
Australian Securities and Investments Commission v Westpac Banking Corp (Liability Trial)

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On 13 August 2019, the Federal Court of Australia (Perram J) delivered its decision in the civil penalty proceedings brought by the Australian Securities and Investments Commission (ASIC) against Westpac Banking Corp (Westpac) in respect of alleged contraventions of s 128 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act). ASIC's application was dismissed with costs, Perram J having found against ASIC both on its proffered construction of the NCCP Act and the facts it alleged amounted to the contravention.¹

Procedural history

ASIC commenced civil penalty proceedings against Westpac in March 2017 in relation to alleged breaches of responsible lending obligations in respect of Westpac's home loan application assessment processes between December 2011 and March 2015. Specifically, the following conduct was alleged to have breached responsible lending obligations:

- In applying the Serviceability Rule in its automated decision system, Westpac used the Household Expenditure Measure (HEM) benchmark value, instead of the amount of living expenses that the consumer stated in their loan application, in computing the consumer's monthly cash surplus or shortfall (living expenses issue).
- In relation to loans with an initial interest-only period, Westpac computed monthly repayments for use in the serviceability calculation on the basis that the principal amortised over the entire term of the loan, rather than the residual term of the loan after the expiry of the initial interest-only period (interest-only loans issue).

The alleged contraventions concerned 261,987 loans. ASIC and Westpac agreed on a settlement in which Westpac would pay a pecuniary penalty of \$35 million plus ASIC's costs. However, in a decision on 13 November 2018,² Perram J refused to make the orders sought by Westpac and ASIC, as the statement of

agreed facts submitted by ASIC and Westpac did not disclose any contravention of the NCCP Act. That decision is explained in an earlier case note.³

The case was then argued on its merits before Perram J, leading to the decision that is the subject of this case note.

Issues

At the core of both the living expenses issue and the interest-only loans issue is the allegation that Westpac contravened its obligation under s 128(c) of the NCCP Act to make an assessment in accordance with s 129 covering the day on which the credit contract is entered into. Section 129 requires such an assessment to specify the period that it covers and assess whether the credit contract will be unsuitable for the consumer if the contract is entered into or its credit limit increased during that period. Section 131(2) sets out the circumstances in which a credit contract will be unsuitable for a consumer. Relevantly for the living expenses issue and the interest-only loans issue, a credit contract will be unsuitable for a consumer if, at the time of assessment, it is likely that the consumer could not comply with their financial obligations under it or could only comply with substantial hardship.⁴ ASIC's case rested on the proposition that Westpac's assessments of the 261,987 loans were so defective that they did not amount to an "assessment" under s 129, leaving the s 128(c) obligation unfulfilled at the time of entry into the credit contract. This turned on the proper construction of ss 128(c), 129 and 131(2)(a) of the NCCP Act.

Important to understanding the decision are the things that ASIC did not plead in these proceedings. ASIC did not allege that any of the 261,987 loan contracts entered into by Westpac were unsuitable for those consumers. ASIC also did not allege that Westpac's assessment attempted to consider something other than whether the consumer could likely comply with their financial obligations under the home loan or that they could only do so with substantial hardship (referred to as "the s 131(2)(a) Questions" throughout the judgment).

Decision

On the living expenses issue, it was held that the NCCP Act does not require a licensee to use the consumer's declared living expenses when assessing whether or not the credit contract will be unsuitable under s 131(2)(a). On the interest-only loans issue, it was held that the NCCP Act does not require a licensee to use expected repayment amounts at the expiry of the initial interest-only period in preference to any other amount in determining whether or not the credit contract will be unsuitable under s 131(2)(a). All that is required under s 129 is for the licensee to ask and answer the s 131(2)(a) Questions and, in relation to both issues, Westpac did ask and answer those questions.⁵

It was also held that the assessment under s 129 is a "thing" resulting from the process of assessment, rather than a legal construct. Consequently, the NCCP Act does not impose any threshold conditions on an assessment of unsuitability (other than those set out in the text of s 129), below which the assessment is invalid and therefore not an assessment for the purposes of s 128. How the credit provider carries out that assessment is a matter within its discretion.⁶

ASIC's case also failed on the facts on the living expenses issue. Central to that case was that by using the HEM value instead of the consumer's declared living expenses in the Serviceability Rule, Westpac failed to have regard to the consumer's financial situation in carrying out that assessment. However, in another rule in its automated decision system — the "70% Ratio Rule" — Westpac did take into account the consumer's declared living expenses.⁷

