LEGITIMACY IN AUSTRALIA'S FINANCIAL SYSTEM EXTERNAL DISPUTE RESOLUTION FRAMEWORK: NEW AND IMPROVED OR SIMPLY NEW?

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The new Australian Financial Complaints Authority ('AFCA') has become an important and influential fixture in the Australian financial services landscape. It must be regarded as legitimate in order to adequately fill this role. This article examines AFCA's legitimacy, by reference to the predecessor schemes on which it was modelled, to assess whether recent reforms to the financial system external dispute resolution ('EDR') framework have rectified previously existing legitimacy gaps and, consequently, improved the EDR framework. Considering AFCA's largest predecessor scheme, the Financial Ombudsman Service, provides evidence that certain features of EDR schemes' informal justice model potentially give rise to legitimacy gaps with accompanying adverse consequences. AFCA's underpinning legislation and rules are closely scrutinised to ascertain the likelihood of these adverse consequences continuing, notwithstanding recent reforms. Mitigating factors and further items for consideration are proposed, noting that adaptability built in to AFCA's design eases the way for further legitimacy-constructing reforms, if needed.

I INTRODUCTION

The Australian Government's intention to 'overhaul' Australia's financial system external dispute resolution ('EDR') framework was reified on 14 February 2018 with the passing of the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth) ('*AFCA Act*'), which created the Australian Financial Complaints Authority ('AFCA').[1] EDR plays a pivotal role in the enforcement of financial services regulation in Australia by providing an alternative dispute resolution forum for retail consumers and financial services providers. The effective fulfilment of this role requires that institutions facilitating financial EDR be legitimate and be

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1 Kelly O'Dwyer, 'Overhauling the Dispute Resolution Framework' (Media Release, 26 July 2017).

regarded as such. Australia's financial services sector has undergone considerable scrutiny in recent years.[2] The overhaul, sparked by such scrutiny, has involved consolidation of the three existing EDR bodies into AFCA, a 'one-stop-shop' for consumer financial services disputes.[3] Two of these bodies were EDR industry ombudsman schemes approved by the Australian Securities and Investments Commission ('ASIC'): the Financial Ombudsman Service ('FOS') and the Credit and Investments Ombudsman ('CIO') (together, 'Predecessor EDR Schemes'). The third was the Superannuation Complaints Tribunal ('SCT'), a Commonwealth statutory body. AFCA's establishment follows an independent expert panel's comprehensive review of the existing EDR framework, chaired by Professor Ian Ramsay ('*Ramsay Review*'). The aim of the *Ramsay Review* was to improve consumer financial dispute resolution.[4] The expert panel produced 11 recommendations for the improvement of Australia's financial system EDR framework in its final report ('*Ramsay Review Final Report*'),[5] several of which formed the substance of the *AFCA Act*, amending the *Corporations Act 2001* (Cth) ('*Corporations Act*') to implement these recommendations.

This article will assess AFCA's legitimacy, and therefore its potential value to Australia's consumer financial dispute resolution landscape, by identifying and analysing legitimacy gaps in the largest of the Predecessor EDR Schemes, FOS.[6] Given the structural and functional similarities of the Predecessor EDR Schemes, only certain novel features of the smaller CIO will be highlighted where relevant. The analysis will be conducted against a working model of legitimacy and give rise to a parallel assessment of the new AFCA regime. The central question to be answered is whether AFCA's creation and replacement of the Predecessor EDR Schemes has effectively addressed legitimacy gaps evident therein. Does AFCA reflect a new *and* improved financial EDR framework, or simply a new one? As put by one Australian senator who referred to FOS' perceived flaws as 'gremlins

2 For example, the Review of the Four Major Banks, Parliament's scrutiny of Australia's 'Big Four' bank CEOs, and most recently the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('Banking Royal Commission'): see, eg, House of Representatives Standing Committee on Economics, Parliament of Australia, *Review of the Four Major Banks: First Report* (2016); Jonathan Shapiro, 'Brace Yourself For a Week of Banking Drama', *The Australian Financial Review* (online), 3 October 2016 <http://www.afr.com/business/banking-and-finance/financial-services/brace-yourself-for-a-week-of-banking-drama-20161002-grt9hs>; Fleur Anderson, 'Forget the Budgie Nine … Ho Hum, It's the Four Big Bankers', *The Australian Financial Review* (Sydney), 7 October 2016, 6; Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (28 September 2018), <https://financialservices.royalcommission.gov.au>.

3 Kelly O'Dwyer and Craig Laundy, 'Consumers Win as a One-Stop-Shop for Financial Complaints Passes through Parliament' (Joint Media Release, 14 February 2018).

4 Kelly O'Dwyer, 'New Independent Expert Panel' (Media Release, 5 May 2016).

5 Review into Dispute Resolution and Complaints Framework, 'Final Report: Review of the Financial System External Dispute Resolution and Complaints Framework' (Final Report, 3 April 2017) 14–17 ('*Ramsay Review Final Report*').

6 In the 2016–17 financial year, FOS received 39 479 complaints, whereas the CIO received approximately 6000 and the SCT received 2138: FOS, 'Annual Review 2016–17' (Annual Review, October 2017) 4; CIO, 'Annual Report 2017' (Annual Report, 19 October 2017) 6; SCT, 'Annual Report 2016–17' (Annual Report, 2017) 2.

in the system', '[i]f FOS has things going wrong and there are going to [be] the same benchmark criteria for AFCA, what's the point of that?'.[7]

Part II of this article will summarise financial system EDR in Australia and the policy objectives underpinning it, distinguishing the Predecessor EDR Schemes from the SCT as a statutory body. Part III will discuss the importance of legitimacy in financial dispute resolution bodies and propose a working model of legitimacy by reference to various legitimacy standards, in particular, those proposed by Weber, Suchman and Hurd. Part IV will examine the Predecessor EDR Schemes and AFCA by applying the working model, identifying legitimacy gaps problematic in the Predecessor EDR Schemes and assessing whether these gaps will continue in AFCA. By way of comparison, reference will be made to the largely independent framework established for superannuation complaints following the collapse of the SCT into AFCA.

II AUSTRALIAN FINANCIAL SYSTEM EDR AND POLICY

A The Policy of EDR Schemes

Financial system policy drives the design of financial system EDR. Before commencing substantive analysis, a consideration of the financial services policy and regulation in which EDR exists is required. The Australian financial services regulatory model is largely based on the 1997 Financial System Inquiry ('*Wallis Report*').[8] In seeking to define the principles of effective financial services regulation, the *Wallis Report* identified three broad purposes of financial regulation:

1. ensuring that 'markets work efficiently and competitively';
2. prescribing particular standards of service to promote financial safety; and
3. achieving consumer objectives.[9]

This was echoed by the subsequent 2014 Financial System Inquiry ('*Murray Report*'), which highlighted that the financial system needs to operate in an efficient, resilient and fair manner.[10] The *Murray Report* demonstrated greater encouragement than previously seen towards fairness as a regulatory goal, for example by describing the prevalence of 'unfair consumer outcomes' as a regulatory weakness and stressing that '[f]inancial firms need to place a high degree of importance on treating customers fairly'.[11] The *Ramsay Review*

7 Cara Waters, '"A Very Unusual Case": Financial Ombudsman Service's Failings Laid Bare Before Royal Commission', *Sydney Morning Herald* (online), 28 May 2018 <https://www.smh.com.au/business/small-business/a-very-unusual-case-financial-ombudsman-service-s-failings-laid-bare-before-royal-commission-20180528-p4zhwo.html>.

8 Financial System Inquiry, 'Final Report', (Final Report, March 1997) ('*Wallis Report*'); Gail Pearson, *Financial Services Law and Compliance in Australia* (Cambridge University Press, 2009) 20.

9 *Wallis Report*, above n 8, 177–8.

10 Financial System Inquiry, 'Final Report' (Final Report, November 2014) xv ('*Murray Report*').

11 Ibid xiii, 6.

acknowledged the importance of policy positions taken in the *Wallis* and *Murray Reports*.[12]

These positions are evident in chapter 7 of the *Corporations Act,* which regulates financial services. Chapter 7 is directed at promoting 'confident and informed decision making by consumers', fairness and honesty in financial services providers and fair, orderly and transparent markets for financial products.[13] The *AFCA Act* inserted part 7.10A into chapter 7, creating AFCA and amending the existing landscape to pave the way for AFCA's function as a one-stop-shop for consumer financial disputes. Financial EDR consists of two primary functions which serve chapter 7's policy goals: (1) providing a forum for promoting consumer confidence and safety by addressing individual consumer grievances; and (2) assisting to secure compliance from financial services providers.

In relation to the first function, low-cost and accessible dispute resolution is a pillar of a well-functioning financial system,[14] which directly influences consumer protection and indirectly affects market integrity.[15] EDR, in theory, satisfies this policy imperative by providing substantive relief, free of charge, to consumers in a manner more obtainable than the often lengthy and expensive judicial route.

The second function consists of two activities which are regulatory in flavour but not the acts of a regulator: (1) widespread private enforcement which encourages compliance from financial services providers; and (2) data collection, systemic issue identification and reporting, which better informs and enables regulators.[16] These activities, further discussed below, can be described as the exercise of an institutional regulatory tool. On this basis, financial system EDR bodies can be seen as quasi-public bodies whose existence is mandated by government to achieve a desired public benefit.

Regulatory approaches adopted to meet these policy goals should anticipate the method of enforcement in order to be effective.[17] EDR is a method of private enforcement, decisions from which 'may well have the effect of influencing perceptions of the law … if not the development of the law itself.'[18] This is consistent with the view that sanctions afforded to ASIC 'supplement a broader system of private redress'.[19] EDR is a prominent figure in that system of private

12 *Ramsay Review Final Report*, above n 5, 20, 34.

13 *Corporations Act* ss 760A(a)–(b).

14 *Murray Report*, above n 10, 6, 197.

15 *Wallis Report*, above n 8, 237–8. See also recent comments made by ASIC Deputy Chair Peter Kell: 'Fair, timely and effective dispute resolution is a cornerstone of the financial services consumer protection framework': Australian Securities and Investments Commission, 'ASIC Welcomes Establishment of the Australian Financial Complaints Authority' (Media Release, 18-041MR, 14 February 2018).

16 Such systemic issue identification by FOS has been clearly demonstrated in evidence collected by the Banking Royal Commission: see, eg, Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report* (2018) vol 1, 9, 171, 174.

17 Robert Baldwin, 'Why Rules Don't Work' (1990) 53 *Modern Law Review* 321, 328; Julia Black, *Rules and Regulators* (Clarendon Press, 1997) 47.

18 Paul O'Shea, 'Underneath the Radar: The Largely Unnoticed Phenomenon of Industry Based Consumer Dispute Resolution Schemes in Australia' (2004) 15 *Australasian Dispute Resolution Journal* 156, 157.

19 Department of the Treasury, 'Review of Sanctions in Corporate Law' (Review, 5 March 2007) vii.

redress and thus must be accounted for in the financial system regulatory approach, and vice versa.

Predecessor EDR Schemes' collective size, position and substantive power afforded them the potential to influence the law or perception of the law. In the 2015/16 financial year FOS, CIO and SCT received approximately 41 000 disputes combined.[20] The overwhelming majority of these – 34 095 – were received by FOS.[21] This number has continued to increase, with FOS reporting receipt of 39 479 disputes in the 2016/17 financial year, an increase of 16 per cent on the previous year.[22] Most recently in the 2017/18 financial year, the number of complaints received by FOS rose to 43 684, an increase of 11 per cent on the previous year.[23] This is over double the number of disputes it received in the 2008/09 financial year and demonstrates consumers' growing reliance on EDR and, by volume, FOS in particular.[24] Growth in FOS' workload has been complemented, and likely caused, by the continued widening of its subject matter and monetary value jurisdiction. Such jurisdictional expansion is a clear manifestation of the longstanding policy to encourage EDR usage. This is evident beyond the Predecessor EDR Schemes. The *Murray Report*, for example, recommended broadening industry codes to allow for a greater number of disputes to be handled by FOS,[25] clearly encouraging the continued growth of financial system EDR. This may have public consequences where outcomes are aggregated over large volumes of disputes.[26]

Systemic issue identification is closely tied to, and reliant on, the quality of an EDR body's dispute resolution function. Regulators do not have a statutory monopoly over financial services providers, who provide essentially private services. The consequence is that regulators must place greater reliance on private enforcement initiated by consumers to supplement their own compliance efforts.[27] Accessible dispute resolution services are, therefore, 'essential if the regulator is to encourage consumers to bring examples of market failure to their attention'.[28] EDR schemes' ability to process disputes effectively and vigilantly is important in

20 *Ramsay Review Final Report*, above n 5, 36.

21 Ibid. In this period the CIO received 'about … 5000 complaints' and the SCT received 2368 complaints: CIO, 'Annual Report 2016' (Annual Report, 20 October 2016) 4; SCT, 'Annual Report 2015/16' (Annual Report, 18 October 2016) 4.

22 FOS, 'Annual Review 2016–17', above n 6, 4. In this period the CIO received 'almost 6000 complaints' and the SCT received 3151 complaints: CIO, 'Annual Report 2017', above n 6, 4; SCT, 'Annual Report 2016–17', above n 6, 2.

23 FOS, 'Annual Review 2017–18' (Annual Review, 2018) 4. In this period the CIO received 6293 complaints and the SCT received 2255 complaints: CIO, 'Annual Report on Operations 2017/18' (Annual Report, 2018) 5; SCT, 'Annual Report 2017–18' (Annual Report, 21 September 2018) 6.

