FEDERAL COURT OF AUSTRALIA

Australian Securities and Investments Commission v Westpac Banking Corporation [2020] FCAFC 111

Appeal from:	*Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244
File number:	NSD 1455 of 2019
Judges:	**MIDDLETON, GLEESON AND LEE JJ**
Date of judgment:	26 June 2020
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 the assessment required of unsuitability **APPEAL** – whether primary judge erred in failing to find respondent contravened s 128 by not making an assessment in accordance with s 128(c) of *National Consumer Credit Protection Act 2009* (Cth) – appeal dismissed with costs
Legislation:	*Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) *National Consumer Credit Protection Act 2009* (Cth) *National Consumer Credit Protection Regulations 2010* (Cth)
Case cited:	*Re Kabalan* (1993) 40 FCR 560
Date of hearing:	25 February 2020
Registry:	New South Wales
Division:	General Division
National Practice Area:	Commercial and Corporations
Sub-area:	Regulator and Consumer Protection
Category:	Catchwords

Number of paragraphs:	175
Counsel for the Appellant:	N Hutley SC with J Clarke SC and S Patterson
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ORDERS

NSD 1455 of 2019

BETWEEN:	**AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION** Appellant
AND:	**WESTPAC BANKING CORPORATION (ACN 007 457 141)** Respondent
JUDGES:	**MIDDLETON, GLEESON AND LEE JJ**
DATE OF ORDER:	**26 JUNE 2020**

THE COURT ORDERS THAT:

1. The appeal be dismissed with costs.

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

REASONS FOR JUDGMENT

MIDDLETON J:

INTRODUCTION

1 The primary issue in this appeal is whether the respondent ('**Westpac**') contravened s 128 of the *National Consumer Credit Protection Act 2009* (Cth) (the '**Act**') in respect of certain home loans: more particularly, whether Westpac undertook the assessment of unsuitability required by s 128, specifically s 128(c) of the Act. The appellant ('**ASIC**') contends that the primary judge erred in failing to find that Westpac did contravene s 128 by not making an assessment in accordance with s 128(c).

2 That primary issue raises two questions. First, ASIC contends that to comply with s 128(c), a credit provider must undertake an assessment of whether the particular credit contract proposed to be entered into will be unsuitable for the particular consumer in question, and necessarily must consider and evaluate all the expenses of that consumer as part of assessing a consumer's financial situation. The second question arises because ASIC contends that with home loans with an initial interest only period, Westpac contravened s 128 because Westpac's assessments were done not by reference to the terms of such interest only loans and the actual repayments to be made thereunder.

3 Before going to the relevant legislative provisions, it is to be noted that ASIC did not contend that any of the home loans entered into by Westpac were in fact unsuitable nor that Westpac was not attempting to assess whether the consumers could likely comply with their financial obligations under the home loans or that they could only do so with substantial hardship. In fact, it is quite apparent that Westpac's system and multiple rules were extensive and well documented. However, the question remains whether Westpac, in the circumstances relating to its assessment of the relevant home loans, made the assessment necessarily directed to be made under the Act by reference to the particular consumer and all their expenses, including their general living expenses, and by reference to the terms of the home loan entered into between the consumer and the credit provider.

4 I should observe that just because in any given case a particular home loan is not unsuitable, does not mean that there may not have been a breach of s 128. Nor does it matter whether Westpac should have made further inquiries of one of the consumers who entered into a home loan. These are not matters in contention. The main complaint in this appeal and before the

primary judge was that Westpac failed to make the required assessment by a consideration of the particular consumer and their particular circumstances. This is a question of process (making an assessment) leading to the entering into of a credit contract, irrespective of whether that credit contract turns out to be unsuitable or not. This is in fact a proceeding (as observed by the primary judge at [10] of his reasons) about the operation of responsible lending laws without any allegation of irresponsible lending (that is, entering into an unsuitable credit contract). However, the fact there is no allegation of irresponsible lending is a matter of no significance in this appeal if there was in fact a breach of s 128 by Westpac.

5 Section 128 is found in Div 3, which 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 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.*

6 One immediate matter to observe is that Div 3 of the Act looks not only to the consumer's financial situation, but also to the consumer's requirements and objectives. The consumer's requirements and objectives are necessarily personal to each consumer, and reasonable inquiries of the consumer must be made about them by the credit provider. The focus on the consumer's financial situation should similarly be upon the individual consumer and their own circumstances. Undoubtedly, as the assessment of unsuitability is made prior to the credit contract being entered into, and involves an assessment of future compliance with the consumer's obligations under the credit contract, the assessment involves making a prediction. The assessment is about the likelihood of a consumer being unable to comply with the consumer's financial obligations under the credit contract, or being only able to comply under substantial hardship.

7 However, to be a reliable prediction it should be based on all information currently available or reasonably available to a credit provider. This information can then be considered (and tested) by the credit provider, and some of that information may be disregarded as not impacting on the particular consumer's ability to comply with future financial obligations. In this instance, Westpac in making its assessment did proceed (as is to be expected) by looking at income and expenses. If expenses are relevant at all to an assessment of unsuitability, there is no reason to turn a blind eye to one aspect of those expenses, which (depending on an individual consumer's circumstances and predisposition) may be of significance.

8 It is also important to observe at the outset that one significant aim of the legislation is to have an assessment process so as to prevent consumers from entering into unsuitable credit contracts in the first place. The assessment procedure set out in the Act is introduced to facilitate this aim. Whilst coming to the content of the legislative provisions later, it is worth observing now that s 128 (and s 130) cast standalone obligations and create civil penalty provisions on the credit provider, quite apart from ss 131 and 133. If a consumer does enter into an unsuitable credit contract then part of the damage the legislation is seeking to address has already occurred, even though a credit provider may be liable pursuant to s 131 or s 133.

9 The primary judge failed to approach the legislation by reference to its focus on the individual consumer, and failed to appreciate the importance of the assessment requirements in the Act so as to prevent, in the first place, the entry into of a home loan that was unsuitable. The primary judge's approach can be seen at [82] of the primary judge's reasons:

> *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.*

10 As far as legislative context is concerned, the relevant civil penalty provisions of the Act are contained in Ch 3, which is headed "responsible lending conduct". They impose specific obligations on credit providers beyond the general conduct obligations imposed on licence holders by s 47 of the Act.

11 Chapter 3 as a whole has a specific purpose to create and enforce a new norm of conduct for credit providers (and brokers) when entering into credit contracts. This context explains the very specific and detailed requirements of the provisions of Pt 3-2, and the very significant

penalties to which those contravening those requirements may be subjected. Each of the requirements is a critical part of a sequence leading up to the credit provider making an assessment of unsuitability, by reference to the consumer's financial situation and requirements and objectives.

12 The relevant civil penalty provisions in the Act are a key aspect of a regulatory regime imposing prescriptive procedural obligations on the credit provider. This makes it evident that Parliament intended for the credit providers themselves to follow, in a step-by-step way, the responsible lending obligations in Ch 3 of the Act.

13 It is also to be observed by way of preliminary comment that the double negative "not unsuitable" has an important significance. The "not unsuitable" test is directed to avoiding harm to the consumer. The focus is not on whether there is <u>benefit</u> to the consumer. The inquiries and verification required by the Act (to be made prior to the assessment) put the credit provider in a position where it can assess whether making the loan is unsuitable, because it is likely that the consumer will be unable to comply with the consumer's financial obligations under the loan or could only comply with them by enduring substantial hardship. Those inquiries and verification are not suited to assessing what, if any, benefit the consumer will gain by borrowing. The assessment process in s 128 is there to protect the consumer from entering into an unsuitable credit contract.

THE RELEVANT LEGISLATIVE PROVISIONS

14 I now turn to the relevant statutory provisions, each of which have a different scope and purpose, although there may be some overlap.

15 Divisions 3 and 4 are 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.

Division 4—Prohibition on entering, or increasing the credit limit of, unsuitable credit contracts

133 Prohibition on entering, or increasing the credit limit of, unsuitable credit contracts

Prohibition on entering etc. unsuitable contracts

(1) *A licensee must not:*

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

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

if the contract is unsuitable for the consumer under subsection (2).

Civil penalty: 2,000 penalty units.

When the contract is unsuitable

(2) *The contract is unsuitable for the consumer if, at the time it is entered or the credit limit is increased:*

(a) *it is likely that the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship; or*

(b) *the contract does not meet the consumer's requirements or objectives; or*

(c) *if the regulations prescribe circumstances in which a credit contract is unsuitable—those circumstances apply to the contract.*

(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 it is entered or the credit limit is increased:

(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 it is entered or the credit limit is increased, 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 contract is entered or the credit limit is increased, the information:

(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.

Credit contract not unsuitable under regulations

(5) The regulations may prescribe particular situations in which a credit contract is taken not to be unsuitable for a consumer, despite subsection (2).

Offence

(6) A person commits an offence if:

(a) the person is subject to a requirement under subsection (1); and

(b) the person engages in conduct; and

(c) the conduct contravenes the requirement.

Criminal penalty: 100 penalty units, or 2 years imprisonment, or both.

Note: Sections 178 and 179 provide for remedies for anyone who suffers, or is likely to suffer, loss or damage because of a breach of this section.

