

ITEM FOR FINANCE COMMITTEE

**HEAD 148 – GOVERNMENT SECRETARIAT :
FINANCIAL SERVICES AND THE TREASURY BUREAU
(FINANCIAL SERVICES BRANCH)**

**Subhead 700 General non-recurrent
New Item “Financial Dispute Resolution Centre”**

Members are invited to approve a new commitment of \$92 million for supporting the establishment of a Financial Dispute Resolution Centre and its operating costs for the first three years.

PROBLEM

We need to set up the Financial Dispute Resolution Centre (FDRC) to provide an independent and affordable avenue for resolving monetary disputes between individual consumers and financial institutions.

PROPOSAL

2. The Secretary for Financial Services and the Treasury proposes to create a new commitment of \$92 million to meet the set-up cost of FDRC and its operating costs in the first three years from 2011-12 to 2014-15.

JUSTIFICATION

Features of FDRC

3. FDRC is to administer a financial dispute resolution scheme by way of primarily mediation and, failing which and if the claimant so wishes, arbitration. The aims of mediation are to help the parties communicate in a rational way, encourage collaborative problem solving in order to achieve some agreed goals, and reach a solution that both parties can accept. Where mediation is unsuccessful, FDRC may assist the claimant who wishes to pursue the case further through arbitration. An arbitrator agreed by both the claimant and financial institution should decide the claim.

4. Arbitration is an alternative to lengthy and costly litigations. An arbitral award has the advantage of being final and binding on both parties¹. In Hong Kong, the Arbitration Ordinance (Cap. 609) governs the procedural issues. Arbitral awards are enforceable through the courts. Hong Kong also has a strong and large pool of arbitrators.

5. The FDRC service will be offered at a fee to both claimants and financial institutions according to a “pay-as-you-use” principle. The fee structure is set according to the guiding principle that consumers should have an affordable avenue for resolving disputes, and financial institutions should have enough incentive to resolve the disputes at an early stage. The schedule of fees is summarised in the table at Enclosure 1. FDRC will review the levels of fees regularly.

Encl. 1

Scope of FDRC

6. Financial institutions regulated by the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) will be obligated to be members of the financial dispute resolution scheme operated by FDRC. HKMA and SFC will respectively amend the licensing conditions for authorized institutions and the Code of Conduct for SFC-licensed corporations to include the requirement to abide by the FDRC procedures. Currently there are about 1 900 such financial institutions. The coverage of FDRC will be reviewed later.

Claimable Amount

7. As the purpose of setting up FDRC is to offer claimants quick resolutions with minimum formalities, we consider it prudent to impose a limit on the maximum amount that a consumer can claim. The maximum claimable amount per case is set at HK\$500,000, which covers about 83% of the monetary disputes handled by HKMA and about 80% of stock investors. A consumer may claim over \$500,000 if he or she submits claims for more than one case. One can also bring to FDRC a claim that involves more than \$500,000, but the maximum claimable limit still applies. We shall review the maximum claimable amount, based on the experience gathered over time and evolving market development.

/Institutional

¹ Comparing the functions and powers of an arbitrator and a financial ombudsman in overseas jurisdictions, there is no difference between them as both are acting as an umpire to decide on a dispute based on the parties' submissions. Both have the power to collect information from the parties concerned but none of them possesses the same investigative or disciplinary powers of regulators. In some aspects, an arbitrator enjoys wider power than an ombudsman as the Arbitration Ordinance (Cap. 609) in Hong Kong stipulates that an arbitral award is final and binding on all parties whereas a UK ombudsman's determination is non-binding.

Institutional set-up of FDRC

8. The Government will set up FDRC as a limited company by guarantee under the Companies Ordinance (Cap. 32). It will be non-profit making. The objectives of FDRC will be clearly set out in its Memorandum and Articles of Association.

9. FDRC should operate independently while being subject to appropriate checks and balances. A Board of Directors will be appointed by the Government to oversee its operation and formulate the overall policy and strategy. The Board shall not interfere with the processes and outcomes of mediations and arbitrations.

