

## **LegCo Panel on Financial Affairs**

### **Reference materials for deliberation on the protection for consumers in the banking sector**

This paper outlines the reference materials to facilitate deliberation on the concerns relating to the protection for consumers in the banking sector.

#### **Background**

2. The need to study the protection for consumers has been raised by Members in different forums. Following the announcement by some banks that charges might be raised for services for small depositors in early January 2001, the Financial Affairs (FA) Panel at its meeting on 11 January 2001 examined the impact of these charges on bank customers, particularly those low-salaried employees with fixed payroll accounts with these banks.

3. On 14 February 2001, the Council passed a motion on "protecting the interests of small depositors of banks" moved by Hon LAU Chin-shek as amended by Hon CHAN Kam-lam, as follows: -

"That this Council is concerned about the substantial increase in charges by some banks on their small depositors, and its impact on the elderly and the disadvantaged groups in the community; to enhance the transparency of the charging policies of banks and protect the interests of depositors, this Council urges the Government and the Hong Kong Monetary Authority to review the relevant provisions in the Code of Banking Practice, so as to enhance the transparency of fee revisions by banks, and examine at the same time the empowerment of the Hong Kong Monetary Authority to protect consumers of banking services."

4. According to the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA), the Government is not inclined to interfere in matters relating to the revision of a bank's fees and charges as this is a commercial decision. There is however an increasing need to address the issue of protection for banking customers as the banking sector has become more competitive. At present, there is no clear mandate for the Hong Kong Monetary Authority (HKMA) to function as a banking consumer watchdog, but HKMA is planning to review the need for it to have a more explicit mandate in dealing with consumer issues.

5. Studies have since then been conducted by both the Administration and the FA Panel. Apart from including consumer protection as one of the subjects to be studied by the delegation visiting the United Kingdom (UK) and the United States in April 2001, the FA Panel has also commissioned the Research and Library Services Division of the Legislative Council (LegCo) Secretariat to conduct a research on this subject to facilitate further discussion by the Panel.

### **Study conducted by the Hong Kong Monetary Authority**

6. In April 2001, the HKMA issued the report on the "Comparative study on banking consumer protection and competition arrangements in the United Kingdom, Australia and Hong Kong" which was circulated to Members vide LC Paper No. CB(1)1120/00-01(02) on 27 April 2001. Taking note of the respective systems of banking consumer protection in UK and Australia, members raised the following concerns about the corresponding systems and practices in Hong Kong at the FA Panel meeting on 3 May 2001-

- (a) the enforcement and sanctions against non-compliance with the Code of Banking Practice which was non-statutory;
- (b) the availability of measures to ensure access to basic banking services for the financially disadvantaged groups and some special classes of customers including pensioners, students and the disabled;
- (c) the existing complaint handling mechanism in Hong Kong as compared to the Ombudsman scheme in operation in UK and Australia; and
- (d) the empowerment of HKMA to assume the statutory responsibility for consumer protection.

### **Study conducted by the delegation of the overseas duty visit**

7. The issue of consumer protection in the financial services sectors was one of the subject areas studied by the delegation comprising members of the Financial Affairs Panel and the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 during its overseas duty visit to London, Washington, DC and New York in April 2001. The delegation gave particular attention to the mechanisms for gauging customers' views on and reaction to policy and legislative proposals and the mechanism for dealing with customer complaints in these overseas places. The report of the delegation was issued vide LC Paper No. CB(3) 866/00-01 dated 3 July 2001 and tabled at the Legislative Council meeting on 4 July 2001. The relevant extracts from the report covering consumer protection are attached at **Appendix I**.

## **Research conducted by the Research and Library Services Division**

8. The Research and Library Services Division conducted its research on protection for banking consumers in UK and the United States with particular regard to fees and charges imposed by banking institutions and accessibility of the disadvantaged groups to basic banking services. It also made reference to the materials brought back from the overseas duty visit and the findings of the delegation. The research report entitled "Protection for Banking Consumers in the United Kingdom and the United States of America: Fees and Charges" was issued to members vide LC Paper No. CB(1)626/01-02(01) dated 17 December 2001.

## **Overall comparison on protection for banking consumers between Hong Kong and overseas jurisdictions**

9. To facilitate the Panel's deliberation on the subject, the LegCo Secretariat, based on the aforesaid documents, has developed a comparison table outlining the respective systems and mechanisms in UK, the United States, Australia and Hong Kong for protecting the interests of banking consumers. In the light of members' concerns expressed on previous occasions, the following topics have been included in the comparison table -

- (a) Prudential supervision of the banking sector
  - (i) regulatory framework
  - (ii) compensation
  
- (b) Conduct regulation of the banking sector
  - (i) regulatory framework
  - (ii) fees and charges for basic banking services
  
- (c) Customer services and protection
  - (i) complaints handling mechanism
  - (ii) consumer consultation
  - (iii) access to credit reference
  - (iv) consumer education

The comparison table is attached at **Appendix II**.

**Extracts from****"Report on the Financial Systems in the United Kingdom and the United States of America based on the findings of the overseas duty visit paid by the delegation of the Financial Affairs Panel and the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 in April 2001"**

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**Chapter 7 Consumer protection**

7.1 One of our major achievements in this overseas duty visit is the opportunity to understand the way in which the two countries protect the rights of consumers. All regulatory legislation is said to be for the purpose of protecting consumers' interests. What those interests are and how they may be ascertained are usually not clearly explained. Protection of consumers' interests in fact covers a much wider scope than the handling of customers' complaints. Industries are often under the impression that by ensuring the protection of customers' interests, the rights and interests of the industries are forgone. We observe that the concept of consumer protection has been very comprehensively implemented in the FSM Act of the UK which links the protection of consumers to the macro interest of maintaining the international competitive position of the financial markets. With globalization, it is no longer realistic to believe that market players and investors would solely engage their investment activities in any single market or any single economy. To enhance the competitiveness of one's own markets, the government has the obligation to ensure the interests of all those who play a part in the markets are protected.