> *For example, if a consumer makes an unsuitable credit contract with a licensee, rather than making a not unsuitable credit contract for a reverse mortgage, a person who suffered, or is likely to suffer, loss as a result may be able to get court orders under section 178 or 179 to put the person in a position like the one they would have been in had the consumer entered into the contract for the reverse mortgage.*

16 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 could they have an impact. This was the position taken by the primary judge. The provisions set out above are those as at 1 March 2013.

17 I also note that under reg 28J of the *National Consumer Credit Protection Regulations 2010* (Cth), if the credit to be provided under the credit contract will be used for the purchase of a residential property, and the credit will be secured by a mortgage over the property, then the period of time for the purpose of s 128 of the Act is 120 days. This was the relevant period of time in respect of the home loans the subject of the proceedings before the primary judge.

18 No other relevant regulations were made under the Act. The regulations themselves could prescribe what particular inquiries or steps must be made or taken, or do not need to be made or taken, for the purposes of inquiring into or verifying (as the case may be) the consumer's requirements and objectives, or the consumer's financial situation: see ss 130(1)(a)-(c) and 130(2). In addition, the regulations could prescribe particular inquiries and steps to verify any (other) matters: see ss 130(1)(d) and (e)). However, the fact that these matters may be subject to regulation does not itself detract from the requirements of the Act, and the need to make the assessment of the particular consumer as required by the Act. It is to be noted that the purposes of ss 130(1)(a)-(c) (for which a regulation may be made) all relate to the particular consumer's requirements and objectives, or financial situation.

OVERVIEW

19 The facts are not in contention and the following factual background is largely taken from the description carefully given by, and the Statement of Agreed Facts which was before, the primary judge.

20 During the period December 2011 to March 2015, 261,987 Westpac-branded home loans were entered into by Westpac with consumers. These loans had terms of up to 30 years, were

secured against residential property, and were "credit contracts" within the meaning of s 5 of the Act. The home loans were conditionally approved by Westpac's "Automated Decision System" (the '**ADS**') without being referred for manual assessment. The fact that there was no manual assessment of any of the 261,987 home loans is significant. Of these home loans, 154,351 had an initial interest only period before payment of principal was required (the '**Interest Only Loans**').

21 The terms of the home loans were contained in a "Loan Offer" document which was signed by the consumer and included details specific to the particular home loan (such as the amount of credit, the repayment amounts and the property over which the home loan was secured), and a booklet entitled "You and Your Loan" which contained standard terms and conditions.

22 As part of its home loan application process, Westpac collected information from consumers including personal details, employment details, monthly income, expenses, whether the consumer expected a change to their financial situation, current assets, currently liabilities, and details of the property to be purchased.

23 In respect of expenses, Westpac collected information in the following categories:

(a) "Absolute Basic Expenses (eg groceries, transport, petrol, utilities, rates, clothing)";

(b) "Education Expenses";

(c) "Childcare Fees";

(d) "Insurance (including car, CTP, building, contents, health, income protection)";

(e) "Mobile Phone/Internet/Pay TV";

(f) "Other (for example, holidays, entertainment, gym membership, cleaning or gardening services)";

(g) "Ongoing Rent/Board after loan is drawn"; and

(h) "Child Maintenance/Alimony".

24 This information was collected from the consumer in "Form PFI001" and when 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" (the '**GOE**'). The applications entered into the GOE were then assessed by the ADS. Within the ADS, Westpac treated the items listed in paragraphs (a) to (f) of the preceding paragraph as "Expenses" (the '**Declared Living Expenses**'). It treated the items listed in paragraphs (g) and (h), together

with consumers' liabilities (such as relating to other loans and credit cards), as "Outgoings" ('**Outgo**').

25 Westpac operated the ADS for the purpose of deciding whether or not to offer a home loan to a consumer. The ADS was a system comprising over 200 rules which were applied to the information obtained from Form PFI001. For the purposes of this appeal, it is unnecessary to identify or explain these rules in any detail. It can be accepted that the rules in the ADS were designed, in aggregate and in conjunction with the whole loan assessment process, to assess whether a home loan was unsuitable.

26 There were three possible outcomes for applications submitted to the ADS: conditional approval, referral for manual assessment, or decline. Where an application for a home loan received conditional approval, it was then referred for checks such as valuation of the security property and verification of income.

27 One of the rules in the ADS was the "Serviceability Rule", which undertook the following calculation to determine a consumer's "Net Monthly Surplus/Shortfall":

> *Net Monthly Surplus/Shortfall = Discounted Net Monthly Income* - *(Assessed Monthly Repayments + Outgo + HEM Benchmark + "buffer")*

28 The figure used by Westpac for "Assessed Monthly Repayments" related to the proposed home loan, and was calculated on the basis that monthly repayments of principal (as well as interest and fees) would be made over the full term of the home loan (referred to as the "Full Term Method"). I will return later in these reasons to whether this was an appropriate method.

29 The "buffer" was a percentage (during the relevant period, between 1.56% to 2.16%) added to certain of the consumer's liabilities, including the proposed home loans, for the purpose of allowing for interest rate increases.

30 Instead of using the consumer's Declared Living Expenses in the Serviceability Rule, Westpac used values derived from the "Household Expenditure Measure" (referred to as the "HEM Benchmark"). The HEM Benchmark was compiled by reference to expenditure data from the Australian Bureau of Statistics Household Expenditure Survey, and took the median of expenditure on "absolute basic" expenditures, and added expenses at the 25th percentile in respect of items it classified as "discretionary basic" expenditures. Items of expenditure classified as "non-basic" were excluded. The use of the HEM Benchmark in the Serviceability Rule did not involve an estimate of the consumer's actual living expenses, but it was instead

an estimate of the level of household expenditure a consumer could be "expected" to spend to participate in society with a reasonable standard of living. The use of the HEM Benchmark was, in effect, the allocation by Westpac of an allowance for a consumer's living expenses, based on a statistical measure.

31 Another rule in the ADS was the "70% Ratio Rule", which would be triggered if a consumer's Declared Living Expenses exceeded 70% of the consumer's income. I will return to the 70% Ratio Rule. I observe that neither the repayments under the proposed home loan, nor the consumer's obligations in respect of Outgoings, were inputs into the calculation performed by the 70% Ratio Rule. Apart from the 70% Ratio Rule, no other rule in the ADS relevantly related to the Declared Living Expenses.

32 In relation to the Interest Only Loans, as mentioned, Westpac used the Full Term Method to identify the figure it used for Assessed Monthly Repayments in the Serviceability Rule. That is, for those loans, Westpac did not calculate Assessed Monthly Repayments based on the monthly repayments that the consumer would be required to make at the end of the interest only period (assuming the credit limit of the loan had not been reduced in the meantime) (referred to as the "Residual Term Method"). Rather, Westpac applied the Serviceability Rule in respect of proposed Interest Only Loans as if they were home loans in which repayments of principal, as well as interest and fees ('**PIF**'), would be made over the whole term of the loan ('**PIF Loans**').

33 Westpac used the Full Term Method notwithstanding that in the Loan Offer document for the Interest Only Loans, Westpac identified a figure for the consumer's repayments in the residual term reflecting the Residual Term Method. The example provided by ASIC was that in relation to, for example, home loan A, the Loan Offer document provided that during the interest only period, consumer A was required to make monthly repayments of interest, fees and any applicable government charges, and it also provided that during the residual term, consumer A would be required to make repayments of principal, interest, and applicable fees and charges, amounting to $7,709. It was not in dispute that this was the amount consumer A's Assessed Monthly Repayment would have been if Westpac had used the Residual Term Method when applying the Serviceability Rule, and that instead, Westpac used the figure of $6,267, reflecting the Full Term Method.

THE BORROWER'S DECLARED LIVING EXPENSES

34 The first question before the Full Court and the primary judge then relates to the Declared Living Expenses. A factual question before the primary judge was whether the consumer's financial situation had been taken into account in answering what the primary judge referred to as "the s 131(2)(a) Questions". This was a reference to the requirement that a credit provider is 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). This is a phrase conveniently adopted in these reasons. The primary judge found that ASIC's case failed both on the facts and as a matter of statutory construction. The primary judge's approach was to conclude that Westpac did consider the consumer's financial situation, even though the Declared Living Expenses were not part of that consideration, which in any event was not required for the purposes of making an assessment under s 128 of the Act.

35 It will be recalled that 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. These rules were described by the primary judge, and his description was not criticised nor the subject of any real contention on appeal. However, it will be necessary to focus on the 70% Ratio Rule and the primary judge's reliance upon it. As for the other rules, the primary judge correctly accepted that they do not take into account the Declared Living Expenses.

36 However, before going to the various rules and the Westpac system, I make this observation. The assessment that needs to be made is just that: it is an evaluation based on the material before Westpac which, based upon Westpac's expertise, knowledge and experience, it employs in assessing loan applications. It involves making a <u>prediction</u> as to the particular consumer's future capacity to meet the loan. A prediction to be properly made should be made based upon all relevant and material information presently available, which would necessarily include (whether discounted or not in the eventual decision) past expenses of a consumer (whether they were necessarily incurred or discretionary). Even if one accepted that past expenses may not at a general level be an indication of loan serviceability, past expenses in an individual consumer's particular circumstance <u>may</u> well be. This is so, even if such expenses are difficult to verify or even if a consumer's current spend at the time of assessment is "discretionary".

