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**The Demise of Australian Motorists
by
Shauna Ferris**

Shauna.Ferris@efs.mq.edu.au

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The Demise of Australian Motorists

by Shauna Ferris

"Oh what a tangled web we weave when first we practise to deceive"

In October 1977, a small Australian insurer went out of business.

It did not attract much attention: just a few paragraphs near the bottom of page 2 of the Sydney Morning Herald. After all, it was only a small company – the premium income was only about \$1 million per annum. And in the mid 1970s, scores of small insurers were disappearing each year.

Why were they vanishing ? Because in 1973, the government had passed a new law, to tighten up the regulation of insurance companies. The Insurance Act 1973 imposed a new requirement : capital reserves must equal to at least 15% of net premium income.

Many small insurers simply did not have enough capital to satisfy the new, more stringent solvency standards. Some vanished quietly : they did not even apply for authority to stay in business. But others fought very hard to stay in business.

The Australian Motorists and General Insurance Company Pty Ltd (AMGIC or the Company) was one of the companies which fought back. In fact, as we shall see, the owners of the company demonstrated a truly remarkable determination to remain solvent. Or at least, to maintain the *appearance* of solvency - which is, after all, not quite the same thing.

To achieve this objective, it was necessary to display a great deal of ingenuity (particularly in relation to the company accounts); it was necessary to overcome many obstacles (including some of the more cumbersome provisions of the Companies Act).

In March 1976, the government appointed an investigator, Mr Rodney Purvis, to examine the affairs of the Company. The following information is drawn primarily from his subsequent report to the Treasurer (1).

Background information – The Company

The Australian Motorists and General Insurance Company (AMGIC) was founded in August 1969. Over the next three years, it made substantial losses in every year.

In May 1972, the owners decided to sell. The company was purchased by a Mr Disney.T. Fayle. Mr Fayle later transferred his shares to Fayle Custodians Pty Ltd, which was trustee for the Fayle Family Trust. Mr DT Fayle and Mrs KL Fayle were the Directors of the trustee company.

Mr Fayle and Mrs KL Fayle were also the owners of another companies which will also play a part in our saga: Austco Insurance Brokers Pty Ltd.

The 1975 accounts

According to the 30 June 1975 accounts, AMGIC was a successful company. Premium income had increased considerably during the year - the premium income had more than trebled in just one year. The company was showing a healthy profit of \$162,234 for the year.

However, the auditors were not entirely happy with the accounts – and in particular, they were not happy with the size of the unearned premium provision.

In a general insurance company, the unearned premium provision represents money paid in one financial year, which is set aside to cover claims arising in the following financial year. For example, suppose that policyholders pay \$1000 on 1 January 1975. Part of the money is used to cover initial expenses, such as commission. The rest of the money is divided pro-rata: half is used to cover claims occurring before 30 June 1975, and the other half is set aside to cover claims occurring in the second half of the year.

Suppose initial expenses are 20%, i.e \$200. Then the “earned premium” for the financial year ending 30 June 1975 would be \$600 (consisting of \$200 for expenses and \$400 to cover claims in the first half of the year). The remainder of the premium, i.e. \$400, would be set aside as an “unearned premium provision” to cover claims after 30 June 1975.

Suppose that the claims amount to \$400 in each half year. Then the accounts would appear as follows.

	1975	1976
Earned Premium	\$600	\$400
less expenses	\$200	\$0
less claims	\$400	\$400
Profit	\$0	\$0

However, if profits are poor in 1975, the company might be tempted to “adjust” the division of premiums. For example, suppose that the company claims that initial expenses are 70% of premiums. The earned premiums would increase to \$850 (\$700 for expenses and \$150 for claims) and the unearned premiums would fall to just \$150 (15% of premiums). The revised accounts would be as follows:

	1975	1976
Earned Premium	\$850	\$150
less expenses	\$200	\$0
less claims	\$400	\$400
Profit	\$250	-\$250

Note that the profit for 1975 has (apparently) increased in a delightful fashion – but unfortunately the profits for 1976 will be reduced by the same amount.

In other words, understating the unearned premium provision merely delays the inevitable. By making this “adjustment”, the accounts in 1975 can be made to show a (non existent)

profit. But this simply pushes the losses forward into the next accounting year – the losses from 1975 will eventually emerge, in the 1976 accounts.

Now in 1975, AMGIC had premium income of \$515,620 for the year, but according to the company accounts, the amount set aside for unearned premiums was just \$89,869, or about 17% of the premium income. This seems very low – for a typical insurance company, one would expect the unearned premiums to be about 40% of premiums.

Upon investigation, the auditors discovered that the company had assumed initial expenses of 70% of the premium. In a note to the accounts, the auditors suggested that the 20% would have been more reasonable. The auditors suggested that the unearned premium provision should be increased to \$239,650. If this suggestion had been adopted, the 1975 accounts would have shown profits of just \$12,453 instead of \$162,234. The company's net assets would then reduce to just \$2,972.

