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**Panel on Financial Affairs**

**Meeting on 5 May 2011**

**Background brief on proposed establishment of  
a financial dispute resolution centre**

**Purpose**

This paper provides background information on the Administration's proposal to establish 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).

**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, inter alia, that an independent dispute resolution scheme that provides quick, simple, customer friendly service should be put 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", also recommended, inter alia, 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 a Financial Dispute Resolution Centre

4. The Administration commenced on 9 February 2010 a three-month public consultation on the proposed establishment of a FDRC and an Investor Education Centre<sup>1</sup>. 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.

5. 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.

6. 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 Securities and Futures Ordinance (Cap. 571) (SFO) to obligate them to join the scheme.

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<sup>1</sup> For details about the proposal on the establishment of an Investor Education Centre, please refer to LC Papers No. [CB\(1\)1213/09-10\(01\)](#) and [CB\(1\)910/10-11\(04\)](#).

## **Discussion of the Panel on Financial Affairs on 1 March 2010**

7. The Panel discussed the proposals to establish an Investor Education Centre and a FDRC on 1 March 2010. The major concerns and views expressed by members regarding the proposed FDRC are as follows -

- (a) The scope of the proposed financial dispute resolution scheme is too limited, as it covers only the financial institutions which are licensed or regulated by HKMA and SFC.
- (b) Based on the experience in the Lehman Brothers Minibonds Incident, most of the monetary disputes involve allegations of regulatory breaches. In view of the lack of investigative powers of the FDRC and the disparity of the amount of information possessed by the claimant and the financial institution concerned, it is doubtful whether the FDRC could resolve the monetary disputes in a fair manner.
- (c) As a result of the mediation/arbitration conducted by the FDRC, many regulatory breach cases would not be revealed.
- (d) The Lehman Brothers Minibonds Incident reveals that SFC does 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.
- (e) 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.
- (f) The proposed maximum claimable amount of HK\$500,000 is too low to cater for the need of many investors for an alternative dispute resolution channel other than the traditional court adjudication.

## Consultation conclusions and revised proposal

8. The Administration published the consultation conclusions on 13 December 2010. According to the Administration, a total of 115 submissions were received from a diverse group of stakeholders during the consultation period. The respondents 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.

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

- (a) the proposed fee structure has been revised<sup>2</sup> 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.

10. The Administration also indicated 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;
- (b) whether the insurance and Mandatory Provident Fund sectors should be carved out from FDRC's purview;

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<sup>2</sup> Please refer to paragraph 66 of LC Paper No. CB(1)771/10-11(01).

- (c) the maximum claimable amount under FDRC's dispute resolution scheme; and
- (d) the various fees under the scheme.

### **Discussion of the Panel on Financial Affairs on 3 January 2011**

11. The Administration briefed the Panel on 3 January 2011 on the consultation conclusions and the way forward. The major concerns/views expressed by members and the Administration's responses are summarized in the ensuing paragraphs.

#### *Coverage of the financial dispute resolution scheme*

12. Some members were concerned whether setting the maximum claimable amount under the financial dispute resolution scheme at \$500,000 was appropriate. The Administration advised that this maximum claimable amount covered about 80% of the complaints handled by HKMA and about 80% of stock investors.<sup>3</sup> After the FDRC had operated for some time, a review of the scope of work and the maximum claimable amount would be conducted. A member opined that a review of the maximum claimable amount should be conducted as soon as possible.

13. A member was concerned that while the FDRC would not handle monetary disputes involving insurance companies, it would deal with cases involving insurance products sold in banks. The member opined that to ensure consistency in the regulation of insurance services, all monetary disputes involving insurance products should be handled by one regulatory body, e.g. the future independent Insurance Authority, and not the FDRC. The Administration undertook to consider the member's view.

#### *Legal representation in the mediation/arbitration process*

14. A member pointed out that in the existing adjudication mechanisms such as the Small Claims Tribunal and Labour Tribunal, an "inequality of arms" situation could arise. He enquired what measures would be taken to ensure

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<sup>3</sup> According to the supplementary information (LC paper No. CB(1)1071/10-11(01)) provided by the Administration after the meeting, if the maximum claimable amount is set at HK\$1million, it would cover around 89% of the monetary disputes handled by HKMA and about 88% of stock investors.

that there would be an "equality of arms" in the resolution of financial disputes handled by the FDRC. The member suggested that consideration be given to forbidding companies from being represented by lawyers during mediation/arbitration.

15. The Administration advised that a working group on FDRC comprising representatives from the Law Society of Hong Kong, the Hong Kong Bar Association, the Hong Kong International Arbitration Centre, the regulators and professionals had been set up. One of the major issues being discussed in the working group was how to ensure "equality of arms". Consideration was being given to empowering the arbitrators under the Mediation and Arbitration Rules to obtain information for arbitration. The member's proposal of banning all forms of legal representation would be relayed to the working group for consideration.

#### *Mediation and arbitration versus the ombudsman model*

16. A member opined that in order to provide adequate protection for investors, a one-stop service system such as a financial services ombudsman should be established to deal with complaints from investors, investigation of the cases, imposition of sanctions and order of compensation from financial institutions.

17. The Administration responded that under the proposed financial dispute resolution scheme, banks would be obligated under the licensing conditions to join a mediation requested by a customer in order to resolve a monetary dispute. SFC was empowered under SFO to investigate complaints and impose sanctions on a financial institution if appropriate. Although SFC could not order a financial institution to give compensation, SFC might arrange the financial institutions and the complainants concerned, through mediation, to come to a resolution agreement, as in the case of the Lehman Brothers Minibonds Incident. At this stage, the Government had no plan to amend the SFO for empowering the SFC to order compensation.

#### **Recent development**

18. The Administration will consult the Panel on 5 May 2011 on the funding proposals for the setting up of the FDRC and its operating expenses in the first three years.

## **Relevant papers**

19. The relevant papers are available at the following webpages -

Papers

[http://www.legco.gov.hk/yr11-12/english/panels/fa/papers/fa\\_s9.htm](http://www.legco.gov.hk/yr11-12/english/panels/fa/papers/fa_s9.htm)

Minutes of the Panel meeting on 1 March 2010

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

Minutes of the Panel meeting on 3 January 2011

<http://www.legco.gov.hk/yr10-11/english/panels/fa/minutes/fa20110103.pdf>

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