Reasons

Living expenses issue

Section 129(b) of the NCCP Act requires a licensee to assess whether the credit contract will be unsuitable for the consumer — that is, whether it will satisfy any of the criteria in s 131(2). Section 130(1) requires a licensee to, *before the making the assessment*, make reasonable inquiries about the consumer's financial situation (among other things). It was noted that each of the things that a credit provider must inquire into under s 130(1) link directly to particular criteria for unsuitability in s 131(2) — specifically, the requirement to make reasonable inquiries about the consumer's financial situation links directly to the whether the consumer will be unable to comply with their financial obligations under the contract or only able to comply with substantial hardship.⁸

However, all that follows from the links between information items in s 130(1) and unsuitability criteria in s 131(2) is that the NCCP Act requires a licensee to collect information for the purpose of assessing whether

or not a credit contract is unsuitable, rather than for its own sake. It does not follow that that purpose can only be achieved by taking into account all information collected, regardless of its relevance or materiality to the assessment of unsuitability.⁹ Perram J gave examples of the other kinds of information, such as irregular income or capital assets, which are no less "about the consumer's financial situation" than declared living expenses, but which can rightly be disregarded in considering the s 131(2)(a) Questions because of their low relevance to loan serviceability. So far as Pt 3-2 Div 3 of the NCCP Act prescribes any mandatory matters to be taken into account in an assessment under s 129(b), it is only those aspects of a consumer's financial situation that are necessary to determine whether or not the credit contract will be unsuitable.¹⁰

It was not accepted that the consumer's declared living expenses are necessary to determine whether or not the consumer could comply with their financial obligations under the credit contract or could only comply with substantial hardship. Simply labelling something as a living expense, and the fact that the consumer incurs that expense on their current lifestyle, does not make them an unchangeable aspect of the consumer's financial situation. Some expenses are entirely discretionary in nature, and represent a standard of living significantly above any objective concept of "substantial hardship". A consumer may choose to, and can be expected to, forgo particular living expenses in order to meet their financial obligations under a credit contract.¹¹

Perram J held that the only way that a consumer's declared living expenses can be necessary to answer the s 131(2)(a) Questions is if there are some living expenses which cannot be forgone or reduced below some minimum value. However, this is again not determined by the mere labelling of an expense item. Perram J illustrated the reasoning with the "Wagyu beef ... washed down with the finest shiraz"¹² example that made headlines in the immediate aftermath of the judgment. Everyone has to eat so there is a minimum amount that a consumer must spend on food. However, it does not follow that all food expenses declared by the consumer must be used in the assessment at their stated values. If a consumer currently dines extravagantly, they can reduce their expenditure on food without suffering substantial hardship. Whilst the Wagyu beef and shiraz example is an extreme one (and lightens up otherwise dry, technical analysis of Ch 3 of the NCCP Act), the reasoning is equally applicable to less opulent discretionary expenditure. The mere labelling of expenditure of being a particular category is not determinative; more information is needed to assess whether or not it can be

forgone or reduced by the consumer.¹³ The HEM benchmark, as “an estimate of the level of household expenditure that [a] consumer could reasonably be expected to spend to participate fully in society with a reasonable standard of living”,¹⁴ could be relevant to this inquiry, but this did not need to be decided because of the finding that an assessment under s 129 is a “thing” that cannot be invalid.

Interest-only loans issue

On this construction of the NCCP Act, ASIC’s case on the interest-only loans issue also fell away. First, except in the case of a fixed rate loan, the actual amount of repayments at the end of the initial interest-only period are not known, as interest rates may change in the intervening period. To use the interest rate at the time of loan inception would be to assume that they are functionally equivalent to fixed rate loans, and to require one estimate of future repayments to be used in preference to another estimate. Though the consumer’s entire financial position is not a mandatory consideration for answering the s 131(2)(a) Questions as part of the s 129 assessment, ASIC’s position would have required Westpac to disregard one part of the consumer’s financial situation (repayments during the initial interest-only period) in favour of another, more uncertainly, part of the consumer’s financial situation (the expected repayments at the expiry of the initial interest-only period). This position is internally inconsistent unless there is some implied requirement of conservatism in the s 129 assessment obligation. Once it was accepted that the manner of conducting an assessment was within the credit provider’s discretion, this position could not succeed.

An assessment as a “thing” rather than a legal construct

Though the question did not arise because Westpac was found to have taken into account the consumers’ declared living expenses and considered to the s 131(2)(a) Questions in its assessment, Perram J gave obiter dicta reasons for why an assessment under s 129 is a “thing” rather than a legal construct capable of invalidity.