7.2 Both the UK and the US have placed much emphasis on the protection of consumers' rights, but they have adopted different approaches which seem to fit into the individual characteristics of their respective businesses and living environments. In studying the mechanisms adopted by these countries, it is important to refer to the wider context of how financial services are provided to customers in these places, the range of services available and how far these services are regulated.

**Consumer protection under the FSM Act of the UK**

7.3 The FSM Act of the UK has tackled the subject of consumer protection from the macro perspective of competition scrutiny to the handling of complaints from individual customers. As we have not had the opportunity to study the issue of competition during the overseas visit, we focus in this report on the consultation mechanism and redress systems in relation to consumer protection.

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7.4 Under the FSM Act, the protection of consumers is an objective written into the legislation to secure the appropriate degree of protection for consumer. In considering what degree of protection may be appropriate, the FSA must have regard to<sup>1</sup> --

- (a) the differing degrees of risk involved in different kinds of investment or other transactions;
- (b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity;
- (c) the needs that consumers may have for advice and accurate information; and
- (d) the general principle that consumers should take responsibility for their decisions.

7.5 The FSM Act provides the ante facto duty of the FSA to consult a Consumer Panel, and the post facto redress through an ombudsman scheme.

### Consumer Panel

7.6 A consumer panel was at first established voluntarily by the FSA in 1998 as a consultative body to gauge the consumer reaction to the proposed Financial Services and Markets Bill. In the course of the scrutiny of the Bill, it was felt that the consumer panel should be given a statutory basis and the FSA should have a duty to consult the panel. The FSA is now by statute required to consult consumers on the extent to which its general policies and practices are consistent with its general duties under the Act<sup>2</sup>. It is also under a duty to establish and maintain a panel of persons to represent the interests of consumers<sup>3</sup>. The panel so established is called the Financial Services Consumer Panel.

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<sup>1</sup> Section 5 of FSM Act.

<sup>2</sup> Section 8 of FSM Act.

<sup>3</sup> Section 10 of FSM Act.

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7.7 The current Consumer Panel has 13 members including the chairman. They have been appointed by an open recruitment process based on the principles recommended by the Nolan Committee. The appointees are on contract terms for a fixed period. The remuneration for an ordinary member is £ 8,000 per annum, not enough for a full time job. One is expected to work about 25 days a year, but the actual workload demands much more time. The Panel meets formally about 10 times a year. It has its own budget and is supported by a secretariat of four full time staff. The Panel has to issue annual reports which would be laid before the Parliament.

7.8 During the past two and half years, the Consumer Panel has responded to 86 consultation papers and 20 other major papers on the new regime in addition to the FSM Bill itself. We are advised that as members of the Panel are basically part-time, there is not much chance for them to be proactive, but with the opportunity to respond to proposals, members have become broader in outlook when looking at the regulatory framework. Although they are appointed by the FSA and the four full-time staff come from the FSA, the experience they had in the past two and half years shows that they could be entirely independent in operation. The Panel is completely transparent in its operation although its meetings are closed. All proposals put to the Panel for views are published and put on the Internet, so that views from the public could be channeled to the members before they formulate their views on the proposals. The Panel also has close working relationship with the Financial Ombudsman Service, the Consumer Help-line and consumer associations. The fact that the FSA needs to explain to the public why the Panel's representations are not accepted has compelled the FSA to be more aware of the interests of consumers<sup>4</sup>.

#### The Ombudsman system

7.9 The delegation had the benefit of visiting the Financial Ombudsman Service (FOS) in the midst of a major organizational change in the ombudsman system of the financial sector of the UK. The FSM Act, which may come into effect in November 2001, provides for the creation of a single, compulsory ombudsman scheme for the resolution of disputes between authorized firms

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<sup>4</sup> Meeting with FSA on 6 April 2001.

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and their customers. The object of the scheme is to resolve disputes involving customers quickly and with minimum formality. The operator of the scheme must be a body corporate<sup>5</sup>.

7.10 The proposal to provide a single operator to deal with disputes involving customers came about when the Government saw the need to rationalize the eight dispute resolution schemes in the financial markets in the mid 90s. To reduce the scope for confusion about the roles and responsibilities of different schemes, and to ensure improved access for consumers by providing a single point of entry, the FSM Act establishes "the ombudsman scheme" to replace the following eight schemes:

- Banking Ombudsman
- Building Societies Ombudsman
- the FSA complaints service
- Insurance Ombudsman
- Investment Ombudsman
- Personal Investment Arbitration Service
- Personal Investment Authority Ombudsman
- SFA Complaints and Arbitration Service

7.11 We understand that these various schemes were formerly set up by the respective industries. Some of these schemes were compulsory, while others voluntary. Some were set up under statute, while others were based on contract. When a complaint could not be resolved to the satisfaction of the complainant, he still had the right to go to court. But the chance of winning was very little as the ombudsmen of the respective services had already taken the legal considerations into account. In the case of the Complaints and Arbitration Service of the Securities and Futures Authority (SFA) which the FOS has now taken over, its role was mainly arbitration as the decisions of SFA were by law final.

7.12 We notice that when the proposal was examined by the Joint Committee on the FSM Bill, despite the general support for the single ombudsman scheme, there was concern that "the scheme, given the due process

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<sup>5</sup> Section 225 of FSM Act.

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requirements of the European Convention on Human Rights, might resemble a court or Tribunal rather than an Ombudsman scheme". Attempts had been made by the various Ombudsmen "to consider and plan how reformed procedures might comply with these requirements while retaining the informality and flexibility that are hallmarks of an Ombudsman approach". The Joint Committee therefore considered it "important that the procedures should be fair and transparent but within those parameters... it will prove possible to ensure that the Financial Ombudsman Scheme does not become over-legalistic"<sup>6</sup>.