24 In the financial year ending 30 June 2009, FOS received 19 107 complaints: FOS, 'Annual Review 2008–2009' (Annual Review, 2009) 1.

25 *Murray Report*, above n 10, 264.

26 Paul O'Shea and Charles Rickett, 'In Defence of Consumer Law: The Resolution of Consumer Disputes' (2006) 28 *Sydney Law Review* 139, 142.

27 O'Shea, 'Underneath the Radar', above n 18, 164.

28 Michael Shames, 'Preserving Consumer Protection and Education in a Deregulated Electric Services World: Challenges for the Post-Modern Regulator' in Moazzem Hossain and Justin Malbon (eds), *Who Benefits from Privatisation?* (Routledge, 1998) 119, 144.

identifying systemic issues which may be indicative of non-compliance or regulatory gaps. Consumers' confidence in bringing disputes to a scheme is a necessary precondition of EDR schemes' systemic issue identification.

B The Industry Ombudsman Scheme Model

The Predecessor EDR Schemes and AFCA follow the industry ombudsman scheme model. The aim of that model generally is to provide a 'free, informal, speedy and cost-effective alternative to court action'.[29] This model forms the basis of most Australian industry ombudsman schemes. In Australia, industry ombudsman schemes have grown sharply in number and size since the mid-1990s.[30] This 'ombudsmania'[31] has been seen internationally across many jurisdictions and industries since the 1960s, such that one commentator suggested that the 'ombudsman institution is one of the most rapidly developing institutions in modern democratic states'.[32] Public sector ombudsmen with jurisdiction over public services were the predecessor of industry ombudsman schemes, 'established in response to … the perceived inadequacy of traditional forms of accountability'.[33] In Australia, the Commonwealth Ombudsman and its equivalent in state and territory jurisdictions are available to hear complaints from individuals who believe they have been treated 'unfairly or unreasonably' by an Australian Government agency.[34] 'Enabling factors', including 'the floating of the dollar, deregulation of the market, market misbehaviour' and government commitment to consumer protection led to the establishment of the first private industry ombudsman scheme in 1991.[35]

Since then, industry ombudsmen across all sectors have been embraced by government as 'good business practice, providing industry sectors with an external, cost-effective option to resolve disagreements with consumers'[36] and also a 'low cost way (for government) to provide consumers with access to dispute resolution outside the state/federal legal systems.'[37] Traditionally, industry ombudsman schemes have enjoyed a 'light touch' or 'hands off' regulatory approach.[38]

A unifying underlying role of both private and public sector ombudsmen is 'to promote confidence in the sector or industry to which they belong … as well as

29 Australian and New Zealand Ombudsman Association, *Ombudsman: A Particular Model of Alternative Dispute Resolution* <http://www.anzoa.com.au/about-ombudsmen.html>.

30 Paul O'Shea, 'The Lion's Question Applied to Industry-Based Consumer Dispute Resolution Schemes' (2006) 8 *ADR Bulletin* 83, 83.

31 Chris Gill et al, 'The Future of Ombudsman Schemes: Drivers for Change and Strategic Responses' (Research Report, Queen Margaret University, 15 July 2013) 9.

32 Milan Remáč, 'Coordinating Ombudsmen and the Judiciary?' (2014) 12(2–3) *International Public Administration Review* 11, 11.

33 Gill et al, above n 31, 9.

34 Commonwealth Ombudsman, *What We Do* <http://www.ombudsman.gov.au/what-we-do>.

35 Bill Dee, Simon Smith and John Wood, 'Industry Ombudsman Schemes Twenty Years On: World Benchmark or Industry Captured?' (2009) 34 *Alternative Law Journal* 183, 183.

36 The Treasury, 'Key Practices for Industry-Based Customer Dispute Resolution' (Key Practices, February 2015) 3 ('*Ombudsman Key Practices*').

37 Dee, Smith and Wood, above n 35, 183.

38 Ibid 184, 187.

achieve changes in industry or sector behaviour, and redress of grievance either on a system-wide or individual basis'.[39] As one former Commonwealth Ombudsman observed, '[o]mbudsman schemes are an integral part of a framework that provides access to justice, to consumers as well, and [they] contribute significantly to the standards of public administration'.[40] His observations are directly applicable to contemporary industry ombudsmen schemes in Australia and are reflected in their structure and function.

In Australia, most ombudsmen are members of the Australian and New Zealand Ombudsman Association ('ANZOA'), the 'peak body for ombudsmen'. According to ANZOA, ombudsmen are 'the leaders in independent resolution, redress and prevention of disputes'.[41] Membership ensures that industry ombudsmen conform with certain principles and embody certain structural and functional features.[42] These principles and features have been designed in consultation with the Australian Government and published by Treasury. The principles, enshrined in the Benchmarks for Industry-Based Consumer Dispute Resolution ('*Ombudsman Benchmarks*'), are accessibility, independence, fairness, efficiency and effectiveness.[43] They are complemented by the Key Practices for Industry-based Dispute Resolution ('*Ombudsman Key Practices*'), which provide guidance on implementation of the *Ombudsman Benchmarks*.

The *Ombudsman Benchmarks* and *Ombudsman Key Practices*, together with widespread ANZOA membership, establish a high degree of uniformity across industry ombudsman schemes. This uniformity is evidenced by the widespread practices adopted by industry ombudsman schemes. Near universal features of industry ombudsman schemes include that they are free of charge for complainants, a non-adversarial approach, independence from scheme members, publication of determinations and activities, and regular independent review.[44]

Given the breadth of the industries to which similar features have been applied through the industry ombudsman model, it is necessary to consider the tailoring of these features to each sector. This article, whilst not seeking to assess the legitimacy of industry ombudsman schemes generally, will incorporate this analysis in its discussions of FOS and AFCA's legitimacy to glean whether identified legitimacy gaps necessarily exist by virtue of the industry ombudsman model.

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39 Commonwealth Ombudsman, 'Annual Report 2007–2008' (Annual Report, October 2008) 46.

40 Commonwealth, *Exploring the Role of the Commonwealth Ombudsman in Relation to Parliament*, Parl Paper No 63 (2015) 44.

41 ANZOA, *About ANZOA* <http://anzoa.com.au/about-anzoa.html>.

42 Simon Cohen, 'Fair and Reasonable – An Industry Ombudsman's Guiding Principle' (2010) 63 *AIAL Forum* 20, 22.

43 The Treasury, 'Benchmarks for Industry-based Customer Dispute Resolution' (Benchmarks, February 2015) ('*Ombudsman Benchmarks*').

44 Cohen, above n 42, 22.

C Key Features of Financial System EDR: The Old and the New[45]

Despite the overhaul, AFCA is undeniably similar to the Predecessor EDR Schemes, including in respect of membership, approval and dispute resolution. Key differences include formality of legislative underpinning, breadth of jurisdiction and oversight arrangements. AFCA's jurisdiction to hear superannuation disputes, integrating the SCT's functions, carries with it a set of features largely independent to superannuation disputes and presents an interesting point of comparison against non-superannuation disputes. These contrasts will be raised where relevant.

1 Mandatory Membership for Australian Financial Services Licensees

FOS and CIO were industry-based ASIC-approved EDR schemes formalised, but not empowered, by statute. Former sections 912A(1)(g) and 912A(2)(b) of the *Corporations Act* required that all Australian financial services licensees ('AFS licensees') who provide services to retail clients must be members of at least one ASIC-approved EDR scheme.[46] A mirror obligation existed in the former *National Credit and Consumer Protection Act 2009* (Cth) applying to credit licensees.[47] These obligations commenced in 2002 as part of a series of financial services reforms implemented following the *Wallis Report*.[48] The reforms were intended to 'generate substantial benefits for both the industry and consumers' by '[introducing] a harmonised regulatory regime for market integrity and consumer protection' which is 'globally competitive and consumer focused'.[49] In 2002, there were seven EDR schemes operating, each with jurisdiction specific to certain products or service providers.[50] In 2008, the three largest of these were merged to establish FOS.[51] The SCT, by comparison, was a Commonwealth statutory body created by the *Superannuation (Resolution of Complaints) Act 1993* (Cth), and existed in parallel to the ASIC-approved EDR regime.

The *AFCA Act* has further consolidated Australia's financial system EDR schemes from three to one. In the same way that former provisions required AFS licensees to be members of at least one ASIC-approved EDR scheme, sections

45 This section describes the structure and function of Predecessor EDR Schemes as they were prior to the amendments made to the *Corporations Act* by the *AFCA Act*. For this reason, legislative references in this section described as 'former' refer to legislation in force immediately prior to the *AFCA Act*'s royal assent, being 5 March 2018. All other legislative references are to legislation in force at the time of writing.

46 Unlicensed product issuers and secondary sellers are also bound by these requirements: former *Corporations Act* s 1017G.

47 Former *National Credit and Consumer Protection Act 2009* (Cth) s 47(1)(i).

48 *Financial Services Reform Act 2001* (Cth) s 2(2). See also Supplementary Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [3.62]–[3.70].

49 Commonwealth, *Parliamentary Debates*, House of Representatives, 5 April 2001, 26521 (Joe Hockey).

50 These were the Financial Complaints Service, Banking and Financial Ombudsman Service, Insurance Ombudsman Service Limited, Insurance Brokers Disputes Limited, Credit Union Dispute Resolution Centre, Financial Co-operative Dispute Resolution Scheme and Credit Ombudsman Service Limited (which was renamed CIO in November 2014).

51 ASIC, 'ASIC Approves New Complaints Scheme That Promotes Better Outcomes for Consumers and Industry' (Media Release, 08-103, 20 May 2008).

912A(1)(g)(i) and 912A(2)(c) of the *Corporations Act* now require AFS licensees who provide services to retail clients to be members of AFCA.

2 Approval

Previously, EDR schemes required ASIC approval to exist. ASIC was empowered to approve EDR schemes and attach conditions to that approval.[52] ASIC's approval required an assessment of the EDR scheme against criteria stipulated in the *Corporations Regulations 2001* (Cth), namely, accessibility, independence, fairness, accountability, efficiency and effectiveness.[53] ASIC approved FOS as an EDR scheme in 2008,[54] and the CIO under a predecessor name in 2003.[55]

Approval is also required in the new framework, however, the power of approval has been reallocated to the Minister who 'may, by notifiable instrument, authorise an external dispute resolution scheme if the Minister is satisfied that the mandatory requirements under section 1051 [of the *Corporations Act*] will be met.'[56] Requirements in section 1051 include organisational, operator, operational and compliance requirements.[57] Section 1051A lists general considerations which must be considered by the Minister in approving an EDR scheme. They are the same as ASIC's previous EDR approval criteria and the *Ombudsman Benchmarks*: accessibility, independence, fairness, accountability, efficiency and effectiveness.[58]

3 Jurisdiction

As is typical in industry ombudsmen, the Predecessor EDR Schemes' jurisdiction was based in contract. FOS' jurisdiction empowered it to deal with a diverse range of complaints relating to financial and credit products and services brought by consumers and small businesses against banks, credit unions, foreign exchange dealers, deposit takers, credit providers, mortgage brokers, general insurers, insurance brokers, life insurers, funds managers, financial advisers and planners, stockbrokers and some superannuation providers.[59] FOS' monetary jurisdictional limits prevented it from:

1. considering disputes valued over $500 000;[60]

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52 Former *Corporations Regulations 2001* (Cth) reg 7.6.02(3)–(4).

53 Former *Corporations Regulations 2001* (Cth) reg 7.6.02(3).

54 ASIC, 'ASIC Approves New Complaints Scheme', above n 51.

55 ASIC, 'Mortgage Industry Ombudsman Scheme Approved by ASIC' (Media Release, 03-411, 22 December 2003).

56 *Corporations Act* s 1050(1).

57 *Corporations Act* s 1051(1).

58 *Corporations Act* ss 1050(2)(a), 1051A.

59 FOS, 'Terms of Reference' (1 January 2015) [4.2]–[4.3] <https://www.fos.org.au/custom/files/docs/fos-terms-of-reference-1-january-2010-as-amended-1-january-2015.pdf> ('*FOS Terms of Reference*'); ASIC, *ASIC-Approved Dispute Resolution Schemes* (16 June 2016) <http://asic.gov.au/regulatory-resources/financial-services/dispute-resolution/asic-approved-dispute-resolution-schemes>.

60 *FOS Terms of Reference*, above n 59, [5.1(o)].

2. awarding over $309 000 in compensation;[61] and
3. considering small business credit facility claims valued over $2 million.[62]

CIO's jurisdiction covered similar subject matters with the addition of privacy related complaints, and had lower monetary limits.[63]

AFCA's jurisdiction is significantly broader than the Predecessor EDR Schemes'. AFCA combines the subject matter jurisdiction of FOS, the CIO and the SCT and is empowered to hear complaints about financial firms in relation to a broadly defined category of financial services and superannuation complaints.[64] AFCA also enjoys higher monetary limits for the disputes it can consider:

1. unlimited value for superannuation disputes;[65]
2. maximum $1 million for the amount claimed in non-superannuation consumer disputes, excluding those of the type listed in point 3 below;
3. unlimited value for the amount claimed in non-superannuation consumer disputes involving the setting aside of a guarantee supported by security over the guarantor's principal place of residence; and
4. maximum $5 million for claims relating to credit facilities provided to a small business and primary producer,[66]

and the value of compensation it can award:

5. unlimited value for superannuation disputes;[67]
6. maximum $500 000 for non-superannuation consumer disputes, excluding those of the type listed in point 7 below;
7. unlimited value for the amount claimed in non-superannuation consumer disputes involving the setting aside of a guarantee supported by security over the guarantor's principal place of residence; and
8. depending on the type of security involved, maximum $1 million or $2 million for claims arising from credit facilities provided to a small business or primary producer.

