Chapter 18

MEDIATION IN THE BANKING AND FINANCE INDUSTRY

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1. Introduction

18.1 No review of mediation in banking and finance in Hong Kong would be complete without a review of the developments surrounding the Lehman liquidation in 2008. The Lehman legacy casts a long shadow over recent developments in Hong Kong and will continue to do so for years to come.

18.2 Using the Lehman legacy as a starting point, recent developments in Hong Kong have seen the establishment of a dedicated dispute resolution centre to resolve a limited range of financial disputes with a "mediate first" policy.

18.3 As with other industries, banking and finance is coming to understand the utility of dispute resolution as an alternative to adversarial processes for resolving disputes. Even more so, the benefits of mediation over an unfocused negotiation can also be appreciated by an industry that looks to the bottom line.

18.4 Mediation has already been used for financial disputes, although for most disputes of this nature, negotiation is the more typical option. The launch of the FDRC has tried to change the landscape in Hong Kong for eligible financial disputes. The scope of the FDRC has been expanded with effect from 1 January 2018 (with the final changes coming into effect 1 July 2018 for small enterprises). However, without doubt, the FDRC may raise the profile for mediation in relation to financial disputes amongst the general public.

18.5 The standard range of options remains available to parties not wishing to use the FDRC or who are ineligible including negotiation, mediation, arbitration, and litigation. For disputes between financial institutions, negotiation has long been the preferred option. However, recent developments by the International Swaps and Derivatives Association (the "ISDA") and P.R.I.M.E Finance may provide a greater range of options for institutional parties.

2. The Lehman Legacy

18.6 On 14 September 2008, Lehman Brothers Holdings Inc, the ultimate parent of the Lehman group filed for Chapter 11

protection from bankruptcy in the United States.[1] The impact from this event was felt globally, however, in Hong Kong, retail investors were dramatically impacted.

18.7 Although Lehman Brothers typically dealt with professional investors such as hedge funds and mutual funds, they had been very active in the issuance of a class of product specifically designed for retail investors. The Hong Kong Monetary Authority ("the HKMA") estimated that Hong Kong investors had bought approximately HK$20 billion of Lehman structured products and that over 48,000 investment accounts held Lehman structured products.[2] This is an astonishing figure, particularly when compared to other countries with significantly more potential investors. For example, the Financial Services Authority in the United Kingdom reported that approximately 5,000 retail investors had invested GBP107 million in Lehman structured products.[3] The enormity of the issue for Hong Kong investors immediately becomes apparent.

18.8 In Hong Kong, Lehman Brothers had structured a series of products, but had encountered great success with products, which were sold under the product name "minibonds." The minibonds were in fact, not bonds in the traditional sense, but were callable credit-linked notes.[4] The minibonds were sold to retail investors through a network of distributor banks and brokers.

18.9 With the liquidation of Lehman Brothers, it quickly became clear that investors would lose their investment. For some people this represented their life savings and would have to considerable hardship.[5] There was widespread consternation and Hong

1 *Lehman Brothers Files for Bankruptcy, Scrambles to Sell Key Business*, CNBC (15 September 2008) (http://www.cnbc.com/id/26708143).

2 *Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies*, HKMA (2008), at p11.

3 *FSA's Investigation into the Impact of Lehman's Collapse on the UK Structured Investment Product Market – Review of Findings*, FSA (www.fsa.gov.uk/library/other_publications/structured).

4 *Issues Raised by the Lehmans Minibonds Crisis – Report to the Financial Secretary*, SFC (2008), at p1.

5 Leanne Wang, *Lehman Brothers' Minibonds Teach Hong Kong Investors a Big Lesson* (www.chinastakes.com/2008/9/lehman-brothers-minibonds-teach-hong-kong-investors-a-big-lesson.html).

Kong was witness to a wave of protests and demonstrations.[6] In addition, Hong Kong people tried to seek redress through a range of other options.

Complaint filed with	HKMA	Consumer Council	Political party	Police
Number of complaints	20,578	11,919	8,000	5,383

Source: Report of the Working Group on Mediation, Annex 3 (February 2010)

18.10 There were also attempts by investors to use litigation, a group of 135 investors brought claims in the Small Claims Tribunal, however, their claims were all referred to the District Court as the claims were held to be too complex to be dealt with in the Small Claims Tribunal.[7] However, the move from Small Claims Tribunal, where parties can represent themselves, to the District Court, with legal representation, represents a significant increase in costs for plaintiffs.

18.11 By far, the largest number of investors made complaints to the HKMA. However, the HKMA is not empowered to resolve disputes. Instead, the HKMA partnered with the Hong Kong International Arbitration Centre ("the HKIAC") to create a tiered dispute resolution scheme specifically for the Lehman minibonds issues.[8] The scheme became known as the "Lehman Scheme", it provided for mediation first and then a voluntary arbitration.[9]

6 Bobby Yip, and James Pomfret, *Hong Kong Investors Protest over Lehman Losses* (http://www.reuters.com/ article/2008/10/31/us-hongkong-lehman-idUSTRE49U29620081031).

7 Shahla F. Ali et al., *After Lehman: International Response to Financial Disputes – A Focus on Hong Kong*, 10 Rich. J. Global L. & Bus., 159.

8 *Lehman Brothers-related Investment Products Dispute Mediation and Arbitration Scheme Status Update*, HKIAC (www.hkiac.org/index.php/en/mediation-news/390-19July).

9 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*, Journal of International Business & Law (2010), at p143.

