FEDERAL COURT OF AUSTRALIA

Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial) [2019] FCA 1244

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| File number: | NSD 293 of 2017 |
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| Judge: | **PERRAM J** |
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| Date of judgment: | 13 August 2019 |
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| Catchwords: | **CONSUMER LAW** – alleged contraventions of s 128 of *National Consumer Credit Protection Act 2009* (Cth) – where respondent used automated system for conditional approval of home loans – where respondent calculated proposed repayments with principal amortised over life of interest only loan – whether respondent made assessment of unsuitability – whether assessment of unsuitability requires direct comparison of declared living expenses against loan repayments – whether assessment of unsuitability requires assessment by reference to repayments due after interest only period  |
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| Legislation: | *Federal Court of Australia Act 1976* (Cth) ss 37AF, 37AG*National Consumer Credit Protection Act 2009* (Cth) ss 125, 128, 129, 130, 131, 132, 133  |
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| Cases cited: | *Australian Securities & Investments Commission v Thorn Australia Pty Ltd* [2018] FCA 704*Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2018] FCA 155*Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926*Australian Securities and Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174*CSR Limited v Eddy* [2005] HCA 64; 226 CLR 1  |
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| Date of hearing: | 6-9, 13-14 May 2019 |
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| Registry: | New South Wales |
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| Division: | General Division |
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| National Practice Area: | Commercial and Corporations |
|  |  |
| Sub-area: | Regulator and Consumer Protection |
|  |  |
| Category: | Catchwords |
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| Number of paragraphs: | 105 |
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| Counsel for the Applicant: | Mr J Clarke SC, Mr Y Shariff and Ms S Patterson |
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| Solicitor for the Applicant: | Australian Securities and Investments Commission |
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| Counsel for the Respondent: | Mr J Kirk SC, Mr J Williams and Mr D Wong |
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| Solicitor for the Respondent: | King & Wood Mallesons |

ORDERS

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|  | NSD 293 of 2017 |
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| BETWEEN: | AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSIONApplicant |
| AND: | WESTPAC BANKING CORPORATION ACN 007 457 141Respondent |

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| JUDGE: | PERRAM J |
| DATE OF ORDER: | 13 AUGUST 2019 |

THE COURT ORDERS THAT:

1. The further amended originating application be dismissed.
2. The applicant pay the respondent’s costs.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

PERRAM J:

# Introduction

1. The Australian Securities and Investments Commission (‘ASIC’) alleges Westpac Banking Corporation (‘Westpac’) breached the *National Consumer Credit Protection Act 2009* (Cth) (‘the Act’) in the manner in which it extended Westpac-branded home loans across the period 12 December 2011 to March 2015. Westpac owns other banks such as the Bank of Melbourne and St George Bank but this case does not concern them and is confined in its scope to the banking business conducted by Westpac under its own brand.
2. The alleged breaches relate to Westpac’s computer operated loan approval system which it calls its automated decision system (‘the ADS’). The breaches fall into two categories. The *first* involves an allegation that in approving its home loans Westpac failed to have regard to any of the living expenses declared by consumers on their loan application forms. I reject this case on the facts. Westpac did have regard to these declared living expenses.
3. In any event, even if that were not so, the Act does not operate as ASIC alleges. I deal with the Act’s precise terms below. For present purposes, it will suffice to observe in a summary fashion that so far as the consumer’s financial position is concerned, the Act requires a credit provider to ask itself only whether ‘the consumer will be unable to comply with the consumer’s financial obligations under the contract’ or, alternatively, whether the consumer ‘could only comply with substantial hardship’: s 131(2)(a). In the interest of brevity I will refer to these two questions as ‘the s 131(2)(a) Questions’ to adopt a phrase used at the trial. Whilst this is not perhaps the most enlightening of shorthand nomenclatures, it avoids the risk of impermissibly glossing s 131(2)(a) with other expressions such as ‘affordability’ (cf. ASIC’s closing written submission at ¶73). I return to the full text of the relevant provisions later in these reasons.
4. Whilst I accept that the Act requires a credit provider to ask the consumer about their financial situation (s 130(1)(b)) and, in turn, to ask itself—and to answer—the s 131(2)(a) Questions, I do not accept that this has the further consequence that the credit provider must use the consumer’s declared living expenses in doing so.
5. In fact, the Act is silent on how a credit provider is to answer the s 131(2)(a) Questions. Division 3 of the Act contains neither an express statement that a credit provider must use the consumer’s declared living expenses in doing so nor, in my opinion, can such a requirement be discerned from its terms as a matter of necessary intendment. To foreshadow what lies ahead, one may ask what knowing that a consumer currently spends $500 per month on wine tells one about whether the consumer can afford the repayments on a proposed $2 million loan (the first of the s 131(2)(a) Questions) or whether, whilst able to afford to make the repayments on that loan, the consumer could do so only by being placed in circumstances of substantial hardship (the second of the s 131(2)(a) Questions).
6. ASIC alleges that Westpac breached the Act in this first way on some 261,987 occasions, being every Westpac-branded home loan it made in the period 12 December 2011 to March 2015. This case fails both on the facts and as a matter of statutory construction.
7. ASIC’s *second* set of alleged contraventions is that Westpac breached the Act in the manner in which it answered the s 131(2)(a) Questions in the case of loans having an initial interest only period before payment of principal was required. In answering the s 131(2)(a) Questions for these loans Westpac treated them as if there was no initial interest only period and amortised the principal across the life of the loan. ASIC alleges that this was a contravention of Div 3 of the Act because Westpac failed to have regard to the terms of the actual loan being extended to the consumer. It says that Westpac should have calculated the serviceability of the loan using the higher repayments due at the expiry of the initial interest only period. Alternatively, it says that Westpac failed to have regard to the correct amount of interest that the consumer would ultimately be required to pay in total. This was because by treating it as if it were a loan without an initial interest only period, Westpac underestimated the total amount of interest that would be payable over the life of the loan. This arithmetic consequence, which may not be immediately self-evident, arises because the amount of principal on which interest is due is higher in the case of a loan with an initial interest only period than in the corresponding loan where principal repayments are made throughout the life of the loan.
8. In any event, I reject both arguments. Westpac’s legal obligation was to ask and answer the s 131(2)(a) Questions. The fact that it did so as if the loan did not involve an initial interest only period does not mean that it did not ask and answer those questions. ASIC alleges that Westpac contravened the Act in this way on 154,351 occasions across the same period as its first allegation (these loans are a subset of the 261,987 loans which figure in ASIC’s primary case). ASIC’s case on these loans fails too.
9. For completeness, it should be noted that ASIC does not allege that Westpac in fact answered the s 131(2)(a) Questions incorrectly in the case of any of the 261,987 loans. It does not allege that the alleged defects in the ADS resulted in Westpac extending loans to any consumers who it ought to have found would be unable to meet their financial obligations under the credit contracts or who would be able to do so only in circumstances of substantial hardship. ASIC did originally make several such allegations in relation to specified loans but it abandoned these on the day before the trial commenced. This then is a case about the operation of the responsible lending laws withoutany allegation of irresponsible lending. In saying that I do not disregard ASIC’s submission at trial that it did not accept that all the loans were suitable but it was ‘not alleging that they’re unsuitable’: at T322.9. I do not think, for present purposes, that ASIC’s non-acceptance of the suitability of all of the loans has any forensic relevance.
10. It should also be noted that ASIC does *not* allege that Westpac was entirely prohibited by the Act from using what was referred to as ‘the HEM benchmark’ in answering the s 131(2)(a) Questions. Its case is instead that in doing so Westpac had not used the consumer’s declared living expenses and had, rather, relied *solely* on the HEM benchmark. It will be necessary to describe the HEM benchmark later in these reasons but it will suffice for present purposes to say that it measures household expenditure across the Australian community. For example, it contains information such as ‘in Sydney, 25% of households spend less than an average of $446 per month on discretionary basic expenses’.
11. ASIC’s application will be dismissed with costs.

