

6-1-2012

## Alternative Dispute Resolution Design in Financial Markets—Some More Equal Than Others: Hong Kong's Proposed Financial Dispute Resolution Center in the Context of the Experience in the United Kingdom, United States, Australia, and Singapore

Shahla F. Ali

Antonio Da Roza

Follow this and additional works at: <https://digitalcommons.law.uw.edu/wilj>

Part of the [Banking and Finance Law Commons](#), [Comparative and Foreign Law Commons](#), and the [Dispute Resolution and Arbitration Commons](#)

---

### Recommended Citation

Shahla F. Ali & Antonio Da Roza, *Alternative Dispute Resolution Design in Financial Markets—Some More Equal Than Others: Hong Kong's Proposed Financial Dispute Resolution Center in the Context of the Experience in the United Kingdom, United States, Australia, and Singapore*, 21 Pac. Rim L & Pol'y J. 485 (2012).

Available at: <https://digitalcommons.law.uw.edu/wilj/vol21/iss3/5>

This Article is brought to you for free and open access by the Law Reviews and Journals at UW Law Digital Commons. It has been accepted for inclusion in Washington International Law Journal by an authorized editor of UW Law Digital Commons. For more information, please contact [cnyberg@uw.edu](mailto:cnyberg@uw.edu).

**ALTERNATIVE DISPUTE RESOLUTION DESIGN  
IN FINANCIAL MARKETS—  
SOME MORE EQUAL THAN OTHERS:  
HONG KONG’S PROPOSED FINANCIAL DISPUTE  
RESOLUTION CENTER IN THE CONTEXT OF THE  
EXPERIENCE IN THE UNITED KINGDOM,  
UNITED STATES, AUSTRALIA, AND SINGAPORE**

**Shahla F. Ali<sup>†</sup> & Antonio Da Roza<sup>††</sup>**

*Abstract:* Systems of financial dispute resolution currently operate in most major financial centers throughout the world. As such systems expand and develop to address a growing number of finance-related disputes, they must inevitably address the question of their role and function in financial market regulation. Such questions are rooted in the larger socio-legal dispute processing debate examining how institutional dispute resolution mechanisms effectively regulate the repeat player knowledge/power gap through appropriate policies and procedures. Using the example of Hong Kong in comparison with financial dispute resolution models currently in existence in the United Kingdom, Australia, Singapore, and the United States, this article finds that the appropriateness of a dispute resolution method is arguably informed by whether it takes on a regulatory or non-regulatory role. Regulatory dispute resolution modes taking on inquisitorial elements may be preferred when displacing the judicial function as they incorporate safeguards for disputants against the discretion of the third party intervener. But even for non-regulatory schemes, inquisitorial elements aimed at addressing the power/knowledge gap including suggesting the provision of information regarding relevant standards and rules, at least as touchstones, may still be incorporated into consensual models of dispute resolution, which aim to ensure a *de minimis* level of equity and fairness in the process.

I. INTRODUCTION

In the aftermath of the financial crisis in 2008, Hong Kong’s regulators proposed to create a Financial Dispute Resolution Center (“FDRC”) for the purposes of deploying and centralizing alternative dispute resolution techniques in Hong Kong’s financial markets.<sup>1</sup> In recent times, legal scholars have offered important insights in the area of designing

---

<sup>†</sup> Assistant Professor and Deputy Director, L.L.M. in Arbitration and Dispute Resolution, Faculty of Law, University of Hong Kong; B.A., Stanford University; M.A., Landegg University; J.D., Boalt Hall School of Law; Ph.D., Jurisprudence and Social Policy, University of California at Berkeley. The authors thank the Government of Hong Kong’s University Grants Committee for its kind support through its Public Policy Research Grant (HKU7001-PPR-10).

<sup>††</sup> Barrister-at-Law, New Chambers, Hong Kong.

<sup>1</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, PROPOSED ESTABLISHMENT OF AN INVESTOR EDUCATION COUNCIL AND A FINANCIAL DISPUTE RESOLUTION CENTRE (2010), *available at* <http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-1127-1-e.pdf>.

effective and efficient systems of dispute resolution in diverse sectors.<sup>2</sup> This article will focus in particular on practical and principle based considerations relevant to the design of Hong Kong's Financial Dispute Resolution Center.

In comparing the key elements of the proposal for Hong Kong with dispute resolution schemes for financial markets of other jurisdictions—specifically, the United Kingdom, Australia, Singapore and the United States—two related issues arise. First, what is the role of dispute resolution in financial markets and their regulation? Second, which alternative dispute resolution techniques are most appropriate for use in financial markets and what is their level of appropriateness, not only in resolving disputes, but also in light of the role dispute resolution plays in financial markets and their regulation? The United Kingdom, United States, Australia, and Singapore are selected since they represent two very different approaches to financial dispute resolution in well-developed financial centers: one is an ombudsman-based system (United Kingdom and Australia) and the other is an arbitration model (United States and Singapore).<sup>3</sup>

The well-documented importance of the rule of law to Hong Kong's financial markets is evidenced by the fact that financial services disputes of the highest orders occur and are resolved in Hong Kong (e.g., the recent "Congo" case at the Court of Final Appeal<sup>4</sup> concerning the enforceability of debts against the Democratic Republic of Congo in Hong Kong courts). However, the financial crisis demonstrated the limits of the existing methods of dispute resolution. Calls for the establishment of an affordable and

---

<sup>2</sup> See, e.g., WILLIAM L. URY, JEANNE M. BRETT & STEPHEN B. GOLDBERG, *GETTING DISPUTES RESOLVED: DESIGNING SYSTEMS TO CUT THE COST OF CONFLICT* 41-64 (1988); Janet Martinez & Stephanie Smith, *An Analytic Framework for Dispute System Design*, 14 HARV. NEGOTIATION L. REV. 123 (2009); CATHY A. COSTANTINO ET AL., *DESIGNING CONFLICT MANAGEMENT SYSTEMS: A GUIDE TO CREATING PRODUCTIVE AND HEALTHY ORGANIZATIONS* (1996); Lisa Blomgren Bingham et al., *Dispute System Design and Justice in Employment Dispute Resolution: Mediation at the Workplace*, 14 HARV. NEGOTIATION L. REV. 1 (2009); THE CONSENSUS BUILDING HANDBOOK 61-168 (Lawrence Susskind et al. eds., 1999); Richard C. Rueben, *Democracy and Dispute Resolution: Systems Design and the New Workplace*, 10 HARV. NEGOTIATION L. REV. 11 (2005); Jill Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 OHIO ST. J. ON DISP. RESOL. 329 (2006); John Lande, *Using Dispute System Design Methods to Promote Good-Faith Participation in Court-Connected Mediation Programs*, 50 UCLA L. REV. 69 (2002); Sharon Press, *Building and Maintaining a Statewide Mediation Program: A View from the Field*, 81 KY. L.J. 1029 (1992); Ellen E. Deason, *Procedural Rules for Complementary Systems of Litigation and Mediation-Worldwide*, 80 NOTRE DAME L. REV. 553 (2004); Andrea Kupfer Schneider, *The Intersection of Dispute Systems Design and Transitional Justice*, 13 HARV. NEGOTIATION L. REV. 329 (2008); Carrie J. Meadow, *Are There Systemic Ethics Issues in Dispute System Design? And What We Should [Not] Do About It: Lessons From International and Domestic Fronts*, 14 HARV. NEGOTIATION L. REV. 195, 195-231 (2009).

<sup>3</sup> For further elaboration, please see SHAHLA F. ALI, *CONSUMER FINANCIAL DISPUTE RESOLUTION IN A COMPARATIVE CONTEXT: PRINCIPLES, SYSTEMS AND PRACTICE* (forthcoming 2013).

<sup>4</sup> *Democratic Republic of the Congo and Ors v. FG Hemisphere Associates LLC* [2011] FACV 5, 6, 7/2010 (H.K.).

efficient method of dispute resolution arising from the crisis thus address themselves towards the first issue: dispute resolution is necessary for financial markets not only in providing assurance that disputes over financial rights and legal obligations can be determined by an independent arbiter, and give rise to enforceable remedies, but beyond that is a greater need for accessibility—particularly for consumers. Hong Kong’s financial markets are characterized by high numbers and high levels of participation by private individual investors at the retail level, giving rise to its “short-term outlook and quasi-gambling nature.”<sup>5</sup> It is these private investors on the retail level which the proposal addresses—disputes between consumers and financial service providers. Improving accessibility to justice, or the ease with which investors may protect their own rights in financial markets, not only serves to enhance market participation and capitalization via increased consumer confidence, but also serves to enhance market efficiency by lowering the amount of resources that need to be dedicated to the resolution of disputes. This, in turn, could potentially lead to a redistribution of those resources back into capitalization of the financial market.

More specifically, in the context of the regulation of financial markets, the introduction of alternative dispute resolution, (i.e., alternative to the judicial system) while clearly furthering market efficiency by lowering the resource-intensiveness of resolving financial disputes, raises the issue of whether or not alternative forms of dispute resolution necessarily play the same role as the courts in standard-setting and norms for consumer protection. In every jurisdiction, the role of alternative dispute resolution in a regulatory context seems to differ, leading to the question of whether or not it is desirable for alternative dispute resolution in financial markets to have an *ad hoc* regulatory role in trying to achieve consistency of outcomes and awards.

With regards to market efficiency, determining an appropriate method of dispute resolution thus becomes doubly important, as the shortcomings of an ineffective dispute resolution method could well lead to an adverse effect not just on consumer confidence, but market efficiency, as well as an increase in the amount of resources dedicated to and associated with dispute resolution.

As Hong Kong moves toward the development of a centralized, systemized, alternative dispute resolution scheme at the retail level, it may well benefit from the experience of other jurisdictions in being able to

---

<sup>5</sup> BERRY HSU ET AL., FINANCIAL MARKETS IN HONG KONG: LAW AND PRACTICE (2006).

design an alternative dispute resolution scheme that is both appropriate for its financial markets, and also for its regulatory system.

## II. BACKGROUND

At the end of 2008, the world experienced what is considered to be the worst financial crisis since the Great Depression of the 1930s. The effects of the crisis manifested in Hong Kong in a number of ways, of which the most prominently featured in local media was the Minibonds Crisis, in respect to which the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) received over 16,000 complaints and resulted in many protests and demonstrations.<sup>6</sup> In response, the Hong Kong government set out to establish a dispute resolution mechanism to handle complaints arising out of the crisis.

### A. *Resolving the Minibonds Crisis and Dispute Resolution in Hong Kong*

At the heart of the Minibonds Crisis was whether or not the risks associated with these complex products were fully disclosed and communicated to the retail investors who purchased them. This gave rise to two complaints in particular: first, the way in which Minibonds had been sold to the retail market, particularly by the banks carrying on securities business; and second, their suitability for particular customers given their complexity.

As a result of these complaints, retail investors who had purchased Minibonds felt they were entitled to the return of the principal invested following the filing for bankruptcy of Lehman Brothers, which triggered the unwinding of the Minibonds—leading to their value falling to little more than a fraction of the principal. In late September and early October 2008, hundreds of Minibond investors took to the streets of Hong Kong’s central business district in protest, and also staged demonstrations at the offices and branches of distributing banks.

In response, on October 2, 2008, the Hong Kong Association of Banks formed a task force on Lehman-related investment products.<sup>7</sup> On October 6, 2008, the Hong Kong government proposed that the distributing banks buy

---

<sup>6</sup> Hong Kong Democratic Foundation, *Proposal for Resolution of Mini-Bond Issue* (Nov. 2008), <http://www.hkdf.org/pr.asp?func=show&pr=178> (last visited May 1, 2012).

<sup>7</sup> The Hong Kong Association of Banks, *The Hong Kong Association of Banks Sets Up Task Force to Follow Up Lehman Brothers Incident* (Oct. 2, 2008), <http://www.hkab.org.hk/DisplayWhatsNewsAction.do?ss=1&id=37> (last visited May 1, 2012).

back the Minibonds at market price, to which the Task Force agreed.<sup>8</sup> However, legal hurdles in the form of the relevant United States bankruptcy laws prevented the liquidation of the Minibonds, which would have been necessary for the buy-back.<sup>9</sup> A cease-and-desist letter was issued in respect to the liquidation of the Minibonds on November 25, 2008, leading to an announcement by distributing banks that they would be prepared to finance the trustee for the Minibonds up to \$100 million to assist its performance of its duties to protect the interests of Minibond investors.<sup>10</sup>

### 1. *Regulatory Gap*

Article 109 of the Basic Law of Hong Kong requires that “the Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.”<sup>11</sup> In particular, in respect to the financial retail market, it serves to highlight the importance of Hong Kong’s status as an international financial center in its enshrinement in a constitutional document.

The day-to-day regulation of Hong Kong’s financial markets is generally sectoral, with a separate regulator for each sector (i.e., HKMA for banks and banking, SFC for securities and futures institutions and markets, and the Office of the Commissioner of Insurance (“OCI”) for insurance business). One notable exception to the sectoral approach of Hong Kong’s regulatory system is the oversight of the HKMA of all activities of banks, including their business in securities or insurance. The HKMA regulates the banks in these areas using the same rules and standards that are applied by the sector regulators, i.e., the SFC and OCI, but banks are otherwise regulated on an institutional basis.