37 The nature of the inquiries the credit provider must make under the Act informs the nature and purpose of the required assessment. In determining a consumer's financial situation as a whole (including assets) it will be necessary to consider and have a sufficient understanding of a consumer's income and expenditure. This is the approach taken by Westpac through its various rules. This is not to prescribe one methodology – but whatever methodology is adopted it must be based on the consumer's financial position. It is to be recalled that Westpac purported to look at income and expenses, and did not, for instance, just focus on the consumer's assets. It is appropriate therefore to focus on income and expenses for the purposes of this appeal. The credit provider must make reasonable inquiries about what income the consumer has had in recent times and whether the consumer can reasonably expect to enjoy that level of income for a reasonable time in the future. All income should be considered, whether regular or not. Then, the credit provider must also make reasonable inquiries about the consumer's expenditures – both what expenditures the consumer has had, and what level of expenditures the consumer can reasonably be expected to have in the future. This means assessing the particular consumer's expectation. This may involve receiving irregular income, or curtailing an extravagant lifestyle for the sake of servicing the loan. Whether it be Wagyu beef washed down with the finest Shiraz (to use the example of the primary judge), or less expensive expenditure on food and drink, this may not be willingly forgone or even able to be reduced by a particular consumer. The unsuitability of a loan cannot be determined if the focus is not on the particular consumer, applying criteria divorced from that consumer's circumstances.

38 The inquiry that needs to be made is more than an inquiry about whether the credit provider considers that the consumer is unlikely to default in performance of the home loan which is an aspect of credit risk. The responsible lending provisions of the Act introduced new and additional requirements over and above credit risk, which has been an inquiry that prudent lenders have always made in the past. The Act requires more than the lender being satisfied that the loan is an acceptable credit risk. More particularly, identifying that the consumer's income is larger than a general statistical benchmark for expenditures by consumers whose domestic circumstances are generally similar to those of the person seeking the loan, does not in itself reveal the particular consumer's financial situation. Whilst it does convey information to the credit provider sufficient for it to decide that the risk of the consumer failing to service the loan is acceptable as far as the credit provider is concerned, it does not address the central issue of unsuitability for a particular consumer.

THE 70% RATIO RULE

39 It is convenient at this point to consider the 70% Ratio Rule and the primary judge's consideration of it. 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. ASIC 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: without such an analysis it could not be said that Westpac had answered the s 131(2)(a) Questions.

40 The primary judge did not accept ASIC's contention that the 70% Ratio Rule did not constitute a rule which assessed whether the loan would be unsuitable for the consumer, but said this was beside the point. The primary judge considered that the issue was not whether the 70% Ratio Rule complied with Div 3 but rather whether Westpac so complied. So much can be accepted. As the primary judge again correctly observed, what Westpac did with loan applications involved more than the mere application of the 70% Ratio Rule, and Westpac's entire system (including manual assessment where referral is triggered) must be examined, and compliance with Div 3 gauged that way. It is to be recalled there was no manual assessment of the relevant home loans the subject of the proceedings.

41 The primary judge went on to say:

> *[23] 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).*
>
> *[24] 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.*
>
> *[25] 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'.*
>
> *[26] 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).*
>
> *[27] 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.*

42 The primary judge's "characterisation" was that the purpose of the 70% Ratio Rule was to gauge "risk of default", and that "a rule" whose purpose is to gauge risk of default can also be a rule with respect to the ability of the consumer to meet their financial obligations under the credit contract. The primary judge then concluded that the 70% Ratio Rule was "a measure of unsuitability".

43 The 70% Ratio Rule would not be expected to deal with the capacity to pay; this is the very object of the Serviceability Rule. In any event, as alluded to already, it does not follow that because a rule whose purpose is to gauge risk of default will happen also to be one that can assess whether it is likely that the consumer will be able to meet their financial obligations under a proposed credit contract. It is necessary to ask whether the particular rule in question enables the credit provider to assess whether the consumer's financial obligations under the proposed credit contract can be met, or only met with substantial hardship. Any rule whose purpose is to gauge risk of default is not also <u>necessarily</u> one that can operate to assess the ability of the consumer to meet their financial obligations under the credit contract. In my view, the 70% Ratio Rule did not assess the consumer's financial obligations under the particular credit contract to be entered into, or any of the consumer's other liabilities, and so the calculation it performed could not have the character of the assessment required under s 128(c). Hence, the primary judge erred in finding that Westpac had, in its assessment of unsuitability in respect of the home loans, taken into account the consumer's Declared Living Expenses by means of the 70% Ratio Rule.

44 In so concluding, I accept that the 70% Ratio Rule did identify a class of consumers who had high levels of expenses compared to income, in respect of whom Westpac chose to determine their loan applications via manual assessment, regardless of how much they sought to borrow. However, it was just a trigger for Westpac to determine loan applications in a different way as regards a defined class of consumers; it was not an assessment of unsuitability in respect of the home loans the subject of the appeal.

45 I briefly mention one other matter on this first question of Declared Living Expenses. Westpac raised a notice of contention that the consumer's Declared Living Expenses were taken into account in the Serviceability Rule as an Outgo and Westpac used the HEM Benchmark for general variable living expenses. I will come to the HEM Benchmark next. However, all that can be said in support of this contention by Westpac is that some (perhaps many) of a consumer's expenditures were so taken into account, but not all of a consumer's living expenses by reference to the individual consumer. Therefore, Westpac did not assess the particular consumer's financial position as it was required to do under the Act.

THE HEM BENCHMARK

46 I now come to the HEM Benchmark. Before the Full Court both parties made oral and written submissions about the HEM Benchmark, but as the primary judge observed in relation to the argument before him, it is of marginal relevance. ASIC's case did not turn on the fact that Westpac had used the HEM Benchmark but instead on the fact that it did not use any of the consumer's Declared Living Expenses in answering the s 131(2)(a) Questions. ASIC's case was, in effect, that the HEM Benchmark did not go far enough. It did not take into account the Declared Living Expenses of the individual consumer.

47 As the primary judge observed, 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. The primary judge concluded 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.

48 There is no doubt that the HEM Benchmark can have some utility when assessing serviceability: in assessing whether a particular consumer is <u>likely</u> for instance to experience substantial hardship as a result of meeting their obligation to repay a line of credit. However, the measure cannot be used as a substitute for inquiries or verification under the Act which

should be directed to the consumer; and equally (relevantly in this appeal) cannot be in the nature of an assessment under s 128(c) based on that consumer's verified income and expenses. Even with approximately 80% of the consumer's declared expenses being below the applicable HEM Benchmark, this still does not direct attention to the individual consumer's expenses.

49 At best the HEM Benchmark was an indirect check on a consumer's living expenses to verify the consumer's financial situation. Reliance on the HEM Benchmark itself cannot ensure compliance with the responsible lending provisions of the Act without attention to the individual consumer.

CONSTRUCTION OF THE ACT

50 It is now necessary to go into some analysis of the directly relevant statutory provisions, with the previous observations as to the object of the Act and the whole of Ch 3 in mind. The proceeding below concerned, and this appeal concerns, the nature of the obligation in s 128 of the Act. Section 128 provides that a credit provider must not enter into a credit contract with a consumer, unless the credit provider has "made an assessment that ... is in accordance with s 129" (s 128(c)) and "made the inquiries and verification in accordance with s 130" (s 128(d)). The nature of the assessment required by s 128(c) is as set out in s 129, and the content of the inquiries and verification required by s 128(d) is as set out in s 130. An assessment that does not meet the description in s 129 is not the assessment required to be performed under s 128(c) prior to entering into the relevant credit contract.

51 Section 129 provides that, for the purposes of s 128(c), the credit provider "must make an assessment that", relevantly, "assesses whether the credit contract will be unsuitable for the consumer if the contract is entered". Section 129(b) provides the content to s 128(c). Further, as the primary judge accepted, there must be an assessment which assesses whether the credit contract will be unsuitable for the consumer if the contract is entered into by the consumer and credit provider.

52 It follows from the text of ss 128(c) and 129 of the Act that the credit provider must undertake an assessment of whether the particular credit contract proposed to be entered into will be unsuitable by reference to the specific consumer in question. The most obvious way a particular credit contract might not be suitable for a specific consumer is if that specific consumer cannot afford the actual repayments under the particular credit contract proposed to be entered into.

53 Section 130(1) of the Act provides that, for the purposes of s 128(d), and "before making the assessment", the credit provider must make reasonable inquiries about the consumer's requirements and objectives (s 130(1)(a)); make "reasonable inquiries about the consumer's financial situation" (s 130(l)(b)); and "take reasonable steps to verify the consumer's financial situation" (s 130(1)(c)).

