

# Chapter 1

## Introduction and background

1.1 On 14 February 2019, the Senate referred the issue of the resolution of disputes with financial service providers within the justice system to the Legal and Constitutional Affairs References Committee for inquiry and report by 8 April 2019. The terms of reference for the inquiry are as follows:

The ability of consumers and small businesses to exercise their legal rights through the justice system, and whether there are fair, affordable and appropriate resolution processes to resolve disputes with financial service providers, in particular the big four banks considering:

a. whether the way in which banks and other financial service providers have used the legal system to resolve disputes with consumers and small businesses has reflected fairness and proportionality, including:

i. whether banks and other financial service providers have used the legal system to pressure customers into accepting settlements that did not reflect their legal rights,

ii. whether banks and other financial service providers have pursued legal claims against customers despite being aware of misconduct by their own officers or employees that may mitigate those claims, and

iii. whether banks generally have behaved in a way that meets community standards when dealing with consumers trying to exercise their legal rights;

b. the accessibility and appropriateness of the court system as a forum to resolve these disputes fairly, including:

i. the ability of people in conflict with a large financial institution to attain affordable, quality legal advice and representation,

ii. the cost of legal representation and court fees,

iii. costs risks of unsuccessful litigation, and

iv. the experience of participants in a court process who appear unrepresented;

c. the accessibility and appropriateness of the Australian Financial Complaints Authority (AFCA) as an alternative forum for resolving disputes including:

i. whether the eligibility criteria and compensation thresholds for AFCA warrant change,

ii. whether AFCA has the powers and resources it needs,

iii. whether AFCA faces proper accountability measures, and

iv. whether enhancement to their test case procedures, or other expansions to AFCA's role in law reform, is warranted;

- d. the accessibility of community legal centre advice relating to financial matters; and
- e. any other related matters.<sup>1</sup>

### **Conduct of the inquiry**

1.2 Details of the inquiry were advertised on the committee's website, including a call for submissions to be received by 1 March 2019. The committee also wrote directly to a number of individuals and organisations inviting them to make submissions.

1.3 The committee received 153 submissions, including 23 accepted in confidence. Public submissions are available on the committee's website. A list of all submissions received is at appendix 1 of this report.

1.4 The committee held a public hearing in Sydney on 21 March 2019. A full list of all witnesses who gave evidence to the committee at this hearing is at appendix 2 of this report.

### **Structure of the report**

1.5 There are three chapters in this report:

- This chapter outlines the administrative details of the inquiry, and provides an overview of previous inquiries relevant to the terms of reference of the committee's current inquiry;
- Chapter 2 addresses the issues raised with the committee during the inquiry; and
- Chapter 3 sets out the committee's view in respect of these issues.

### **Previous inquiries into financial disputes**

1.6 There have been a series of recent reviews and inquiries into the financial system, including by Senate committees.<sup>2</sup> However, none of these inquiries have focused exclusively on the particular issue of consumers and small businesses exercising their legal rights when resolving disputes with financial service providers.

1.7 There are two recent independent inquiries that provide significant context to this Senate inquiry: the review of the financial system external dispute resolution and complaints framework, chaired by Professor Ian Ramsey (the Ramsay Review), which completed its work in 2017; and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission), which tabled its final report in the Parliament on 4 February 2019.

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1 *Journals of the Senate*, No. 140, 14 February 2019, p. 4673.

2 See, for example Phil Khoury, *Independent Review of the Code of Banking Practice*, 2017; House of Representatives Economics Committee, *Review of the Four Major Banks*, 2016–present; Senate Economics References Committee, *Scrutiny of Financial Advice*, 2017.

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## *The review of the financial system external dispute resolution and complaints framework*

1.8 The Ramsay Review was the first comprehensive review of the external dispute resolution framework for the financial system.

1.9 The terms of reference of the review were released on 8 August 2016, and subsequently amended by the government on 2 February 2017 to consider a compensation scheme of last resort (CSLR), 'and to consider the merits and issues involved in providing access to redress for past disputes'.<sup>3</sup> The final report of the review was published in April 2017, and contained 11 recommendations.

1.10 The final report discussed two forms of alternative dispute resolution—tribunals and ombudsman schemes. It was identified that, when compared with ombudsman schemes, tribunals can be less accessible, less flexible and dynamic, can apply a 'black letter law' approach, and can be focused on specific decisions rather than systemic change.<sup>4</sup>

1.11 In contrast, in providing an alternative to the judicial system, ombudsman schemes were said to offer a number of benefits to complainants, such as a simple process, an examination of non-legal issues, a capacity to investigate systemic issues, and the promotion of access to justice.<sup>5</sup>

1.12 The final report discussed the merits of the then three external dispute resolution (EDR) bodies in the financial system framework—the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO), and the Superannuation Complaints Tribunal (SCT).

1.13 In its report, the review panel identified that the current arrangements for superannuation disputes are in need of fundamental reform through an industry-based EDR body.<sup>6</sup> The panel's 'central recommendation' was therefore 'the establishment of a new single EDR body for all financial disputes (including superannuation disputes) to replace FOS, CIO and SCT'.<sup>7</sup>

1.14 A Supplementary Final Report was published in September 2017, and went directly to the issue of a CSLR. The Supplementary Final Report made four recommendations on the establishment of a 'limited and carefully targeted' CSLR 'to cover future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid'.<sup>8</sup>

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3 Review of the financial system external dispute resolution and complaints framework (Ramsay Review), *Final Report*, April 2017, p. 3.