10. The Board's membership will be broadly based and representative of the major stakeholders, with well-regarded community personalities equipped with knowledge of financial services and consumer protection.

11. The executive team of FDRC will be headed by a Chief Executive Officer with extensive experience and knowledge in the field of alternative dispute resolution. The core team will comprise about 20 professional staff including in-house mediators who will deal with claims smaller than HK\$100,000², as well as Intake Officers who will receive claimants and decide if a case should be accepted by FDRC. The qualification and training of Intake Officers are of particular importance. A set of criteria for taking up cases will also be clearly laid down.

12. To keep a lean staffing structure, FDRC will not employ in-house arbitrators. Mediation of claims above HK\$100,000 and arbitration will be outsourced to outside mediators and arbitrators coming from a roster maintained by FDRC. FDRC will be the sole authority to maintain such roster; decide the entry and exit of mediators and arbitrators on the roster; and appoint mediators and arbitrators in case the parties could not agree on one. Training on knowledge and skills to handle financial disputes is required as a pre-condition of mediators and arbitrators.

13. The arrangement to outsource cases to mediators and arbitrators on the roster provides flexibility to FDRC on resources deployment having regard to the caseload at any particular point of time. For the variable costs that are dependent on caseload, they would broadly be recovered via case fees to be shared by both

/claimants

² Deploying in-house mediators has the advantage of not only lowering the costs, hence affordability for small claimants, but also facilitating FDRC to accumulate experience for the majority of cases. About 80% of the claims received by HKMA now involve an amount less than HK\$100,000.

claimants and financial institutions according to the schedule of fees set out at Enclosure 1. FDRC will regularly review its staffing level having regard to the actual operational experience and caseload.

Interface with regulators

14. FDRC will not have any investigation or disciplinary powers as the regulators. Regulators deal with regulatory breaches while FDRC deals with monetary disputes. The guiding principle in the interface between FDRC and regulators is not to burden financial institutions with excessive requirements whilst not compromising regulators' powers and duties to investigate alleged regulatory breaches. A memorandum of understanding (MoU) between FDRC and regulators will be in place to delineate their roles.

15. FDRC should not be, or give the impression, that the confidentiality of its process would become a regulatory blind spot. FDRC should share observations and information with regulators, for example when there are a number of similar disputes that may indicate the existence of wider implications for the regulated sector. It should also regularly disclose summary data of cases it has handled on an unnamed basis for public education purpose.

Funding arrangement of FDRC

16. As the establishment of FDRC will contribute to an important public policy function of investor protection, the Administration has agreed with HKMA and SFC to share on a 50:25:25 basis the set-up costs as well as the operating costs of FDRC for the first three years from 1 January 2012 to 31 December 2014. From 1 January 2015 onwards, financial institutions shall shoulder all the operating costs, in line with the overseas practice in respect of similar mechanisms. The funding formula will be worked out by FDRC in consultation with the industry after some initial caseload has been built up.

17. Based on an estimated caseload of 2 000 a year, the annual budget of FDRC is estimated to be about \$55 million. This covers staff cost, premises rentals, professional and consultancy services, publicity and education, training for mediators and arbitrators, insurance, etc. A breakdown of major operating expenditure items is at Enclosure 2. The set-up costs covering office renovation, furniture and equipment, computer and data management systems, promotion and publicity, etc. are estimated to amount to \$15 million. A breakdown of major set-up cost items is at Enclosure 3.

Encl. 2

Encl. 3

18.

18. The staffing structure will be lean at the outset. If the operating costs of FDRC during its initial period of operation fall below the estimated budget, any unused balance will be kept as a reserve fund to provide flexibility in resources deployment in case of an upsurge in caseload and allow the conduct of independent reviews of FDRC's operations.

19. The funding arrangement will be set out in an MoU among the Government, HKMA and SFC before FDRC commences operation.

