

SPOTLIGHT ON INVESTOR PROTECTION: THE FINANCIAL DISPUTE RESOLUTION CENTRE IMPLEMENTS A MORE MODERATE PACKAGE OF REFORMS

04 September 2017 | Hong Kong
Legal Briefings

The Financial Dispute Resolution Centre (**FDRC**) has issued its [conclusions](#) to its [consultation](#) on proposals to significantly expand the jurisdiction of the Financial Dispute Resolution Scheme (**FDRS**), its alternative dispute resolution scheme for conflicts between financial institutions and their individual customers.

The FDRC's consultation met with mixed responses, with respondents from the banking and securities sectors opposing the proposed changes while other respondents, including the Department of Justice and consumer rights groups, supported the suggested reforms. Given this, the FDRC has chosen to implement a more moderate package of reforms than those it originally contemplated (as outlined in our October [briefing](#)).

The key changes from the consultation paper include:

- raising the maximum claimable amount to HK\$1,000,000. This is an increase from the current limit of HK\$500,000, but significantly lower than the proposed increase to

HK\$3,000,000;

- extending the limitation period for lodging claims from 12 months to 24 months from the date of purchase of the financial instrument or date of first knowledge of loss, whichever is later, rather than the 36 months previously suggested; and
- that the FDRC will cease its current practice of providing case information such as application forms, mediated settlement agreements or arbitral awards, to the Securities and Futures Commission (**SFC**) and Hong Kong Monetary Authority (**HKMA**). However, it will continue to provide monthly reports regarding the number and type of disputes handled by the FDRC and information regarding systemic issues and suspected serious misconduct.

The FDRC also announced that it will enact a range of other reforms in a form largely unchanged from that proposed in its consultation paper. These include:

- expanding the scope of eligible claimants (**ECs**) by allowing "small enterprises" to bring complaints against financial institutions (**FIs**);
- accepting applications for claims which are under current court proceedings without requiring the claimant to withdraw the case from court; and
- introducing a voluntary referral system.

These reforms amount to a sizeable expansion of the FDRC's jurisdiction. As foreshadowed in our previous bulletin, FIs are likely to see an increase in claims being accepted by the FDRC once these reforms are enacted, though this increase is likely to be smaller than that which would have resulted from the enactment of the FDRC's original proposals.

The amended terms of reference for the FDRS are expected to take effect on **1 January 2018**, with the exception of the reforms allowing small enterprises to bring claims, which will take effect on **1 July 2018**.

EXPANSION OF THE FDRC'S JURISDICTION

The FDRC currently handles monetary disputes involving an FI and their individual customers for amounts of HK\$500,000 or less and in which court proceedings are not currently underway. The reforms announced by the FDRC will expand the category of eligible disputes in several ways.

MAXIMUM CLAIMABLE AMOUNT AND LIMITATION PERIOD

As stated above, the maximum claimable amount will be increased to HK\$1,000,000, which brings the limit closer to international equivalents in jurisdictions like Singapore, the UK and Australia. Several respondents who opposed the proposed increase to HK\$3,000,000 were concerned that the higher limit would encourage abuse and lead to increased operating costs by the FDRC, which would eventually be borne by the parties using the FDRC.

Additionally, the limitation period for claims will increase to 24 months, rather than the proposed 36 months. This new period is consistent with current securities regulation requirements that contract notes and other relevant documents be kept for 24 months.

ALLOWING CLAIMS BY SMALL ENTERPRISES

The FDRC's [Intake Criteria](#) will also broaden to include small businesses as eligible claimants, on the basis that, like individuals, they tend to be less financially sophisticated than the FIs they deal with.

However, the definition of eligible "small enterprise" will be narrower than originally suggested, and will require a business (or its broader corporate group) to have:

- an annual turnover of no more than HK\$50,000,000;
- gross assets of no more than HK\$50,000,000; and
- no more than 50 Hong Kong based employees.