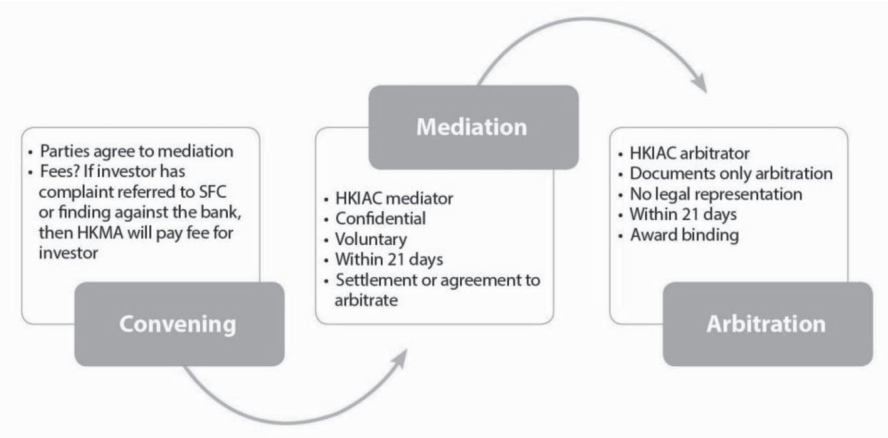

Figure 1: Lehman Scheme

18.12 The scheme is similar to other tiered dispute resolution schemes, which exist in other countries for financial disputes. In Singapore, the Financial Industry Disputes Resolution Centre ("the FIDReC") runs a tiered dispute scheme where mediation is the first stage, and only if unsuccessful will the matter be referred to adjudication.[10] This two-stage approach encourages complainants to utilise mediation first to try and resolve their dispute with the service provider.

18.13 In Hong Kong, the HKIAC reported that from the commencement of the scheme (ie 31 October 2008) to 12 May 2011, they had received 355 requests for mediation, which resulted in 143 mediations with a settlement rate of 89%.[11] Although the settlement rate is satisfyingly high, some attention should be paid to the relatively low usage rate. Compared to the number of investment accounts impacted or the number of complaints received by the HKMA, the number of mediation represented a small percentage of those affected by the Lehman minibonds. The low uptake can be attributed to several different causes, including alternative options and a lack of education.

10 FIDReC's website (www.fidrec.com.sg/website/processdisp.html).

11 *Supra* note 8.

18.14 Faced with an expanding crisis, including a lack of public awareness of regulator alternatives, negotiated solutions, etc, the regulators – the HKMA and the SFC – stepped in and negotiated with the distributor banks to repurchase the Lehman minibonds.[12] The Mediation Working Group also commented on the low usage and considered that investors prefer to use conventional platforms rather than mediation.[13] With this in mind, the Working Group recommended goals for future mediation schemes including as follows:

- ensuring there is publicity and clarity of message for any future schemes,
- promoting future schemes to the relevant stakeholders, and
- ensuring public education.[14]

3. Developments at the Financial Dispute Resolution Centre (FDRC)

A. Introduction

18.15 In the aftermath of the Lehman minibonds crisis, both the SFC and the HKMA released reports that recommended the introduction of a dispute resolution scheme of some type in Hong Kong, with both the HKMA and the SFC suggesting an ombudsman style scheme.[15] Given the public outcry and intense focus on this issue, the Financial Services and Treasury Bureau ("the FSTB") released a consultation paper which proposed two of the following new developments:

- creation of an Investor Education Centre, and
- establishment of the FDRC.[16]

12 *SFC, HKMA and 16 banks Reach Agreement on Minibonds*, SFC (22 July 2009) (www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=09PR100).

13 *Report of the Working Group on Mediation*, Department of Justice, at p145 (February 2010).

14 *Ibid*, at p151.

15 *Report of the Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies*, HKMA (2008), at p80; SFC, *supra* note 12, at p68.

16 *Proposed Establishment of an Investor Education Council and a Financial Dispute Resolution Centre Consultation Paper*, FSTB (February 2010).

18.16 The Lehman Scheme may be seen as a testing ground for the eventual FDRC tiered dispute resolution scheme. Although, initially, both the SFC and HKMA recommended an ombudsman solution for Hong Kong, more akin to the Financial Ombudsman Service ("the FOS") in the United Kingdom or Australia, the FSTB proposed a two-tiered dispute resolution scheme for Hong Kong.

18.17 The consultation process elicited comments from a wide variety of sectors, including consumer advocates (such as the Consumer Council), industry groups (such as the Hong Kong Association of Banks), and professionals (such as the Law Society of Hong Kong). The FSTB outlined its vision for the FDRC to provide consumers "with an independent and affordable avenue for resolving monetary disputes with the financial services providers…[as] an alternative to litigation."[17]

18.18 The FDRC scheme was launched in June 2012, much as outlined in the initial FSTB proposal. The principles of the FDRC are:

- **independence** – the resolution procedures should be independent;
- **impartiality** – the process of the FDRC should ensure that both parties are treated in an impartial way;
- **accessibility** – the FDRC should be accessible and user friendly. The procedures should be straightforward, clear, and easy to understand;
- **efficiency** – the disputes should be settled in a timely and efficient manner; and
- **transparency** – the FDRC should be as transparent as possible in dealing with the disputes, whilst acting in accordance with confidentiality and privacy obligations as required by Hong Kong law.[18]

18.19 Although launched as a financial dispute scheme, there are some limitations, which restrict the impact of the scheme for Hong Kong

17 *Ibid*, at p29.