Unlike in Singapore, where the Monetary Authority of Singapore announced on January 16, 2009 that financial institutions who had fraudulently sold Minibonds would make full or partial settlement to 58% of

---

<sup>8</sup> Legislative Council, *Background Brief on the Lehman Brothers Minibonds Collateral Recovery Agreement and Related Issues* (Apr. 15, 2011), <http://www.legco.gov.hk/yr1011/english/panels/fa/papers/fa0421cb1-1979-e.pdf> (last visited May 1, 2012).

<sup>9</sup> REPORT OF THE HONG KONG MONETARY AUTHORITY ON ISSUES CONCERNING THE DISTRIBUTION OF STRUCTURED PRODUCTS CONNECTED TO LEHMAN GROUP COMPANIES 6 (2008), available at [http://www.info.gov.hk/hkma/eng/new/lehman/lehman\\_report.pdf](http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf).

<sup>10</sup> *Id.*; see also Letter from Weil, Gotshal & Manges LLP to U.S. Bank Corporate Trust Services-CDO Group (Nov. 25, 2008), available at [http://www.pwchk.hk/webmedia/doc/634354518955653280\\_minibonds\\_doc\\_wgm\\_nov2008.pdf](http://www.pwchk.hk/webmedia/doc/634354518955653280_minibonds_doc_wgm_nov2008.pdf).

<sup>11</sup> The Basic Law of the Hong Kong Special Administrative Region, Art. 109 (promulgated by the President of the People’s Republic of China, Apr. 4, 1990, effective July 1, 1997), available at [http://www.basiclaw.gov.hk/en/basiclawtext/images/basiclaw\\_full\\_text.pdf](http://www.basiclaw.gov.hk/en/basiclawtext/images/basiclaw_full_text.pdf).

complainants—with 25% receiving all of the principal invested while 33% would receive at least part of their principal—the powers of the regulators in Hong Kong do not extend to direct interventions on behalf of consumers in consumer disputes. As was noted in an earlier review of banking consumer protection by the HKMA:

A key difference between Hong Kong and the other two comparison jurisdictions is that the regulators in both the UK and Australia have been given an explicit mandate in relation to the protection of consumers of financial and banking services. In the case of Hong Kong, the HKMA only has a general duty to ‘provide a measure of protection to depositors’ under the Banking Ordinance (Cap.155). There is no explicit mandate with respect to consumer protection.<sup>12</sup>

A similar provision is found in the Securities and Futures Ordinance (Cap.571) in respect to the functions of the SFC: “to secure an appropriate degree of protection for members of the public investing in or holding financial products . . . .”<sup>13</sup>

Consumer complaints or disputes are instead dealt with in the Code of Conduct for Persons Licensed by or Registered with the SFC, which applies to all persons licensed by the SFC to conduct regulated activities such as dealing in securities.<sup>14</sup> The Code of Conduct also applies to banks registered with the SFC to carry out such activities. Under section 12.3 of the Code of Conduct:

A registered person should ensure that: (a) complaints from clients relating to its business are handled in a timely and appropriate manner; (b) steps are taken to investigate and respond promptly to the complaints; and (c) where a complaint is not remedied promptly, the client is advised of any further steps which may be available to the client under the regulatory system.<sup>15</sup>

---

<sup>12</sup> Hong Kong Monetary Authority, *Comparative Study on Banking Consumer Protection and Competition Arrangements in the UK, Australia and Hong Kong: An Introductory Note* 3-4 (Apr. 27, 2001), available at <http://www.legco.gov.hk/yr00-01/english/panels/fa/papers/a1112e02.pdf>.

<sup>13</sup> Securities and Futures Ordinance (2003), Cap. 571, 5 § (1)(1) (H.K.).

<sup>14</sup> Under Schedule 5 of the Securities and Futures Ordinance, the ten types of regulated activities are: dealing in securities, dealing in futures contracts, leveraged foreign exchange trading, advising on securities, advising on futures contracts, advising on corporate finance, providing automated trading services, securities margin financing, asset management and credit ratings services. *Id.*

<sup>15</sup> Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (2010), § 12.3 (H.K.).

Little information has been made available as to whether or not Minibond complainants had made use of internal complaints systems (if any) of the Minibond distributors, what the results of those complaints were, and how the internal complaints systems of the distributors might interact with the regulatory system. This left Minibond complainants to contend with the various modes of dispute resolution in Hong Kong.

## 2. *Courts, Litigation, and Alternative Dispute Resolution Culture in Hong Kong*

While the court system in Hong Kong is well established, the lack of a centralized dispute resolution scheme for Hong Kong's financial industry may be attributed to the nascent exposure to alternative dispute resolution in Hong Kong, specifically mediation. With the exception of arbitration, which is governed by the Arbitration Ordinance (Cap. 609),<sup>16</sup> "other ADR processes such as mediation do not have any statutory procedures and operation"<sup>17</sup> in Hong Kong. In particular, the lack of knowledge and experience with alternative dispute resolution procedures amongst legal professionals in Hong Kong is attributed to the traditional legal environment and culture in which these lawyers are trained and practice.<sup>18</sup> Alternative dispute resolution is currently an elective subject in law school curriculum. Due to this voluntary participation, the number of practicing lawyers who had mediation training in 2007 was cited as 0.08%.<sup>19</sup>

Furthermore, litigation remains the first choice for individuals and commercial enterprises where courts are better equipped to understand the legal dispute, where there is a desire for authoritative and legal precedent (which would be thus binding on similar cases), and where court procedures allow for judgments to be obtained quickly and cheaply, as may be the case in proceedings such as summary judgment.<sup>20</sup> Civil litigation was reported to have been initiated by Minibond investors in several cases between 2008 and 2009<sup>21</sup>—the first lawsuits of their type. However, greater progress appears

---

<sup>16</sup> Pre Arbitration Ordinance (2011), Cap. 609 (H.K.).

<sup>17</sup> Gu Weixia, *Civil Justice Reform in Hong Kong: Challenges and Opportunities for Development of Alternative Dispute Resolution*, 40 H.K. L.J. 43, 52 (2010).

<sup>18</sup> *Id.*

<sup>19</sup> Chan Bing Woon & Oscar Tan, *Building a Mediation Culture in Hong Kong*, ASIAN DISP. REV. 126 (2007) (though this figure has almost certainly risen since the Civil Justice Reforms came into force).

<sup>20</sup> Gary Soo, Yun Zhao & Dennis Cai, *Better Ways of Resolving Disputes in Hong Kong—Some Insights from the Lehman-Brothers Related Investment Product Dispute Mediation and Arbitration Scheme*, 9 J. INT'L BUS. & L. 137 (2010).

<sup>21</sup> Amy Nip, *Two Investors Reach Settlement With Bank Before Court Case*, SOUTH CHINA MORNING POST, Nov. 11, 2008, at A4, available at <http://www.pressdisplay.com/pressdisplay/viewer.aspx>; Patsy



to have been made in criminal litigation related to the Minibonds Crisis than civil litigation. In January 2010, a former Dah Sing Bank employee was charged with forging a customer's signature to buy Minibonds from the bank.<sup>22</sup> In April 2010, two staff members of the Bank of China (Hong Kong) were charged by the Commercial Crimes Bureau for misleading and inducing customers to purchase structured products such as the Minibonds,<sup>23</sup> though they were subsequently acquitted.<sup>24</sup>

Cases have also been taken to the Small Claims Tribunal, a court that deals quickly, informally, and inexpensively with claims not exceeding HK\$50,000. Rules and procedures are less strict than other courts, and no legal representation is allowed. One hundred thirty-five Minibond investors whose claims did not exceed \$50,000 sought to recover money against banks in the Tribunal.<sup>25</sup> The adjudicator, having heard all the cases, came to conclusion that the claims should be referred to the District Court, as the cases concerned banks' responsibilities and risks to consumers, involving new and complicated legal points which would have an impact on the public banking sector. The lack of precedent and the fact that the Tribunal might not have had the legal power to handle such cases also contributed to the decision to refer the cases to the district court.<sup>26</sup>

Driven by its incorporation into civil court procedure during the Civil Justice Reform, alternative dispute resolution and mediation in particular is now receiving much greater attention in Hong Kong. The success of existing court-annexed mediation schemes, such as the pilot scheme for family mediation<sup>27</sup> and construction disputes,<sup>28</sup> has led to the extension of such schemes into various facets of civil procedure.<sup>29</sup> Alternative dispute resolution is explicitly incorporated under Order 25 of the Rules of the High Court (Cap. 4A, Sub.Leg.).<sup>30</sup> Order 25 deals with case management

---

Moy, *Lehman Investor to Get her Day in Court*, THE STANDARD, Sept. 25, 2009, available at [http://www.thestandard.com.hk/news\\_detail.asp?sid=25487561&art\\_id=88391&con\\_type=1&pp\\_cat=30](http://www.thestandard.com.hk/news_detail.asp?sid=25487561&art_id=88391&con_type=1&pp_cat=30).

<sup>22</sup> *Bank Staff Arrested over Minibonds*, LEHMAN VICTIMS ALLIANCE, Mar. 27, 2010, available at <http://www.lbv.org.hk/content/pages/posts/bank-staff-arrested-over-minibonds7571.php>.

<sup>23</sup> *Id.*

<sup>24</sup> HKSAR v. Chu Lai Sze [2010] HCMA 527/2010; HKSAR v. Tai Ching [2011] DCCC 527 & 1272/2010; Re Cheung Kwai Kwai [2011] DCCC 526/2010.

<sup>25</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 65.

<sup>26</sup> *Id.*

<sup>27</sup> Civil Justice Reform-Interim Report, *Interim Report of the Chief Justice's Working Party on Civil Justice Reform*, para. 666 (Nov. 21, 2001), available at <http://www.civiljustice.gov.hk/ir/paperHTML/Wor kingParty.html>.

<sup>28</sup> CIVIL JUSTICE REFORM, FINAL REPORT OF THE CHIEF JUSTICE'S WORKING PARTY ON CIVIL JUSTICE REFORM, para. 831 (Mar. 3, 2004), available at <http://www.legco.gov.hk/yr06-07/english/bc/bc57/papers/bc570611cb2-1960-e.pdf>.

<sup>29</sup> *Id.* para. 797, n.640.

<sup>30</sup> Rules of the High Court (1989), Cap.4A, O.25 (H.K.).

summons and conferences, the means by which the High Court sets out the details of proceedings prior to their commencement.<sup>31</sup> Amongst the requirements in Order 25 is the mandatory completion of the timetabling questionnaire that is filed by the parties on the close of pleadings.<sup>32</sup> The first section of the questionnaire deals with alternative dispute resolution, and requires the parties to either: 1) confirm they have attempted to settle the case by alternative dispute resolution but were not successful, or that they have no intention of settling the case, or that they are willing to try to settle the case by alternative dispute resolution or other means and thus request a stay of the proceedings, 2) confirm they have filed a mediation certificate, or 3) confirm they have filed a mediation notice/response.<sup>33</sup> The mediation certificate sets out whether or not parties are willing to attempt mediation to settle the proceedings, and the reasons if the party is not willing.<sup>34</sup> Where parties wish to attempt mediation, they should file a mediation notice,<sup>35</sup> and in response, the other party to the proceedings will file a mediation response.<sup>36</sup> Under Practice Direction 31 on Mediation, the court may make adverse costs orders against parties who unreasonably fail to engage in mediation.<sup>37</sup>

### 3. *The Consumer Council*

Established in 1974, the Consumer Council provides consumer complaint and inquiry services, though it has no powers of adjudication or investigation itself. Complaints about the Minibonds were made to the Consumer Council, leading to the creation of a special workforce to handle Lehman Brothers Cases on October 30, 2008.<sup>38</sup> The workforce was tasked with identifying cases for consideration of financial assistance for legal action under the Consumer Legal Action Fund (“CLAF”).<sup>39</sup> According to the press release issued by the Consumer Council, the criteria for financial

---

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*, r.1.

<sup>33</sup> *Id.* Annex A (Practice Direction 5.2 on Case Management).

<sup>34</sup> *Id.* App. B (Practice Direction 31 on Mediation).

<sup>35</sup> *Id.* App. C.

<sup>36</sup> *Id.* App. D.

<sup>37</sup> HONG KONG BAR ASSOCIATION, CIRCULAR NO. 097/10 (Sept. 27, 2010), available at <http://hkbademo.zmallplanet.com/members/circulars/2010/2010097.pdf>. The Circular has, however, suggested that some practitioners were approaching court-mandated mediation processes as a mere formality preceding litigation rather than making genuine efforts to reach settlement. *Id.*

<sup>38</sup> Consumer Council, *Consumer Council Has Put in Place a Special Workforce to Handle the Lehman Brothers Cases* (Oct. 30, 2008), available at [http://www.consumer.org.hk/website/ws\\_en/news/pre ss\\_releases/2008103001.html](http://www.consumer.org.hk/website/ws_en/news/pre ss_releases/2008103001.html).