FINANCIAL IMPLICATIONS

20. In view of the above funding arrangement of FDRC, the estimated total amount of funds required from the Administration to support FDRC from 2011-12 to 2014-15 is \$92 million, broken down as follows -

	2011-12	2012-13	2013-14	2014-15	Total
	\$ million				
(a) Set-up cost	8	-	-	-	8
(b) Operating cost	7	28	28	21	84
Total	15	28	28	21	92

21. We have earmarked sufficient provision in the 2011-12 Estimates and will reflect the same in the Estimates of subsequent years to meet the cash flow requirements.

PUBLIC CONSULTATION

22. On 9 May 2011, we consulted the Legislative Council Panel on Financial Affairs (the Panel) on our proposal. Members generally supported the proposal and raised no objection to submitting it to the Finance Committee for funding approval.

BACKGROUND

23. Since the global financial crisis, financial markets worldwide have been moving towards the provision of more protection for financial consumers. The Administration thus proposed to set up an FDRC to help individual consumers

/settle

settle monetary disputes with financial institutions through a simple and quick resolution mechanism. Public consultation on the proposed establishment of an FDRC was conducted in February 2010. The Administration announced in December 2010 the decision to establish an FDRC by mid-2012. The Panel was briefed on the proposed establishment of an FDRC and consultation conclusions on 1 March 2010 and 3 January 2011 respectively. The proposal has the general support of the public.

Financial Services and the Treasury Bureau
June 2011

Schedule of fees

	Claimant (\$)	Financial institution (\$)
Making enquiries	Nil	Not Applicable
Filing a claim form	200	Not Applicable
Mediation	(Case fees)	(Case fees)
Amount of claim		
- less than \$100,000	1,000	5,000
- between \$100,000 and \$500,000	2,000	10,000
Arbitration (amount of claim up to \$500,000)	(Case fees) 5,000	(Case fees) 20,000

**Establishment of a Financial Dispute Resolution Centre (FDRC)
Major operating expenditure items in the first three years**

Items	Explanatory notes	Estimated annual expenditure (\$ million)
Staff costs	A	26
Operating costs	B	16
Professional and consultancy services	C	4
Publicity and education	D	3
Training and development	E	1
Contingency	-	5
	Total	55

Explanatory notes

- A This is based on the assumption of a core team of about 20 professional staff, including the Chief Executive Officer of FDRC, in-house mediators and Intake Officers. Exact staffing requirements may vary in the light of operational needs.
- B Operating costs include premises rentals, staff on-cost, insurance, contract and maintenance fees, and other general office expenditures, etc.
- C Professional and consultancy services may be engaged for researches and reviews, legal advice, translation and interpretation, etc.
- D This is to cater for the expenses for organising publicity activities, issuing publications to promote public awareness of FDRC and publishing annual reports, etc.
- E This includes the resources for training in-house professionals as well as mediators/arbitrators on the roster maintained by FDRC.

**Establishment of a Financial Dispute Resolution Centre (FDRC)
Major set-up cost items**

Items	Explanatory notes	Estimated expenditure (\$ million)
IT infrastructure and systems, hardware and software	A	4
Promotion and publicity	B	4
Office renovation	C	3
Office furniture and equipment	D	3
Professional and consultancy services	E	1
	Total	15

Explanatory notes

- A This is to cater for the expenses incurred in engaging contractors to build the IT infrastructure, applications systems, database management system, and webpage of FDRC. This also covers expenses in the acquisition of computer hardware and software.
- B This includes the resources for organising outreach programmes and publicity activities to promote public awareness of FDRC, its objectives and work before its official opening.
- C This refers to the engagement of agencies/contractors in sourcing office venues and carrying out renovation works including interior design and fitting-out.
- D Office furniture and equipment include office desks and chairs, filing and storage racks, office machines, and audio-visual conference facilities.
- E Professional and consultancy services may be engaged in the provision of legal advice, recruitment of key personnel of FDRC, etc.