In addition, the *Corporations Act* allows for these monetary limits to be increased if ASIC believes such an increase is required.[68]

Consistent with *Ombudsman Key Practices*, AFCA itself determines whether a complaint falls within its jurisdiction,[69] and can exercise discretion in excluding

61 Ibid sch 2.
62 Ibid [5.1(r)].
63 CIO, *Rules & Guidelines* (2018) <https://www.cio.org.au/about-us/cio-rules.html>.
64 AFCA, *Complaint Resolution Scheme Rules*, (Rules, 1 November 2018) [B.1]–[B.2], [E.1] (definitions of 'Financial Firm', 'Financial Service' and 'Superannuation Complaint') ('*AFCA Rules*').
65 Ibid [D.1.3].
66 These are defined terms in the *AFCA Rules*: ibid [E.1] (definitions of 'Small Business' and 'Primary Producer').
67 Ibid [D.1.3].
68 *Corporations Act* s 1052B.
69 *AFCA Rules*, above n 64, [A.4.4]; *Ombudsman Key Practices*, above n 36, [1.22].

a complaint. Alternatively, AFCA can consider a complaint if it and all parties agree in writing.[70]

4 Organisation and Oversight

FOS' recognised aim was to provide low-cost dispute resolution services, conducted with minimal technicality.[71] FOS was a company limited by guarantee. Its constitution, Terms of Reference and operational guidelines together set out FOS' jurisdiction, membership requirements and dispute resolution procedures. The *FOS Terms of Reference* were approved by ASIC against criteria of accessibility, independence, fairness, accountability, efficiency and effectiveness as stipulated in the *Corporations Regulations 2001* (Cth).[72] FOS was independent of government and industry but overseen by ASIC, whose mandate was to oversee the effective operation of EDR schemes.[73] FOS' systemic issue identification mandate arose from its obligation to identify and 'report any systemic, persistent or deliberate conduct' to ASIC.[74] The *Ramsay Review* suggested that systemic issue investigation and reporting 'acts as a deterrent and encourages good behaviour'.[75] But for nomenclature, CIO was largely identical in its organisational and oversight features.[76]

The *Ramsay Review* praised these features for their facilitation of flexibility in dispute resolution.[77] As such, it is unsurprising that the same organisational and oversight features have been replicated and, in some cases, amplified in AFCA. It too is a company limited by guarantee, constituted by a constitution and operating according to scheme rules ('*AFCA's Rules*') and operational guidelines. Many features have been legislatively entrenched as 'mandatory requirements' in the *Corporations Act*.[78] For example, AFCA must be a company limited by guarantee,[79] AFCA membership must be open to all entities required to be members[80] and AFCA must report systemic issues to APRA, ASIC or the Commissioner of Taxation.[81] AFCA's constitution also refers to its obligations 'required by or contemplated by Law', in relation to the establishment and

70 *AFCA Rules*, above n 64, [A.4.7].

71 *Cromwell Property Securities Ltd v Financial Ombudsman Service Ltd* (2014) 288 FLR 374, 433 [230] (Tate JA).

72 Former *Corporations Regulations 2001* (Cth) reg 7.6.02(3).

73 ASIC, 'Approval and Oversight of External Dispute Resolution Schemes' (Regulatory Guide No 139, June 2013) 11 [31].

74 Ibid 26 [117].

75 *Ramsay Review Final Report*, above n 5, 75.

76 CIO, 'Credit and Investments Ombudsman Rules 10th Edition' (Rules, 15 August 2016) [1]–[2], [11], [41] ('*CIO Rules*').

77 *Ramsay Review Final Report*, above n 5, 102, 119.

78 For example, AFCA must be a company limited by guarantee: *Corporations Act* s 1051(3)(b); AFCA membership must be open to all entities required to be members: *Corporations Act* s 1051(2)(a); AFCA must report systemic issues to Australian Prudential Regulation Authority ('APRA'), ASIC or the Commissioner of Taxation: *Corporations Act* ss 1052E(4), 1051(5)(a)(iv).

79 *Corporations Act* s 1051(3)(b).

80 *Corporations Act* s 1051(2)(a).

81 *Corporations Act* ss 1052E(4), 1051(5)(iv).

maintenance of its EDR functions.[82] ASIC similarly oversees AFCA, but with significantly increased oversight powers, discussed further below at Part IV(3).[83]

5 Determination of Disputes

(a) Dispute Resolution Powers

The Predecessor EDR Schemes' dispute resolution powers were entirely contractual. FOS' dispute resolution process was as such:

1. a consumer would lodge a dispute with FOS against a financial services provider who was a member of FOS;[84]
2. when this happened, the *FOS Terms of Reference* became a tripartite contract between FOS, the consumer and the financial services provider;[85]
3. FOS would consider whether it had jurisdiction over the dispute and whether it should exercise its discretion to exclude a dispute;[86] and
4. if FOS decided it had jurisdiction, it was contractually empowered by the *FOS Terms of Reference* to use a 'wide range of methods to resolve a Dispute'[87] including negotiation, conciliation, mediation or determination.[88]

A financial services provider could only lodge a dispute with FOS with a consumer's consent.[89]

AFCA's dispute resolution powers are similarly based in contract, with the *AFCA Rules* containing the substance of its dispute resolution procedure. The *AFCA Constitution* expressly states that its provisions and 'the Applicable Rules in respect of a complaint … shall form a binding contract between each Member and [AFCA]'.[90] As will be elaborated in the following sections, the *AFCA Rules* mirror the jurisdictional and dispute resolution processes used by FOS.

(b) Multi-tiered Dispute Resolution Process

FOS employed a multi-tiered dispute resolution process. First, financial services providers' internal dispute resolution systems and facilitated methods such as negotiation, conciliation and mediation were engaged. Where these were unsuccessful, FOS would make a non-binding recommendation which was 'a comprehensive assessment that [set] out: all the relevant facts of the Dispute; the

82 AFCA, 'Constitution' (Constitution, 1 March 2018) [2.1(a)(b)] ('*AFCA Constitution*').

83 For ASIC's general directions power, see *Corporations Act* s 1052C. For ASIC's other oversight powers, see *Corporations Act* ss 1052A, 1052B, 1052BA, 1052D.

84 *FOS Terms of Reference*, above n 59, [6.1].

85 As has been judicially confirmed: see, eg, *Cromwell Property Securities Ltd v Financial Ombudsman Service Ltd* (2014) 288 FLR 374, 378 [6] (Warren CJ); *Bilaczenko v Financial Ombudsman Service Ltd* [2013] FCA 1268 (29 November 2013) [6]–[7] (Mansfield J); *Wealthsure Pty Ltd v Financial Ombudsman Service Ltd* [2013] FCA 292 (4 April 2013) [5] (Gilmour J).

86 *FOS Terms of Reference*, above n 59 [5.1]–[5.2].

87 FOS, 'Operational Guidelines to the Terms of Reference' (Guidelines, 1 January 2018) 60 ('*Terms of Reference Operational Guidelines*').

88 *FOS Terms of Reference*, above n 59, [7.1].

89 Ibid [6.1(c)].

90 *AFCA Constitution*, above n 82, [12.1(d)].

information relied on; the view reached by FOS about how the Dispute should be resolved; and the reasons for that view'.[91] If a consumer rejected FOS' recommendation, upon the consumer's agitation 'FOS [would] proceed to a determination by an Ombudsman, an Adjudicator or by a FOS panel'.[92]

AFCA employs the same multi-tiered dispute resolution process, whereby it 'generally [tries] to resolve a complaint by informal methods'.[93] This non-adversarial approach is consistent with the Ombudsman Benchmark of accessibility, according to the *Ombudsman Key Practices* which suggests an industry ombudsman should use 'appropriate techniques including conciliation, mediation and negotiation in attempting to settle complaints.'[94] If unsuccessful, AFCA may proceed to making a 'preliminary assessment' which '[sets] out reasons for any conclusions made about the merits of the complaint and … [provides] a recommendation as to how the complaint should be resolved'.[95] If a preliminary assessment is not accepted by either disputing party, it is followed by a determination.[96]

(c) Effect and Enforcement of Determinations

The tripartite contract required the financial services provider to perform the stipulations of a determination made by FOS, which '[was] a final decision and [was] binding' upon the financial services provider if the consumer accepted the determination.[97] There was no right of appeal within FOS. If the financial services provider did not comply with the determination, the consumer and FOS could commence court proceedings against the non-compliant financial services provider to enforce the tripartite contract. If the consumer rejected the determination, they could pursue any legal right available to them, including litigation. In contrast, the CIO had a limited internal appeal process by which a determination could be reviewed upon a party's request if the CIO was satisfied that the determination contained a clerical mistake, material error, oversight or omission, material miscalculation, defect in form or the determination did not reflect the CIO's 'actual intentions'.[98]

For non-superannuation complaints, AFCA's determinations are similarly 'final, and binding upon the parties if accepted by the Complainant'.[99] If a complainant rejects AFCA's determination, they may take 'any other available action against the Financial Firm'.[100] This arises from provisions now in the *Corporations Act,* which state that determinations are 'binding on members of the

91 *Terms of Reference Operational Guidelines,* above n 87, 83.
92 *FOS Terms of Reference,* above n 59, [8.5]. FOS also has the power to expedite disputes to the determination stage: [8.6].
93 *AFCA Rules,* above n 64, [A.8.1].
94 *Ombudsman Key Practices*, above n 36, [1.24].
95 *AFCA Rules*, above n 64, [A.12.1].
96 Ibid [A.8.1].
97 *FOS Terms of Reference*, above n 59, [8.7(b)].
98 *CIO Rules*, above n 76, [39.4].
99 *AFCA Rules*, above n 64, [A.15.3].
100 Ibid [A.15.4].

scheme; but not binding on complainants under the scheme'.[101] If the financial services provider does not comply with a determination, it may be expelled as a member of AFCA and therefore be in breach of its statutory requirements under the *Corporations Act*.[102] These features replicate FOS' previous structure, but for the added layer of statutory direction contained in the *Corporations Act*.

(d) Reasoning

FOS' reasoning was based on 'legal principles; applicable industry codes or guidance … good industry practice; and previous relevant decisions of FOS or a predecessor scheme (although FOS [was] not … bound by these)', in accordance with what was in FOS' opinion fair in all of the circumstances.[103]

This same reasoning is used by AFCA's decision makers for non-superannuation complaints, who 'must do what [they consider] is fair in all the circumstances having regard to: legal principles, applicable industry codes or guidance, good industry practice and previous relevant Determinations of AFCA or Predecessor Schemes'.[104] The relation to the Ombudsman Benchmark of fairness and *Ombudsman Key Practices* is clear, as the latter requires that '[t]he decision-maker bases final determinations on what is fair and reasonable, having regard to good industry practice, relevant industry codes of practice and the law.'[105] AFCA's decision makers are 'not bound by rules of evidence or previous AFCA or Predecessor EDR Scheme decisions'.[106] The near identical wording of the *AFCA Rules* and the *FOS Terms of Reference* in this regard, as was recommended by the *Ramsay Review*, suggests that there will be little substantive difference between FOS and AFCA's dispute resolution processes and substantive decision making.[107]

6 Superannuation Disputes

The addition of superannuation disputes into the ombudsman-style EDR system is entirely new. The *Ramsay Review* acknowledged that '[s]uperannuation disputes can have unique and complex characteristics, which can distinguish them from other financial disputes', 'not only because of factual matters but also due to the complex intersection of trust law and statutory regulation',[108] and as such should be 'supported by appropriate statutory provisions'.[109] Consistent with this acknowledgement, AFCA is bound by a parallel system for the resolution of superannuation-related complaints, dictated by statute. The source of most rules concerning the resolution of superannuation complaints in AFCA is the *Corporations Act*, whereas the equivalent for non-superannuation complaints is

101 *Corporations Act* s 1051(4)(e).
102 *AFCA Constitution*, above n 82, [3.4(a)(i)].
103 *FOS Terms of Reference*, above n 59, [8.2].
104 *AFCA Rules*, above n 64, [A.14.2].
105 *Ombudsman Key Practices*, above n 36, [3.1].
106 *AFCA Rules*, above n 64, [A.14.3].
107 The *Ramsay Review Final Report* recommended that FOS' decision-making test of fairness should be adopted by AFCA: above n 5, 126.
108 Ibid [7.2].
109 Ibid 139.

largely the *AFCA Rules* or *AFCA Constitution*. The *Corporations Act* sets out the circumstances in which superannuation complaints can be made to AFCA,[110] the process and basis on which AFCA will make determinations,[111] the effect of those determinations,[112] AFCA's powers in making those determinations,[113] and the right of either party to appeal to the Federal Court on questions of law.[114]

In some regards, there is a material difference between the approach AFCA must take for superannuation and non-superannuation disputes. The reasoning of determinations is a notable example. As described above, fairness is the overriding consideration that AFCA decision makers must consider for non-superannuation disputes: determinations do not have to be made in accordance with the law. Determinations of superannuation complaints, however, must comply with the law.[115]

III LEGITIMACY AS A METRIC OF EDR SCHEMES

A The Necessity of Legitimacy

Legitimacy is imperative for financial system EDR if it is to successfully contribute to the regulation, enforcement and functioning of Australian financial services regulation. Legitimacy gaps hinder an EDR body's ability to perform its functions and, by extension, hinder the optimal performance of the Australian financial services sector. As described above, the Predecessor EDR Schemes were private companies and lacked the traditional elements of a public state-sanctioned tribunal. AFCA, leaving to one side its largely statute-regulated superannuation functions, is the same. Statutory underpinning and public purpose, however, prevent the Predecessor EDR Schemes and AFCA from being described as wholly private, notwithstanding that independence is one of their underpinning principles. This discrepancy makes them novel legal creatures, a status which raises questions about legitimacy.

