

# Proposal by the Hong Kong Government to establish a new Financial Dispute Resolution Centre

## Introduction

The Secretary for Financial Services and the Treasury, Professor K C Chan, recently published the results of its consultation process on the establishment of a new Financial Dispute Resolution Centre (**FDRC**), confirming its intention to have the FDRC up and running by mid-2012.

Similar schemes exist in both Singapore (the Financial Industry Disputes Resolution Centre) and the United Kingdom and Australia (the Financial Ombudsman Service). The FDRC is seen by the Government as a key development in promoting greater accountability and transparency for the consumer in the financial sector, forming a central pillar in the ongoing reform process in the aftermath of the Securities & Futures Commission HK (**SFC**) and Hong Kong Monetary Authority's (**HKMA**) investigation into the selling of Lehman mini-bonds. According to Professor Chan:

*"FDRC is responsible for managing an independent and impartial dispute resolution scheme by way of "mediation first, arbitration next". It offers a speedy and affordable way to handle monetary disputes between consumers and financial institutions. If disputes cannot be handled through mediation, claimants can choose to bring their cases to arbitration."*

## What is the FDRC?

The intended FDRC structure of *"mediation first, arbitration next"* is in theory straightforward:

- the FDRC will administer a financial dispute resolution scheme in which all financial institutions regulated or licensed by the HKMA or SFC would be required to join
- upon a dispute arising with a customer, the FDRC may require a financial institution firstly to enter into mediation to reach a negotiated resolution
- the initial mediation will involve a neutral and independent mediator appointed by the FDRC to assist the parties in their attempts to reach such a resolution
- where unsuccessful, the FDRC may further assist the claimant in proceeding to arbitration for a hearing on the matter and adjudication by an independent arbitrator
- the process will be limited to monetary claims of HK\$500,000 and under. This would, apparently, account for more than 80 per cent of the financial disputes currently handled by the HKMA

## Key Issues

What is the FDRC?

Who will be the mediators and arbitrators?

Who is an eligible claimant?

Will there be vetting of claims?

Who will pay?

Will arbitration be compulsory for the FSPs?

How will the FDRC interface with regulators?

Observations

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The FDRC will be established alongside the new Investor Education Council (**IEC**), a dedicated educational body tasked with improving the "financial and capability of the general public".

The provision of an independent body separate from the courts responsible for the swift and confidential resolution of disputes between financial service providers (**FSPs**) and their customers has been broadly welcomed by the industry. The results of the consultation process have given further insight into the Government's proposals and how they will implement the reforms come mid-2012:

### 1. Who will be the mediators and arbitrators?

*"Mediators and arbitrators should be objective and impartial and have the necessary knowledge to enable them to deal with financial disputes."*

The integrity of the process hinges on procedural fairness and a merits based approach which, in turn, will rely upon the FDRC engaging strong, independent and sufficiently experienced mediators and arbitrators. To operate effectively and efficiently, both mediation and arbitration require individuals with the strength to assess each case on its merits whilst resisting any perceived external pressures of the type that has been witnessed in recent times.

The Government has indicated that it intends to provide training on the knowledge and skills to handle financial disputes. Given the relative immaturity of the mediation industry in Hong Kong, the challenge for the FDRC will be to establish and retain a panel of mediators/arbitrators with the necessary experience of both mediation/arbitration and investment products, whilst at the same time ensuring that the costs of the scheme are kept under control.

### 2. Who is an eligible Claimant?

Only individual consumers and sole proprietorships having a customer relationship with a financial services provider should be regarded as "eligible" claimants to FDRC. The Government declined an invitation to include small companies on the basis that individual consumers are in most need of the service. However, they have not ruled out extending the scope of the scheme over time.

### 3. Will there be vetting of claims?

In short, yes. The vetting of claims was a key emphasis of the consultation process, with the need for clear and acceptable vetting criteria being considered of utmost importance. Whilst the Government has not set out defined criteria, they have indicated broadly that the FDRC will not handle claims:

- concerning the performance of financial investments;
- regarding the general policies, practices or fees charged by financial service providers;
- that have been before the courts; or
- that the FDRC considers vexatious or frivolous.

Intake officers are to be appointed and trained with mediation knowledge and given an overview of the regulatory landscape. The early identification of vexatious or frivolous claims will be a central concern for FSPs, given that there will be no further point in the process until a full arbitration in which a claim by a determined claimant would otherwise be dismissed.

### 4. Who will pay?

In the first three years of the scheme, the Government will foot the start up and running costs of the FDRC. Thereafter it will be funded by the industry itself, in the same way that similar schemes are funded in other jurisdictions.

For the parties themselves, the fees will be fixed as follows:

**Schedule of Fees** (in Hong Kong dollar)

	Claimant	Financial Institution
Making enquiries	Nil	Not Applicable
Filing a claim form	\$200	Not Applicable
Mediation	(Case fees)	(Case fees)
Amount of claims		
- less than \$100,000	\$1,000	\$5,000
- between \$100,000 and \$500,000	\$2,000	\$10,000
Arbitration (regardless of the amount of claims)	(Case fees) \$5,000	(Case fees) \$20,000

The Government has indicated that 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."* The higher fee for the FSP is to *"encourage them to invest in and make best use of their own complaint handling system."* Such sentiments appear to pre-suppose a level of inherent wrongdoing on the part of financial institutions. Not only does they appear to run contrary to a merits based approach to the scheme, the emphasis on settlement by the FSP potentially incentivises an individual consumer to "try their luck" in any dispute (however weak their claim may be).

**5. Will arbitration be compulsory for the FSPs?**

In short, yes (if the Claimant decides to continue). If a Claimant gets past the initial vetting process and refuses to settle at mediation, they will be able to bind the FSP into an arbitration process. The Government has refused requests from FSPs to introduce a second gatekeeper to the arbitration process following mediation. Again, there appears to be a built-in incentive for the FSP to settle at mediation, given the internal management time and legal fees that may potentially arise in proceeding to arbitration.

**6. How will the FDRC interface with regulators?**

Never the twain shall meet appears to be the message: *"regulators deal with regulatory breaches while FDRC deals with monetary disputes."* But what happens when a case involves both regulatory concerns and a monetary dispute? The answer appears to be that it will be for the consumer to decide, with the FDRC intake officers tasked with explaining the options to them and how they may take their cases forward. Where a systemic case is suspected by the FDRC, it will direct all relevant complaints to the regulators for investigation.

The intake officers are therefore key to the entire process. From the outset, they have to (i) weed out the unworthy claims by an application of the entry criteria; (ii) identify where a claim involves both regulatory and monetary disputes; (iii) advise consumers on their options; and (iv) at the same time, assess whether a systemic case has occurred which merits regulatory investigation.

**Observations**

The establishment of the FDRC is generally to be welcomed in attempting to streamline the resolution of smaller monetary disputes. Recent experience in Hong Kong suggests that the FDRC will be in demand. If the FDRC runs in practice as per the theory, it will be a useful mechanism for both the FSP and the customer. However, if it provides a means for customers to try their luck against the supposed "deep pockets" of the FSPs, it is unlikely to have the support of the industry. The integrity of the scheme is key and, in turn, the abilities of the mediators, the arbitrators and...the intake officers.

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