

# Securities and Futures Appeals Tribunal issues first decision relating to breaches under the Financial Dispute Resolution Scheme

Recently, the Securities and Futures Appeals Tribunal (**SFAT**) upheld sanctions imposed by the Securities and Futures Commission (**SFC**) against The Pride Fund Management Limited (**PFM**) for its failure to enter into mediation with an eligible claimant under the Financial Dispute Resolution Scheme (**FDRS**).

This marks this first case whereby the SFC has enforced obligations under the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) requiring intermediaries to comply with the FDRS.

## The Financial Dispute Resolution Scheme

The FDRS came into operation in June 2012. It provides an independent and affordable avenue for financial institutions and their customers to resolve monetary disputes, not exceeding HK\$500,000 (per case), by mediation and, failing which, arbitration. The Financial Dispute Resolution Centre Ltd (**FDRC**) was established to administer the FDRS.

The Code of Conduct was amended at the same time to include a new paragraph 12A which created an obligation on all licensed or registered persons to participate in the FDRC process and abide by Terms of Reference for the FDRC in relation to the FDRS (**Terms of Conduct**).

Our previous briefing on the establishment of FDRS and FDRC can be found [here](#).

## The Dispute

In 2008, Ms. Ha, through a licensed representative of PFM, made an investment totalling US\$780,000 in a

closed-end private equity fund (the **Fund**). The Fund was not a financial product authorised by the SFC and did not guarantee that the investor's capital would be protected. Further, unbeknown to Ms. Ha, a substantial portion of her investment (US\$117,000) was paid as commission to a company affiliated with The Pride Investment Group.

Ms. Ha suffered significant losses on her investment and sought redress, first by reporting the matter to the SFC, the ICAC and the Police. She then proceeded to bring a civil claim against PFM under the FDRS. Ms. Ha's losses had exceeded the HK\$500,000 ceiling under the FDRS, however she was willing to reduce the quantum of her claim so that the FDRC could handle her application.

The FDRC accepted Ms Ha's application in May 2013. It advised PFM that it was necessary for the company to participate in the FDRS in good faith and attend the relevant mediation meeting in accordance with the Code of Conduct.

However, PFM was adamant that there was no basis to Ms Ha's claim and refused to participate in

## Key issues

- Mediation/arbitration under the FDRS are not optional for financial institutions.
- Licensee and registered persons are expected to understand the FDRS, the Terms of Reference that govern the scheme and their obligations under the Code of Conduct.

mediation. As a result, in August 2014, the SFC issued a notice of proposed disciplinary action against PFM pursuant to s.194 of the Securities and Futures Ordinance (Cap. 571). The notice sought to impose two penalties against PFM, the first a public reprimand, and the second, a fine of HK\$1 million. The fine was subsequently lowered to HK\$700,000 by the SFC. On review, the SFAT further reduced to fine to HK\$400,000 on account of the fact that PFM was a modest business. The public reprimand remains.

## **Basis of the claim against PFM**

PFM argued that it should not be made subject to the FDRS because Ms. Ha had no basis for making a claim against it. It was submitted that since: (i) no direct contractual relationship existed between PFM and Ms. Ha, and (ii) no fees were received directly by PFM, there was nothing for the parties to mediate or arbitrate. Further, investigations by the SFC, the ICAC and the Police into this matter had been concluded with no action being taken against PFM.

The FDRC and the SFAT disagreed. First, they found that since the Fund and its manager were located offshore, an administration services agreement had been entered into between the fund manager and PFM. By entering into this administration services agreement, PFM was clearly acting as the fund manager's agent in providing information to clients (and potential clients) and in receiving applications for investment.

Secondly, the SFAT clarified that it was irrelevant whether PFM had received fees directly from Ms. Ha. Pursuant to Clause 12.1(f) of the Terms of Reference, Ms. Ha had the right to bring a claim against a financial institution, when it has acted as an agent, in connection with the provision of a financial service. "Financial service" had not been defined in the context of financial reward and a financial service does not cease to be such because the provider of the service receives no payment.

In light of the above, Ms. Ha's claim fell within the ambit of the FDRS and PFM was obligated to participate in the process. Mediation and arbitration under the FDRS are not voluntary for financial institutions. They have been imposed on licensed and registered persons by the amendments to paragraph 12 of the Code of Conduct.

## **FDRS process is different to criminal or other disciplinary investigations**

The SFAT further clarified that proceedings under the FDRS are of an entirely different nature from other criminal or disciplinary proceedings undertaken by the SFC, the ICAC or the Police. FDRS proceedings are civil in nature and are geared towards the resolution of monetary disputes as an alternative to litigation through the court system.

Also, pursuant the Terms of Reference, it is for the case officer employed by the FDRC to determine the eligibility of a claimant and the validity of their claim. Under Clause 18.3.2 of the Terms of Reference, only an applicant (i.e. the person lodging a claim against a financial institution) may object to a decision made by the case officer. No basis for objection is given to a financial institution if a claim is accepted by the FDRC. As such, all licensed or registered persons are bound to the FDRS and cannot unilaterally opt out of the scheme.

## **Implications**

Licensed and registered persons are advised to be familiarise themselves with the Code of Conduct and the Terms of Reference which govern the FDRS. The SFC has stated that the scheme cannot be effective if licensed persons can freely choose not to participate in the dispute resolution process. This case demonstrates that the SFC will seriously pursue and punish those individuals that do not comply with the FDRS.

The SFAT has also warned that following this case, there should be no further excuse on the part of members of the financial industry for a lack of understanding of the basic architecture of the FDRS. Serner penalties can be expected in the future for non-compliance with the FDRS.

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