54 A number of observations can be made which have been generally touched upon above. As the inquiries and verification required by s 130(1) must precede the assessment, it follows that the purpose for which they are done is for the purpose of carrying out the assessment, as the primary judge accepted. This is also confirmed by s 125 of the Act, which is entitled "Guide to this Part" (Pt 3-2), and explains that Div 3 (where ss 128-132 are located) "requires a licensee ... to make an assessment as to whether the contract will be unsuitable. To do this, the credit provider must make inquiries and verifications about the consumer's requirements, objectives and financial situation". These steps required by s 130 are a critical part of the sequence leading up to the assessment. Such inquiries and verification are intended to inform the assessment, in order to enable the credit provider to perform the assessment.

55 Then it is notable that the inquiries required under s 130(1) are in respect of the consumer's requirements and objectives (s 130(1)(a)) and the consumer's financial situation (s 130(1)(b)), and the verification is in respect of the consumer's financial situation (s 130(1)(c)). As the inquiries are to be in respect of both the consumer's requirements and objectives and the consumer's financial situation, it follows that the assessment of unsuitability is to consider whether the contract is unsuitable for the consumer by reference to each of the consumer's requirements and objectives, and the consumer's financial situation. Further, the separate requirement to verify the consumer's financial situation indicates that the consumer's specific financial situation is not only relevant to the assessment, but that the statutory intention is that the information regarding the consumer's financial situation is to be reasonably reliable.

56 Section 131 is a separate provision. Section 131 provides that a credit provider <u>must</u> assess that the credit contract will be unsuitable for the consumer if the contract will be unsuitable under s 131(2). Under s 131(2), the contract will be unsuitable for the consumer if, at the time of the assessment, it is likely that the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship (s 131(2)(a)), or the contract will not meet the consumer's requirements or objectives (s 131(2)(b)), or as prescribed by the regulations (s 131(2)(c)). As the primary judge observed,

there is a connection between those three circumstances in s 131(2) and the three kinds of information that s 130(1) requires a credit provider to obtain, and this suggests that the information collected under s 130 is collected for the purpose of assessing the loan against the unsuitability criteria in s 131(2).

57 The assessment referred to in s 131 is the same assessment referred to in ss 128(c) and 129(b), and accordingly, the statutory assessment of unsuitability the credit provider is obliged to undertake by s 128(c) must include an assessment (by reference to s 131(2)(a)) of whether it is likely that the consumer will be unable to comply with the consumer's financial obligations under the contract or could only do so with substantial hardship. In essence, that assessment involves an assessment of the consumer's "capacity to service the loan", which involves the credit provider asking whether it is possible for the consumer to service the loan or only do so by the making of repayments which would put the consumer in circumstances of substantial hardship.

58 It should then be observed that the Note after s 131(1) states the credit provider may also still assess that the contract will be unsuitable for other reasons, even if the contract will not be unsuitable for the consumer under s 131(2). A credit provider is able to conclude that a proposed credit contract will be unsuitable (and to decline to enter into it) for reasons that are different to those prescribed in s 131(2), and to obtain and use whatever information it considers appropriate for that purpose. However, any such additional assessment of this nature must not be such that the credit provider fails to discharge its statutory obligation to undertake an assessment of unsuitability of the kind required by the provisions of Div 3-2, including the obligation to assess the particular consumer's capacity to meet their repayment obligations under the proposed loan.

59 Section 131(4) provides that for the purposes of determining whether the contract is unsuitable under s 131(2), only information that is about the consumer's financial situation and which the credit provider had reason to believe was true, or would have had reason to believe was true if the credit provider had made the inquiries and verification under s 130, is to be taken into account. The effect of this provision is that the question of whether a credit provider has contravened s 131 is to be determined by "taking into account" information about the consumer's financial situation, requirements or objectives, which at the time the credit provider had reason to believe was true (or would have had such reason to believe if the inquiries and verification required under s 130 had been made). Section 131(4) proceeds on the assumption

that the consumer's financial situation is able to be assessed and that the statutory assessment of unsuitability will be made by reference to the financial situation of the particular consumer, and on the basis of information which will be reasonably reliable.

60 Another separate provision is to be found in s 133. It does not just deal with unsuitability relating to financial obligations, but also deals with meeting the consumer's requirements or objectives. Section 133 prohibits the entering into of a credit contract that is unsuitable (as defined in s 133(2)) by reference to the time the contract is entered into and certain criteria.

61 After considering the legislative provisions, the primary judge reasoned in essence that a consumer's Declared Living Expenses could not be shown to be "*necessarily* relevant" (at [75]) without having additional information that shows that the consumer cannot reduce their living expenses. Hence, it was reasoned that without that additional information, it cannot be said that a consumer's Declared Living Expenses are relevant to whether it is likely that the consumer will be unable to comply with their financial obligations under the proposed home loan.

62 However, as already alluded to, a determination as to whether, for any particular consumer, their Declared Living Expenses (or some aspects of them) may or may not be able to be reduced can only be determined by the credit provider giving some consideration to what those expenses are and the characteristics of the consumer. The credit provider would need to assess the specific individual consumer's living expenses in order to be able to be in a position to form a view as to whether any or some of that consumer's living expenses may be foregone or reduced without substantial hardship. As ASIC contended, the possibility that *some* consumers might be able to reduce their living expenses in order to meet loan repayments does not support a conclusion that Westpac was entitled to ignore all consumers' Declared Living Expenses. It cannot be assumed, even in the case of housing finance, that a particular consumer will forego or reduce discretionary expenses so as to be able to service the loan. This may be likely as a general proposition, but not necessarily so.

63 This does not deny a great deal of flexibility in making an assessment. If Westpac compared a consumer's Declared Living Expenses to the relevant HEM Benchmark figure, observing that they were lower, but chose to use the HEM Benchmark figure, Westpac's assessment would have involved consideration of the consumer's Declared Living Expenses, together with a decision to take a more conservative approach, by adding some margin to the figure used to represent living expenses. Similarly, on identifying that a consumer's Declared Living

Expenses were higher than the HEM Benchmark, Westpac could have made inquiries of the consumer, or otherwise conducted some further analysis, to satisfy itself that this particular consumer was in a situation that would enable them to reduce their living expenses. This would involve an assessment of the likelihood of that consumer being able to meet their financial obligations under the proposed home loan without substantial hardship.

64 It was argued by Westpac that ASIC's approach is substantially indeterminate, and it was not possible to determine the content and extent of the assessment. However, this is not an answer to the issue before the Court: it can be accepted that the content and extent of the assessment is a matter for Westpac, as long as the assessment is made in respect of the actual consumer's financial situation in the way I have attempted to explain.

65 As a separate point, the primary judge then considered the operation of s 129, in light of its own text and the context of s 132. The primary judge posed the question that if contrary to his conclusions, Westpac had been obliged to take into account all the Declared Living Expenses, and if it had failed to do so, whether it then had failed to carry out the assessment called for by s 129.

66 On this question, the primary judge reasoned at [88]-[91] as follows:

> *[88] 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.*
>
> *[89] 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.*
>
> *[90] 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.*
>
> *[91] ASIC's contention that an assessment is a legal construct which can be invalid, therefore, fails. I reject the third step in its argument.*

67 With respect, I cannot accept the primary judge's line of reasoning. If my earlier analysis is correct, and Westpac has failed to make the required assessment, this is then a failure to comply with s 128. Section 129 gives content of that assessment by referring back to s 128(c). Whilst the reference in s 129(a) to specifying the period the assessment covered may indicate some sort of written specification, I do not consider in light of its text or context, it has this meaning. Section 129 relates to "making" an assessment, and is an evaluative exercise involving the criteria in s 129(a) (period of time) and s 129(b) (unsuitability). Then s 132 is another separate and discrete provision which clearly refers to a document being provided to the consumer. It creates a separate civil penalty provision, and refers to the written assessment in fact created by the credit provider after carrying out the assessment required under s 128(c).

68 It is true that there is no separate contravention of s 129 (unlike with s 130 which is also referred to in s 128(d)). If a credit provider fails to comply with s 128(d) and s 130 of the Act, it could be liable in respect of two contraventions. This reflects the importance of making inquiries and verification by the credit provider as independent requirements before making the assessment (s 130).

69 However, the important point is that s 129 does not itself impose any obligation on a credit provider giving rise to a civil penalty: it defines the content of the obligation imposed on a credit provider by s 128(c) to make the assessment. Section 128 is the relevant civil penalty provision: if Westpac enters into a credit contract failing to comply with s 128(c), it will have contravened s 128. With respect, the primary judge incorrectly concluded that if a credit provider had not carried out an assessment of the kind defined in s 129 that it did not follow that it had contravened s 128(c). This is because failing to make the assessment required by s 129 results in a contravention of s 128.

LOANS WITH AN INITIAL INTEREST ONLY PERIOD

70 I now turn to the second question concerning loans with an initial interest only period. Here also the facts are not in dispute, and were succinctly outlined by the primary judge. 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.

71 It can be accepted that where, in all other respects, the terms of a particular Interest Only Loan and a particular PIF Loan are the same (such as, term, credit amount, interest rate at commencement, and whether or not the loan has a variable interest rate), the terms of these loans are different as regards the terms governing the consumer's repayment obligations. Under the terms of an Interest Only Loan, a consumer is obliged to make repayments of principal over a shorter period of time (the residual term), with the result that the monthly repayments of principal the consumer will be required to make during the residual term will be higher than the monthly repayments the consumer would be required to make if they entered into a PIF Loan on terms that are otherwise the same.

