

**Extract from the minutes of the meeting of
the Financial Affairs Panel on 9 May 2011**

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IV Funding proposals for the setting up of the Financial Dispute Resolution Centre and its operating expenses in the first three years

(LC Paper No. CB(1)2040/10-11(03) — Administration's paper on "Proposed Establishment of a Financial Dispute Resolution Centre"

LC Paper No. CB(1)2049/10-11 — Background brief on proposed establishment of a Financial Dispute Resolution Centre prepared by the Legislative Council Secretariat)

Briefing by Administration

7. At the invitation of the Chairman, the Secretary for Financial Services and the Treasury (Acting) (SFST (Atg)) briefed members on the proposed funding arrangement for the establishment of a Financial Dispute Resolution Centre (FDRC), by highlighting the salient points in the paper.

Discussion

Scope of work

8. Mr Albert HO enquired whether it was due to pressure from the financial sector that the Government had proposed to set up a FDRC instead of a financial services ombudsman to deal with financial disputes.

9. SFST (Atg) responded that the FDRC model using mediation and then arbitration was in line with the overseas practice in similar mechanisms. Comparing the functions and powers of an ombudsman and an arbitrator, an arbitrator had the same power as an ombudsman in collecting information from the parties concerned. Yet an arbitrator enjoyed much wider power than an ombudsman as stipulated in the respective legislations.

10. Mr Albert HO pointed out that for other similar schemes, such as the Deposit Protection Fund, the maximum compensation amount usually covered about 90% of the stakeholders involved. He enquired why the maximum claimable amount per case of the FDRC was set at \$500,000 but not a higher amount. Mr HO further enquired whether claimants of cases involving a claimable amount of more than \$500,000 would have to seek redress in court.

11. SFST (Atg) responded that with reference to similar overseas jurisdictions, it was considered necessary to impose a limit on the maximum amount that a consumer could claim. The maximum claimable amount was set at \$500,000 each case after consulting the industry and the public. A review on the maximum claimable amount, among others, would be conducted having regard to the experience gathered over time and the evolving market development. The existing arrangements for dealing with claims of more than \$500,000 would continue.

12. Mr James TO remarked that the Democratic Party supported the setting up of a financial services ombudsman with investigative powers to deal with financial disputes, although the Party did not object to the establishment of the FDRC. Mr TO enquired whether the FDRC would provide mediation and arbitration services for cases with a claimable amount exceeding \$500,000, if both the claimant and the financial institution had agreed to refer their dispute case to the FDRC. Mr TO remarked that for such cases, the claimants and financial institutions concerned might be required to pay higher fees to the FDRC.

13. SFST (Atg) responded that she personally would be open to having FDRC dealing with cases with a maximum claimable amount exceeding \$500,000 if both the claimant and the financial institution concerned agreed to resolving their dispute through the FDRC. However, as the current maximum claimable amount of \$500,000 was an outcome of the public consultation, she saw the need to discuss the issue with stakeholders again. This could take some time. Mr James TO requested the Administration to provide a written response to his suggestion.

(Post-meeting note: The Administration's response was issued to members vide LC Paper No. CB(1)2334/10-11 on 30 May 2011.)

14. Mr Ronny TONG enquired about the calculation of maximum claimable amount, e.g. whether the claimable amount would cover both the investment amount and the amount of compensation claimed. SFST (Atg) responded that the claimable amount covered all components of a claim including any compensation sought.

Fee level

15. Mr Ronny TONG enquired whether a scale of fees would be set for the services provided by FDRC. SFST (Atg) responded that a schedule of fees for the FDRC had been drawn up. If the claimable amount was \$100,000 or below, the claimant and the financial institution concerned would be required to pay a fee of \$1,000 and \$5,000 respectively for a mediation of four hours. The fees would be doubled if the claimable amount was between \$100,000 and \$500,000. The fees for arbitration service were \$5,000 for the claimant and \$20,000 for the financial institution. SFST (Atg) pointed out that the fees charged by the FDRC were much lower than those charged by private mediators and arbitrators.

Staffing and operating expenses of FDRC

16. Mr Jeffrey LAM expressed concern whether the FDRC had the required resources to deal with the mediation and arbitration cases, as according to the Administration's estimate, the 20 core staff of the FDRC would have to handle some 2 000 financial disputes each year. Mr LAM further enquired about the arrangement for provision of arbitration services by the FDRC. Mr CHIM Pui-chung shared Mr LAM's concern, and pointed out that, based on the estimated staff and caseload, the FDRC would have to complete mediation of a case within three days. Given that the estimated expenditure of FDRC would be \$55 million and 2 000 cases would be handled in a year, Mr CHIM was concerned that the average expenditure for handling a case amounted to \$28,000, which he considered was high especially for cases involving a claimable value of \$100,000 or less.

17. SFST (Atg) responded that the FDRC would have six to seven full-time professional mediators to handle financial disputes the claimable amount of which was less than \$100,000. Financial disputes involving a claimable amount from \$100,000 to \$500,000, and arbitration cases would be handled by qualified mediators/arbitrators through outsourcing.