Until the *Ramsay Review*, analysis of EDR schemes had been 'scant'.[116] In times where financial firms and the legal regime in which they operate are under increasingly close scrutiny, further discussion of the EDR framework is necessary. This is especially so following the significant reforms which have inserted AFCA squarely into that legal regime. The remainder of this article will present analysis on this new addition through the lens of legitimacy, identifying 'legitimacy gaps' in FOS as a means of assessing AFCA's prospective legitimacy and capacity to meet policy imperatives. Though comprehensive in other respects, the *Ramsay Review* did not specifically consider legitimacy. This article's core proposition is

110 *Corporations Act* s 1053.
111 *Corporations Act* s 1055.
112 *Corporations Act* s 1055B.
113 See, eg, *Corporations Act* ss 1054, 1054A.
114 *Corporations Act* s 1057.
115 *Corporations Act* s 1055(7)(a).
116 O'Shea, 'Underneath the Radar', above n 18, 169.

that legitimacy gaps were evident in the Predecessor EDR Schemes. Whilst these may have not be fatal to the legitimacy of the financial system, such gaps gave rise to accusations of there being 'gremlins in the [financial EDR] system,' which in turn created consumer doubts about the safety and fairness of financial products.

Legitimacy is an important metric for assessing institutional bodies. Practically, legitimacy is a 'critical element in motivating behavioural responses'.[117] Motivating behavioural responses is key to voluntary compliance, which has been said to be the 'bedrock of regulation'.[118] EDR schemes can motivate behavioural responses directly and indirectly, both being referable to the nature and purpose of industry ombudsman schemes generally, as discussed above. EDR schemes can directly motivate the behaviour of financial services providers towards individual customers in individual disputes, for example, by rectifying misconduct through compensation or other remedies. Indirectly, they can motivate behaviour of financial services providers towards future customers through their referral of potential systemic issues to ASIC. This indirect function illustrates an implied deterrent effect of the dispute resolution body.

The success of regulatory and enforcement regimes can, therefore, turn on whether they are legitimate.[119] Legitimacy is strongly connected to a body's ability to perform its functions adequately, more easily and ultimately better.[120] If AFCA is legitimate, it will motivate behavioural responses and be better placed to achieve its purposes. Conversely, organisations that lack legitimacy 'are more vulnerable to claims that they are negligent, irrational or unnecessary'.[121] Legitimacy also enhances the 'stability and comprehensibility' of a body's activities.[122] Stability and comprehensibility are particularly important in retail financial services because of the inherent instability that arises from uncontrollable market factors, innovative financial products and technology, a rapidly changing regulatory landscape, and so on. It is also a highly complex field in which retail clients, by definition, lack skill.[123]

B A Working Model of Legitimacy

EDR legitimacy can be evaluated against a theoretical and functional working model of legitimacy. In establishing a working model, this article does not seek to evaluate the aspects of various legitimacy models themselves, but instead to adopt

117 Julia Black, 'Legitimacy and the Competition for Regulatory Share' (Working Paper No 14/2009, London School of Economics and Political Science, 2009) 13, citing M Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' (1995) 20(3) *Academy of Management Review* 571.

118 Pearson, above n 8, 21.

119 Julia Black, 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes' (2008) 2 *Regulation & Governance* 137, 139.

120 Karl DeRouen Jr and Shaun Goldfinch, 'What Makes States Stable and Peaceful? Good Governance, Legitimacy and Legal-Rationality Matter Even More for Low-Income Countries' (2012) 14 *Civil Wars* 499, 504.

121 John W Meyer and Brian Rowan, 'Institutionalized Organizations: Formal Structure as Myth and Ceremony' in Walter W Powell and Paul J DiMaggio (eds), *The New Institutionalism in Organizational Analysis* (University of Chicago Press, 1991) 41, 50.

122 Suchman, above n 117, 574.

123 *Corporations Act* ss 761G, 761GA.

elements of the wider legitimacy literature which are most appropriate in this context.

Legitimacy can be viewed in two primary ways: descriptive and normative. If interpreted as a descriptive concept, legitimacy refers to beliefs about authority and obligations.[124] According to Weber, who presents an entirely descriptive idea of legitimacy, 'the basis of every system of authority, and correspondingly of every kind of willingness to obey, is a belief, a belief by virtue of which persons exercising authority are lent prestige'.[125] In contrast, normative legitimacy 'refers to some benchmark of acceptability or justification'.[126] The content of these benchmarks or justifications will, understandably, vary according to the nature and purpose of the authority seeking legitimacy.

EDR schemes are a dispute resolution forum, therefore, it is appropriate to invoke institutional and judicial legitimacy frameworks to establish a working model. Suchman defines legitimacy for the purposes of assessing institutional legitimacy as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions'.[127] Hurd highlights an additional relevant quality of legitimacy, being a 'belief by an actor that a rule or institution ought to be obeyed'.[128] Framed in this way, legitimacy is an objective fact dependent on participants' perceptions. These approaches follow the descriptive concept of legitimacy. The legitimacy analyses which follow, therefore, ask whether the design features of FOS and AFCA display characteristics that lead to a belief that they have authority and rightfully bestow obligations.

Institutional legitimacy is said to comprise of at least three subspecies of legitimacy:[129]

1. Moral legitimacy – is the body performing a function which is 'the right thing to do?'[130]
2. Pragmatic legitimacy – are the body's activities supported because it is seen as being responsive to individual participants' interests?[131]

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124 Fabienne Peter, 'Political Legitimacy' in Edward N Zalta (ed), *The Stanford Encyclopaedia of Philosophy* (Metaphysics Research Lab, Stanford University, Summer 2017 Edition) <https://plato.stanford.edu/archives/sum2017/entries/legitimacy/>.

125 Max Weber, *The Theory of Social and Economic Organization* (Free Press, 1964) 382.

126 Peter, above n 124.

127 Suchman, above n 117, 574. This definition is adopted by a number of scholars: see, eg, Black, above n 119, 144.

128 Ian Hurd 'Legitimacy and Authority in International Politics' (1999) 53 *International Organization* 379, 381.

129 These three metrics have also been adopted by Julia Black: Black, above n 119; and Mark Suchman: Suchman, above n 117.

130 Howard E Aldrich and C Marlene Fiol, 'Fools Rush In? The Institutional Context of Industry Creation' (1994) 19 *Academy of Management Review* 645, 648. The terms 'moral legitimacy', 'normative legitimacy' and 'sociopolitical legitimacy' are used interchangeably in the literature. This article will adopt the term moral legitimacy.

131 Suchman, above n 117, 578–9.

3. Cognitive legitimacy – is the body and its function perceived as inevitable such that it is 'taken-for-granted'?[132]

Each of these subspecies of legitimacy has constituent elements which can be used to tangibly assess legitimacy.

Black suggests that a body's legitimacy can be 'challenged', causing legitimacy gaps to arise, and 'constructed', causing legitimacy gaps to be resolved.[133] That approach is consistent with Weber's use of the word 'lent' in relation to the authority underpinning legitimacy, indicating that legitimacy is not absolute nor forever. Black's language of challenging and constructing legitimacy will be adopted in the following sections.

Of these three subspecies of legitimacy, moral legitimacy best lends itself to an objective discussion, which makes its assessment the most useful in evaluating FOS and AFCA. Pragmatic legitimacy centres on expected value to individual participants as a measure of support.[134] Factors which contribute to pragmatic legitimacy include efficiency and ease-of-use. These are inherently subjective, experience-dependent and difficult to measure. These factors are also discussed at length in the *Ramsay Review Final Report*. Cognitive legitimacy is demonstrated by a body's 'taken-for-grantedness'. Pragmatic and cognitive legitimacy will follow moral legitimacy, which makes moral legitimacy a key indicator of legitimacy more broadly.

The question raised in assessing moral legitimacy is 'whether the activity [undertaken by an institution] is "the right thing to do"'.[135] Weber divides moral legitimacy into four components: procedural, structural, consequential and personal. The following part will address in detail the first three of Weber's legitimacy components. Personal legitimacy will not be discussed as it relates to support garnered by individual institutional members; its transience makes its assessment non-essential for the purposes of this article.

IV IDENTIFYING LEGITIMACY GAPS

This part will apply the working model of legitimacy to FOS, as an example of the Predecessor EDR Schemes, to identify legitimacy gaps in its structure and features described in Part II(C). This exercise will serve as a platform to answer the question of whether AFCA's establishment has or will rectify these legitimacy gaps and, in turn, assess AFCA's prospective legitimacy.

132 Ibid 582; Ronald L Jepperson, 'Institutions, Institutional Effects, and Institutionalism' in Walter W Powell and Paul J DiMaggio (eds), *The New Institutionalism in Organizational Analysis* (University of Chicago Press, 1991) 143, 147; Aldrich and Fiol, above n 130, 648.

133 Black, above n 119.

134 Suchman, above n 117, 578–9.

135 Ibid 579.

A Procedural Legitimacy

Procedural legitimacy is assessed on the means by which a body achieves its ends. Some have argued that legitimacy is wholly dependent on a belief that a correct process has been followed.[136] EDR schemes' procedural legitimacy may be assessed by analogy with procedural legitimacy held by judicial bodies. It is generally accepted that courts have high procedural legitimacy, causing their decisions to carry an obligation to accept and obey even when those decisions are disagreeable.[137] It is thus instructive to compare the hallmarks of judicial procedure with FOS and AFCA's procedures.

1 Decision-Making Process

(a) Legitimacy Gaps in the Decision-Making Standard

FOS' decision-making process was guided first by fairness and second by 'legal principles; applicable industry codes or guidance … good industry practice; and previous relevant decisions of FOS or a Predecessor Scheme'.[138] FOS applied this reasoning standard generally and also in relation to questions of law when FOS interpreted legislation and case law.[139] For example, in *FOS Determination 264676*, FOS interpreted the breath of section 46 of the *Insurance Contracts Act 1984* (Cth) ('*ICA*') which relates to pre-existing defects. It did so by referring to case law that the financial services provider submitted was relevant and applied common law tests to evidence before it.[140] In *FOS Determination 278925*, FOS interpreted section 47 of the *ICA* concerning a life insurance policy and the existence of pre-existing health conditions, noting the absence of appropriate judicial authority on section 47's interpretation.[141] In *FOS Determination 211826*, FOS interpreted section 54 of the *ICA* which lists circumstances where an insurer's liability is reduced if a claimant contributes to a claimed loss. FOS was required to determine its application to a motor vehicle insurance policy.[142] To do so, FOS interpreted case law on section 54's application and relied on tests set out in those cases to determine the financial services provider's liability.[143] In one dispute, FOS declined to hear a dispute on the grounds that the primary legal question of whether the complainant could seek compensation in her circumstances '[had] been dealt with by the Supreme Court of Victoria in the negative'. Not until the Supreme

136 Thomas M Franck, 'Legitimacy in the International System' (1988) 82 *American Journal of International Law* 705, 706.

137 James L Gibson, Milton Lodge and Benjamin Woodson, 'Losing, But Accepting: Legitimacy, Positivity Theory, and the Symbols of Judicial Authority' (2014) 48 *Law & Society Review* 837, 840.

138 *FOS Terms of Reference*, above n 59, [8.2].

139 As has been recognised by FOS' lead ombudsman: FOS, 'Recent Supreme Court Decision Confirms FOS Approach to Resolving Disputes' (Circular, 18, August 2014).

140 *FOS Determination 264676* (29 August 2012) 9–11.

141 *FOS Determination 278925* (23 September 2013). This is clearly demonstrated in Determination 278925 when FOS states 'It is not clear from any case law whether, in order for section 47 to apply, it must be established that the Insured was aware of the inflammatory aneurysm prior to inception of the Policy, or merely aware of the symptoms of such a condition': 10 [45].

142 *FOS Determination 211826* (undated).

143 Ibid 3–4.

Court had changed its view – which it did – did FOS consider itself able to hear the dispute.[144]

In other circumstances, FOS did not expressly interpret the law where a judicial decision maker would likely consider it necessary to do so. For example, in *FOS Determination 393884*, the key question was whether a consumer had been fraudulent in relation to an income protection policy pursuant to section 56 of the *ICA*.[145] Whereas courts have spent much time defining fraud and establishing the standard of proof for the purposes of section 56,[146] FOS simply stated that it was 'satisfied that the applicant's failure to notify the [financial services provider] was not fraudulent'.[147] Whether this is a sufficient response to the key contentious issue in dispute is questionable. In contrast, FOS expressly took account of case law on the meaning of fraud in *FOS Determination 209648*.[148]

What these examples demonstrate is inconsistency in FOS' approach to legal interpretation.[149] FOS' approach to the determination of legal questions differed from the courts', who conclusively interpret and apply the law. This approach, in fact, is a key and unavoidable feature of the industry ombudsman model, purporting to 'ensure that the office performs its functions in a manner that is fair and seen to be fair' in accordance with the Ombudsman Benchmark of fairness.[150] The question is whether and to what extent this stark difference created a legitimacy gap.