<sup>39</sup> *Id.*

assistance included: vulnerability of the complainants, cogency of evidence on untoward sales tactics, inadequate risk disclosure, and misrepresentation.<sup>40</sup> The process involved interviewing selected complainants, conducting a preliminary legal analysis, and reporting to the CLAF Management Committee for recommendation to the Board of Administrators for approval.<sup>41</sup> A portion of the work was commissioned to barristers in private practice in order to expedite the process.<sup>42</sup> By the end of 2008, the Consumer Council reported it had received some 8,274 complaints in respect to Minibonds, which contributed to a tenfold increase in complaints against financial services for that year.<sup>43</sup> At the end of 2009, the number of complaints received by the Consumer Council against financial services was 4,968.<sup>44</sup> One of the key difficulties for consumers in complaining to the Consumer Council is that referral to the CLAF would simply direct complainants back to the litigation system.<sup>45</sup>

#### 4. *Assisted Negotiations*

On December 9, 2008, the Democratic Party announced that it had assisted over sixty investors, reaching settlements totaling \$30 million in compensation from fourteen of the distributing banks.<sup>46</sup> The range of compensation was described as “wide” and the average percentage of principal received in compensation was described as “high,” but was not disclosed.<sup>47</sup> The settlements were attributed to the fact that the cases all involved regulation violations; however, resolved cases represented less than 1% of the total number of complaints at the time.<sup>48</sup>

---

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> Consumer Council, *Year Ender 2008* (Jan. 19, 2009), available at [http://www.consumer.org.hk/website/ws\\_en/news/press\\_releases/2009011901.html](http://www.consumer.org.hk/website/ws_en/news/press_releases/2009011901.html).

<sup>44</sup> Consumer Council, *Public Education Proved to be Effective: Consumer Complaints Alleviated in 2010* (Jan. 26, 2011), available at [http://www.consumer.org.hk/website/ws\\_en/news/press\\_releases/2011012701.html](http://www.consumer.org.hk/website/ws_en/news/press_releases/2011012701.html).

<sup>45</sup> “The Fund aims to . . . assist consumers to bring or defend representative action.” CONSUMER COUNCIL, INFORMATION PAMPHLET ON CONSUMER LEGAL ACTION FUND (June 2003), available at [http://www.consumer.org.hk/website/ws\\_en/legal\\_protection/consumer\\_legal\\_actions\\_fund/CLAFBriefPDF.pdf](http://www.consumer.org.hk/website/ws_en/legal_protection/consumer_legal_actions_fund/CLAFBriefPDF.pdf).

<sup>46</sup> Democratic Party, 成功促使 60 宗雷曼個案和解涉及金額近 3,000 萬港元: 民主黨介紹銀行和解進度和特點 (Dec. 9, 2008), available at <http://www.dphk.org/wp-content/uploads/2009/10/081209PRESS.pdf>.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

### 5. *The Minibonds Mediation and Arbitration Scheme*

On October 31, 2008, the HKMA announced a mediation and arbitration scheme administered by the HKIAC for complainants in respect to Lehman-related investment products distributed by banks (“the Scheme”).<sup>49</sup> The Scheme applied to issues of compensation between investors in Lehman Brothers-related products and banks licensed by the HKMA, and it was specifically limited to investors who had made complaints to the HKMA, and whose complaints were referred to the SFC or, if there had been a finding, against a relevant individual or executive officer of a bank against whom a complaint was made.<sup>50</sup> The HKMA informed such eligible investors in writing, and would pay half the fee of the service, with the other half being borne by the relevant bank.<sup>51</sup>

However, the HKIAC also offered a similar service, using the same procedures applicable to the Scheme, to investors who were not eligible under the above criteria, if the relevant bank consented to take part, though the costs would have to be borne by the parties themselves.

The procedure involved a preparatory meeting followed by mediation and, in the event mediation was unsuccessful, arbitration.<sup>52</sup> Before the dispute resolution process began, parties would attend preparatory meetings to familiarize themselves with the mediation process, explore settlement options, and exchange information and documents. The first step of the Scheme involved mediation, by which the mediator would attempt to assist the parties in reaching a negotiated settlement, or if that were not possible, to narrow the issues in dispute, in particular, to agree on common facts that may be used in subsequent arbitration or litigation. In the event that the mediation was unsuccessful, the parties could then elect to arbitrate, which would be binding on both parties. Another person that is not the mediator would be appointed as arbitrator, and conduct a documents-only arbitration to the extent possible. The arbitrator’s decision would be final. This procedure, however, was not intended for use in all disputes; in particular, it was not intended for use in those involving complex issues or requiring the examination of witnesses.<sup>53</sup>

---

<sup>49</sup> Press Release, Hong Kong Monetary Authority, *Lehman-Brothers-Related Products Dispute Mediation and Arbitration Scheme* (Oct. 31, 2008), available at <http://www.hkma.gov.hk/eng/key-information/press-releases/2008/20081031-5.shtml> (last visited May 1, 2012).

<sup>50</sup> *Id.*

<sup>51</sup> Hong Kong Monetary Authority, *Explanatory Note on the Scheme* (Oct. 31, 2008), [http://www.hkma.gov.hk/eng/other-information/lehman/explanatory\\_b.shtml](http://www.hkma.gov.hk/eng/other-information/lehman/explanatory_b.shtml) (last visited May 6, 2012).

<sup>52</sup> Shahla F. Ali & John Koon Wang, *After Lehman: International Response to Financial Disputes—A Focus on Hong Kong*, 10 RICH. J. GLOBAL L. & BUS. 151 (2011).

<sup>53</sup> *Id.*

According to the HKIAC's Year-End Report for 2009, a total of 334 cases were referred to the Scheme, of which 243 were handled.<sup>54</sup> As of December 31, 2009, eighty-six cases went through mediation with seventy-five achieving settlement.<sup>55</sup> Thirty-seven cases were settled by direct negotiation.<sup>56</sup> No cases were referred to arbitration.<sup>57</sup>

#### 6. *Regulator-Negotiated Mass Settlement and Subsequent Top-Up*

It was the intervention of the regulators that proved the most effective in respect to driving settlement forward. In early 2009, Sun Hung Kai Investment Services and KGI Asia voluntarily offered to repurchase the Minibonds after the SFC raised a number of concerns in respect to the Minibond sales practices, which formed the basis of reprimands from the SFC. The repurchases were completed on July 2, 2009, and clients of both securities broker distributors recovered the principal amounts invested.<sup>58</sup>

On July 22, 2009, an agreement was reached between the SFC, HKMA, and sixteen of the distributing banks, whereby the banks offered to repurchase the Minibonds at a price equal to 60% of the original investment amount for their customers below the age of sixty-five, and at 70% for those above the age of sixty-five. Investors who had previously reached settlements with the banks would also receive *ex gratia* payments to bring their settlement amounts in line with the agreed settlement rate. In exchange, the distributing banks admitted no liability, and furthermore, the SFC discontinued its investigations into the sale and distribution of Minibonds by the banks. The HKMA also informed the banks of its intention not to take any enforcement action in respect to the banks whose customers accepted the offer.<sup>59</sup>

Approximately 24,168 Minibond investors accepted the repurchase scheme, for which approximately 97% qualified. A further 4,800 Minibond

---

<sup>54</sup> GARY SOO, HONG KONG INTERNATIONAL ARBITRATION CENTRE, YEAR-END REPORT FOR 2009 FROM THE SECRETARIAT 2-3 (Nov. 23, 2009), available at [http://www.hkiac.org/qwert/images/stories/news/pdf/HKIAC\\_Year\\_End\\_Report\\_for\\_2009\\_from\\_Secretariat.pdf](http://www.hkiac.org/qwert/images/stories/news/pdf/HKIAC_Year_End_Report_for_2009_from_Secretariat.pdf).

<sup>55</sup> Anthony Connerty, *Lehman Lessons*, 160 NEW L.J. 948, 967 (2010).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> Securities and Futures Commission, *Sun Hung Kai Investment Services Ltd Agrees with SFC to Repurchase Minibonds From Its Clients at Original Value*, SFC ENFORCEMENT NEWS, Jan. 22, 2009, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR8>; *KGI Asia Ltd Agrees with SFC to Repurchase Minibonds from Its Clients at Original Value*, SFC ENFORCEMENT NEWS, Apr. 5, 2009, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR39>.

<sup>59</sup> Securities and Futures Commission, *SFC, HKMA and 16 banks reach agreement on Minibonds*, SFC ENFORCEMENT NEWS, July 22, 2009, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR100>.

investors who reached settlements before the offer was made in July also received top-up payments.<sup>60</sup>

Thereafter, an agreement on the same terms in respect to compensation was reached between the SFC and Grand Cathay Securities on December 17, 2009,<sup>61</sup> bringing an end to investigations of all nineteen Minibond distributors.

Several days later, on December 23, 2009, the SFC, the HKMA, Dah Sing Bank, and Mevas Bank reached an agreement in respect to equity-linked fixed coupon principal protected notes (“Notes”) issued by Lehman Brothers, whereby the two banks would repurchase the Notes at 80% of the principal amount and also bring earlier settlements in line with that amount. Both the SFC and the HKMA agreed not to take any enforcement action against the two banks.<sup>62</sup>

On January 13, 2010, the SFC reached an agreement with Karl Thomson Investment Consultants—who were not distributors of Minibonds but had purchased and consequently sold them to eleven clients. Karl Thomson agreed to repurchase the Minibonds on the same terms agreed upon by the banks, the SFC, and the HKMA under the July 22, 2009 settlement. This may be contrasted with the voluntary repurchases offered by SHK Investment Services and KGI Asia.<sup>63</sup>

On March 27, 2011, the sixteen distributing banks announced a joint proposal along with the receivers of the Minibond collateral for the distribution of the net value of the underlying collateral assets and an *ex gratia* top-up payment to Minibond investors, estimated on average to bring the value of compensation to 85% and 96.5% of the principal amounts invested, respectively. This has resulted in the disparity between the settlements made by securities intermediaries that are directly regulated by the SFC, and those made by the registered institutions, such as banks, that

---

<sup>60</sup> Press Release, Hong Kong Monetary Authority, Progress of the HKMA’s Investigations in Lehman Brothers Related Cases, HKMA, Oct. 30, 2009, available at <http://www.info.gov.hk/gia/general/200910/30/P200910300277.htm>.

<sup>61</sup> Press Release, Securities and Futures Commission, SFC Completes Investigations of All 19 Minibond Distributors, Dec. 17, 2009, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR176>.

<sup>62</sup> Press Release, Securities and Futures Commission, SFC, HKMA, Dah Sing Bank Ltd., and Mevas Bank Ltd. Resolve Issues Concerning Lehman Equity Index-linked Principal Protected Notes, Dec. 23, 2009, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR178>.

<sup>63</sup> Press Release, Securities And Futures Commission, SFC Reaches Agreement With Karl Thomson Investment Consultants Ltd. Concerning Sale of Lehman Brothers Minibonds, Jan. 13, 2010, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=10PR5>.

are regulated primarily by the HKMA based on the regulations established by the SFC being reduced.<sup>64</sup>

### 7. *The Recommendations of the Regulators*

In response to the Minibonds Crisis, the Financial Secretary requested that both the HKMA and the SFC prepare reports in respect to issues arising from the crisis. The reports were delivered and published in December 2008.

The issue of dispute resolution is specifically dealt with in Section 35 (“Dispute resolution”) of the SFC’s Report to the Financial Secretary on Issues Raised by the Lehman Minibonds Crisis, and in paragraphs 5.2 and 5.3 on “Remedies available to investors” and paragraphs 8.44 to 8.50 on “Recommendations” in the Report of the HKMA on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies.<sup>65</sup>

Both the SFC and the HKMA noted that one of the issues raised by the Minibonds Crisis was the lack of any quick, simple, or efficient means by which disputes could be resolved. The HKMA particularly noted that the role of the regulators in receiving complaints is confined to ensuring compliance with regulatory requirements, but there was no power to adjudicate disputes or order compensation.

The SFC suggested in its report that a dispute resolution scheme should be “simple, consumer friendly, and free of charge (or substantially so)”<sup>66</sup> while the HKMA noted that dispute resolution mechanisms are available in other jurisdictions for low cost.<sup>67</sup> The SFC also suggested that such a scheme should be made mandatory under the Code of Conduct by specifying a right to dispute resolution procedures under client agreements, but should avoid unduly legalistic procedures and discourage the involvement of legal representatives. It also suggested that a financial ombudsman would need to be empowered to order compensation.<sup>68</sup>

---

<sup>64</sup> Securities and Futures Commission, *SFC and HKMA Welcome Minibond Collateral Recovery Agreement*, SFC ENFORCEMENT NEWS, Mar. 27, 2011, available at <http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=11PR35>.

<sup>65</sup> SECURITIES AND FUTURES COMMISSION, ISSUES RAISED BY THE LEHMANS MINIBONDS CRISIS: REPORT TO THE FINANCIAL SECRETARY (2008), available at [http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review Report/Review Report.pdf](http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf).

<sup>66</sup> *Id.* para. 35.3.

<sup>67</sup> Hong Kong Monetary Authority, REPORT OF THE HONG KONG MONETARY AUTHORITY ON ISSUES CONCERNING THE DISTRIBUTION OF STRUCTURED PRODUCTS CONNECTED TO LEHMAN GROUP COMPANIES 6 (2008), available at [http://www.hkma.gov.hk/media/eng/doc/other-information/lehman\\_report.pdf](http://www.hkma.gov.hk/media/eng/doc/other-information/lehman_report.pdf).

<sup>68</sup> SECURITIES AND FUTURES COMMISSION ISSUES RAISED BY THE LEHMANS MINIBONDS CRISIS: REPORT TO THE FINANCIAL SECRETARY, *supra* note 65.