Raising Capital

Since the unearned premium provision was understated in the 1975 accounts, the company's liabilities were also understated, and hence the company's solvency status (as shown in the accounts) appeared much better than it was in reality.

But apparently, the Insurance Commissioner was not convinced. When AMGIC applied for an authority to transact insurance business, the Insurance Commissioner refused: the level of net assets was clearly well below the minimum required by the Insurance Act 1973. The company immediately appealed against the Commissioner's decision. The appeal was considered by the Insurance Tribunal, which determined that AMGIC would be authorised only if the issued capital of the company was increased from \$20,000 to \$200,000. The determination was announced on April 6, 1976.

On April 7, 1976, Fayle Custodians applied to the Bank of New South Wales (the Bank), asking for a loan of \$180,000. The loan would be used to buy newly-issued shares in AMGIC, hence providing additional capital to the insurer. Mr Fayle's letter to the Bank explained the situation:

“This Company has neither financial nor liquidity problems, but it has been, by a Government Act, forced into a position whereby to continue in business it is required to obtain funds to increase a capital that, although it has not need for the same, will nevertheless improve a strong financial position.”

The Bank agreed to make the loan, and the new shares were subsequently issued by AMGIC. On 14 May 1976, Mr Fayle wrote to the Insurance Commissioner to advise him of the increase in capital, promising that the funds raised would be *“invested only in first ranking security with reputable and secure financial instruments”*.

On May 27, 1976 the Insurance Commissioner duly authorised AMGIC to carry on insurance business.

Repayment Arrangements

The Bank was willing to lend \$180,000 to Fayle Custodians, but naturally the Bank expected to be repaid.

The loan was drawn down on 17 May 1976. According to Mr Ogden, the manager of the Bank, Mr Fayle agreed to repay \$45,000 before 30 June 1976, and then make repayments of \$10,000 per month until the debt was fully repaid.

On June 4 1976, the Directors of AMGIC passed a resolution:

“As the Company continued buoyant trading and business income and cash flow maintained high levels, it was resolved to make a monthly dividend remittance of \$12,000 to be offset against future dividends declared by the Company.”

On June 24 1976, the Directors of AMGIC passed a resolution:

“Due to the satisfactory trading of the Company for the year to 30 June 1976, it was resolved to declare a final dividend of \$35,000 payable immediately to Fayle Custodians.”

Now these arrangements apparently aroused some concern in the offices of the Insurance Commissioner.

Firstly, as the investigator subsequently pointed out, the references to “buoyant trading” were rather optimistic. In the 1976 financial year, the company actually incurred an operating loss of \$102,760. There were no profits at all. Any dividend payments would, necessarily, be taken from capital reserves, and hence any such payment would simply erode the solvency of the company.

During the subsequent investigation, Mr Fayle was asked why the directors had agreed to pay a dividend, when the profits were non-existent. Mr Fayle pointed out that their own accounts **did** show a profit, at least initially. But the accountant had (most unreasonably) revised their figures, insisting that the company should use a much lower expense ratio to calculate the unearned premium provision. After this adjustment, the profit turned into a loss.

What happened to the dividend payments ? As agreed by the directors, \$35,000 was duly paid to the owner of the company, Fayle Custodians, on June 24. Fayle Custodians then paid out the full amount: fourteen members of the Fayle family received \$2,500 each. By a strange coincidence, just a few days later, on June 28, six *other* members of the Fayle family made loans to Fayle Custodians, of an amount totalling exactly \$35,000.

The amount of \$35,000 was then paid to the Bank of NSW as part-payment of the \$180,000 loan.

In the investigator’s report, the following interchange is recorded:

***Mr Purvis (the investigator) :** Mr Fayle, why were the moneys paid out to fourteen members, or allegedly to fourteen members of the Fayle family, and then same sum then repaid by six members of the Fayle family ?*

***Mr Fayle :** Privilege. Well, for reasons of taxation so far as I understand it.*

Mr Purvis: *Are you telling me, Sir, that these payments did not take place further to your instructions as Chairman of Directors of Fayle Custodians?*

Mr Fayle : *The payments did take place.*

Mr Purvis : *Further to your instructions ?*

Mr Fayle : *Privilege. Further to my instructions.*

Mr Purvis : *Why did you so instruct ?*

Mr Fayle : *Privilege. On advice I was given, it was split up into fourteen members - \$35,000 was split up into fourteen members of Fayle Custodians who were not in receipt of an income, and therefore the taxation situation so far as they are concerned would be minimised, and a number of those are children, unemployed – nine are children.*

Mr Purvis : *And the money then being paid back on 28 June – why did that happen ?*

Mr Fayle : *To pay the Bank of NSW the \$35,000 that was paid in on 30 June.*

Now in Australia, there are laws which prevent companies from funding the purchase of their own shares. The manager at the Bank of NSW, Mr Ogden, was well aware of these laws, and he apparently felt some reservations about the proposed repayment arrangements. On 7 April 1976, immediately after the bank loan was first mooted, he wrote a letter to Mr Fayle:

“We refer to our discussion of this morning.