18 *Terms of Reference*, Clause 5, FDRC (June 2012).

investors. The FDRC only handles a narrow range of financial cases, unlike the FOS in the United Kingdom or Australia which are open to receive complaints for a wide range of financial services including, pensions, insurance, and banking services. In Hong Kong, the decision was made to limit the scope of the FDRC although there is potential that it may be widened in future.

18.20 The FDRC was originally only empowered to accept claims of HK$500,000 or less. This figure raised some concerns during the consultation process but the FSTB defended the amount on the basis that 80% of the claims received by the HKMA were under this amount.[19] However, in their comment, the ICC made the point that the Lehman Scheme mediated cases up to HK$5 million.[20]

18.21 Although the FSTB noted general support for a tiered dispute mechanism, they also commented on objections made to the use of mandatory binding arbitration. Comments from the financial services industry included objections to the use of arbitration, as it would be unfair to financial services providers and inappropriate.[21]

18.22 There was some discussion about the level of fees. The SFC had originally suggested that any mechanism should be free to investors.[22] Upon starting operation, the FDRC charged a non-refundable administrative fee of HK$200 for the filing of an application form. If the application proceeded to mediation then the claimant was required to pay HK$1,000 (for claims under HK$100,000) and the financial institution would pay HK$5,000 (for claims under HK$100,000) for the first four hours of the mediation.[23]

18.23 Concerns were also expressed that the level of fees for mediators and arbitrators would not be sufficient to attract suitably qualified

19 FSTB, *supra* note 16, at p16.

20 *Proposed Establishment of a Financial Dispute Resolution Centre*, ICC – Standing Committee on Arbitration, at p8 (14 May 2010).

21 FSTB, *supra* note 16, at p12.

22 SFC, *supra* note 12, at p68.

23 *Fees*, FDRC (www.fdrc.org.hk/en/html/resolvingdisputes/resolvingdisputes_scheduleoffees.php).

professionals.[24] However, the FSTB clarified their intention that claims for less than HK$100,000 would be mediated by the in-house mediators belonging to the FDRC.[25] The FSTB advised that 80% of the claims received by the HKMA were for an amount less than HK$100,000, thus implying that the majority of claims would be processed in-house without the need for external mediation.[26]

18.24 During the consultation process, there were comments that queried whether there were adequate numbers of arbitrators in Hong Kong who would be able to handle financial disputes of any complexity.[27] Further, the Hong Kong Association of Banks objected to the use of mandatory arbitration at all.[28]

B. FDRC Structure

18.25 The FDRC was created as an independent, non-profit making company limited by guarantee.[29] The governance of the FDRC is the responsibility of its board, which includes representatives from all stakeholder groups including: representatives from the FSTB, the HKMA, and the SFC; the financial industry; and consumer advocates. All financial institutions authorised by the HKMA or licensed by the SFC are required to be members of the Financial Dispute Resolution Scheme, which is operated by the FDRC.[30]

18.26 The funding for the set-up and operation of the FDRC was originally provided by the Government, the HKMA, and the SFC for the first three years, and thereafter the operating costs were to be borne by the financial institutions "as part of their commitment

24 *Proposed Establishment of an Investor Education Centre and a Financial Dispute Resolution Centre – Consultation Conclusions*, FSTB, at para 63.

25 *Ibid*, at para 65.

26 FSTB, *supra* note 16.

27 *Letter Dates 5 May 2010 in Response to the FSTB Consultation Paper on the IED and FDRC*, Hong Kong Association of Banks, at para 13.1.4.

28 *Ibid*, at para 13.

29 FDRC, *supra* note 23.

30 *Ibid*, Clause 9.

to the general public to resolve disputes in a fair and efficient manner."[31] However, as of 2020, the operating costs of the FDRC were still primarily met by the original funding commitments and any accumulated surplus. The Finance Committee of the Legislative Council in considering the future funding arrangements noted that there is sufficient funding in place until 2019 and that the funding formula will be under review.[32] The FDRC Annual Report 2016 notes that the FDRC will carry out consultation in respect of its funding formula and that subject to the results of the consultation, the FDRC "shall be funded by the members of the FDRS, as part of the financial industry's commitment to the general public to resolve disputes in a fair and efficient manner".[33] It remains to be seen how the financial industry will respond to this consultation and undoubtedly much will depend on the perceived utility and usefulness of the FDRC. As of 2020, the 2019 Annual Report details income / revenue:

Description	**2019 (HKD)**	**2018 (HKD)**
Capital employed	30,372,722	40,872,769
Application fee for mediation	4,200	3,000
In-house mediation service	24,000	
Renewal fee for mediators / arbitrators	6,400	2,800
Room rental income	283,850	318,140
Interest income	741,190	730,283
Sundry income	20,500	9,250
Staff costs	5,025,390	5,470,530
Other items (lease / depreciation / etc.)	6,269,457	6,323,931

18.27 The FDRC remit and procedures are set forth in the Terms of Reference[34] ("the ToR") and the Guidelines on Intake Criteria

31 *Ibid*, Clause 8.

32 Legislative Council (http://www.legco.gov.hk/yr15-16/english/fc/fc/papers/fi16-07e.pdf).

33 FDRC, *Annual Report 2016*, p62.

34 FDRC, Terms of Reference (http://www.fdrc.org.hk/en/doc/FDRC_ToR_Section_B_en.pdf#nameddest=5) (2018).

of Cases.[35] The FDRC is empowered to process applications, provide guidance to neutrals, notify regulators of system issues, and publish data for research purposes.[36]

18.28 One of the main concerns arising out of the consultation process was that the FDRC would cause confusion in the Hong Kong market, as there could be overlap between the FDRC, the SFC, and the HKMA.[37] However, the FDRC, the HKMA, and the SFC have laid out in the Memorandum of Understanding ("the MOU") the respective duties and focus for each organisation.[38] The MOU outlines the distinct roles of each organisation and then goes on to detail how they will co-operate with each other and how information will be shared, although the 2018 amendment removed the sharing of FDRC mediation documents with the relevant regulator.[39] The MOU expresses a collaborative and co-operative relationship for example, it confirms that each of the FDRC, the HKMA, and the SFC will consult one another at an early stage in the event that there are issues, which may have significant implications for the other parties (Clause 6 (a)).