# The Evidence

1. The documentary evidence comprised a Court Book which became Exhibit 1. The Court book included all the affidavits and pleadings. Some small parts of the affidavit evidence were rejected on the basis of minor evidentiary rulings.
2. ASIC’s case was principally documentary and it did not call any lay witnesses. It did call expert evidence about the nature of the HEM benchmark. This was the affidavit of *Professor Garry Fergus Barrett* affirmed 3 August 2018. Professor Barrett is the Head of the School of Economics at the University of Sydney. He gave expert evidence about measurements of poverty and the HEM benchmark. He was cross-examined on Thursday 9 May 2019 from T285-303. I accept his evidence.
3. Westpac led affidavit evidence from the following witnesses:
* *Ms Melissa Aimee Higgins* affirmed 21 May 2019. Ms Higgins is the Executive Manager, Originations at Westpac. She gave evidence about the manner in which Westpac made home loans including the use of the ADS and a description of the manual verification checks. She was not required for cross-examination.
* *Mr Matthew Luke Coleiro* sworn 2 June 2018. Mr Coleiro is a risk manager at Westpac. At the relevant times he was responsible for programming and implementing the codes in the ADS. He also performed an analysis on the rate at which the rules in that system were triggered. He was not responsible, however, for the credit policies which the system implemented. He was not required for cross-examination.
* *Mr Jian (Ken) Huang* affirmed 12 June 2018. Mr Huang is a senior risk manager at Westpac. He gave evidence about the manner in which Westpac stores data and the steps he took to extract some home loan data from its systems. In particular, he was able to give detailed evidence about the various ways in which the 261,987 loans had been processed. For example, he was able to say how many had been manually handled, what kind of loan was involved and so forth. Mr Huang was not required for cross-examination.
* *Mr William David Malcolm* sworn 6 June 2018 with a supplementary affidavit sworn 22 August 2018. Mr Malcolm is presently the General Manager of Credit at Westpac. During the period with which this case is concerned he held two positions. Between 2011 and 2013 he was the Chief Risk Officer of Australian Banking Risk within Westpac. Between 2013 and 2015 he was the Chief Risk Officer for Westpac’s New Zealand operations. Mr Malcolm gave evidence about Westpac’s risk management processes and its approach to responsible lending. He was cross-examined on Tuesday 8 May 2019 and Wednesday 9 May 2019 at T136-212. Mr Malcolm gave his evidence carefully and made several concessions against his interests. He was a credible witness whose evidence I accept.
* *Mr Robert Gordon Love* sworn 5 June 2018. Mr Love is presently the Head of Credit Risk Optimisation at Westpac. He occupied two positions during the relevant period. Between 2011 and 2013 he was the Head of Unsecured Risk. Between 2013 and 2015 he was Head of Secured Risk, Products and Operations Risk. He gave evidence about the ADS including a number of its specific rules. Some parts of his evidence revealed aspects of how Westpac assessed loans for approval which, if made publicly available, would permit potential borrowers and/or mortgage brokers to manipulate the ADS to their advantage. There was also evidence about aspects of Westpac’s overall loan book which would be advantageous for its competitors to know. On Tuesday 8 May 2019, on Westpac’s application, I suppressed those aspects of Mr Love’s evidence under s 37AF of the *Federal Court of Australia Act 1976* (Cth) being then satisfied, as s 37AG(1) requires, that this was necessary to prevent prejudice to the administration of justice. At the same time, I also suppressed on privacy grounds the names of individual customers of Westpac whose details were disclosed in the course of this litigation. Mr Love was cross-examined on Wednesday 8 May 2019 from T214-244. Mr Love was a credible witness whose evidence I accept.
* *Ms Heather Gaye Green* affirmed 14 June 2018 with a further affidavit affirmed 12 April 2019. Ms Green is a Senior Risk Manager, Westpac Mortgages, Retail Credit Risk. She gave detailed evidence about how home loans were processed and also how, if they were manually processed, this was done. She gave evidence that each of the specific loans which ASIC had originally nominated as being unsuitable would have been approved even if they had been manually processed. This evidence was principally directed to the case ASIC abandoned before the trial commenced about specific allegedly unsuitable loans but was useful nevertheless in relation to the way Westpac’s system worked. Ms Green was cross-examined on Wednesday 8 May 2019 at T245-260. She was a most impressive witness whose evidence I unhesitatingly accept. In particular, I reject the suggestion put to her in cross-examination that she gave evidence favourable to her employer out of self-interest. As she said at T256.16-.17 ‘I have loyalty to my employer as – such as that they employ me and they pay me, but I don’t need – *I won’t lie for them*’. Having seen Ms Green give her evidence, I do not doubt this.
* *Mr Stephen Philip Nagle* affirmed 14 June 2018. Mr Nagle is an actuary. He gave expert evidence for Westpac based on the data which had been extracted by Mr Huang from Westpac’s systems. On what was otherwise a somewhat torpid afternoon, he gave evidence about the delinquency rate for loans and its correlation with certain data sets. Mr Nagle was cross-examined on Wednesday 8 May 2019 at T261-275. He was unmoved by the experience which he appeared to regard with a chilly air of detached indifference. I accept his evidence.

# The Borrower’s Declared Living Expenses

1. Across the period 12 December 2011 to March 2015, Westpac conducted its home loan business through three channels: through its retail branches, through mortgage brokers or through a direct sales channel (via phone or the internet). Regardless of which channel was used, eventually consumers were required to provide information about their financial position. ASIC did not suggest its case worked any differently in the case of loans originated through these different channels. It is therefore only necessary to examine the loans originated through its retail branches.
2. In that process, the consumer was eventually required to complete a form known as a ‘PFI001’. It collected a range of information about the consumer including personal details, details of employment, monthly income, estimated expenses, whether the consumer expected any change in their financial situation, current assets, current liabilities and details of the property to be purchased. Form PFI001 contained a section headed ‘MY MONTHLY EXPENSES’ which was as follows:

|  |  |
| --- | --- |
| **MY MONTHLY EXPENSES** |  |
| (money you spend – do not include loan repayments) | $ per month |
| Ongoing Rent/Board **AFTER** this loan is drawn |  |
| *Absolute Basic Expenses**(eg groceries, transport, petrol, utilities, rates, clothing)* |  |
| *Education Expenses* |  |
| *Childcare Fees* |  |
| Child Maintenance/Alimony |  |
| *Insurance (including car, CTP, building, contents, health, income protection)* |  |
| *Mobile Phone / Internet / Pay TV* |  |
| *Other (eg holidays, entertainment, gym membership, cleaning or gardening services)* |  |
| Office use – Total repayments from pages 6-7 |  |
| Office Use – Total Monthly Expenses |  |

1. As a matter of ordinary language it would be natural to describe each of these expenses as living expenses and, because they had been declared by the consumer on the Form PFI001, as declared living expenses. However, for reasons which need not delay these reasons, the parties agreed that the amount declared for rent/board and the amount declared for child maintenance/alimony were to be referred to as liabilities and that it would only be the remaining monthly expenses (such as ‘Absolute Basic Expenses’) that would be encompassed within the concept of ‘declared living expenses’. These so-defined declared living expenses are italicised above.
2. ASIC’s case is that the consumer’s declared living expenses, in that admittedly artificial sense, had not been taken into account in answering the s 131(2)(a) Questions. ASIC admitted that Westpac had taken into account rent/board and child/maintenance in its Serviceability Rule but it denied that the declared living expenses had been taken into account by the ADS.
3. When the Form PFI001 was completed and a Westpac home finance manager determined that the loan application could proceed, the information on the form was then entered into the ‘Generic Origination Engine’ (‘GOE’). Applications entered into the GOE were then assessed by the ADS. The ADS was a system comprising over 200 rules which were applied to the information obtained from the Form PFI001. Once a loan application was put through the ADS there were three possible outcomes: ‘conditional approval’, ‘referral for manual assessment’ or ‘decline’. Where the ADS indicated that the application was conditionally approved it was then referred for other checks relating to security valuation, verification of income details and so on.
4. A number of the rules in the ADS related to the declared living expenses of a consumer as declared on the Form PFI001. Westpac relied upon the 70% Ratio Rule, the Serviceability Rule, the Application Score Rule, the Aligned Risk Grade Rule, the Aged Term Rule and other less relevant rules.