4 Ramsay Review, *Final Report*, pp. 27–28.

5 Ramsay Review, *Final Report*, pp. 30–31.

6 Ramsay Review, *Final Report*, p. 92.

7 Ramsay Review, *Final Report*, p. 91.

8 Ramsay Review, *Supplementary Final Report*, September 2017, p. v.

1.15 On 14 February 2018, as a result of the recommendations arising from the Ramsay Review, the Parliament passed legislation to establish the Australian Financial Complaints Authority (AFCA), a body that would:

...provide a one-stop shop to ensure consumers get a fair deal in resolving disputes with banks, insurers, super funds and small amount credit providers, without the expense, inconvenience, and trauma associated with going to court.<sup>9</sup>

1.16 AFCA commenced operations on 1 November 2018.

***The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry***

1.17 The Royal Commission, led by Commissioner Kenneth Hayne, was established on 14 December 2017 to examine ten subjects of inquiry, set out in the terms of reference.<sup>10</sup>

1.18 The final report of the Royal Commission was tabled in the Parliament on 4 February 2019, and contained 76 recommendations.

1.19 One of the terms of reference of the Royal Commission was to examine whether any further changes to the legal framework 'are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government)'.<sup>11</sup>

1.20 In its final report, the Royal Commission examined access to professional legal advice and financial counselling services. The report identified the 'asymmetry of knowledge and power between consumers and financial services entities',<sup>12</sup> and commented on the 'very valuable work' undertaken by the legal assistance sector and financial counselling services.<sup>13</sup> It was noted that legal advice and counselling services assisted claimants to identify that they had a financial dispute and engage with alternative dispute resolution processes.<sup>14</sup> It was also noted that 'the difference between the result the [consumer] ultimately achieved and the situation that they initially faced' prior to receiving legal assistance was often 'very large'.<sup>15</sup>

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9 The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services and the Hon. Craig Laundry MP, Minister for Small and Family Business, the Workplace and Deregulation, 'Consumers win as a one-stop-shop for financial complaints passes through parliament', *Media Release*, 14 February 2018.

10 See, Letters Patent, Register of Patents No. 52, 14 December 2017, p. 67.

11 Term of Reference (h)(i).

12 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), *Final Report*, 2018, p. 490.

13 Royal Commission, *Final Report*, 2018, p. 491.

14 Royal Commission, *Final Report*, 2018, pp. 490–491.

15 Royal Commission, *Final Report*, 2018, p. 491.

1.21 Commissioner Hayne considered the role of the legal assistance sector and financial counselling services to be 'complementary' to the recommendations in the report, designed to hold financial institutions to account.<sup>16</sup> Commissioner Hayne concluded that law reform and reform to practices of regulators and entities will not eliminate the need for legal advice or financial counselling services, 'though they will properly aim to reduce it'.<sup>17</sup> Commissioner Hayne considered that:

...there will likely always be a clear need for disadvantaged consumers to be able to access financial and legal assistance in order to be able to deal with disputes with financial services entities with some chance of equality of arms.<sup>18</sup>

1.22 Although Commissioner Hayne acknowledged that '[t]he legal assistance sector and financial counselling services frequently struggle to meet demand', no specific recommendations were made in the final report about funding for these services. Rather, Commissioner Hayne commented on 'the desirability of predictable and stable funding for the legal assistance sector and financial counselling services', and suggested that there should be 'careful consideration' regarding the delivery of such funding.<sup>19</sup>

### **The role of AFCA in the resolution of financial disputes**

1.23 AFCA is 'a free and independent alternative to the courts',<sup>20</sup> established pursuant to the *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (the AFCA Act) to replace the FOS, CIO and SCT.

1.24 The operational requirements of AFCA are outlined in the AFCA Act, as follows:

- (a) the complaints mechanism under the scheme is appropriately accessible to persons dissatisfied with members of the scheme; and
- (b) complaints against members of the scheme are resolved (including by making determinations relating to such complaints) in a way that is fair, efficient, timely and independent; and
- (c) appropriate expertise is available to deal with complaints; and
- (d) reasonable steps are taken to ensure compliance by members of the scheme with those determinations; and
- (e) under the scheme, determinations made by the operator of the scheme are:
  - (i) binding on members of the scheme; but

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16 Royal Commission, *Final Report*, 2018, p. 491.

17 Royal Commission, *Final Report*, 2018, p. 491.

18 Royal Commission, *Final Report*, 2018, pp. 491–492.

19 Royal Commission, *Final Report*, 2018, p. 483.

20 Australian Financial Complaints Authority (AFCA), *Submission 41*, p. 8.

- (ii) not binding on complainants under the scheme; and
- (f) for superannuation complaints, there are no limits on:
  - (i) the value of claims that may be made under the scheme; or
  - (ii) the value of remedies that may be determined under the scheme.<sup>21</sup>

1.25 The AFCA Act also implements 'an enhanced [internal dispute resolution] framework to deal with all consumer financial disputes about products and services provided by financial firms, including superannuation disputes'.<sup>22</sup>

1.26 AFCA's role, and issues of concern with the way in which AFCA is a means by which disputes with financial service providers can be resolved, will be examined in more detail in chapter 2.

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1.27 The following chapter addresses the issues raised with the committee in respect of this inquiry.

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21 *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (AFCA Act), s. 4, sch. 1, pt. 1, item 2, ss. 1051(4).

22 AFCA, *Enabling legislation*, <https://www.afca.org.au/about-afca/rules-and-guidelines/enabling-legislation/> (accessed 14 March 2019).