The HKMA noted that such a scheme would reduce pressure on the regulators' limited resources, particularly where the incidents generated large numbers of complaints, but if such a scheme were to be introduced, protocols would also be needed where systemic issues arose.

*B. The Proposal of the FDRC and Comparison with Schemes in Four Jurisdictions*

The recommendations made by the SFC and HKMA in their respective reports gave rise to a proposal in February 2010 by the Financial Services and the Treasury Bureau ("FSTB") in respect to the establishment of the FDRC. The FSTB conducted a study of dispute resolution schemes for the financial industries of four jurisdictions: the United Kingdom, Australia, Singapore, and the United States. The four dispute resolution schemes considered were the Financial Ombudsman Service of the United Kingdom ("FOS (UK)"), the Financial Ombudsman Service of Australia ("FOS (Aus)"), the Financial Industry Dispute Resolution Centre ("FIDReC") and the Financial Industry Regulatory Authority ("FINRA"), respectively.

*1. United Kingdom*

In the United Kingdom, the Financial Services and Markets Act of 2000 consolidated the regulation of financial services and markets under the Financial Services Authority ("FSA"), a single regulator for the entire financial industry.<sup>69</sup> A consolidated statutory dispute resolution scheme was also created—the Financial Ombudsman Service ("FOS").<sup>70</sup>

Eight independent ombudsmen and complaint-handling schemes were incorporated into the FOS (UK), including the Insurance Ombudsman Bureau (as the insurance division of the FOS), the Personal Investment Authority and the Securities and Futures Authority Complaints Bureau (as the investment division of the FOS (UK)), and the Banking Ombudsman and the Building Societies Ombudsman (as the banking and loans division of the FOS (UK)).<sup>71</sup>

---

<sup>69</sup> Financial Services and Markets Act (2000), cl. 8 (U.K.).

<sup>70</sup> Under the Financial Services and Markets Act (2000), § 16, sch. 17, cl. 8 (U.K.) and the Consumer Credit Act (2006), § 59, cl. 14 (U.K.), the FOS (UK) is set up as the statutory dispute-resolution scheme.

<sup>71</sup> FINANCIAL OMBUDSMAN SERVICE, LAYING THE FOUNDATIONS: FIRST ANNUAL REPORT 1999-2000 (2000), available at <http://www.financial-ombudsman.org.uk/publications/first-annual-report/ar-1999-2000.pdf>.



## 2. *Australia*

Responsibility for the regulation of financial markets in Australia is primarily split between the Australian Securities and Investment Commission (“ASIC”) and the Australian Prudential Regulation Authority. On July 1, 2008, three of the largest existing complaints schemes in the financial services industry of Australia were consolidated into a centralized financial dispute resolution scheme approved by ASIC.<sup>72</sup> The Banking and Financial Services Ombudsman, the Insurance Ombudsman Service, and the Financial Industry Complaints Service were merged into a single external dispute resolution service under a newly created company.<sup>73</sup> On January 1, 2009, the Credit Union Dispute Resolution Centre and Insurance Brokers Disputes Limited were also merged to become the Mutual division and the Insurance Broking divisions, respectively.<sup>74</sup>

In addition to the Financial Ombudsman Service, another external dispute resolution scheme has recently emerged from obscurity in respect to financial advice and investment-related disputes—the Credit Ombudsman Service Limited (“COSL”). The COSL was originally incorporated as the Mortgage Industry Ombudsman Service Limited in 2003, before adopting its present name in 2004.<sup>75</sup> It provides a free dispute resolution service for consumer complaints against its members, which include non-bank lenders, finance brokers, credit unions, building societies, debt collection firms, financial planners, trustees, servicers, aggregators, and mortgage managers, among others.<sup>76</sup> It was in the past considered an external dispute resolution scheme only for the mortgage broking industry, but this was the result of misinformation and the investment industry’s relative ignorance of its existence.<sup>77</sup> However, financial advisory and investment groups appear to be taking greater notice of the scheme, which has also had its profile raised by the introduction of the national consumer credit regime in Australia.

---

<sup>72</sup> FINANCIAL OMBUDSMAN SERVICE, INQUIRY INTO COLLAPSES IN THE FINANCIAL SERVICES INDUSTRY, available at [http://www.afp.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/fps/submissions/sub388.pdf](http://www.afp.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/fps/submissions/sub388.pdf).

<sup>73</sup> *Id.*

<sup>74</sup> *The Financial Ombudsman Service Establishes Mutuals and Insurance Broking Divisions* FINANCIAL OMBUDSMAN SERVICE, [http://www.fos.org.au/centric/home\\_page/news/the\\_financial\\_ombudsman\\_service\\_establishes\\_mutuals\\_and\\_insurance\\_broking\\_divisions.jsp](http://www.fos.org.au/centric/home_page/news/the_financial_ombudsman_service_establishes_mutuals_and_insurance_broking_divisions.jsp) (last visited May 1, 2012).

<sup>75</sup> *COSL’s History*, CREDIT OMBUDSMAN SERVICE, <http://www.cosl.com.au/COSLs-History> (last visited May 1, 2012).

<sup>76</sup> *COSL’s Role*, CREDIT OMBUDSMAN SERVICE, <http://www.cosl.com.au/COSLs-Role> (last visited May 1, 2012).

<sup>77</sup> Lucinda Beaman, *FOS Alternative Emerges*, MONEY MGMT. (July 23, 2010), <http://www.moneymanagement.com.au/news/fos-alternative-emerges>.

The existence of two competing dispute resolution schemes, as noted by the COSL head of operations and chairman,<sup>78</sup> is inherently positive for consumers and financial service providers, particularly in encouraging competitiveness in lowering the costs of dispute resolution and enhancing consumer protection via the broad range of disputes covered by the two schemes.

Due to the similarity between FOS (Aus) and the COSL, for the purposes of this article, discussion in respect to Australia will focus on FOS (Aus).

### 3. *Singapore*

The banking and insurance sectors of Singapore previously had in place dispute resolution mechanisms—the Consumer Mediation Unit and the Insurance Disputes Resolution Organization respectively—but there was no such mechanism for its capital markets. A working group of capital markets representatives concluded in 2003 that it would be more cost effective to leverage the resources of existing schemes rather than to establish a new scheme for capital markets given the relatively small number of complaints in the capital markets sector.<sup>79</sup>

In May 2004, the Monetary Authority of Singapore formed an Integration Steering Committee to facilitate the integration of dispute resolution schemes for Singapore’s financial sector.<sup>80</sup> This integrated scheme, the Financial Industry Dispute Resolution Centre, was aimed at providing coverage for most retail consumer complaints in the financial sector.<sup>81</sup> It was officially launched on August 31, 2005.<sup>82</sup>

### 4. *United States*

In the United States, self-regulatory organizations (“SROs”) form an integral part of federal statutory regulation of the securities industry.

---

<sup>78</sup> “My Board and I are conscious that COSL is one of only two external dispute resolution (‘EDR’) schemes operating in Australia with the approval of the Australian Securities and Investments Commission (‘ASIC’). It is a privilege that we do not take for granted and an acknowledgement that healthy competition in the sector is vital to promote transparency and accountability and to discourage complacency and mediocrity.” CREDIT OMBUDSMAN SERVICE, ANNUAL REPORT ON OPERATIONS 2009–2010 (2010), available at <http://www.cosl.com.au/Resources/COSL/Files/AnnualReportOnOperations-2010.pdf>.

<sup>79</sup> MONETARY AUTHORITY OF SINGAPORE, FINANCIAL INDUSTRY DISPUTES RESOLUTION CENTRE (“FIDREC”) (2004), available at [http://www.mas.gov.sg/resource/publications/consult\\_papers/2004/Public\\_Consultation\\_Paper\\_FIDReC.pdf](http://www.mas.gov.sg/resource/publications/consult_papers/2004/Public_Consultation_Paper_FIDReC.pdf).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> FINANCIAL INDUSTRY DISPUTES RESOLUTION CENTRE LTD., ANNUAL REPORT 2005-2006 (2006).

Originally private sector membership organizations of securities industry professionals that set standards of conduct for their members and disciplined errant members, these organizations pre-date the federal securities laws in 1933 and 1934. Certain concepts of federal law were in fact lifted from SRO regulation and became an added layer of regulation, while the SROs themselves have been integrated into federal statutory regulation, with the Securities Exchange Commission exercising oversight.<sup>83</sup>

Of particular note is the Financial Industry Regulatory Authority (“FINRA”), which consolidated the National Association of Securities Dealers (“NASD”) and the member regulation, enforcement and arbitration functions of New York Stock Exchange Regulation (“NYSE Regulation”). The purpose of consolidating the two was to bring more efficiency to the regulation of the securities industry by creating a single set of rules for broker-dealers under FINRA. Following this merger, FINRA became the largest non-governmental regulator for securities firms doing business in the United States.<sup>84</sup> Its role includes market oversight, salesperson regulation, investor education, enforcement, and arbitration. This differs from the ombudsmen used in the three common law jurisdictions, as an ombudsman exists only to provide an extra-judicial route to resolving disputes, whereas an SRO may have a much wider range of regulatory functions in respect to its members, of which dispute resolution may only be a small part.

### III. THE PROPOSED FINANCIAL DISPUTE RESOLUTION CENTER

The key features of the proposed FDRC are 1) the creation of a FDRC to administer a financial dispute resolution scheme, 2) a two-tiered financial dispute resolution scheme whereby disputes are first mediated, and if mediation fails, arbitrated, 3) participation in the scheme by financial institutions regulated or licensed by the SFC or the HKMA, 4) a HK\$500,000 cap on claims under the scheme, 5) a “pay-as-you-use” charge to both claimants and institutions, with higher fees payable by financial institutions, and 6) the FDRC would not be empowered with any investigatory or disciplinary powers.

While the proposal bears some resemblance to the Scheme, key differences include a ceiling on claims, charges to complainants as well as service providers, the exclusion of Mandatory Provident Fund (“MPF”) and

---

<sup>83</sup> Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151 (2008).

<sup>84</sup> Karen Powell, *Business Law: What Montana Lawyers Need to Know About FINRA*, 33 MONT. L. REV. 31 (2008).

insurance disputes, and systemic concerns being passed back to the regulators for investigation.

#### A. *Jurisdiction*

Not every dispute may be submitted to financial dispute resolution schemes—restrictions are often imposed to exclude certain types of complainant or certain types of dispute. Further to the distinction between the retail and wholesale financial markets, restrictions are applied even within the retail market.<sup>85</sup> The proposed jurisdiction of the FDRC must thus be considered in the context of the limitations imposed on who may bring disputes, and the types of dispute they may bring.

##### 1. *Eligible Complainants*

Complainants are restricted under the FDRC proposal to individual consumers and sole proprietors.<sup>86</sup> Some respondents to the consultation on the proposal suggested that the eligible complainants should be expanded to include small companies, to which the FSTB replied that the intention of the FDRC was to “take care of the group who would need the service most,” though the possibility of expanding the scope of coverage remains open.<sup>87</sup>

There may be a number of reasons for restricting eligible complainants. As can be seen from the example of the United States in the table below, as the FINRA arbitration process is entirely paid for by complainants and securities firms, it was unnecessary to put in place jurisdictional filters. Under the FINRA arbitration model, few of FINRA’s resources are taken up by the dispute resolution process—by contrast, the dispute resolution schemes in the common law jurisdictions are heavily subsidized, giving rise to a need to limit eligible complainants to ensure that the subsidies are taken up by those with the greatest need for them.

The restriction on eligible complainants for the FDRC is the same restriction currently imposed in Singapore in respect to FIDReC, and is perhaps unsurprising given that the FDRC is an entirely new scheme. Equally, however, it should come as no surprise that respondents to the consultation would have raised the issue of allowing small corporate bodies to also be included in the scheme. It has long been an issue in Hong Kong that the expense of civil litigation restricts the access to justice of small- and medium-sized enterprises, described as part of the “sandwich” class by the

---

<sup>85</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1.

<sup>86</sup> *Id.* at 32.

<sup>87</sup> *Id.* at 33-34.

judiciary in addressing concerns about access to justice in civil litigation due to high costs.<sup>88</sup>

It is unclear, however, why the proposed eligible complainants were not determined with reference to persons who fall outside of the “professional investor”<sup>89</sup> definition that is used in the regulation of licensed intermediaries, nor with reference to empirical evidence as to where the need for such dispute resolution services may be most needed. The concept of professional investors is found in the Code of Conduct, and exists to exempt licensed intermediaries from certain investor protection requirements in respect to market professionals (e.g., banks and insurance companies) and high net worth individuals, who by virtue of their experience and resources would be capable of making informed decisions and protecting their own interests. The concept has equivalents in the four jurisdictions that were studied by the FSTB. Under the FDRC proposal, market professionals would be excluded from the eligible complainants, but high net worth individuals would be included—despite the fact that they are considered sufficiently well-resourced and experienced enough to be excluded from certain regulatory requirements.

TABLE 1

SCHEME	ELIGIBLE COMPLAINANTS
FOS (UK)	A person who is a consumer, a micro-enterprise, a charity with an annual income of less than £1 million, or a trustee of a trust with a net asset value of less than £1 million. <sup>90</sup> Certain types of complainant are expressly excluded under the Rules. <sup>91</sup>
FOS (Aus)	“Retail clients” per s.761G of the Corporations Act 2001, including small businesses as defined under that section. <sup>92</sup>
FIDReC	FIDReC’s services are available to all consumers who are individuals or sole-proprietors. <sup>93</sup>
FINRA	Since FINRA complainants must pay an arbitration fee, a hearing deposit, and attorneys’ fees, cost-deterrence serves as a filter, and strict jurisdictional prerequisites for arbitration are unnecessary. <sup>94</sup>

<sup>88</sup> This has been commented upon by former Chief Justice Andrew Li in his final speech at the Opening of the Legal Year Ceremony in 2010 and has also been remarked upon by him in previous speeches.

