The Hong Kong Financial Dispute Resolution Centre – Specialist arbitrators required to perform a delicate balancing act?

Kluwer Arbitration Blog
April 15, 2011

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Please refer to this post as: Justin D'Agostino, 'The Hong Kong Financial Dispute Resolution Centre – Specialist arbitrators required to perform a delicate balancing act?', Kluwer Arbitration Blog, April 15 2011, http://arbitrationblog.kluwerarbitration.com/2011/04/15/the-hong-kong-financial-dispute-resolution-centre-specialist-arbitrators-required-to-perform-a-delicate-balancing-act/

The aftermath of the Lehman Brothers' bankruptcy saw more than 20,000 retail investors in Hong Kong suffer losses from investments in structured products. This gave rise to political pressure on the Hong Kong Government to review its financial regulatory system and to step up its investor protection mechanisms. As one of the key outcomes of this process of review and reform, it is proposed that Hong Kong will roll out a Financial Dispute Resolution Centre ("FDRC") in 2012.

The FDRC is intended to be a platform for retail investors who have monetary disputes with financial institutions to settle those disputes in a quick, affordable and impartial way. All financial institutions licensed or regulated by the Hong Kong Securities and Futures Commission and/or the Hong Kong Monetary Authority ("HKMA") are subject to the scheme. Investors whose attempts at negotiating with the relevant financial institution have failed, may choose to bring claims to the FDRC rather than the courts if they relate to credit cards, loans, stocks, funds and other investment products. If the FDRC accepts the investor's claim, the investor and the relevant financial institution will participate in mediation as a first step in an attempt to settle the dispute. Based on the previous success of the scheme set up by the HKMA and the Hong Kong Mediation Council to deal with Lehmans' mini-bonds claims, it is anticipated that the vast majority of cases will be settled at the mediation stage. The FDRC intends to enlist a team of 4 or 5 in-house mediators to conduct mediations for claims of under HK$100,000, and to engage external mediators for claims over that amount. From the date of the mediator's appointment, the mediation process will last for no more than 21 days. The mediation session itself will last no longer than four hours. If mediation fails, the investor may choose to have the dispute resolved through arbitration administered by the FDRC scheme (or standard court or arbitration proceedings). In an FDRC-administered arbitration, an external arbitrator will be engaged and from the date of appointment of the arbitrator, the arbitration process will also last for no more than 21 days.

The FDRC is aimed at helping the everyday small retail investor and it seeks to do this in two steps. First, the FDRC has gone to lengths to ensure it is targeting the "right" investors by imposing narrow eligibility criteria. For example, the maximum claim amount is capped at HK$500,000 and only individual consumers or sole proprietors are allowed to participate in the scheme. Following that, the FDRC has incorporated various features into the scheme to address the imbalance of power between an individual retail investor and the financial institution – which is often a global conglomerate. For

example, the administration fees charged to the investor and the financial institution are heavily skewed. For mediating a claim between HK$100,000 and HK$500,000, the investor has to pay a fee of only HK$2,000 while the financial institution has to pay HK$10,000. For an arbitration, the fee is HK$5,000 for the investor but HK$20,000 to the financial institution. Also, in the event that mediation fails, only the claimant investor has the choice of whether or not to proceed to arbitration administered by the FDRC; the financial institution has no say in this decision at all. In this sense, the financial institution is stripped of its ability to use arbitration proceedings as a tactical move to discourage the claimant investor from pursuing the claim.

Despite the bias towards investors, the FDRC also brings benefits for the financial institutions. Compared to the legal fees involved in formal litigation or arbitration proceedings, the costs to the financial institution for resolving these relatively small claims through the FDRC are more proportionate to the claim amount and significantly lower. Further, there are reputational benefits as well and this extends beyond the mediation and arbitration being private processes. Through the FDRC, investors now have a proper forum (which is designed to be accessible to potentially-unrepresented investors) to bring their grievances. Hopefully, there is then less incentive for investors to create bad publicity for the financial institution by protesting in front of the bank or alerting the media in a desperate attempt to seek help.