72 ASIC submitted that the important difference between the repayment obligations under an Interest Only Loan as compared to a PIF Loan would exist regardless of any changes in interest rates. The difference between an Interest Only Loan when compared to a PIF Loan meant that when Westpac purported to conduct an assessment of unsuitability of an Interest Only Loan, the assessment it conducted was not an assessment in respect of the particular credit contract to be entered, but an assessment of a different, hypothetical credit contract which neither Westpac nor the consumer was proposing to enter.

73 In dealing with this issue, the primary judge's reasoning was as follows at [94] to [99]:

> *[94] ... 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.*
>
> *[95] 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.*
>
> *[96] 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.*
>
> *[97] 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.*
>
> *[98] 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.*
>
> *[99] 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.*

74 As with the first question, whatever method Westpac chose in order to assess the suitability of a credit contract it was considering entering into with a particular consumer, it was necessary for that method to be one which involved an assessment of the particular contract proposed to be entered into by the consumer. Therefore, any assessment of the unsuitability of a particular credit contract for a particular consumer must necessarily be an assessment that is done by reference to the actual obligations created by the particular contract purportedly being assessed.

75 It was on this basis that ASIC then submitted that in light of the different repayment obligations under an Interest Only Loan (between the interest only period and the residual term), Westpac

could, for example, have chosen to conduct the assessment by reference to those two different periods and the different repayment obligations that would apply during each.

76 Instead, ASIC pointed to the fact that Westpac's assessment of Interest Only Loans was calculated over the whole period of the loan as if the monthly repayments for an interest only loan were the same as those for a principal and interest loan. According to ASIC, that means that for the period after the expiry of the interest only period, Westpac underestimated the monthly repayments under the loan, and thus did not assess the consumer's ability to comply with their obligation to make the actual repayments required under the terms of the loan.

77 I do not consider on this question the primary judge fell into error.

78 Given the nature of interest only loans, there is more than one way of estimating the monthly repayments for use in determining the capacity to pay prior to lending:

(1) calculating the minimum repayment required during the interest only period of the loan, using the original interest rate applicable;

(2) calculating an amount equal to the monthly repayments of principal, interest, and fees that would repay the loan at the end of the proposed term, using the original interest rate applicable, which is the "Full Term Method"; and

(3) calculating a minimum monthly repayment from the end of the interest only period that would repay the loan over the remaining term of the loan using the original interest rate applicable. This method necessarily involves several assumptions, including that the consumer makes only the minimum required repayments of interest and fees and does not accumulate any funds in an offset account during the interest only period and that there are no changes to interest rates during the interest only period.

79 As indicated already, Westpac used the Full Term Method. In my view, the Full Term Method was part of an assessment of the particular credit loan being applied for by the consumer, even though it can be readily contrasted to a PIF Loan. This does not matter. The monthly repayment under the Full Term Method was in fact derived from the terms of the proposed credit contract and served as an estimate for repayments over the life of the loan. The approach of the primary judge was correct; to approach the assessment otherwise would not in fact view the consumer's financial situation as it may vary from the repayments during the initial interest period and the expected repayments in the future at the expiry of that period.

80 The nature of interest only loans means that they do not have a constant repayment amount over their life, even ignoring the impact of changes in interest rates. Westpac effectively assessed the ability of the consumer at loan inception to generate sufficient excess income to repay the particular loan over its full term.

81 It can be observed that the loan repayment amount calculated using the Full Term Method will be higher than the minimum loan repayments during the interest only period, but lower than the repayments during the residual term (assuming rates remain unchanged, the consumer makes only the minimum payments during the interest only period, and takes no step to reduce their repayments). The Full Term Method effectively assessed the consumer's ability to repay the principal, interest and fees on an interest only loan even though the consumer was only required to pay interest (and no principal) in the interest only period. In this way, the Full Term Method reflected a legitimate choice in the exercise of Westpac's judgement as to how to conduct a suitability assessment for an interest only loan.

82 As I have already determined that the approach undertaken by Westpac to calculate serviceability was in fact made by reference to the credit contract of the consumer, I do not need to deal with Westpac's notice of contention which raised the availability of offset accounts as an answer to ASIC's contentions on this question.

DISPOSITION

83 For the foregoing reasons, I would consider it appropriate to allow the appeal in part, set aside the orders of the primary judge, make the appropriate declaration or declarations relating to the contravention or contraventions by Westpac of s 128 of the Act, make orders dealing with the costs of the appeal but otherwise remitting the matter to the primary judge to consider the issue of penalty and any other appropriate orders (including the costs of the trial).

84 However, the majority of the Court would order that the appeal be dismissed with costs, which will be the order of the Court.

I certify that the preceding eighty-four (84) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Middleton.

Associate:

Dated: 26 June 2020

REASONS FOR JUDGMENT

GLEESON J:

85 The appellant (**ASIC**) contends that the primary judge erred by failing to find that the respondent (**Westpac**) contravened s 128 of the *National Consumer Credit Protection Act 2009* (Cth) (**Act**) when it entered into certain home loans without having made an assessment in accordance with s 129 of the Act. Sections 128 and 129 together relevantly require a licensee to make an assessment of whether a proposed credit contract will be unsuitable for the consumer if the contract is entered into (**unsuitability assessment**). The requirement forms part of Ch 3 of the Act, entitled "Responsible lending conduct", and Pt 3-2 which, as stated in s 125, contains rules "aimed at better informing consumers and preventing them from being in unsuitable credit contracts".

86 The relevant home loans comprise 261,987 loans made by Westpac in the period 12 December 2011 to March 2015. Each of the loans was assessed by Westpac's automated decision system (**ADS**) which, as explained below, applied a series of rules to information supplied by each consumer who subsequently obtained a home loan. The application of the rules could produce one of three outcomes: "conditional approval", "referral for manual assessment" or "decline". For each of the 261,987 loans, Westpac's ADS produced the "conditional approval" outcome.

87 I agree with Middleton J that the appeal must fail in relation to grounds 4 and 5 of the notice of appeal, concerning the method by which Westpac assessed home loans with an initial interest only period. However, I respectfully disagree with his Honour concerning grounds 1 to 3, which are directed to whether Westpac conducted an unsuitability assessment within the meaning of the legislation for any of the 261,987 loans.

88 The unsuitability assessment required consideration of two questions, referred to by the primary judge as the **s 131(2)(a) Questions**. Those questions, which reflect the terms of s 131(2)(a) of the Act, are:

(1) Is it likely that the consumer will be unable to comply with the consumer's financial obligations under the contract? and

(2) Is it likely that the consumer will only be able to comply with the consumer's financial obligations under the contract with substantial hardship?

89 In substance, ASIC's case was that the rules applied by the ADS did not test for the consumer's likely ability to comply with the consumer's financial obligations under the contract, either without more or only with substantial hardship.

90 ASIC's primary contention was that, in order to make an unsuitability assessment within the meaning of the Act, Westpac was required to take into account information that it obtained from the relevant consumers concerning their living expenses. The information comprised the consumers' statements about their monthly expenditure in categories stipulated by Westpac, referred to as **declared living expenses**.

91 The primary judge found that Westpac did take this information into account, through its application of a test called the **70% Ratio Rule**. ASIC contended that the primary judge made an error of fact in making this finding.

92 Further, the primary judge concluded that the assessment required by the Act did not oblige Westpac to take into account the declared living expenses. ASIC contended that the primary judge misconstrued the Act in reaching that conclusion. On this aspect of the appeal, ASIC's case was based on the requirements, imposed by s 130 of the Act, to make reasonable inquiries about the consumer's financial situation and to take reasonable steps to verify the consumer's financial situation. The argument was that, on a proper construction of the Act, the unsuitability assessment required Westpac to consider "the consumer's financial situation with a sufficient understanding of the consumer's income and expenses".

93 Westpac's evidence was that its systems and processes were designed to ensure that a customer would meet their financial obligations to the bank by ensuring that the loan was not unsuitable for the customer and that the customer had the ability to service the loan without suffering substantial hardship. Of the 261,987 loans, ASIC did not identify a single case in which the answer to the s 131(2)(a) Questions ought to have been "Yes". Thus, the case concerned a large data set in which Westpac's algorithm did not demonstrably fail to achieve the result for which it was said to have been designed. Even so, ASIC's case was that the legislation required the algorithm to be designed differently in order to answer the s 131(2)(a) Questions. It did not attempt to demonstrate that its different construction would or might have better achieved the purposes of the Act.

SECTION 131(2)(A) QUESTIONS

94 As the primary judge noted, the s 131(2)(a) Questions 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?"

95 The concept of "substantial hardship" is not defined in the Act although, by s 131(3), if a consumer could only comply with their financial obligations under the contract by selling their principal place of residence, this will constitute substantial hardship unless the contrary is proved. The concept of substantial hardship is also used in s 76 and s 177F of the *National Credit Code,* which is Sch 1 to the Act.

96 "Substantial hardship" is more than mere hardship. In its ordinary meaning, "hardship" is "a condition that bears hard upon one; severe toil, trial, oppression, or need". In *Re Kabalan* [1993] FCA 76; 40 FCR 560 at 562, Gummow J stated that "[a]ny condition which presses with particular asperity upon a person may be described as a hardship".