<sup>89</sup> See Securities and Futures Ordinance (2003), Part 1, sch.1 (H.K.).

<sup>90</sup> FINANCIAL SERVICES AUTHORITY, FSA HANDBOOK, DISP 2.7.3 (2012), available at <http://media.fsahandbook.info/pdf/DISP.pdf>.

<sup>91</sup> *Id.*, DISP 2.7.9.

<sup>92</sup> AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION, REGULATORY GUIDE 139 (2011), available at [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg139-published-20-4-2011.pdf/\\$file/rg139-published-20-4-2011.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg139-published-20-4-2011.pdf/$file/rg139-published-20-4-2011.pdf).

<sup>93</sup> *The Jurisdiction of FIDReC*, FIDREC, <http://www.fidrec.com.sg/website/jurisdiction.html> (last visited May 1, 2012).

**RECOMMENDATION 1—ELIGIBLE COMPLAINANTS**

Serious consideration should be given to the expansion of eligible complainants beyond individuals in the proposal of the FDRC. This would serve to address issues of access to justice for a class of potential complainants that has already been identified by the Judiciary as being vulnerable to the high costs of civil litigation.

Moreover, given the potential misallocation of resources, consideration should also be given to restricting the subsidized access of professional investors to the FDRC, perhaps by way of scaled charges for FDRC services for different kinds of user.

**2. Range of Disputes**

The proposed types of disputes the FDRC would handle would be confined to those arising out of services provided by financial institutions which are licensees or regulatees of the HKMA or the SFC that are “monetary” in nature.<sup>95</sup>

**a. Exclusion of Commercial and Pricing Decisions and Cases Already Subject to Court Proceedings**

Specifically excluded from this jurisdiction would be commercial decisions (such as the provision of credit or margin facilities), pricing-related disputes (such as the setting of fees and interest rates), and cases that have already been the subject of court proceedings.<sup>96</sup> These exclusions are largely in line with those in Australia and Singapore, and also those excluded in the United Kingdom as well (see the table below for disputes that can be dismissed without hearing).

**b. Exclusion of the Mandatory Provident Fund (“MPF”) and Insurance**

Also explicitly excluded from the jurisdiction of the FDRC are insurance matters and Mandatory Provident Fund (“MPF”) (i.e., retirement) matters, due to the existence of a dispute resolution scheme for the insurance sector, the Insurance Claims Complaints Bureau, and the lack of monetary disputes in the MPF system.<sup>97</sup>

---

<sup>94</sup> Cory Alpert, *Financial Services in the United States and United Kingdom: Comparative Approaches to Securities Regulation and Dispute Resolution*, 5 *BYU INT'L L. & MGMT. REV.* 75 (2008).

<sup>95</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 35-36.

<sup>96</sup> *Id.* at 37.

<sup>97</sup> *Id.* at 36.

However, the FSTB clarified in the Consultation Conclusions that where there are complaints relating to insurance and MPF products sold by financial institutions within the jurisdiction of the FDRC, those complaints will fall within the jurisdiction of the FDRC. Similar to the HKMA, the jurisdiction of the FDRC would be institutional, rather than sectoral.<sup>98</sup> It is also clarified that the ultimate aim is for the scope of the FDRC to be comprehensive, and thus the coverage of the FDRC will be reviewed from time to time.<sup>99</sup>

While the financial dispute resolution schemes of other leading jurisdictions were mergers of pre-existing, sectoral schemes, given that alternative dispute resolution on a broad level is just beginning to mature in Hong Kong, it is probably preferable that these disputes remain outside of the jurisdiction of the FDRC at the moment. Insurance products in particular, having their own dispute resolution scheme, could potentially give rise to confusion if they are also made subject to the jurisdiction of the FDRC. Moreover, as was seen in the Minibonds Crisis, there is potential for overlapping jurisdictions to give rise to disparity of awards, which would lead to consumer dissatisfaction. It should be noted that even in jurisdictions where there is a single financial dispute resolution scheme, such as Australia and Singapore, separate limits remain for insurance complaints.

### 3. *“Monetary Nature”—A Distinction That is Not Made in Any Other Jurisdiction*

Less clear, however, is the “monetary” dispute requirement. Paragraph 3.4 of the Consultation Paper refers to coverage of the FDRC as restricted to licensees and regulatees of the HKMA and the SFC “given that most disputes of monetary nature involve the services in these two sectors.”<sup>100</sup> Further enlightenment may be found in paragraph 3.10, concerning initial enquiries in the FDRC procedure. Under sub-paragraph (c), “[i]f the dispute also relates to other areas such as concerns about a misconduct of the financial institution and/or its staff, the intake officers would explain to the consumer what other channels are available for taking the case forward.”<sup>101</sup> It is thus presumed that the term “monetary dispute” refers to complaints or the parts of complaints that exclusively concern financial compensation for a complaint. In attempting to make this

---

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 37.

<sup>100</sup> *Id.* at 36.

<sup>101</sup> *Id.* at 40.

distinction, there is a clear indication that the intent behind the FDRC is to avoid any regulatory implications arising from its process.

In the aftermath of the Minibonds Crisis, the attempt to draw a distinction between the part of a complaint that only concerns financial compensation, as opposed to other allegations that may concern regulatory matters, is perhaps understandable. The distinction appears to be intended to emphasize the non-regulatory role of the FDRC, which is to have no investigative or disciplinary powers. As will be seen from the dispute resolution procedures of the schemes in the other jurisdictions studied, this may be out of line with the practices of many other jurisdictions, under which investigations and findings of fact are made. The distinction is not made in any of the other jurisdictions studied, and raises the issue of how a decision about compensation can be accurately made without some consideration of the underlying circumstances (including those that touch upon regulatory matters) and apportionment of blame. Moreover, in light of the experience of other jurisdictions, a further question is whether or not this is an effective way to ensure the FDRC remains non-regulatory.

In response to discussion about the interface between the FDRC and the regulators, the FSTB acknowledges that some disputes, which give rise to monetary losses, inevitably involve complaints of misconduct, and thus complainants are likely to pursue their complaints in parallel with both the FDRC and the regulators. While the concern of the FSTB in this regard appears to be to prevent any encroachment of the regulators' jurisdiction by the FDRC, the idea of running complaints in parallel raises a further issue of whether or not awards made under the FDRC will need to be adjusted to take into account findings of the regulators about the targeted financial institutions. The adjustment to the settlement amount reached with the banks in respect to the Minibonds Crisis is a relevant example of how circumstances following settlement may have an impact on settlement amounts, and the need to make provision for such changes in circumstance in order to ensure the award amount reflects the circumstances accurately.



TABLE 2

SCHEME	RANGE OF DISPUTES
FOS (UK)	The activities to which the compulsory jurisdiction of the FOS applies are regulated activities (see section 22 of the Financial Services and Markets Act 2000), payment services, consumer credit activities, lending money secured by a charge on land, lending money, paying money by plastic card, providing ancillary banking services or any activities including advice. <sup>102</sup> The territorial scope of the compulsory jurisdiction is restricted to activities carried on from an establishment in the U.K. <sup>103</sup>
FOS (Aus)	The jurisdiction of the FOS (Aus) includes: complaints against financial service providers from individual or individuals, partnerships comprised of individuals, corporate trustees of self-managed superannuation funds or family trust, small businesses, clubs or incorporated associations, policy holders of group life or group general insurance policy where the dispute relates to the payment of benefits under the policy; disputes that arise from a contract or obligation under Australian law in respect to the provision of a financial service, provision of a guarantee or security for financial accommodation, entitlement or benefits under life insurance or general insurance policies, legal or beneficial interests arising out of financial investment or a financial risk facility, claims under motor vehicle insurance policies. <sup>104</sup>
FIDReC	FIDReC's jurisdiction extends over all disputes brought by individuals and sole proprietors against financial institutions who are members of FIDReC, except disputes over commercial decisions (including pricing and other policies, e.g., interest rates and fees), cases under investigation by any law enforcement agency, and cases which have been subjected to a court hearing, for which a judgment or order is passed. <sup>105</sup>
FINRA	The FINRA Code of Arbitration Procedures for Customer Disputes applies to any dispute between a customer and a member of FINRA that is submitted to arbitration. <sup>106</sup>

<sup>102</sup> FINANCIAL SERVICES AUTHORITY, *supra* note 90, DISP 2.3.1.

<sup>103</sup> *Id.* DISP 2.6.1.

<sup>104</sup> *Terms of Reference*, FINANCIAL OMBUDSMAN SERVICE, [http://www.fos.org.au/centric/home\\_page/about\\_us/terms\\_of\\_reference\\_b.jsp](http://www.fos.org.au/centric/home_page/about_us/terms_of_reference_b.jsp) (last visited May 6, 2012).

<sup>105</sup> MONETARY AUTHORITY OF SINGAPORE, *supra* note 79.

<sup>106</sup> FINANCIAL INDUSTRY REGULATORY AUTHORITY, CODE OF ARBITRATION PROCEDURES FOR CUSTOMER DISPUTES (2011), *available at* <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbrul/documents/arbmed/p117546.pdf>.

**RECOMMENDATION 2—RANGE OF DISPUTES**

The proposed jurisdiction of the FDRC should have a sectoral, rather than institutional basis not only to avoid the issues of inconsistency, confusion, and forum-shopping by eligible complainants, but to reflect the underlying regulatory regime that applies to the services that are the subject of the FDRC resolution. Hence, all MPF and insurance disputes should be referred back to the relevant dispute resolution/complaint scheme, or alternatively, uniform handling processes for such disputes must be developed by the FDRC in conjunction with such schemes in order to ensure that such disputes are dealt with in the same way.

The parallel complaints process should be streamlined so that complainants need not go through complaint filing twice, as with the dual oversight of listing documents by the Hong Kong Exchanges and Clearing Limited and the SFC.

In developing the concept of a parallel complaints process, issues arise as to how findings of fact in one part of the process will inform the other. It may thus be preferable to abandon the use of the “monetary nature” distinction in favor of a streamlined complaints process that, where regulatory issues arise out of a complaint, the findings of any investigation may be used in the dispute resolution process and any regulatory breaches could give rise to a summary procedure for an award under the FDRC.

**B. Procedure**

The proposed procedure that the FDRC will follow involves three stages. First, there is a preliminary stage at which complaints will be assessed for whether or not they fall within the jurisdiction of the FDRC.<sup>107</sup> Second, where the complaint falls within the jurisdiction of the FDRC, it will be mediated.<sup>108</sup> Finally, if mediation fails to resolve the dispute, the dispute will be referred to an arbitrator.<sup>109</sup> *Prima facie*, the proposed procedure resembles the procedures found in the four jurisdictions studied.

---

<sup>107</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 37-38.

TABLE 3

SCHEME	DISPUTE RESOLUTION PROCEDURE
FOS (UK)	The approach of the FOS (UK) depends on the facts of the complaint, but generally, the FOS (UK) will attempt to settle the complaint informally through mediation or conciliation. If such conciliation or mediation is not possible, based on the relevant documents, an adjudicator's view on how the case should be resolved is given in writing to both sides. Where one side is unhappy with the adjudicator's view, it can ask for a review and final decision by an ombudsman.
FOS (Aus)	The FOS (Aus) will review and consider the dispute, and try to resolve the dispute through mutual agreement, including conciliation or negotiation methods. <sup>110</sup> Where mutual agreement is not possible, the FOS (Aus) will conduct a detailed investigation and may offer initial views on the merits of the dispute if it will assist the parties in reaching a resolution. <sup>111</sup> The FOS (Aus) will often issue a recommendation, and if it is not accepted by either party, a determination can be made. <sup>112</sup>
FIDReC	There is a three-stage process in the settlement of disputes by the FIDReC. First, the Counseling Service assists in a preliminary review of the case based on facts and documents provided by the complainant. After the preliminary review, the consumer is provided with a copy of FIDReC's dispute resolution form and allowed time to consider whether to proceed to lodge a formal complaint against the financial institution in question. <sup>113</sup> A case manager will try to mediate a settlement between the consumer and financial institution. Where appropriate, mediation conferences are arranged to allow parties to communicate face-to-face. <sup>114</sup> Disputes that cannot be resolved by mediation and case management will proceed to the third stage, where an adjudicator or panel of adjudicators with relevant expertise will decide in favor of either the consumer or the financial institution. <sup>115</sup>
FINRA	FINRA Dispute Resolution ("FINRADR") provides a non-binding mediation program and arbitration services.

### 1. The Preliminary Stage

The preliminary stage of the FDRC dispute resolution process involves an intake officer trained in mediation.<sup>116</sup> Complainants make an

<sup>110</sup> *Dispute Handling Process in Detail*, FINANCIAL OMBUDSMAN SERVICE, [http://www.fos.org.au/centric/home\\_page/resolving\\_disputes/dispute\\_handling\\_process\\_in\\_detail.jsp](http://www.fos.org.au/centric/home_page/resolving_disputes/dispute_handling_process_in_detail.jsp) (last visited May 6, 2011).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> FINANCIAL INDUSTRY DISPUTES RESOLUTION CENTRE LTD, ANNUAL REPORT 2009-2010 (2010).