The FDRC also attempts to use aspects of its arbitral procedure to address the imbalance of power between the individual investor and the financial institution. For example, the arbitration will be “documents only” and no legal representation will be allowed. The idea is to keep the process simple in order to aid the investor – all the investor needs do is: (i) set out on a form his/her complaints and what redress he/she seeks; and (ii) provide relevant supporting evidence. There would be no need for formal pleadings, voluminous disclosure of documents or advocacy before the arbitrator. The rationale is that the process could easily be handled by a “lay person”.

However, while this pragmatic approach sounds very reasonable, the situation may not be so ideal in practice. While the claimant investors will fill out the simple claim form themselves, the financial institution is likely to have its in-house legal counsel preparing a robust defence to the claims. Further, the investors typically have far fewer documents in relation to their accounts and trading activities than the financial institution. One notable example of this are recordings of telephone conversations during which the investors may have placed a particular trade and which clearly show the circumstances in which the investors entered into the transaction complained-of. When the financial institution is armed with a much more extensive array of documentary evidence, a “documents only” arbitration will not do any favours for the investor claimant. Further, in many situations, individual investors gain the biggest advantage by appearing at a hearing before the arbitrator. This is because live testimony from the claimant is often more genuine and compelling than written submissions, and this is especially so if the written submissions are not professionally drafted. This evidentiary advantage is likely to be enhanced if the personal circumstances of the investor are more powerfully conveyed by seeing them in person, for example, if they are elderly or of a low education level. By having a “documents only” arbitration, the investor loses the opportunity to arouse sympathy for their case from the arbitrator. It seems that the very mechanisms that the FDRC has designed to aid the claimant investor may have the opposite effect to that intended.

The FDRC’s answer to this lies with the arbitrators. It hopes that experienced, well-trained and qualified arbitrators will be able to conduct balanced arbitrations. For starters, the arbitrators will have the power to call an informal “hearing” where the parties come together to clarify certain issues orally. However, this will only occur in restricted circumstances and where critically necessary. The arbitrators will also have the power to demand information and documents from the parties. At this stage, it is envisioned that the arbitrators may be able to “assist” the investors in this way by seeking specific information and documentary evidence from them to guide them through the process.

However, one of the maxims of the FDRC is that it is an impartial dispute resolution platform. Once the arbitrator is seen to assist one party in the proceedings, the integrity of the system may be diminished. It seems it will be down to the arbitrator to appreciate the arbitral landscape with which the investor is bringing the claim and perform a fine balancing act to ensure that on the one hand, the claimant is not placed at a disadvantage compared to the financial institution and on the other hand, the arbitrator remains impartial.

In my February blog, I discussed the advantages and disadvantages of mediator-arbitrators. One advantage is that if the arbitrator in the dispute has acted as the mediator, he/she would have become very familiar with the parties and their cases. This advantage may play well in the FDRC model. Under the scheme, disputes are first required to be mediated and then, should that fail, proceed to arbitration. If a mediator who has gained familiarity with the claimant through the mediation process subsequently acts as arbitrator of that case, this could address to an extent certain of the shortcomings discussed above in relation to a "documents only" arbitration. Of course, whether the concept of mediator-arbitrators would be truly workable is still very much a live issue.

Although the consultation period for the FDRC scheme is now closed, there are still a number of details which require clarification. For example, it is unclear whether and, if so, how an investor would be able to compel a financial institution to comply with the FDRC dispute resolution procedures if there were a separate valid arbitration agreement in the relevant contract concluded between the parties. It will be interesting to see how various issues may play out once the scheme is launched. However, the reality may be that because the claim amounts involved are relatively small (being capped at HK$500,000), many of these disputes will settle during direct negotiations between the investor and the financial institution or at the mediation stage, and the more delicate issues may not be tested.