



INVESTOR PROTECTION IN THE SPOTLIGHT: PROPOSALS TO SIGNIFICANTLY ENHANCE THE FINANCIAL DISPUTE RESOLUTION SCHEME

Overview

The Financial Dispute Resolution Centre (**FDRC**), which since June 2012 has been providing alternative dispute resolution services to financial institutions and their individual customers in Hong Kong, has recently launched a [consultation](#) to significantly enhance the Financial Dispute Resolution Scheme (**FDRS**). The proposals, which will bring the FDRS more into line with financial dispute resolution schemes in other jurisdictions, can be summarised as follows:

- To raise the maximum claimable amount from HK\$500,000 to HK\$3,000,000;
- To extend the limitation period for lodging claims from 12 months to 36 months from the date of purchase of the financial instrument or the date of first knowledge of loss, whichever is the later;
- To enlarge the scope of “eligible claimants” (**ECs**) by incorporating “small enterprises” which have/had a customer relationship with a financial institution (**FI**);
- To accept applications for claims which are under current court proceedings; and
- To provide for the FDRC to deal with the following cases subject to a prior mutual agreement between the parties:
 - A financial dispute with a claimable amount in excess of the amended maximum claimable amount;
 - A financial dispute exceeding the amended limitation period for lodging claims;
 - Where there is a financial dispute between an EC and a FI, the FI may refer the financial dispute to the FDRC, subject to the consent of the EC; and
 - Where there is a claim by an EC against an FI, the FI with a counterclaim may lodge the counterclaim to the FDRC, subject to the consent of the EC.

In cases that are beyond the [Intake Criteria](#) and subject to mutual agreement, the FDRC also proposes to offer “mediation only” or “arbitration only” options in addition to the original two-stage mechanism of “mediation first, arbitration next”. With the proposed amendments to the FDRS, there would be a need to revise the FDRC’s fee schedule. The FDRC has also produced a handy diagrammatic comparison between the existing scheme and the proposed new scheme (click [here](#)).

The proposals mean that the FDRC’s jurisdiction is likely to be significantly increased, thereby permitting a greater number of monetary disputes to be handled by the FDRC rather than (or as well as) the courts. This may have the knock-on effect that claims which would have otherwise not progressed may now proceed under the FDRS.

In light of the proposed amendments, the FDRC also proposes that all previously rejected applications could re-apply for consideration by the FDRC if they now fall within the amended Intake Criteria.

The deadline for providing comments is **31 December 2016**.

19 October 2016

Hong Kong

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Current scheme

The FDRC began operating in June 2012, and receives seed funding from the Government, the Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**). The FDRC administers the FDRS and provides a channel for FIs and their individual customers to resolve monetary disputes by way of “mediation first, arbitration next”. All financial institutions which are authorised by the HKMA or licensed by/registered with the SFC (except those institutions which only provide credit rating services) are required to be members of the FDRS and be bound by the terms of the FDRS.

Under the current scheme:

- Eligible claimants are individual customers of a member of the FDRS;
- An eligible dispute is a monetary dispute involving FIs and their individual customers which is HK\$500,000 or less;
- For a dispute to be eligible, it must also have been dealt with by the relevant member of the FDRS in the first place;
- Claims are rejected if the dispute is under court proceedings; and
- The FDRC currently accepts eligible disputes raised by individual customers but not FIs within 12 months from the date of purchase of the financial instrument or the date of first knowledge of loss, whichever is the later.

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Proposed amendments

Maximum claimable amount and limitation period

According to the FDRC’s complaint enquiries data, exceeding the maximum claimable amount and the limitation period for lodging claims are two major reasons for the FDRC to reject applications under the FDRS. The proposed increased maximum claimable amount also reflects the proposed higher jurisdictional limits of the District Court and the Small Claims Tribunal as well as similar practices in other jurisdictions. For example the maximum claimable amounts in Canada, UK and Australia are all set above HK\$1,500,000. Changes in various economic indices and indicators may also lead to higher dispute amounts.

The proposed extension to the limitation period is based on the following considerations:

- The complaint enquiries data also shows that if the limitation period could be extended for two more years, it could allow more complaints out of the 65% portion previously rejected to be covered by the FDRS; and
- In the FDRC’s view, in light of the fact that memory usually deteriorates with the lapse of time, the information/evidence within three years could be more easily located or identified by both parties for submission to the FDRC for mediation/arbitration, given that many cases lodged with the FDRC were alleged to be mis-representation or mis-selling.

The proposed 36 month limitation period, however, falls far short of the six-year time bar commonly adopted overseas as the limitation period for lodging similar claims, such as in the USA, the UK, Canada, Australia and Malaysia.

Incorporation of small businesses as eligible claimants

The FDRC considers that it would be reasonable to incorporate small businesses, which are financially less capable to resolve their disputes with FIs through legal proceedings. Incorporating small businesses is also consistent with overseas experience, with several jurisdictions also covering the business section, small-sized companies in particular. The FDRC proposes defining “small enterprises” (**SEs**) as a partnership or a limited company with an annual turnover/revenue of not more than HK\$50 million as shown in its latest financial statements. If it belongs to a larger group, the consolidated turnover/revenue will be considered instead.