7.13 Under the FSM Act, all firms authorized by the FSA are required to submit to the jurisdiction of the ombudsman scheme. The FSA is to make rules determining which activities of authorized persons fall within the compulsory jurisdiction. Firms can join the ombudsman scheme under the voluntary jurisdiction where they are not authorized by the FSA or in respect of activities falling outside the scope of compulsory jurisdiction. Voluntary jurisdiction rules can be made by the scheme operator with the approval of the FSA.

7.14 To enable a smooth transition, the FOS was established as a company incorporated by guarantee to serve as the interim scheme operator until the FSM Act comes into force in November 2001. With its budget approved by the FSA, it provides the appropriate complaints-handling service on behalf of each of the boards of the existing complaints-handling and ombudsman schemes under service agreements signed with the boards. Those staff who originally worked for these various schemes were taken over by the FOS.

7.15 The service of the FOS is free to consumers. Any unsatisfied customers may bring their complaints to the FOS but they must have lodged their complaints with the financial firms first. The firm should try to resolve the issues first. The complainants may then bring their cases to the FOS or to court. The FOS may only deal with cases with a value up to £ 100,000 (excluding costs of the redress).

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<sup>6</sup> Paragraph 295 of the First Report of the Joint Committee on Draft FSM Bill.

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7.16 The ombudsman will make a decision about the complaint on the basis of what he considers is fair and reasonable in the circumstances. If the complainant accepts the ombudsman's decision, it is then binding on both the complainant and the firm. If the decision is made in favour of the complainant, the respondent may be ordered to pay compensation up to a maximum limit which may be set by the FSA. The yardstick in determining the level of compensation is on the basis of "no change to the consumer", i.e. putting back to the position should the situation have not taken place<sup>7</sup>.

7.17 As the scheme operator, the FOS is given the power to make rules concerning the costs which can be awarded by the ombudsman but subject to certain constraints. Where a complaint is settled in favour of the complainant, the rules can allow the firm concerned to be required to meet the costs of both the complainant and the scheme operator. Once a prima facie case is established, the firm will be asked to pay a case fee of £ 500 (recently reduced to £ 400) which is not refundable even if the complaint is not upheld in the end. The firm may not get the legal costs back even though the process is done through legal representatives. While the ceiling of compensation currently set by the FSA for each case is £ 100,000 (excluding redress fees), the ombudsman may recommend to the courts for a higher compensation.

7.18 The ombudsman's role is inquisitorial but the whole process is informal and principally paper-based. Public hearings may be conducted if considered appropriate. Legal representation is allowed but it is not an absolute right. The scheme operator is provided the powers to require the production of specified information necessary for the fair determination of the complaint. Failure to comply with the requirement can be dealt with as if it were a case in contempt of court. Although consideration of the case must be legally based, the ombudsman also looks at the practices and other circumstances. The particular circumstances of the consumer will be given more consideration than a court would normally do. Having concluded his investigation, the ombudsman would make an award. It would be binding on the firm but not the consumer, who may resort to the courts if not satisfied with the outcome of investigation or the award.

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<sup>7</sup> Meeting with FOS on 6 April 2001.

7.19 Although all costs in supporting the FOS come from the industries, with 50% funded by levies (based a formula calculated from income) and 50% from case fees, the FOS is independent of the government and financial firms. Members of the FOS Board are appointed and liable to be removed from office, by the FSA<sup>8</sup>.

7.20 We also understand from the FOS that while a completely free system to customers may be subject to abuse, the existence of the system of redress helps the industries to restore the confidence in the business. The in-flow of work may at times be influenced by press reporting, but on the whole there is no indication of abuse especially in the banking sector. According to the information provided to the delegation, out of about 6 000 complaints against the banking sector in a month, only about 7 get to the ombudsman. The law requires all complaints to be dealt with by the banks first before they can be forwarded to the ombudsman. On average, of 1 000 calls received by the FOS on banking-related matters, only 400 would subsequently be put down as written complaints. Of these 400 cases, only about 250 need to be followed up and 150 could already be resolved at the bank level. For the 100 cases dealt with by the FOS, efforts will first be made to bring the two parties together and reach a compromise on the settlement. If no settlement can be reached, a full investigation will then be conducted.

7.21 The situation in other industries may be different especially in the insurance and investment sectors. In the investment sectors, the regulation is on both prudential and how the detailed work is done. More involvement by the regulator is therefore inevitable. As a result, a large proportion of complaints may subsequently go to the ombudsman. Generally speaking, there still remains a danger that a free ombudsman service might encourage investors who have suffered loss in a volatile market to make unsubstantiated complaints.

## **The US system**

7.22 In the US, the rights of consumers are protected by laws. All

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<sup>8</sup> Paragraph 3 of Part I of Schedule 17 of FSM Act.

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legislation, regulations and rules must not contravene the individual rights enshrined in the US Constitution. The statutory requirements to protect consumer's rights are embedded in the statutes in respect of the specific trade. We have only had the opportunity to understand the system in the banking field through our meeting with the Federal Reserve Bank of New York. It is however illustrative of the protection of consumer rights as reflected in the US laws.

7.23 Taking credit protection as an example, the Consumer Credit Protection Act of 1968, which launched Truth in Lending disclosures, had for the first time required creditors to state the cost of borrowing in a common language that every ordinary consumer could figure out what the charges are, compare costs, and shop for the best credit deal. Since 1968, the concepts of "fair" and "equal" credit have been written into laws that bar unfair discrimination in credit transactions, require that consumers be told the reason for the denial of credit, allow customers to find out about their credit records from credit-reporting agencies, and set up a way to settle billing disputes. These laws set a standard for how individuals are to be treated in their financial dealings. Today, on credit protection alone, there are acts on truth in lending and consumer leasing, equal credit opportunity, fair credit billing, fair credit reporting, and electronic fund transfer.

