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Panel on Financial Affairs

Meeting on 3 January 2011

**Background brief on proposed establishment of an Investor Education
Council and a Financial Dispute Resolution Centre**

Purpose

This paper provides background information on the Administration's proposals to establish an Investor Education Council (IEC) and a Financial Dispute Resolution Centre (FDRC), and a summary of members' concerns and views when the subject was discussed by the Panel on Financial Affairs (FA Panel) on 1 March 2010.

Background

2. The events of the global financial crisis have shown that some investors would need more support and protection as they engage in financial services. The Securities and Futures Commission (SFC) in its report of December 2008 on “Issues raised by the Lehmans Minibonds crisis” recommended that an IEC be established as a separate body corporate chaired and funded by SFC. The proposed IEC would co-ordinate and deliver an expanded investor education programme across the whole financial services sector. SFC also recommended that an independent dispute resolution scheme that provides quick, simple, customer friendly service should be in place. It should avoid unduly legalistic procedures and discourage involvement of legal representatives. The scheme should contain elements of conciliation (for achieving a mutually acceptable resolution) and ultimately determination by a panel if the parties remain unable to arrive at an agreed outcome. The financial ombudsman, if set up, could be given the power to order compensation.

3. The Hong Kong Monetary Authority (HKMA), in its report of December 2008 entitled "Report of the Hong Kong Monetary Authority on Issues concerning the Distribution of Structured Products Connected to Lehman Group Companies", recommended that an independent dispute resolution mechanism should be established in Hong Kong to provide an efficient means to adjudicate or settle disputes between investors and intermediaries. The power to order compensation is an essential feature of the mechanism.

Proposed establishment of an Investor Education Council

4. The Administration commenced on 9 February 2010 a three-month public consultation on the proposed establishment of an IEC and FDRC. Under the Administration's proposal, the proposed IEC will implement its strategy primarily through –

- (a) reaching large audiences through regular, mass media campaigns;
- (b) building sustainable and tailored outreach programmes for different sectors of the community; and
- (c) a website for the public to get access to comprehensive and impartial investor education information.

5. The proposed IEC will be a company wholly owned and fully funded by SFC. No extra levies and charges will be imposed on investors for the establishment of the IEC. There will be an SFC-appointed board of directors to govern the IEC. Relevant financial regulators and the Administration will be represented on the IEC Board. The SFC Board will recommend to the Financial Secretary an SFC Non-Executive Director as the Chairman of the IEC Board.

6. To take forward the proposal, the Administration proposes to amend the Securities and Futures Ordinance (Cap. 571) (SFO) to broaden SFC's investor education remit to cover financial services and products other than those in the securities and futures sector, as well as to empower SFC to form the IEC as a wholly owned company with delegated investor education responsibilities from SFC.

Proposed establishment of a Financial Dispute Resolution Centre

7. Under the Administration's proposal, the FDRC will administer a financial dispute resolution scheme by way of primarily mediation and, failing which and if the claimant so wishes, arbitration. Financial institutions

regulated or licensed by HKMA or SFC will be obligated to join the scheme as members. FDRC may require scheme members (i.e. banks, brokers, fund houses, etc.) to enter into mediation and arbitration at times of a monetary dispute if (a) the claimant so wishes, and (b) the dispute cannot be resolved directly between the parties. An arbitration award is final and binding on both parties.

8. The FDRC would not have any investigation or disciplinary powers as the regulators. The regulators deal with regulatory breaches while FDRC deals with monetary disputes. The maximum claimable amount under the scheme is proposed to be HK\$500,000, which is expected to cover more than 80% of the monetary disputes handled by HKMA. The Administration, together with HKMA and SFC, will provide the set-up costs and operation costs of the FDRC in the first three years. The FDRC will be funded by the financial industry, and to a lesser extent the claimants, thereafter. The FDRC service will be offered at a fee to both the claimants and financial institutions, under a “pay-as-you-use” principle, with a higher fee for financial institutions to incentivize them to resolve the disputes at an early stage.

9. For obligating the authorized institutions (AIs) regulated by HKMA to join the financial dispute resolution scheme, it would be necessary to amend the licensing condition applied to AIs and such amendment would be subject to the statutory consultation requirements under the Banking Ordinance (Cap. 155). For SFC’s licensed institutions, the then intention of the Administration was to amend the SFO to obligate them to join the scheme.