Section 132(1) requires a licensee to give the consumer a copy of the assessment on request by the consumer, with non-compliance punishable by a civil penalty. If it follows that a defective assessment is invalid and therefore not an assessment, there would be nothing that a consumer would be entitled to in the case that the licensee carried out a defective assessment, or that it would be impossible for the licensee to comply with their obligation under s 132(1).¹⁵ Rather, what s 132(1) requires a licensee to give to a consumer is a

copy of the thing that results from the process of assessment. That an assessment can be copied also supports the view that it is a thing rather than a legal construct.

Perram J also held that construing an assessment as a “thing” rather than a legal construct is also more consistent with the text of ss 128 and 129, specifically the lack of any civil penalty attached to s 129. Construing “assessment” as a legal construct capable of invalidity would transform failure to comply with s 129, which does not carry a civil penalty, into contravention of a civil penalty provision. An intention to make contravention of s 129 punishable by a civil penalty could be more naturally expressed by making s 129 a civil penalty provision.¹⁶

Significance of the case

The authors consider the case to be less significant than what some of the commentary that immediately followed the decision suggests. Perram J applied orthodox approaches to statutory interpretation to determine the proper construction of s 129, and then applied them to Westpac’s conduct. It does not follow that this represents any lessening of responsible lending obligations. Rather, it recognises that the legislation allows credit providers considerable discretion in how they assess whether or not a credit contract is unsuitable for a potential debtor.

On the living expenses issue, it would appear to be a common-sense position (to the authors at least) that a consumer can be expected to forgo or reduce discretionary expenses in order to be able to afford repayments under a credit contract. This is particularly the case where the credit finances a necessity such as housing. Whether the reasoning in this decision applies in as strong terms to other kinds of credit, particularly personal lending financing discretionary expenditure, is a question for a future case. The reference to Wagyu beef and shiraz is illustrative and does not purport to represent the average consumer — it would have similar force if Wagyu beef and shiraz were replaced with takeaway food and mass-market beer.

On the interest-only loans issue, it is unobjectionable to acknowledge that future repayments under a variable rate loan are uncertain and any incorporation into a present assessment of unsuitability necessarily involves forecasts and estimates. It would be a very interventionist interpretation of the NCCP Act to imply into it a requirement to use a particular forecast of the future, or the most conservative foreseeable estimate of the future. Followed through to its logical end, requiring repayments at the end of the initial interest-only period based on present interest rates to be used in the serviceability calculation would also justify using expected income at

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the end of the interest-only period, with adjustments for expected wage growth and industry-specific information, to be used in the calculations answering the s 131(2)(a) Questions. However, nobody of note appears to be promoting this approach, and justifiably so as forecasts of the future are inherently uncertain.

Lastly, this case does not necessarily render responsible lending laws unenforceable. Any consideration of the Federal Court's decision must acknowledge that ASIC did not plead that any of the 261,987 loans in question were unsuitable in contravention of s 133(1) of the NCCP Act. ASIC also did not plead that Westpac failed to make reasonable inquiries into the consumers' financial situations or take reasonable steps to verify their financial situations before entering into the loans. The essence of ASIC's case was that the assessment process was defective and therefore any purported assessment was invalid, even though it did not result in an unsuitable credit contract being entered into. The main consequence is that, going forward, ASIC will likely need to pursue a similar case by identifying failures to make reasonable inquiries or take reasonable steps to verify information and seeking penalties for contravention of ss 128(d) and 130(1), or to identify unsuitable credit contracts entered into and seeking penalties for contravention of s 133(1). This is not necessarily undesirable, as it would result in ASIC's enforcement activities being focused on cases of genuine harm, rather than merely suboptimal conduct or reasonable exercises of discretion.



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Footnotes

1. *ASIC v Westpac Banking Corp (Liability Trial)* [2019] FCA 1244; BC201907218 at [6], [8] and [11].
2. *ASIC v Westpac Banking Corp* (2018) 132 ACSR 230; [2018] FCA 1733; BC201810662.
3. A Beatty and G Papdi "Responsible lending update: ASIC v Westpac Banking Corp" (2019) 34(10) *BLB* 180.
4. NCCP Act, s 131(2)(a).
5. Above n 1, at [8].
6. Above n 1, at [89]–[91].
7. Above n 1, at [86].
8. Above n 1, at [61].
9. Above n 1, at [62].
10. Above n 1, at [70]–[71].
11. Above n 1, at [74]–[75].
12. Above n 1, at [76].
13. Above n 1, at [77]–[79].
14. Above n 1, at [46].
15. Above n 1, at [88].
16. Above n 1, at [90].