7.24 Another example is the Gramm-Leach-Bliley Act which the delegation studied in some depth during the visit. The Act requires the Federal Trade Commission, the enforcement body of a variety of federal antitrust and consumer protection laws, along with the Federal banking agencies, the National Credit Union Administration, the Treasury Department, and the SEC, to issue regulations ensuring that financial institutions protect the privacy of consumers' personal financial information. Such institutions must develop and give notice of their privacy policies to their own customers at least annually, and before disclosing any customers' personal financial information to a nonaffiliated third party, must give notice and an opportunity for that customer to "opt out" for such disclosure. While the Federal Trade Commission stops actions that threaten consumers' opportunities to exercise informed choice, the respective regulatory bodies also have the responsibility to institute complaint-handling mechanism to deal with customers' complaints.

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7.25 To ensure that customers are aware of their rights, handbooks and pamphlets are published by the enforcement and regulatory bodies to explain their rights under the laws. Regulatory bodies also lay down detailed regulations setting out the consumer complaint procedures and defining unfair or deceptive acts or practices. Each bank or financial institution must have its own complaints handling office to help the redress customer grievances. If customers are unable to resolve the problem, they may file a written complaint with federal agencies responsible for enforcing the related laws. Many of the agencies however do not handle individual complaint, but they will use information about the customers' experiences to help enforce the credit laws.

### Complaints against banks

7.26 Bank customers may direct their complaints to the Federal Reserve System. The Federal Reserve investigates all cases against state-chartered banks and refers all other cases to the relevant federal regulatory agencies. Under the Federal Reserve System, the Division of Consumer and Community Affairs (DCCA) is responsible for handling consumer complaints. Once a complaint has been received, it will be reviewed by the consumer affairs staff. The relevant Reserve Bank will investigate each issue raised in the complaint and ask the bank concerned for information and records. The bank's response will be analysed to ensure the consumer's concern is addressed. The complainant will be informed of the Reserve Bank's findings in writing.

7.27 If the investigation reveals violation of the laws, the Reserve Bank will direct the bank to take corrective action. The Federal Reserve does not have the authority to resolve all types of problems, such as contractual or factual disputes or disagreements about bank policies or procedures. If the matter cannot be resolved with the bank even after a complaint has been made, the customer may consider taking legal action against the institution.

7.28 The laws also lay down the penalties a creditor, i.e. the bank, must pay if the customer wins in a lawsuit<sup>9</sup>. For example, if any creditor fails to disclose information required under the various acts, or give inaccurate information, etc., the customer as an individual may sue for actual damages and any money loss

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<sup>9</sup> Page 36, Consumer Handbook to Credit Protection Laws.

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he suffer. In addition, the customer may sue for twice the finance charge in the case of certain credit disclosure, or if a lease is concerned, 25% of total monthly payments. In either case, the court may award the customer, if he wins, a minimum of US\$100, or a maximum of US\$1,000. The customer who wins in the lawsuit is entitled to reimbursement for court costs and attorney's fees. In the case of violation of the Fair Credit Reporting Act, again the customers who are successful in the lawsuits are entitled to actual damages, court costs and attorney's fees, plus punitive damages that the court may allow if the violation is proved to have been intentional. In addition, a person who obtains a credit report without proper authorization or an employee of a credit-reporting agency who gives a credit report to unauthorized persons may be fined up to US\$5,000 or imprisoned for one year or both. Class action suits are permitted for filing claims on behalf of a group of people with similar claims.

#### Complaints against institutions regulated by the Securities & Exchanges Commission

7.29 As regards complaints related to securities, the Office of Investor Education and Assistance (OIEA) of the SEC is charged with the duty to ensure that the problems and concerns of the individual investors are known to the SEC and considered when the agency takes action. Members of the public can lodge their complaints with the SEC Complaint Center. After a complaint is received, it would be thoroughly reviewed and evaluated. General questions of securities laws and complaints relating to financial professionals or a complainant's personal financial matters will be handled by the OIEA. It may counsel the complainant of possible remedies and may, in appropriate circumstances approach the brokerage firms, advisers or other financial professionals concerned. Any complaints implicating violation of securities laws will be referred to the Division of Enforcement. Confidential investigation would be carried out if necessary and enforcement actions taken. The OIEA does not have the power to make any awards or any official capacity to resolve disputes. It is meant to provide advisory services only. The SEC does not mete out penalties. Those are the responsibilities of the administrative judges.

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## **Things to consider**

7.30 In Hong Kong, protection of consumers' rights is done through prudential supervision and conduct regulation by the respective regulatory bodies. The regulations governing the conduct of the markets are made on the basis of what constitutes good practice. Under the current system, redress is sought through civil proceedings in courts. By legislating consumers' rights and providing statutory remedies as in the US, unfair practices in the markets may be deterred. However, in seeking redress, the usual avenue of litigation is time-consuming and costly. There is no specific provision in the Securities and Futures Bill setting out the SFC's obligations on consumer protection. To make Hong Kong's securities and futures markets competitive and to uphold the principle of fair trading, consideration should be made to conducting a comprehensive review on the subject with a view to formulating an overall policy on the protection of customer's rights.

7.31 The financial system in Hong Kong is different from those in the UK and the US; the redress system should therefore be congruent with the circumstances in Hong Kong rather than a copy of the systems from other jurisdictions. The particular difficulty in Hong Kong lies in the collation of the views of consumers. That is because consumers are not a homogeneous group and there is no strong consumer association in Hong Kong representing a sufficiently broad cross-section of consumers. We are therefore particularly impressed by the work of the Consumer panel and the Practitioner Panel of the FSA in the UK. The two Panels, though working independently, have maintained some form of informal link with each other. The two Panels appear to have worked harmoniously together, with each putting forward its own representation from its own angle, but fully aware of the concerns of the other. The FSA has been able to make the two Panels working as partners rather than opponents although they represent different interests. One interesting thing we observe is that the two Panels are involved in the appointment of the key positions of the FSA. This arrangement enhances the accountability of the key staff to the achievement of the FSA's objectives.