# The 70% Ratio Rule

1. The 70% Ratio Rule was triggered if a consumer’s declared living expenses, as recorded on the Form PFI001, exceeded 70% of their verified monthly income. Once triggered, an application was referred for manual processing by a credit officer. Westpac submitted that this rule was a complete answer to ASIC’s argument that it had not had regard to the consumer’s declared living expenses. ASIC, on the other hand, submitted that the 70% Ratio Rule neither included any consideration of the consumer’s obligations under the loan contract nor any comparison between the declared living expenses and the consumer’s income or assets. ASIC submitted that without such an analysis it could not be said that Westpac had answered the s 131(2)(a) Questions.
2. I do not accept this. The first objection is that even if one accepted ASIC’s contention that the 70% Ratio Rule did not constitute a rule which assessed whether the loan would be suitable for the consumer (which for reasons I give below I do not), this would go nowhere by itself. The issue is not whether the 70% Ratio Rule complies with Div 3 but rather whether Westpac does. In fact, what Westpac did with loan applications involved a lot more than the mere application of the 70% Ratio Rule. It is not enough to point to an individual rule in the ADS and to submit that it does not comply with Div 3. Westpac’s entire system (including manual assessment where referral is triggered) must be examined, and compliance with Div 3 gauged that way. In a sense, ASIC accepted that this was so and sought to show that none of the rules in the ADS discharged the burdens it submitted Div 3 imposed upon Westpac.
3. A second difficulty is, as I explain in the next paragraph, that the 70% Ratio Rule involves an assessment of the risk of default by the consumer. The question then is whether an assessment of the risk of default by the consumer involves an assessment of whether a ‘consumer will be unable to comply with the consumer’s financial obligations under the contract, or could only comply with substantial hardship’ (i.e., the s 131(2)(a) Questions).
4. This is a question of characterisation. Mr Malcolm gave evidence about the origins and purpose of the 70% Ratio Rule. Historically, Westpac regarded consumers whose ratio of declared living expenses to pre-tax income was more than 50% to be at a higher risk of default. The ADS used after-tax income and therefore a 70% ratio was used. The purpose of the rule was therefore to assess the risk of default.
5. I do not accept that a rule whose purpose is to gauge the risk of default is not also a rule with respect to the ability of the consumer to meet their financial obligations under the credit contract. ASIC submitted that credit risk to the bank, on the one hand, and the inability of the consumer to meet the financial obligations under the credit contract, on the other, were not identical matters. It submitted that the explanatory memorandum accompanying the introduction of what was then the National Consumer Credit Protection Bill 2009 (Cth)had distinguished between these two kinds of risk and noted that the question of whether the consumer would be able to meet their financial obligations under the credit contract is an objective standard and ‘is not directly linked to the credit provider’s own internal standards and guidelines’: at [3.153]. Thus the fact that a credit provider reached the conclusion that there was no credit risk in the case of a consumer did not ‘necessarily mean that it met the standard in the legislation’.
6. However, it went on to say that ‘the types of inquiries made and assessments conducted for the purposes of the credit provider’s internal standards and guidelines would, in most cases, be very similar to those that are required in order to assess the likelihood that a consumer can meet the financial obligations under the proposed contract’. In this case, that remark appears pertinent. Contrary to ASIC’s submissions, I accept that the 70% Ratio Rule is a measure of unsuitability. It is no less such a measure merely because it identifies a certain class of consumers whose applications were to be manually assessed (as ASIC submits).
7. By means of the 70% Ratio Rule Westpac did take into account the consumer’s declared living expenses from the Form PFI001 as part of a process leading to an answer to the s 131(2)(a) Questions. Lest this conclusion prove frangible on appeal, however, it is necessary to consider the balance of ASIC’s case about declared living expenses.

# Further Relevant Rules in the ADS

## The Serviceability Rule

1. This rule when applied yielded a number called the *Net Monthly Surplus* or *Net Monthly Shortfall* (depending on whether it yielded a positive or negative figure). *Net Monthly Surplus* and *Net Monthly Shortfall*  were calculated using this formula:

*Net Monthly Surplus/Shortfall = Discounted Monthly Income – (Assessed Monthly Repayments + Outgo + HEM benchmark + ‘buffer’)*

1. Where a shortfall resulted and the consumer was required to have mortgage insurance, the application would be referred for manual assessment. Typically, mortgage insurance related to the perceived inadequacy of the security proffered by the consumer. Where the consumer was not required to hold mortgage insurance because the security was otherwise satisfactory, the rule would be triggered if a shortfall of more than $400 resulted from the application of the rule.
2. In the formula above, *Outgo* was defined in a way which included actual expenses (referred to as liabilities in the Statement of Agreed Facts) of the consumer drawn from Form PFI001. Mr Malcolm gave evidence at ¶70 of his affidavit that *Outgo* was calculated using the following actual expenses of the consumer:
* ongoing rent/board payments after the loan is drawn down;
* child maintenance or alimony payments;
* credit card repayments;
* other loans secured by mortgages;
* other unsecured loans (such as vehicle loans and so forth); and
* other liabilities including provisional taxation, HECS, guarantees on loans and leases.
1. Mr Coleiro explained that the monthly amounts were entered by a home finance manager for the liabilities which were not being cleared by the proposed loan. Mr Malcolm explained that in the case of credit card repayments it was assumed that the consumer would pay 2% of the higher of the balance due or the approved credit limit. It is unclear, however, how the contingent debts referred to by Mr Malcom could result in a specified monthly repayment. It may be that the ADS treated contingent debts as being owed by the consumer as a primary debtor and therefore attributed to the consumer the underlying repayments due by the party whose performance was being guaranteed. But Mr Malcolm did not give evidence to that effect and this is supposition on my part. I am unable, therefore, to account for what Mr Malcolm’s evidence about contingent debts actually signifies in the calculation of *Outgo*.
2. However, this does not matter much for present purposes. Mr Malcolm’s evidence shows that in applying the Serviceability Rule Westpac did not take into account the declared living expenses disclosed in the Form PFI001 (that were taken into account in the 70% Ratio Rule), that is to say, absolute basic expenses, education expenses, childcare fees, insurance, mobile phone/internet/Pay TV and other discretionary expenses (e.g. holidays, gym memberships, cleaning and gardening expenses). It did take into account the consumer’s liabilities including rent/board, child maintenance/alimony and obligations that the consumer had under other credit contracts. Whilst these liability obligations do show that Westpac had regard to the financial situation of the consumer, they do not directly meet ASIC’s case about declared living expenses because they are not, themselves, part of those declared living expenses. I mention them for completeness.

## The Application Score Rule

1. This rule was the result of a statistical analysis of Westpac’s loan book to identify variables correlated with a risk of default (this evidence is subject to the suppression order above). Quite a lot of information about each consumer was fed to this rule but that information did not include the consumer’s declared living expenses. This rule shows that Westpac did take into account this aspect of the consumer’s financial position in the operation of the ADS. It does not meet ASIC’s case, however, in relation to declared living expenses.

## The Aligned Risk Grade Rule

1. This was similar to the Application Score Rule except that it was based on the borrower’s recent financial and repayment performance with Westpac or St George (and was therefore limited in its application to current customers of those banks). As with the Application Score Rule, this rule did take into account the consumer’s financial situation but this consideration did not extend to declared living expenses.

## Other rules

1. There were then a number of minor rules which, although formally relied upon by Westpac in its written submissions, failed to make the cut in oral submissions. These were the Aged Term Rule (which was triggered for consumers aged over 55 years old, and who would be over 75 years old at the end of the loan term, if the net value of the consumer’s assets, excluding their owner-occupied home, did not exceed their existing and proposed liabilities secured against their home); the 50% Dividend and Interest Rule (which was triggered if the consumer’s income consisted of more than 50% dividend and interest income); the 50% Rental Income Rule (which was triggered if more than 50% of the borrower’s income came from rental income); the Bonus Income Rule (which was triggered if the borrower’s monthly bonus income exceeded a predetermined level); and the Change in Financial Position Rule (which was triggered if the consumer expected an adverse financial event over the next three years). None of these rules is an answer to ASIC’s contention that Westpac was obliged to take into account in answering the s 131(2)(a) Questions the declared living expenses of the consumer for none does so. On the other hand, they do show that Westpac did consider the financial situation of the consumer.