18.29 The FDRC also outlines its agreement to:

- explain to claimants what other possible channels they may have to resolve disputes (Clause 7(a));
- submit information to the HKMA or the SFC about its knowledge of systemic issues and/or suspected serious misconduct cases (Clause 7(b));
- provide the HKMA or the SFC with a copy of any non-compliance letter in the event that a financial institution fails to fulfil its obligations under the Terms of Reference (Clause 7(c)); and

35 FDRC, *Guidelines on Intake Criteria of Cases* (2018).

36 FDRC, *supra* note 34, Clause 4.3.

37 FSTB, *supra* note 16, at para 50.

38 *Memorandum of Understanding*, FDRC, SFC, HKMA (1 January 2018).

39 *Ibid*.

- provide regular information to the HKMA or the SFC about the number and type of disputes handled by the FDRC on an anonymous basis (Clause 7(d)).[40]

18.30 In the 2018 revision, as noted above certain clauses were removed which provided for the sharing of documents with the regulators, specifically the clauses removed provided that the FDRC would:

- provide the HKMA or the SFC with a copy of the application form if the claimant consents (Clause 7(c));
- provide copies of the agreement to mediate, the mediated settlement agreement (if applicable) and the mediation certificate to the HKMA or the SFC (Clause 7(d)), and
- provide copies of the notice to arbitrate (if applicable) and the arbitral award to the HKMA or the SFC (Clause 7(e)).

18.31 These clauses were generally perceived to be unpopular with the financial industry in that they represented additional disclosure of mediations / arbitrations to the regulators. With these clauses removed, it may be that the financial industry changes its perceptions of the FDRC.

C. FDRC Procedures

18.32 The FDRC has worked to increase public awareness about their processes and procedures. The FDRC regularly provide a pre-application briefing session to provide further information about their services and how mediation can help to resolve disputes.[41] In addition, they attend fairs and offer briefings to the public, financial institutions, and neutrals.[42]

18.33 In 2016, the FDRC released a consulation paper which proposed several changes to the existing FDRC intake criteria and process with the aim of increasing the relevance of the FDRC for claimants

40 FDRC, *supra* note 34, Clause 7.

41 *Free Public Enquiry Meeting*, FDRC (www.fdrc.org.hk/en/html/events/public_briefing_session.php).

42 *Public Relations Activities*, FDRC (www.fdrc.org.hk/en/html/events/practivities_list.php).

and the financial industry.[43] Changes which were suggested included:

- increasing the maximum limit to HK$ 3 million;
- increasing the limitation period;
- allowing small enterprises to be eligible claimants;
- allowing parallel proceedings (i.e. court proceedings);
- allowing Financial Institutions ("FI") to lodge – subject to eligible claimant consent;
- allowing FIs to file counterclaims – subject to eligible claimant consent
- revise the fee structure;
- allowing retrospective effect for changes to enable previous ineligible claimants to apply; and
- increasing the ability of parties to elect variation of the FDRC process.

18.34 Following the Consultation Conclusions, the following changes have been made with effect from 1 January 2018: [44]

- Introduction of Standard Eligible Disputes and Extended Eligible Disputes (i.e. with written consent of parties).
- Maximum claimable amount is raised to HK$1 millon.
- Limitation period will be extended to 24 months.
- Eligible claimants include small enterprises (meeting certain criteria), effective as of 1 July 2018.
- Parallel proceedings are permitted.
- Cases beyond the intake criteria will be allowed subject to mutual agreement of the FI and the claimant.

43 FDRC, *Proposals to Enhance the Financial Dispute Resolution Scheme*, Consultation Paper (http://www.fdrc.org.hk/en/doc/Consultation_Document_ToR_EN.pdf).

44 FDRC, *Consultation Conclusions, Proposals to Enhance the Financial Dispute Resolution Scheme*, (http://www.fdrc.org.hk/en/doc/FDRC_consultation_conclusions_en.pdf)

- The FI can now initiate a dispute with the consent of the eligible claimant and can file a counterclaim.
- Revised fee structure including escalating fees to take into account the increased claim limits.

18.35 Of particular interest is the attempt to increase procedural flexibility to provide more options for parties. Under the revised 2018 Rules, the parties may now opt for (i) mediation first, arbitrate next, or (ii) mediation only, or (iii) arbitration only subject to mutual agreement. This means that the FDRC can now operate a multi-tiered, multi-track dispute system. It remains to be seen how this will impact the statistics on claims managed by the FDRC.

18.36 The process still commences with an application being made at the FDRC and the case officer will confirm whether the application is within the FDRC's Terms of Reference. The dispute may then proceed as a standard eligible dispute with a tiered mediation / arbitration process, or it may proceed as a mediation only or arbitration only process.

18.37 The FDRC notes in the 2020 Annual Report that following the implementation of the changes:

- Four applications in 2019 had claim amounts over HK$ 500,000.
- Two of these applications were made by FIs – one was a Standard Eligible Dispute and the other was an Extended Eligible Dispute (claim amount over HK$1 million)[45].