7.32 It is pre-mature to suggest if a neutral body similar to the single ombudsman system in the UK is needed in Hong Kong. The free service of the FOS may appear very attractive to consumers. However, the problem of preventing the making of unsubstantiated complaints remains unresolved.

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The possible abuse of a free ombudsman service needs serious consideration as the funding of which might cut into the competitiveness of Hong Kong as an international financial centre.

7.33 It is obvious that the US does not have an ombudsman system similar to the UK regime for consumer protection, nor any formalized pre-consultation machinery like the Consumer Panel of the FSA. Nevertheless, proposals on new rules are widely published for public consultation. We notice that services similar to the OIEA are already provided by our SFC. However, protection of customers' rights is a pre-requisite in ensuring confidence in the industries and therefore deserves special attention. In the absence of an overall policy on consumer protection, the principles enunciated in the relevant Articles of ECHR are of high referential value. To maintain Hong Kong as an international financial centre, it is not only the hardware of infrastructure that needs to be comparable to leading markets, but also the software of the spirit of the rule of law and the respect for human rights.

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## **Chapter 8    Other observations**

8.1    The delegation finds the visit to the UK and the US very timely. Hong Kong is in the middle of a major revamping in its financial infrastructure. Since 1998, some 70 legislative proposals, including 17 bills and 52 pieces of subsidiary legislation related to Hong Kong's financial system and regulatory framework have passed through the Legislative Council. Some of these legislative changes, such as the structural reform of exchanges and clearing houses, strengthening of the regulation of securities margin financing and short-selling, criminalizing the provision of false information, etc., were introduced to address some of the major misgivings in the operation of the financial services industry. Today, the Legislative Council is scrutinizing a legislative proposal which aims to set up a new regulatory regime for the securities and futures market. Our visit to the UK and the US has provided us an opportunity to pause and think where all these legislative changes are going to take us to.

8.2    The financial services industry, including insurance and related business services, has since mid 1990s accounted for over 20% of the Gross Domestic Product of Hong Kong. Hong Kong, in face of the keen competition from its neighbouring regions, relies heavily on its financial services industry to steer the growth of its economy. To maintain its leading position as an international financial centre, Hong Kong needs to be alert to the changes in the world markets, including the emergence of new business trends and changes in market behaviours, and provide a level playing field for all market participants with sufficient protection for investors.

8.3    In view of the importance of our financial services industry, there is every reason for us to ensure that we have a financial system which would continue to serve Hong Kong well. Therefore, in studying the financial systems in Hong Kong, the UK and the US, we are conscious of the difference in the constitutional structures and historical backgrounds which shapes the development of these financial markets. What serve the UK and the US well may not be entirely applicable in the Hong Kong setting. Nevertheless, there are a few observations we consider particularly enlightening and of special value in spite of the difference of their political and constitutional structure.

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## **Need for a strategic direction for development**

8.4 During our visit, we had the opportunity to meet different people from different spectrums of the financial hierarchy - from the government, the legislature, the regulators, traders, major market players to consumer representatives. We observe that despite their different roles and interests, they share the same objectives and same understanding of the general direction of development in their systems. With this common understanding of the long-term goal, it has made compromises and cooperation much easier. For example, in the UK, it has taken two years for the FSM Bill to pass through the two Houses, and more than one year for the FSA to pave the way for the FSM Act to come into effect. The Government is aware of the need to have the full commitment of the different trades in the financial services industry to the new regulatory structure and has therefore provided ample time for public discussion and for the assessment of risks in implementing the new structure. Much of the discussion on the Bill was focused on the regulatory objectives of the FSA, and on the basis of which the FSA would make its rules for the authorized persons. The extensive discussions on the objectives to be included in the Bill helped bring out the concerns of different parties and facilitated the achievement of common understanding despite their different interests. The four regulatory objectives, namely market confidence, public awareness, the protection of consumers and the reduction of financial crime, now embodied in the FSM Act have become the basis of the direction to be pursued by the entire industry.

8.5 In Hong Kong, regulatory objectives are for the first time included in the Securities and Futures Bill. Whilst it is definitely one step forward, questions remain in how far the objectives would fully be implemented by the Bill and in what manner would these objectives also apply to other sectors, e.g. banking, insurance, of the financial services industry. There is no overall picture of whether this will eventually be the way forward for the entire industry, and without this overall picture, it is difficult to ensure that the development of individual sectors is moving in a direction of common interest to the industry.

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8.6 We consider that there is a general lack of discussion in the community, especially among the trades and institutions concerned, about the strategic direction which Hong Kong should take to maintain or elevate its status in the international financial arena. Since the attack on Hong Kong dollar in 1997 and the Asian financial turmoil that followed, the general public and the financial services sector have been receptive to proposals from the Government to restore confidence in the Hong Kong currency and the stock markets. There is however little discussion on what direction Hong Kong should take in building its financial infrastructure. Without a shared understanding of the strategic direction, it is not easy for different trades, different regulators and different policy bureaux to work in concerted efforts for the long-term development of the Hong Kong financial markets. There would even be inconsistencies in the standard of regulation for different trades, lack of long-term plans to cope with global changes and mismatch of human resources for the sustainable growth of the financial services industry.