# The HEM benchmark

1. Both parties made oral and written submissions about the HEM benchmark but by the trial’s conclusion it was of marginal relevance. This is because, as finally articulated, ASIC’s case did not turn on the fact that Westpac had used the HEM benchmark but instead on the alleged fact that it did not use any of the consumer’s declared living expenses in answering the s 131(2)(a) Questions. Indeed, ASIC accepted that it was lawful for Westpac to use the HEM benchmark to answer those questions. What it could not do was to answer them without taking into account any of the consumer’s declared living expenses. For reasons which I have given in the previous section, this case insofar as it concerns the contention that Westpac did not use any of the declared living expenses fails on the facts. It did use them.
2. Be that as it may, the fact that ASIC accepted that it was permissible for Westpac to use the HEM benchmark tended to reduce its role at trial. Indeed, by the end of the trial it had become clear that the evidence concerning the HEM benchmark was relevant only to one minor issue. It arose from Westpac’s claim that what the s 131(2)(a) Questions required it to assess was the risk of substantial hardship to the consumer and its allied submission that the HEM benchmark was a good proxy for what substantial hardship might be. This was denied by ASIC which pointed to various aspects of the HEM benchmark which were said to be reduce its suitability as such a proxy.
3. However, this issue does not actually arise and does not need be resolved. ASIC is either right or wrong in its contention that Westpac was obliged to base its assessment of unsuitability on the consumer’s declared living expenses. If ASIC is right about that, it is irrelevant whether the HEM benchmark is a good, bad or indifferent proxy for substantial hardship because, regardless, this can have no impact on the fact that Westpac failed to take into account any of the declared living expenses. If, on the other hand, ASIC is wrong about that, the qualities of the HEM benchmark also do not matter because they have no impact on the result. This is because ASIC will, on that hypothesis, already have failed. Consequently, the capacity of the HEM benchmark to serve as a proxy for substantial hardship is not an issue which is actually live in the litigation. By the conclusion of the submissions at trial, the irrelevance of this issue was suspected on both sides of the bar table but neither party, having expended so much effort on the HEM benchmark over the course of the litigation, seemed willing to bite the bullet and to let it go. However, I can see no utility in resolving the issue. Beyond the fact that the HEM benchmark appears to be a mechanism for assessing hardship and Westpac thought it to be such, I see no relevance to this material.
4. It remains necessary briefly to explain what the HEM benchmark is. As Mr Love explained in his evidence, prior to 2010 the banking industry had used Henderson Poverty Index (‘HPI’) to assess household expenses in serviceability calculations. The problem with the HPI was that it was based on data from the United States gathered in the 1960s and thereafter indexed for inflation. In 2009-2010 there were several meetings of a body known as the Risk Managers Roundtable Group. This was a body on which all the major credit providers were represented (indeed, it was Mr Love who attended on behalf of Westpac). This group focussed on the desirability of developing an autochthonous equivalent to the HPI using recent Australian data. To this end, they engaged a consulting firm to assist them, Edgar Dunn & Company, and it, in turn, recommended that the Melbourne Institute of Applied Economic and Social Research (‘Melbourne Institute’) be retained to conduct research into alternative expenditure measures that were more tailored for Australian circumstances than the HPI. This resulted in the publication of the Household Expenditure Measure (‘HEM’) by the Melbourne Institute. The Melbourne Institute continues to publish the HEM benchmark on a quarterly basis.
5. The HEM was first published in May 2011. It used the most recent Australian data available on expenditure which happened to be the 2003/2004 Australian Bureau of Statistics Household Expenditure Survey (‘the HES’). When the 2009/2010 ABS figures became available the HES was updated using that data. The HES collects detailed information on expenditure, income and characteristics of households resident in Australia and is used by the ABS to update the weighting pattern of the consumer price index. Average weekly expenditure on over 600 goods and services is collected as part of the HES. The HES data covers 98% of the Australian population. The HEM took the HES data and classified the 600-odd expenditure items tracked in it into one of three categories: (i) absolute basic expenditures; (ii) discretionary basic expenditures; and (iii) non-basic expenditures.
6. It then took the median of expenditure on goods and services which were absolute basic expenditures, that is to say, it took the absolute basic expenditure on goods and services by households which spent more on these items than 50% of all other households (and correspondingly less than the other 50% of households). To this median it then added the expenses on goods and services in the discretionary basic category which lay in the 25th percentile, that is to say, it added the discretionary basic expenditure by a household on goods and services which was more than 25% of all other households (and less than 75% of the rest of Australian households). Absolute basic expenditure included all food apart from restaurant meals and certain confectionaries, utilities, house repairs, toiletries, and household cleaning products. Discretionary basic expenditures included restaurant meals and alcohol, sports lessons and domestic holidays. Non-basic expenditures included items such as jewellery and overseas travel.
7. The data used to generate the HEM benchmark distinguished between households in the individual major capital cities and households not in those cities (this was a limitation inherent in the HES data). It also treated the Northern Territory and the Australian Capital Territory together. It distinguished between different types of households (single, partnered, with or without children and so on) and also distinguished between different levels of income. In the version used by Westpac, the scaling by reference to income level was omitted.
8. What the HEM actually measures may be debateable. However, a person on the HEM benchmark by definition spends more on absolute basic expenses than 50% of the relevant population (as segmented by geographic location etc.) and more on discretionary basic expenditure than 25% of the relevant population. Although it is not necessary to form any concluded view about this, it seems unlikely that a household which spent the HEM benchmark on absolute and discretionary basics would be in poverty given the use of the median on absolute basics. Westpac submitted, and if it were necessary I would be inclined to accept, that the HEM benchmark captures expenses of a modest level that would permit individuals to participate in society. Because of the limitations in the underlying HES data the limitations of the HEM benchmark may readily be acknowledged. Doing so does not deny its nature as an attempt to assess hardship.
9. Professor Barrett pointed out that the level of the HEM benchmark is less than the median expenditure for all households. This is no doubt true and an inevitable consequence of combining the median for absolute basics with the 25th percentile for discretionary basics. However, that is not inconsistent with the tentative conclusion I have just reached.
10. For the purposes of this case, the three key points about the HEM benchmark are: (a) it does not involve the use of the individual borrower’s own declared expenses; (b) it is designed to measure comparative levels of hardship; and (c) Westpac was involved in its instigation which was explicitly for the purpose of measuring hardship. ASIC criticised the HEM benchmark as a measure to assess hardship on various bases (for example, its failure to descend to the level of individual postcodes). It is not necessary conclusively to assess these criticisms for the reasons I have already given. Assuming in ASIC’s favour that they are well-founded and that the HEM benchmark is imperfect, this does not prevent me drawing the conclusion that Westpac understood the HEM benchmark to be a measure to assess hardship and that it used it in the ADS, in good faith, for that purpose.
11. I reject Westpac’s faintly pressed submission that the use of the HEM benchmark did involve an assessment of the borrower’s actual expenses and accept instead its contention at ¶122 of its closing written submissions that the use of the HEM benchmark is not an estimate of the borrower’s actual living expenses but ‘an estimate of the level of household expenditure that the consumer could reasonably be expected to spend to participate fully in society with a reasonable standard of living.’
12. Westpac also sought to make something of the fact that in some of its published materials ASIC had suggested that benchmarks such as the HEM benchmark could be used. I do not think that that proposition is inconsistent with ASIC’s case. In any event, this case is concerned with the meaning of Div 3 and ASIC’s regulatory advice can have no impact on that issue.

# The Legal Argument

1. ASIC’s case concerns Division 3 of Part 3-2 of Chapter 3 of the Act which is entitled ‘Obligation to assess unsuitability’. The wording of Div 3 varied across the period 2011 to 2015 but none of these variations was said to be material. In these reasons, I have used the form that the legislation took on 1 March 2013 (as I explain more fully below).
2. To appreciate the structure of Div 3 it is useful to begin, not with the text of its provisions which are dense, but with an outline sketch. There are only five sections in Div 3. They are headed as follows:

|  |  |
| --- | --- |
| s 128 | Obligation to assess unsuitability |
| s 129 | Assessment of unsuitability of the credit contract |
| s 130 | Reasonable inquiries etc. about the consumer |
| s 131 | When credit contract must be assessed as unsuitable |
| s 132 | Giving the consumer the assessment |

1. In ASIC’s closing written submissions it explained its construction of s 128 by reference to 20 individual propositions which occupied pp 15-21 of its closing written submissions from ¶56 to ¶80. Leaving aside the historically low success rate for arguments having so many moving parts, I will be forgiven if I take the liberty of distilling these 20 steps into something a little more manageable.
2. It seems to me to have three basic components. The first step is that in conducting an assessment under s 129 a credit provider must take account of information about the particular consumer’s financial situation obtained under s 130. The second step is that across the whole of its home loan approvals that were not referred for manual assessment for the period 12 December 2011 to March 2015 Westpac failed to take account of the consumer’s declared living expenses in purportedly assessing whether a credit contract was unsuitable and therefore failed to take into account information about each consumer’s financial position. The third step is that Westpac’s failure to take account of the consumer’s declared living expenses in purporting to carry out an assessment under s 129 meant that it had not carried out an assessment as required. ASIC eschews directly submitting that the assessments carried out by Westpac were ‘invalid’ but this is only terminological coyness. Its submission is that what Westpac did was not, in law, an assessment under s 129. It then followed that Westpac contravened s 128 which required it to conduct an assessment under s 129 before extending a loan to a consumer.
3. I reject each of these three steps. It is useful to begin with the provisions.
4. Division 3 is contained in Pt 3-2 which is entitled ‘Licensees that are credit providers under credit contracts general rules’. Part 3-2 begins with Div 1 which is headed ‘Introduction’ and which contains but one section, s 125:

**125 Guide to this Part**

This Part has rules that apply to licensees that are credit providers. These rules are aimed at better informing consumers and preventing them from being in unsuitable credit contracts.

Division 2 requires a licensee to give its credit guide to a consumer. The credit guide has information about the licensee and some of the licensee’s obligations under this Act.

Division 3 requires a licensee, before doing particular things (such as entering a credit contract), to make an assessment as to whether the contract will be unsuitable. To do this, the licensee must make inquiries and verifications about the consumer’s requirements, objectives and financial situation. The licensee must give the consumer a copy of the assessment if requested.

Division 4 prohibits a licensee from entering or increasing the credit limit of a credit contract that is unsuitable for a consumer.