“After your departure we perused the file of [Fayle Custodians] together with the relevant portions of section 67 of the Companies Act in relation to the subject in question....”

“For your information we quote :

Section 67

(1) Except as otherwise expressly provided by this Act, no Company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person or for any shares in the Company or, where the Company is a subsidiary in its Holding Company or (except in the shares of a Building Society) in any purchase, deal in or lend money on its shares.

(2) Exceptions :

- (a) When in ordinary course of business*
- (b) When in trust for employees*

(c) Loans to employees

We hope the foregoing will be of assistance.”

On April 8, 197, Mr Fayle replied and set Mr Ogden’s mind at rest. He wrote as follows

“Fayle Custodians Pty Ltd acts solely as Trustee for Fayle Family Trust and the Directors warrant that the dividends paid by Australian Motorists & General Insurance Company will be in the ordinary course of business and in accordance with the provisions of the Income Tax Assessment Act. Dividends will not be increased solely to permit Fayle Custodians Pty Ltd to meet repayments of the Bank loan.”

In the light of these statements, it is interesting to read the testimony of the directors of the company, when questioned about dividend policy by the government investigator. The directors interviewed were Mr Fayle, Mr O’Brien, and Mr Young.

Interview with Mr Fayle

Mr Purvis : *Was there any reason prompting the Directors of Australian Motorists to declare dividends in June 1976 ?*

Mr Miller : *Privilege.*

Mr Fayle : *I think the reason might be contained possibly in that document from the Bank of New South Wales.*

Mr Purvis : *Well, I am asking you to give me the reason, Sir.*

Mr Fayle : *Well, it was to reduce the loan from the Bank of New South Wales.*

Interview with Mr O’Brien

Mr Purvis : *Why was it that a dividend was declared on 24 June 1976 in the sum of \$35,000 ?*

Mr O’Brien : *Because of the unappropriated profits existing in the books as at 30 June 1975 at that date.*

Mr Purvis : *Why was it then necessary to declare that on 24 June 1976 ?*

Mr O’Brien : *It was also to assist the shareholders in their repayments to the Bank.*

Mr Purvis : *That was a matter put to the Board by Mr D.T. Fayle ?*

Mr O’Brien : *Yes.*

Mr Purvis : *What did Mr Fayle say to the Meeting ?*

Mr O'Brien : *I believe to the effect that he would like the Dividend paid to cut down the interest rates that had to be paid to the Bank for the amount which was payable to the Bank.*

Mr Purvis : *But why at that time – why 24 June 1976 ?*

Mr O'Brien : *Trying to recall, I believe it to be because a payment was due to the Bank at that stage.*

Interview with Mr Young

Mr Purvis : *Why was it, Mr Young, that the Board of Australian Motorists at that time, that is early June 1976, was then considering payment of a dividend ?*

Mr Young : *I cannot give you a reason for that.*

Mr Purvis : *You, as a Director of the Company, were interested, I suppose, in whether or not it should pay a dividend ?*

Mr Young : *Yes. Absolutely.*

Mr Purvis : *What were the circumstances then in existence so far as you know which warranted the Board considering a payment of a dividend ?*

Mr Young : *I think that dividend was to be paid to the shareholders regarding various other loans etc and were to be taken out with the Company.*

Mr Purvis : *What were the various other loans ?*

Mr Young : *I think that is to do with Fayle Custodians.*

Mr Purvis : *And what did it have to do with Fayle Custodians ?*

Mr Young : *I think at the time Fayle Custodians were purchasing a property – Not purchasing a property – it was a loan on the property, and they were purchasing shares in Australian Motorists.*

Mr Purvis : *You tell me that it was your understanding that the dividend had something to do with the purchase of shares ?*

Mr Young : *That is correct. Not with the purchase of shares but*

Mr Purvis : *.... with payment ?*

Mr Young : *Yes.*

On the basis of his investigations, Mr Purvis subsequently made a report to the government which stated that:

“No proper assessment of the profit or loss of the Company for the year ending 30 June 1976 was made prior to the dividend being declared...”

“There were no circumstances other than the reduction of the ‘Fully Drawn Advance Account’ warranting the declaration and payment of dividend at the relevant date.”

“The payment of the dividend reduced the liquidity of the Company at a time when the Company had not accumulated, since the allotment of [the newly issued shares], funds enabling the same to be withdrawn from the Company without affecting its solvency.”

