not yet known whether branches had proceeded to make refunds - investigations were to proceed into that matter;
- (v) it was possible that some branches had made refunds but had not reported to anyone that the refunds had been made;

(vi) if branches had made refunds of amounts originally under rebated, second rebate certificates would have been submitted for accounting purposes, but the TPF & C records do not enable the second rebates to be readily identified.

When Mr. Shaw gave evidence for the last time on 11 and 12 April 1989 he explained the final results of the checks that had been made of cases of under rebating. Those checks established that there had been 1710 cases of under rebating of credit insurance premiums related to personal loans and retail sales contracts and 43 related to real estate loans.

There was also a large number of cases in which the rebates made or allowed to borrowers exceeded the amounts required to be given. However, none or almost none of these cases were caused by calculation errors, but rather by branch staff choosing not to recalculate the net balance due on the early discharge of a loan when a loan instalment date had intervened between the date originally nominated by the borrower as the intended discharge date and the date of actual discharge.

On 11 April Mr. Shaw also expanded on his earlier explanation of the procedures that would be followed if a branch, having been advised by Heritage of a rebating error, proceeded to make a refund of the amount originally under rebated. Mr. Shaw had explained in February that such a refund would require the branch to submit a second rebate certificate to Heritage for processing in the same manner as a normal rebate certificate.

Mr. Shaw explained that there appeared to be a problem in the TPF & C system in that although TPF & C would process the second rebate certificate, that in itself did not result in the correction of the original error as standing on the TPF & C computer record; the TPF & C record would continue to show an uncorrected rebate error unless Heritage also completed a separate computer input form which "instructed" the TPF & C computer that the first rebate error had been corrected.

The Authority then asked Mr. Shaw a number of questions -

Chairman: "Do you believe it was frequent that Heritage would not have caused the correcting instructions to go to TPF & C when they were advised and got rebate certificates of an adjusting rebate?"

Mr. Shaw: "I don't know. We can't find any real evidence that there were additional rebates coming through the Heritage system."

Chairman; "What about all those batch returns that I was asking you about a few minutes ago?"

Mr. Shaw: "I've had a look at some testing of some of the prior years, going back to 85 and 1986, to see if there was any evidence of a second rebate certificate going through and I haven't been able to find that in any of the ones that I ..."

Chairman: "Coming through - you mean just coming into Heritage General?"

Mr. Shaw: "That's correct."

Chairman: "In view of the fact that you said that they have to - that if they make a second rebate they are going to get it back from Heritage in order to balance - does it not follow from that there were none made?"

Mr. Shaw: "I would have to agree with that. To date we can't find any evidence of those second rebates being processed through the Heritage system and if they tried to process a rebate and not submit a rebate certificate, then they should be out of balance in their insurance premium control accounts." (8749-50)

Mr. Shaw's acceptance that no refunds had been made fundamentally changed the nature of the matters which the Authority was required to examine.

No longer was it relevant for the Authority to examine -

- (a) on how many occasions had there been breakdowns in procedures which normally led to refunds being made of amounts under rebated; and
- (b) was it reasonable for Heritage and HFC to rely on those procedures or should the breakdowns have been anticipated

and measures taken to detect them so that refunds would be made without delay.

The relevant questions now were -

- (i) why were no refunds made of amounts under rebated?
- (ii) were Heritage and HFC aware that refunds were not being made?
- (iii) what action did Heritage and HFC take to prevent the recurrence of the problem and what steps did they take to make refunds to the borrowers who had earlier been underpaid?

As to the first question, the evidence is clear that in some cases after Heritage had identified an underrebating error, it notified the relevant branches but in other cases it did not. As no rebates were made whichever had happened, the only difference between the two situations is that in the former case HFC was directly at fault in not making a rebate whereas in the latter it was Heritage that was directly at fault.

As to knowledge of the problem, it is clear that Mr. Hood was very conscious of it from early 1986 onwards. Indeed the problem might well have been cured much earlier had Mr. Hood enjoyed more success in his various attempts in 1986 and the first half of 1987 to persuade HFC to do something effective about it.

As to Mr. Shaw, the evidence is not so straightforward. On 7 February, 1989 Mr. Shaw said that he first knew that there was a "real problem" in May or June 1988 when he saw the TPF & C error list that Mr. Hood had caused to be produced. That may well be, but other evidence indicates that two years earlier he was at least prepared to assume that the problem existed.