D. Mediation Process

18.38 The FDRC has the ability to take some preparatory steps, which may impact the mediation. Once an application is accepted, the FDRC may require parties to the dispute to "do anything else that the FDRC may consider may assist the conduct of the Mediation and Arbitration."[46] This power is exceptionally wide and is not

45 FDRC Annual Report 2020 (https://www.fdrc.org.hk/en/html/publications/annualreport.php?lang=en).

46 FDRC *supra* note 34, Clause 18.4.2.

limited by a reasonableness requirement. In practice, the FDRC is likely to exercise this power with restraint; the examples provided include requiring parties to attend a pre-mediation session, providing a translator or additional information, etc.[47]

18.39 The FDRC will maintain a list of mediators for FDRC mediations and mediations shall be conducted in accordance with the FDRC rules. As noted previously, claims of below HK$100,000 will generally be handled by in-house mediators. If the claim is in excess of HK$100,000, the parties may agree on the appointment of a mediator from the FDRC list; however, if the parties cannot agree then the FDRC will appoint a mediator.

18.40 Each of the parties is required to sign an Agreement to Mediate prior to the mediation session, although there may be pre-mediation meetings which occur without substantive discussion. The Agreement to Mediate includes a provision requiring both parties to agree that they will "co-operate in good faith with the Mediator and each other during the Mediation."

18.41 The FDRC has implemented a four-hour limit on mediations through their use of the Specified Mediation Time. In addition to keeping the costs of the process low, there may be a belief that this concentrated time period will help parties to focus on the issues at hand. Whilst the actual mediation may be limited to four hours, the FDRC case officers can work with the parties prior to the mediation to prepare them for the process.

18.42 Much of the work of the mediator can be reduced if parties are prepared for how the mediation process will be conducted, or what parties should think about in terms of their positions and interests prior to entering the mediation room. Although, this may be a cost-efficient process, for the case officers to work with the parties to prepare them for the mediation, it results in the mediator having one less opportunity to build the trust and rapport with the parties in the pre-mediation phase.

18.43 It is possible for a mediator to create a relationship with parties during the four-hour mediation; however, it is an additional

47 *Ibid*.

burden for the mediator. The pre-mediation phase provides a significant chance for the mediator to create a relationship of trust outside the pressured environment of the mediation itself and without the presence of the other side.

18.44 If the mediation cannot be resolved within the four-hour period, then provided that the FDRC, the mediator and both parties agree, the mediation may be extended.

18.45 The mediation may be terminated by either party or by the mediator. The Mediation Certificate completed by the mediator will reveal whether the mediation was terminated due to: termination by either party; the execution of a settlement agreement; or termination by the mediator due to ethical concerns about continuing the mediation.

E. Arbitration Process

18.46 If the dispute cannot be resolved through mediation, or is only partially resolved, or the parties have mutually agreed to arbitrate, the EC may request that the matter be resolved by arbitration. The request to arbitrate must be filed with the FDRC within 60 days from the date of the Mediation Certificate. The form of arbitration will be a documents-only mediation with a single arbitrator selected from the FDRC list of arbitrators. As with mediation, the FDRC can act as an appointing authority if the parties fail to agree to an arbitrator.

18.47 If the parties and the arbitrator agree then the arbitration may include a hearing, if necessary, for the arbitrator to render a decision. Unless otherwise extended by the consent of the FDRC and the parties, the arbitrator will render an award within one month from receipt of the last document or the last hearing, if applicable.

18.48 Arbitrators have various powers, including the power to:

- make monetary awards;
- conduct inquiries as he/she considers necessary or expedient;
- order the parties to make any property or thing available for inspection by the arbitrator;

- order the production of documents (unless protected);
- take into account oral or written evidence; and
- proceed with the arbitration even if the parties have failed or refused to comply with the arbitrator's directions.

18.49 Although the FI cannot terminate the arbitration, the EC may apply to the arbitrator to terminate the arbitration.[48] Following consultation with the FI and the EC, the arbitrator may decide to terminate the arbitration.

18.50 Any arbitral award rendered by the arbitrator shall be final and binding on the parties. The award may consist of compensation for monetary loss but shall not include any amount for punitive or aggravated damages and cannot exceed HK$500,000 (inclusive of interest).

18.51 As with any mediated settlement agreement, a copy of the arbitral award shall be provided to the FDRC, the HKMA, and the SFC.

F. FDRC Statistics

18.52 In the early stages, the FSTB provided some initial information about the usage of the FDRC in its first year of operation.[49] Statistics for the FDRC are released annually in the FDRC annual reports.

Inquiries	Applications	Settlement Rate
1,540	28	85%

Figure 4: Statistics from June 2012 to February 2013[50]

48 *Ibid*, Clause 20.7.

49 *Controlling Officer's Reply to Initial Written Question*, Legislative Council (Question Serial No. 0446) (Reply Serial No. FSTB (FS) 083) (http://www.legco.gov.hk/yr12-13/english/fc/fc/w_q/fstb-fs-e.pdf).