Courts interpret law according to well-established precedent that is similar across jurisdictions in Australia,[151] creating a perception of consistency. This process gives rise to the 'myth of legality', whereby judicial decisions are legitimate because of a belief that they are made according to autonomous legal principles applied through neutral legal reasoning.[152] FOS was not, and was not intended to be, a court. FOS did not employ judicial reasoning on questions of law. This challenged FOS' legitimacy, especially when FOS' reasoning process could be perceived as inconsistent with the reasoning that a court has or may have undertaken on the same question of law. Similarly, FOS' reasoning process could

144 *Bendigo and Adelaide Bank Ltd v Dimitrov* [2018] NSWDC 152 [12] (Russell DCJ).

145 *FOS Determination 393884* (27 May 2016).

146 For a detailed discussion of relevant case law, see Minter Ellison Lawyers, *Insurance Contracts Act Handbook: An Annotated Version of the Insurance Contracts Act 1984* (Minter Ellison, 8th ed, 2014) 174–9.

147 *FOS Determination 393884* (27 May 2016) 3.

148 *FOS Determination 209648* (undated) 2–3.

149 The same issue arises in the United Kingdom's equivalent Financial Ombudsman Service, 'The jurisprudence of FOS in insurance matters demonstrates an obvious departure from strict rules of law, although because most cases are dealt with by adjudicators, many of whom are not legally trained, decisions are inconsistent and generally unpredictable': Rob Merkin, 'Unfair Terms in Insurance Contracts: A Solution in Search of a Problem' (2012) 23 *Insurance Law Journal* 272, 275.

150 *Ombudsman Key Practices*, above n 36, 15, [3.1].

151 Chief Justice Murray Gleeson, 'Judicial Legitimacy' (Paper presented at Australian Bar Association Conference, New York, 2 July 2000).

152 John M Scheb II and William Lyons, 'The Myth of Legality and Public Evaluation of the Supreme Court' (2000) 81 *Social Science Quarterly* 928, 929.

be criticised where determinations were perceived to impose lesser or greater obligations than the law would otherwise seem to do.[153]

Departure from law and legal reasoning created uncertainty about the compatibility of FOS' process with the rule of law and specifically the ideal of consistency.[154] Rule of law and consistency are highly regarded in dispute resolution systems.[155] The rule of law is synonymous with fairness.[156] Decisions which accord with rule of law values are often perceived as legitimate.[157] Legitimacy is challenged when rule of law values are not followed. Consistency is most significant for financial services providers, as inconsistency creates uncertainty and reduces their capacity to effectively organise commercial activities. The adverse effects of inconsistency are, therefore, likely to be most felt by financial services providers.

The above is indicative of a wider debate about fairness as a decision-making criteria. Fairness has different meanings for consumers and financial services providers: whilst both parties will seek fairness for themselves in outcomes of individual disputes, financial services providers as repeat players are more likely to perceive fairness in rules and consistency.[158] For example, in *FOS Determination 355625*, FOS came to a 'fair' conclusion by applying sections of the *Life Insurance Act 1995* (Cth) and *Evidence Act 1995* (Cth), but expressly rejected the application of the *Acts Interpretation Act 1901* (Cth).[159] Individualistic treatment of the dispute, whilst perhaps subjectively fair for the consumer, is not so for the financial services provider because of the inconsistent application of statutory rules.

The *Ramsay Review* supported the decision-making test of fairness as adopted by FOS, stating that it was 'generally operating soundly'.[160] Its recommendation was that the decision-making test should continue,[161] and this has manifested in AFCA's decision-making criteria for non-superannuation disputes being nearly identical to FOS'. As such, the above discussion of FOS' legitimacy gaps is directly applicable to AFCA.

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153 Sharon Gilad 'Exchange Without Capture: The UK Financial Ombudsman Service's Struggle for Accepted Domain' (2008) 86 *Public Administration* 907, 912.

154 Rebecca Hollander-Blumoff and Tom R Tyler, 'Procedural Justice and the Rule of Law: Fostering Legitimacy in Alternative Dispute Resolution' (2011) 1 *Journal of Dispute Resolution* 1, 8. This issue has been taken to the European Court of Human Rights, where it was decided that the process employed by the UK's FOS was not so incompatible with the rule of law as to make the scheme a breach of the European Convention of Human Rights: *Heather Moor & Edgecomb Ltd v United Kingdom* (1550/09) [2011] ECHR 1019.

155 Brian Tamanaha 'A Concise Guide to the Rule of Law' (Research Paper No 07-0082, St John's University School of Law, September 2007) 2.

156 Hollander-Blumoff and Tyler, above n 154, 9.

157 Ibid 12.

158 Sharon Gilad, 'Why the "Haves" Do Not Necessarily Come Out Ahead in Informal Dispute Resolution' (2010) 32 *Law & Policy* 283, 283.

159 *FOS Determination 355625* (11 February 2015) 2–3.

160 *Ramsay Review Final Report*, above n 5, 126.

161 Ibid.

Adverse effects of these legitimacy gaps will be magnified in AFCA due to its significantly increased monetary limits.[162] Jurisdiction to hear higher value disputes will likely lead to more complex disputes being heard by AFCA. Jurisdiction to award higher compensation sums, of unlimited value in some circumstances, will result in greater financial impact on financial services providers who must comply with AFCA's determinations. The appropriateness of fairness as a decision-making basis, as opposed to judicial consistency and comprehensibility, will be seriously tested when used for complex disputes and high value compensation orders because of the greater impact these will have on financial services providers. This is compounded by the limited and informal fact finding that AFCA is empowered to undertake. For example, AFCA lacks formal fact finding structures such as discovery and the parties have limited power to demand documents or evidence be disclosed.[163] Consequently, legitimacy is challenged.

(b) Addressing the Fairness/Consistency Tension

The tension between AFCA's fairness-based, individualistic dispute resolution approach and the desire for legitimacy-constructing rule of law and consistency ideals creates an impasse that may be impossible to resolve.[164] This impasse arises from the adoption of the industry ombudsman model, and will exist as long as that model is retained. Four points can be made in this regard which alleviate or justify legitimacy concerns to some extent.

First, as discussed above, fairness is an essential element of the industry ombudsman model and the public ombudsman model from which it was derived. It would be contrary to the industry ombudsman model, *Ombudsman Benchmarks* and *Ombudsman Key Practices* for AFCA to use any other kind of decision-making criteria. As discussed in Part II(B), that model is widely adopted, has been refined over a number of decades and is formally encouraged by the Australian Government.

Second and relatedly, industry ombudsmen across a number of sectors use the criteria of fairness to reach their conclusions.[165] There are at least 71 ombudsmen and complaints bodies in Australia, both public and private, most of whom utilise comparable standards of fairness for decision making.[166] Legitimacy is constructed when decision-making standards are used frequently and consistently and this forms part of the legitimacy accorded to courts under the myth of legality.

Third, legitimacy is constructed when a body is perceived to be doing the right thing. Fairness is an important consideration in the financial services domain

162 See the discussion at Part II(C)(3) for details of AFCA's increased monetary value jurisdiction.

163 *AFCA Rules,* above n 64, [A.9]. AFCA has additional statutory powers to obtain information in superannuation disputes: *Corporations Act* ss 1054A, 1054B.

164 For a discussion of fairness in financial services dispute resolution, see generally Mary Condon, 'Ideas of Fairness in Financial Services Dispute Resolution' in Janis P Sarra (ed) *An Exploration of Fairness: Interdisciplinary Inquiries in Law, Science and the Humanities* (Carswell Thompson, 2013) 241, 250.

165 Cohen, above n 42, 26–7.

166 Productivity Commission, 'Access to Justice Arrangements' (Inquiry Report No 72, 5 September 2014) 5.

because the complexity and opacity of financial products can be problematic for retail consumers.[167] This has been highlighted in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('Banking Royal Commission'). The Banking Royal Commission has closely investigated conduct which 'does not meet community standards and expectations'.[168] The community is, of course, a synonym for the consumers who are likely to perceive informal dispute resolution as fair, and the fairness decision-making criteria as justified. Consumers will be reluctant to engage financial services if concerns about unfair treatment exist.[169] Negative publicity regarding financial services providers' actions, such as that uncovered and heavily publicised during the Banking Royal Commission, is likely to increase consumer demands for fairness being used as a decision-making criterion.[170]

Fourth, Remáč's discussion on the division of labour between the judiciary and public ombudsmen is, in several key regards, directly applicable to the present discussion.[171] Ombudsmen 'have some additional competencies that distinguish them and their dispute resolution from that of the judiciary' including, as described above, the power to make non-binding recommendations and discretion to approach disputes in creative ways.[172] These additional competencies demonstrate that an 'ombudsman institution is not a kind of inferior court'.[173] This links to an earlier point made: AFCA is not, and is expressly not intended to be, a court.

These four points are entirely premised on AFCA's ability to successfully procure fair outcomes by using the fairness criteria. If that is to fail, the four factors moderating the seriousness of the legitimacy gaps fall away to seriously challenge AFCA's legitimacy. One example where FOS did not conclude a fair outcome was highlighted during the Banking Royal Commission and related to its resolution of a business loan complaint. Called and questioned as a witness at a Banking Royal Commission hearing, a FOS lead ombudsman admitted in relation to the resolution of that dispute, '[i]n hindsight, I don't think that was the correct thing to do'.[174] AFCA's power to award monetary compensation in excess of that seen in the Predecessor EDR Schemes amplifies legitimacy concerns. Financial services providers who perceive a purportedly fair decision on compensation payable as unfair because of AFCA's inconsistent approach will suffer the ramifications at

167 James F Devlin, Sanjit Kumar Roy and Harjit Sekhon, 'Perceptions of Fair Treatment in Financial Services: Development, Validation Application of a Fairness Measurement Scale' (2014) 48 *European Journal of Marketing* 1315, 1316–17.

168 Letters Patent from Queen Elizabeth the Second to The Honourable Kenneth Madison Hayne AC QC, 14 December 2017, (c).

169 Devlin, Roy and Sekhon, above n 167, 1327.

170 Though beyond the scope of this article, it should be noted that there is significant discussion around the definition of fairness in the consumer context: see, eg, Pankaj Aggarwal and Richard P Larrick, 'When Consumers Care About Being Treated Fairly: The Interaction of Relationship Norms and Fairness Norms' (2012) 22 *Journal of Consumer Psychology* 114, 114–16.

171 Remáč, above n 32, 11.

172 Ibid 16.

173 Ibid.

174 Transcript of Proceedings, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* [2018] 2552 (28 May 2018) [25]–[26].

greater financial cost. For complex and high value disputes especially, legitimacy will continue to be problematic due to the application of fairness as a decision-making criteria. Ultimately, the fact that AFCA is not a court or tribunal raises doubts about the policy to funnel such a wide range of disputes, through its very broad jurisdiction, into AFCA.

2 Lack of Review Process

(a) Existing Legitimacy Gaps

The *FOS Terms of Reference* did not provide for internal reconsideration of its determinations. This challenged its legitimacy. If a consumer was dissatisfied with FOS' determination, they could reject it and pursue other available forms of redress.[175] Conversely, dissatisfied financial services providers were at the behest of a consumer's acceptance of a determination. Financial services providers unsuccessfully attempted to obtain judicial review of FOS' determinations several times, including on the grounds that determinations contained errors of law,[176] were made in excess of jurisdiction,[177] calculated losses incorrectly[178] and were biased.[179] The overall conclusion was that FOS' determinations were final decisions of a private body and not amenable to judicial review unless meeting the criteria of *Wednesbury* unreasonableness.[180] Pagone J in *Mickovski v Financial Ombudsman Service Ltd* concluded that the *Datafin* principle[181] should be applied to FOS, however, because FOS was involved in private transactions which do not carry a public element, its operations were insufficient to invoke application of the *Datafin* principle in those circumstances.[182] This approach was confirmed in the Victorian Court of Appeal.[183] Tribunals similarly refused to review FOS' determinations for lack of jurisdiction.[184] The result was that financial services providers could not seek judicial redress for disagreeable FOS determinations.