Round Robin Payments

The Insurance Commissioner monitors each insurance company, to ensure that each company maintains an adequate level of capital. As part of this process, insurance companies are required to provide a quarterly statement of assets, to show that their funds are invested securely.

Now clearly, AMGIC was going to have some difficulty in satisfying these requirements. Despite a complete absence of profits, they had already paid out \$35,000 as a dividend, and they were also paying out \$12,000 per month.

There seems to be some doubt about the exact nature of these monthly payments of \$12,000— in the Minutes of the Board Meeting, these payments were described as *“monthly dividend remittances of \$12,000 to be offset against future dividends declared by the Company.”* Were these dividend payments ? Or were they loans to be repaid by future dividends ?

Mr Fayle clearly regarded it as a dividend payment, not a loan.

Mr Purvis : *Do you consider that when payment of \$12,000 is made it is - passing of ownership of that money from Australian Motorists to Fayle Custodians ?*

Mr Fayle : *Privilege. Yes.*

Mr Purvis : *And there is not, following that payment an obligation on Fayle Custodians to repay to Australian Motorists ?*

Mr Fayle : *There is no obligation, but Fayle Custodians would, if the occasion arose.*

Mr Purvis : *There is no obligation.*

Mr Fayle : *No obligation.*

However, some other employees of the company seemed to think that the payments should be regarded as a loan – in any event, it seems that some of these payments were shown as a loan in the AMGIC accounts.

In either case, the result was likely to be unsatisfactory to the Insurance Commissioner. Under section 30 of the Insurance Act, a loan to Fayle Custodians would not be considered to be an acceptable investment for solvency purposes.

Each month, as the dividends were paid, AMGIC's solvency level would be further depleted.

- By the end of September 1976, four payments had been made, totalling \$48,000.
- By the end of December 1976, seven payments had been made, totalling \$84,000.
- By the end of March 1977, ten payments had been made, totalling \$120,000.

So how could AMGIC demonstrate adequate solvency in the quarterly reports to the Commissioner?

The investigator, Mr Purvis, noticed an unusual pattern of transactions in the accounts.

On September 30, 1976, the Bank of NSW debited the sum of \$50,000 to the account of Fayle Custodians.

On the same day, the same amount was received by AMGIC. AMGIC then deposited this sum with Partnership Pacific for one day.

On 1 October 1976, Partnership Pacific returned the money to AMGIC, which then repaid the money to Fayle Custodians.

On 1 October 1976, the Bank of NSW credited the same sum to the account of Fayle Custodians.

On 31 December, a very similar set of transactions took place – except the sum had increased from \$50,000 to \$87,500.

On 31 March 1977, it happened again – except the sum involved had increased to \$125,000.

The investigator, Mr Purvis, asked the bank manager about these transactions.

***Mr Ogden :** As indicated by the diary, Mr Fayle usually contacts me and says that, you know, they will be drawing one cheque and it will be returned in a couple of days, and...*

***Mr Purvis :** Mr Ogden you may be able to assist me – you may not. Reference is made in this diary note of the Bank of New South Wales, “Round robin to take place”. What is your understanding of these words ? What of the use of those words?*

***Mr Ogden :** Well, cheques drawn on one account and credited to another, and then drawn on the other account and credited back to the original account.*

***Mr Purvis :** Well, may I ask you, Sir, why it was within your diary note you used the words “Quarterly Round Robin” ?*

Mr Ogden : *Yes, that would be Mr Fayle's words. He probably rang up and said that we are having our quarterly Round Robin, or words to that effect, on this particular of about this particular time.*

Mr Purvis : *It was your understanding that on each quarter day the funds that would be drawn on the account of Fayle Custodians paid to Australian Motorists, and shortly thereafter the funds would be returned.*

Mr Ogden : *Yes.*

Of course Mr Purvis also questioned the directors and the company accountant about these transactions.

"When asked why a procedure had been followed by Custodians, the Company, Partnership Pacific, and the Bank of New South Wales each quarter day, Mr Fayle initially said that this was in accordance with correct accounting procedure but he was not qualified to give a more precise explanation. He said that there was nothing sinister going on.

"He said that the purpose was not to deceive the Insurance Commissioner, although he agreed that the effect of the transaction would be to not disclose that payments had been made by the Company to Custodians."

"The Company's accountant, Mr West, said that the reason he suggested the passage of moneys on quarter days was that it would enable there to be shown as an investment within the Company the moneys so paid to Custodians rather than as an advance."

"Mr Young [a director of AMGIC], when he was asked questions in relation to this subject, indicated that Mr Fayle had said that the passage of moneys was done to reduce the Loan Account of the Company as at the end of each quarter, or keep the Loan Account down at the end of each quarter. It was further indicated by Mr Young that this was done so that the moneys that had been paid by the Company to Custodians would not appear in the accounts of the Company at the end of each quarter.