### **Transparency of the decision-making process**

8.7 Notwithstanding the different regulatory structures and different modes of market operation in the UK and the US, one thing which is common to both jurisdictions is the emphasis they place in consulting the public and the parties concerned before deciding on the way forward or making changes to the current system, no matter how small the changes may appear to be. The consultation process is often done in an open and systematic manner so that views from all parties can be documented and considered before a decision is made. We mentioned in Chapters 5 and 7 that the FSA has the statutory duty to consult practitioners and consumers and to consider their representations. Where it disagrees with the views made in such representations, the FSA also has the duty to give its reasons in writing. The formalization of the consultation process has made it possible for all supporting or opposing views to be brought to open discussion. This has effectively drawn public attention to the implications of the subject matter during the formative stage of the proposal.

8.8 We notice in the US, some agencies, instead of just publishing a paper for consultation, have provided information in different forms for consumption by people from all walks of life. To facilitate a meaningful exchange of views,

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the parameters that may have a bearing on the subject are also set out for public reference.

8.9 Quoting deposit insurance as an example, the US has operated its deposit insurance scheme for 67 years. The Federal Deposit Insurance Corporation (FDIC) is at present conducting a major review to reconsider the policy objectives of the scheme and to address the flaws in the current system. The FDIC has provided hyper-link on its homepage to the homepage of the Working Group on Deposit Insurance of the Financial Stability Forum<sup>1</sup>, of which the US is a member. The Working Group was established in April 2000 to develop guidance on deposit insurance. Such guidance aims at identifying the issues associated with deposit insurance, the options available to policymakers to self-assess and to address those issues, and the trade-offs involved in choosing particular approaches. It has identified 16 guidance topics and issued 12 discussion papers on those topics. These discussion papers help economies in assessing their own situation when deciding whether to establish or modify a deposit insurance system. In other words, instead of just trying to commce the public the merits of its proposal, the agency has provided as much information as possible to the public on the subject so that the exchange of views can be analytical, thorough and comprehensive.

8.10 A meaningful consultation exercise is one way to enhance the transparency of the decision-making process. In both the UK and the US, policy-makers are aware of the importance of arousing public discussion on a new policy or a scheme before deciding on it. The general public, or even those who are in the trades, may not have any knowledge of the implications involved. It is therefore the responsibility of the government to assist the general public to understand not only the merits of the proposal but its implications and the extent of the commitments required of all parties concerned, in a language that they would understand. It is only through open and thorough discussion that uncertainty could be reduced and resistance due to lack of understanding minimized.

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<sup>1</sup> The Financial Stability Forum was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. It established the Working Group on Deposit Insurance in April 2000 to develop guidance on deposit insurance.

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8.11 We observe that our government has also placed much emphasis on public consultation in recent years. We believe that the more a proposal is debated by the community, the more information the Government would be able to ascertain for deciding its way forward. Extensive and meaningful public discussion at an early stage of the formulation of a policy is the root to greater understanding of the subject matter and support by the community.

### **Concern for the community**

#### Public education

8.12 All jurisdictions including Hong Kong are aware of the importance of public education so that individuals will know how they may benefit from any new policy or legislation or its impact on them. We notice the efforts made by some agencies or regulators in helping the public understand their rights and obligations in a totally customer-oriented manner. Complex subjects are explained by way of situation illustrations to help even an ordinary citizen understand what he/she would face or can pursue in his/her daily life. Even for matters involving complicated procedures, such as application for a license, the explanatory notes are written in an easy-to-read fashion, so that anyone would be able to know the procedural steps involved without having to rely on professional advice. Public education has become an essential part of the job of the government and the regulators. The challenge to them now is how public education can be done in the most inexpensive yet effective manner.

#### Proactive approach to cater for social needs

8.13 We have had the opportunities of meeting trade associations and major market players in this visit. We notice that some of the trade associations do place their concern for the community as an objective for their work. For example, in the UK, upon the outbreak of the Foot-and-Mouth disease, the British Bankers' Association requested its members to proactively look into the special needs of those of their customers who were affected by the spread of the disease and offer special terms to help them tide over their financial hardships.

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8.14 In the US, we note the decision of the New York Board of Trade to maintain the manual and electronic systems on the grounds that "changing the system to an entirely electronic one will put a lot of people out of job". The operating of the two systems in parallel is obviously more expensive especially when the Board has to continue to inject money into the electronic system to make its market competitive. Yet, with the interest of the workforce in mind, the Board has decided to keep the old system running.

8.15 Another example is the American Stock Exchange which gives special attention to companies with small and medium capital. One of their objectives is to help these companies grow. A dedicated team is deployed to teach these individual companies how to develop their business.

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**Chapter 9 Conclusions and recommendations**

Paragraph 9.4

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Consumer protection

- (e) The success of the financial industry relies heavily on the extent of public confidence in the financial markets. Protection of consumers is one of the prerequisites in building up confidence in the markets and fostering the continued growth of the industry. Consideration should be given to arouse public discussion on how far the public could be made aware of their rights and obligations, and on a more uniform consumer protection mechanism to enhance consumer protection.

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## INFORMATION NOTE

### Comparison of Measures to Protect Banking Consumers in the United Kingdom, the United States of America, Australia and Hong Kong