Interestingly, the Federal Court in *Wealthsure* examined FOS' process in a dispute that was on foot.[185] Wealthsure argued that FOS had improperly split one claim into three to bring each smaller claim within FOS' jurisdiction and sought a declaration that FOS should treat the claim as one single claim. Gilmour J concluded that FOS' approach was correct. Although this was not a review of a determination, it showed the court's willingness to intrude in some procedural

175 *FOS Terms of Reference*, above n 59, [8.9].
176 *Cromwell Property Securities Limited v Financial Ombudsman Service Limited* [2013] VSC 333.
177 *Mickovski v Financial Ombudsman Service Limited* (2012) 36 VR 456; *Bilaczenko v Financial Ombudsman Service Ltd* [2013] FCCA 420; *Goldie Marketing Pty Ltd v Financial Ombudsman Service Ltd* [2015] VSC 292.
178 *Utopia Financial Services Pty Ltd v Financial Ombudsman Service Ltd* [2012] WASC 279; *Patersons Securities Ltd v Financial Ombudsman Service Ltd* [2015] WASC 321.
179 *Financial Ombudsman Service Ltd v Pioneer Credit Acquisition Services Pty Ltd* [2014] VSC 172.
180 *Cromwell Property Securities Ltd v Financial Ombudsman Service Ltd* [2013] VSC 333, [49] (Digby J).
181 *R v Panel on Take-overs and Mergers; Ex Parte Datafin PLC* [1987] QB 815.
182 *Mickovski v Financial Ombudsman Service* [2011] VSC 257, [12] (Pagone J).
183 *Mickovski v Financial Ombudsman Service* (2012) 36 VR 456, 465–7 (Buchanan and Nettle JJA, Beach JA).
184 *Candice Gate v FOS* [2012] NSWCTTT GEN: 12/51694; *Lazarus v HSBA and FOS* [2012] VCAT C6851/2012.
185 [2013] FCA 292.

issues with potentially significant ramifications for the substantive outcome. Similarly, it is interesting to note the depth with which the court has considered FOS' decision making. For example, in *Patersons Securities Ltd v Financial Ombudsman Service Ltd*, Mitchell J closely examined FOS' decision-making processes, identifying that FOS erred, but concluding that its errors were not sufficient to be in excess of its contractual decision-making power because they did not demonstrate dishonesty, irrationality or inconsistency with the *FOS Terms of Reference's* commercial purposes.[186]

Those who perceived a FOS determination as unfair were more likely to perceive FOS as illegitimate because of the absence of appeal or review, noting the distinction between the particular legal meaning of 'appeal' as a right afforded by statute and a matter of statutory construction,[187] and the general meaning of 'review'. Whilst consumers could pursue fresh redress in the courts, the need to do so was contrary to FOS' policy purpose of providing efficient and low-cost dispute resolution. Time spent engaging FOS may also have caused the consumer's claim to be statute-barred from civil action, leaving a consumer with no avenue of redress at all.[188]

The much smaller CIO provided an internal review mechanism, which could be engaged by either party on their application within 28 days of the determination or on the CIO's own motion. Where the CIO was satisfied of certain circumstances, they had the power and discretion to re-open a complaint, make amendments to the determination, re-issue the determination or give appropriate directions in connection with the determination.[189] The *Superannuation (Resolution of Complaints) Act 1993* (Cth) provided parties to a dispute a right of appeal to the Federal Court within 28 days of a determination on matters of law.[190]

For non-superannuation disputes, AFCA has a similarly limited review structure in accordance with the *Ramsay Review's* recommendation that AFCA should adopt review rights similar to that employed by FOS.[191] However, and separate to the merits of a dispute, AFCA is empowered to review a decision to exclude a complaint if 'the Complainant objects within the specified timeframe … [and] AFCA is satisfied that the objection may have substance'.[192] This is a new power not seen in FOS, allowing internal review of jurisdictional decisions, but not extending to determinations. Superannuation disputes retain a similar appeal right to that provided by the SCT: the *Corporations Act* stipulates that either party can appeal AFCA's determination to the Federal Court on questions of law within 28 days.[193]

186 [2015] WASC 321, [95]–[96], [157], [160].
187 *Victorian Stevedoring and General Contracting Co-Pty Ltd v Dignan* (1931) 46 CLR 73, 108 (Dixon J).
188 However, the *FOS Terms of Reference* allow a consumer to institute legal proceedings alongside FOS action if the relevant limitation period is nearing expiry: *FOS Terms of Reference*, above n 59, [5.1(m)(ii)].
189 *CIO Rules*, above n 76, 39.4.
190 *Superannuation (Resolution of Complaints) Act 1993* (Cth) s 46.
191 *Ramsay Review Final Report*, above n 5, 128, 137.
192 *AFCA Rules*, above n 64, [A.4.6].
193 *Corporations Act* s 1057.

Whilst AFCA will have an Independent Assessor, as was also recommended by the *Ramsay Review* and is now a mandatory requirement under the *Corporations Act*,[194] the Independent Assessor will not be empowered to review the merits of determinations but instead only to review how disputes are handled.[195] This is contrary to some stakeholders' positions that 'the independent assessor should be able to conduct merits review of an AFCA decision, particularly where a procedural failure may have led to [a] substantively unfair outcome, or review a jurisdictional decision'.[196] As such, similar legitimacy gaps will exist in AFCA as did in FOS in respect of review procedures for non-superannuation disputes and non-jurisdictional decisions.

Availability of internal review procedures is an important feature of dispute resolution bodies. The court system expressly manifests this through a right of appeal, being a 'remedy conferred by statute within a particular hierarchy … for the substitution of a different decision from that of a lower court'.[197] Many Australian tribunals of wide jurisdiction, or 'super tribunals' as some have described them,[198] employ two-tier dispute resolution enabled by expressly legislated availability of internal review.[199]

Appeal rights present numerous benefits for dispute resolution bodies' legitimacy, including improving the quality of decisions, increased social value and policy consistency. A former Victorian Civil and Administrative Tribunal President has noted that 'justice institutions' have a strong interest in consistency, predictability and quality and that appeal 'machinery' addresses such interests.[200] Appeal rights enable these benefits by building a 'bank of jurisprudence', from which a 'large palette of guidance' can be taken.[201]

Although FOS was not bound to abide by its previous determinations, common characteristics of informal justice schemes, further discussed below, suggest benefits in a tendency towards internal consistency.[202] These include that

194 *Ramsay Review Final Report*, above n 5, 11; *Corporations Act* s 1051(2)(c).

195 'The Independent Assessor does not consider the merits or the substantive outcome of a complaint against a financial firm, such as a determination or other finding issued by AFCA about the merits of a complaint, or AFCA's jurisdiction. The role is not an appeal or review mechanism for AFCA's decision and judgments on the facts or merits of a complaint.': AFCA, 'Independent Assessor Terms of Reference', (Terms of Reference, September 2018) [8]. See also *Ramsay Review Final Report,* above n 5, 11, 179–81.

196 Australian Securities and Investments Commission, 'Response to Submissions on CP 298 Oversight of the Australian Financial Complaints Authority' (Report 577, June 2018) [32].

197 Margaret J Beazley, Paul T Vout and Sally E Fitzgerald, *Appeals and Appellate Courts in Australia and New Zealand* (LexisNexis Buttersworth, 2014) 3.

198 Kevin O'Connor, 'Appeal Panels in Super Tribunals' (2013) 32 *University of Queensland Law Journal* 31.

199 For example, the NSW Civil and Administrative Tribunal: *Civil and Administrative Tribunal Act 2013* (NSW) s 32; the Queensland Civil and Administrative Tribunal: *Queensland Civil and Administrative Tribunal Act 2009* (Qld) ss 25–7; and the ACT Civil and Administrative Tribunal: *ACT Civil and Administrative Tribunal Act 2008* (ACT) pt 8.

200 To adopt the language of former Victorian Civil and Administrative Tribunal President, Justice Kevin Bell, 'One VCAT: President's Review of VCAT' (Review, 30 November 2009) 58.

201 O'Connor, above n 198, 34–5.

202 Bryan Finlay and Richard Ogden, 'Consistency in Tribunal Decision-Making' (2012) 25 *Canadian Journal of Administrative Law & Practice* 277, 280–2.

unsuccessful parties know they have been treated similarly to previous unsuccessful parties, parties can assess their likelihood of success and parties can prepare a focused case.[203] This is demonstrated, albeit inconsistently, in FOS' determinations. For example, in *FOS Determination 254858*, FOS expressly adopted reasoning of a previous determination to interpret an insurance contract.[204] In *FOS Determination 257397*, FOS expressly adopted a previous determination's approach to documentary evidence.[205]

There is further public value in providing internal review rights, including containing costs, reducing disputes proceeding to court and, by extension, reducing the burden on the judicial system. As discussed above, consumers agitating their disputes to a court to be examined afresh is undesirable and problematic for legitimacy. In the AFCA model, financial services providers do not have the option of agitating disputes to court.

In light of these considerations, it is curious that access to internal and external review processes were not more closely discussed in the *Ramsay Review* nor implemented by the *AFCA Act*. A review procedure could mitigate the effect of several legitimacy gaps evident in FOS, particularly those arising from perceived absence of legal reasoning processes, subjective decision-making criteria and limited information and document gathering powers. AFCA has, however, reframed the procedures adopted from FOS to highlight the characteristics of review which already existed between the recommendation and determination stages of FOS' dispute resolution. The following section will consider how such emphasis can, theoretically, construct legitimacy where a review process seems unlikely to eventuate.

(b) Reframing Existing Procedures

Each progression in AFCA's multi-tiered dispute resolution process can be seen as a quasi-review process where issues are narrowed. These tiers fall into three categories: non-binding facilitative methods, non-binding preliminary assessment and binding determinations. At each tier of dispute resolution, parties' expectations about outcome are mitigated to align with realistic possibilities, in light of available evidence, applicable legal principles and information exchange.

Although not an express right of review, the step from preliminary assessment to determination embodies several characteristics of a review process.[206] Preliminary assessments made by AFCA are a statement of AFCA's opinion on the merits and outcome of a dispute.[207] Based on the content of a preliminary assessment, parties can be alerted to and address issues including legal interpretation and evidentiary gaps to present in support of their position before a

203 Ibid 281.
204 *FOS Determination 254858* (2 November 2012) 6.
205 *FOS Determination 257397* (6 September 2012) 5.
206 This argument was also presented by P E Morris in relation to the UK FOS: P E Morris, 'The Financial Ombudsman Service and the Hunt Review: Continuing Evolution in Dispute Resolution' (2008) 8 *Journal of Business Law* 785, 798.
207 *AFCA Rules*, above n 64, [A.12.1].

determination is made. If one classifies AFCA's preliminary assessments as non-binding decisions, AFCA mimics characteristics of a *de novo* appeals process by permitting the remaking of a decision with a full presentation of evidence absent any requirement of error by the preliminary assessor.[208]

In the *de novo*-like situation, decision makers do not rely on the earlier reasoning, and this was demonstrated in FOS when FOS ombudsmen did not rely on the recommending case manager's conclusions in reaching their determination. For example, in *FOS Determination 360175*, the ombudsman expressed agreement with the case manager's recommendation but noted that all materials had been taken into account afresh.[209] In other cases, however, it would appear that FOS ombudsmen made determinations on a review of a recommendation and any further post-recommendation submissions made by parties. For example, FOS' recommendations were occasionally attached to determinations and ombudsmen expressed agreement or disagreement with the recommendation. In *FOS Determination 289292*, the ombudsman 'carefully considered the case manager's Recommendation, together with the parties' further submissions'.[210] In *FOS Determination 211105*, the ombudsman made express his consideration of material submitted following the recommendation and the subsequent reasoning did not make clear that he had reconsidered earlier material.[211] Such cases do not mimic a *de novo* appeals process. This shows an inconsistency in FOS' practice which created a legitimacy gap that can easily be remedied.

The *AFCA Rules* further require that where a complaint proceeds to a determination at a party's request, the AFCA Decision Maker 'must consider the party's reasons for disagreeing with the preliminary assessment, but is not limited to those reasons'.[212] If a party requests a complaint proceed to binding determination, they must provide reasons for disagreeing with the preliminary assessment.[213] This is an extremely valuable tool in narrowing issues for determination and allowing AFCA Decision Makers to come to decisions which the parties subjectively consider to be fair. This requirement was not evident in the *FOS Terms of Reference* to guide decision makers from the recommendation to determination stages and should be considered an improvement on FOS' procedural rules. However, it does not expressly require AFCA decision makers to take a *de novo* approach. To the contrary, the AFCA Decision Maker cannot ignore the conclusions made in the preliminary assessment.

The *de novo*-like review which sometimes occurred between FOS' recommendation and determination tiers should be expressly enunciated in, and required by, AFCA Decision Makers as a matter of legitimacy construction. The effective implementation of this proposition will require importing a greater

208 A description of *de novo* appeals was given by Gaudron, McHugh, Gummow and Hayne JJ: *Allesch v Maunz* (2000) 203 CLR 172, 180. See also Dean Mildren, *The Appellate Jurisdiction of the Courts in Australia* (Federation Press, 2015) 10–12.

209 *FOS Determination 360175* (1 December 2014) 1, 3.

210 *FOS Determination 289292* (19 August 2013) 9.

211 *FOS Determination 211105* (undated).

212 *AFCA Rules,* above n 64, [A.12.5].

213 Ibid [A.12.3(b)(ii)].

number of formal justice characteristics into EDR processes. Formal justice structures are those which display 'proceeding by rule'[214] and are contrasted against informal justice structures, which are characterised by minimal bureaucracy and a tendency to adopt norms which are 'vague, unwritten, commonsensical, flexible [and] ad hoc'.[215] Some such steps have already been taken in AFCA's creation, for example the change in nomenclature from FOS' *recommendations* to AFCA's *preliminary assessments* makes clearer the purpose of the 'first tier' of dispute resolution and carries more authority. Further such steps may also cure the 'mismatch' between binding determination powers creating financially valuable rights and the nature of informal justice, resulting in increased procedural consistency.[216]

Whilst this may help, it will not entirely alleviate the legitimacy gaps resulting from a lack of review mechanism. Preliminary assessments are an informal assessment of merits, but they are not attended by the same level of inquiry as a determination. The information underlying a preliminary assessment may be incomplete, especially noting the absence of formal document production and information gathering powers. Preliminary assessments are not expressly required to be made by an AFCA Decision Maker, whereas determinations are only made by AFCA Decision Makers who are 'duly appointed to make binding decisions under [AFCA's] Rules'[217] by AFCA's board of directors who equally 'have experience in carrying on the kinds of businesses operated by [financial services providers] … [and] in representing consumers.'[218] It is not clear who makes the preliminary assessment, or the required training and experience of that person. Their expertise may be distinguishable from, and insufficient compared to, that of an AFCA Decision Maker. The quality of the preliminary assessment may, as such, be limited and based on insufficient or incorrect information and interpretation.