This according to Mr Young was done 'mainly to deal with the quarterly statement that the Company had to render to the Insurance Commissioner'.

Mr O'Brien, in giving his evidence, confirmed that the payment month by month of the sums of \$12,000 (together with the initial Dividend of \$35,000) had the effect of reducing assets of the Company otherwise available to meet outstanding claims and by July 1977 to the extent of \$180,000. He stated that the quarter-day adjustments were introduced as a method of 'removing the problem of Taxation'. Mr O'Brien said that the adjustments were done to give the appearance of the debt being repayable so that the amounts received by Custodians would not be liable to taxation, even though the resolutions [of the Board of Directors] referred to the payments as a dividend.

Mr O'Brien agreed that the effect of the movements of funds and the then description of the moneys outstanding on the Returns furnished to the Insurance Commissioner

would be to show the item on the Return as 'Deposits with and loans to other business – unsecured', and conceal from the Insurance Commissioner that moneys had been paid by the Company to its Shareholders."

"Happy Money"

Dividend payments were not the only drain on Company funds. During the financial year ending 30 June 1976, the company apparently incurred considerable expenses in relation to "Travelling and Entertaining Expenses", "Advertising", and "Management Expenses", amounting to about \$35,000. The payments were all authorised by the Directors of the Company and paid in cash.

The auditors were somewhat puzzled about the nature of these expenses. In their audit report for the 1976 accounts, they noted that *"Independent supporting evidence for these disbursements is not available."* They evidently had several discussions with Mr Fayle on this topic. The Insurance Commissioner, alerted by the auditor's report, also began asking questions about these mysterious payments. Why were there no receipts available to verify these expenses ?

Mr O'Brien, a director of the company, replied to the Insurance Commissioner's enquiry in November 1976:

"The disbursements are made to promote and protect this company but the recipients refused to provide accounts or receipts for same which under the circumstances is understandable."

You may wonder : who are these people, who are so reluctant to provide accounts for legitimate business transactions ?

Eventually, after enquiries from the Insurance Commissioner and a stern letter from the auditors, AMGIC changed its procedures. Starting from November 1976, payments in relation to "Travelling and Entertainment Expenses", "Advertising", and "Management Expenses" abruptly ceased.

However, starting in November 1976, the Company began to make substantial payments, in cash, to Karva Credits (which, you may recall, was a company wholly owned by Fayle Custodians). But surprisingly, the accounts of Karva Credits did not show that any such payments had been received.

Mr Purvis, the investigator, subsequently questioned the staff of AMGIC about these payments. It appears that all of these cheques were cashed in at the bank by one of the younger staff members, and then the cash was handed over to Mr Fayle. Mr Fayle then divided the money up, putting it into different envelopes which were marked with different letters: S, H, or K. The marked envelopes were later collected by messengers and then delivered to three car dealerships : S for Suzuki, H for Honda, and K for Kawasaki.

Other people also received money, in cash, from AMGIC. Mr Young reported that money was often handed over to officers of the Police Department - about \$500 per week. The Police often came to Mr Young's own home, in uniform, with a police car or paddy wagon,

to collect the money. Sometimes they came to the office, in the evening, after most of the staff had gone home.

What was the purpose of the payments ? Mr Young said that it was "*to further the progress of the company*", and agreed that it could be described as "*a form of bribery*". He claimed that he was unable to identify any of the police officers who had collected the money.

Mr O'Brien, a director of the Company, backed up Mr Young's statement. He admitted that the cash disbursements were not related to Entertainment Expenses - the accounts were incorrect. He agreed that the money was used to pay the police, and the payments were made "*to assist the Company in maintaining the insurance market in a particular field*". He contended that it was not an improper transaction - perhaps a bit irregular - but it was bringing business to the Company. He understood that the payments were some sort of bribe. He did not know the identity of the recipient, and he did not want to know - in his opinion, it was much safer to be quite ignorant.

Some other staff members also testified that payments were made, and information obtained, but they all denied any knowledge of the identity of the recipient of the payments.

The investigators were puzzled by this. After all, Mr O'Brien said that the money was paid to get information in a hurry on accident reports, and to get details that would otherwise take weeks to obtain. So what if AMGIC needed some information in a hurry - who would they contact in order to request the information ? Surely someone in the company must know the identity of the helpful officer ?

Mr O'Brien agreed that this was a reasonable assumption. But nevertheless, no one seemed to able (or willing) recall the name.

Smaller payments were also made to government officials in the Department of Transport, in order to obtain details of driving records, convictions, the registration numbers of vehicles, the names of owners of vehicles, and so on. Once again, no one seemed to be quite sure of the name of the recipient - although one junior staff member suggested that it was someone called Smith.