50 *Controlling Officer's Reply to Initial Written Question*, Legislative Council (Question Serial No. 1237) (Reply Serial No. FSTB (FS) 146) (http://www.legco.gov.hk/

18.53 It may well be that the FDRC only achieves a significant caseload in times of market disruption. Given that the scope of disputes is limited to monetary loss, in times when the market is performing well, there will necessarily be fewer disputes occurring. In terms of numbers of cases handled and completed they have yet to exceed 40 cases per year. In terms of the initial expectations that the FDRC would be managing 2,000 cases per year these numbers are disappointing. It is understandable that the financial industry has displayed no enthusiasm for funding the annual costs for the FDRC of HK$10 million (FDRC 2020 Annual Report) given this level of usage. In 2019, the first year following the rule changes[51]:

- 707 enquiries of which 403 related to financial products.
- Of the 403 complaints, 333 were prima facie ineligible disputes under the Intake Criteria with the main reasons being: exceeding the limitation period / disputes not related to the FDRS / claim amount in excess of maximum claim amount.
- 20 applications for services in 2019, of which 15 were accepted – 12 went through the mediation process. 11 cases were completed with a settlement rate of 91%.

18.54 In terms of deciding whether the FDRC is successful, the public and legislators may want to consider the yardstick it may be based on:

- settlement rate,
- number of cases mediated,
- number of cases arbitrated,
- increase in public education about dispute resolution, and/or
- provision of a forum for the smaller investors.

yr12-13/english/fc/fc/w_q/fstb-fs-e.pdf).

51 FDRC Annual Report 2019 (https://www.fdrc.org.hk/en/html/publications/annualreport.php?lang=en).

18.55 As with all new schemes, the FDRC needs to be given sufficient time to establish their practice and presence in Hong Kong before being judged. Although critical will be determining what measure of success is most appropriate for the FDRC. In respect of the appropriate measure, there is no consensus.

G. Alternatives to the FDRC

18.56 Whilst the FDRC has attracted most of the attention in discussions concerning financial disputes, there is a wealth of disputes which fall outside its scope. For example, if the dispute concerns an amount in excess of HK$1 million and there is no consent for an Extended Eligible Dispute then the parties will not be able to make an application to the FDRC.

18.57 For such parties, the options include the traditional paths of negotiation, mediation, arbitration, and litigation. As the base for many ADR processes, negotiation can often be an effective means of resolving financial disputes. Given the reputational and franchise issues at risk, parties may find that they are powerfully motivated to negotiate. In addition, financial institutions are designed to make profit and not engage in litigation; if the choice is between saving a valuable relationship and fighting a case in the courts, settlement may present a more attractive option.

18.58 As with other disputes, if private negotiation does not work, then it is open the parties to attempt mediation or arbitration. These processes are confidential and therefore there is no data to show the number of cases conducted each year. However, anecdotally, most litigation lawyers will number a few cases they handled which chose mediation, although it would appear that for the moment negotiation holds sway.

18.59 It is also open to parties to litigate their cases. During the Lehman crisis, litigants who attempted to bring their claims in the Small Claims Tribunal were referred to the District Court, as their cases were too complex for Small Claims Tribunal. Given that cases in the District Court require legal representation this may make it prohibitively expensive. However, if the monetary value of the dispute is large then an aggrieved party may consider it worthwhile to bring the case to the District Court.

4. Special Considerations for Financial Dispute Mediation

18.60 In addition, to the general considerations of which a mediator must be conscious, the following chapters offer a discussion of a few special areas to focus on.

A. Subject Matter Expertise

18.61 Although mediators for financial disputes are not required to adjudicate on the issues involved any more than they are for other forms of dispute, the subject matter for financial disputes can be complex and confusing. During the FDRC consultation process, some of the comments received from parties included concerns about the experience and knowledge base of the neutral.[52]

18.62 The question often arises in discussions about mediation, whether process knowledge is more important than subject matter knowledge. For some disputes, subject matter knowledge is less relevant. For example, it does not take technical knowledge about the internal combustion engine to mediate a dispute about a car accident. However, in financial disputes, where parties' positions may rely on the minutiae of financial products and practice, in order to facilitate the most efficient and thorough mediation process, a mediator should have subject matter knowledge. Consider the use of reality testing and doubt creation, a mediator who does not understand the subject matter of the dispute will be at a considerable disadvantage to a knowledgeable mediator.

18.63 This holds true for mediations within the FDRC and also those arranged privately outside the FDRC remit. The FDRC has sought to address this by only accepting neutrals to their panels once they have satisfied the FDRC's own requirements through a training course and examination.

52 *Consultation Paper on Financial Dispute Resolution Centre – Submission*, Law Society of Hong Kong (2010) (http://www.fstb.gov.hk/fsb/ppr/consult/consult_iec_fdrc_submissions_files/organizations/Law%20Society%20of%20Hong%20Kong,%20The.pdf).

B. Personal Impact

18.64 One of the most challenging aspects of the Lehman minibonds crisis was that for many of the investors, the investment represented either a part of or their entire life savings:

> "I am illiterate. I have deposited my savings in the bank year after year. When the salesman (at the bank) recommended me the minibonds as the most suitable financial product for retirement, promising higher interest rate and low risk, I invested HK$500,000, all the money I have saved from decades of manual work', said an old man in a trembling voice on [sic] a meeting organi[s]ed by the Consumer Council of Hong Kong."[53]

18.65 Many disputes involve monetary sums, but rarely do they deal with a person's life savings. This adds an element of desperation to one side's position and intensifies their interests. Rather than losing disposable income, this money may have represented the difference between a comfortable old age and destitution.

18.66 With these heightened circumstances, there is likely to be a very high degree of emotion. A mediator must be able to manage the potential for high emotion from the investor. Whilst the Hong Kong Process Model stresses the importance of adherence to the ground rules, in order for the mediation to be as productive as possible, the parties must be able to express strong emotion. The opportunity to communicate the depth of feeling to the perceived wrongdoer is a critical component of the mediation process. Stifling such speech can prevent the resolution of the interests underlying the dispute.

