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Responsible lending and hardship variations — capitalising interest and fees

Leonie Chapman *LAWYAL SOLICITORS*

Background

The National Consumer Credit Protection Act 2009 (Cth) (NCCPA) requires credit providers to fulfil certain responsible lending obligations where there is an increase to the credit limit of a credit contract or where a new credit contract is entered into. The responsible lending obligations[1] include making reasonable inquiries about a customer's financial situation and requirements and objectives, and conducting reasonable verification of the customer's financial situation, in order to make an assessment that the loan is not unsuitable for the customer. The purpose of this assessment is to make sure the customer can afford the loan and that it meets the customer's requirements and objectives. The very interesting and in some ways confusing question is, whether certain variations that are made by credit providers with consumers as a result of hardship requests by the customer, trigger the responsible lending obligations? In particular, this paper explores whether hardship variations to capitalise interest and arrears by customers result in a credit limit increase and therefore must be originated in accordance with the responsible lending provisions.

What do the definitions say?

The law is a little uncertain in this area. To understand whether technically the capitalisation of interest and arrears into a customer's loan is an increase in the credit limit, we need to understand what the definitions say. Under the NCCPA and National Credit Code (NCC), "credit limit" is defined as: "the maximum amount of credit that may be provided under the contract".[2]

According to the NCCPA and NCC, "credit" is provided by a credit provider under a credit contract where a payment of a debt that is owed to the credit provider is deferred, or the customer incurs a deferred debt to the credit provider.[3] "Amount of credit" is defined in the NCC (only) as:[4]

> For the purposes of this Code, the ***amount of credit*** is the amount of the debt actually deferred. The ***amount of credit*** does not include:
> (a) any interest charge under the contract; or
> (b) any fee or charge:
> (i) that is to be or may be debited after credit is first provided under the contract; and
> (ii) that is not payable in connection with the making of the contract or the making of a mortgage or guarantee related to the contract.

The result of the above NCC provisions is that interest charges and any fees payable by a customer under a loan do not form part of the "amount of credit". In effect, what this could mean is, where interest charges and fees and charges owed by the customer to a credit provider under the credit contract then fall into arrears, and after applying for and being granted hardship relief by the credit provider, the customer's arrears (including interest and fees payable), are capitalised into the loan by way of variation, the interest and fees portion from the variation date could in fact amount to an increase in the credit limit.

The reason for this appears to be a technicality based on how the definitions are phrased, however there is certainly some debate about whether or not, in light of that definition, under the NCC any deferral of interest or fees that applied under the original loan contract, would be an increase in the amount of credit from the variation. Because the interest and fees are re-categorised from being interest and fees under the original contract (and therefore excluded from the definition of deferred amount of credit according to the NCC), to being deferred credit (part of the principal amount, upon which interest accrues) on and from the capitalisation variation, there is an argument that a variation to capitalise fees will increase the credit limit and trigger responsible lending obligations.

Where there is uncertainty, there is risk that a consumer, lawyer or court might interpret the provisions against a credit provider to require them to undertake responsible lending obligations on a hardship application that involves capitalising interest and arrears over and above the original credit limit.

To further add to this confusion, the definition of amount of credit is only defined in the NCC and has not been incorporated into the NCCPA. While it does not entirely make sense that a definition in the NCC is not also to be applied in the same manner as the NCCPA given the NCC is a Schedule to the NCCPA, there may

be a technical argument that this NCC definition only applies for the purposes of the NCC and therefore amount of credit does not exclude interest and fees from its definition when used in the NCCPA definition of credit limit.

If interest and fees are able to be included in the amount of credit, then deferring interest and fees as part of a hardship variation will not increase the credit limit, as it will not increase the "the maximum amount of credit that may be provided under the contract"[5] given the original credit limit already included those interest and fees.

Does this sound confusing to you too? It should. The definitions do not neatly tie together to clarify the situation, and common sense tells us that, as variations for hardship that involve capitalising interest and fees do not involve additional advances to the customer, why would anyone consider this variation an increase the credit limit of a credit contract for the purposes of s 128 of the NCCPA? To assist, industry and the banking and finance legal profession would welcome further guidance from the Australian Securities and Investments Commission (ASIC) on this particular topic.

Industry and regulator view

Rather than rely on the technicalities of tracing through confusing definitions, many banking and finance institutions and their legal counsel, look to guidance from ASIC. ASIC's Information Sheet 105 says that hardship variations made under s 72 of the National Credit Code (NCC) or cl 28 of the Code of Banking Practice are not exempt from the responsible lending provisions under the NCCP, where the variation involves either an increase to the credit limit under a credit contract or the entry into a credit contract. The question in this paper is, does a credit provider need to undertake a credit assessment where the credit limit is increased beyond "the maximum amount of credit that may be provided under the contract"[6] as a result of capitalising interest and fees? Logic tells us that, by virtue of the customer being in hardship it will be difficult for any hardship request to be agreed in these circumstances, as generally hardship involves a level of temporary financial hardship which would no doubt fail a credit provider's serviceability test.

While responsible lending provisions will apply to hardship variations if additional credit is provided, it looks like ASIC does not believe that the provision of additional credit would be very likely in the vast majority of cases. In ASIC's Information Sheet 105 it further explains that many hardship arrangements involve a reduction in the amount of the repayments for a period (including the capitalisation of interest, fees and charges). It therefore appears that ASIC's view is that capitalisation of interest, fees and charges would not constitute a credit limit increase after all. While this is an ideal position from a credit provider's point of view, the problem is, the law is not clear and so the release of further specific guidance from ASIC on this point, with reference to the unclear sections in the NCCPA and NCC, might be the only way to resolve this issue for the industry.

There appears to be some confusion by the banking and finance industry and their advisers about the correct answer, with Financial Ombudsman Service (FOS) and Credit and Investments Ombudsman (CIO) apparently sharing ASIC's view that capitalising interest and fees should not amount to a credit limit increase and trigger responsible lending provisions under the NCCPA.

Conclusion

While the question whether some hardship variations technically trigger responsible lending obligations may not have a clear answer under the NCCPA, NCC and ASIC guidance when it comes to defining an increase to credit limits for the purposes of hardship variations to capitalise arrears, what is clear is that ASIC intends for all credit providers who provide credit limit increases to customers (including those customers who apply for credit limit increases as a result of a hardship application) to conduct unsuitability assessments in accordance with the NCCPA. The hope from the banking and finance and legal industry is that, this level of uncertainty in areas as important as hardship and responsible lending under the NCCPA will prompt quick action by ASIC to clarify their position on the topic so that credit providers can be sure that they are applying the correct policy and procedures to hardship applications moving forward.

Leonie Chapman
Principal Lawyer and Director
LAWYAL Solicitors
leonie.chapman@lawyal.com.au.

About the author
Leonie Chapman*'s experience extends to banking and finance, consumer credit and mortgage lending, contract negotiation, trade practices and fair trading legislation, intellectual property and trade marks, corporate and financial services. After completing her Bachelor of Laws and Bachelor of Commerce in 2002, Leonie went on to work both in private practice and as senior in-house lawyer supporting a specialist lender and then for six years, Macquarie Bank Limited. Having achieved a Master of Laws in 2009 specialising in banking and*

finance law, Leonie's main focus now as Principal of LAWYAL Solicitors is on regulation and compliance for banking and financial institutions.

Footnotes

1. NCCPA, ss 128–130.
2. NCCPA, s 5(1) and NCC, s 204.
3. NCC, s 3(1).
4. NCC, s 3(2).
5. NCCPA, s 5(1), and NCC, s 204.
6. Above n 5.