1. Division 3 is then as follows:

**Division 3—Obligation to assess unsuitability**

**128 Obligation to assess unsuitability**

A licensee must not:

(a) enter a credit contract with a consumer who will be the debtor under the contract; or

(aa) make an unconditional representation to a consumer that the licensee considers that the consumer is eligible to enter a credit contract with the licensee; or

(b) increase the credit limit of a credit contract with a consumer who is the debtor under the contract; or

(ba) make an unconditional representation to a consumer that the licensee considers that the credit limit of credit contract between the consumer and the licensee will be able to be increased;

on a day (the ***credit day***) unless the licensee has, within 90 days (or other period prescribed by the regulations) before the credit day:

 (c) made an assessment that:

(i) is in accordance with section 129; and

(ii) covers the period in which the credit day occurs; and

 (d) made the inquiries and verification in accordance with section 130.

Civil penalty: 2,000 penalty units.

**129 Assessment of unsuitability of the credit contract**

For the purposes of paragraph 128(c), the licensee must make an assessment that:

(a) specifies the period the assessment covers; and

(b) assesses whether the credit contract will be unsuitable for the consumer if the contract is entered or the credit limit is increased in that period.

Note: The licensee is not required to make the assessment under this section if the contract is not entered or the credit limit is not increased.

**130 Reasonable inquiries etc. about the consumer**

*Requirement to make inquiries and take steps to verify*

(1) For the purposes of paragraph 128(d), the licensee must, before making the assessment:

(a) make reasonable inquiries about the consumer’s requirements and objectives in relation to the credit contract; and

(b) make reasonable inquiries about the consumer’s financial situation; and

(c) take reasonable steps to verify the consumer’s financial situation; and

(d) make any inquiries prescribed by the regulations about any matter prescribed by the regulations; and

 (e) take any steps prescribed by the regulations to verify any matter prescribed by the regulations.

Civil penalty: 2,000 penalty units.

(1A) If:

(a) the credit contract is a small amount credit contract; and

(b) the consumer holds (whether alone or jointly with another person) an account with an ADI into which income payable to the consumer is credited;

the licensee must, in verifying the consumer’s financial situation for the purposes of paragraph 128(d), obtain and consider account statements that cover at least the immediately preceding period of 90 days.

(1B) Subsection (1A) does not limit paragraph (1)(c) of this section.

(2) The regulations may prescribe particular inquiries or steps that must be made or taken, or do not need to be made or taken, for the purposes of paragraph (1)(a), (b) or (c).

**131 When credit contract must be assessed as unsuitable**

*Requirement to assess the contract as unsuitable*

(1) The licensee must assess that the credit contract will be unsuitable for the consumer if the contract will be unsuitable for the consumer under subsection (2).

Civil penalty: 2,000 penalty units.

Note: Even if the contract will not be unsuitable for the consumer under subsection (2), the licensee may still assess that the contract will be unsuitable for other reasons.

*Particular circumstances when the contract will be unsuitable*

(2) The contract will be unsuitable for the consumer if, at the time of the assessment, it is likely that:

(a) the consumer will be unable to comply with the consumer’s financial obligations under the contract, or could only comply with substantial hardship, if the contract is entered or the credit limit is increased in the period covered by the assessment; or

(b) the contract will not meet the consumer’s requirements or objectives if the contract is entered or the credit limit is increased in the period covered by the assessment; or

(c) if the regulations prescribe circumstances in which a credit contract is unsuitable—those circumstances will apply to the contract if the contract is entered or the credit limit is increased in the period covered by the assessment.

(3) For the purposes of paragraph (2)(a), it is presumed that, if the consumer could only comply with the consumer’s financial obligations under the contract by selling the consumer’s principal place of residence, the consumer could only comply with those obligations with substantial hardship, unless the contrary is proved.

(3A) If the contract is a small amount credit contract (the ***relevant contract***) and either of the following apply:

(a) at the time of the assessment:

(i) the consumer is a debtor under another small amount credit contract; and

(ii) the consumer is in default in payment of an amount under that other contract;

(b) in the 90 day period before the time of the assessment, the consumer has been a debtor under 2 or more other small amount credit contracts;

then, for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer’s financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.

*Information to be used to determine if contract will be unsuitable*

(4) For the purposes of determining under subsection (2) whether the contract will be unsuitable, only information that satisfies both of the following paragraphs is to be taken into account:

(a) the information is about the consumer’s financial situation, requirements or objectives, or any other matter prescribed by the regulations under paragraph 130(1)(d) or (e);

(b) at the time of the assessment:

(i) the licensee had reason to believe that the information was true; or

(ii) the licensee would have had reason to believe that the information was true if the licensee had made the inquiries or verification under section 130.

**132 Giving the consumer the assessment**

*Requirement to give assessment if requested*

(1) If, before entering the credit contract or increasing the credit limit, the consumer requests the licensee for a copy of the assessment, the licensee must give the consumer a written copy of the assessment before entering the contract or increasing the credit limit.

Note: The licensee is not required to give the consumer a copy of the assessment if the contract is not entered or the credit limit is not increased.

Civil penalty: 2,000 penalty units.

(2) If, during the period that:

(a) starts on the day (the credit day) the credit contract is entered or the credit limit is increased; and

(b) ends 7 years after that day;

the consumer requests the licensee for a copy of the assessment, the licensee must give the consumer a written copy of the assessment:

(c) if the request is made within 2 years of the credit day—before the end of 7 business days after the day the licensee receives the request; and

(d) otherwise—before the end of 21 business days after the day the licensee receives the request.

Civil penalty: 2,000 penalty units.

*Manner of giving assessment*

(3) The licensee must give the consumer the copy of the assessment in the manner (if any) prescribed by the regulations.

*No payment for assessment*

(4) The licensee must not request or demand payment of an amount for giving the consumer a copy of the assessment.

Civil penalty: 2,000 penalty units.

*Strict liability offence*

(5) A person commits an offence if:

(a) the person is subject to a requirement under subsection (1), (2) or (4); and

(b) the person engages in conduct; and

(c) the conduct contravenes the requirement.

Criminal penalty: 50 penalty units.

(6) Subsection (5) is an offence of strict liability.

Note: For strict liability, see section 6.1 of the Criminal Code.

1. As a matter of formality, I note that the relevant provisions were amended by the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) which, inter alia, introduced ss 128(aa) and 128(bb). These amendments commenced on 1 March 2013 which was part way through the relevant period of alleged contraventions. Neither party submitted that these amendments had a bearing on the contraventions nor do I see that they could have an impact. The provisions set out above are those at 1 March 2013.

## First Step: A credit provider must take account of the consumer’s financial information obtained by it under s 130(1)(b) in performing an assessment under s 129

1. ASIC confronts at the outset the fact s 129 does not say this. Rather, it says that the assessment must have two qualities. It must ‘specify’ the period to which it relates and it must ‘assess’ whether the credit contract ‘will be unsuitable for the consumer’. If a credit provider performs an assessment which does both of these things then it will have made an assessment in accordance with s 129.
2. ASIC submits that more may be drawn from Div 3. It begins by submitting that the wording of s 129(b) is the key to its proper construction. It is not just any assessment of unsuitability which will do; it must be an assessment which assesses ‘whether *the credit contract* will be unsuitable for *the consumer* if the contract is entered’. Consequently, s 129(b) requires the credit provider to assess the particular credit contract to be entered into by the specific individual applying for the loan.
3. Obviously, this is correct. ASIC does not submit that s 129(b) prohibits a credit provider from using the HEM benchmark. Its point is more nuanced. Because the HEM benchmark is not about a particular consumer or a particular credit contract, a credit provider who assessed a loan’s suitability based *only* on the HEM benchmark would not have carried out the assessment required by s 129(b). The critical part of ASIC’s case is not that Westpac must not use the HEM benchmark—ASIC accepts that it may—but that it must take into account the individual financial position of the consumer in doing so and that the HEM benchmark, by itself, will not satisfy that requirement.
4. ASIC then observes that the inquiries required by s 130 must take place before the assessment is in fact carried out. This submission is correct and is expressly required by the provision’s opening words (‘the licensee must, before making the assessment … make reasonable inquiries … ’). Next it submits that the only purpose for which these inquiries are made is for the purpose of carrying out the assessment. I accept this submission, too. ASIC is correct to submit that the purpose of s 130 is to ensure that credit providers put themselves in an informed state about the financial position of the consumer before making an assessment of the suitability or otherwise of the loan.
5. It is the next step in ASIC’s argument that is problematic. This is that ‘the assessment is to be based on those inquiries’. There is no doubt that this submission involves a contention that s 129(b) has a mandatory requirement secreted within it, although what ‘based on’ actually means may be more elusive.
6. Regardless, one needs to identify precisely what it is that s 129(b) requires. The answer to that must turn on the nature of the assessment which is required. What is clear is that the assessment is to be an assessment of whether the proposed credit contract would be unsuitable for the borrower. This is the express requirement of s 129(b). The concept of unsuitability is not explicitly defined in Div 3 but ss 131(1) and (2) set out in a non-exhaustive fashion three circumstances in which the credit provider *must* determine that a credit contract would be unsuitable. There is a connection between those three circumstances and the three kinds of information that s 130(1) requires a credit provider to collect. The relationship may be illustrated with this table:

|  |  |
| --- | --- |
| **Section 130(1)**  | **Section 131(2)** |
| *Requirement to make reasonable inquiries about certain matters* | *Mandatory circumstances of unsuitability* |
| (a) make reasonable inquiries about the consumer’s requirements and objectives in relation to the credit contract | (b) the contract will not meet the consumer’s requirements or objectives if the contract is entered or the credit limit is increased in the period covered by the assessment |
| (b) make reasonable inquiries about the consumer’s financial situation | (a) the consumer will be unable to comply with the consumer’s financial obligations under the contract, or could only comply with substantial hardship, if the contract is entered or the credit limit is increased in the period covered by the assessment |
| (d) make any inquiries prescribed by the regulations about any matter prescribed by the regulations | (c) if the regulations prescribe circumstances in which a credit contract is unsuitable—those circumstances will apply to the contract if the contract is entered or the credit limit is increased in the period covered by the assessment |