On 30 May, 1986 Ms. Jaworski wrote to Mr. Hardacre proposing a new accounting procedure to be adopted for insurance rebates which have been over or under paid by HFC branches. It included, amongst other things, a proposal that Heritage General would in some circumstances forward a cheque direct to the customer where the amount under rebated was \$5.00 or more. It also contemplated that the HFC branch might draw refund cheques (0391). Copies of that memorandum were sent to Mr. Shaw and to Mr. Hood.

Mr. Shaw wrote a note in reply to Ms. Jaworski in which he said "I would also question whether it is worthwhile refunding underpaid premium refunds." He explained that note in the following terms "I knew we had a lot of errors of one or two cents and I hadn't seen any figures to suggest what the actual errors were at that point in time." (8138). Ms. Jaworski accordingly produced further figures which she supplied to Mr. Shaw on 9 July, 1986. (0392, 0393). Mr. Shaw thereupon referred the matter to Mr. Carter, the operations head of HFC, for attention as an operational matter.

It is implicit in Mr. Shaw's note to Ms. Jaworski, in his explanation of his knowledge of a lot of errors and of the amounts involved and in his referral of the matter to Mr. Carter that he knew refunds were not

always made of amounts that had been under rebated. What is more, Ms. Jaworski's memorandum to him of 9 July, 1986 had revealed to him that not all the amounts under rebated were "one or two cents", since that memorandum showed that the aggregate amount under rebated for April 1986 for credit insurance on personal loans only, Australia wide, was \$554.42.

We do not suggest that the above or other occasions on which Mr. Hood and Ms. Jaworski brought the under rebating problem to Mr. Shaw's notice were sufficient to establish to Mr. Shaw the true extent of the problem; indeed the chronology of the evidence as to the successive investigations, which has been set out earlier, demonstrates that nobody knew the exact extent of the problem until after the end of 1988. But, nonetheless, both Mr. Hood and Mr. Shaw were aware before the end of 1986 that refunds were not always being made of amounts that had been under rebated, and that is the first critical point in our view.

The second critical point is that nothing effective was done about the problem until mid 1988, by which time moneys had been outstanding to some borrowers for two years or more. Part of that period has been described as a period for which the matter was put in the "too hard basket".

The current position is that where under rebating occurred on the early termination of contracts which were not refinanced, action is being taken to make refunds, together with appropriate interest, by 30 June, 1989. (see Miller, 9102). Where the under rebating occurred at the time of the refinancing of a contract, the matter of compensation to

the borrower will be left to be dealt with by the Credit Division of the Small Claims Tribunal in the course of HFC's major section 85/86 applications.

The Applicant has argued that while the evidence of the rebating problem is not "particularly complimentary" of HFC's internal procedures, it would be unjust to conclude that there had been any deliberate dishonesty on the part of HFC. The Authority accepts that there is no evidence of any formal or conclusive decision being taken by HFC that refunds were not to be made of amounts under rebated; Mr. Shaw's note of June 1986 questioning "whether it is worthwhile refunding underpaid premium refunds" goes perilously close however, even allowing for his belief at the time that HFC had a lot of errors of one and two cents.

In the Authority's opinion it is sufficient to constitute dishonesty for it to be established that knowing, or having good reason to suspect, that rebates had been underpaid, HFC failed to take effective action for a long period to remedy the matter. It is not to the point that the real extent of the underpayments, that is the number and amounts involved, was not known. Accordingly, the Authority finds that HFC did act dishonestly in this matter.

WITHHOLDING OF INFORMATION

CCLS claimed during the hearing that the Applicant had at various stages withheld or attempted to withhold information as to the under rebating problem and the overcharged premium problem.

So far as the under rebating problem is concerned, the main complaints centred on certain denials in the Applicant's formal response document filed before the hearing commenced, on Mr. Wilson's statement in October that there were 568 cases of under rebating and on the late discovery by the Applicant of certain documents, mainly originating from Heritage, in which both the under rebating and overcharging of premiums were dealt with.

The Authority does not consider that the evidence sustains a conclusion that in any of those matters the Applicant acted in bad faith or intended to mislead the Authority.

As to the matter of overcharged premiums, the complaint was that this problem was not revealed to the Authority or the Objectors until late December 1988 when the late discovery referred to above occurred. The Authority was initially troubled by this matter, because of the apparent breadth of some remarks made during the introduction into the proceedings of the AC2 document and proposals. Ultimately we have concluded that notwithstanding our initial concerns, the Applicant cannot be said to have acted improperly in this matter.