<sup>114</sup> ANNUAL REPORT 2005-2006, *supra* note 82.

<sup>115</sup> MONETARY AUTHORITY OF SINGAPORE, *supra* note 79.

<sup>116</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1.

inquiry, and it is then up to the intake officer to address the enquiry and decide whether or not the dispute raised by the complainant is within the jurisdiction of the FDRC.<sup>117</sup> Where that dispute falls within the jurisdiction of the FDRC, the complainant shall complete a claim form, upon receipt which the intake officer will conduct a fact-finding exercise and also invite a response from the relevant financial institution.<sup>118</sup> The intake officers at this stage explore the settlement of the dispute before it enters the mediation stage, and it is proposed that the intake officers have final and conclusive discretion not to process a dispute where it appears frivolous or vexatious.<sup>119</sup> In the Consultation Conclusions on the FDRC, it was clarified that the qualification and training of the intake officers are of particular importance, and the criteria for taking up cases should also be made clear.<sup>120</sup>

This proposed preliminary stage reflects the importance of the hotline and the preparatory meetings in gathering information before the dispute resolution process begins, which was one of the key lessons learned from the Lehman Scheme.<sup>121</sup> It also bears some resemblance to the preliminary review of the FIDReC, though the proposed exploration of an early settlement does not appear to go as far as to highlight relevant clauses and issues for the complainant. The experience in Singapore reflects a high success rate with its case management process, introduced in 2007. For the thirty-six months from July 1, 2007 to June 30, 2010, FIDReC's Counseling Service amicably resolved 1,634 cases, resulting in savings of time and resources.<sup>122</sup> This measure was designed to further enhance its dispute resolution processes, and is especially suitable for resolving disputes which are simpler in scope and issues by helping the consumer better understand the dispute and relevant issues as well as aiding the consumer in considering any settlement offer made by the financial institution in a more objective light.

One of the challenges the Lehman Scheme had to overcome<sup>123</sup>—which has also been mentioned above in respect to the Civil Justice Reform—relates to the potential abuse of the dispute resolution process,

---

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> PROPOSED ESTABLISHMENT OF AN INVESTOR EDUCATION COUNCIL AND A FINANCIAL DISPUTE RESOLUTION CENTRE: CONSULTATION CONCLUSIONS [hereinafter CONSULTATION CONCLUSIONS], available at [http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult\\_iec\\_fdrc\\_conslusion\\_e.pdf](http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_iec_fdrc_conslusion_e.pdf).

<sup>121</sup> Gary Soo et al., *Better Ways of Resolving Disputes in Hong Kong—Some Insights from the Lehman-Brothers Related Investment Product Dispute Mediation and Arbitration Scheme*, 9 J. INT'L BUS. & L. 137 (2010).

<sup>122</sup> ANNUAL REPORT 2009-2010, *supra* note 113.

<sup>123</sup> *Id.*

particularly where parties or one party does not approach the dispute resolution process with a real intent to resolve the dispute.

While abuses may have been prevented during the preparatory meeting stage in the Lehman Scheme, the proposal to weed out complaints that lack merit and other abuses that would be a drain on resources at this early stage is not unusual. In common law jurisdictions, it is not unusual for complaints falling outside the jurisdiction of a tribunal to be excluded without a hearing, but in the United Kingdom, it is the Ombudsman who is empowered to dismiss a complaint without a hearing on its merits for a number of well-defined reasons.<sup>124</sup> Similarly, it is therefore imperative that the FDRC intake officers be trained not only with mediation knowledge but also knowledge about the financial industry, and either be subject to review or reviewed following an application by the relevant financial institution on clearly established grounds. The prospect of dismissal without hearing or review at such an early stage is an area for potential abuse and therefore safeguards and oversight will be necessary.

Given the limits on available resources, a balance must be struck between access to justice and preventing abuses of process. However, it is unusual, in comparison with other jurisdictions, for complaints to be weeded out at such an early stage, and indeed this may not be appropriate given the lack of evidence at this stage. The task of the intake officer to explore settlement and his power to exercise final discretion over vexatious or frivolous claims may be interpreted as improper pressure on complainants to settle. In this regard, the concept of an abuse of process in civil court procedure and the definitions of vexatious and frivolous complaints might be considered for their potential applicability to the preliminary stage, and the processes by which unmeritorious claims are dealt with in other jurisdictions could also be applied to the FDRC process.

---

<sup>124</sup> FINANCIAL SERVICES AUTHORITY, *supra* note 90, DISP 3.3.4.

**RECOMMENDATION 3—THE PRELIMINARY STAGE**

In light of the high rate of success in Singapore, consideration may be given towards modifying the FDRC proposal in respect to the preliminary stage to more closely resemble the FIDReC's preliminary review. The establishment of the issues between the parties early on would help to make the entire dispute resolution process more efficient, and indeed, such reviews may help a high number of cases reach an early settlement without even resorting to the other stages of the FDRC dispute resolution process.

It would be preferable, however, for intake officers not to be responsible or empowered with final discretion in respect to frivolous or vexatious complaints. This would not be in line with the practices of other jurisdictions nor even the judicial system of Hong Kong, where processes against frivolous or vexatious complainants are usually initiated by the respondent rather than the arbiter—the inappropriateness for the arbiter to be both initiator and judge of such a process is clear. A process separate from the exclusion of ineligible complaints or complainants to handle frivolous and vexatious complaints should be adopted.

## 2. *Mediation*

All leading jurisdictions have come to rely primarily on mediation as the preferred process for the resolution of disputes, given mediation's speed and simplicity. All four jurisdictions studied show that the vast majority of cases are concluded at the mediation stage. The criticisms that have been leveled against alternative dispute resolution processes, such as the lack of an independent and impartial third party during negotiations, and the capacity for such processes to mask inbuilt power inequalities between the parties,<sup>125</sup> are genuine concerns that must be examined alongside questions of efficiency.<sup>126</sup>

In its Consultation Conclusions, the FSTB emphasized the need for quality and qualified mediators and arbitrators, including those with the necessary knowledge to deal with financial disputes<sup>127</sup> presumably in response to these concerns raised during the consultation.

---

<sup>125</sup> THE HON. McCLELLAN, CIVIL JUSTICE IN AUSTRALIA—CHANGES IN THE TRIAL PROCESS, CIVIL JUSTICE REFORM—WHAT HAS IT ACHIEVED? 65 (2010).

<sup>126</sup> Lauren Edelman, Howard Erlanger, & John Lande, *Internal Dispute Resolution: The Transformation of Civil Rights in the Workplace*, 27 LAW & SOC'Y REV. 497, 497-534 (1993).

<sup>127</sup> See, e.g., Lela P. Love, *Images of Justice*, 1 PEPP. DISP. RESOL. L.J. 29 (2000), available at <http://ssrn.com/abstract=229990>.

a. *Forms of Mediation*

The use of mediation in the FDRC process raises the issue of what form that mediation will take. Generally speaking, among the numerous forms of mediation, there are two modes relevant to the resolution of financial disputes: facilitative, which is interest-based, and evaluative or rights-based.

In interest-based mediation, the mediator assists or facilitates communications between the parties and negotiations generally. The role of the mediator is to help the parties reach a settlement via exploration of the parties underlying interests and needs.<sup>128</sup> This is the form of mediation now most commonly deployed in Hong Kong through the Civil Justice Reform.<sup>129</sup>

On the other hand, evaluative mediation involves a mediator making an assessment of and expressing a view on the merits of the dispute, albeit a non-binding view.<sup>130</sup> This form of mediation is more common to the Ombudsman process in other jurisdictions, and is closer to the command model of dispute resolution (where a third party is empowered to suggest a resolution of the dispute) than a consensual model (where the power to resolve the dispute rests with the parties).

What form of mediation is to be deployed by the FDRC goes to the heart of the issues that this study raises: what type of dispute resolution methods are most appropriate for use in the context of financial regulation, and how do the aims of financial regulation inform the choice of method?

b. *Criticisms of the Mediation Process*

Despite the success mediation has enjoyed in terms of high rates of settlement, particularly in other jurisdictions, it is a form of alternative dispute resolution that is not without its critics. The risk of mediation, being an unregulated form of “informal justice”—enjoying a quasi-regulatory authority without the safeguards that are built into litigation—is that it can mask power imbalances in the relationship between parties.<sup>131</sup> This in turn could lead to consumer dissatisfaction. Such critics may also point to the

---

<sup>128</sup> *Id.*

<sup>129</sup> DEPARTMENT OF JUSTICE OF THE HKSAR, REPORT OF THE WORKING GROUP ON MEDIATION (2010), available at <http://www.gov.hk/en/residents/government/publication/publication/consultation/docs/2010/Mediation.pdf>.

<sup>130</sup> See Leonard L. Riskin, *Understanding Mediators' Orientations, Strategies, and Techniques: A Grid for the Perplexed*, 1 HARV. NEGO. L. REV. 7 (1997)

<sup>131</sup> See, e.g., Marc Galanter, *Why the Haves Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974).

heavier cost consequences in the event that alternative dispute resolution processes break down and necessitate court intervention.<sup>132</sup>

Locally, despite its wider use and integration into the civil litigation process, mediation has been abused by insincere litigants and legal professionals,<sup>133</sup> which may be attributable to the lack of local experience with mediation and the relatively high degree of public trust in the independence and expertise of the judicial system.

*c. Appropriateness of Mediation in Financial Dispute Resolution*

One key issue in the facilitative model of mediation is that the solution is negotiated, but not required to be principled. This arguably limits the role that the substantive law plays in the settlement of a dispute—as the positive law’s norm enforcement is subordinated to the dispute resolution process. In the context of financial markets, this may not be desirable for consumers, whose complaints or grievances are likely to arise from a sense of wrongdoing on the part of financial service providers, and thus parties may have expectations about the protection of the consumers’ rights and principled settlements to reflect those rights. For example, as described above, the key issue for Minibonds disputes was whether or not the risks were fully disclosed and communicated. In mediating or arbitrating their claims, complainants were quite simply not in a position to understand and unravel the complex structure of these instruments in order to quantify the risk they potentially represented, and thus know the true value of their own claims.<sup>134</sup> This placed Minibond complainants at an enormous disadvantage when trying to resolve their disputes with the relevant financial institutions, in not being fully aware of what their rights against the financial institutions were.<sup>135</sup> Overcoming this issue requires the integration of legal norms to enhance transparency and consistency of settlements. The use of an evaluation of merits such as in evaluative mediation may potentially lend itself towards a more satisfactory experience for consumers than interest-based mediation.

The power imbalance to be addressed in the financial industry between the consumer and financial service provider is based on the

---

<sup>132</sup> McCLELLAN, *supra* note 125.

<sup>133</sup> Patsy Moy, *Mediation Isn’t Being Taken Seriously*, SOUTH CHINA MORNING POST, July 29, 2011, available at <http://topics.scmp.com/news/hk-news-watch/article/Mediation-isnt-being-taken-seriously>.

<sup>134</sup> Kent Ewing, *Lehman Burns HK’s Low-Risk Investors*, ASIA TIMES, Oct. 7, 2008, available at [http://www.atimes.com/atimes/China\\_Business/JJ07Cb01.html](http://www.atimes.com/atimes/China_Business/JJ07Cb01.html).

<sup>135</sup> Douglas W. Arner et al., *The Global Financial Crisis and the Future of Financial Regulation in Hong Kong 77* (AIIFL Working Paper, No. 4, 2009), available at <http://ssrn.com/abstract=1349625>.



assumption that the financial institution is in the best position of knowledge in respect to products, services, and risks—arguably even better than regulators. Therefore, safeguards such as regulatory and legal guidelines and external oversight may be required to effectively address such imbalances. In the specific context of Hong Kong, its historical development as a *laissez-faire* economy is based on norms of efficiency and effective competition, which in turn is driven by the free flow of information. Much of the regulatory framework in Hong Kong's financial markets is built on a notion of a level playing field in terms of the knowledge of all the participants, rather than the protection of consumers. An example of the regulatory framework redressing knowledge imbalance is the regime against insider dealing in Hong Kong, which gives extensive powers of investigation to regulators—in particular, the power to curtail the right of silence.<sup>136</sup> Evaluative mediation, in some cases, may thus be more appropriate in the setting of Hong Kong's financial regulation system to address imbalances of power and knowledge between financial service provider and consumer.

#### RECOMMENDATION 4—MEDIATION

In developing the mediation stage of the FDRC's proposed procedure, serious consideration may be given to the adoption of evaluative mediation in certain cases, in line with the practices of Ombudsmen in other jurisdictions. The relevant power imbalance that the proposed FDRC will primarily be called upon to address is that of the state of knowledge between the financial service provider and the consumer. An approach to dispute resolution that integrates regulatory standards or uses them as touchstones, such as evaluative mediation, thus appears to be more consistent with aims of financial oversight in Hong Kong, which is largely disclosure-based.