1. This suggests that the information which is collected under s 130(1) is collected for a purpose, namely, the purpose of assessing the loan against the unsuitability criteria in s 131(2). But to say that information is collected for a purpose says nothing expressly about how that purpose is to be achieved. I do not think it can be said that the mandatory obligation that ASIC submits exists in s 129(b) could require the credit provider to carry out the assessment using *all* of the information gathered under s 130(1). The converse of ASIC’s own argument on the revenue side shows that this must be so. A consumer might, for example, disclose several kinds of income including share dividend income. Is a credit provider *bound* to take this income into account by s 129(b) or may it lawfully say that income of that kind is not sufficiently stable or predictable to be relied upon in carrying out an assessment of whether the credit contract would be unsuitable?
2. There are related problems. The financial position of the borrower will very frequently include a statement of assets and liabilities. Some borrowers will have substantial equity in real property or capital reserves of some other kind. Does s 129(b) *require* a credit provider to assess the borrower’s capacity to service the loan not only from the disclosed income sources but also from capital? Or, may a credit provider lawfully decide that it does not wish to include the ability of a borrower to service a loan out of capital in an assessment of unsuitability? It would be surprising if Div 3 were to be interpreted so as to *require* a credit provider to take account of these two matters in assessing the suitability of the loan when both would appear to be matters that one would hope in many cases ought not be included in a suitability analysis.
3. Observations of that kind demonstrate that it would be surprising if s 129(b) required every element of declared income or capital to be used in the process of assessing whether a loan was unsuitable. Of course, ASIC’s case is not concerned with declared income or capital but instead with declared living expenses. But nothing in ASIC’s argument is textually any less applicable to disclosed income and capital than it is to disclosed expenses.
4. It was for this reason that ASIC accepted during argument that it was not the case that there would be a failure to carry out an assessment of unsuitability under s 129(b) where a credit provider failed to take into account *all* of the information obtained under s 130(1). At T470 senior counsel for ASIC, Mr Clarke SC, submitted the following:

Further, it is not ASIC’s case that the licensee has to use all or some of the information that is obtained, which is what they have put in their written submissions. There’s no requirement to use in this way and ASIC’s case does not plead or contend that there is such a requirement. It is not ASIC’s case that the licensee cannot consider the consumer’s asset position. The licensee can consider the consumer’s asset position as part of the consumer’s financial situation.

This has not been the battleground in the present case because the case concerns Westpac’s ADS: excluding home loans that may be approved under manual assessment when a consumer’s asset position might be considered as sufficient to override otherwise failing of the serviceability rule. Assets can be – can properly be considered but it’s not – they’re not relevant to the present case. Again, Mr Kirk’s submission says – he now accepts you can use assets. So that’s a – that’s another gotcha moment. But that rests on the false premise that ASIC’s case is that the suitability assessment must always and only consider income less expenses. It is not and has never been ASIC’s case that the licensee must only conduct a simple income minus expenses calculation. Rather, it is ASIC’s case that, in order to conduct an assessment under section 129 of the character we’ve referred to, the licensee must at least conduct an assessment of the consumer’s financial situation with a sufficient understanding of the consumer’s income and expenses.

It is – it is an assessment of the consumer’s financial position as a whole as was stated in *Silberman*. It is not ASIC’s case that the statute requires a one size fits all mechanistic approach to conducting the assessment. ASIC’s construction does not require a lender to add up income, subtract expenses and decline the loan if there is a deficit. What it requires is for the lender to make an assessment of the consumer’s financial situation. What process, rules, formula or approach the bank adopts to assessing capacity to repay, affordability, whichever label one puts on it, is legitimately up to the lender as long as it remains based on the consumer’s financial situation. When it’s not based on the consumer’s financial situation, it’s not an assessment of the consumer. It is a false premise that the decision in *Silberman* somehow undermines ASIC’s section 128 case.