Further, the FDRC will allow FIs which fall within this definition of a "small enterprise" to bring claims under the FDRS against other FIs, despite the fact that these small FIs should have a higher level of financial sophistication than other small enterprises.

PRACTICE DIRECTION 31 CASES

The FDRC reforms will also allow claims subject to pending court proceedings to be brought to the FDRC without withdrawing the case from the court as currently required. The FDRC anticipates that this will create a special category of [Practice Direction 31 \(PD31\)](#) cases where parties will use the FDRC's mediation services to discharge their obligations under PD31 to consider attempting mediation. Importantly, and in contrast to other matters dealt with by the FDRC, parties to these PD31 disputes may be legally represented. The FDRC has suggested that its mediation services should be an attractive alternative to private mediators given their familiarity with the financial industry and disputes of this type.

As foreshadowed by our earlier bulletin, the FDRC has addressed the issue of "parallel proceedings" by indicating that either a stay or a formal notification to the court of the FDRC's role will be required for PD31 cases.

NEW VOLUNTARY REFERRAL JURISDICTION

The FDRC has also announced it will proceed with its proposal to allow for voluntary referral of matters outside its Intake Criteria, including matters above the maximum claimable limit and limitation period. While under the Intake Criteria only the customer may choose to refer a dispute to the FDRC, the new voluntary referral scheme may be initiated either by a FI or their customer, although both parties must agree to the referral.

While matters within the Intake Criteria are dealt with on a "mediation first, arbitration next" basis, parties who voluntarily refer their matters may choose to have them dealt with on a "mediation only", "arbitration only" or "mediation first, arbitration next" basis. However, cases referred voluntarily and which exceed the maximum claimable limit under the Intake Criteria will be subject to higher mediation and/or arbitration fees than those under the Intake Criteria, which may remove some of the attractiveness of the FDRC as a lower cost alternative dispute resolution option.

RETROSPECTIVE EFFECTS OF THE PROPOSED AMENDMENTS

A number of respondents were concerned around the proposal to re-consider previously rejected applications if they now fall within the amended Intake Criteria on the basis that, for example, it might lead to a wave of frivolous or vexatious claims. As such, the FDRC amended its proposal and the revised implementation rule of the amended Intake Criteria is:

- All claims whose date of first knowledge of loss by the EC falling **on or after** the effective date of the amended Terms of Reference shall be subject to the amended Terms of Reference; and
- All claims whose date of first knowledge of loss by the EC falling **before** the effective date of the amended Terms of Reference shall be subject to the **original** Terms of Reference.

COMMENTARY

Although the reforms adopted by the FDRC are more moderate than those originally contemplated, it is clear from the consultation conclusions that the FDRC has ambitions to establish itself as a specialised alternative dispute resolution destination for a wide range of financial disputes between FIs and their customers. For example, the proposed fee scale for voluntarily referred matters contemplates matters involving claims exceeding HK\$10,000,000, which are likely to be matters of considerable factual complexity.

The FDRC's announcement that it will no longer pass case information to the SFC or HKMA unless it relates to systemic issues or suspected serious misconduct seems intended to provide comfort to FIs that voluntarily referring matters to the FDRC will not prompt unwanted regulatory scrutiny. While the SFC and HKMA will retain the right to request that the FDRC provides information reasonably required to discharge their statutory functions, the FDRC has stressed that no such information has ever been requested of it. This development may well lead to a greater uptake of the FDRC's voluntary referral jurisdiction than otherwise anticipated.

Finally, although the new maximum limit is lower than originally proposed, FIs are likely to find an increase in the number of claims being accepted by the FDRC, particularly as the scope of ECs now included small enterprises. Firms should revisit their complaints handling procedures to ensure their continuing compliance with the SFC's [Code of Conduct for Persons Licensed by or Registered with the SFC](#). Firms should be mindful of the following requirements in particular:

- 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;
- 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; and
- paragraph 12.6 - 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.

If you have any questions then please do not hesitate to contact your usual Herbert Smith Freehills contact or the key contacts below.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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