Deliberations of the FA Panel

10. The Administration briefed the FA Panel on the proposals to establish an IEC and a FDRC on 1 March 2010. The major concerns and views expressed by members are as follows -

Proposed IEC

- (a) After the IEC had been established, HKMA, SFC and financial institutions might shirk their responsibility of offering advice to investors on the risks of the financial products offered in the market, and refer all enquiries to the IEC.
- (b) Unless the IEC provided specific advice on individual financial products rather than generic advice, its establishment would not be of much help to investors, since the nature of risks of individual

financial products and the way they were structured could vary a lot.

- (c) As SFC had all along been carrying out investor education work, it would be more appropriate to set up a separate department within SFC to continue the work, instead of establishing a separate body, so that the regulatory structure would not become too cumbersome.

Proposed FDRC

- (d) The scope of the proposed financial dispute resolution scheme was too limited, as it covered only the financial institutions which were licensed or regulated by HKMA and SFC.
- (e) Based on the experience in the Lehman Brothers Minibonds Incident, most of the monetary disputes involved allegations of regulatory breaches. In view of the lack of investigative power of the FDRC and the disparity of the amount of information possessed by the claimant and the financial institution concerned, it was doubtful whether the FDRC could resolve the monetary disputes in a fair manner.
- (f) As a result of the mediation/arbitration conducted by the FDRC, many regulatory breach cases would not be revealed.
- (g) The Lehman Brothers Minibonds Incident revealed that SFC did not have the authority to order compensation. Apart from establishing the FDRC, the Administration should consider empowering the regulatory bodies to order compensation, or setting up a financial services ombudsman with the authority to impose penalties and order compensation.
- (h) There should be proper mechanisms in place to prevent abuse of the proposed financial dispute resolution scheme. For example, the intake officers of the FDRC should have the authority to reject frivolous and vexatious claims, and the fee structure should not be too lopsided in favour of claimants.
- (i) The proposed maximum claimable amount of HK\$500,000 was too low to cater for the need of many investors for an alternative dispute resolution channel other than the traditional court adjudication.

Recent developments

11. The Administration published the consultation conclusions on 13 December 2010. As set out in the Administration's paper (LC Paper No. CB(1)771/10-11(01)), a total of 115 submissions were received from a diverse group of stakeholders during the consultation period. The respondents in general welcomed the establishment of an IEC to holistically oversee the delivery of investor education. The respondents also indicated support in principle for setting up a one-stop service for solving financial disputes. There were however very diverse comments on the proposed establishment of an FDRC. While consumers generally supported the proposal, reactions from industry organizations ranged from qualified support to opposition.

12. Having regard to the comments received, the Administration upholds the proposals in the consultation document at large with the following proposed revisions -

- (a) the proposed fee structure has been revised¹ with a view to minimizing abuse by either consumers or financial institutions;
- (b) for those cases with wider implications and/or involving allegations by consumers of misconduct of financial institutions, instead of putting the cases on hold while regulators are investigating into the matters and have carried out disciplinary actions, FDRC should, unless advised by the relevant regulator(s) otherwise, proceed with those cases in parallel; and
- (c) instead of introducing legislative amendments to SFO to mandate SFC licensees to participate in the financial dispute resolution scheme operated by FDRC, the Administration will pursue a non-legislative means through amendments to the Code of Conduct for SFC licensees to include the requirement to abide by the FDRC procedures.

13. The Administration also indicates that the following issues would be kept under review based on the experience gathered over time and having regard to evolving market developments -

- (a) whether eligible claimants to FDRC should be restricted to individuals or should be extended to include small companies;

¹ Please refer to paragraph 66 of LC Paper No. CB(1)771/10-11(01).

- (b) whether the insurance and Mandatory Provident Fund sectors should be carved out from FDRC's purview;
- (c) the maximum claimable amount under FDRC's dispute resolution scheme;
- (d) the levels of various fees under the scheme.

14. The Administration will brief the FA Panel on 3 January 2011 on the consultation conclusions and the way forward.

Relevant papers

15. The relevant papers and the minutes of the FA Panel meeting on 1 March 2010 are available at the following webpages -

http://www.legco.gov.hk/yr11-12/english/panels/fa/papers/fa_s9.htm

<http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20100301.pdf>

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