WESTPAC'S ADS AND "DECLARED LIVING EXPENSES"

97 The primary judge found that, for each home loan, the consumer was required to complete a form known as Form PFI001. The form 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)	

98 Westpac treated the listed items (except “Ongoing Rent/Board AFTER this loan is drawn” and “Child Maintenance/Alimony”) as expenses, and ASIC defined them as declared living expenses.

99 Westpac classified “Ongoing Rent/Board AFTER this loan is drawn” and “Child Maintenance/Alimony” as “Outgo” together with liabilities such as other loans and credit cards.

100 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”. Applications entered in this way were then assessed by the ADS.

101 The ADS comprised over 200 rules which were applied to the information obtained from the Form PFI001. Consistent with the three outcomes of the ADS mentioned above, the parties agreed that the rules included “decline rules” and “refer rules”.

102 The two rules relevant to this appeal are the 70% Ratio Rule and the **Serviceability Rule**.

70% Ratio Rule

103 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.

104 The 70% Ratio Rule involves an assessment of the risk of default by the consumer. The primary judge accepted the evidence of Mr Malcolm, the General Manager of Credit at Westpac, as follows (at [24]):

> 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.

Serviceability Rule

105 The Serviceability Rule undertook the following calculation to determine a consumer’s “Net Monthly Surplus/Shortfall”:

> Net Monthly Surplus/Shortfall = Discounted Monthly Income – (Assessed Monthly Repayments + Outgo + HEM benchmark + Buffer)

106 At [29], the primary judge found:

> 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.

107 ASIC noted that the figure used by Westpac for Assessed Monthly Repayments related to the proposed home loan and was calculated on the basis that monthly repayments of principal (as well as interest and fees) would be made over the full term of the home loan.

108 The **HEM benchmark** measured household expenditure across the Australian community. His Honour made detailed findings about the HEM benchmark at [41]-[46], concluding:

> [45] 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.
>
> [46] … [T]he 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.'

109 The evidence was that, in about 20% of the 261,987 loans, the consumer's declared living expenses were higher than the HEM benchmark.

110 At [94], the primary judge found that the purpose of the buffer in the Serviceability Rule was to "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".

REQUIREMENTS FOR UNSUITABILITY ASSESSMENTS UNDER S 128 AND S 129

111 ASIC contended that, upon a proper construction of the provisions of Div 3 of Pt 3-2 of the Act, the primary judge ought to have held that Westpac did not make an assessment of the

s 131(2)(a) Questions and accordingly did not make the unsuitability assessment required by s 128 of the Act. Division 3 is set out at [15] of Middleton J's reasons for judgment.

112 The primary judge's reasoning was based on his Honour's rejection of ASIC's case, which his Honour distilled into the following three propositions (set out at [51] of his Honour's reasons):

(1) 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.

(2) Across the whole of the relevant 261,987 home loan approvals, 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.

(3) 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.

Requirement to take account of information obtained under s 130

113 The primary judge correctly noted (at [5] of his Honour's reasons) that Div 3 of the Act does not contain an express statement that a credit provider must use the consumer's declared living expenses in making the unsuitability assessment. Nor did ASIC suggest that, as a matter of construction, s 130 of the Act requires a licensee to obtain the information comprised in "declared living expenses" from a consumer in order to satisfy the requirement of s 130(1)(b) of making reasonable inquiries about the consumer's financial information.

114 Division 3 also does not expressly state that, in order to make an unsuitability assessment, a credit provider must "take account of" information obtained under s 130 about a consumer's financial situation.

115 However, s 125 confirms that the purpose of the obligation imposed by s 130 is to enable the licensee to make the unsuitability assessment.

116 The primary judge accepted, at [57] and [58], that s 129(b) requires the licensee to assess the particular credit contract to be entered into by the specific individual applying for the loan.

117 His Honour also accepted that:

(1) the inquiries required by s 130 must take place before the unsuitability assessment is in fact carried out (at [59]);

(2) the only purpose for which the s 130 inquiries are made is for the purpose of carrying out the assessment (at [59]);

(3) 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 (at [59]); and

(4) in principle, whatever must as a matter of necessity be considered to answer the s 131(2)(a) Questions is a mandatory matter which a credit provider must take into account (at [70]).

118 As his Honour observed, a comparison of the mandatory circumstances of unsuitability in s 131(2) and the kinds of information required to be collected under s 130(1) suggest that the information collected under s 130(1) is collected for the purpose of assessing the loan against the unsuitability criteria in s 131(2).

119 At [62], his Honour reasoned as follows:

> 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?

120 This passage draws attention to the fact that, if there is an implied requirement to "take account of" *all* information collected under s 130(1), that requirement raises a further question about the content of the obligation to take the information into account. It could be an obligation to consider the information, or it could be an obligation to include the information in a mathematical calculation of the consumer's likely ability to comply with the consumer's financial obligations under the contract. If the latter, a further question arises whether there is an implied requirement as to the elements of the calculation.

121 At [64], the primary judge reasoned that, on ASIC's construction, a licensee need not take into account *all* information obtained by s 130 inquiries. This construction is consistent with s 131(4), which restricts the information that may be taken into account for the purposes of s 131(2) to information that meets the following two criteria:

> (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.

122 Those criteria draw attention to the obvious problem that inquiries directed to the consumer may not yield completely robust information about the consumer's financial situation.

123 Thus, his Honour recorded at [65], ASIC accepted 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)".

124 At the trial, as recorded by the primary judge at [64], ASIC sought to give content to the requirement as follows:

> … [I]t 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. … 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.

125 At [68], the primary judge noted:

> 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.

126 On the appeal, ASIC did not take issue with the primary judge's reasoning to this point.

127 At [71], his Honour rejected ASIC's submission that all of the financial circumstances of the consumer must be considered to make an unsuitability assessment. As his Honour observed and illustrated, many consumers' financial circumstances include matters of no relevance to the s 131(2)(a) Questions, for example, an asset which will not be available to meet the

consumer's financial obligations under the credit contract, a one-off expenditure prior to the loan approval, a pattern of expenditure that the consumer will cease after the credit contract is entered into or a pattern of discretionary spending that the consumer can change to free up funds to meet the consumer's financial obligations under the credit contract. In this context, by discretionary spending, I mean spending that the consumer can avoid without experiencing substantial hardship.

128 At [72], the primary judge considered whether some of the financial circumstances of the consumer are a relevant consideration including, at least, the consumer's declared living expenses. As his Honour explained, a consumer's total historical spending is not a necessary integer in an assessment of the consumer's likely future ability to comply with the consumer's financial obligations under the contract.

129 ASIC did not dispute the primary judge's observation, at [76], that "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". Thus, the primary judge concluded, some of the declared living expenses may be relevant to the unsuitability assessment but this does not mean that declared living expenses must be considered in order to make an unsuitability assessment. His Honour also noted (at [79]) that additional facts would be required to determine the relevance of one or more integers of the declared living expenses but ASIC did not allege that Westpac had contravened s 130 by failing to make further inquiries.

130 The primary judge then explained what his Honour considered to be a more likely interpretation of s 128 and s 129. His Honour first observed (at [81]) that Div 3 is very concerned to ensure that the unsuitability assessment is correct. His Honour then expressed the following views, which were vigorously challenged by ASIC on the appeal:

> 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.

131 If his Honour was suggesting that the policy of Div 3 does not include the promotion of responsible lending behaviour through the requirement to make an unsuitability assessment,

then I would respectfully disagree. However, in the previous paragraph, his Honour referred to the concern of Div 3 to ensure that the unsuitability assessment was correct. In my view, his Honour was simply construing the legislation as permitting the licensee to determine the method by which it would make unsuitability assessments, the only relevant constraint being that it must do so after having informed itself about the consumer by complying with s 130 and the assessment must conform to the requirements of s 129.

132 ASIC submitted that, to make an unsuitability assessment, a licensee cannot assess "some normalised information without regard to the circumstances of the individual concerned". I accept that submission at a general level, but it does not answer the question of what legislative constraints are imposed on the identification of the consumer's financial situation and the permissible approach or approaches to the assessment by reference to that situation.

133 The next contention was that "[w]hen a licensee chooses to embark on a particular course, or use a particular method, in order to undertake the statutory assessment, if in applying that method it fails to assess the actual repayment obligations under the particular proposed credit contract, or uses statistically-based figures to represent a hypothetical or normalised consumer without regard to the specific consumer's actual financial situation, it cannot be said to have conducted the assessment required by 128(c) of the Act".

134 ASIC specifically did not contend that Westpac was obliged to use consumers' declared living expenses in the Serviceability Rule calculation.

135 However, ASIC argued that "in order to conclude that a particular consumer's living expenses could be reduced (such that the consumer's declared living expense figure itself was not relevant), the licensee would need to assess the specific individual consumer's living expenses, in order to be able to be in a position to form a view as to whether any or some of that consumer's living expenses may be foregone or reduced without substantial hardship". The ADS did not allow for the possibility that a particular consumer had living expenses that could not be reduced or dispensed with, such as medical expenses, school fees, other expenses to support dependents (such as elderly relatives), or higher than usual utilities or transport expenses.