18. Mr CHIM Pui-chung enquired whether a mechanism would be put in place to regulate the outsourcing of mediation/arbitration work by FDRC. SFST (Atg) responded that the FDRC would maintain a roster of private mediators and arbitrators to handle the outsourced cases. Training on knowledge and skills to handle financial disputes would be required as a pre-condition of mediators and arbitrators. The appointment of private mediators/arbitrators would be subject to the mutual agreement of the financial institution and the claimant concerned in each case.

19. Noting that the set-up cost for the FDRC was \$15 million and the annual budget for the FDRC was about \$55 million, Mr Jeffrey LAM enquired about the location of the FDRC office and the estimated rental for the office.

20. SFST (Atg) responded that the FDRC would be located outside the prime commercial areas so that the expenditure on rental could be reduced. The major part of the set-up cost was for provision and installation of information technology systems as well as promotion and publicity programmes. FDRC would receive income from its services to support part of its operation.

21. Noting that the annual operation costs of the FDRC was estimated to be \$55 million, and financial institutions were expected to shoulder the operation costs of FDRC from 1 January 2015 onwards, the Deputy Chairman expressed concern about the financial situation of FDRC if there were less than 2 000 cases a year, or when there was a sudden increase in caseload resulting from a major financial incident. The Deputy Chairman pointed out that as a result of the Lehman Brothers Minibonds Incident, measures had been taken by the regulators to tighten up the regulation of the sale of financial products, and given the level of fees charged by the FDRC, the caseload of FDRC might be less than 2 000 a year.

22. SFST (Atg) responded that there were fixed overhead costs for the FDRC, such as office rental. To keep down the operating costs, the FDRC would start with the modest provisions, and would maintain a slim establishment as far as possible. The arrangement to outsource cases to private mediators/arbitrators also provided flexibility to FDRC on resources deployment having regard to the caseload at any particular point of time. The FDRC would have contingency plans to meet any sudden upsurge in the number of cases, such as utilizing the offices of related organizations. SFST (Atg) pointed out that the fees charged by FDRC were lower than the market rates charged by private mediators and arbitrators. Based on the "pay-as-you-use" principle, the fees collected from users of the FDRC's services would be able to support part of the operating expenses of FDRC. The FDRC would review its operation and staffing level having regard to the actual operational experience and caseload.

23. Mr CHIM Pui-chung was concerned that the setting up of the FDRC might encourage clients of the financial institutions to make more complaints, especially when the clients were not satisfied with the resolution proposed by the financial institutions.

24. SFST (Atg) responded that FDRC was set up to provide an affordable avenue for consumers to resolve monetary disputes with financial institutions. Its establishment would in a way encourage the financial institutions to better handle their disputes with consumers through their internal complaint handling mechanisms and seek resolutions at an early stage.

Collaboration with regulatory bodies

25. Mr Ronny TONG enquired about the role of the regulatory bodies, such as the HKMA and SFC, in the work of the FDRC. Mr TONG asked whether the regulators would provide preliminary advice on whether there was a prima facie case of regulatory breach to the claimants and the financial institutions concerned.

26. SFST (Atg) responded that the role of the regulators would remain unchanged with the establishment of the FDRC. Regulators would deal with regulatory breaches while FDRC deal with monetary disputes. While the claimants could seek mediation/arbitration with the financial institutions through the FDRC, the claimants might simultaneously make complaints to the regulatory bodies if breach of the relevant legislation/regulations was suspected. The FDRC would also sign a Memorandum of Understanding (MOU) with the regulatory bodies, which would set out, inter alia, the delineation of roles between FDRC and regulators as well as the arrangements for referral of suspected cases of regulatory breaches to the regulatory bodies for investigation. SFST (Atg) said that the relevant complaints sections of the regulatory bodies would also, where appropriate, advise the parties concerned to seek the FDRC's assistance if the matter in dispute concerned monetary elements.

27. Given that the mediators would play the role of a facilitator during mediation at FDRC, and the information provided to the FDRC for mediation or arbitration purpose would be kept confidential, Mr Albert HO enquired, in cases where FDRC suspected that the financial institutions had breached the relevant legislation or regulations, whether the FDRC would forward the relevant information to the regulatory bodies for follow-up action.

28. SFST (Atg) responded that FDRC should not be, or give the impression that the confidentiality of its process would become a regulatory blind spot. If there were numerous complaints concerning the same financial institutions and/or same type of malpractice, and/or if there was any suspicion of a breach of the relevant legislation/regulation, based on the MOU signed between the FDRC and the regulatory bodies, the FDRC would share its observations and

information with regulators for the latter to take forward the investigations into regulatory breaches.

General

29. The Chairman said that while the Democratic Alliance for the Betterment and Progress of Hong Kong supported the proposal of establishing a FDRC, the operation of the FDRC should be highly transparent so that investors would fully understand the role and service scope of FDRC. Since small investors would be in a comparatively weaker position in negotiating a resolution with financial institutions in a financial dispute, and notwithstanding the establishment of the FDRC, the regulatory bodies should continue to perform their supervisory and enforcement functions on the financial institutions in accordance with the relevant legislation and regulations. The Chairman said that the Administration should provide more information about the FDRC in the funding proposal to the Finance Committee, in particular details relevant to the queries and concerns raised by members during this discussion.

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