	United Kingdom	United States of America	Australia	Hong Kong
<b>Prudential Supervision</b>				
<b>Regulatory Framework</b>				
Legislation	<ul style="list-style-type: none"> <li>• Bank of England Act 1998</li> </ul>	<ul style="list-style-type: none"> <li>• Federal and state laws</li> </ul>	<ul style="list-style-type: none"> <li>• Banking Act 1959</li> </ul>	<ul style="list-style-type: none"> <li>• Banking Ordinance</li> </ul>
Regulator	<ul style="list-style-type: none"> <li>• Financial Services Authority</li> </ul>	<ul style="list-style-type: none"> <li>• National banks — Office of the Comptroller of the Currency</li> <li>• State member banks — Board of the Federal Reserve</li> <li>• State non-member banks which are federally insured — Federal Deposit Insurance Corporation</li> <li>• State non-member banks which are not federally insured — Federal Trade Commission</li> <li>• Thrifts — Office of Thrift Supervision</li> </ul>	<ul style="list-style-type: none"> <li>• Australian Prudential Regulation Authority</li> </ul>	<ul style="list-style-type: none"> <li>• Hong Kong Monetary Authority</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Prudential Supervision</b>				
<b>Compensation</b>				
Legislation	<ul style="list-style-type: none"> <li>Financial Services and Markets Act 2000</li> </ul>	<ul style="list-style-type: none"> <li>Federal Deposit Insurance Act of 1933</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>
Responsible authority	<ul style="list-style-type: none"> <li>Financial Services Authority</li> </ul>	<ul style="list-style-type: none"> <li>Federal Deposit Insurance Corporation</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>
Compensation scheme	<ul style="list-style-type: none"> <li>Insure deposits up to £31,700 (100% coverage for the first £2,000, thereafter 90% coverage of deposits, up to a maximum of £33,000)</li> </ul>	<ul style="list-style-type: none"> <li>Insure deposits up to US\$100,000</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>	<ul style="list-style-type: none"> <li>The Hong Kong Monetary Authority has issued two discussion papers to the banking industry for comment: one on funding and premium assessment, and the other one on reimbursement netting.</li> <li>A set of proposals of the deposit insurance scheme will be released for consultation with the industry in the first quarter of 2002.</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Conduct Regulation</b>				
<b>Regulatory Framework</b>				
Legislation	<ul style="list-style-type: none"> <li>Bank of England Act 1998</li> </ul>	<ul style="list-style-type: none"> <li>Federal and state laws</li> </ul>	<ul style="list-style-type: none"> <li>Australian Securities and Investments Commission Act 2001</li> </ul>	<ul style="list-style-type: none"> <li>Banking Ordinance</li> </ul>
Regulator	<ul style="list-style-type: none"> <li>Financial Services Authority</li> </ul>	<ul style="list-style-type: none"> <li>National banks — Office of the Comptroller of the Currency</li> <li>State member banks — Board of the Federal Reserve</li> <li>State non-member banks which are federally insured — Federal Deposit Insurance Corporation</li> <li>State non-member banks which are not federally insured — Federal Trade Commission</li> <li>Thriffs — Office of Thrift Supervision</li> </ul>	<ul style="list-style-type: none"> <li>Australian Securities and Investments Commission</li> </ul>	<ul style="list-style-type: none"> <li>There is no designated authority with an explicit mandate to protect banking consumers. However, under the Banking Ordinance, the Hong Kong Monetary Authority has a general duty to "provide a measure of protection to depositors".</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Conduct Regulation</b>				
<b>Fees and Charges for Basic Banking Services</b>				
Imposition of or increase in fees and charges	<ul style="list-style-type: none"> <li>• 30 days advance notice</li> </ul>	<ul style="list-style-type: none"> <li>• 30 days advance notice</li> </ul>	<ul style="list-style-type: none"> <li>• 30 days advance notice</li> </ul>	<ul style="list-style-type: none"> <li>• 30 days advance notice</li> </ul>
Reference relating to the level of fees and charges levied by banks in the Code of Banking Practice	<ul style="list-style-type: none"> <li>• Nil</li> </ul>	<ul style="list-style-type: none"> <li>• Nil</li> </ul>	<ul style="list-style-type: none"> <li>• Nil</li> </ul>	<ul style="list-style-type: none"> <li>• Nil</li> </ul>
Basic banking services for disadvantaged groups	<ul style="list-style-type: none"> <li>• Basic Bank Accounts — on-line, no-overdraft, and no-service-charge accounts offered by major banks in the UK</li> </ul>	<ul style="list-style-type: none"> <li>• Electronic Transfer Accounts — low-cost accounts which may only be opened by federal benefits recipients</li> <li>• First Accounts — low-cost accounts for people who do not have any checking or savings account or any other relationship with a bank</li> </ul>	<ul style="list-style-type: none"> <li>• Individual banks have offered low-cost accounts or provided special financial products (for which there are substantial fee discounts and exemptions) for low-income group, pensioners, students and the disabled.</li> </ul>	<ul style="list-style-type: none"> <li>• Individual banks may exempt social welfare benefits recipients, the disabled or customers over aged 65 from fees and charges levied on some basic banking services.</li> <li>• Some banks have introduced free-of-charge accounts.</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Customer Services and Protection</b>				
<b>Complaints Handling Mechanism</b>				
Responsible authority	<ul style="list-style-type: none"> <li>Financial Ombudsman Service</li> </ul>	<ul style="list-style-type: none"> <li>Complaints handling office of respective regulators</li> </ul>	<ul style="list-style-type: none"> <li>Australian Banking Industry Ombudsman Scheme</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>
Dispute resolution procedures	<ul style="list-style-type: none"> <li>The complainant has to make the complaint to the bank concerned first.</li> <li>If the complainant is not satisfied with the bank's response, he may take the complaint to the Financial Ombudsman Service (FOS).</li> <li>The FOS may order the bank concerned to pay the complainant compensation up to a maximum of £100,000.</li> <li>If the complainant is still not satisfied with the outcome of the investigation conducted by the FOS, he may take the case to court.</li> </ul>	<ul style="list-style-type: none"> <li>The complainant may resolve the complaint with the bank concerned directly.</li> <li>If the complainant is not satisfied with the resolution, he may take the complaint to the regulator concerned for further investigation, or take the case to court directly.</li> <li>If the complainant wins the court case, the bank concerned is required to pay him compensation.</li> </ul>	<ul style="list-style-type: none"> <li>If a complainant has a complaint which is about a specific banking service, or that the actions of a bank have directly caused him to suffer a financial loss which is less than A\$150,000, the complainant may lodge the complaint to the Australian Banking Industry Ombudsman Scheme (ABIO).</li> <li>The ABIO is able to award compensation up to A\$150,000.</li> <li>If the complainant is not satisfied with the Ombudsman's decision, he may take the case to court.</li> </ul>	<ul style="list-style-type: none"> <li>The Hong Kong Code of Banking Practice requires banks to establish procedures for handling customer complaints.</li> <li>In the event that a complaint cannot be resolved with the bank concerned, the complainant may take the case to the Hong Kong Monetary Authority (HKMA). The HKMA will refer the case to the bank concerned for investigation.</li> <li>The HKMA is not authorized to award compensation.</li> <li>The complainant may also take the case to court.</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Customer Services and Protection</b>				