The investigator also questioned Mr Fayle about the payments:

Mr Purvis : *I think you also say, and do correct me if I'm wrong in any respect in this regard, Mr Fayle, that these payments are an account of what you have described as "Graft"*

Mr Fayle : *Well, privilege. The Police have described it to me as "happy money", which is the same thing, I suppose*

Mr Purvis : *And it is paid by Australian Motorists in cash ?*

Mr Fayle : *In cash.*

Mr Purvis : *I think it is also your contention, Mr Fayle, is it not, that payments of this kind have been made by Australian Motorists in order that the company can maintain itself at a profitable level ?*

Mr Fayle : Privilege. Yes.

Mr Purvis also discovered that some employees had received additional payments, in cash, as "bonuses"; no income tax had been paid on these "bonuses".

According to the accounts (and by this time you may wonder how reliable they are), the company was indeed doing well. The premium income grew from about \$160,00 in 1974, to \$517,000 in 1975, then up to \$1,115,000 in 1976. Of course, as any actuarial student will tell you, an increase in premiums does not necessarily result in a corresponding increase in profits.

In his report on this matter, the investigator simply reported that the records of the company, in relation to these cash payments, *"did not correctly describe the nature of the payments that in fact had taken place."*

He added that *"If the payments ... did in fact take place, then the Company maintained its level of business substantially as a result of the payment of moneys which can only be described as by way of graft and bribery."*

However, he was still suspicious about those payments. It was clear that some of the money had been spent in bribery and corruption; but Mr Purvis wondered if some of the money might have been diverted to other purposes : his report suggested that

"The probabilities are that whilst some bribery took place and some graft payments took place, a substantial portion of the withdrawals were for other purposes, namely those of Mr Fayle".

What were these "other purposes" ? An examination of the 1976 accounts may be enlightening.

The 1976 Accounts : the liabilities

Even if the company did not have much spare cash, perhaps it could trade its way out of its financial difficulties ?

Unfortunately, an inspection of the 1976 accounts revealed yet more problems, in the calculation of liabilities and assets

First consider the liability side. In general insurance companies, there is some time lag between the date when a claim occurs, and the date when a claim is paid out. The time lag may be just a few weeks, but when a claim is disputed there may be delays of several months or even years. At the end of the financial year, some money must be set aside to pay for these unpaid claims – this is called an outstanding claims provision.

AMGIC set aside an amount of \$165,000 for an outstanding claims provision.

But after reading the auditor's report, the Insurance Commissioner was worried. The auditors stated that they were *"unable to form an opinion"* about some parts of the calculation.

The auditors clearly had a difficult task – when the investigator later inspected the claims register, he found that it was *“not an accounting record which could be relied upon as disclosing with any measure of accuracy the extent of the Company’s liability.”*

The auditors had made a number of suggestions for improving the record keeping. Some of these recommendations were later implemented, but others were not. The Company considered some recommendations to be *“too burdensome”*.

After a great deal of work, checking through the records, Mr Purvis decided that the company had overestimated the amount of money which they would be likely to recover from other insurers and from third parties. Hence the outstanding claims liability had probably been understated by about \$33,000.

The 1976 accounts had another disturbing feature : there were no commission payments to Austco.

As you may recall, Austco was another company which was wholly owned by Mr DT Fayle and Mrs KL Fayle. The business of Austco was to act as an insurance broker, collecting premiums from customers on behalf of AMGIC. During the year ended 30 June 1976, Austco collected premiums of \$138,947.

Now normally, an insurance company pays commission to its brokers in return for the introduction of business. Based on testimony from AMGIC directors, Austco would normally have been paid about \$40,000 in commission.

But apparently 1976 was not a normal year. In 1976, Austco generously decided not to make any commission charges to AMGIC. This was a level of generosity which Austco could ill-afford: in the same financial year, Austco made a loss of more than \$68,000 and ended the year with a deficiency of shareholder’s funds.

It is, of course, exceedingly difficult for an insurance broker to make a profit when it does not collect commissions.

The overall effect was to transfer a loss from AMGIC to Austco.

As Mr Purvis noted in his report:

“The non-charging by Austco of any commission to the Company in respect of business introduced by Austco in order that the financial position of the Company should be ‘more substantial than it would have been’ if it had paid commission for business received had the effect of inflating the profit (if any) of the Company.

“As to the reason why commission was not charged by Austco to the Company, Mr O’Brien confirmed that this was in order that the position of the Company would be shown in a more favourable light and so that the costs and expenses of the Company would be less than they might otherwise be....the Company ‘would have that much more assetwise by not paying commission’ to the end that ‘on a solvency basis to keep the Company that much more solvent’, having in mind the requirements of the Insurance Act.”

Based on this evidence, it looks as if the 1976 balance sheet might have understated the Company's liabilities by at least \$70,000.

The 1976 accounts : the assets

Now let's look at the assets side of the balance sheet. According to the 1976 accounts, AMGIC's assets included a significant amounts due from Austco Insurance Brokers ; Austco owed \$109,890 to AMGIC.