1. In my opinion, the position ultimately adopted by ASIC was inevitable. The contrary proposition would have been indefensible.
2. That being so, ASIC’s case is not that the consumer’s declared living expenses are themselves something which is directly required by Div 3 to be taken into account in assessing whether a loan will be unsuitable. Rather, the matter which must be taken into account is the much more amorphous concept of *the financial situation of the borrower*. For example, at T314.17 Mr Clarke submitted that ‘when conducting the assessment of affordability, the licensee is required to take into account the consumer’s financial position’.
3. On this view of Div 3, the mandatory matter which must be taken into account is the consumer’s financial situation viewed overall and not any particular integer of which it consists. Whether that financial situation has been taken into account and how it has been taken into account will therefore be a question of fact and degree and, as ASIC accepted, this could in many cases be a difficult question.
4. Part of that difficulty emerges from the fact that ASIC’s argument does not identify *what* a credit provider is to do with the financial information it has gathered under s 130(1)(b). Indeed, it was clear in Mr Clarke’s submission that what the credit provider did with the information about the financial situation of the borrower was ‘legitimately up to the lender’. There is an element of vagueness about this submission. This may, I think, be seen in Mr Clarke’s submission (above at [65]) that the credit provider ‘must at least conduct an assessment of the consumer’s financial situation with a sufficient understanding of the consumer’s income and expenses’. But, it might well be asked (again rhetorically), having obtained that ‘sufficient understanding’, what is it that the credit provider is actually meant to be doing with it?
5. The answer to that rhetorical question turns out to be of some significance. The only statutory purpose for which the information is collected is, in my opinion, to answer the s 131(2)(a) Questions (or, in a case where they were relevant, the s 131(2)(b) or (c) questions). They are precise questions: is it possible for the consumer to service the loan at all and, if it is, can it nevertheless only be serviced by the making of repayments which would put the consumer in circumstances of substantial hardship? I accept that, in principle, whatever must as a matter of necessity be considered to answer those two questions is a mandatory matter which a credit provider must take into account.
6. I do not, however, accept ASIC’s contention that *all* of the financial circumstances of the consumer can be such a mandatory matter. Many of the consumer’s financial circumstances are not relevant to either question. For example, the fact that a consumer had superannuation could have no relevance to the s 131(2)(a) Questions of whether the consumer could in absolute terms afford the repayments; so too, the fact that the consumer takes an annual first class holiday to the United States is not relevant to assessing whether the repayments will put the consumer into circumstances of substantial hardship. Thus, the mandatory matters flowing from the terms of the s 131(2)(a) Questions cannot include as a single mandatory matter *all* of the financial circumstances of the consumer. And, because they do not include all of those circumstances, it cannot be said that this argument has the consequence that the subset of all of the financial circumstances of the consumer comprising the consumer’s declared living expenses must be a mandatory consideration either.
7. A weaker form of the argument is that *some* of the financial circumstances of the consumer are mandatory matters and that, in this case, this included at least the consumer’s declared living expenses. The form of this weaker argument would be that the nature of the s 131(2)(a) Questions is such that they cannot be answered without knowing the consumer’s declared living expenses.
8. However, I am unable to discern why, as a matter of principle, the consumer’s declared living expenses *must* be considered in answering the s 131(2)(a) Questions. The *first* of those questions concerns the absolute ability of the consumer to make the repayments on the loan. This inquiry is only concerned with the consumer’s ability to service the loan and not with any issues as to whether doing so will put the consumer in circumstances of substantial hardship. I am unable to perceive why, in answering that question, one *must* know what the declared living expenses of the consumer are. ASIC’s submissions did not seek demonstrate why this might be so.
9. A worked example illustrates the problem. Let it be assumed artificially that a consumer with a monthly after-tax income of $4000 has three declared living expenses of food ($1200 per month), utilities and internet ($200 per month) and gym memberships ($200 per month). The declared living expenses are therefore $1600 per month and the consumer will have a surplus of $2400 per month. If the consumer proposes to take out a home loan which will require monthly repayments of $2500 the outgoings will then be $4100 per month as opposed to the after-tax income of $4000 per month. The consumer will therefore have a shortfall of $100 per month.
10. But this does not tell one that the consumer cannot afford to meet the repayments. One reason this is so is because the consumer may choose to discontinue their gym memberships and meet the repayments in that way. The problem for ASIC’s argument is that the mere fact that there are living expenses is not necessarily relevant to whether a consumer will be unable to comply with their loan obligations because it is always possible that some of the living expenses might be foregone by the consumer in order to meet the repayments.
11. In fact, the only way that one or more declared living expenses can be shown to be *necessarily* relevant to the issue of whether the consumer can afford to make the repayments is by identifying some living expenses which simply cannot be foregone or reduced beyond a certain point. For example, everyone has to eat so there must be an amount for food which is the minimum which can conceivably be spent. But that minimum is an entirely different concept to the declared living expense of what the consumer actually spends on food. Indeed, knowing how much the consumer actually spends on food does not tell one anything about that conceptual minimum. I may eat Wagyu beef everyday washed down with the finest shiraz but, if I really want my new home, I can make do on much more modest fare. Knowing the amount I actually expend on food tells one nothing about what that conceptual minimum is. But it is that conceptual minimum which drives the question of whether I can afford to make the repayments on the loan.
12. Without additional information, I do not consider that it is possible to accept that the consumer’s declared living expenses tell one anything about their capacity to meet the repayments under the loan. I do accept that with additional information, it may be possible to do so. For example, if the monthly utilities expense disclosed by the consumer is known by the credit provider to be the minimum possible monthly utilities expense, then with that additional information one can deduce that the monthly utilities expense cannot be further reduced. Depending on what is known about the other declared living expenses, it may then be possible to conclude that the repayments cannot be met. But without additional information of that kind, it is not possible to say that any one or more of the declared expenses *must* be relevant to the first of the s 131(2)(a) Questions (i.e. whether the consumer can afford to make the repayments under the loan).
13. The situation is no better in relation to the *second* of the s 131(2)(a) Questions (i.e. whether the consumer, whilst able to afford the repayments, will not be able to do so without being placed in circumstances of substantial hardship). Largely the problem is the same as that described in the preceding paragraph although it is now more acute. Here the issue is not whether some or all of the declared living expenses can be done without but the even more complex question of whether, if done without, this would give rise to circumstances of substantial hardship. Again, one cannot say that as a matter of necessity this can be discerned from the declared living expenses by themselves. The fact that the consumer spends $100 per month on caviar throws no light on whether a given loan will put the consumer into circumstances of substantial hardship. Nor for that matter does knowing that the consumer spends $500 per week on basic food items. For that to be relevant to the hardship question posed by s 131(2)(a) one would need to know at least the following matters:
	1. that the loan repayments would require the consumer to cut their budget by a certain amount, say for the sake of argument, $200 per week;
	2. that the $200 would have to be cut from the amount the consumer spent on food (i.e. $500 per week); and
	3. if the consumer cut the amount spent on basic food from $500 per week to $300 per week then this would place the consumer in circumstances of substantial hardship.
14. With those additional facts, one may be able to say that the declared living expenses must necessarily be relevant to the second of the s 131(2)(a) Questions. I note that ASIC does not allege Westpac contravened s 130(1) by failing to make inquiries along these lines and these reasons do not deal with any such contention. Absent additional facts of that kind, however, one cannot be sure that the declared living expenses *must* be relevant to the s 131(2)(a) Questions. At best they might be relevant, but possible relevance is not sufficient for ASIC’s argument.
15. It follows that as a matter of analysis, declared living expenses by themselves do not necessarily have to be relevant to the s 131(2)(a) Questions. If they do not necessarily have to be relevant to the answering of those questions, one cannot say that s 129 requires that the declared living expenses be taken into account in performing an assessment of unsuitability. I therefore reject the first step in ASIC’s argument.
16. That conclusion is consistent with what seems to me a more likely operation for ss 128 and 129. To grasp this it is first necessary to know that Div 3 is very concerned to ensure that the assessment which the credit provider carries out is correct. The credit provider is obliged by s 129 to carry out an assessment of the suitability of the loan for the consumer (strictly, unsuitability) and is prohibited, on pain of civil penalty, by s 128 from entry into a credit contract unless it has performed such an assessment. ASIC’s argument effectively telescopes substantial obligations into ss 128 and 129 relating to how a credit provider goes about this process. But this appears to me to be pointless because of ss 131 and 133. Section 131 requires certain credit contracts to be assessed as unsuitable and s 133 prohibits entry by a credit provider into a credit contract which is unsuitable.
17. The policy of the statute that unsuitable loans should not be made is explicitly and directly given force by ss 131 and 133. Given that statutory fact, what purpose can be served by prescribing how a credit provider goes about the assessment process? Sections 131 and 133 make that the problem of the credit provider. A credit provider may do what it wants in the assessment process, so far as I can see; what it cannot do is make unsuitable loans. ASIC’s argument creates a whole new range of implied rules which appear altogether unnecessary in light of ss 131 and 133.
18. For completeness, I should record that I have not disregarded ASIC’s submission that the failure to take into account the declared living expenses involved a failure to comply with ss 131 and 133. Section 131(1) requires a credit provider to assess a credit contract as unsuitable if any of the s 131(2) Questions are answered affirmatively. Section 133(1) prohibits a credit provider from entering into a credit contract which is unsuitable as defined in s 133(2). The definitions in ss 131(2) and 133(2) are identical. A breach of ss 131(1) or 133(1) is a civil penalty contravention.
19. ASIC did not allege that Westpac had ‘contravened’ either provision so that it was liable to pay a civil penalty. Instead, it submitted that the provisions had not been complied with rather than contravened. That submission then engendered a lively debate about whether one could fail to comply with a provision without also contravening it. Perhaps disappointingly, it is not necessary to resolve that debate. I take ASIC’s submission about this only to be that because Westpac had not (allegedly) taken any of the disclosed living expenses into account it could not have asked itself the s 131(2)(a) Questions (or the identical questions posed by s 133(2)(a)). This meant that it had not complied with either s 131 or s 133. However, that depiction of the provisions does not advance matters any further and does not alter the conclusion above.
20. Nor I have disregarded ASIC’s submission that the responsible lending obligations involve new norms of conduct and represent matters of substance or its allied submission that the legislation should be seen as beneficial and therefore construed liberally. However, those matters cannot be used to bend Div 3 so that it is construed to say something which it does not say. It is not necessary, in that circumstance, to decide whether ASIC’s case about declared living expenses would represent an outcome which could be described beneficial. For what it is worth, the proposition appears to me to be, at the very least, contestable. On one view, seeking to determine circumstances of objective hardship by reference to actual household expenditure may be quite misconceived. With knowledge of the consumer’s declared living expenses, one may well be able to discern that a consumer will have to trim their sails if the loan proceeds. But there is arguably a conceptual gulf between a trimming of sails and poverty.

## ASIC’s second step: Across the whole of its home loan book for the period 12 December 2011 to March 2015 Westpac failed to take account of the borrower’s declared living expenses and therefore failed in each case to take into account each borrower’s financial situation

1. This case fails on the facts. Westpac did not fail to take into account the consumer’s declared living expenses. It took them into account in applying the 70% Ratio Rule as part of its process of assessment under the ADS, i.e. in conjunction with the other rules such as the Serviceability Rule. It was this that forced ASIC to submit that the 70% Ratio Rule was not about unsuitability and to submit that the Serviceability Rule did not take any of them into account. These two positions were forensically, in my opinion, very strained.