136 Equally, as the primary judge recognised, in order to form a view that the declared living expense figure was relevant to the s 131(2)(a) Questions in a particular case, it is necessary to

know more. The most obvious question is whether the declared living expense figure is a likely reflection of the consumer's future expenditure if they enter into the credit contract.

137 ASIC contended that the possible capacity of some consumers to reduce their living expenses in order to meet loan repayments could not support a conclusion that Westpac was "entitled to ignore" all consumers' declared living expenses. But that contention misses the point, which is whether Westpac was obliged to "take account of" declared living expenses as a relevant fact in answering the s 131(2)(a) Questions.

138 There is a separate question whether Westpac was obliged to consider the integers of the declared living expenses, for the purpose of analysing the extent to which individual expenses would likely be necessary (or necessary to avoid substantial hardship). ASIC submitted that, where Westpac purported to conduct its assessment of whether the consumer was likely to be unable to meet their financial obligations under the proposed home loan on the basis of a calculation of the consumer's cash flow position (necessarily involving an assessment based on income less deductions for outgoings and living expenses), the primary judge should have held (and erred in failing so to hold) that in order to discharge its obligation pursuant to s 128(c), Westpac was required to give some consideration to each consumer's declared living expenses.

139 The Act cannot be construed to require Westpac to consider the total figure for declared living expenses in each case for the purpose of assessing the consumer's likely ability to meet their financial obligations. The Act did not oblige Westpac to obtain that information and, when obtained, the Act did not prescribe the use to which Westpac must put such information. As it turns out, Westpac used the declared living expenses to apply the 70% Ratio Rule, on the basis of its belief that this rule identified a group of customers at higher risk of default.

140 Further, ASIC did not explain satisfactorily how the Act implied a requirement to examine the integers of the declared living expenses in each case for the purpose of assessing the consumer's likely ability to meet their financial obligations.

141 The language of the Act does not support the degree of prescription contended for by ASIC. Rather, the Act leaves it open to the licensee to decide:

(1) what inquiries it will make under s 130(1)(a) and (b), provided that those inquiries are reasonable;

(2) what steps it will take to verify the consumer's financial situation under s 130(1)(c), provided that those inquiries are reasonable; and

(3) how it will use the results of its inquiries and verification to make the unsuitability assessment, provided that it in fact assesses whether the contract will be relevantly unsuitable for the particular consumer and noting that the licensee is otherwise motivated by the Act to refrain from entering into an unsuitable contract.

142 Westpac's ADS sought to answer the s 131(2)(a) Questions most particularly by the Serviceability Rule. The application of the Rule required calculations of the individual consumer's Discounted Monthly Income, Assessed Monthly Repayments and Outgo, and the identification of an HEM benchmark figure applicable to the consumer's circumstances. It is not fairly described as an assessment "without regard to the circumstances of the individual concerned", and it is plainly directed to the risk of the particular consumer being unable to meet their financial obligations under the proposed credit contract without significant hardship as measured by the HEM benchmark.

143 ASIC sought to posit theoretical circumstances in which a consumer might not have failed either the 70% Ratio Rule or the Serviceability Rule and yet, the home loan ought to have been assessed as unsuitable. However, the argument was made at such a high level of generality that it is a matter of speculation whether such an outcome is realistically possible. Accordingly, ASIC did not identify any mischief that is not addressed by the primary judge's construction of the Act.

144 I respectfully agree with Middleton J that a failure to make an assessment that conforms with the requirements of s 129 is a failure to make an assessment within s 128(c), giving rise to a contravention of s 128 where, relevantly, the licensee enters into a credit contract with a consumer who will be the debtor under the contract within the meaning of s 128(a). However, for the reasons set out above, I do not consider that the primary judge erred in concluding that Westpac asked and answered the s 131(2)(a) Questions and, accordingly, the primary judge was correct to conclude that ASIC's case failed.

70% RATIO RULE

145 ASIC also contended that, as a matter of fact, the primary judge erred in concluding (at [27] of the reasons for judgment) that "[b]y 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".

146 Based on [86] of his Honour's reasons, the process to which the primary judge referred at [27] was the ADS. There, his Honour found that Westpac took into account the consumer's declared living expenses in applying the 70% Ratio Rule as part of its process of assessment under the ADS in conjunction with other rules such as the Serviceability Rule.

147 The primary judge rejected ASIC's contention 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". His Honour referred to para 3.155 of the Explanatory Memorandum to the *National Consumer Credit Protection Bill 2009* which states:

> The standard for the consumer being likely to meet the financial obligations in the contract is an objective one. It is not directly linked to the credit provider's own internal standards and guidelines regarding assessing a capacity to repay. Such internal standards and guidelines would be expected to factor in the credit provider's own policies on risk exposures and may vary from time to time, in line with changes to the risk appetite of the credit provider, and the commercial and economic environment. Accordingly, the fact that an application for credit satisfied a credit provider's own policies for affordability does not necessarily mean that it met the standard in the legislation. However, it is expected that the types of inquiries made and assessments conducted for the purposes of the credit provider's internal standards and guidelines on affordability 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.

148 The primary judge stated (at [26]), that the 70% Ratio Rule was no less a measure of "unsuitability" because it identifies a certain class of consumers whose applications were to be manually assessed.

149 On the appeal, ASIC noted that the 70% Ratio Rule did not use either repayments under the proposed home loan or the consumer's obligations in respect of outgoings, as inputs into the calculation performed by the 70% Ratio Rule.

150 ASIC also noted that, though a rule whose purpose is to gauge risk of default may also be a rule that can assess whether it is likely that the consumer will be able to meet their financial obligations under the proposed credit contract, such a rule will not necessarily operate in that way.

151 ASIC argued that it is necessary to consider whether the 70% Ratio Rule enabled Westpac to assess whether the consumer's financial obligations under the proposed credit contract can be

met, or only met with substantial hardship. ASIC pointed to evidence that the 70% Ratio Rule could be triggered, even if there may be no real doubt about the loan's serviceability because the loan amount is very small resulting in very small monthly repayments.

152 ASIC submitted that the 70% Ratio Rule was not an assessment of unsuitability, but only a "trigger" for Westpac to determine that the relevant loan application would be assessed manually where the consumer exceeded the 70% ratio. The rule served only to identify a class of consumers who had high levels of expenses compared to income.

153 ASIC's case at trial was that the ADS did not require any regard to be had to the consumer's declared living expenses other than by virtue of the 70% Ratio Rule. On the appeal, ASIC submitted, in effect, that the 70% Ratio Rule was applied prior to the ADS, saying:

> The 70% Ratio Rule was only directed to identifying which of Westpac's processes a particular consumer will undergo (that is, the ADS or manual assessment), but was not directed to conducting the assessment of unsuitability itself.

Consideration

154 Contrary to what might have been suggested by ASIC on the appeal, the 70% Ratio Rule did form part of the ADS, and was applied to (but not triggered by) the loan applications that led to the credit contracts the subject of this proceeding. It follows that, by applying the 70% Ratio Rule in each case, Westpac did take into account the consumer's declared living expenses as part of the process comprised by the ADS.

155 As explained above, his Honour did not err in the implied finding that the ADS was "a process leading to an answer to the s 131(2)(b) Questions".

156 By applying the 70% Ratio Rule, Westpac tested whether or not each relevant consumer was in a class that had been identified by Westpac as being at a higher risk of default. That is a test about an individual consumer's likely risk of default in relation to any credit contract including the relevant home loan.

157 In the case of the home loans the subject of this proceeding, in every case, the 70% Ratio Rule showed that the consumer's declared living expenses were less than 70% of their income (as defined by the rule). That is a fact concerning the consumer's financial situation which is an indicator of the consumer's likely ability to comply with financial obligations. It involves an evaluation of two aspects of the consumer's financial situation, being the consumer's declared living expenses and the consumer's income.

158 The unsuitability assessment required Westpac to consider future possibilities. A high ratio of expenses to income places the consumer in a higher risk of default category, which raises an obvious possible future incapacity to meet financial obligations, or only to have the capacity to do so with substantial hardship. Of course, high ratio of expenses to income may ultimately not reflect adversely on the suitability of the credit contract, particularly where the amount of the financial obligations under the contract are very small or where the consumer's income is very high. However, ASIC did not suggest that Westpac should not use the 70% Ratio Rule in evaluating the consumer's financial situation for the purpose of the unsuitability assessment.

159 Conversely, the fact that a consumer is not in an identified class of consumers at higher risk of default by reason of their high ratio of expenses to income is a positive although not conclusive indicator of the consumer's likely capacity to meet financial obligations. By not triggering the 70% Ratio Rule, and acknowledging that the rule applied information supplied by the consumer, each consumer demonstrated that at least 30% of their income was presently available to meet financial obligations under the proposed credit contract, subject to the possibility of expenditure in the categories of "Ongoing Rent/Board AFTER this loan is drawn" and "Child Maintenance/Alimony", taken into account by the Serviceability Rule. Thus, the Serviceability Rule was applied only to consumers who had a significant surplus of income (as defined) over declared living expenses.