In theory, a small-sized FI, if it could meet an SE qualifying test, could lodge a claim as an EC against a larger FI under the FDRS, provided that: (i) the smaller FI as an EC has or had a customer relationship with the larger FI to whom a claim is made against; (ii) the dispute is related to a financial service provided by the larger FI; and (iii) the dispute is of a financial/monetary nature. The Intake Criteria also have to be met.

Concurrent court proceedings

Under the current scheme, any claim that is/has been the subject of current court proceedings shall be rejected by the FDRC. If an EC wishes to pursue the mediation/arbitration processes at the FDRC, the EC has to withdraw the case from the court before lodging the application with the FDRC. The FDRC has recorded one such withdrawal case so far.

Under the proposal, claims which are subject to court proceedings can be brought to the FDRC removing the unnecessary procedures of withdrawing the case from the court. This is in line with the current court practice which strongly encourages parties to attempt mediation (as stipulated under [Practice Direction 31](#)), in the course of court proceedings. PD31 applies to almost all civil proceedings in the Court of First Instance and the District Court. The proposal is said to be consistent with one of the underlying objectives of the Civil Justice Reform, namely to facilitate settlement of disputes.

It is also proposed that legal representatives of both parties be allowed to participate in the FDRC mediation, taking into account the fact that legal representatives are commonly involved in PD31 cases. Other than PD31 cases, however, the ordinary cases under the FDRS cannot be legally represented.

Broadening the service scope of the FDRS subject to mutual agreement

In addition to the above proposed amendments to the existing FDRS, the FDRC also proposes to permit certain cases to be accepted by the FDRC where the parties are in mutual agreement, for example where the amount being claimed is greater than the amended maximum claimable amount. These proposals reflect practices overseas. For example, [New Zealand's Banking Ombudsman](#) can consider a complaint that would otherwise be outside its mandate if both sides agree. [New Zealand's Insurance and Financial Services Ombudsman](#) also states that "*Nothing in these Terms of Reference will prevent the Scheme from considering a Complaint, that is otherwise outside the Scheme's jurisdiction, if the Participant consents*".

However, in practice, it is not expected that the claimable amount would be much higher than HK\$3,000,000 given that the ECs are of relatively less financial strength or operating small businesses.

Mediation or arbitration only

To provide flexibility for cases on a mutual agreement basis, the proposals would also permit parties to choose either mediation rules and procedures or arbitration rules and procedures. This may be helpful in circumstances where contracts between FIs or FIs and their customers are subject to arbitration provision in case of dispute.

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Commentary

The FDRC's proposals come following several years of experience since its inception in June 2012, and following comments from various stakeholders, as well as reference to similar schemes in overseas jurisdictions. Indeed, increasing the maximum claimable amount will put the FDRS onto a similar footing to the schemes in the UK, Australia and Canada. The proposals also reflect the increasing complexity in financial products leading to higher value claims and a greater need for customers to have recourse to a quick, affordable and independent means of resolving disputes.

With greater investor protection, however, FIs are likely to find an increase in the number of claims being accepted by the FDRC, particularly if the proposal to extend the scope of ECs to include small enterprises is adopted. Under paragraph 12.6 of the SFC's "*Code of Conduct for Persons Licensed by or Registered with the SFC*" (the **Code**), licensed/registered firms are required to: (i) make honest and diligent disclosure before mediators and/or arbitrators in connection with the FDRS; and (ii) render all reasonable assistance to the FDRS. Licensed/registered firms should also be mindful of the following additional requirements if the proposals go through:

- Paragraph 12.3(c) - Where a complaint is not remedied promptly, there is a requirement to advise the client of any further steps which may be available to them under the regulatory system including the right to refer a dispute to the FDRC. Extending the scope of eligible claimants to encompass small enterprises may require a change to firms' complaints handling processes; and
- Paragraph 12.5(g) - Any determinations or settlements of a complaint in connection with the FDRS (including the details of the determination or settlement) must be notified by firms to the SFC if so requested.

The proposals also have a significant retrospective impact in that the FDRC proposes that all previous applications could re-apply for consideration by the FDRC, if they now fall within the amended Intake Criteria. This might lead to a wave of complaints being resurrected.

The FRDC will also share observations and information with regulators, for example when there are a number of similar disputes that may indicate the existence of wider implications for the regulated sector. If the subject matter of a complaint relates to other clients, or raises issues of broader concern, licensed/registered firms also have a duty under the Code (12.3(d)) to take steps to investigate and remedy such issues, even if the other clients may not have filed complaints with the firm and/or the FDRC.

Finally, allowing claims which are subject to court proceedings may also lead to practical challenges where there is a “parallel run” between the FDRC and the courts, although in most cases it is likely that an application to stay proceedings would be sought, particularly where mediation is attempted in the context of those proceedings.

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