18.67 Even if the investor has not lost his/her life savings, the dispute may represent a significant breach of trust. For some investors they will have had a long-standing relationship with the individual salesperson or the financial institution itself. Therefore, dealing with the financial loss may only represent part of the needs of the investor. Mediations may lead to the achievement of "non-legal goals" including "a desire for an apology for the broker's alleged

53 Wang, *supra* note 5.

unprofessional conduct, the desire for the firm to increase its supervision over the broker so another customer does not become another victim or the desire to continue the investment relationship at the firm but perhaps with a different broker."[54] It may not be possible for the re-establishment of a trading relationship between the parties, but an effective mediation will ensure that the issues surrounding broken trust and relationship are addressed.

C. Cultural Differences

18.68 An aspect of increasing interest to mediators is the impact of culture on dispute and dispute style. Although much attention has been focused on how social and national culture may affect disputes, one of the major aspects of culture in a financial dispute is that of the financial institution and of the individuals who work there.

18.69 Some of the markers that define a culture may determine how people from a culture will react in conflict situations and how they will react during the mediation. The vast majority of investors in Hong Kong will be Chinese. Much has been written of the Chinese approach to disputes and China has a long history of mediation.

18.70 Discussions about Chinese culture typically focus on the traditional philosophies, which encourage parties to promote the importance of harmony over rights.[55] The use of traditional mediation in China is well documented as an effective and culturally preferred alternative to litigation.[56] Although Hong Kong is a Chinese city, it must be remembered that Hong Kong is also a city of the world and that many people and cultures have come to live and work in Hong Kong as their adopted home. In addition, many Hong Kong people have either lived or been educated overseas.

54 Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, 21 Ohio St. J. on Disp. Resol, at p379 (2006).

55 Bobby K. Y. Wong, *Traditional Chinese Philosophy and Dispute Resolution*, Hong Kong L. J. (2000), 30, 309.

56 Jun Ge, *Mediation, Arbitration and Litigation: Dispute Resolution in the People's Republic of China*, UCLA Pac. Basin L.J. (1996), 15, 123.

18.71 Without a doubt, for many Chinese people the traditional tenets of Chinese philosophy are influential, but in Hong Kong people are also subject to many other influences and ideas. Whilst there may be an underlying preference for harmony over discord, it would be foolish to assume that Hong Kong people shy away from conflict. The Working Group on Mediation noted the necessity for civil justice reform based on "social change and technological advances which had resulted in a sharp increase in civil litigation."[57]

18.72 Whilst the staff of financial institutions in Hong Kong may also be Chinese, they belong to an in-group created by the financial institution itself. Corporate entities create their own cultures and financial institutions are pressure cookers for creating a group identity and culture. Langevoort has commented that due to the high velocity and hyper competitive nature of the financial industry, financial institutions have developed a strong sense of the in-group (ie people within the institution) and the out-group (ie those outside) and that the result has been a culture in which confidence and optimism trump doubt and uncertainty.[58] According to Langevoort, doubt and uncertainty can hamper the quest for profits in competitive environments, therefore they are perceived as threats which need to be "edited down, if not out."[59]

18.73 Although Langevoort does not examine the impact of such cultural attitudes on dispute style, it is unlikely that such a culture would lead to a desire for collaboration in the face of conflict. It is much more likely that the competitiveness of the culture and the strong sense of the in-group will translate into the behaviour of representatives in the course of the mediation. In particular, the mind-set of representatives from financial institutions may reflect their cultural preference for optimism and confidence about risk taking which may make it difficult for them to appreciate

57 *Supra* note 13, at para 1.7.

58 Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture and Ethics of Financial Risk-taking*, 96 Cornell L. Rev. 1209-1246 (2011).

59 *Ibid*.

the perspective of a single investor who has committed their life savings and now faces ruin.

18.74 Mediators need to be aware of the possible cultural impact on party behaviour. Further, mediators need to be aware of their own cultural preferences so that they may better guide and assist the parties.

D. Repeat Player Advantage

18.75 Repeat players are viewed as parties who are repeatedly involved in a dispute mechanism and who are perceived over time to accrue expertise in how to manoeuvre through the dispute mechanism. In financial disputes, the financial institutions are likely to be repeat players and the investors or claimants are more likely to be first time or limited users of the process.

18.76 Bingham summarises the advantages, which can accrue to repeat players including:

- "experience leading to changes in how the repeat player will structure the transaction next time";
- "expertise, economies of scale and access to specialist advocates";
- "informal continuing relationships with institutional incumbents";
- "reputation and credibility in bargaining";
- "long-term strategies facilitating risk-taking in appropriate cases";
- "influence over rules through lobbying and other resources";
- "playing for precedent and favourable future rules";
- "distinguishing symbolic and actual defeats"; and
- "resources invested in getting rules favourable to them implemented."[60]

60 Lisa S. Bingham, *On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, McGeorge L. Rev. (1998),

18.77 There is a significant amount of discussion as to whether being a repeat player leads to an advantage in the process. There is some empirical evidence to suggest that repeat players benefit the most from informal disputing processes, such as mediation.[61] Within the FDRC, the financial institutions will undoubtedly be heir to some of these advantages, although until the number of mediations increases significantly it will be of negligible impact. Even within private mediations outside the FDRC, the individual investors are unlikely to be repeat players on the scale of the financial institutions. Does this make mediation unsuitable for financial disputes between investors and financial institutions?