Preliminary assessments are not binding, thereby carrying little authoritative value. Moreover, not all disputes will receive a preliminary assessment, either because of an express exception or the exercise of AFCA's discretion.[219] There seems, however, to be no intention to establish formal review rights in AFCA for the outcome of individual disputes.[220] Close attention should be paid to the nature of complaints raised with AFCA's Independent Assessor and elsewhere regarding AFCA's functioning, such that further consideration in this regard can be had at AFCA's first independent review.[221]

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214 H L A Hart, *The Concept of Law* (Clarendon Press, 1961) 156.

215 Richard Lempert, 'The Dynamics of Informal Procedure: The Case of a Public Housing Eviction Board' (1989) 23 *Law & Society Review* 347, 353.

216 Hazel Genn, 'Tribunals and Informal Justice' (1993) 56 *Modern Law Review* 393, 400.

217 *AFCA Constitution*, above n 82, [11.1(d)], [1.1] (definition of 'EDR Decision Maker'); *AFCA Rules,* above n 64, [A.13].

218 *Corporations Act* s 1051(3)(d).

219 *AFCA Rules*, above n 64, [A.12.1] ('AFCA *may* choose to provide …'), [A.12.3].

220 *Ramsay Review Final Report*, above n 5, 137.

221 *AFCA Rules*, above n 64, [A.16]; *Corporations Act* s 1051(3)(a).

3 Accountability Processes

Accountability processes can, in some circumstances, cure institutional legitimacy gaps.[222] Accountability is defined as a relationship in which one party gives account to another, where the latter can control or punish the former.[223] In the EDR context, accountability can exist at the individual dispute level and at the institutional level. The former was discussed above in relation to review processes. The latter will be discussed in this section.

FOS' main accountability relationship existed in its requirement to undergo private audit.[224] FOS underwent one such private audit during its existence. The 2013 audit was conducted by private consulting firm Cameron Ralph Navigator, who made 27 recommendations.[225] FOS reported that by July 2015, all recommendations were implemented.[226] Whilst it is not possible to determine whether this is the case, it is evident that significant changes were made to the *FOS Terms of Reference* pursuant to the recommendations.[227] Neither Cameron Ralph Navigator nor ASIC, however, had any power to enforce the audit's recommendations. Absence of an enforcement power indicates the existence of an indirect accountability relationship only.

One of the most significant enhancements to the EDR system has been the increased and legislated oversight of AFCA. The *Corporations Act* requires the following forms of oversight:

1. a permanent Independent Assessor who will review complaints about AFCA's handling of claims;[228]
2. a more prominent and defined governance structure;[229]
3. ASIC's new general directions power, under which ASIC can require that AFCA take specific measures or comply with requirements or conditions. A direction under this power is not a legislative instrument. ASIC's directions are enforceable by application to the court;[230]
4. ASIC's new funding-specific directions power, which allows ASIC the power to direct AFCA to take specific measures to ensure it is 'sufficiently financed';[231]

222 Black, above n 119, 149–50.
223 Richard Mulgan, 'Accountability: An Ever-Expanding Concept?' (2000) 78 *Public Administration* 555, 563–6; Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13 *European Law Journal* 447, 450–2.
224 Australian Securities and Investments Commission, above n 73, 32–3.
225 Cameron Ralph Navigator, 'Report to Board of Financial Ombudsman Service: 2013 Independent Review' (Report, 2014) 138–48.
226 FOS, 'Annual Review 2014–2015' (Annual Review, October 2015) 4 ('*Annual Review 2014*').
227 For example, the insertion of section F into the *FOS Terms of Reference* creating a special set of processes for disputes relating to traditional trustee company services: *FOS Terms of Reference*, above n 59, [14]–[19.2].
228 *Corporations Act* s 1051(2)(c).
229 *Corporations Act* s 1051(3)(d)–(e).
230 *Corporations Act* s 1052C.
231 *Corporations Act* s 1052BA.

5. ASIC's new power to issue regulatory requirements relating to either AFCA's compliance with mandatory requirements as listed in section 1051 of the *Corporations Act*, or to the general considerations listed in section 1051A. Unlike the directions power, a regulatory requirement is a legislative instrument;[232] and
6. the requirement of ASIC approval for material changes to the AFCA scheme.[233]

ASIC's new powers in relation to AFCA are notable and have created a direct accountability relationship; a relationship which FOS lacked. Such a direct accountability relationship has a legitimacy-constructing effect on AFCA's procedural legitimacy. It may reduce the harm resulting from the lack of review procedures for individual disputes on the basis that an authoritative body – ASIC – can control AFCA's systemic actions. This control would seem to be both general, through the power to issue regulatory requirements, and specific, through the power to issue a direction, both of which are enforceable against AFCA in the event of non-compliance. Such control will not remedy disagreeable determinations which are perceived to arise from non-legalistic reasoning and subjective decision making. It does, however, construct procedural legitimacy, not only by oversight but also by indirect absorption of ASIC's authority. This raises an interesting question beyond the scope of this article, of how such power by direct accountability measures alters the independence and nature of industry-based schemes.

B Structural Legitimacy

Structural legitimacy asks whether an institution's structure allows it the capacity to perform its designated functions.[234] Elements relevant to an EDR scheme's structural legitimacy include institutional landscape and guiding principles. The move to amalgamate three existing EDR schemes into one single AFCA is of particular significance for its positive effect on structural legitimacy.

1 Institutional Landscape

(a) Ramifications of Consolidation

FOS suffered significant legitimacy gaps because it was one of multiple EDR schemes. The *Ramsay Review* concluded that the multi-scheme EDR system was problematic because of overlap in EDR jurisdictions,[235] risk of inconsistent outcomes and approaches across EDR schemes,[236] difficulties associated with

232 *Corporations Act* s 1052A.

233 *Corporations Act* s 1052D. In relation to oversight and accountability generally, see Australian Securities and Investments Commission, above n 196.

234 W Richard Scott, 'Effectiveness of Organizational Effectiveness Studies' in Paul S Goodman, Johannes M Pennings and Associates (eds), *New Perspectives on Organizational Effectiveness* (Jossey-Bass Publishers, 1977) 63, 84–6.

235 *Ramsay Review Final Report*, above n 5, 103.

236 Ibid 104–5.

disputes where financial services providers were members of multiple schemes,[237] consumer confusion,[238] duplicated costs,[239] and competition between schemes.[240] To the extent that these factors intrusively manifested themselves – as the Review suggests they did – the multi-scheme landscape challenged FOS' structural legitimacy. AFCA gains significant structural legitimacy from being the primary dispute resolution forum for retail consumer financial services disputes.

Combining multiple institutional avenues into a single dispute resolution body is consistent with the streamlining of financial services complaint bodies over the last decade. The same trend is demonstrated elsewhere in informal dispute resolution, such as the creation of super tribunals which are now visible in most jurisdictions, for example the Administrative Appeals Tribunal, Victorian Civil and Administrative Tribunal, NSW Civil and Administrative Tribunal, and so on.[241] Creating a single body has a number of benefits, including reducing confusion for consumers, increased accessibility, increased consistency and reduced administrative costs, all of which are consistent with AFCA's policy purposes and its underpinning industry ombudsman model.

The process of consolidating FOS, the CIO and the SCT into one body of broad subject matter jurisdiction in effect quarantines disputes of a certain kind to AFCA, being those that fall into its jurisdiction. Matter type quarantining similarly occurs in the judicial system, as evidenced by the establishment of specialist courts.[242] Such quarantining resolves issues arising from multiple dispute resolution bodies having jurisdiction over the same subject matter and, unsurprisingly, was discussed at length in the *Ramsay Review*.[243] Justice Moore has noted criticisms of specialist courts, including costs associated with duplication of processes, fragmentation of law making and obscuring the need for reform.[244] He acknowledges that specialist courts have the potential to undermine the legitimacy of the court structure.[245] These same reasons, applied in AFCA's context, strengthen the case for the establishment of an exclusive EDR forum because multiple EDR bodies that cover the same or similar subject matter create duplicative costs and inconsistency between EDR decisions and processes.

Judicial quarantining also occurs by monetary value. In the ACT, for example, disputes valued $25 000 or less cannot be commenced in the Magistrates Court, effectively confining low value claims to the ACT Civil and Administrative

237 Ibid 106–7.
238 Ibid 103–9.
239 Ibid 109–11.
240 Ibid 111–16.
241 O'Connor, above n 198, 31–3. See also Bertus de Villiers, 'Accessibility to the Law – The Contribution of Super-Tribunals to Fairness and Simplicity in the Australian Legal Landscape' (2015) 39 *University of Western Australia Law Review* 239.
242 Michael Moore, 'The Role of Specialist Courts – An Australian Perspective' [2000] *Lawasia Journal* 139, 139–42. In NSW alone, such specialist courts include the Land and Environment Court, the Coroner's Court, the Children's Court, the Drug Court, the Chief Industrial Magistrates Court and the Industrial Court of New South Wales.
243 *Ramsay Review Final Report*, above n 5, 102–16.
244 Moore, above n 242, 142–7.
245 Ibid 142–3.

Tribunal.[246] Mid-value claims between $25 000 and $250 000 are confined to the Magistrates Court by its upper limit jurisdiction and the Supreme Court's punitive cost penalties for claims brought to the Supreme Court which could be dealt with by the Magistrates Court.[247]

The converse argument is that the existence of multiple institutional avenues for dispute resolution may foster healthy competition between institutions to resolve disputes more efficiently, satisfactorily and cheaply.[248] Where a financial services provider carries on activities that may be addressed by more than one institution, the financial services provider can select and become a member of the institution which it prefers to handle disputes. It is thus in the institution's interest to operate as fairly, efficiently and cost-effectively as possible to best serve its audience and attract disputants to its services. This competition may increase the quality of all institutions carrying out such functions: with increased quality comes increased satisfaction and therefore increased legitimacy. The *Ramsay Review* considered, but did not support, this notion.[249] In agreement with the *Ramsay Review's* conclusion, competition amongst financial services providers must be cautiously considered because of the apparent ineffectiveness of competition as a driver of change and innovation in this field.[250]

Another reason for caution flagged by stakeholders was the potential for system manipulation which EDR competition allows and even encourages.[251] Such manipulation is evident from an American example. Arbitration is a commonly used form of institutional redress for financial services disputes in the United States.[252] Many financial services contracts include a mandatory pre-dispute arbitration clause, requiring parties to arbitrate a dispute in the first instance.[253] Arbitral decisions are rarely open to judicial review, meaning that financial services disputes are largely removed from the courts' purview.[254] Although there is a central institutional body providing arbitration services – the Financial Industry Regulatory Authority – it is one of many doing so,[255] creating competition between institutional dispute resolution services. This competition has led to public litigation based on allegations of ties between arbitrators and industry, where arbitrators and industry have colluded to appoint particular arbitrators,

246 *Magistrates Court Act 1930* (ACT) s 266A(1)(b); *ACT Civil and Administrative Tribunal Act 2008* (ACT) s 18(2)(a).

247 *Magistrates Court Act 1930* (ACT) s 257(1); *Court Procedure Rules 2006* (ACT) r 1725.

248 Shahla F Ali and Antonio Da Roza, 'Alternative Dispute Resolution Design in Financial Markets – Some More Equal Than Others: Hong Kong's Proposed Financial Dispute Resolution Centre in the Context of the Experience in the United Kingdom, United States, Australia and Singapore' (2012) 21(3) *Pacific Rim Law & Policy Journal* 485, 501.

249 *Ramsay Review Final Report*, above n 5, 111–16.

250 Ibid 112.

251 Ibid.

252 For a discussion of consumer financial services dispute resolution in the United States, see generally Shahla F Ali, *Consumer Financial Dispute Resolution in a Comparative Context: Principles, Systems and Practice* (Cambridge University Press, 2013) 111–36.

253 For example, consumer disputes for credit card agreements: ibid 113.

254 Ibid 118; *Rodriguez de Quijas v Shearson/American Express, Inc.*, 490 US 477, 485–6 (5th Cir, 1989).

255 Ali, above n 252, 111.

raising obvious issues of bias and conflict.[256] This litigation completely undercut the legitimacy of the United States' arbitration-based consumer financial services dispute resolution system.[257] Such an outcome is highly undesirable.

(b) An Exclusive Forum?

A potential legitimacy gap exists as a result of a consumer's ability to reject a determination and seek judicial redress. This is a legislated right in AFCA.[258] A further step in the consolidation of dispute resolution fora could be to make AFCA's determinations binding on both consumers and financial services providers, thereby removing the possibility of subsequent litigation and making AFCA the exclusive forum for disputes within its jurisdiction. The Takeovers Panel provides a useful comparison for this consideration, however, it must be viewed cautiously in light of special considerations applicable to retail consumers.

The Takeovers Panel is a statutory dispute resolution body which, similar to FOS and AFCA, uses a principled approach to dispute resolution relying on informal non-legalistic procedures. It was largely regarded as being unsuccessful for the first 10 years of its existence.[259] Similar to AFCA, a number of reforms resulted in the Takeovers Panel becoming the primary forum for takeovers disputes, including privative legislation preventing access to the courts for disputants during the takeover bid period (the period during which litigation is most likely to occur during a takeover).[260] The Takeover Panel's jurisdiction was simultaneously broadened to enable it to act in all circumstances where courts traditionally would have, but for the privative legislation. These reforms had the effect of clearly delineating the role of the Takeovers Panel from the role of the courts. More relevantly, these reforms empowered the Takeovers Panel to make socially and legally authoritative final decisions on an individualistic and commercially appropriate basis. Such empowerment is an indicator of legitimacy.

