

**For discussion
on 5 May 2011**

Legislative Council Panel on Financial Affairs

Proposed Establishment of a Financial Dispute Resolution Centre

PURPOSE

This paper updates the Panel on the Administration's plan to seek funding from the Finance Committee for the establishment of a Financial Dispute Resolution Centre ("FDRC") to help resolve monetary disputes between individual consumers and financial institutions.

BACKGROUND

2. The Administration announced in December 2010 the decision to establish an FDRC by mid-2012 to help individual consumers settle monetary disputes with financial institutions through a simple and quick resolution mechanism. This followed a public consultation on the proposed establishment of an FDRC in February 2010. The proposal had general support of the public. The Administration had also briefed this Panel on 1 March 2010 and 3 January 2011 respectively.

PROPOSAL

3. Following the decision on the establishment of an FDRC, the Administration has agreed with the Hong Kong Monetary Authority ("HKMA") and the Securities and Futures Commission ("SFC") to share the set-up costs as well as the operating costs of FDRC for the first three years on a 50:25:25 basis as FDRC is contributing to an important public policy function of investor protection. In this connection, the

Administration proposes to provide a grant of \$92 million to FDRC from 2011-12 to 2014-15. A corresponding amount will be provided by HKMA and SFC.

Features of FDRC

4. 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 maximum claimable amount per case is HK\$500,000¹.

5. Financial institutions regulated by HKMA/SFC will be obligated to be members of the 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.

6. The aim of mediation is to help the parties to communicate in a rational way and 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 to bring the case further to arbitration if the claimant so wishes. An arbitrator agreed by both the claimant and financial institution should decide the claim. An arbitral award is final and binding on both parties.

7. The FDRC service will be offered at a fee to both claimants and financial institutions under a “pay-as-you-use” principle. The fee structure is set according to the guiding principle that consumers should on the one hand have an affordable avenue for resolving disputes, and financial institutions on the other hand should have enough incentive to resolve the disputes at an early stage.

¹ HK\$500,000 is set as the maximum claimable amount as it covers about 83% of the monetary disputes handled by the HKMA and about 80% of stock investors.

8. The operation of the financial dispute resolution scheme including its coverage, the maximum claimable amount, the fee structure, etc. can be reviewed with the experience gained over time.

Institutional set-up of FDRC

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

10. 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.

11. 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.

12. 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 mediators² who will deal with claims smaller than HK\$100,000, as well as Intake Officers who will receive claimants and decide if a case should be accepted by FDRC.

13. To keep a lean staffing structure, FDRC will not employ in-house arbitrators. Mediation of claims above HK\$100,000 and arbitration will be carried out by mediators and arbitrators coming from a roster maintained by FDRC. FDRC will regularly review its staffing

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.

structure having regard to the actual operational experience and caseload.

Funding arrangement of FDRC

14. The Administration, HKMA and SFC are to fund the set-up costs as well as the operating costs for the first three calendar years from 1 January 2012 to 31 December 2014. From 1 January 2015 onwards, financial institutions shall shoulder all the operation costs. The amount to be borne by each financial institution will be contingent on the sector-specific caseload (e.g. banks, securities brokerages), share of the retail market, etc. The funding formula will be worked out by FDRC in consultation with the industry after some initial caseload has been built up.

15. Based on an estimated caseload of 2 000 a year, the annual budget of FDRC is estimated to be at about \$55 million. This covers primarily staff salaries, premises rentals, publicity and education, training to mediators and arbitrators, insurance, etc. A breakdown of major expenditure items is at Annex A. 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 expenditure items is at Annex B.

16. The Administration proposes to provide a total of \$15 million, i.e. one-off set-up costs of \$8 million with a three-month provision of operating costs of \$7 million, in 2011-12 for the set-up preparation and also operation of a provisional FDRC. FDRC is expected to formally come into service by mid-2012.

17. With a lean staffing structure at the outset, it is expected that the operating costs of FDRC during its initial period of operation might fall below the estimated budget. Any unused balance will be kept as a reserve fund to enable flexibility in resources deployment in case of an upsurge in caseload and allow the conduct of independent reviews of the FDRC's operations.

18. As a statutory requirement under the Companies Ordinance (Cap 32), FDRC will have to prepare annual audited accounts. These accounts will be submitted to the Financial Services Branch for financial control purposes.

FINANCIAL IMPLICATIONS

19. In view of the above funding arrangement of FDRC, the total funding that the Administration seeks is as follows –

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

WAY FORWARD

20. We plan to seek funding approval for the proposed establishment of an FDRC from the Finance Committee at its meeting on 10 June 2011.

Financial Services and the Treasury Bureau
April 2011

Annex A

Establishment of a Financial Dispute Resolution Centre (FDRC) Major expenditure items in the initial years of operation

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.

Annex B

Establishment of a Financial Dispute Resolution Centre (FDRC) Major expenditure items for the initial set-up

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.