18.78 Gross argues that securities mediation contains the hallmarks of fairness, regardless of the potential effect of the repeat player advantage.[62] Having reviewed the literature, Gross suggests that by considering the five dimensions below, the fairness of securities mediation can be assessed:

- **party choice** – the nature and scope of the informed consent by both parties to the process and their control of the process itself;[63]
- **legal justice** – what are the parties legally entitled to and whether mediation meets these expectations;[64]
- **substantive outcome** – are investors better off by using mediation rather than the FINRA mandatory arbitration process;[65]
- **procedural justice** – Gross considers factors such as access to the forum and party perception of a fair system;[66] and

Vol. 29, at p223.

61 James R. Coben, *Gollum Meet Smeagol: A Schizophrenic Rumination on Mediator Values beyond Self-determination and Neutrality*, Cardozo J. of Conflict Resol. (2004), Vol. 5, at p70.

62 Jill I. Gross, *Securities Mediation: Dispute Resolution for the Individual Investor*, Ohio St. L. J. (2005), 21, at p329.

63 *Ibid*, at p366.

64 *Ibid*, at p368.

65 *Ibid*, at p374.

66 *Ibid*, at p376.

- **achievement of non-legal goals** – does the mediation provide the parties with an opportunity to achieve their non-legal goals such as a desire for punishment or an apology.[67]

18.79 Having used employment arbitration as a means of testing the impact of the repeat player effect, Bingham concluded that repeat players do have unequal bargaining power to one-time players which did affect the outcome of their arbitrations.[68] However, she does conclude that an increased alertness to possible structural or individual bias can ensure access to justice even in circumstances where one-time players are dealing with repeat players.[69]

E. Initiatives by the ISDA and P.R.I.M.E. Finance

18.80 The ISDA was initially formed by industry players to reduce the "battle of the forms" which was brewing over the new forms of agreement governing derivatives trading. Over time, the ISDA's role has grown to include acting as an active voice for the derivatives industry and growing to include buy-side firms amongst its membership. One of the key achievements of the ISDA is the creation of a master agreement, which is considered the industry standard for documenting OTC derivatives trades. As part of their work, ISDA consider how to improve on the ISDA master agreement and also how to respond to market developments. Over the last few years, the ISDA has been considering the introduction of an arbitration clause for use with the ISDA master agreement.[70] In fact, this mechanism already exists within the ISDA architecture as ISDA had included an arbitration clause in the in the ISDA/IIFM Tahawwut Master Agreement for Islamic derivative transactions under the International Chamber of Commerce ("the ICC") rules.[71]

67 *Ibid*, at p378.

68 Bingham, *supra* note 60, at p259.

69 *Ibid*.

70 *Memorandum for Members of the International Swaps and Derivatives Association Inc*., ISDA (10 November 2011).

71 ISDA and IIFM (www.cbs.db.com/new/docs/ISDA_IIFM_Tahawwut_Master_Agreement.pdf).

However, introducing arbitration for the mainstream derivative transactions would be a new step.

18.81 In September 2013, the ISDA released its *2013 ISDA Arbitration Guide* ("*ISDA Arbitration Guide*"). The *ISDA Arbitration Guide* provides an overview of arbitration practice and procedure.[72] In addition, the guide describes some of the reasons why parties may choose to use arbitration for disputes regarding financial transactions, including:

- neutrality,
- finality,
- procedural flexibility, and
- privacy and confidentiality.[73]

18.82 The *ISDA Arbitration Guide* also includes a Model Clause for inclusion into the ISDA Master Agreement that replaces the existing s13(b) and includes a submission to arbitration clause, a choice as to the relevant arbitral rules and confirms seat of the arbitration.[74] One of the possible choices for the seat of the arbitration is Hong Kong with use of the *HKIAC Rules*.[75]

18.83 This new focus on ADR mechanisms has also seen the establishment of P.R.I.M.E. Finance, which has created an expert panel of neutrals specifically for financial disputes.[76] The PRIME arbitration rules were released in January 2012[77] and are based on the *2010 UNCITRAL Arbitration Rules*.[78] PRIME also provides for a mediation mechanism, which is based on the UNCITRAL

72 ISDA, *2013 ISDA Arbitration Guide* (2013), generally.

73 ISDA, *supra* note 72, at s 2 generally.

74 *Ibid*, at s 3 generally.

75 *Ibid*, Appendix D.

76 Herbert Smith, *PRIME Finance: A New Dispute Resolution Option for the Financial Sector* (22 February 2012) (http://www.herbertsmith.com/NR/rdonlyres/EB4C609F-5516-450F-8A97-2F65AD166854/0/PRIMEFinance.html).

77 P.R.I.M.E. Finance Arbitration Rules, P.R.I.M.E. Finance (1st Edn) (16 January 2012).

78 *Ibid*.

Conciliation Rules 1980.[79] The ISDA has recognised PRIME by including them as an option for choice of rules/seats.[80]

18.84 It remains to be seen whether there will be significant buy-in from the financial industry for any of these new initiatives. Although it is open to the parties to select and ADR process post-dispute, this may not be the easiest time for them to negotiate a relatively untried mechanism. The introduction of the ISDA Model Clauses may be seen as a step forward. However, the ISDA often comments that the ISDA Master is the most executed agreement in the world. Each financial institution will have many tens of thousands, if not hundreds of thousands, of the ISDA master agreements in place and will be loath to open the door to renegotiation to insert a dispute resolution clause. The argument to renegotiate will need to be extremely compelling in order to renegotiate these agreements. It is possible that financial institutions will embrace the Model Clauses for new agreements.

79 P.R.I.M.E. Finance (www.primefinancedisputes.org/index.php/mediation).

80 ISDA, *supra* note 72, Appendix G, Parts 1-3.