### 3. Arbitration

Much attention has been focused on the decision that the FDRC use an arbitral rather than an ombudsman model. One key issue in respect to appropriateness is following the failure of the mediation process, what is the reason the parties have failed to reach a settlement? Where there are inconsistent interpretations of the facts or rules, the role of an intervening third party is interpretive, thereby requiring an adjudicator. Where mediation is unsuccessful, complainants may proceed to arbitrate their claims. Arbitration will generally take the form of a documents-only

---

<sup>136</sup> Securities and Futures Ordinance (2003), Cap. 571, § 187.

arbitration, before a single arbitrator, unless the issues are too complex, in which case the arbitrator will determine whether or not a hearing is necessary. Among the benefits of arbitration is its final binding nature.<sup>137</sup> In the Consultation Conclusions, the FSTB argued that the use of a two-tiered dispute resolution process is in line with overseas experience, and there is functionally little difference between an arbitrator and an ombudsman, other than that an arbitrator enjoys greater power.<sup>138</sup> The FSTB particularly highlighted the fact that Hong Kong has a strong and large pool of arbitrators.<sup>139</sup> However, some potential challenges with the use of an arbitral model also exist given the unique circumstances of Hong Kong.

*a. Submissions by the Law Society*

In adopting an arbitration process over setting up an ombudsman, the Consultation Conclusions made particular reference to the submissions of the Hong Kong Law Society, which expressed “serious reservations” about the establishment of an ombudsman for the purposes of dispute resolution for financial service providers.<sup>140</sup> The Law Society submissions suggested that the negotiation-mediation-arbitration formula proposed for the FDRC would be preferable to ombudsman or ombudsman-like set-ups in other jurisdictions.<sup>141</sup>

*b. The Circumstances of Hong Kong*

The lack of familiarity of the public with alternative dispute resolution processes should raise concerns about public understanding and expectations—the multi-tiered approach of the FDRC resembles the hierarchy of the Hong Kong court system, but the arbitral process under the proposed FDRC procedure is of course not intended to be a review of the mediation process. It should be noted that in the United States, mediation is not mandatory, and undergoing mediation is not a prerequisite to securities arbitration. The absence of review between the mediation and arbitration processes in the proposed FDRC should be contrasted with the multi-tiered structure used by the ombudsmen in other common law jurisdictions, and in particular, the notion of an internal right of review as mentioned above,

---

<sup>137</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 41.

<sup>138</sup> See CONSULTATION CONCLUSIONS, *supra* note 120.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

which more closely resembles the court processes to which the public of Hong Kong is accustomed.

It should also be borne in mind that at present, the pool of arbitrators with sufficient experience in both arbitration and financial regulation appears to be limited—the HKIAC issued a notice to the Bar offering training for the purposes of the Scheme (emphasizing prior mediation experience in particular),<sup>142</sup> illustrating the need for growth in the existing pool of mediators and arbitrators in this area.

In the context of financial regulation in Hong Kong, questions as to the appropriateness of arbitration must be raised in light of the experience in the United States in contrast with that of the FOS (UK). In this regard, appearance and perception of consumers appears to play as important a role as actual function.

---

<sup>142</sup> HONG KONG BAR ASSOCIATION, CIRCULAR NO. 118/08 (Nov. 17, 2008), *available at* <http://hkbademo.zmallplanet.com/members/circulars/2008/2008118.pdf>.

**RECOMMENDATION 5—ARBITRATION**

The arbitral process proposed under the FDRC already avoids one of the major issues that have made the United States' securities arbitration controversial, in that the arbitral process is non-mandatory.

The advantages offered by the ombudsman model do not necessarily mean that an ombudsman model need be adopted by the FDRC wholesale; rather, the FDRC arbitral process may be customized to resemble the ombudsman model or to offer its benefits, for example, by using an informal process. Rather than adopting a papers-only arbitration, which offers efficiency but may raise issues about transparency, particularly in the decision-making process, a procedure resembling the Small Claims Tribunal should be considered. Complainants should still be offered a papers-only arbitration if they prefer, with costs scaled appropriately, but complainants should not be denied the opportunity to air their grievances in person and to scrutinize the decision-making process—particularly as it appears from the experience in the United Kingdom that a more personal approach is more successful in addressing consumer expectations and attitudes.

Although proponents of arbitration in the FDRC argue that finality may be one of the key advantages offered over the ombudsman model, serious consideration should be given to increasing the scrutiny of the courts over the FDRC arbitral process, possibly through the adoption of the relevant opt-in clauses under the new Arbitration Ordinance. While in the short term, this may lead to increased costs, the courts' expanded powers to penalize litigants whose cases are frivolous under the Civil Justice Reform should be borne in mind. The long-term advantage is the strengthening of the authoritativeness of the FDRC through its interaction and confirmation by the courts.

#### 4. *Litigation*

One issue that is not detailed in the proposal is how the FDRC processes will interact with or inform litigation, for example, where a complainant engages in the FDRC mediation process and subsequently opts to air remaining dissatisfaction in the courts rather than by way of arbitration. Of particular relevance is how information that has been exchanged by the parties in the course of the preliminary stage or the mediation stage (or indeed even the arbitration stage) is to be dealt with before the courts.

The mediation process under the Civil Justice Reform is a confidential process—effectively characterized as “without prejudice” negotiations.

However, as has been noted above, there exists between consumers and financial service providers a potential information gap, which the FDRC may be required to bridge to enhance the fairness between parties. It therefore may not be a simple matter of applying the same confidentiality to FDRC processes, as the information that emerges may well be key to attaining justice for either side before the courts.

#### **RECOMMENDATION 6—LITIGATION**

Where a complainant seeks to bring a case from the FDRC to the courts, the FDRC should play a role similar to that of the scheme—to attempt to narrow down the facts and issues between the parties. This would make the litigation process more efficient and overcome any issues relating to disclosed information by agreement between the parties as to the facts prior to litigation.

#### 5. Awards

The maximum award that is proposed to be made under the jurisdiction of the FDRC is HK\$500,000.<sup>143</sup> This is said to cover “over 80% of the monetary disputes handled by the HKMA and about 80% of stock investors.”<sup>144</sup>

TABLE 4

SCHEME	LIMITS OF AWARDS
FOS (UK)	The maximum money award the Ombudsman may make is £100,000 <sup>145</sup> (approx. HK\$1,270,000), from which costs, interest on the principal award and interest on costs are excluded. <sup>146</sup>
FOS (Aus)	As of January 1, 2012, the ASIC will require compensation caps from external dispute resolution schemes of at least AU\$280,000 (approx. HK\$2,296,000), except in the case of general insurance brokers, where the compensation cap is at least AU\$150,000. <sup>147</sup>
FIDReC	The maximum monetary awards for compensation are US\$100,000 for claims against insurance companies, and US\$50,000 (approx. HK\$310,000) for all other disputes. <sup>148</sup>
FINRA	No statutory cap is imposed on the value of awards, <sup>149</sup> and awards are final and binding, even if new evidence surfaces later. <sup>150</sup>

<sup>143</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 42.

<sup>144</sup> *Id.*

<sup>145</sup> FINANCIAL SERVICES AUTHORITY, *supra* note 90, DISP 3.7.4.

<sup>146</sup> *Id.*, DISP 3.7.5.

<sup>147</sup> AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION, *supra* note 92.

<sup>148</sup> ANNUAL REPORT 2005-2006, *supra* note 82.

<sup>149</sup> Alpert, *supra* note 94.

The monetary award limit is considerably lower than that of the UK or Australia, but higher than that of Singapore. The FSTB clarified in its Consultation Conclusions that the cap applies to individual claims, and thus complainants could bring claims that add up to more than \$500,000 where there is more than one dispute.<sup>151</sup> It was also clarified that claims for over \$500,000 could be brought, but the maximum award would remain at \$500,000.<sup>152</sup> This cap will be reviewed from time to time.<sup>153</sup>

While the reasoning behind the limit on awards appears sound, it is unclear whether or not the complaints handled by the HKMA concerning monetary disputes mentioned in the Consultation Document include the large numbers of Minibond claims, and if such a figure takes into account claims that are taken to court by eligible complainants rather than to the HKMA. It should be noted that the civil jurisdiction of the district court is currently for claims under \$1,000,000, and thus consumers may have chosen to pursue their private rights at the district court rather than to bring the matter to the HKMA given the HKMA's lack of jurisdiction in respect to consumer compensation.

#### RECOMMENDATION 7—AWARDS

Serious consideration should be given to raising the limit of the FDRC's jurisdiction to HK\$1 million in order to bring it in line with other jurisdictions. Provision should also be made for the jurisdiction of the FDRC to track the jurisdiction of the district court so that when the district court increases its jurisdiction, the FDRC should follow suit. This would also serve to ensure that the courts need not be overly burdened by smaller securities claims and at the same time, would enable a greater number of consumers to make use of the FDRC rather than be forced to engage in costly litigation merely because their claims are of a sum higher than HK\$500,000.

---

<sup>150</sup> *Overview of Arbitration & Mediation*, FINANCIAL INDUSTRY REGULATORY AUTHORITY, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/OverviewofArbitrationMediation>.

<sup>151</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1.

<sup>152</sup> *Id.* at 52.

<sup>153</sup> *Id.*

C. *Costs*

It is proposed that the FDRC will charge both consumers and financial institutions on a “pay as you use” basis for its services.<sup>154</sup> Under the Consultation Conclusions, the fee structure was set out as follows:

TABLE 5

<b>FEE TYPE</b>	<b>CLAIMANT</b>	<b>FINANCIAL INSTITUTION</b>
Making enquiries	Nil	Not applicable
Filing a claim form	HK\$200	Not applicable
Mediation	(Case fees)	(Case fees)
Amount of claims:		
- less than HK\$100,000	HK\$1,000	HK\$5,000
- between HK\$100,000-\$500,000	HK\$2,000	HK\$10,000
Arbitration (regardless of amount of claims)	(Case fees)	(Case fees)
	HK\$5,000	HK\$20,000

1. *Comparing the Charges of Ombudsmen and the SROs*

The proposed costs of the FDRC may be contrasted with the ombudsmen in common law jurisdictions, which offer their services free of charge, or charge a nominal case fee for adjudication under Singapore’s FIDReC.

---

<sup>154</sup> *Id.* at 42.

TABLE 6

SCHEME	COSTS FOR DISPUTE RESOLUTION SERVICES
FOS (UK)	Consumers do not pay to bring complaints to the FOS. <sup>155</sup> Businesses do not pay case fees in respect to the first three complaints settled during a year, but there is a fee of £500 for the fourth and each subsequent complaint. <sup>156</sup> The FSA Handbook expressly sets out that complainants do not need to have professional advisers to bring complaints, and thus awards of costs should be uncommon. <sup>157</sup>
FOS (Aus)	Per the requirements of ASIC, external dispute resolution schemes provide their services free of charge to consumers. <sup>158</sup>
FIDReC	No fees are charged to consumers where the dispute is resolved by case management or mediation. <sup>159</sup> A US\$50 fee is charged to consumers where the dispute is escalated to the adjudication stage to deter frivolous complaints, but is kept low in order to ensure FIDReC is affordable for consumers. <sup>160</sup>
FINRA	As of April 14, 2011, the arbitration filing fee for a customer of a member firm of FINRA for an undisclosed amount and/or other relief (determined by a panel of three arbitrators per Rule 13900(b)) is US\$1,250 (approx. HK\$9,750) and the estimated hearing fees for one day of hearing is US\$3,000 (approx. HK\$23,400). <sup>161</sup>

## 2. Purposes of Charging

In the consultation process, it was stated that the fee structure was intended to be affordable for complainants but at the same time be set at levels that would provide an incentive to resolve disputes at an early stage.<sup>162</sup> The amounts also take into consideration the market rates for mediators in Hong Kong at present.<sup>163</sup>

Due to the express mandate of the regulators of the United Kingdom and Australia in respect to consumer protection, ombudsmen services are free of charge.

<sup>155</sup> *The Case Fee*, FINANCIAL OMBUDSMAN SERVICE, [http://www.financial-ombudsman.org.uk/faq/answers/research\\_a5.html](http://www.financial-ombudsman.org.uk/faq/answers/research_a5.html) (last visited May 1, 2012).

<sup>156</sup> *Id.*

<sup>157</sup> FINANCIAL SERVICES AUTHORITY, *supra* note 90, DISP 3.710.

<sup>158</sup> *How to Complain About Companies or People*, AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION, <http://www.asic.gov.au/asic/asic.nsf/byheadline/Complaining+about+companies+or+people?openDocument> (last visited May 6, 2012).

<sup>159</sup> ANNUAL REPORT 2005-2006, *supra* note 82.

<sup>160</sup> *Id.*

<sup>161</sup> Calculated using the "Arbitration Filing Fee Calculator." See *Arbitration Filing Fee Calculator*, FINRA, <http://apps.finra.org/ArbitrationMediation/ArbFeeCalc/1/Default.aspx> (last visited May 1, 2012).

<sup>162</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 37-38.

<sup>163</sup> *Id.* at 43.



A considerably lower nominal amount is charged to consumers in Singapore when the dispute is escalated to the adjudication stage—the fee is imposed to deter frivolous complaints, but is minimized in order to ensure FIDReC is affordable for consumers.

In respect to the considerably higher costs of FINRA arbitration, one commentator has pointed out that unlike in the case of the United Kingdom or Australia, since FINRA complainants must pay an arbitration fee, a hearing deposit, and attorneys' fees, cost-deterrence serves as a filter, and therefore strict jurisdictional prerequisites for arbitration are unnecessary.<sup>164</sup>

It is thus clear that one of the purposes of charging costs of dispute resolution to consumers is to filter out frivolous complaints, as well as to encourage settlement of disputes at an early stage, thus preventing draining limited resources. However, as is noted above, jurisdictional prerequisites also serve similar purposes in respect to allocation of resources.