Disputants cannot take a step in judicial proceedings whilst a complaint is handled by AFCA.[261] During this period where court involvement is restricted, AFCA is the exclusive body for dispute resolution and it garners legitimacy from that position. A consumer's rejection of a determination and subsequent litigation of the issues challenges AFCA's legitimacy. Removing that possibility would have benefits including increased finality, increased pressure on AFCA to perform satisfactorily, reduced jurisdictional overlap, reduced administrative costs and reduced consumer forum shopping. Most importantly for legitimacy, this would give determinations increased authority to obey and perform. It is a relatively small

256 Chris Herring 'Minnesota AG Files Suit Against Leading Arbitration Firm' *The Wall Street Journal* (online) 15 July 2009 <https://blogs.wsj.com/law/2009/07/15/minnesota-ag-files-suit-against-leading-arbitration-firm/>.

257 Ali, above n 252, 114.

258 *Corporations Act* s 1051(4)(e)(ii).

259 Ian Ramsay, 'The Takeovers Panel: A Review' in Ian Ramsay (ed), *The Takeovers Panel and Takeovers Regulation in Australia* (Melbourne University Publishing, 2010) 13.

260 *Corporations Act* s 659B; Michael Hoyle, 'An Overview of the Role, Functions and Powers of the Takeovers Panel' in Ian Ramsay (ed), *The Takeovers Panel and Takeovers Regulation in Australia* (Melbourne University Publishing, 2010) 51.

261 *AFCA Rules*, above n 64, [A.7].

conceptual step from determinations being binding on financial services providers only to determinations being binding on both parties, as the former admits that a determination made by an EDR scheme is an acceptable substitute for judicial decisions. Put simply, if the outcome is good enough to be binding on a financial services provider, it should be similarly good enough to bind a consumer for whose primary benefit the EDR system operates.

That position, however, is sharply counterbalanced by the special needs of retail consumers who engage with AFCA. The legitimacy garnered by the Takeovers Panel should be contextualised by noting the absence of power, information and resource imbalances between the sophisticated parties before it. In contrast, AFCA complainants will, by definition, always be the weaker, less informed and less resourced party. Preserving complainants' legal rights in these circumstances may actually construct legitimacy. For example, preservation of legal rights may alleviate independence and bias concerns that consumers have towards AFCA, as a body funded by industry. Were consumers to lose such legal rights upon application to AFCA, they may be deterred from doing so. This complements the fact that a consumer's pursuit of a matter in court following a determination does not automatically mean that determination was 'incorrect'.

2 Guiding Principles

FOS was guided by EDR criteria set by ASIC: accessibility, independence, fairness, accountability, efficiency and effectiveness.[262] Those criteria mirror the *Ombudsman Benchmarks* and clearly show the importance of the industry ombudsman model in FOS' design. These criteria are now legislatively enshrined in AFCA as general criteria which the minister must consider in approving the scheme,[263] also demonstrating the importance of the industry ombudsman model to AFCA's design. These same criteria may be the basis for ASIC's issuance of a regulatory instrument[264] and ASIC must take the criteria into account in considering whether to approve a material change.[265]

AFCA's legitimacy will be affected by the legitimacy of the criteria and, by extension, the *Ombudsman Benchmarks* and industry ombudsman model from which they derive. The discussion in Part II(B) demonstrates that industry ombudsmen have become an important pillar in consumer disputes across all industries. A recent review by the Commonwealth Consumer Affairs Advisory Council found that the *Ombudsman Benchmarks* 'retain ongoing relevance for industry dispute resolution schemes', and they have been adopted by a number of industry-based dispute resolution bodies.[266] Their widespread use in ombudsman structures suggests a legitimacy-constructing capacity, which AFCA benefits from by their adoption and reinforcement in legislation.

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262 FOS, *Annual Review 2014*, above n 226, 9.

263 *Corporations Act* s 1050(2)(a).

264 *Corporations Act* s 1052A(b).

265 *Corporations Act* s 1052D(3)(b).

266 Commonwealth Consumer Affairs Advisory Council, 'Review of the Benchmarks for Industry-based Customer Dispute Resolution Schemes' (Final Report, July 2014) v.

C Consequential Legitimacy

Consequential legitimacy assesses an institution's achievements and is described by some as 'output legitimacy'.[267] Using this definition, legitimacy is constructed when the objective 'best result' is achieved,[268] assuming that there is an objective best result.[269] An EDR scheme's objective 'best result' is achievement of its policy imperative, being to provide low-cost and accessible dispute resolution services which result in a harmonised regulatory regime for the benefit of market integrity and consumer protection.

1 Cost

FOS and AFCA's services are free for consumers.[270] However, this is not to say that the dispute resolution process is objectively free. In the 2017/18 financial year, approximately 7428 consumers used non-family/friend representatives including lawyers, accountants and financial advisers during their FOS-administered disputes, suggesting that consumers paid for these services.[271] This is over double the figure for the 2014/15 financial year.[272] The *FOS Terms of Reference* made provision for financial services providers to pay consumers up to $3000 as a contribution to costs incurred in connection with a FOS dispute[273] and FOS awarded such costs compensation in its determinations.[274] Whether this sum was proportionate to the costs expended by complainants is unclear. AFCA can require a financial services provider to contribute up to $5000 to 'legal or other professional costs or travel costs incurred by the Complainant in the course of the complaint'.[275] It is also unclear whether this sum is proportionate to the actual costs incurred by complainants where they seek legal or other advice.

On the one hand, AFCA's power to order a costs 'contribution' acknowledges that there are costs incurred by complainants, contrary to the policy of the industry ombudsman model. This acknowledgement is not necessarily detrimental to AFCA's legitimacy. One fallacy of informal justice is the notion that informal adjudicators possess special skills which enable them to assess complicated law and its application without the assistance of legal representation, evaluate evidence which would be excluded in courts as unreliable, be capable of giving evidence due weight and assess the credibility of witnesses and written evidence.[276] Professional assistance in the way of paid legal or accounting services is likely to assist EDR scheme ombudsmen by presenting cases in a manner more coherent

267 Phillip Paiement 'Paradox and Legitimacy in Transnational Legal Pluralism' (2013) 4 *Transnational Legal Theory* 197, 213.
268 Ibid 214.
269 Daniel Bodansky, 'The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?' (1999) 93 *American Journal of International Law* 596, 620.
270 A mandatory requirement of AFCA as contained in the *Corporations Act* is that its services in relation to a complaint are free of charge to complainants: *Corporations Act* s 1051(2)(d).
271 FOS, *Annual Review 2017*, above n 23, 52.
272 FOS, *Annual Review 2014*, above n 226, 34.
273 *FOS Terms of Reference*, above n 59, [9.4].
274 See, eg, *FOS Determination 391283* (6 November 2015) 4–5.
275 *AFCA Rules*, above n 64, [D.5].
276 Genn, above n 216, 406.

than is likely from a layperson, simply by virtue of their training and experience in disputes. This may result in higher quality and faster dispute resolution for the parties. For this reason, the cost compensation can balance the playing field and, at the very least, not deter consumers from seeking professional assistance.

On the other hand, the discretion and limitation of cost compensation to $5000 is a clear message that AFCA is not encouraging a court-like model where representation is expected and a successful party can, in many instances, expect to receive a beneficial costs order. Similarly the inclusion of travel costs in the $5000 limit demonstrates that costs can be incurred elsewhere, and costs compensation need not be exclusively for professional assistance. The *AFCA Rules* expressly state that 'Complainants do not generally need legal or other paid representation to submit or pursue a complaint through AFCA'.[277] Reducing the involvement of lawyers by capping the cost compensation awardable maintains the informality and accessibility of an EDR Scheme, both key in the *Ombudsman Benchmarks* and *Ombudsman Key Practices*.

2 Unpaid Determinations

The issue of unpaid determinations is closely linked to the outcomes of market integrity and consumer protection. Unpaid determinations arise when financial services providers have not complied with a determination to pay compensation to a consumer. In the 2017–18 financial year, FOS estimated the value of unpaid determinations to be 'more than $16 million (excluding interest)'.[278] At 30 June 2017, that figure was $14 146 094 (excluding interest).[279] This issue is likely to worsen given AFCA's powers to order higher value compensation orders. There are two reasons for this. First, the higher compensation sums ordered will proportionately increase the sums being unpaid. Second, higher value compensation powers may not necessarily be consistent or compatible with current indemnity insurance practices. Increased risk of higher compensation orders may increase the cost of, and therefore decrease financial services providers' ability to, obtain appropriate insurance. In any event, some policies may exclude EDR compensation from the insurer's risk.[280]

FOS called for the establishment of a statutory compensation scheme, whereby consumers who are not paid their determination awards by a financial services provider are compensated from the statutory compensation scheme.[281] Where a consumer goes through a dispute resolution process only to find that the financial services provider declines to honour a determination, there is a clear failure and a significant legitimacy gap.

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277 *AFCA Rules*, above n 64, [A.1.3].

278 FOS, *Annual Review 2017*, above n 23, 9.

279 Review of the Financial System External Dispute Resolution and Complaints Framework, 'Supplementary Final Report' (Final Report, September 2017) 38 ('*Ramsay Review Supplementary Final Report*').

280 *Ramsay Review Final Report*, above n 5, [8.19], [8.23]; Association of Financial Advisers, Submission to Treasury, 21 June 2017, 2, 10, 16; Huggins Legal, Submission to Treasury, 25 January 2017, 6.

281 FOS, *Annual Review 2014*, above n 226, 26.

This call had not been heeded in relation to FOS and the corresponding legitimacy gap continues to exist. The *Ramsay Review* separately considered a statutory compensation scheme of last resort in relation to the EDR overhaul.[282] Public consultation on the issue suggested that establishing a statutory compensation scheme of last resort would 'ensure that consumers who suffer loss from misconduct are compensated; build trust and confidence in the current EDR arrangements; and ensure trust and confidence in the financial services sector more generally'.[283] Such outcomes go directly to the policy goals of consumer protection and market integrity, not only constructing legitimacy generally, but also closing the consequential legitimacy gap that arises from unpaid determinations.

The *Ramsay Review's Supplementary Final Report* recommended a 'limited and carefully targeted' statutory compensation scheme of last resort.[284] This indicates a shift from the position taken in 2012, when the Australian Government commissioned a report on compensation arrangements for consumers of financial services as part of the Future of Financial Advice reforms. The conclusion of that report was that a comprehensive last resort compensation scheme 'would be inappropriate, and possibly counter-productive'.[285] For now, the issue has not been developed further and any such development will likely be premised on the policy decisions responsive to the Banking Royal Commission.[286]

V CONCLUSION

Returning in conclusion to the central question of this article: is AFCA a new and improved financial system EDR body, or is it simply new? The importance of legitimacy in EDR bodies, for reasons described in Part III(A), makes appropriate and necessary an answer which relies on legitimacy as its key metric. There have no doubt been legitimacy-constructing improvements in AFCA when compared to the Predecessor EDR Schemes. Looking particularly at non-superannuation disputes, these include: (1) a comprehensive legislative supporting structure in part 7.10A of the *Corporations Act*; (2) enhanced and enforceable accountability mechanisms which are clearly enunciated in the *Corporations Act*; (3) clearer delineation between preliminary assessments and determinations; (4) the new institutional context in which AFCA is the primary dispute resolution body for disputes captured by its broad subject matter jurisdiction; and (5) its power to

282 The Treasury, 'Amendment to Terms of Reference of the External Dispute Resolution Review' (Media Release, 3 February 2017).

283 Review of the Financial System External Dispute Resolution Framework, 'Supplementary Issues Paper' (Paper, May 2017) 19.

284 *Ramsay Review Supplementary Final Report*, above n 279, 3.

285 Richard St John, 'Compensation Arrangements for Consumers of Financial Services' (Report, April 2012) iii.

286 The author notes that the Banking Royal Commission's Final Report, released shortly before the publication of this article and therefore not considered here, recommended that the *Ramsay Review's Supplementary Final Report's* recommendation on the establishment of a compensation scheme of last resort 'should be carried into effect': Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (2019) vol 1, 41, 482–7.

internally review jurisdictional decisions. These features alone are enough to conclude that AFCA is indeed a new and improved EDR scheme. However, this is not to say that AFCA is a perfect replacement. AFCA's legislated informal justice model carries the same legitimacy gaps which afflicted FOS: (1) use of fairness as a decision-making criteria, especially for high value and complex disputes which may now be captured by AFCA's higher monetary value jurisdiction; (2) a lack of internal or external review for determinations; (3) a lack of clarity in the approach taken between a preliminary assessment and a determination; and (4) the potential growth in the value of unpaid determinations. These legitimacy-challenging features were replicated in AFCA largely on recommendation from the *Ramsay Review* and have benefits as well as capacity to challenge legitimacy. AFCA's accountability mechanisms may somewhat offset these legitimacy gaps, however, that is yet to be seen in its operation. Its accountability mechanisms also mean that AFCA is highly adaptable. If it becomes clear that AFCA's legitimacy gaps outweigh the benefits ascribed to its informal justice model, AFCA should be able to adapt to mitigate that imbalance. For this reason, AFCA's function should be closely monitored by stakeholders and appropriate recourse had to AFCA's Independent Assessor if its procedural and substantive actions are perceived as illegitimate.