Enabling Legislation: Check; Code of Practice for Third Party Funders: Check; Third Party Funding for Arbitration in Hong Kong is Ready for Lift Off!

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Hong Kong's legislative regulations

On 7 December 2018, the Hong Kong government published its eagerly awaited Code of Practice for Third Party Funders and confirmed that from 1 February 2019, Hong Kong's Arbitration Ordinance, as amended, will be fully in force (save for provisions which relate to third party funding of mediation). The sections which are coming into operation are Divisions 3 and 5 of the new Part 10A of the Arbitration Ordinance (Amendment Ordinance): these sections expressly permit the use of third party funding for arbitration in Hong Kong. This development will bring Hong Kong into line with Singapore as jurisdictions which permit the funding by professional third parties of arbitrations and arbitration related litigation.

The Code of Practice For Third Party Funders, which has been awaited since the Arbitration and Mediation Legislation (Third Party Funding) (Amendment)

Ordinance 2017 (Amendment Ordinance) came into force on 23 June 2017.

The Code of Practice details the standards and practices with which third party funders will be ordinarily required to comply in order to operate in the Hong Kong arbitration market. They include the following which third party funders must do:

- "*take reasonable steps to ensure that the funded party is made aware of the right to seek independent legal advice on the funding agreement before entering into it*" (with such obligation being regarded as satisfied where the funded client party confirms the same in writing);
- maintain access to minimum capital of HK $20m, maintain the capacity to "*pay all debts when they become due and payable*" and maintain the capacity to "*cover all of its aggregate funding liabilities under all of its funding agreements for a minimum period of 36 months*";
- include provisions in funding agreements which set out clearly that the funder "*will not seek to influence the funded party or the funded party's legal representative to give control or conduct of the arbitration to the third party funder, except to the extent permitted by law*";
- explain in funding agreements whether (and the level to which) it agrees to be liable for adverse costs, insurance premiums or any other financial liability and whether it will provide security for costs if such security is ordered;
- state in funding agreements the circumstances in which the funder may terminate (with discretionary termination by the funder in circumstances not detailed in the Code of Practice being prohibited);
- effectively manage any conflicts of interest and maintain an effective complaints procedure; and
- ensure promotional materials are "*clear and not misleading.*"

Compliance with the Code of Practice will be overseen by an advisory body in Hong Kong to which each third party funder must submit information regarding its financial position and annual returns regarding any complaints received.

As mentioned, this development will bring Hong Kong into line with Singapore, where third party funders also have certain requirements imposed upon them by law in order to enter the market. For example, the funding of dispute resolution costs (whether in Singapore or elsewhere) in actions to which they are not party must be the principal business of a funder and funders must have paid-up share

capital of not less than SG $5m or not less than SG $5m in managed assets. They should also pay heed to the Guidelines for Third Party Funders which were published by SIArb (Singapore Institute of Arbitrators) in May 2017 which aim to promote best practices among funders who intend to provide funding to parties involved in international arbitrations seated in Singapore. Unlike in Hong Kong, the Guidelines are non-binding but it is expected that professional litigation financiers will comply with them and there are good reasons for this.

Are the regulations welcome?

Professional, reputable litigation funders would welcome the regulations that have been imposed by the legislatures of Singapore and Hong Kong in conjunction with the opening up of the market for third party funding of arbitrations in those jurisdictions. This is evidenced by virtually all, if not all, the main players in the industry providing their views during the respective consultation periods. Whilst differing regimes in different jurisdictions add a degree of administrative burden for funders to ensure compliance with the various regulations or codes of practice for each jurisdiction in which they operate, this is a small price to pay in circumstances where new jurisdictions open up for funders to expand their businesses. Furthermore, and more importantly, professional funders are well aware that the regulatory frameworks are put in place to benefit and protect the ultimate end user clients. Requirements which mean that only professional funders are able to operate in jurisdictions like Singapore and Hong Kong further this important legislative aim.

The corollary advantage to professional funders of this regulation is that the reputation of the funding industry is protected from the damage which could result from an environment where there is no limit on who can financially support arbitration disputes and inexperienced or purely opportunistic financiers are able to operate in an uncontrolled manner.

Unregulated access to the third party funding market could potentially lead to situations where the clients ultimately lose out and these regulations in Singapore and Hong Kong are designed to avoid this eventuality. Imagine the scenario where a finance source dries up at a crucial stage in a case in circumstances where a client has sought outside assistance because they are impecunious. Who loses

out? First, the client who is unable to continue with their meritorious claim. Second, professional funders who could be tarred with the same brush in the event the unfortunate occurrence becomes widely known in the market. Similar reputational damage to the third party funding industry could result from a scenario where a case concludes and a recovery is made but the whole of that recovery is paid to the lawyers and the funder, with the ultimate client being left empty-handed having been forced to agree onerous terms with an inexperienced, unprofessional and/or improperly motivated funder.

The reputation of third party funding could be put at risk by a failure by funders to comply with the new regulations. All those entering the funding market in Hong Kong and Singapore have a responsibility to play their part in maintaining and improving the reputation of the industry in Asia, which has been slower to embrace funding than other parts of the world (for example, Australia and the UK). Further, the legislatures of Hong Kong and Singapore have so far merely dipped their toes into the funding world by permitting financing by third parties of arbitration and arbitration related litigation only[fn]The funding of insolvency disputes is also permitted but this has evolved through developments in case law rather than by legislation[/fn]. This means that a failure by funders to protect the reputation of the funding industry will likely eradicate any hope that consideration will be given in future to extending the types of disputes for which funding can be provided, such as litigation in the Singapore International Commercial Court or in the high courts of Hong Kong or Singapore. Any such extension will only become likely if professional funders adhere to the well thought out and welcome regulatory frameworks, which are designed to protect funded party clients. It is expected that professional funders will so adhere, since whilst funding assists clients to gain access to justice as well as offering alternative financing methods, it is clearly also in the interests of the funding industry as a whole to do so.