The debt from Austco largely represented premiums which had been collected from customers, which had not yet been paid to AMGIC. As the investigator pointed out, the indebtedness arose from Austco's need to finance its losses (as noted above, Austco had losses of about \$68,000 in the year ended 30 June 1976).

Now the Insurance Commissioner was rather concerned about this. The auditor stated that he was "unable to form an opinion on the extent to which these debts will ultimately be realized". Mr Purvis was asked to investigate.

Mr Purvis found that Austco would not be able to repay its debt, unless:

- (a) it borrowed money,
- (b) it raised more capital,
- (c) it charged some commission to AMGIC, or
- (d) it sold its assets.

Option (d), selling assets, might look the most promising. But the only significant asset of the company was "Goodwill". According to Austco's 1976 accounts, the value of this goodwill was about \$140,000.

Now part of this Goodwill arose from the purchase of two smaller brokers, one in Newcastle, one in Gosford. Austco had purchased these companies in 1974 for about \$28,000.

The rest of the Goodwill arose from a decision by the directors of Austco (Mr DT Fayle, Mr O'Brien, Mr Young, and DW Fayle). In 1975, the directors had decided to write up the value of the business by \$116,000.

Mr Purvis later questioned Mr Fayle about this decision :

Mr. Purvis : Are you able to tell me, Mr Fayle, on what basis Austco insurance Brokers Pty Limited, a Company which in 1975 made a loss, in 1976 made a loss, and to date in 1977 is incurring comparable expenses to those which were incurred in 1976 and is deriving an income which you are not able to tell me was more or less than it was in 1976, can attract goodwill in the sum of \$139,553 ?

Mr Fayle : Yes, I am able to tell you that.

Mr Purvis : Thank you. Would you be so kind ?

Mr Fayle : Certainly. The selling price for an Insurance brokerage as a going concern is from 2.5 to 4.5 times the annual premium income [Inspector's Note –

should be 'Annual Commission'], and that is the value of the goodwill of Austco Insurance Brokers, or any brokerage as far as that is concerned.

Mr Purvis : *And do you tell me, Mr Fayle, that is regardless of whether the Company is making a profit ?*

Mr Fayle : *Regardless*

.....

Mr Purvis : *Did you, or did anyone on your instructions obtain a valuation of the then business of Austco in support of the Goodwill figure placed in the books in respect of the 1975 financial year ?*

.....

Mr Fayle : *...You cannot obtain such a valuation. There is no value.*

Mr Purvis : *Did you obtain from any person, or more than one person, any offer to acquire the business of Austco ?*

Mr Fayle : *No.*

Mr Purvis ultimately concluded that :

"The Goodwill item of \$116,000 is a book entry only, unsupported by a bona fide valuation or profitability structure. Goodwill, at least to the extent of \$116,000, should be disregarded in any assessment of Austco to meet its commitments."

But this was not the end of the story.

Debt repayments

Reading between the lines, it seems probable that the Insurance Commissioner was disinclined to count the money due from Austco as an asset, for the purpose of the solvency tests under the Insurance Act. It seems probable that Mr Fayle was aware of this threat to his Company's future. So he took steps to rectify the problem.

During the months from August 1976 to February 1977, Austco repaid a great deal of money to AMGIC. In fact, by the end of February 1977, the accounts showed that the position had reversed : AMGIC owed money to Austco. Mr Fayle wrote a letter to the Insurance Commissioner, to assure him that the doubtful debt had been rectified.

One might well ask : how was Austco able to make these repayments ? After all, we already know that Austco was in a fairly precarious financial position.

When Mr Purvis asked to inspect the Cash Books of Austco for the relevant period, he was told that they were not available, because they had not yet been written up. But soon afterwards, he was given a set of accounts which purported to show that Austco had received \$52,616 from Custodians and from various members of the Fayle family.

Once again, this was rather puzzling.

Firstly, the accounts for Custodians, for the same period, did not record any such payments. When questioned, Mr Fayle said that this must be a mistake - he admitted that he had paid the money himself.

Secondly, according to Austco's records, cheques had been received from several members of the Fayle family, drawing on cheque accounts at the Kings Cross Branch of the Bank of New South Wales. But the bank averred that no such cheque accounts existed.

Mr Purvis advised that :

“No reliance can be placed upon the specified persons as having advanced the designated money. No certainty is available as to any part of the moneys coming from members of the Fayle family, other than possibly, as to a part, from Mr DT Fayle himself ”

Well, if the money was not coming from Mr Fayle's relatives, where was it coming from ? At some point Mr Purvis noted an interesting coincidence : when the AMGIC stopped making “cash disbursements”, then the Fayle family stopped making payments to Austco.