## ASIC’s third step: Westpac’s failure to take account of the consumer’s declared living expenses in purporting to carry out an assessment under s 129 meant that it had not carried out any assessment at all as required by law

1. Like the second question, this question does not actually arise. However, if Westpac had been obliged to take into account all declared living expenses (which it was not) and if it had failed to do so (which it did not), then the question would be whether it had failed to carry out the assessment called for by s 129.
2. The problem with this contention is s 132(1) which requires the credit provider to give the consumer a copy of the assessment on request. This is a civil penalty provision carrying (as at 1 March 2013) a maximum penalty of 2,000 penalty units. If ASIC is correct that Westpac’s processes resulted in a situation where, as a matter of law, it failed to carry out a suitability assessment for any of the 261,987 loans it made without manual assessment between 12 December 2011 and March 2015, then it must follow that there are no suitability assessments of which any of its 261,987 borrowers could have requested copies under s 132(1) either.
3. It seems an unlikely construction of Div 3 that a credit provider is required to provide consumers with copies of their assessment only where the assessment is valid. A more likely construction of the word ‘assessment’ in s 132 is that it refers to the thing which results from the process of assessment rather than to a legal construct. That an assessment is a thing rather than a legal construct is supported by the fact s 132(1) proceeds on an assumption that an ‘assessment’ may be copied, a quality difficult to ascribe to a legal construct. I therefore reject ASIC’s submission at T472 that an assessment might be valid for the purposes of s 132 but invalid for the purposes of s 129. This involves giving the same word a different meaning in two provisions in the same division. Although not impossible, such an outcome strikes me as unlikely.
4. Reading the word ‘assessment’ as a thing rather than a legal construct also comports more comfortably with the text of ss 128 and 129. The requirement to make an assessment of unsuitability is specified by s 129 but it is *not* a civil penalty provision. The consequence of reading ‘assessment’ as a legal construct which can be invalid is to transform a failure to carry out an assessment in accordance with a provision which does not impose a civil penalty (s 129) into a contravention of a civil penalty provision (s 128). If it were intended that a failure to carry out an assessment was itself a civil penalty contravention, it would be much more natural to make s 129 a civil penalty provision.
5. ASIC’s contention that an assessment is a legal construct which can be invalid, therefore, fails. I reject the third step in its argument.
6. That conclusion means that I do not accept its construction of Div 3. For completeness, I should note that ASIC submitted that its construction was supported by a number of decisions of this Court. These were *Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 per Davies J, *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2018] FCA 155 per Middleton J, *Australian Securities & Investments Commission v Thorn Australia Pty Ltd* [2018] FCA 704 per Jagot J, and *Australian Securities and Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174 per Greenwood J. I do not accept that any of these cases is of assistance. *ASIC v Cash Store* was an undefended case. There was no debate about the issue which is presently before the Court. Whilst the respondent was represented in *ASIC v ANZ* this was in the context where both parties were seeking to have the Court impose an agreed penalty and make consent declarations. There was no debate about the present issue. The same may be said of *ASIC v Thorn. ASIC v Channic* was the result of a contested hearing but not one in which the present issue was live. Accepting in ASIC’s favour that there are various brief remarks in these judgments which are consistent with its proposed construction, the short fact is that none of these statements results from a contested hearing or any process of analysis by the Court: cf. *CSR Limited v Eddy* [2005] HCA 64; 226 CLR 1 at 11-12 [13]-[15] per Gleeson CJ, Gummow and Heydon JJ. In my opinion, these decisions have no value in the present contest.

# Loans with an Initial Interest Only Period

1. Turning then to the second part of ASIC’s case concerning loans with an initial interest only period, there is no dispute about the facts. Westpac made home loans which had initial interest only periods. The length of those periods could vary. Some of the loans were fixed interest loans, some were variable. In calculating the serviceability of each loan Westpac treated them as if they had no interest only period and instead amortised the principal over the life of the loan. ASIC’s contention is that Westpac was legally required, instead, to assess the serviceability of the loan on the basis of the repayments which would be due once the interest only period had expired, or alternatively by reference to the additional cost of interest incurred on an interest only loan. ASIC’s submission was that Westpac, by not doing so, had failed to assess the suitability of the particular loan being sought by the consumer.
2. It will be recalled from the Serviceability Rule formula set out above at [28] that one of its inputs was ‘Assessed Monthly Repayments’. In the case of many loans, this can only be an informed guess. In the case of a loan with a variable interest rate, what the actual repayments will be is heavily influenced by the prevailing interest rate. It was in fact to address that uncertainty that the Serviceability Rule included a ‘buffer’ whose explicit purpose was to try a manage interest rate fluctuations. The buffer included a ‘buffer floor rate’ which was a minimum interest rate percentage used to ensure that an unduly low interest rate was not used in the serviceability calculations due to a low interest rate environment. ASIC does not allege that where Westpac calculated the monthly repayments on a variable interest rate loan using the rate prevailing at the inception of the loan that it infringed Div 3 if the interest rate subsequently shifted.
3. A related problem of indeterminacy also afflicts loans with initial interest only periods. In the case of such loans which have a fixed interest rate, the problem is relatively straightforward. Does one assess the monthly repayments due under the loan on the basis of the repayments due at the inception of the loan (which will not, by hypothesis, include a component for repayment of principal), or on the basis of the repayments which will be due when the interest only period ends, or on some other basis? Westpac decided to opt for the third option and assessed the monthly repayments on the basis that there was no interest only period and that the principal repayments were amortised across the life of the loan.
4. ASIC submits that Div 3 required Westpac, as a matter of law, to adopt the second approach and that if it did not do so it would not have carried out an assessment as required by s 129. Alternatively, ASIC submits that Westpac did not make an assessment as required by s 129 as it disregarded the ‘additional cost of interest only loans’ which was the total additional interest payments that would be made for the interest only period compared to if repayments had been made to reduce the principal during that period.
5. So far as loans with a variable rate are concerned the problem is the same but with the superadded difficulty that one cannot know the interest rate which will apply at the end of the interest only period. In the case of such loans, ASIC also submitted that Westpac was required to assess the monthly repayments on the basis of what those repayments would be at the end of the interest only period. As it did with the fixed rate loans, Westpac in fact assessed the monthly repayments on the basis that there was no interest only period and amortised the principal across the life of the loan.
6. This part of ASIC’s case may be readily dispatched. What it submits is impossible. Because the interest is variable it is not possible to know what the repayments will be at the end of the only interest only period. In the case of these loans the choice is between assessing the monthly repayments as the repayments of interest due at the inception of the loan or doing as Westpac did which is to amortise the principal across the life of the loan on the assumption that the initial interest rate applies across the life of the loan. ASIC’s contentions about these loans can be rescued from incoherence only by adding an additional assumption that the repayments at the end of the initial period should be estimated at the initial interest rate. If that assumption is made, the position of these loans collapses to the formal position of the fixed rate loans. Accordingly, it is only fixed rate loans with an initial interest only period that require consideration. ASIC’s case about the corresponding variable rate loans is either impossible or functionally equivalent to the position of fixed rate loans. As it happens, ASIC’s submissions did not distinguish the two situations.
7. There were two alternatives to ASIC’s argument. ASIC’s first case was that Westpac had failed to take into account the financial position of the consumer because the repayments the consumer would actually be required to make after the interest only period were not the ones which Westpac had assessed or, putting it another way, it had not taken into account the terms of the credit contract. One problem with this argument is that it is self-defeating. If Westpac had used the payments due at the end of the initial interest only period it could equally be said that it had failed to take into account the financial position of the consumer because it had not used the repayments which would actually be due during the initial period.
8. Leaving that debating point to one side, there is nothing in this argument. The burden of ASIC’s submission is that the repayments due at the end of the initial interest only period is a mandatory matter which must be taken into account in answering the s 131(2)(a) Questions. I do not see how that can be. As I have explained above, the consumer’s entire financial position is not a mandatory consideration for the purpose of answering the s 131(2)(a) Questions. One cannot reason therefore that the repayments due at the end of the interest only period is mandatory through the fact that they make up part of the consumer’s financial position.
9. What is in fact mandatory are those matters which must be known before the s 131(2)(a) Questions can be answered. Since the manner of answering those questions is not itself regulated by s 131 it may be difficult to identify such matters in advance although I would not at this stage exclude the possibility. But in any event it certainly cannot remotely be said that those questions cannot be answered without knowing the repayments which will be due at the end of the initial interest only period.
10. I am unable to discern how Div 3 can be construed in such a way that the numerical figures used in process of assessment can result in there having been no assessment at all. Indeed, ASIC accepted in its closing written submissions that it was not a contravention of s 128 ‘for a licensee to make a wrong assessment’ and this was because ‘s 128 is not about being *right or wrong*’. I would accept that an invalid assessment would result if a credit provider failed to ask itself the s 131(2)(a) Questions and asked itself some other question. But once it is accepted that Westpac did in fact ask itself the s 131(2)(a) Questions, how it went about answering those questions was, as Mr Clarke put it, legitimately a matter for it. In that regard, ASIC’s position on its primary case (where it accepted that what the credit provider did with the information it gathered was a matter for it) was inconsistent with its secondary case about loans with initial interest only periods (where it said that the credit provider has to calculate the repayments in a particular way). In any event, I do not think Div 3 comes close to involving the implication for which ASIC contends.
11. ASIC’s alternative case was that Westpac, in approaching the matter in that way it had, underestimated the amount of interest which was payable and thereby failed to consider the financial situation of the consumer. I reject this argument for the same reason.
12. This makes it unnecessary to deal with a number of Westpac’s other defences in relation to these loans. Had it been necessary, I would not have accepted that if ASIC’s argument was made good that the availability of offset accounts or the fact that many borrowers had paid well ahead of their obligations under the loans would have been an answer to ASIC’s case. Nor do I think that the evidence that the average life of Westpac home loans was 76 months for interest only loans would have met ASIC’s case.

# Result

1. ASIC’s application will be dismissed with costs.

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| I certify that the preceding one hundred and five (105) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Perram. |

Associate:

Dated: 13 August 2019