160 The 70% Ratio Rule evaluated the financial situation of the consumer and specifically the risk of default under the home loan based on current expenditure. In doing so, it contributed to the process of making the unsuitability assessment which also included application of the Serviceability Rule, albeit that the 70% Ratio Rule did not evaluate the unsuitability of the particular home loan. For those additional reasons, I also do not consider that the primary judge erred in his Honour's conclusion that the 70% Ratio Rule was part of a process leading to an answer to the s 131(2)(a) Questions.

CONCLUSION

161 In my view, the appeal should be dismissed. Costs should follow the event.

I certify that the preceding seventy-seven (77) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Gleeson.

Associate:

Dated: 26 June 2020

REASONS FOR JUDGMENT

LEE J:

162 Civil penalty provisions are justified on the basis that they prevent or punish public harm. Given that a punitive sanction can flow from a breach of such provisions, one would expect that any norm which, upon contravention, attracts a civil penalty, should be expressed with clarity to ensure that those regulated are left in no doubt as to what they are required to do (or not do). As this dispute demonstrates, if as ASIC contends, by enacting Pt 3-2, Div 3 of the *National Consumer Credit Protection Act 2009* (Cth) (**Act**), Parliament intended to make it pellucid exactly what licensees needed to do before entering into a credit contract, that effort miscarried.

163 In broad terms, the following contravening conduct was alleged by ASIC:

(1) In applying the "Serviceability Rule" in its automated decision system (**ADS**), Westpac used the Household Expenditure Measure benchmark value (**HEM Benchmark**), instead of the amount of the consumer's "Declared Living Expenses" (being the figures included by the consumer in some, but not all, of the "expense fields" in Westpac's application form), in computing the consumer's monthly cash surplus or shortfall (**Declared Living Expenses issue**); and

(2) As 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 whole period of the loan, rather than the residual term of the loan after expiry of the interest-only period (**Interest-only issue**).

164 I have had the benefit of reading in draft the reasons of both Middleton J and Gleeson J. I agree with Middleton J's reasons in concluding that no error has been demonstrated in the approach of the primary judge to the determination of the Interest-only issue; however, I do not consider the primary judge fell into error in dealing with the Declared Living Expenses issue.

165 It is useful to commence by recalling that the relevant question before the primary judge was whether ASIC was correct in alleging contraventions of s 128 of the Act on the 261,987 occasions Westpac entered into a home loan that had been assessed by its ADS during the relevant period. As has already been explained, the merit of this contention turned upon the proper construction of ss 128, 129 and 131 of the Act.

166 As can be seen from the judgment below (**J**), ASIC's argument relevantly proceeded as follows:

(1) Westpac collected information from consumers including personal details, employment details, monthly income, expenses, whether the consumer expected a change to their financial situation, current assets, currently liabilities, and details of the property to be purchased (J[16]);

(2) Westpac entered the information it collected from consumers into a "Generic Origination Engine" which was then assessed by the ADS (J[19]) and treated various expenses as Declared Living Expenses and other items as "Outgo" (j[16], [17], [28], [30]);

(3) Westpac operated the ADS for the purpose of deciding whether or not to offer a home loan to a consumer, which was a system comprised of two hundred plus "rules", the application of which might trigger either a referral to manual assessment or an adverse outcome; if an application did not trigger either such outcome, it received "conditional approval" (J[19]);

(4) one of the rules in the ADS was the Serviceability Rule, which calculated a consumer's "Net Monthly Surplus/Shortfall", which amount was equal to a figure derived as follows: "Discounted Net Monthly Income - (Assessed Monthly Repayments + Outgoings + HEM Benchmark + 'buffer')" (J[28]);

(5) Westpac did not use the consumer's Declared Living Expenses in the Serviceability Rule (J[32]); rather, Westpac used values derived from the HEM Benchmark;

(6) the use of the HEM Benchmark in the Serviceability Rule did not involve an estimate of the consumer's actual living expenses, but was instead "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" (J[46]);

(7) s 128(c) of the Act requires the assessment to be whether the *particular* credit contract proposed to be entered into will be unsuitable for the *specific* individual consumer, including whether it is likely that the relevant consumer will be unable to comply with their financial obligations under the proposed credit contract, or could only do so with substantial hardship; and

(8) the operation of the ADS in the way used by Westpac meant it failed to assess the actual repayment obligations under the particular proposed credit contract, and hence was not an assessment as required by s 128(c) of the Act.

167 The difficulty with this argument is that the word "assessment", as used in ss 128(c) and 129, does not seem to me to incorporate the obligation for which ASIC contends. There is no textual requirement specifying *how* the assessment is to be undertaken, and indeed ASIC accepted that "it remains open to a licensee to choose how it conducts the assessment required". Section 129 spells out only two requirements for an assessment: *first*, specifying the period covered; and *secondly*, assessing whether the contract (or an increase in credit limit) will be unsuitable for the consumer.

168 Contextually, s 129 is part of an elaborate statutory regime requiring reasonable inquiries to be undertaken to identify (and to verify) the consumer's "financial situation" before making the assessment under s 129. It is a regime, however, which allows a licensee to take into account *other* information, including things such as the HEM Benchmark and, as ASIC accepted, did not oblige Westpac to take into account *all* of the information it gathered (J[62]–[66]). Moreover, the information gathered for the purposes of the assessment could no doubt extend beyond that obtained upon the making of the inquiries required by s 130.

169 There is substance in Westpac's submission that if, as ASIC accepted, what a lender did with the information obtained under s 130 was "legitimately up to the lender", and not all information gathered needed to be used, how does one delineate the information to which Westpac must have regard, from information to which it need not have regard? Nothing in the text allows a licensee in the position of Westpac to know which specific parts of the information obtained *must* be used in the assessment to avoid incurring a civil penalty. This uncertainty is difficult to reconcile with a mandatory requirement, implied from the text, that in performing an assessment under s 129, Westpac must have specifically used (by "having regard to") the consumer's Declared Living Expenses.

170 When viewed in context, Pt 3-2, Divs 3 and 4, identify three stages: making inquiries and verification; conducting a suitability assessment; and entering into (or increasing the credit limit of) a contract. As to the *first* stage, s 130 imposes an initial duty to undertake inquiries and investigations into the consumer's requirements and objectives, and financial situation (obligations directed to "knowing the customer"); as to the *second*, in conducting the assessment, s 131 provides that the licensee must assess that the credit contract will be

unsuitable for the consumer if the conditions in s 131(2) apply, and that a contract must be assessed as unsuitable if it is likely that the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship; as to the *third*, it relevantly provides that a licensee must not enter into the contract unless it has made the inquiries "in accordance with section 130" (s 128(d)), and made an assessment "in accordance with section 129" (that is, an assessment that specifies the period the assessment covers, and assesses whether the credit contract will be unsuitable for the consumer if the contract is entered into in that period), and the day the contract is entered into is within the period covered by the assessment (s 128(c)).

171 It is correct to say that Div 3 has a specific purpose of creating and enforcing a new norm of conduct for credit providers when entering into or increasing the credit limit of credit contracts, and that the specific and detailed requirements of the provisions of Pt 3-2 are part of a sequence leading up to the credit provider making an assessment of unsuitability, by reference to the consumer's financial situation and their requirements and objectives. But this does not mean that these initial mandated inquiries and verifications (which require the credit provider to "know the customer") are then separately required to be used in the assessment in any particular way on pain of a civil penalty. Although the evident purpose of the process is to protect the consumer from entering into an unsuitable credit contract, this is achieved by requiring (s 128(c)) an assessment "in accordance with section 129", that is, an assessment as to whether the credit contract "will be unsuitable for the customer", in a manner left up to a fully informed licensee.

172 I respectfully agree with the primary judge (see J[71]) that it does not follow that the statutory purpose can only be achieved by taking into account *all* information collected, regardless of its relevance or materiality to the assessment of unsuitability. Simply labelling an expenditure as a Declared Living Expense, and the fact that the consumer incurs that expense on their current lifestyle, does not necessarily change its nature from being discretionary. It is plain that 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.

173 This was an unusual case, being a case alleging a serious want of compliance with responsible lending norms, divorced from consideration of any facts about any specific consumers. It was Westpac's job to assess suitability and although not determinative, for my part, it is far from intuitively odd that Westpac would focus on independent, objective data as represented by the

HEM Benchmark and use the Declared Living Expenses in the way it did (through the use of the "70% Ratio Rule").

174 As would be evident from reading the judgments of Middleton J and Gleeson J, identifying the proper construction of ss 128, 129 and 131 is not straightforward. The result below, however, is justified by reference to ordinary principles of statutory construction which include, in the current context, the notion that to the extent it could properly be said that there is an interpretative choice between tenable views, it should be recalled that although the penalties imposed are not criminal, civil penalty provisions should be interpreted on the basis that it is to be expected that an obligation imposed would have been identified clearly and unambiguously: see Pearce D, *Statutory Interpretation in Australia* (9th Ed, LexisNexis Butterworths, 2019) Ch 9, see esp at [9.17].

175 I otherwise agree with the reasons of Gleeson J and the appeal should be dismissed with costs.

I certify that the preceding fourteen (14) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Lee.

Associate:

Dated: 26 June 2020