Mr Purvis decided to have another chat with Mr O'Brien. Mr O'Brien revealed that from time to time, between August 1976 and January 1977, Mr Fayle would hand him an envelope with cash, and send it off to the Newcastle office or the Gosford office of Austco. The money would be broken up into small amounts, and then treated as premium or commission payments for the brokerage.

Once again, it was necessary to discuss this with Mr Fayle

***Mr Fayle :** Well, previously I said that I wouldn't know why or how this was broken up, but over lunch I recalled the reason that this was broken up in this way. I didn't think that there was anything incorrect in it because the moneys involved were paid through Newcastle and Gosford for the purpose, the sole purpose of boosting the value of those two places in order that we should sell... This is the reason that it was paid in that way so it obviously was insurance premiums, and I certainly did not know until I discussed this with my Solicitor today that it was an incorrect thing to do. I certainly didn't know.*

***Mr Purvis :** That statement you have just made extends to the whole of the \$52,616 ?*

***Mr Fayle :** I am not sure of the whole of it but I think the bulk in any case.*

***Mr Purvis :** On the assumption that the whole of the various amounts ascribed to members of the Fayle family and Fayle Custodians from September 1976 to February 1977 totals \$52,616, does the whole of that sum come within the description of the money that you have just described ?*

***Mr Fayle :** Yes.*

Mr Purvis : So what you are saying, Mr Fayle, is that these moneys were paid in through Newcastle and Gosford, and were to be shown in the books of Austco in such a fashion as to lead a prospective purchaser to believe that the Company as well as being in receipt of other commissions, had between September 1976 and February 1977 also received a sum of \$52,616 by way of commission.

Mr Miller : We claim privilege

Mr Fayle : Yes.

Now this does not account for the whole debt : at the start of the financial year Austco owed more than \$100,000, and it was all repaid. But we have only accounted for \$52,616 of that sum. Where did the rest come from ?

Mr Purvis noted that:

“The obligation of Austco to pass on to the Company premiums received by its clients in respect of business introduced to the Company has, however, not been recorded in the books of Austco or the Company in respect of a major portion of the 1977 financial year.”

Now Mr Purvis was obviously not a man to jump to conclusions, but the implications were inescapable.

“It is an inference to be drawn, and I do so draw it, that a substantial proportion of the moneys so banked to the credit of Austco’s Bank account and thence used to reduce indebtedness to the Company had its origin in the commercial activities of the Company, and was paid out by the Company in cash to be received by Austco in cash, and by ways stated, namely cheques, the same drawn on non-existent bank accounts.”

Urgent Action Required

By June 1977, Mr Purvis had decided that urgent action would be needed. The “dividends” (totaling \$144,000) which had been paid to Custodians must be returned to AMGIC, and the “cash disbursements” must cease.

Of course Custodians no longer had \$144,000 : that money had been used to repay the bank loan. But Mr Fayle agreed to transfer ownership of two home units to AMGIC, in order would replace the missing capital. He promised to do so before the deadline of June 27.

On June 29, Mr Purvis received a letter. Mr Fayle had changed his mind – he argued that the transfer of the home units would no longer be necessary, because AMGIC soon would be merging with another insurance company and the merged company would be “comfortably solvent”. Mr Fayle would continue as a Director and Managerial Consultant in the new company. [I wonder how the Insurance Commissioner felt when he heard this proposal ?] The merger would be completed within 28 days.

No doubt you will be surprised to hear that, despite repeated appeals from Mr Purvis and stern instructions from Insurance Commissioner, the capital was never replaced. Nor, it seems, did the proposed merger go through within the allotted timespan.

The investigator's report was delivered to the Treasurer on September 15, 1977.

On October 6, 1977 the Treasurer took action: AMGIC was directed not to issue any new policies, and not to renew any existing policies.

The newspapers reported Mr Fayle's reaction:

"Australian Motorists and General Insurance Company Pty Ltd of St Leonards will appeal against the action in the Administrative Appeals Tribunal tomorrow, and has complained to the Commonwealth Ombudsman."

"The chairman of the company, Mr Disney Fayle, said that the company was shocked at the action and no reason had been given for it."

Mr Fayle said the company which had almost 15,000 policyholders, had no financial or liquidity problems and the Government appeared to have 'acted in a drastic manner without a real knowledge of the company's finances'."

The Australian Motorists and General Insurance Company was sold to another insurer in November 1977.

References :

(1) *Australian Motorists and General Insurance Company Pty Ltd : Report of an investigation of certain matters concerning the conduct of the company*, by Rodney N Purvis, 15 September 1977, Commonwealth of Australia 1978

(2) *"Insurance Company to Appeal,"*, Sydney Morning Herald,

(3) *"Insurance Company Bribed Police, Parliament Told"*, Sydney Morning Herald, page 1, 22 September 1977

(4) *"Police Chief doubts bribe claim in report"*, Sydney Morning Herald, 23 Sept 1978