In comparison with the costs of litigation, the proposed costs of the FDRC are still relatively low, but whether or not these costs could serve as an obstacle to access to justice may depend on associated costs.

### 3. *Associated Costs*

One key issue that was addressed in the recommendations of the SFC is that of legal representation, and whether or not parties will be entitled to have legal representatives, particularly at the arbitration stage. In the case of the ombudsmen in common law jurisdictions, legal representation is not allowed, in line with the suggestion of the SFC that legal representation should be discouraged for the purposes of a financial dispute resolution scheme in Hong Kong. In the United States, the involvement of legal representatives has increased both the cost and complexity of securities regulation. This is a significant issue for the FSTB to address, as it has the potential to either drive up costs and formality (where legal representation is allowed) or to create an impression of inequality between the parties, particularly as to their experience with disputes and presenting their cases (where legal representation is not allowed).

---

<sup>164</sup> Alpert, *supra* note 94.

**RECOMMENDATION 8—COSTS**

It is suggested that costs should be scaled for persons falling under the “professional investor” definition, particularly high net worth individuals, to ensure the subsidies of the FDRC to dispute resolution processes are allocated according to need.

It is also suggested that costs should be brought in line with the costs of other schemes such as the one for insurance products in order to enhance consistency and discourage forum shopping by consumers.

**IV. ASSESSING THE PROPOSAL AGAINST THE MINIBONDS CRISIS**

In view of the Minibonds Crisis as providing the impetus for the creation of the FDRC, it is a pertinent and useful exercise to examine the dispute resolution process of the FDRC in a hypothetical application to the Minibonds Crisis in order to further explore certain regulatory issues in a practical context.

One may presume that with Hong Kong’s financial markets characterized by a high number of individual retail investors and Minibonds framed as over-the-counter retail investment product, a high number of Minibond complainants would have been eligible complainants. One may also presume that a high proportion of those eligible complainants would have claims within the award limit of the FDRC given the reasoning by which the award limit was established. Thus, had the FDRC existed at the time of the Minibonds Crisis, it could be presumed that the FDRC would have received a high number of Minibond complaints.

While the Minibonds Crisis in and of itself may be characterized as highly out of the ordinary, the issues it raises in the context of the FDRC may not be.

**A. *Consistency and Playing for the Rules***

One aspect of the FDRC process that could potentially lead to complainants being at a disadvantage is the fact that as time progresses, financial institutions may build up experience in respect to claims amounts and settlements as repeat players. By contrast, consumers, as one-time users, may be left in the dark as to the true value of their complaint. Under the facilitative model of mediation, as mediators only facilitate discussions and are not supposed to give advice, the experience of the mediators in this regard does not assist complainants.

While it is proposed that the FDRC will publish data about disputes,<sup>165</sup> the confidential nature of the settlements appears to mean that there will be no guidance for consumers or even arbitrators as to settlement amounts and awards for cases that involve similar facts or issues. This not only gives rise to a potential issue of uneven rates of settlement but also means that each dispute is destined to go through the same time-consuming process rather than to increase efficiency in reaching settlement of common or similar complaints.

One study in the United Kingdom demonstrated the effectiveness of the ombudsman model in neutralizing the advantage of financial service providers due to the lack of formality and evaluative nature of decision-making. Such characteristics could well be adopted by the FDRC, and in order to ensure consistency, the FDRC should arrange for frequent meetings of its staff, mediators, and arbitrators to discuss their experiences with claims and how they handled them.

### *B. Systemic Issues and Parallel Jurisdiction*

As set out in the consultation document, the role of the FDRC is not intended to be regulatory. It thus does not engage in any investigation and would only deal with the monetary aspects of cases that could also include regulatory violations.<sup>166</sup> Furthermore, where the FDRC handles cases involving systemic and widespread regulatory violations, the FDRC will turn these cases over to the regulators to deal with and cease to handle them.<sup>167</sup>

Thus, even though Minibond claimants may have been eligible complainants and within the award limit of the FDRC, they may potentially have been barred from bringing the regulatory aspects of the complaints to the FDRC.

Thus far, no review of the Minibonds Crisis has characterized it as systemic, but whether or not its widespread nature may have led it to be considered systemic at least for the purposes of early warning or until more facts about the Minibonds emerged raises questions about what actions would be appropriate in the face of a systemic concern, and what effect systemic issues will have on the private rights of complainants in the FDRC context.

---

<sup>165</sup> FINANCIAL SERVICES AND THE TREASURY BUREAU, *supra* note 1, at 46.

<sup>166</sup> *Id.* at 46-48.

<sup>167</sup> *Id.* at 48.

## V. ASSESSING THE APPROPRIATENESS OF DISPUTE RESOLUTION METHODS FOR FINANCIAL REGULATION

Whether or not the FDRC can avoid the perception of a *de facto* protector of consumer rights in the financial markets of Hong Kong remains to be seen. Other than its place in the regulatory structure, an equally important assessment is the appropriateness of alternative dispute resolution techniques for financial dispute resolution. In the course of this article, several ideas have emerged for the enhancement of the FDRC proposal with respect to the experience of similar schemes in other jurisdictions. This suggests that some methods of dispute resolution may be preferred over others due to the needs of disputes between consumers and financial service providers. One example of such a need is the need to bridge the power/knowledge gap between consumers and financial service providers.

Different jurisdictions offer different answers to the question of whether or not financial dispute resolution schemes necessarily play regulatory roles. Alternative dispute resolution schemes are usually set up with efficiency in mind—in the particular context of financial markets, enhancing market efficiency by reducing the resources devoted to dispute resolution. Such schemes are supplemental to, rather than substitutive of the court system, and lack a judicial mandate. The non-binding nature of the ombudsmen and adjudicator's decisions (except where accepted by the complainant) is perhaps the clearest indicator that there is no intent to completely displace the judicial function. By contrast, the FINRA arbitration scheme is accepted as part of the regulatory mechanism in the United States, and its mandatory nature and unrestricted jurisdiction appear to imply a mandate to displace the court function in certain aspects of financial regulation.

In navigating the potential areas of overlap between the regulatory and non-regulatory functions of financial dispute resolution service providers, the parallel complaints procedure must be clearly established between the dispute resolution service and the regulators, and in matters of fact-finding, the lead must be taken by the regulators.<sup>168</sup> For jurisdictions that do not have a specific consumer protection mandate, such as in Hong Kong, it should be borne in mind that in the aftermath of the Minibonds Crisis, there may be an expectation on the part of the public that a dispute resolution body be set up for the purposes of filling in the consumer protection gap and resolving disputes in the absence of such a regulatory mandate.

---

<sup>168</sup> *Id.* at 46.

In considering what forms of alternative dispute resolution are suitable for addressing disputes between consumers and financial service providers, the need for the third party intervener in any mode of dispute resolution to address the power/knowledge gap is clear. The need to address the gap may, particularly at the early stages of dispute resolution, lend itself towards the command end of the dispute resolution spectrum and the integration of relevant standards and rules, at least as touchstones, to inform an equitable negotiation process. It may suggest the need for external experts, information centers, and resources to be made available to unrepresented parties. The integration of such norms, however, does not necessarily lend itself to a regulatory role.

Even in the absence of, or separate from a consumer protection mandate, the principles of equity, fairness and transparency operate to bridge the power/knowledge gap between consumers and financial service providers in order to achieve equity in the dispute resolution process. This may arguably be considered a reflection of the regulatory philosophy of disclosure that dominates financial regulation.

The premise that inquisitorial, semi-evaluative models of dispute resolution are better suited where the intent is a regulatory role, and consensual models are to be preferred in the context of non-regulatory dispute resolution schemes, must therefore be supplemented by an underlying notion of what is necessary to achieve equity and fairness between the two disputing parties in determining appropriateness. Hence, to a certain extent, command elements may be necessary for the resolution of financial disputes even where consensual models are being used.

## VI. CONCLUSION: ENHANCING THE FDRC

The consultation documents on the FDRC refer to four main principles on which the FDRC is based: independence, impartiality, accessibility, and efficiency.<sup>169</sup> Further reference is made to principles such as affordability, speediness, cost effectiveness, and confidentiality—all of which are important principles in the implementation of financial dispute resolution programs.<sup>170</sup>

Specific suggestions have been made in this paper to different aspects of the FDRC process in light of experience in other jurisdictions. These include 1) improving accessibility via the expansion of eligible complainants, while at the same time enhancing cost effectiveness by restricting the

---

<sup>169</sup> *Id.* at 35.

<sup>170</sup> *Id.* at 29.

subsidized access of professional investors or scaling the charges of the FDRC for different types of users, 2) reducing the reliance upon the monetary nature distinction, instead of streamlining and emphasizing the parallel procedure of processing complaints by regulators and the FDRC, and avoiding inconsistency and confusion by clearly carving out disputes relating to MPF and insurance products from the jurisdiction of the FDRC or creating uniform handling processes for such disputes, 3) where the FDRC process fails to resolve the dispute, attempts should be made at the FDRC stage to narrow down the factual disputes and issues between the parties in order to enhance the efficiency of litigation, 4) the limit on awards the FDRC can make should be increased to reflect the jurisdiction of the district court and further enhance accessibility, and 5) costs should not only be scaled, but associated costs of the FDRC process should be reduced by barring legal representation from the FDRC, thus improving the cost effectiveness of the process overall.

While it is clear that some of the ideas and suggestions enhance the proposed FDRC in accordance with the principles on which it is based, (e.g., expanding eligible complainants increases accessibility), many of the ideas and suggestions emerge from the comparison of the proposal to the experience with financial dispute resolution schemes of other jurisdictions.

In the context of the foregoing discussion on distinguishing between regulatory and non-regulatory schemes of dispute resolution, many of the suggestions can be explained by their emphasis on the non-regulatory role of the FDRC. Specifically, the adoption of a parallel complaints-handling procedure led by the financial regulators emphasizes the fact that the FDRC has no investigative powers of its own, while the suggestion that the FDRC arbitral awards should not be binding unless the complainant so chooses means that the FDRC process does not exercise a judicial function or displaces the courts, which is arguably the strongest indicator of a regulatory role.

The appropriateness of the form of dispute resolution for a non-regulatory scheme also implies that many of the suggestions are concerned with the reduction of the command elements in the FDRC process, or with moving them down the spectrum away from the command end. The idea of non-binding arbitral awards is one way in which the FDRC process can be made more consensual, while the exclusion of legal representation not only lowers costs but also has the potential to decrease formality.

However, the principles that bind the majority of the suggestions together are those of equity and fairness. Restricting professional investors' subsidized access to the FDRC not only improves cost effectiveness but also

enhances the distribution of the FDRC's resources to where the need for them may be greater. The parallel complaints-handling mechanism and suggestion of reference to regulatory and legal touchstones operates to ensure that the knowledge gap between consumers and financial service providers will be bridged. The adoption of a separate process for dealing with frivolous or vexatious complaints should ensure that complainants are not barred from the FDRC process on a mere *prima facie* basis—but at the same time, such a process should also help to protect against frivolous and vexatious claims.

The appropriateness of the evaluative model of mediation has been discussed already: the need to bridge the knowledge gap for consumers speaks to a principle of equity and fairness by ensuring a level playing field in terms of information—particularly about the true value of claims, as the Minibonds Crisis served to demonstrate.

The changes suggested in respect to the arbitration stage of the FDRC process serve not only to enhance the fairness of the process but also the appearance of fairness—justice not only being done but also seen to be done. Allowing hearings where complainants desire them and increasing the oversight of the courts over the FDRC process subjects the FDRC to greater scrutiny and the safeguards of the court system, which in turn should serve to build confidence in the FDRC.

By charging the FDRC with a further duty to narrow down factual disputes and issues between the parties even if the complaint cannot be resolved should assist in dealing with how information that has been disclosed during the FDRC process is to be treated in the course of litigation. This should enhance the efficiency of litigation, but also offers a degree of protection to parties where, for example, in the course of the FDRC process it comes to light that there may be some contributory negligence on either side—encouraging parties to agree how disclosed information is to be dealt with prevents the abuse of positions of information that are established under the FDRC.

The study of financial dispute resolution schemes in different jurisdictions has, in this paper, led to tentative conclusions that the appropriateness of the dispute resolution method is arguably informed by a regulatory or non-regulatory role—dispute resolution modes closer to the command model must incorporate safeguards for the disputants against the discretion of the third party intervener. But even for non-regulatory schemes, command elements such as the provision of legal and regulatory standards to complainants may still be incorporated into consensual models of dispute resolution, which speaks to a *de minimis* level of equity and fairness that

must be achieved. The establishment and future effectiveness of the FDRC will undoubtedly be measured against a number of important principles, as espoused in the Consultation document, and not least of which include fairness and equity. Just as the deceived investor will not invest, complainants with no confidence in a financial dispute resolution scheme will not make use of it, serving only to drive up the resources needed to resolve financial disputes. Even absent a consumer protection mandate, the need for a financial dispute resolution scheme to be designed according to principles of fairness and equity not only reflects broader aims of a financial regulation system, but on a practical level, furthers the aim of such schemes to increase market efficiency, stability, and ideally to prevent the exploitation of consumer investors.