<b>Consumer Consultation</b>				
Responsible organization and its functions	<ul style="list-style-type: none"> <li>• The Financial Services Consumer Panel advises the Financial Services Authority (FSA) on its policies, monitors the effectiveness of its work, reviews developments in financial services which may affect banking consumers.</li> <li>• The Consumer Panel —                             <ul style="list-style-type: none"> <li>(a) makes formal responses to consultations on financial services proposed by the FSA and the Government;</li> <li>(b) commissions surveys and research on areas of consumer concern; and</li> <li>(c) recommends consumer representatives to contribute to the work of the FSA.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• There is no formalized consultation machinery such as the Financial Services Consumer Panel in the UK.</li> <li>• Regulators may provide information in different forms for public consultation.</li> <li>• National lobbying organizations also speak for the public against specific issues.</li> </ul>	<ul style="list-style-type: none"> <li>• Consumer Advisory Panel advises the Australian Securities and Investments Commission (ASIC) on key consumer protection issues and give feedback on ASIC activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Nil</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Customer Services and Protection</b>				
<b>Access to Credit Reference</b>				
Legal provision	<ul style="list-style-type: none"> <li>The Data Protection Act provides that a consumer should be told if the files of a credit reference agency are to be searched when one applies for credit.</li> </ul>	<ul style="list-style-type: none"> <li>The Equal Credit Opportunity Act mandates that every consumer who applies for credit has an equal chance to obtain it.</li> <li>The Fair Credit Reporting Act ensures that consumers' rights and privacy are protected.</li> </ul>	<ul style="list-style-type: none"> <li>The Privacy Act provides that —                             <ul style="list-style-type: none"> <li>(a) a consumer should have the right to obtain a copy of his credit file free of charge if application for credit is rejected; and</li> <li>(b) an individual's file at a credit reference agency can only be accessed by a credit provider for lawful purposes.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>The Code of Practice on Consumer Credit Data governs the collection, accuracy, use, security, access and correction of such data by credit reference agencies and lending institutions.</li> <li>The provisions of the Code are not legally binding. A breach of the Code, however, will give rise to a presumption against the data user in any legal proceedings under the Personal Data (Privacy) Ordinance (Cap. 486).</li> </ul>
Responsible organization and its functions	<ul style="list-style-type: none"> <li>Information on credit history of an individual is provided by private companies.</li> </ul>	<ul style="list-style-type: none"> <li>Information on credit history of an individual is provided by private companies.</li> </ul>	<ul style="list-style-type: none"> <li>Information on credit history of an individual is provided by private companies.</li> </ul>	<ul style="list-style-type: none"> <li>Information on credit history of an individual is provided by private companies.</li> </ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Customer Services and Protection</b>				
<b>Consumer Education</b>				
Responsible authority	<ul style="list-style-type: none"> <li>Financial Services Authority</li> <li>Relevant industry associations</li> </ul>	<ul style="list-style-type: none"> <li>Department of the Treasury</li> <li>Relevant industry associations</li> </ul>	<ul style="list-style-type: none"> <li>Australian Securities and Investments Commission</li> <li>Relevant industry associations</li> </ul>	<ul style="list-style-type: none"> <li>There is no designated authority responsible for educating consumers about financial services. However, the Hong Kong Monetary Authority and the Consumer Council both provide relevant information for banking consumers.</li> </ul>
Means of delivery	<ul style="list-style-type: none"> <li>The Financial Services Authority —                             <ol style="list-style-type: none"> <li>maintains a web site;</li> <li>publishes booklets and leaflets;</li> <li>conducts consumer education forum;</li> <li>organizes workplace/ community based meetings;</li> <li>incorporates financial services education into the national curriculum; and</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>The Department of the Treasury (the Treasury) —                             <ol style="list-style-type: none"> <li>maintains a web site;</li> <li>produces publications; and</li> <li>conducts conferences and seminars.</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>The Australian Securities and Investments Commission —                             <ol style="list-style-type: none"> <li>maintains a web site;</li> <li>produces publications;</li> <li>conducts advertising campaigns;</li> <li>develops consumer tips and advice column in relevant publications;</li> <li>provides relevant materials for television and radio programmes;</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>The Hong Kong Monetary Authority —                             <ol style="list-style-type: none"> <li>maintains a web site;</li> <li>produces publications on banking services; and</li> <li>organizes exhibitions for the public.</li> </ol> <li>The Consumer Council publishes information on fees and charges levied by banks for consumers' reference.</li> </li></ul>

	United Kingdom	United States of America	Australia	Hong Kong
<b>Customer Services and Protection</b>				
<b>Consumer Education</b>				
Means of delivery (cont'd)	(f) maintains a public enquiries helpline. <ul style="list-style-type: none"> <li>Industry associations publish fact sheets and other financial literature for banking consumers. Information is also available in their web sites.</li> </ul>	<ul style="list-style-type: none"> <li>The Treasury also works with communities and industry associations to provide incentives for financial institutions to develop financial literacy programmes.</li> </ul>	(f) conducts seminars/ training sessions and develops a financial services issues kit for community workers; and <ul style="list-style-type: none"> <li>(g) incorporates financial services education into the existing courses.</li> <li>Industry associations produce fact sheets about the banking industry and also brochures on loan selection for banking consumers.</li> </ul>	

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